JANUARY 2018 SUPPLEMENTARY/ AEGROTAT EXAMINATION

MODULE:

STRATEGIC AND CHANGE MANAGEMENT

PROGRAMME:

MASTER OF BUSINESS ADMINISTRATION (NQF 9)

DATE: 15 January 2018	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 **[20]**

Read the following article and answer the questions that follow:

Does Netflix Have a Sustainable Competitive Advantage?

Jeremy Bowman Sep 1, 2016

Netflix (NASDAQ:NFLX) has long been one of the most controversial stocks on the market, and recent analyst research has served as a reminder that the stock remains intensely debated

Earlier this week, Axiom Capital Management's Victor Anthony initiated coverage on the leading streamer with a "sell" rating and an $80 price target, arguing that rising competition, diminishing pricing power, and rising content costs would undermine its ability to meet subscriber and earnings targets.

Meanwhile, also this week, RBC's Mark Mahaney reiterated a "buy" rating and a price target of $130, arguing that the company has "reached a level of sustainable growth, scale, and profitability" that isn't reflected in the stock price.

The debate over Netflix seems to boil down to whether or not the company has a sustainable competitive advantage. Defined as a set of attributes that allows a business to maintain an advantage over competitors, the concept is crucial to finding stocks that will outperform.

It's also one of Warren Buffett's favourite qualities in a stock. He tends to favour big-brand stocks with strong cash flow, like Coca-Cola, which has been the leader in beverages for generations. Economist Michael Porter argued that competitive advantage can be delivered in one of two ways: It either comes through a price advantage, often as a result of economies of scale, or from differentiation, by providing greater value or a better experience at the same price.

Oft-cited examples of competitive advantages are brand, distribution, scale, network effects, and switching costs.

The tricky part with Netflix is that the company seemed to own a competitive advantage over traditional TV, but that's changed with the increasing expansion of other players into the streaming industry, which now includes Amazon.com, Hulu, HBO Now, Showtime, and others. That competition seems to be at the crux of Netflix bears' argument.

However, analysts are making a mistake by assuming that the increase in competition means Netflix lacks a competitive advantage. Let's take a look at a few of the reasons that Netflix stands out from its peers.

Big brand

Having a well-known brand name helps separate a company like Netflix against newcomers in its space. Customers understand what Netflix stands for: all-you-can-watch, ad-free movies and TV shows for about $10/month. The library includes classics as well as new TV shows and movie studios and Netflix originals like *House of Cards* and *Orange is the New Black*.

Netflix has also held firm in its streaming smorgasbord, making for a clear brand proposition. Hulu, on the other hand, has introduced multiple tiers, some with ads, some without, some with free programming, others with a cost, making its brand less consistent for the customer. Amazon also offers ad-free movies and TV shows for Prime members, but also rents content a la carte.

A 2015 study showed that Netflix's brand identity was much stronger than either Amazon's or Hulu's, and that the name has become inseparable from streaming.

Reach/distribution
Netflix's brand name also extends beyond the U.S. The service is now available in all but a handful of countries around the world, something no other streaming service can match, and Netflix reached more than 83 million subscribers as of last quarterly report. That reach is an advantage by itself, as Netflix can distribute its own programming to subscribers around the world, and it's also an economic benefit as that subscriber base enables it to spend $6 billion on content and create 600 hours of original programming this year, figures that are unmatched by media companies old or new.

That budget should enable it to continue attracting new subscribers, which will in turn allow it to spend more on content, making it even more attractive and creating a virtuous cycle. That's an economic moat against competition, and a reason why Netflix garnered more Emmy nominations than any other network except HBO or FX this year.

Netflix as a pure play
Virtually all of Netflix's competitors have a stake in the old model of television. Hulu is a joint venture of ABC/Disney, NBC/Comcast, Fox, and now Time Warner. That service has struggled with questions such as when to stream new episodes as execs are loath to cut into profits from shows airing on broadcast networks.

Likewise, premium networks like HBO and Showtime have launched their own streaming services, but the cable model is still the best way for both companies to earn profits. Investors anticipate a streaming service from ESPN, but that will carry the same conflicts other linear TV networks have. Only Amazon does not have a stake in linear TV -- but even that company is primarily focused on e-commerce, and its brand association reflects that.

Disruption tends to come from outside operators rather than those inside an industry, as disrupting a functioning model often causes profits to evaporate -- which explains why Netflix is the one that has consistently pushed the envelope in streaming, taking steps like producing original content, expanding internationally, and forging partnerships with different tech channels such as game systems and now Comcast.

