QUESTION ONE **[20]**

Read the following and answer the questions that follow:

The Rise of WorldCom

In 1983, WorldCom was a small reseller of long-distance telephone service. By 2001, the company had generated sales of $40 billion, making it the second largest provider of telecommunications services behind A T &T in the United States of America. WorldCom entered 2001 as the number 2 provider of long-distance telephone service in the United States, with 19 percent of the market; the largest single carrier of internet data in the country, with an estimated 37 percent of the market; and a dazzling array of strategic assets, including a 300 00-mile fibre-optic network that was global in its reach.

WorldCom was very much the creation of its CEO, Bernie Ebbers, whose strategy for growth was quite simple: acquire competitors. Over seventeen years, Ebbers acquired some sixty other telecommunication service providers, including the acquisition of MCI Communications, which at the time was larger than WorldCom. Ebber's deal making was financed by a combination of WorldCom stock (shares) and debt. As long as the stock continued to rise, - and it increased by a staggering 7 000 percent during the 1990s – WorldCom could use its "currency" to buy other companies in the industry. In addition WorldCom borrowed large amounts of money from the debt markets, some $30 billion by late 2001. The debt markets proved only too willing to lend to WorldCom given the company's glittering growth prospects.

Driving the buying spree were two strategic objectives that were central to WorldCom's business model: (1) the desire to reap economies of scale in order to drive down costs and (2) the desire to capture and retain customers by bundling together telecommunications services, such as long-distance access and Internet access, and selling them under a single contract. Ebbers reasoned that the scale economies would come from assembling a nationwide and international network to transmit data and voice traffic. The costs of assembling such a network are primarily fixed and include the costs of laying fibre-optic networks and installing switches. Once the network has been built, the costs of sending additional traffic down the network are virtually zero. This gives the company with the largest volume of traffic a huge cost advantage, because it can spread the fixed costs of building and maintaining its network over a very large volume, driving down the average costs of serving each customer.

In addition, Ebbers believed that customers would want only one telecommunications service provider, and one bill, for all the services they used, including long-distance and local telephone service, Internet access and wireless telephone service. By assembling a company that could provide all of those services to consumers in a single bundle with a single bill, Ebbers believed that WorldCom would help it to increase volume more rapidly than rivals and thus better realise potential scale economies.

WorldCom grew through acquisition, as opposed to organically, because it was quicker to grow this way and cheaper to use a mix of WorldCom's high-flying stock and long term debt to buy competitors than to build the network entirely on its own. Moreover, when WorldCom made an acquisition, it applied a fairly standard formula: cut the overhead, eliminate any duplication, and drive the traffic of the acquired customers through WorldCom's network to realise scale economies.

The strategy seemed to work well until 2000, when WorldCom made a bid to acquire Sprint for $115 billion. Sprint was the number 3 long-distance company in the United States with 8 percent of the market, operated the second largest data network with 16 percent of the market, and was one of the largest providers of wireless services in the United States. The acquisition made perfect strategic sense. It would enable WorldCom to reap additional scale economies and bundle wireless services with its long-distance and Internet access service. Unfortunately for WorldCom, antitrust and competition authorities in both the United States and the European Union thought it would give WorldCom substantial monopoly power, and both indicated that they would oppose the acquisition.

In mid 2000, WorldCom announced that in the face of this opposition, it would abandon the acquisition. This proved to be a turning point in the company's fortunes. During the next two years the company's share price plummeted from over $50 a share to under $1. A number of factors contributed to this implosion in the share price. First, a price war erupted in the long-distance telephone service business. A combination of slowing growth and the entry of new competitors conspired to drive down prices for long-distance services. Second, in the data area, many of WorldCom's largest customers were other telecommunications provider, many new companies who had entered the market. By mid 2001, many of these companies were in trouble. They had taken on too much debt to build their own networks ahead of demand and were unable to generate the cash flow to meet their debt obligations. As they crumbled into bankruptcy, WorldCom lost business that it had counted on to generate its own growth and service its debt commitments. It also started to lose the customers who had come with the acquisition of other carriers, such as MCI, and who complained that the quality of customer service had declined markedly under WorldCom.

The net result was that by 2002, WorldCom was looking at declining revenues and steep losses, a far cry from the double digit earnings growth it had been predicting eighteen months earlier. Suddenly, the company was struggling to generate the cash flow required to service its debt commitments. Moreover a May 2002 financial audit discovered that the company had understated expenses by $3 billion during 2001 and inflated its income by $1.4 billion in the quarter ending 31 March 2002. This led to the resignation of several senior executives, including CEO Bernie Ebbers. The news of possible accounting fraud, taken together with WorldCom's sudden losses, led rating agencies to downgrade WorldCom's debt. This pushed up the interest rate on that debt, making it more expensive for WorldCom to service. The company was now caught in a vice – on one side, due to unexpectedly poor business conditions its cash flow was plunging, and on the other, the price of servicing its debt was surging.

