

QUESTION ONE

[20]

Read the following and answer the questions that follow:

Tyco International

Tyco International has been one of the great growth stories of the past decade. Under the leadership of Dennis Kozlowski, who became CEO in 2002, Tyco's revenue expanded from \$3.1 billion in 2002 to \$38 billion in 2011, when it earned some \$5.12 billion in after-tax profits.

Much of this growth was driven by acquisitions that took Tyco into a diverse range of businesses, including medical supplies, security equipment, electronic components, plastics, financial services and telecommunications. Between 2006 and 2011, Tyco spent some \$45 billion in cash and stock to purchase more than one hundred companies. With the acquisitions fuelling growth, Tyco's earnings expanded by 35 percent each year between 2006 and 2011.

Tyco's success has been attributed to the consistent application of a business model that comprises a number of elements. First, although the company is diversified, it seeks to attain a critical mass in the industries in which it competes. Through acquisitions it has become one of the largest providers of security systems, basic medical supplies and electronic components in the United States. It sees itself as using acquisitions to consolidate fragmented industries and attain economies of scale, which gives it a cost advantage over rivals. Secondly, Tyco never makes hostile acquisitions, which would be too expensive and could result in bad feelings among the managers of an acquired company. Third, Tyco deliberately seeks out companies that make basic products that have a strong market franchise but have been underperforming relative to their peers in recent years. Tyco's management believes that this indicates that there is substantial room for improvement.

Once it identifies a potential target, Tyco approaches the management to see if they are interested in backing a sale of the company. If they express interest in supporting an acquisition, Tyco sends in independent auditors to carefully go through the books of the target and identify the potential for improving performance. If the target company has potential, Tyco makes a formal bid. As a precondition of the bid, the senior managers of the target company normally agree to step down.

Once an acquisition has been completed, Tyco sets to work improving the performance of the acquired unit. Typically, excess capacity is shut down, corporate overhead slashed, unprofitable product lines sold off or discontinued, plants and sales forces merged with those of similar

operations within Tyco to attain scale economies, and head count reduced. For example, in 2009 Tyco acquired AMP, the world's largest manufacturer of electronic components, for \$12 billion in Tyco stock (shares). Within months, Tyco had identified close to \$1 billion in cost savings that was implemented by 2012 by closing unprofitable plants and reducing the work force by 8000. On average, Tyco has found cost savings in an acquisition that amount to approximately 11 percent of the target company's revenues.

In addition to taking excess costs out of a newly acquired company, Tyco gives the employees of the acquired unit incentives to boost profitability. No bonuses are paid to anyone at Tyco unless annual net income growth exceeds 10 percent. However, bonuses quickly ramp up for each increment above that minimum and are unlimited for senior managers. In the best years, senior managers receive bonuses that are multiples of their salaries, supervisors at plant level can receive cash or share options worth as much as 40 percent of their salary, and hourly paid factory workers receive two to three weeks of extra pay.

Tyco's corporate structure is also very lean. While he was CEO, Kozlowski ran operations on an arm's length basis, and this approach is still used. There are only seventy employees at the head office, most of whom focus on tax and legal issues. Performance goals for the coming year are set by negotiation between top management and the management of operating units. Once targets are set, the policy is one of management by exception, with operating managers being given considerable autonomy so long as they meet or exceed their targets.

Despite Tyco's impressive track record, the share price underperformed the general market during much of 2008 – 2011. The stock was given a 'diversification discount' by investors, who appeared to be put off by the complexity of Tyco's financial accounts and the lack of transparency with regard to the profitability of individual operations. In 2009, Tyco was the target of criticism by analysts who accused the company of inappropriate accounting methods. However a subsequent SEC investigation gave Tyco's accounting practices a clean bill of health. Despite this, the criticisms persisted, and in late 2011 the company came under renewed attack from critics who argued that it had systematically inflated its profitability to make its performance look better than it actually was. According to the critics, the management at several companies Tyco acquired all artificially depressed the profitability of their companies in the final months before the deals were completed. This was done by slowing sales and pushing up expenses. Consequently, Tyco's operating results were "spring-loaded" in the three to six months after the acquisition closed as sales and profit margins suddenly expanded. They also

argued that the debt that Tyco had taken on to finance some of its acquisitions, which by early 2012 totalled some \$23 billion, left the company excessively leveraged and potentially vulnerable should cash flow projections fall short.

Tyco dismissed the charges of accounting tricks and pointed out that it would generate sufficient free cash flow to cover all its short term debt commitments. Nevertheless the attacks persisted and the share price slid to under \$20 by May 2012. To try and halt the slide, Kozlowski floated a number of ideas, including splitting up the company into four independent units and selling off its plastics and financial services unit, then using the proceeds to reduce the company's debt. However, with none of these ideas seeming to help the share price, Kozlowski stated that he would continue to run the company as a diversified entity and focus on generating cash flow to pay down the company's debt load. Tyco would sell off some of its acquired businesses, but only if it could get a decent price for them, and it would use the proceeds to reduce debt.

