CGMA STRATEGIC CASE STUDY FEBRUARY 2019 EXAM ANSWERS

Variant 2

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SECTION 1

Viability of the Go-Run acquisition proposal

Suitability

The first question to ask is, does the acquisition of Go-Run have strategic fit with the rest of our business? It seems to be a fit with our mission and vision statements. It would certainly take advantage of an opportunity to move into the smartwatch market more quickly than developing smartwatch technology ourselves. The Sprint smartwatch is clearly aimed at the fitness and activity market and therefore it should fit into and moreover, enhance, our existing product portfolio. We certainly have strengths in our own proprietary health and fitness technologies and therefore the acquisition of a health and fitness smartwatch (which contains highly accurate heart rate monitoring technology) would also build on our strengths. Overall, the acquisition of Go-Run is considered to be suitable.

Acceptability

We need to assess whether the acquisition would be acceptable to our key stakeholders. What are the potential risks and returns to our shareholders of an acquisition strategy? At predicted sales of 20 million for 2019, only its second full year of sales, returns are likely to be acceptable for our shareholders, as this is clearly a popular product which has achieved rapid growth. However, we must undertake more detailed calculations to confirm any predicted future returns, as in such a highly competitive market, the reliability of long term forecasts in the smartwatch market are likely to be risky and future growth is unlikely to occur at such high rates.

We would also have to take into consideration the views of the two founders, Gal and Rhea. They still play an active role in our organisation as board members and they may see the development into smartwatches as a step away from the core business of fitness and activity trackers. Our staff are not likely to be highly interested in this acquisition as it is unlikely to directly affect them. However, they may be concerned about redundancies if the two organisations are merged together and duplicate roles need to be rationalised. Our customers will be interested in this new technology. Our customers are likely to accept this strategy if it means a wider product base within our product portfolio and also if the knowledge and experience of Go-Run can enhance the future products of Vita.

Feasibility

We need to consider whether we have the necessary resources and competencies for an acquisition. Firstly, do we have the financial resources to acquire Go-Run? We are not in detailed discussions yet, so we do not have an idea of the price we may have to pay, but this is likely to be considerable for a growing business which is clearly challenging this highly attractive sector of the wearable technology market. We are likely to be able to raise the finances necessary for an acquisition but we also need to consider the on-going financial resources required to grow and develop this business potential. Whilst our retained earnings are very healthy at the moment, it may not make sense to utilise all of these (even if it proved sufficient) because, as you know, our industry is very R&D intensive, so we need to ensure funds are always available for future development activity. We should look at carrying out a cost/benefits analysis to ensure that, even if we could afford it, that it would be worthwhile.

Also, we need to consider if we have the internal competencies to undertake both the acquisition and post-acquisition activities. We have not undertaken an acquisition before and we have no experience of smartwatch manufacture and design so this may be an obstacle to the acquisition. However, as we are in a highly related area I do not see this as a realistic obstacle to an acquisition, with our current skills and technological knowledge.

Risks of acquiring Go-Run

Obviously, there is the strategic risk that the acquisition may fail. As pointed out above, we have not undertaken an acquisition before and an acquisition of Go-Run is likely to be a more-risky option in terms of growth into the smartwatch market than via organic growth. However, in this highly competitive market we do not have time for organic growth and therefore this may be a risk that the Board is willing to take.

There is no guarantee that integration of the two businesses will be successful. Both businesses have highly skilled staff and the Go-Run staff may resent having to work together with Vita’s staff to share their innovative ideas. There is also a high risk that any integration at board level may also prove difficult with two highly innovative and relatively new businesses with directors all competing for positions on a combined board. There may be cultural differences which may result in key staff leaving before acquisition is complete, leading to further difficulties in integration of the businesses

There is a risk that our acquisition of Go-Run may affect our reputation in the market. Adverse publicity surrounding an acquisition may not present a positive image for us, particularly if the bid is seen as hostile. Also, any issues with the Sprint smartwatch in terms of faults or product design defects, which may not yet have materialised due to the early stage of its lifecycle, may impact upon us in the future. This is a new business, in the very early stages of development and growth and there may still be teething problems with products and the organisation itself which have yet to materialise. Taking over the business at this stage in its lifecycle may be dangerous to our reputation in the future if problems materialise post-acquisition. There is a risk that the market may not see this as a good fit for Vita and our share price and, hence valuation, could be affected. However, we should also take into consideration that this acquisition may indeed enhance our reputation in the market place. We would now have an additional product in our portfolio, which we could use to leverage sales of our other products. We may attract a whole new range of customers in athletes and elite runners that would otherwise not have used our tracking devices. This could therefore be considered an upside risk.

The risk that the smartwatch market may stagnate and customers will revert to pure fitness and activity trackers is a real possibility. The technology in our market is rapidly changing, as we have seen ourselves with the rapid developments in the wearable technology market. We have seen huge changes in the diversity of wearable technologies since Vita began only 8 years ago. Smartwatches may themselves be superseded by alternative wearable technology, such as VR headsets or smart-glasses.

