Answers

Tutorial note: *These model answers are considerably longer and more detailed than would be expected from any candidate in the examination. They should be used as a guide to the form, style and technical standard (but not in length) of answer that candidates should aim to achieve. However, these answers may not include all valid points mentioned by a candidate – credit will be given to candidates mentioning such points.*

1 (a) One possible approach to answering this question is provided by using Michael Porter's five forces framework. The framework is designed to analyse 'the structure of an industry and its competitors' (Porter, 2004). There are five inter-connecting forces in the framework; potential entrants (the threat of entry), the bargaining power of suppliers, the bargaining power of buyers, the threat of substitutes and the competitive rivalry that exists amongst existing organisations in the industry. Each of these is now considered in turn in the context of AutoFone, focusing on those factors that have a significant effect on their industry. It must be recognised that other models might have been used in framing this answer and credit will be given for using appropriate models in the context of the AutoFone retail shops division.

Potential entrants (the threat of entry)

New entrants into an industry bring new capacity and resources with which they aim to gain market share. Their entry may lead to price reductions, increased costs and reduced profitability for organisations already in that market. Potential entrants may be deterred by high barriers to entry and by the threat of aggressive retaliation from existing competitors in the industry.

In the context of AutoFone's retail sales business, the following barriers appear to be the most significant:

Access to supply channels

The retail outlets of AutoFone were established before the network providers developed their own retail outlets. At the time, the network providers were sceptical that mobile phones could be sold through shops. Consequently, AutoFone was able to negotiate favourable long-term supply deals. It now seems unlikely that the network providers would sign such deals (because the new entrant will be a competitor of their own retail business) and, if they did, any deals would be at less favourable terms. As the managing director of one of the networks suggested, 'AutoFone had got away with incredible profit margins' when they signed the original deals in 1990. Improved supply terms would be attractive to the network provider and phone manufacturers (who would increase their profitability on each unit sold) but it would also cause profitability problems for the new entrant. Furthermore, the provision of networks is currently highly regulated, with licences still having thirteen years to run. It seems unlikely that public policy restricting the number of network providers allowed to provide services will change in the foreseeable future and so access to supply channels will remain a very significant barrier to entry.

Economies of scale deter entry by forcing the new entrant to come in at such a large scale that they risk strong reaction from existing firms in the marketplace. In the context of AutoFone, these economies of scale are associated with purchasing, service and distribution of products through a large scale retail network of 415 shops. Any new entrant would have to enter at a scale that would incur relatively significant capital investment. Furthermore, evidence suggests that the AutoFone brand is well known in the market place, with consumers identifying it, in 2005, as one of the 'top 20' brands in the country. New entrants would not only have to fund a large number of retail outlets, they would also have to support their entry by investing heavily in 'un-recoverable up-front advertising' (Porter, 2004). Capital will also be required for establishing significant inventories in the large number of retail shops required to achieve the required economies of scale.

Bargaining power of suppliers

Suppliers exert bargaining power over participants in an industry by raising prices or reducing the quality of their goods and services. Suppliers tend to be powerful when the industry is dominated by a few companies. This is the case with the mobile phone industry where the supply of networks is dominated by relatively few suppliers. The potential role of suppliers restricting the supply channel has already been recognised as a barrier to entry. However, when supplier power is high, there is a possibility that the suppliers themselves will seek forward integration, with 'suppliers competing directly with their buyers if they do not obtain the prices, and hence the margins that they seek' (Johnson, Scholes and Whittington, 2005). This is exactly the situation affecting AutoFone, with network suppliers now running their own retail outlets.

There are two further elements of the retail phone market which encourage the supplier group to exert significant power. These are:

– The supplier group does not have to contend with other substitute products for sale to the industry. There are few direct substitutes for the mobile phone (see below).

– The supplier's product is an important input to the buyer's business. In AutoFone's situation it is a vital input into the business.

Hence the bargaining power of suppliers is extremely high in AutoFone's retail industry, although this is reduced by AutoFone's long-term supply contracts.

Bargaining power of buyers

Buyers attempt to obtain lower prices or seek to get increased or better quality services or products. They do this by playing competitors off against each other. Under certain conditions a buyer group can have considerable influence. Many of these conditions only arise when the buyer itself is an organisation, not an individual consumer. For example, Porter suggests that buyer power is high when there is a credible threat of the buyer integrating backwards into the market place and so becoming a competitor. Such conditions do not appear to apply to the retail phone industry which is largely aimed at individual consumers.

However, some of the circumstances of significant buyer bargaining power do appear to exist in the industry. For example: *the products buyers purchase are standard or undifferentiated*. Buyers are always sure that they can find an alternative supplier and so they can play one supplier off against another. This is the case for sale of mobile phones as a whole, not just the retail sector. Furthermore, *buyers face few switching costs*. The only real lock-in is the term of the contract, currently twelve months long, after which buyers can switch to a competitor without penalty.

Threat of substitutes
Substitute products are usually products that can perform the same *function* as the product of the industry under consideration. The threat to the mobile phone industry is largely from other products that support mobile communication, such as Personal Digital Assistants (PDAs). However, the trend has been to integrate this technology into the offerings of the industry. The products offered by AutoFone include phones that are also mp3 players, radios, cameras and allow email and web access. Hence the industry appears to be relatively free of potential substitutes.

