JULY 2017 SUPPLEMENTARY/AEGROTAT EXAMINATION

MODULE:

STRATEGIC AND CHANGE MANAGEMENT

PROGRAMME:

MASTER OF BUSINESS ADMINISTRATION

(NQF 9)

DATE: 18 July 2017 TIME: 13h30 – 16h30

DURATION: 3 hours MARKS: 100

EXAMINER: O M Seedat MODERATOR: D Nag

INSTRUCTIONS TO CANDIDATES:

1. Candidates are required to answer **ALL** questions.
2. This is a closed book examination.
3. No written material may be brought into the examination room.
4. Write legibly and neatly.
5. Do **not turn over this page** until permitted by the Invigilator.

*This question paper consists of **six (6) typed pages** excluding the cover page.*

QUESTION ONE **[25]**

Read the following and answer the questions that follow:

RISKY STRATEGIC CHANGE AT EMI?

After years of struggling to make profits, one of Britain's most famous record companies – EMI – was acquired by the private equity group Terra Firma in November 2007. The price paid was $6.6 billion. The two leading record companies, EMI and Warner, had been for years locked in battles to take over each other with the aim of cutting overheads in a combined operation. However, when Terra Firma came on the scene, it was proposing a different strategy and one that was quite radical for a record company.

Unfortunately for Terra Firma and Guy Hands –it s chief executive – the acquisition of EMI was financed by a highly leveraged deal. This meant that it relied heavily on borrowed money from banks signed before the 2008 credit squeeze made finance more expensive. The pressure on Terra Firma and Guy Hands was quite significant. The critics' viewpoints were summarised in a *financial Times* analysis: "Mr Hands is the classic example of private equity overpaying in a boom and then resorting to crude cost cutting when times are tough." But Guy Hands hit back saying: 'The record business is stuck with a model designed for a world that has changed and gone forever.' He was seeking a radical new strategy for EMI in the record industry. He explained the background to his new strategy by pointing out that there were at least three major flaws in the profitability of the record industry:

- The industry used major chart toppers to subsidise losses elsewhere. Hands commented: '300 000 sales can be massively successful and if we spend appropriately and creatively a record like that can be profitable.'
- The large range of record labels in each company was opposed to produce economies of scale, but their complexity meant that this did not happen. According to Hands 'the major labels response to the Internet has been a major failure of leadership.'
- Individual promoters of a particular type of music (e.g. reggae or hip-hop) claimed to be able to push their products to customers, regardless of customer demand, which had become increasingly varied. 'You don't need people with an 'ear' for hits. People will tell you what they like. It's not magic. It's called market research,' explains Hands.

In essence, Hands said that EMI's culture must change from a bloated bureaucracy to a lean, customer-oriented business. And he was not a person to mince his words. According to one outsider: 'He rules Terra Firma with a rod of iron, so no one else speaks during negotiations.' Mr Hands himself described his style as 'Blunt, direct, and not very tactful.' Terra Firma had been involved in re-invigorating a number of businesses; essentially the Terra Firma strategy was to acquire a failing business, turn around the profitability and then sell the now successful business for a substantial capital gain. It had successfully applied this approach to a chain of public houses, a motorway service operation and a waste treatment basis. Nevertheless, in tackling a company in the record industry Hands accepted that he was faced with a daunting task.

Problems of profitability at EMI business

- Music is a 'people' business in terms of managing its principal assets – artists and music groups. However, only 6 per cent of EMI's staff were working in this area – called 'A&R' – responsible for finding new talent and developing existing artists.
- Only around 200 artists accounted for over half EMI annual sales – out of a total of 14 000 artists on its books. Equally, 80 per cent of EMI's digital revenues were delivered by 7 per cent of its digital contracts.
- 30 per cent of EMI artists had never produced a music album. Similarly, 85 per cent of new artists never make a profit for their record companies.
- EMI spent around £140 million annually subsidising artists who would never make any money. In addition, EMI's annual marketing expenditure was operating around £120 million over budget.
- EMI destroyed around 20 per cent of the CDs that it produced at an annual cost of around £50 million.

