CGMA FEBRUARY 2018 EXAM ANSWERS

Variant 2

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SECTION 1

Hi Karl

Below are my thoughts on the issues you asked me to consider:

Strategic benefits of a merger

A merger offers a much quicker route to expansion than organic growth. A significant benefit would be that a merger with GymGo would consolidate our position as the dominant budget gym provider in Hylandia. Together, the two businesses combined, based on forecast 2018 data, would operate 225 gyms and have members totalling 905,000. This would be approximately 18% of the gym members in Hylandia (905,000/ 5.12 million) forecast in 2018. The nearest budget gym competitor, LoCo, is forecast to operate only 110 gyms and have a membership of 374,400 at the end of 2018, meaning that our combined organisation would be double the size of our nearest budget rival. A merged organisation would hold 63% of the top four budget gym membership of Hylandia. This clearly meets our strategic business aim of increased market share of the budget gym sector in Hylandia. It would also reduce competition in the budget gym sector, as GymGo are clearly one of the main four competitors. Therefore, this removes a competitive threat from the market.

A merger would open up entry into the "virtual" gym market, as we could capitalise on GymGo's use of technology, presenting us with the opportunity to access the GymGo apps. Access to Big Data analytics and fitness app technology could be a key competitive advantage over the other budget gym providers, who currently are not using this technology.

A merged business could result in synergy and the benefits of economies of scale. Being able to negotiate with key suppliers and the ability to utilise the best approaches to fitness delivery from each business should drive efficiency and allow GymGo to continue to drive its efficiency and low cost focus.

Strategic problems of a merger

This is a strategy for growth that Royals has never attempted before. At Royals we have always relied on the success of our organic growth strategy and therefore we have no experience or leadership in this complex area. Expected synergy might not occur, incurring additional costs and impacting on efficiency. This will need thorough investigation in terms of key operations and policies of GymGo, to ensure a smooth transition and that potentially synergies do exist and are exploited.

There may also be cultural clashes in terms of differences in approach, particularly at Board level. GymGo is a family owned business and may have a very different approach to management and culture to Royals. This will need thorough investigation. GymGo is a very technologically focused business and this may drive their culture to be different to Royals. Our own IT staff may feel threatened by this merger with no expertise in this area which may make Royals staff feel inferior and they may also feel their positions may be under threat.

We need to consider the impact on our existing Royals customers. Any changes to delivery, our brand or change in the systems may deter them. A merger may need a change of brand/logo which may mean that potential customers no longer recognise us as a business.

Communicate to key stakeholders

GEM, as a key business partner and funder of Royals, will be highly interested in the proposed merger and will have a degree of power in the decision. We must set up a meeting as soon as possible with our GEM partner to set out and explain our initial proposals and plans for a merger. They will want to know the financial impact, the anticipated growth and any funding requirements which may impact on them. We need to communicate the likely benefits and problems so that they can make an informed decision about whether this would be a good move from their viewpoint. It is important that we do this as soon as possible.

Similarly, the bank will be interested in the costs of the merger and the growth potential. A business plan is likely to be needed to present to the bank. Also, a cash flow forecast for the merged business would be useful.

Our gym staff are also likely to be interested. Obviously, there is no need to communicate the proposal too early to staff but we must ensure that rumours do not spread and that staff do not become concerned for their positions. If the merger seems likely, then we must communicate to staff, probably best achieved through Regional Managers.

Staff will be interested in the safety of their positions in a merged business. We will need to reassure their future positions in a growing business. We could initially send a brief newsletter to all gym staff and ask Regional Managers to convey the initial plans at team briefings or one to one meetings.

Regional managers will need to be informed as soon as possible by Frederik and must be given sufficient information to communicate a positive message to the gym staff about the merger. These are our key communicators to our frontline staff and we must make sure they communicate a positive message in a timely way to every staff member to achieve buy-in. Also, they need to be given information about potential changes to their own extended responsibilities in effective communication from the senior management team. This communication should be carried out altogether so that one clear message is communicated throughout all of the gyms.

IT staff in particular may be directly affected by a merged business. There is likely to be a significant amount of work and, potentially, some IT staff could be made redundant with more experienced staff from GymGo taking responsibility for the work of a merged IT department. We will need to reassure IT staff that they have a role in a merged business and encourage new skill development.

SECTION 2

Composition of the Board

As this is a proposed merger and not a takeover there can be no presumption that the directors of Royals will retain their current positions on a merged board, merely because we are a larger organisation. The size of the organisation should not really matter as to who retains their position.

It will be important to consider the experience and suitability of board members for each role. As a merged organisation, it will obviously be larger than the two separate entities and there is an argument for attempting to retain key directors from both organisations on a larger board, but this may not be feasible in all board positions.