Competitive rivalry in the industry
Rivalry normally always takes place within an industry. Rivals jockey for position by reducing prices, launching advertising campaigns and improving customer service or product warranty. In the context of the retail mobile phone industry, the intensity of the rivalry is fuelled by:

Equally balanced competitors. The information in Table 2 suggests that the retail sales market is relatively equally divided between the five main suppliers. Evidence suggests this creates instability in the market because the companies are 'prone to fight each other and have the resources for sustained and vigorous retaliation'. (Porter, 2004)

Lack of differentiation or switching costs. Mobile phones are largely perceived by customers as commodities. In such circumstances buyer choice is based on price and service, and this results in intense pressure for price and service competition.

Slowing industry growth. Evidence from Table 2 also suggests that industry growth is slowing considerably. There was less than 1% growth in 2007. This means that competitors will increasingly pursue growth by increasing market share. This will intensify the rivalry between the competitors.

(b) The two longest serving directors of AutoFone have suggested that the retail business should be divested and that AutoFone should re-position itself as an on-line retailer of phones. They argue that an organisation concentrating solely on Internet sales and insurance would be a 'smaller but more profitable' organisation. The CEO is vehemently opposed to such a strategy because it was the shop-based approach to selling mobile phones that formed the original basis of the company. He has strong emotional attachment to the retail business. The two directors claim that this attachment is clouding his judgement and hence he is unable to see the logic of an 'economically justifiable exit from the retail business'.

This question asks the candidate to draft a supporting case for the CEO's position, so that his response is not just seen to be based upon emotional attachment. The briefing paper should challenge the suggestion of the two directors and provide a reasoned case for opposing the divestment of the retail sales business. Of course, divestment might be the best option. The four network providers might pay a handsome price to remove AutoFone from the market. However, this is not the focus of the question!

Briefing paper
Introduction
This paper begins by looking at the basis of the directors' suggestion and claims that they have not interpreted the business situation correctly. It then goes on to examine the exit barriers that AutoFone must consider if they are to seriously consider moving out of the retail sales market.

Product and industry life cycles
It has to be recognised that industries and products move through life-cycles. The slow down in market growth documented in table 2 suggests that, in the context of the product life-cycle model, the mobile phone market appears to be in either the shake-out or maturity stage. This means that buyers will be increasingly selective and that for many buyers the purchase will be a repeat event affected by previous experience. Companies in the market will have to fight to gain market share and the emphasis will increasingly be on efficiency and low cost. Similarly, industries pass from rapid growth into the more modest growth associated with industry maturity. Like most infant industries the mobile phone industry experienced rapid growth as it developed. However, evidence from table 2 and table 3 suggests that both growth and profits are now reducing as the industry matures. Slowing growth in the industry means that there is more competition for market share as companies seek to maintain their own growth at the expense of others. The transition to maturity usually means that the old 'way of life' of the company has to change. It is significant that the idea for divestment has come from the two longest serving directors. They can recall the excitement associated with rapid growth and, in the case of AutoFone, the pioneering of a business idea. In many ways the current expansion of AFDirect recalls the early period of AutoFone and so operating in the growing Internet market appeals to them.

Financial analysis
An analysis of Table 3 shows how profitability has fallen. The ROCE has steadily declined from over 18% in 2003 to just over 5% in 2007. Net profit margin has fallen from just over 12% in 2003 to just over 3% in 2007. Gross profit margins have not fallen quite as much as this. However, liquidity has remained almost constant during this period and so the ability of the company to meet its short term financial obligations has not been impaired by the fall in profitability. Gearing has risen during the period, from just over 21% to just over 32% and this reflects increased dependence on borrowed money. However, the absolute level of gearing should probably not be a cause for concern.

Porter suggests that one of the issues of the transition to a mature market is that directors have to scale down their expectations of financial performance. 'If managers try to meet the old standards, they may take actions that are extremely dysfunctional for the long-term health of the company.' The concern is that the two directors are pursuing such a policy, giving up too quickly and sacrificing a market and market share in favour of a course of action that they believe will deliver short-term profits. Divestment means that they are avoiding the challenges of taking a business like AutoFone into its mature stage.

Industry structure

Evidence from the analysis of AutoFone's competitive position (part a) suggests that AutoFone is in a retail industry dominated by powerful suppliers. Customer bargaining power is also relatively strong and reduced growth in the industry has led to relatively fierce competition. However, there is little threat from substitutes or new entrants because of the high entry barriers. Consequently, AutoFone is in a unique position based on its early entry into the market before the network providers became aware of the potential of retail sales. Furthermore, the company's uniqueness is enhanced by the fact that it is the only retail outlet to offer genuinely independent advice. The two directors appear to wish to carry on in the old way rather than changing strategy and expectations to reflect the maturing of the product and the industry. The real challenge for the board is to exploit AutoFone's unique market position in this changing landscape.

Exit barriers

Exit barriers are economic, strategic and emotional factors that keep companies competing in industries in which they are earning low or even negative returns. These are the barriers concerned with preventing the company from leaving the industry. In the context of AutoFone there are at least two potential non-emotional exit barriers which need to be considered.