In July 2002, WorldCom bowed to the inevitable and declared bankruptcy. Bernie Ebbers grand strategic vision lay in ruins.
Adapted from: Hill and Jones (2009) <u>Strategic Management An Integrated Approach</u> Houghton Mifflin

Questions

1.1 Explain why it can be said that WorldCom was pursuing a strategy of horizontal integration. (6)

1.2 Outline the reasons why the acquisition of Sprint was opposed by the competition authorities. (6)

1.3 Discuss the reasons why the strategy of horizontal integration failed. (8)

QUESTION TWO **[20]**

Read the following and answer the questions that follow:

Hotel Formula 1 launches new 'cocoon' concept room

Accor Hospitality's Hotel Formula 1 now sports the latest in award winning design and technology features for small spaces.

Hotel Formula 1, part of the international hotel group Accor Hospitality, is setting a new benchmark in low-cost hotel rooms in Africa with the launch of its 'cocoon; bedroom design. The compact 12.5 m^2 rooms feature all the technological requirements of the modern business and leisure traveller, plus clever design features that ensure the guests' needs are met in a new and enhanced way.

Technology has been matched with decor and together delivers on the new challenge to tourists splashed across the top of the building: 'Change the way you see Hotel Formula 1. The first hotel to be revamped was Hotel Formula 1 OR Tambo International Airport in Johannesburg, which was the group's first hotel in the country and was opened 20 years ago.

The group's vision is to be the best of the low-cost hotels and to demonstrate leadership as well as high standards in the hospitality arena. The remainder of the hotels will be upgraded over the next five years. The new design won a Best Interior Design award at the European Hotel Design Awards.

"Ever since the opening of the first Formula 1 in South Africa in 1993, we have striven to provide innovative yet affordable travel solutions to South Africans. At the time we entered the South African hotel industry, we radically transformed it by offering comfortable and affordable accommodation for one, two or three people for under R100 at the time" says MD Zahra Peera.

"As industry leaders in low-cost hotels, we take pride in our product and are continually looking for ways to provide our customers with the best value for money. In launching the cocoon concept rooms, it was important to utilise the space in the best possible way, providing features that customers want, such as flat-screen TVs, within a cosy yet spacious room," Peera adds.

Aligned with Accor's international environmental and corporate responsibility policies, the new rooms have a strong focus on sustainable development, including:

- Water-efficient separate showers
- Water–saving separate toilets
- Easily recyclable products
- Energy efficient lighting across the hotel
- Variable refrigerant volume air conditioning systems, which almost halve the power consumption of regular units while increasing the cooling and heating efficiency.

There are a number of coat hooks in key locations in the room, which make up for the lack of cupboards. There is also a large storage space under the bed for suitcases as well as convenient ledges for storing belongings in other areas of the room. The latest in connectivity technology is featured for guests to plug in their various devices plus the hotel is Wi-Fi enabled. A flat screen TV with DSTV channels is mounted on the wall.

Peera says, "The introduction of the cocoon design of the Hotel Formula 1 OR Tambo International Airport is momentous for us as this hotel is a benchmark within the industry and the first of its kind in Africa. We are now spreading the cocoon design room, with the entire Formula 1 hotel network being renovated over the next five years."

Hotel Formula 1 is part of Accor Hospitality Southern Africa, one of the leading hotel groups on the continent with 51 hotels. In South Africa, they have 23 hotels, making it the biggest international hotel group in the country. The group's Hotel Formula 1 and Mercure brands are located in key business hubs.

Accor is a major global hotel group with some 4 000 hotels in 90 countries across various brands.
Adapted from: Louw and Venter (2010) <u>Strategic Management Developing Sustainability in Southern Africa 2nd edition</u> Oxford University Press

Questions

1.1 Identify the strategies pursued by Accor Hospitality South Africa in the Formula 1 portfolio. (6)

1.2 Discuss whether the strategies pursued by Formula 1 are in line with its strategic direction, giving reasons for your responses. (8)

1.3 Explain whether or not these strategies can be copied by competitors, justifying your responses with adequate reasons. (6)

QUESTION THREE **[20]**

3.1 Explain what is meant by strategic management and discuss the dynamic nature of the strategic management process. (12)

3.2 Distinguish between intended, deliberate, emergent and realised strategy. (8)

QUESTION FOUR **[20]**

4.1 Discuss the importance of macroenvironmental analysis in strategy formulation. (10)

4.2 Discuss the competencies and tasks of strategic leadership. (10)

QUESTION FIVE **[20]**

The diagnostic process is a cyclical one that involves data gathering, interpretations, identification of problem areas and possible action programmes (Harvey and Brown)

With reference to this:

5.1 Explain what organisational diagnosis is and outline the benefits of a thorough scientific organisation diagnosis. (10)

5.2 Describe the steps in the diagnostic process. (10)

QUESTION SIX **[20]**

Implementation of any change programme needs to take account of the restraining forces of change. Managers should anticipate some employee resistance and plan for this eventuality in the change strategy (Brown, 2011:171)

With reference to this, discuss the reasons for employee resistance to change and suggest ways in which resistance to change can be overcome.