Those who doubt Netflix's ability to turn a profit need only look at the current TV landscape, where billions in profits are spread among cable providers and networks each year. Time Warner's HBO, for example, will make about $2 billion in operating profits next year. As Netflix builds scale, its subscription model should ensure that the bottom line also beefs up. As management has promised, the company is on track to deliver material profits in 2017, and it should grow from that point as the service continues to get better. **https://www.fool.com/**

Questions

1.1 Explain what sustainable competitive advantage is. (5)

1.2 Discuss whether Netflix has a sustainable competitive advantage or not, giving full reasons for your responses . (15)

QUESTION TWO **[30]**

Read the following and answer the questions that follow:

Changing the Rules at Cosmo Plastics

When Alice Thornton took over as chief executive officer at Cosmo Plastics, the company was in trouble. Cosmo had started out as an innovative company, known for creating a new product just as the popularity of one of the industry's old standbys was fading, i.e., replacing yo-yo's with water guns. In two decades, it had become an established maker of plastics for the toy industry. Cosmo had grown from a dozen employees to four hundred, and its rules had grown haphazardly with it. Thornton's predecessor, Willard P. Blatz, had found the company's procedures chaotic and had instituted a uniform set of rules for all employees. Since then, both research output and manufacturing productivity had steadily declined. When the company's board of directors hired Thornton, they emphasised the need to evaluate and revise the company's formal procedures in an attempt to reverse the trends.

First, Thornton studied the rules Blatz had implemented. She was impressed to find that the entire procedures manual was only twenty pages long. It began with the reasonable sentence "All employees of Cosmo Plastics shall be governed by the following . . ." Thornton had expected to find evidence that Blatz had been a tyrant who ran the company with an iron fist. But as she read through the manual, she found nothing to indicate this. In fact, some of the rules were rather flexible. Employees could punch in anytime between 8:00 and 10:00 a.m. and leave nine hours later, between 5:00 and 7:00 p.m. Managers were expected to keep monthly notes on the people working for them and make yearly recommendations to the human resources committee about raises, bonuses, promotions, and firings. Except for their one-hour lunch break, which they could take at any time, employees were expected to be in the building at all times.

Puzzled, Thornton went down to the lounge where the research and development people gathered. She was surprised to find a time clock on the wall. Curious, she fed a time card into it and was even more flabbergasted when the machine chattered noisily, then spit it out without registering the time. Apparently R&D was none too pleased with the time clock and had found a way to rig it. When Thornton looked up in astonishment, only two of the twelve employees who had been in the room were still there. They said the others had "punched back in" when they saw the boss coming.

Thornton asked the remaining pair to tell her what was wrong with company rules, and she got an earful. The researchers, mostly chemists and engineers with advanced graduate degrees, resented punching a time clock and having their work evaluated once a month, when they could not reasonably be expected to come up with something new and worth writing about more than twice a year. Before the implementation of the new rules, they had often gotten inspiration from going down to the local dime store and picking up five dollars worth of cheap toys, but now they felt they could make such trips only on their own time. And when a researcher came up with an innovative idea, it often took months for the proposal to work its way up the company hierarchy to the attention of someone who could put it into production. In short, all these sharp minds felt shackled.

Concluding that maybe she had overlooked the rigidity of the rules, Thornton walked over to the manufacturing building to talk to the production supervisors. They responded to her questions with one word: anarchy. With employees drifting in between 8:00 and 10:00 and then starting to drift out again by 11:00 for lunch, the supervisors never knew if they had enough people to run a particular operation. Employee turnover was high, but not high enough in some cases; supervisors believed the rules prevented them from firing all but the most incompetent workers before the end of the yearly evaluation period. The rules were so "humane" that discipline was impossible to enforce.

By the time Alice Thornton got back to her office, she had a plan. The following week, she called in all the department managers and asked them to draft formal rules and procedures for their individual areas. She told them she did not intend to lose control of the company, but she wanted to see if they could improve productivity and morale by creating formal procedures for their individual departments.

Questions

2.1 Discuss whether Alice Thornton's proposal to decentralise the rules and procedures of Cosmo Plastics will work or not. (10)

2.2 Discuss what you think are the likely reasons for resistance to Alice Thornton's proposal at Cosmo Plastics. (10)

2.3 Outline the strategies that Alice Thornton might adopt to counter worker resistance at Cosmo Plastics (10)

QUESTION THREE [20]

Read the following and answer the question that follows:

How Capitec gave the established banking industry a run for its money

Chances are, most entrepreneurs will never get their hands on R250 million start-up capital. They probably won't have the backing of a large investment company to get their dream of the ground. These are considerable advantages and Capitec bank had both of them. But that's where the dissimilarity with most entrepreneurs ends.