We also need to consider the potential upside risk that the combination of our two business may create huge synergistic benefits, with our own experience and knowledge of fitness and activity technologies combined with Go-Runs experience of smartwatch technologies. The combination of our own skills and the new skills and knowledge of Go-Run may give us a competitive advantage in the industry.

SECTION 2

Defences against acquisition

The senior management of Go-Run appears to be viewing our intentions as a hostile takeover and is likely to take whatever actions it can to prevent it going ahead. Therefore, we need to consider the potential post bid defences that could be taken. As we have already seen from the article, the first post-bid defence used by the senior managers of Go-Run is that they have used a Public Relations Officer to communicate very quickly with its stakeholders to establish strong reasons for remaining independent. Speaking publicly to journalists is an effective way of getting a consistent and strong message to all of its stakeholders at the same time. They have presented the acquisition in a very negative light and this is likely to create a negative impression with the general public before negotiations have even commenced.

A further tactic Go-Run's senior managers could use as a defence, is that they could appeal to the owners that the price that we offer is too low. Although we are not this far into the process yet, as we have only made an initial approach at the moment, once an offer is made then it is likely that the senior management team will attempt to prove to the owners that the price is too low.

Go-Run may also directly try to attack Vita as an organisation. Although at the moment this does not seem to be the case, if negotiations proceed, then a tactic may be to point to our own falling market share or they may try to suggest that our culture or management style is not appropriate to theirs, particularly focusing on their ability to be agile and flexible, which as a larger organisation we may not be able to achieve.

It is highly unlikely that Go-Run will look for a white knight, as it would appear it wishes to retain its independence. I would consider this to be a last resort and therefore I do not think we need to consider any form of defence strategy in this case. Similarly, it is highly unlikely that it would make a counter bid to acquire ourselves.

One final defence strategy could be to call in the Competitions Authority. A combined organisation could be considered as anti-competitive in the fitness and activity tracker market in Newland.

How to counter defences

We need to also issue a PR statement from our own Public Relations officer to establish the reasons and positive points regarding a takeover and to reassure key stakeholders of both businesses. If negotiations continue, then we must ensure that we offer a reasonable price based on an appropriate valuation model. As a relatively new company, which is not listed, we may find some valuation methods difficult to apply. However, this does give us a certain degree of flexibility in the negotiation process. We must ensure that both senior leadership teams are fully involved in the process.

We need to ensure that we are open and transparent in our negotiation process and do not hide our reasons for acquisition. We must try to promote the positive synergistic benefits of the acquisition. Any negative comments made about us should be refuted and in any way possible we should try to turn these in to positives.

We must communicate openly and honestly with any investigation undertaken by the Competitions Authority, should they wish to investigate an acquisition. We need to fully demonstrate how a combined organisation would be of benefit to customers and employees and to the Newlands population health and fitness. The size of the two organisations combined should not create a monopoly or be unfair to the public.

Actions to ensure we are change-adept

Change adept organisations are those that have a culture which embraces change as an on-going process. They are likely to be highly innovative and focus on personal competencies and organisational skills, focused on delivering value to customers. An important factor in change-adept organisations is their openness to collaborate and make partnerships with organisations to enhance their innovation and to energise their practices.

Therefore, if a takeover is to be successful in terms of being a change-adept organisation, our leadership team should focus on the leadership skills required of change-adept organisations. However, it must be said that as an organisation, Vita has demonstrated many change-adept features since its own inception and, that we too are a change adept organisation, needs to be re-iterated to the owners of Go-Run. In this industry, as it is a fast moving one, being change-adept is part of survival and those who are not, and have not been, are not able to survive.

Leaders in change-adept organisations tune into their environment. This is something that was mentioned in the recent newspaper article about Go-Run. By tuning into the environment, we need to create a series of listening posts to identify and keep abreast of the latest developments. As we highlight in our Integrated Report extracts, we have a highly skilled research and development team which do this and we are always looking for our latest development. We also add value through our customer forums, always searching out what our customers want next. This is very similar to Go-Run.

Change-adept leaders also communicate a compelling vision of what they want to achieve. Our vision statement clearly focuses on us developing innovative and accessible fitness trackers to inspire both current and future customers to be part of the fitness community. Therefore, we could say that our vision statement does demonstrate that we are change-adept.

Change leaders in effective change-adept organisations also transfer ownership to the work teams. Responsibility for introducing change cannot be done wholly by the leaders of an organisation and responsibility for change must be handed to others. Again, from the extracts of our Integrated Report, we demonstrate our strong focus in a flexible organisation structure which allows for creativity. This style of leadership assists the organisation to embrace change.

In terms of change-adept leadership skills that we may need to focus on developing, learning to persevere and building coalitions are key skills. To some extent, building coalitions may be achieved by a takeover. Should a takeover not occur then we could demonstrate our change adept skills by working in partnership or a joint venture with Go-Run as an alternative, to develop a collaborative product, using our joint skills and knowledge of fitness trackers with their knowledge of smartwatches.