Costs associated with leaving the industry

- The high cost of terminating shop leases. AutoFone achieved low start up costs by taking on very long leases. These leases are often in areas just outside the main shopping areas and so may be difficult to re-let.
- The high cost of staff redundancies and the liquidation of stock. There are currently 1,400 employees in the retail shops division.

Loss of strategic interrelationship with other parts of the company

The divestment of the retail shops business is likely to have an important effect on the two remaining divisions (AFDirect and AFInsure) in at least two ways

Reduced brand perception. Research has shown that AutoFone is a well recognised brand. However, most of this brand awareness was built by the retail shops division. The brand is also being constantly reinforced by consumers seeing and visiting these shops. Removing these will lose this reinforcement. Indeed if shops lie empty (because of the difficulty of re-letting shops with long leases) it could harm the brand. Customers may perceive that AutoFone is a company in trouble (or indeed has ceased trading altogether) and so the Internet and insurance arms suffer as a result.

Reduced sell-on into related businesses. Evidence (from table 2) suggests that most insurance sales are in the age bands which predominantly purchase from the retail shops. Hence it seems likely that most insurance sales result from the sales of mobile phones in the retail sales operation. There are probably two reasons for this. Firstly, retail sales are mainly to customers in a certain age group. These customers are less confident in their purchase (which is why they are visiting the shop) and as a result can be guided in the purchase of insurance. Secondly, sales assistants giving this advice are given commission incentives to sell insurance. Consequently, the closing of the shops may have a major effect on the income of the insurance business.

There is also the issue of the cross-selling benefits between the retail sales and Internet sales business. There is evidence to suggest that some customers visit a retail branch to physically see the phones and to get advice before ordering on the Internet. This is currently an issue for staff in the shops who spend time explaining the features of a particular phone only to see the potential customer leave and order the same item on the Internet. Of course not all of these Internet orders are made through AFDirect because customers may take advantage of better offers from rival suppliers. However, a percentage of those sales must be as a result of a shop visit and the company potentially loses the benefit of these goodwill sales as a result of closing their shops. There is also evidence that Internet customers value the option of visiting a shop to get after-sales service for a product bought from AFDirect over the Internet. Although sales staff currently dislike offering this service, removing it may again hit Internet sales.

Conclusion

The company needs to recognise that the mobile phone market has matured and this has implications for both growth and profits. However, AutoFone remains in good shape to exploit the opportunities, such as repeat buying, of a maturing market place. Although profitability has declined, liquidity has remained constant. Gearing has increased but it has not risen to a figure which would cause concern. There are significant exit barriers to leaving the market place. The most significant of these is the loss of a strategic interrelationship with other parts of the company. The Internet division could suffer significantly if AutoFone closed its retail shops division.

(c) There are a number of issues concerning the central business idea and its relationship to the rewards system currently in place in the AutoFone retail shops division. Decline in profitability has led some to question whether the central business idea that underpins the business is still appropriate in a maturing industry and product environment. However, if it remains appropriate, it is currently being undermined by a reward system which focuses on profitability.

Conflict between strategy and remuneration

The strategy has at its core the business idea that has driven the company since its inception. This is the giving of impartial advice to customers so that they can select the best equipment and network for their needs. This business idea is prominent in all of its promotional literature and is reflected in the company's motto 'ethical advice: the customer's choice'.

However, the CEO also claims that the shops are autonomous, being given profit targets but not closely monitored within those targets. He states that the company is 'about providing opportunity to its employees, providing them with autonomy and responsibility to achieve their goals'. To support this approach, sales staff are given a relatively low basic salary with a substantial element of profit-related pay linked to the profit targets of the shop. Commission is also paid on sales of mobile phone insurance to the customer.

Evidence from the scenario suggests a largely 'hands-off' approach to shop management based mainly on the achievement of financial targets. The profitability of the central city branch was not fully understood until the activities of the branch were investigated after the visit of three members of the strategic planning committee. Shops are monitored on achieving profit targets, not on their adherence to the central business idea.

The central business idea is undermined by the remuneration package offered to employees. Significant elements of this package are based on the profitability of the shop and so are very dependent on margins. It is clear from the experience of the central city store manager that margins are not the same for all products and services. Hence to meet profit targets, he abandoned the central business idea and steered customers towards products which had higher margins. As a result his shop, himself and his staff achieved their targets and reaped financial rewards but at the cost of abandoning the central business idea. Until he was investigated, he was held up as an example of what could be achieved. However, when his activities were investigated and analysed he was formally disciplined and he left the firm soon after. The message was that adherence to the business idea was more important than profitability, but this message is not supported by the current rewards system. Impartial advice is likely to lead to reduced income.

Business strategy

The challenge now for AutoFone is to ensure that its business strategy makes sense in the current market place. The company will have to consider whether its original business idea is still a basis for a viable business. Impartial advice was valued when the company was first established. Information about competing products was difficult to gather and products and product details were difficult to access. However, information about competing products is now readily available (on the Internet), rival phone shops have been established and the consumer's understanding of the product has increased.