Eliza Vardy is due to retire as Chair of Royals sometime very soon and a merger may in fact make this happen sooner rather than later. Therefore, Marco or Cristiano could take up the position as Chair, with the other taking on the role of CEO. Both have experience in the role as Chair and CEO. It is strongly advised that the role of CEO and Chair is split in a merged organisation.

The role of the Chief Operations Officer is likely to be retained and it would seem appropriate for Frederik to maintain his position in this role. However, deciding on who will undertake the role of the Chief Finance Officer will be more difficult as there is only one position in a merged organisation and therefore any decision must be based on experience.

An IT Director is likely to be a critical position on the board if technological development is to continue. The IT Director is likely to be the current incumbent of GymGo, who has the experience of the app development and Big Data analytics. A Chief Marketing Officer will need to be appointed and also a Human Resource Director, considering the level of staff.

It is also likely that a merged board will require more independent NED's.

Relationship with the Competition Authority

We must make sure that we comply with any relevant legislation and regulations as set out by the Competition Authority of Hylandia. The Hylandia Government will expect the Competition Authority to monitor the merger and ensure that it is in the public interest and importantly, that it is not anti-competitive.

Based on the forecast of a total of 1650 (1500 + 150) gyms in operation at the end of 2018, a combined organisation would operate 14% (225/1650) of the total number of gyms in Hylandia. This is unlikely to cause concern for the Competition Authority. However, it may be concerned that, as over 50% of budget gym membership is held by the top 4 budget operators, a merged organisation would hold about 63% of the top four budget gym membership (905,000/ 1,432,600). As the budget gym sector is clearly the growing trend in Hylandia, with most growth coming from these top 4 players in the industry, a merger may be seen as anti-competitive. Royals and GymGo would possess 905,000 of the total 2.56 million budget gym users based on forecast 2018 figures, which is 35% of the total budget gym market. In some countries, a threshold of 25% of market share would be considered anti-competitive. We must ensure we have regular communication with the Competition Authority throughout the process and explain the reasons for the proposed merger and the benefits to the public of Hylandia.

We could try to gain central Government support for the merger. The Government of Hylandia is clearly keen to improve the health of the nation and to get people exercising. We should therefore highlight to them that a merged organisation, offering highly accessible fitness provision both in the gym and at home, is a key step towards improving the health of the nation.

Advantages and disadvantages of a bonus system

Whether a bonus scheme would be appropriate for gym staff largely depends on their ability to influence membership numbers. If gym staff have no control over membership, then there is little benefit. However, it could be argued that offering bonuses to gym staff may help to motivate them to retain members, which is a critical success factor for our business. It is important that there be a clear link between the bonus payment and the achievement of target customer retention rates. This is likely to be difficult in practice as customers are motivated to stay with a gym by a huge range of alternative factors.

Bonus payments could attract staff from other gyms that don't pay such a bonus and could help us retain staff if they feel that the bonus system means they are being paid over and above gym staff in other businesses.

However, bonuses may be dysfunctional causing gym staff to behave in a way that is not effective. For example, gym staff may 'hard sell' which may put customers off our gyms.

Bonus systems are also likely to be costly. If we are paying bonuses for something which is not in fact in the control of gym staff, then this is ineffective.

As stated above, it is likely to be difficult to monitor and control. How do we prove the linkage between gym staff activity and customer retention? Members are attracted to the gym for many reasons other than the gym staff themselves.

Also, bonuses may not be a motivator at all. There are many other factors which motivate staff such as a good basic salary, good working conditions and promotion and training.

How to manage the current GymGo gym staff if bonuses are stopped

Following on from the discussion above, I would recommend that bonuses are not paid to gym staff should the merger proceed. However, we must be aware of the impact of this decision on the motivation of GymGo staff members. GymGo staff may decide to leave. We must review the current salary levels and ensure that gym staff pay is commensurate with Royals gym staff. An increase in basic pay may overcome any demotivational effect from the loss of a bonus.

We want to maintain the motivation of all gym staff in a merged business, so whatever is implemented must be fair and equal to all staff. We should bring the two salary schemes in line so that staff across the whole company have parity on salaries. We could consider offering alternative benefits, such as holidays or offering flexible working arrangements.

We need to consider team building and team-working events. This will allow them to see how Royals' gym staff are motivated, without being paid a bonus. We should invest in additional training and qualifications for all gym staff and make sure all qualifications are kept up to date. We must keep gym staff informed and make them feel part of the corporate team. They must feel valued within a merged organisation.