If one purchased Capitec shares in 2002 from a listing price of R2 when the company listed, one would have been feeling pretty smug in 2014 when the shares were worth R173. The story is one of disruptive thinking in action, when a new kid on the old block took on a gap that others saw but were unable to fill. In doing so it showed up the big players at a time when they seemed immovably entrenched as market leaders. While it has not dethroned one of the Big Four banks, it certainly had them sitting up and taking notice.

Capitec was South Africa's first new retail bank in decades and it cornered the massive lower-middle income retail banking market, signing on an average of 70 000 new customers a month. It also had ambitious plans to grow its branch network by 55 branches a year for five years from 2014 . In 2014, Capitec posted continued profit growth of 46%.

Capitec's greatest achievement is that it has changed an industry. Its no-frills approach to simple banking that meets the real needs of the customer introduced a new element to the banking landscape and fundamentally changed the rules of the game. Capitec's success has been driven by a “go big or go home” approach. CEO Riaan Stassen points out that “you can’t compete in the banking industry as a small time player. Not if you want to get ahead.” Capitec did for banking what William Webb Ellis did for rugby. It’s what Apple did internationally and it transformed Capitec from “the little guy trying to carve out a market space” to “the next new big thing.”

This had always been Stassen’s goal. In 1995, when he was MD of Boland Bank, he had ambitions of reengineering the bank, but when it merged with BoE, and became part of a larger corporate structure, those plans were scuppered. He didn’t forget them however. “We’d done a thorough analysis of the retail banking market and we knew where there was an opportunity to do things differently,” he says. So when he left BoE to join PSG’s micro-lending outfit, Keynes Rational in 2000, those plans were revisited. Keynes obtained a retail banking license in 2001 and Capitec was born.

While the market gap might have been obvious, no one – not least the established banking players – had taken advantage of it. Stassen outlined where the opportunities lay and used this to clearly articulate the vision of the new bank. “The key thing was to ask ourselves what we wanted to achieve. The answer was directly informed by where we saw the market gaps: affordability, greater and more hospitable branch access, and simplified, easy-to-understand banking products,” says Stassen.

Stassen’s point of departure was the question, “what does the customer want?” At Capitec what the customer wants drives everything. This has given it a differentiating edge, helping it to introduce a range of industry firsts. The pricing structure is one example. “We identified affordability as a huge opportunity. Our bank charges are 50% cheaper than the best product on the market” says Stassen.

Stassen believes that the face-to-face relationship is also critical to providing customers with what they want. “We wanted to improve access – not just from the point of view of having more branches but also by making the bank a hospitable place that people felt comfortable visiting,” he says. In certain areas, branches are open from 7am to 7 pm. Capitec also became the first bank open for Sunday trading.

Industry ‘firsts’ such as these helped Capitec attract new customers at a phenomenal rate. But it is the bank’s products that have set it apart. There is a single transaction and savings product for all customers, regardless of income. It’s a fundamental break from the multiple and complex products offered by traditional banks trying to provide something tailored for every customer group. The transaction account also acts as a savings and loan facility, all rolled into one. The existence of this product (called a Global One account) is proof of Stassen’s innate tendency of turning the tried and tested way of doing things on its head, and challenging entrenched industry beliefs and systems.

Capitec’s pay-off line, *Simplicity is the ultimate sophistication*, is borne through in its products as well as its fees. “I don’t like the bundled fee approach. We’ve gone with a single, pay-as-you-go pricing structure, “says Stassen. All this simplicity leads to greater clarity in the minds of the customer, and transparency is an important deliverable at Capitec.

Stassen believes that one of the reasons why Capitec was able to take advantage of the market gaps where its competitors weren’t is that it had the nimbleness of a small entrepreneurial company.

Adapted from Nieman G and Nieuwenhuizen (editors) (2014) <u>Entrepreneurship A South African perspective. Third Edition</u>. Van Schaik

Describe the environment in which Capitec operates and evaluate the strategy implemented by Capitec, giving reasons for the apparent success of the strategy.

QUESTION FOUR [20]

Strategy implementation is the phase in which management aligns or matches leadership, organisational culture, organisational structures, reward systems and resource allocation with the chosen strategy. These are often referred to as the drivers of strategy implementation.

With reference to this, discuss the drivers of strategy implementation in an organisation.

QUESTION FIVE [10]

Competitive advantage can be built by redefining the product offering of an organisation through value innovation and creating a new market space. The process of thinking through value innovation has been described as searching for a “blue ocean”.

With reference to this, discuss the concept of a ‘blue ocean’ in this context.

END OF QUESTION PAPER