The product has moved into a mature stage of its life cycle where competition often shifts towards greater emphasis on cost and service. Companies are usually forced to rationalise the product mix. During the growth stage of the industry it may be possible to support a broad product line with frequent introduction of new products and options. However, at the mature stage it may be necessary to prune unprofitable items and to focus on products with the best margins. This, of course, is exactly the policy pursued by the manager at the central city branch.

Increased emphasis on service may be something that AutoFone can exploit through its retail shops. In the mature stage of the life cycle firms are increasingly selling to experienced, repeat buyers. Such buyers are more knowledgeable and their focus is on choice between brands, not on whether to buy the product at all. This should suit the AutoFone business model which is based on choice – a model that none of their network-based competitors can offer.

Reward management

AutoFone must also seek to align its business strategy with its reward management. If it maintains its original business idea then it has to base its rewards system on factors that are not linked directly to profitability – such as turnover and customer satisfaction. It also must recognise that the average wage of an employee in 2007 is less than what it was two years ago. Finally, the company also has to tackle the thorny issue of the relationship of the shops with the Internet operation. Giving impartial advice to customers who then place their order through the Internet and providing support for customers who have purchased their phones through AFDirect are valuable services for the group as a whole but are currently irritating, non-income generating activities for the sales staff in the shop.

AutoFone currently give staff a relatively low basic salary with a substantial element of profit-related pay linked to the targets of the shop. It may wish to consider restructuring this to offer a higher base pay, with performance-relating pay reflecting, perhaps in part, achievement of a target associated with the central business idea. However, it must be recognised that devising a measure of 'impartiality' will not be straightforward. Another possibility, reflecting the concern about giving advice to AFDirect customers, would be to include an element of performance related pay associated with the group as a whole.

Within the shop structure it would seem useful to explore a reward system that:

1. Provided higher basic pay to each individual working in the shop.
2. Provided performance-related pay associated with the shop itself. This may continue to be related, in part, to profitability. However other measures more obviously associated with the central business idea must be considered.
3. Provided an element of performance related pay associated with the group as a whole.

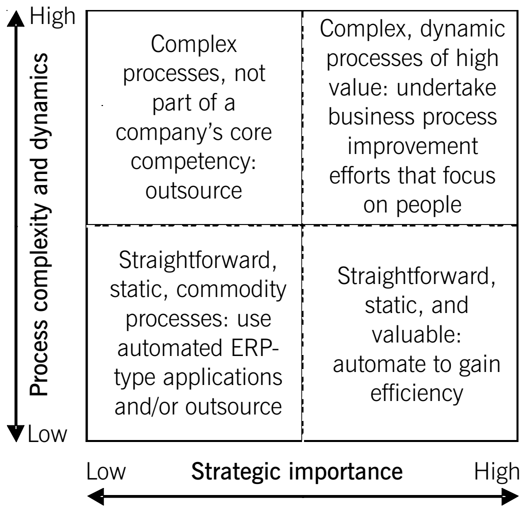
The first and third elements of this suggested structure might also replace the commission-based sales of insurance currently paid to retail sales staff. The ethics of the current approach and how it fits in with the central idea of the business seem open to question.

It must also be recognised that the company may also have to adopt a more 'hands-on' approach to monitoring the performance of the shops to ensure that the business idea is being adhered to. It is unlikely that the company can continue its distant approach, leaving shops alone to achieve their targets. Furthermore, in mature organisations there often has to be scaled-down expectations for both financial performance and personal advancement. This means that the company should consider setting more realistic growth and profit targets.

Finally, the analysis might include some of the ethical issues listed below.

– The inclusion of the word ethical in the company's motto appears to associate ethics with impartiality.
– The conclusion of the board that the manager of the central city branch acted 'unethically'.
– The mismatch between the core business idea and the actual way shops are set targets and monitored.
– The mismatch between the core business idea and the actual way employees are rewarded.
– The treatment of the central city manager
– The commission-based sales of insurance

2 (a) Although the question does not explicitly ask for it, the process-strategy matrix suggested by Paul Harmon would provide an appropriate context for the answer to this question.



The process-strategy matrix

However, other appropriate models or frameworks could be used by candidates to answer this part of the question.

The process-strategy matrix has two axes. The vertical axis is concerned with process complexity and dynamics. At the base of the vertical axis are simple processes often with simple procedures while at the top are complex processes which may require negotiation, discussion and complicated design. On the horizontal axis is the strategic value of these processes. Their importance increases from left to right with low value processes concerned with things that must be done but which add little value to products or services. On the extreme right of this axis are high value processes which are very important to success and add significant value to goods and services. From these two axes, Harmon categorises four quadrants and makes suggestions about how processes should be tackled in each quadrant.

Low strategic importance, low process complexity and dynamics
This quadrant contains relatively straightforward stable processes which add little business value. They are processes that must be carried out by the company but add nothing to the company's value proposition. These processes need to be automated in the most efficient way possible. They are often called 'commodity processes' and are suitable for standard software package solutions or outsourcing to organisations that specialise in that area. Payroll is a good example of this. Many standard software packages are available in the market place. Alternatively, a computer bureau can be used to process the payroll on behalf of the organisation.

Low strategic importance, high process complexity and dynamics
This quadrant is for relatively complex processes that need to be done but do not add significant value to the company's products or services. They are not at the heart of the company's core competencies. Harmon suggests that these should be outsourced to organisations which have them as their core business.