The new strategy at EMI

Hands announced that one third of EMI's entire staff – 2 000 out of 6 000 employees – would be retrenched by June 2008. But he knew this was not enough. He regarded the record industry in general and EMI in particular, as being a *people industry*. The heart of the business revolved around recording artists, their agents and the entertainment industry. Relations with artists were critical to recorded music. The fear was that simply retrenching people would strip out the best managers in a people business. Managers of several artists had expressed unhappiness with Hands. Hands countered by saying he was actually going to *increase* the numbers of A&R managers looking after artists. The staff cuts would come elsewhere in EMI.

Specifically Hands had decided on a three-part strategy for EMI:

1. *Refocus the company on A & R managers* – increase the numbers and give them more scope to make deals and seek out new artists.
2. *Centralise many of the functions* – sales, marketing, manufacturing, distribution and digital operations would be taken away from individual labels and into a new 'music services' division. The main job cuts would be in these areas.
3. *Seek corporate sponsorships for the major EMI artists* – Hands wanted to attach individual brand names to his leading artists.

Terra Firma and Hands announced the major job cuts to the financial press. They also diverted most of the Terra Firma staff to work at EMI. Two major appointments from the Terra Firma organisation into EMI were the new positions of head of music services and head of EMI managers.

Half of the remaining senior and middle managers were re-interviewed for their jobs.
To implement the new strategy, Hands called a meeting to announce the job cuts in January 2008. His office also produced a 50-page booklet of explanation for employees. In outlining the new strategy Terra Firma said that the aim was to present a new vision for the future of EMI alongside the reasoning for the changes. Hands explained: 'We are not trying to do something which is just tinkering.... it will be much fairer and more objective .... we are changing the organisation.... In an ideal world there would be no pain in achieving gains. Unfortunately, we don't live in an ideal world.'

Adapted from Lynch R (2015) Strategic Management Seventh Edition. Pearson Education

1.1 In a 'people' business like the record industry, it may not be seen as wise to take an aggressive stance such as retrenching some managers and asking others to apply for their jobs.
With regard to this, discuss the alternative approaches Hands may have utilised. (10)

1.2 Evaluate the change process and the new Terra Firma strategy. (15)

QUESTION TWO [25]

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. With reference to this:

2.1 Describe the five phases typical of change. (5)

2.2 Describe the factors that lead to resistance to change. (8)

2.3 Explain the difference between “overt’ and “covert” resistance. (2)

2.4 Discuss the ways in which resistance can have positive or negative impacts on the change management process. (10)

QUESTION THREE **[25]**

Read the following article and answer the questions that follow.

How a South African company turned constraints into global strengths

June 18, 2017 John Luiz

SAB’s resilience has allowed it to become a key player globally.

On 28 September 2016, the shareholders of South African born international brewer, SABMiller, approved the company’s acquisition by Anheuser-Busch InBev for $104 billion (R1.5 trillion). The deal paved the way for the creation of what is now by far the world’s largest brewing company.

For a company that started out selling beer to miners in Johannesburg during the gold rush of the late 1800s, it’s been quite a journey. But how did a brewing company from a developing country rise to compete with the multinational brewing behemoths from the developed world?

A series of interviews with senior executives and managers who presided over the growth of what was then South African Breweries’ (SAB) rapid expansion during and after the 1990s are revealing. After building up a monopoly-like position in the beer market in South Africa, the company went in search of new markets. It used its experience in South Africa in its entry strategies abroad.

SAB’s path reflects the differences between multinationals from developed and emerging markets in terms of location choices, sequencing, time horizons and motivation.

A two-phased expansion path emerges to explain the remarkable success story. The first pillar to SAB’s international expansion was a focus on developing markets. Coming from a developing country itself, the company would cope better with emerging market conditions than brewers from the developed world. These ventures became a powerful base for SAB to take on developed markets.

The second was to expand into developed countries. This became necessary as it became clear the company was over exposed to emerging markets.