It would appear that money is not the only motivator, and that staff need more than bonuses to motivate them. A better basic salary is a key starting point but we must investigate the non-monetary motivational factors which will help us to retain staff. We should get Regional Managers to hold one-to-one discussions with gym staff to identify the motivational factors which will help us to retain them.

SECTION 3

Advantages and Risks of Big Data analytics

Advantages

Big Data analytics could have a key strategic value for us. Firstly, it could allow us to segment our customer base to identify high-value customers which is essential for fine-tuning our sales and marketing efforts. Data from Royals website, where members access and book sessions could be invaluable to us in discerning patterns of members behaviour, preferences, retention and levels of satisfaction.

Contextual information such as location of our members, time of day usage, age ranges and other demographic information could provide valuable correlations. Real-time analytics of specific ad campaigns, monetary or non-monetary incentives can be tested with same-day feedback.

Also, Big Data analysis can be employed to test longer-term tactics and strategies for example, advertising expenditure or testing of new machinery. Hypotheses can be proposed, experiments put in place and the results analysed from multiple data pools to verify results. Correlations can feed causal analysis to support current decisions or company forecasts. These experiments are beneficial in judging the usefulness of data from various sources.

Big Data can help Royals better understand the how, why, what and where of customer interactions with our gyms and the Royals brand. These insights can help us develop our product strategy from a reactive one in which improvements are made to existing products based on customer feedback or competitor’s enhancements to a proactive one.

Risks

Big Data analytics is likely to present us with far more information than we have ever been used to before, relating to customers, competitors, the market place etc. from a far wider set of information sources. This may lead to information overload – an over-usage/over analysis of data which causes us to lose focus on our critical success factors. Particularly in our early adoption phase, it is likely that we will be presented with so much data that it is difficult to determine which is the most important to us. We must ensure we maintain a focus on our core strategic aims and focus on the data which relates directly to these.

It is likely that valuable time will be spent analysing the data produced which in fact has no organisational value. This again is likely to occur during the early adoption phase of the project.

A key risk is the security of the data that is now available to us. With more data comes a greater need to keep this secure, particularly if it is critical and competitively sensitive. Any breach in data security could have serious repercussions on our business and our reputation with our customers could be severely damaged

There is a risk to data protection as we are likely to be collecting our data from personal sources such as our customers Facebook and Twitter activities. We must ensure that we do not breach any data protection regulations.

There may also be technical risks associated with trying to integrate our existing customer database with Hadoop (open source programming) systems, which enable the processing of large data sets by simultaneous use of multiple servers. We need to ensure we have the technical capabilities and the technical expertise to manage these complex and dynamic technological interfaces.

Driving and restraining forces on Big Data implementation (including team formation)

The first driving force is the fact that GymGo is currently adopting this technology very successfully, so we must not be left behind by competitors. Technology, such as Big Data is likely to be a key competitive advantage in the future of the fitness industry.

Another driving force is the strategic aim of both increasing and retaining customers. The successful application of Big Data analytics should assist our understanding of customers' needs much better and help us to offer what customers want more effectively.

Marco himself is a driving force behind this initiative and strong and focused leadership in Big Data application should assist us in making it happen.

The restraining forces also must be considered. Firstly is our lack of current expertise in Big Data applications. Our IT team does not have the experience of Big Data applications nor do we have the infrastructure or technological facilities. This would mean that we would have to invest in appropriate technology and expertise.

Our IT staff may be reluctant to undertake a major project without additional training or remuneration. This is likely to mean significantly more work and responsibility than their current responsibilities. Gym staff may also be reluctant to accept such a move to app technology if they consider this a threat to their own positions in the business.

Forming a team

Our current IT team should form the core of the project team to implement Big Data analytics. It should be led by our experienced IT Manager. It is also recommended that we use the services of an external expert to jointly lead the development project. This may be done on a consultancy basis or we may consider employing a permanent member of staff who has experience in Big Data analytics. We could consider employing an IT director who has past experience in Big Data application and could lead the team. An IT director may be required in the long term if we are seriously considering a more technologically driven organisation.

One of the other current Board members should be part of the team. It would make sense for Anika Sohal, the Chief Marketing Officer, to be a part of the team, as marketing will be a key driver of Big Data applications. A senior board member would give the project credibility and ensure that it remains a high profile organisation-wide initiative. It may also be sensible for myself as the Senior Finance Manager to play a role in this team to assess and manage the financial implications of the initiative.

It is important that at least some of the team have experience and knowledge of the application of Big Data. Our IT staff will need to undertake the necessary training if this knowledge is lacking. It would also be useful for the team members to have skills and experience in project management, as this is likely to be a complex and expensive project and team members will need project management knowledge and skills to make sure it is carried out successfully.