High strategic importance, low process complexity and dynamics
These processes lie in the lower right quadrant of the model. They tend to be relatively straightforward processes which, nevertheless, have a significant role in the organisation's activities. They are central to what the business does. The aim is to automate these, if possible, to gain cost reduction and improve quality and efficiency.

High strategic importance, high process complexity and dynamics
Finally, in the top right hand quadrant are high value, complex processes which often include human judgement and expertise and are often very difficult to automate. Harmon suggests that these might be the focus of major process redesign initiatives focusing on business process improvement through the improved performance of the people undertaking those processes.

In the context of 3C, the following recommendations are suggested. Clearly these are value judgements and credit will be given for coherently argued answers which do not match the examiner's conclusions.

(i) Attendance at breakdowns

This appears to be of high strategic importance and, although some breakdowns are bound to be simple to fix, it requires the repairer to be knowledgeable, flexible and diplomatic. Consequently, it appears to be a candidate for the upper right quadrant of the process-strategy matrix. Hence it is suggested that the service should remain in-house and attention should be paid to improving the competency of the 'service patrol engineers'. Information technology should be harnessed to seek improvements in response time to breakdowns by improving the organisation and distribution of these engineers. Systems might also be developed to technically support engineers and to help them diagnose and fix roadside problems.

(ii) Membership renewal

This should be a relatively straightforward process, so it sits in one of the two lower quadrants. It can be argued that it is a process that is core to the business and is not one (like payroll) which can be found across all businesses. It appears to be a candidate for the lower right quadrant. Hence it is a candidate for automation to gain efficiency. The organisation already has a bespoke system operated by in-house permanent employees. This seems an appropriate way of delivering this process. However, it might benefit from revisiting the way the bespoke system works. The scenario suggests that the current system sends out membership renewals on receipt of a confirmation from the member. The system might benefit from being built around a presumption of renewal, so that the member only contacts the organisation if he or she does not wish to renew.

(iii) Vehicle insurance services

These appear to be a relatively complex process which is of little strategic importance to 3C. It appears to inhabit the top left hand quadrant of the matrix. Insurance is not only technically complex, it carries large risks and substantial regulatory requirements. It is likely that these regulatory requirements will undergo frequent changes. It would appear attractive to 3C to outsource this service to a specialist provider who would then badge it under 3C's name. This is relatively common practice and 3C's venture into insurance must have been very expensive. Outsourcing provides it with opportunities for providing a wider service with reduced in-house costs.

(iv) Membership queries

Membership queries are of unpredictable complexity. They are also an important contact point between the company and their members. Failure to handle queries courteously and correctly could have important consequences for membership renewal. It is suggested that this is an upper right hand quadrant process – potentially complex and of high strategic importance to the company. Investment is required in people supported by innovative and speedy IT systems that allow the 3C staff to respond quickly and accurately to a wide range of questions. It is suggested that membership queries continue to remain in-house although the physical location of the call centre might reflect certain financial opportunities – such as low property rents and cheaper labour.

(v) Vehicle history checks

Vehicle history checks appear to be of relatively low strategic importance to 3C. Automation should make such checks relatively straightforward, although the combination of accident damage, stolen vehicles, finance agreements and time when the vehicle was voluntarily taken off the road may make determining this history more complex then it first appears. Furthermore, the consequences of providing inaccurate or incomplete information may be quite severe. Someone who has unsuspectingly purchased a car which has been damaged and repaired might claim for damages against 3C when this was revealed. These damages might be extensive if someone died in the vehicle as a result of a botched repair. Consequently it is suggested that this is predominantly an upper left hand quadrant process which should be outsourced to an organisation which is already in this field.

Table 2.1 summarises the advice to the BAC

Table 2.1

Attendance at repairs	Remains in-house. Improve competency of repair staff. Support them with IT systems
Membership renewal	Remains in-house and revisit basis of automation
Vehicle insurance	Outsource
Membership queries	Remains in-house. Improve competency of call centre staff. Support them with IT systems
Vehicle history	Outsource

(b) In the question scenario the decision to outsource the purchase and maintenance of 3C vehicles is justified by its low strategic importance and its low to medium complexity. However, this only makes it a *candidate* for outsourcing and so tangible and intangible benefits would have to be attached to this suggestion in a subsequent detailed analysis. This part of the question asks candidates to analyse the advantages of outsourcing the process of the purchase and maintenance of 3C vehicles. It is suggested that advantages would include:

Purchasing benefits from economies of scale

AutoDirect purchase thousands of cars and vans for their customers each year. They should be able to negotiate substantial discounts from manufacturers, some of which can be passed on to their customers.

Predictable costs

The vehicle lease payments with AutoDirect are monthly and they include full maintenance of the car, including tyres and exhausts. Hence 3C will have predictable costs for budgeting purposes. Previously, costs would have been variable and unpredictable, depending upon the reliability of the vehicles.

Reduced overhead costs – garage and purchasing
The overhead costs associated with the garage and the garage and purchasing employees have been lost (except for the one manager retained to manage the contract with AutoDirect). There may also be an opportunity for realising income from the sale of the garage site. It is described as being in a residential area with no room for expansion and severe parking congestion. It may be possible to sell the garage for residential development.