Section 3

Stakeholder management activities

The most powerful stakeholder group will be our own shareholders and the owners of Go-Run, and therefore our focus should be on these as the key stakeholders in the acquisition process. However, we must also consider the activities we need to manage both senior management teams and the staff of both organisations. Importantly, all of these stakeholder groups must have belief that the acquisition will be of benefit to them and to the organisation as a whole, both in the short and long term.

We must prioritise our activities and communication with both sets of shareholders pre-acquisition. If we have not yet agreed on the form of consideration for this acquisition, then the first activity we must undertake is to obtain agreement on this critical issue. Clearly negotiation will be needed on this, as one shareholder group may feel that they are benefitting less than the other in the acquisition process. Therefore, we must present open and honest discussions with both sets of shareholders and enter into negotiations to reach a mutually beneficial agreement for both. To do this we will need frequent face-to-face meetings with senior management and owners.

It may be wise for us to appoint a dedicated manager to take on the role of Communication Officer during this process to manage key stakeholder communications, not just with the shareholders, but with all of the key stakeholder groups.

Another key stakeholder group is the management team, post- acquisition. It will be important to set out as soon as possible what will be expected of them post acquisition and to ensure that they understand their roles within a combined organisation. Again, open and frequent communication pre-acquisition should allow for any concerns to be raised and addressed before the acquisition. Similarly, periodic discussions with employees and communications through newsletters and management meetings with staff should be held to maintain the trust and loyalty of both sets of employees.

Reporting the acquisition in the Integrated Report

If the acquisition go ahead then this needs to be reported as part of our Integrated Report for the next reporting period. We will need to address this within our Management Commentary, where we can provide our stakeholders with an overview of the rationale for the acquisition and our overall expected long term outcome for the acquisition. This will need to include an explanation for stakeholders of our changing competitive environment and how the acquisition would address these anticipated environmental changes.

We must bear in mind that our Integrated Report is designed to present information on our activities to all of our stakeholders, not just investors and therefore we need to consider how the decision impacts on stakeholders before we consider how it is reported in the Integrated Report. However, it will be important to clearly highlight to shareholders who have supported us throughout the acquisition that they are now shareholders of the larger organisation and how this is helping us to further grow the business.

We may want to consider its inclusion within our value creation model - particularly our intellectual capital. However, it may be difficult to assess any value adding activities or outcomes until after the integrated business has been in operation for some time.

One area to consider is our risk register. The first risk in our risk register is the competition from smartwatches. As we would now have acquired a smartwatch business, this may result in a re-assessment of the impact of this risk in our risk register.

Go-Run's Internal Control environment weaknesses

Firstly, Go-Run is only sponsoring the event and is not the organiser of the ultra-marathon, therefore its influence on the event may be limited. However, sponsorship will mean a significant degree of financial support for the event. Therefore, it would be in the interests of Go-Run to monitor the effective management of this event, as any adverse actions of the organisers will have significant repercussions, both financial and reputational. It would appear that Go-Run has taken a largely hands-off approach to organisation and management of the event which is a significant internal control weakness which has contributed to this unfortunate incident.

Therefore, we must question the control environment in Go-Run, if the Board was happy to leave risk assessment and control activities to Marat. The control environment is set by the Board and by demonstrating such a lack of interest in this event, despite the evident risks from previous years, may indicate that the 'tone at the top' of the organisation is weak.

The statement by a competitor that Go-Run merely uses the event as a marketing exercise is also concerning. Again, this may be evidence of a weak internal control environment, where the overall attitude to risk management and control within the organisation is considered secondary to making sales.

Knowing that this event was likely to pose significant risks in terms of the safety of the competitors and ultimately its own reputation, Go-Run should have undertaken its own risk assessment of the event and should have played a far greater role in its organisation and management. It would seem that Go-Run did not undertake its own risk assessment of the event, which is a significant internal control weakness.

Mitigating activities

If we are to continue to sponsor this event following an acquisition, then we must take a far more active role in its organisation and management.

As already stated, the general control environment appears weak in Go-Run and therefore post acquisition, we need to ensure that Go-Run's staff and management, who transfer to Vita, are educated and buy-in to our control culture.

Firstly, we should assign a risk manager to undertake a thorough risk assessment of the event to identify which risks can be controlled and therefore what actions can be taken. For example, a thorough vetting process of competitors, carrying out strict medical assessments should be compulsory and we should set in place mechanisms to ensure this occurs. We may not have the skills to do this ourselves but we must ensure that we insist that Marat organises this effectively. This must be monitored by our own risk management team to ensure that this is being carried out effectively.

We also have a responsibility to monitor the event while it is in progress. We should employ our own team of staff to be at the event to assist competitors and to assist Marat in the running of the event. We need to check that suitable medical facilities are provided and undertake background checks of medical staff to ensure they are qualified for such an event.

There is clearly some concern from competitors that Marat is only concerned with taking their money and we need to ensure that this situation is not allowed to continue and that only those competitors fit to take part are allowed to do so. The damage to our own reputation could be significant if this is allowed to happen again.