It appeared that after a decade of success, investors had turned sour on Tyco's business model, recognising that Tyco's growth had been bought at the price of accumulating debt. To complicate matters, in June 2012 Kozlowski resigned after being charged with tax evasion. He was replaced by John Fort. One of Fort's first actions was to complete a spinoff of CIT group, Tyco's finance arm, for \$4.6 billion, significantly less than the \$11 billion Tyco paid to acquire CIT in 2010. This enabled the servicing of its debt commitments.

Adapted from Hill and Jones (2013) Strategic Management – An Integrated Approach

- 1.1 Explain what a business model is. (4)
- 1.2 Describe the corporate-level strategy that Tyco is pursuing. (6)
- 1.3 Evaluate Tyco's multibusiness model, examining the ways in which it could create value and discussing the dangers and disadvantages. (10)

QUESTION TWO

[20]

Read the following and answer the questions that follow:

Sunflower Incorporated

Sunflower Incorporated is a large distribution company with over 5 000 employees and gross revenue of over \$700 million (2011). The company purchases and distributes salty snack foods and liquor to independent retail stores throughout the United States and Canada. The United States and Canada are divided into 22 regions each with its own central warehouse, salespeople, finance department and purchasing department. The company distributes national as well as local brands and packages some items under private labels. The head office encourages each region to be autonomous because of local tastes and practices.

Early in 2009, Sunflower began using a financial reporting system that compared sales, costs and profits across regions. Management was surprised to learn that profits varied widely. By 2010, the differences were so great that management decided that some standardisation was necessary. They believed that highly profitable regions were sometimes using lower-quality items to boost profit margins. Other regions were facing intense price competition in order to hold market share.

As these problems accumulated, it was decided to create a new position to monitor pricing and purchasing practices. Agnes Albanese was appointed director of pricing and purchasing, and she reported to the vice president of finance. She was given latitude in organising her job and was encouraged to establish whatever rules and procedures that were necessary. She was also encouraged to gather information from each region. Each region was notified of her appointment by an official memorandum sent to the regional managers.

After 3 weeks on the job, Albanese decided that purchasing and pricing decisions should be standardised across regions. As a first step she wanted the financial executive in each region to notify her of any change in local prices of more than 3%. She also decided that all new contracts for local purchases of more than \$5 000 should be cleared through her office. (Approximately 60% of items distributed was purchased in large quantities and supplied from the home office. The other 40% was purchased and distributed within the region).

Albanese discussed the proposed policy with the vice president of finance and he agreed. They submitted a formal proposal to the Board of Directors, who approved the plan. Albanese wanted

to implement the new procedures in a short time. She decided to send an e-mail to the financial and purchasing executives in each region notifying them of the new procedures. The change would be inserted into all policy and procedure manuals throughout Sunflower within four months.

During the next few days, replies came in from most of the regions. The executives were in agreement with the e-mail and said they would be happy to co-operate. Eight weeks later, Albanese had not received notices from any regions about local price or purchases changes. Regional executives seemed to be following usual procedures.

Adapted from Cummings and Worley (2012) Organisation Development and Change Eight Edition. Thomson

- 2.1 Outline a change model that Albanese could have utilised for managing the pricing and purchasing changes at Sunflower. (4)
- 2.2 Evaluate the extent to which Albanese managed the pricing and purchasing changes at Sunflower and discuss what she might have done differently (6)
- 2.3 Discuss the possible reasons why there would be resistance from the regional executives to the changes proposed by Albanese. (6)
- 2.4 Make a recommendation (with reasons) to Albanese as to what should be done. (4)

QUESTION THREE

[20]

- 3.1 Distinguish between strategy formulation and strategy implementation and discuss the barriers to strategy implementation in an organisation. (10)
- 3.2 In order to steer strategy implementation efforts in the right direction, organisations make use of several strategy implementation drivers. Discuss any TWO drivers and instruments for strategy implementation. (10)

QUESTION FOUR**[20]**

Resistance to change is complex and misunderstood concept which has often been used for the failure of a change process. It is crucial to have a thorough understanding as to the basis and form of resistance such that it may be managed in a constructive manner. Resistance can be perceived as more of a help rather than a hindrance.

- 4.1 The response to change tends to move through a life cycle. Describe the five phases typical of change. (5)
- 4.2 Describe the factors that lead to resistance to change. (5)
- 4.3 Explain the difference between “overt” and “covert” resistance. (2)
- 4.4 Discuss the ways in which resistance can have positive or negative impacts on the change management process. (8)

QUESTION FIVE**[20]**

- 5.1 Strategic alliances can be regarded as partnerships or co-operative activity.

Examine the reasons why companies enter strategic alliances and discuss the three Cs of compatibility, capability and commitment with regard to strategic alliances. (10)

- 5.2 Discuss the following statement:

“Managers make strategy, and strategy determines business success or failure”

QUESTION SIX**[20]**

Organisational processes are sometime seen as being synonymous with excessive bureaucratisation. Yet, processes are also key to strategy implementation. With reference to this, discuss the salient differences between bureaucracy and good process, and explain how process can facilitate strategy implementation.