Higher vehicle availability
The central garage itself is a bottleneck. Vehicles have to be driven or transported to this garage from all parts of the country and left there while they are serviced or repaired. They then have to be driven back to their operational area. AutoDirect has repair and servicing centres throughout the country and so it will be possible for vehicles to be taken locally for services and repairs – thus reducing vehicle downtime.

Freeing cash to use for other investments – from purchase to lease
The policy of purchasing vehicles meant that a considerable amount of cash has been tied up in fast depreciating assets. Switching to leasing will release this cash for investment elsewhere in the company.

Access to expertise and legislation
It is likely that vehicles will become increasingly subject to legislation designed to reduce carbon emissions. This, together with the increasing technical complexity of vehicles, will mean that vehicles will become increasingly difficult to maintain without specialist monitoring and repair equipment. It is unlikely that 3C can maintain such a level of investment and so outsourcing to a specialist makes good sense. AutoDirect will have to monitor legislation, advise on its implications and implement its requirements for its large customer base.

Concentration on core business
Although this issue is not explicitly considered in the scenario it is something that impacts on all organisations. The management of the garage does not appear to be a core strategic requirement. It must consume some elements of senior management time. Outsourcing frees up that time so it can be used to focus on issues directly relevant to the customer and the business as a whole.

3 (a) A key characteristic of traditional marketing media such as advertising and direct mail is that it is predominantly a 'push' technology where the media is distributed to customers and potential customers. There is limited interaction with the customer and indeed, in the case of advertising and to a lesser degree direct mail, there is no certainty that the intended recipient actually received the message. In contrast, the new media, particularly the Internet, is predominantly a 'pull' technology – the customer having initiated the visit to the web site. This may lead to subsequent push activities, such as sending e-mails to people who have registered their interest on the site, but the initial communication is a pull event. The marketing manager must be careful that, by switching so much of her budget to pull technologies, she does not forego opportunities to find new customers – or reinforce her message – through established push technologies. She must ensure that the company's web site is established in such a way that sufficient people find it, and that when they do, they are prepared to record enough details to allow subsequent push activities.

Dave Chaffey examines the difference between traditional and new marketing media in the context of six 'I's; interactivity, intelligence, individualisation, integration, industry restructuring and independence of location. Four of these are used in this answer.

Interactivity is a significant feature of the new media, allowing a long-term dialogue to develop between the customer and the supplier. In the context of the web site, this is likely to be through e-mails, providing the customer with information and special offers for their areas of specific interest. To initiate this dialogue the web site must capture information such as e-mail address, name, age, gender and areas of interest. The AEC site only collects such information for people who wish to view downloadable study material. This is too restrictive and it will probably exclude all the potential CPD customers. AEC needs to consider ways of making it easier and worthwhile for visitors to the site to register their details. There is no evidence of AEC contemplating the potential use of interactive digital TV or mobile phones to establish long-term dialogues with their customers.

Intelligence has also been a key feature of the new media – allowing the relatively cheap collection of marketing research data about customers' requirements. This is routinely available from web logs and these logs need to be viewed and analysed using appropriate software. This type of analysis is rarely available in the traditional media. For example, AEC does not know how often their training course catalogue is accessed and which pages are looked at. It only knows which training courses are eventually bought. With the new media the company is able to see which services and products are accessed and also to measure how many of these are turned into actual sales. This conversion rate may be an important source of information – for example, why are certain web pages often visited but few sales result – is it a problem with the web page? – is it a problem with the product? An understanding of visit patterns allows the organisation to focus on particular products and services. This analysis should already be available to AEC but there is no evidence that it uses it or is even aware of it.

The new media also permit the marketing to be *individualised*, geared to a particular market segment, company or individual person. In the context of AEC this individualisation could be achieved in at least two ways to reflect clear market segmentation. AEC has recently won a contract to supply professional accountancy training to a global accounting company. All students working for this company will now be trained by AEC in one of its worldwide centres. At present this company and its students will be served through a generic web site. However, the flexibility of the new media means that a site could be developed specifically for this requirement. The whole site would be geared, and branded, towards the requirements of the global accounting company. Information that is irrelevant to that customer, such as CPD, would not appear on the site. This individualised approach should strengthen the relationship with the customer. Similarly, individuals may have their own access customised as a result of the profile that they have entered. So, for example, if they have already stated that they are currently sitting the professional stage of an examination scheme then only information relevant to that stage will be presented to them when they log in. This is an example of the principle of mass customisation that was only available in a limited form in the traditional media. AEC does not exploit this at present, but uses a generic web site that looks and feels the same, whoever the user is.

Finally, the new media provide *independence* of location allowing the company to move into geographical areas that would have been unreachable before. The Internet effectively provides a world wide market that is open 24 hours per day, seven days per week. It is difficult to think of any traditional media which would have permitted this global reach so cheaply. Furthermore, the web site might also omit the actual physical location of the company because there is no requirement for information to be physically sent to an address. It should also be impossible for the potential customer to gauge the size of the supplying company. AEC has exploited this to some extent as it serves a world-wide market from no clear geographical centre. However, the absence of on-line course booking means that certain physical contact details have to be provided and these might undermine the global perspective.