The first phase of expansion

After a few early forays into South Africa's neighbouring countries prior to 1993, SAB executives realised that the company could exploit its knowledge of institutional shortcomings in its home country. It would use this experience to adapt more easily than its competitors to conditions in developing countries.

And so began the first part of its internationalisation strategy: a rapid expansion into emerging markets worldwide.

Through a series of acquisitions and joint ventures throughout the 1990s, SAB gained a foothold in various countries in Africa, Eastern Europe and Asia. Although many were geographically distant (like Hungary, Czech Republic, China and India), they echoed South Africa in terms of their socioeconomic development. Eastern Europe, for example, was still emerging from political reform in the wake of communism, and infrastructural, institutional and economic weaknesses persisted.

By expanding into countries that shared socioeconomic characteristics with South Africa, SAB was able to make use of its experience to turn a perceived drawback – institutional weakness – into a strength. As one respondent explained:

"To be quite frank, we actually accepted that we would live with the political risk and poor institutions. We didn't really shy away from high-risk countries unless, of course, there was a raging civil war that we would have to wait to subside."

Once it had established this expansion plan, SAB diversified into developed markets such as Italy and the US. As one interviewee put it:

"Investors became sceptical of companies whose only business was in emerging markets".

In 2002 it took a step closer to consolidating its position as a multinational brewing giant when it acquired US-based Miller Brewing Company. It became SABMiller.

Turning weakness into strength

The advantages that SAB gained from its experience in its home country are many. One was employee aptitude.

SAB employees had built up an extraordinary resilience, flexibility and entrepreneurial spirit through their exposure to the unsteady South African environment of the 1980s. As one executive said:

"They survived labour trouble, survived interest rates at 25%, inflation at 16% to 17%, survived political disorder, political violence… That toughened you, toughened us.
This robustness, combined with an ability to connect with many different cultures, gave the company a valuable flexibility in its risk, location and investment choices".

Another strength was its ability to turn around neglected breweries and businesses. The experience it gained in South Africa, with its large rural population and pockets of poor infrastructure, meant that finding innovative ways to overcome challenges was embedded in the company's DNA.

Another advantage the company gained was brand development and marketing ability. SAB was developed into a major operation without reliance on strong, globally-recognised brands. Using its home experience the company took brands it acquired in distant countries and built them into powerful national brands.

These became a base from which it launched into premium brands such as Grolsch and Peroni through acquisitions. This offset being over-invested in domestic brands.

SAB also had a philosophical edge over many competitors. It's risk appetite was much bigger. By comparison a company like Anheuser-Busch had a conservative approach to risk and international expansion.

For example, Anheuser-Busch didn't react to the rapidly changing global brewer consolidation until it was too late. And when it did, it realised that it had little emerging market experience.

This weakness meant that in 2008 Anheuser-Busch was unable to avoid a hostile takeover by InBev. This gave rise to AB Inbev, then the world's largest brewer. AB Inbev, in turn, was compelled to make an offer for SABMiller to acquire complementary emerging market presence.

SABMiller's long journey from the mine heaps of Johannesburg to global brewing colossus may appear to have come to an abrupt end after its acquisition by Anheuser-Busch InbevAB Inbev in 2016. But what's clear is that its extraordinarily successful approach continues to hold many lessons for aspiring global companies from the developing world.
[Adapted from an article by John Luiz, Dustin Stringfellow and Anthea Jefthas that first appeared in the February 2017 issue of Global Strategy Journal, Volume 7, Issue 1 (83-103).]

3.1 The process of strategic management means setting a pathway for an organisation to change and then putting in place plans and policies which enable it to achieve its corporate aim. With reference to this, critically discuss the nature of key decisions made by SAB within the process of change as it built a global business. (15)

3.2 Explain the difference between organic and inorganic growth and discuss the benefits that SAB enjoyed from acquisitions. (10)

QUESTION FOUR [25]

4.1 Discuss the reasons why currently successful organisations may lose their edge and competitive advantage. (10)

4.2 Critically discuss the following statement:
"Strategic leadership is at the core of strategic management". (15)

END OF QUESTION PAPER