(b) The marketing mix has traditionally consisted of four major components: product, place (distribution), promotion and price. More recently, three further elements have been added, particularly for the marketing of services – people, process and physical evidence. Some authors, however, contend that these new elements are really only sub-sets of the original four components.

In the context of this question, the Ps, whether there are 4 or 7, provide a good framework for the answer, although such a framework is not mandated. The model answer below actually uses '5Ps', relating them to both technology and the situation at AEC.

Product
The product is a fundamental element of the marketing mix. If the product is not 'right' it is unlikely that the marketers will be able to persuade customers to buy the product or, if they do buy it, to convince them to become repeat buyers. In the context of the new technology, an organisation may seek opportunities for developing the product or service. These opportunities emerge from re-considering the core product or identifying options for extending it.

In the context of AEC the consideration of the product is complicated by there being at least three products promoted on their web site; training courses and training manuals for students studying for professional qualifications and training courses for qualified accountants undertaking continuing professional development (CPD). The course training manual is a tangible physical product that can be handled before purchase. Potential customers can try before they buy because a sub-section of a manual is available for inspection. This is an admirable policy. Potential customers do not have to believe that the manuals are comprehensive and well-written, they can make their own judgement based on a sample. In contrast, the training courses are services, bought on the promise of satisfaction.

AEC might profitably consider delivering elements of both student and CPD training courses through web casts and pod casts. Such courses might be fully on-line or the new technologies might be integrated with older ones, such as workshops and off-line assignments, to provide a blended approach to learning. This may be particularly appropriate for student tuition where competence is assessed by a formal examination, not by attendance at a course. AEC is already distributing course catalogues and course schedules through the Internet. However, there is no physical evidence to support the customer's evaluation of such courses. AEC might consider having sample videoed sessions available on the web so that prospective customers can assess the content and approach to training.

Although training documentation is currently available through the web site it could benefit from re-focusing. At present students pay a fixed fee which gives them access to the whole set of manuals. However, manuals for modules at the end of the scheme will only be relevant if the student passes the earlier modules. Lack of confidence may deter the student from committing to the whole manual set at the beginning of his or her studies. Similarly, candidates who become aware of AEC products only after they have passed the first few modules are unlikely to pay a fee for a manual set which includes manuals for modules that they have already passed or for which they are exempted. Consequently, it would appear more sensible to allow candidates to select the manuals they require and pay a fee per manual, with a discounted fee for buying the whole set.

AEC might also wish to consider *product bundling* where it offers further products and services to complement its core products. For example, travel booking, accommodation services and entertainment bookings might be offered to qualified accountants attending CPD courses. AEC is also in a market place where the product needs to be continually updated and developed to reflect changing or clarified requirements. For example, new training manuals may need releasing every year.

Price
The Internet has allowed pricing to be much more transparent to potential customers. They can easily visit the sites of competing companies and compare prices for similar products and services. Such accessibility may deter AEC from using the web site to offer *differential pricing*. The Internet makes products available world wide but candidates in poorer countries are often unable to afford prices set in richer parts of the world. Consequently, AEC should consider the potential of differential pricing, making prices reflect local currencies and conditions. There is a risk of alienating people in richer countries but it may be a risk worth taking and it is possible that candidates in these richer countries may perceive differential pricing as ethical practice. Web sites produced in national languages using domain names registered in that country might not be discovered

or accessed by candidates in the developed world and so differential pricing is never uncovered. However, there is still a risk that customers buying at a lower price will then sell to buyers in the segments that are charged a higher price – so AEC will have to monitor this.

The ability to continually update information on the Internet makes the dynamic pricing of products and services attractive. It is extensively used by airlines (booking early attracts large discounts) and hotels (auctioning off rooms they cannot fill that night). It appears that AEC should also consider differential pricing, particularly using early booking discounts to get the CPD courses up and running. It may also be possible to provide cheap 'late booking' offers to fill the last few places on a course. However, there is the possibility that this will alienate people who have already booked and paid the standard fee. Hence, this will also have to be given more detailed consideration.

AEC might also wish to consider an alternative pricing structure for the documentation. At present manuals are purchased and this might still be the case if it adopts the more modular approach suggested in the previous section. However, there may be large areas of the manual that the student is familiar with. An alternative approach is to charge the student only when they access the material. Hence, students pay for a web service on demand – rather than through purchased download. This 'on demand' payment for actual use is becoming an increasingly popular model of delivering products.

Finally, because off-line booking incurs administrative costs and overheads it is usual to offer on-line customers a significant discount. Hence the pricing structure must recognise this. People booking through an on-line channel now expect to get a discounted price.

Place
It has been argued that the Internet has the greatest implications for place in the marketing mix because, as a distribution channel, it has a global reach, available 24 hours per day, seven days per week. AEC is already exploiting this global reach, although it has to ensure that its products make sense in a global perspective. The training manuals are easy to exploit globally as they are downloaded products which can be printed off throughout the world. The dates and locations of training courses, in their current format, is also globally accessible but is only really relevant to people living in the geographical regions near to the eight training centres. This is particularly true of CPD courses which are only run in three centres world wide. The global reach of the Internet can only be exploited in the context of the courses if they use the technology discussed in the *product* section of this answer, perhaps exploiting the *price* differentials discussed in the previous section.

Promotion
Although AEC has an established web site it has not actively promoted it. The promotion of the web site may involve both technology and established marketing media. From the technology perspective, AEC might consider the following to increase its web site visibility.

1. Search Engine registration. This remains the primary method of users finding products and services. Over 80% of web users state that they use search engines to find information. There are five main parameters on which search engines base the order of their ranking.
   - Title – keywords in the title of a web page
   - Meta tags
   - Frequency of keyword in the text
   - Hidden graphic text
   - Links from other sites

   AEC must ensure that their web site is constructed in such a way that it has a good chance of appearing on the first page of search engine listings.
2. Building links with other web sites should increase traffic to the site as well as improving search engine ranking. The current AEC site does not appear to link (or be linked) to any other sites.
3. Viral marketing is the term used when e-mail is used to transmit a promotional message to another potential customer. It enables a customer browsing the site to forward a page to a colleague. There is no evidence that the AEC site supports this.
4. On-line advertising includes *banner advertising*. As well as potentially driving customers to the site, the banner advert also builds brand awareness and reminds the customer about the company and its services. AEC must consider this.

Off-line marketing should also be concerned with promoting the web site in established media such as print, TV and radio. Key issues to communicate are the URL and the online value proposition. It may also be used for special sales promotions and offers to attract visitors to the site. 50% of the marketing manager's budget is being spent on off-line marketing media. She must consider how to integrate the web site into this part of the promotional mix.

Process
This concerns the processes used to support the customer's interaction with AEC. At present the training course part of the web site is predominantly an information site. It provides information about the product and the location and cost of the product. However, it is not used for either purchase or post-sales support. Hence if a student or a qualified accountant wishes to book on a course they have to physically contact a person who then takes booking and payment details. There is no evidence that post-sales support such as sending joining instructions, answering queries and receiving course feedback is supported by the web site. It would be useful for AEC to consider whether training purchase and post-sales processes could be integrated into its web site. After all, a payment process has already been set up for the training manual part of the site. The automation of routine processes and answers to common questions might help free up the company's administrative resources as well as providing a better service to customers and exploiting the Internet's *independence of location*.

4 **(a)** The proposal to develop and sell a software package for the general retail industry represents a major strategic decision for PSI. Up till now it has been relatively successful in identifying and servicing the software needs of a specialist niche market – the retail pharmacy market. In Michael Porter's terms it is currently a focused differentiator. Its proposed entry into the general retail market represents both a new product and a new market and so, using the perspective of Ansoff's growth matrix, it is a diversification strategy with high levels of risk. The proposal would lead to significant strategic change and, perhaps not surprisingly, is meeting resistance from the software development director who is responsible for a key activity in this change.

Johnson, Scholes and Whittington (JSW) argue that there is a danger in believing that there is 'only one way, or one best way, to change organisational strategies'. They believe that most strategies are profoundly influenced by earlier strategies and their success or failure. Consequently, strategies are often incremental in nature, adding to or adapting, previous or existing strategy. Rarely is the proposed change so fundamental that it challenges the existing business model and the processes and activities that support it.

JSW make use of a model developed by Balogun and Hope Hailey, which identifies four types of change which have very different degrees of impact. It is suggested that there are two key measures of change. Firstly, the *nature of change* – how big is it? *Incremental* or 'step-by-step' change does not challenge the existing way of doing things and may indeed reinforce the organisation's processes and culture. It is therefore likely to meet less resistance than *Big Bang* or quantum change, which represents significant change to most or all the organisation. Often this *Big Bang* change is necessary to respond to a crisis facing the firm, such as a major fall in profitability, and/or the appointment of a new chief executive.

Secondly, the *scope* of change process is important – how much of the firm's activities are to be changed? If the change does not alter the basic business model (or 'paradigm' in JSW's terms) then it is regarded as 'a *realignment of strategy* rather than a fundamental change in strategic direction' (JSW). However, if the proposed change is a radical challenge to the existing business model or paradigm then it is regarded as a *transformational* change.

The consideration of the two key measures of change enables the identification of four types of change. These four types are used in this answer but other models and approaches would be acceptable.

	Scope of change	
Nature of Change	**Realignment**	**Transformation**
Incremental	Adaptation	Evolution
Big Bang	Reconstruction	Revolution

– *Adaptation* is a change that can be made within the current business model (realignment) and it occurs incrementally. JSW argue this is the most common form of change in organisations.

– *Reconstruction* represents significant change in the organisation, often prompted by a crisis, such as an unwelcome takeover bid, but it does not require a fundamental change to the business model. Turnaround strategies where the aim is to rapidly reduce costs or increase revenues to ensure business survival may affect the whole organisation, but not change the basic business model.

– *Evolution* is a change in strategy, which requires the business model to be significantly changed over a period of time. The perceived need for 'transformation' may be as result of careful business analysis leading to a planned evolutionary change. Alternatively, change may take place through an emergent process where the scope of change only becomes apparent once it is completed.

– *Revolution* affects the whole of the organisation and the scope of change requires a fundamental shift in the business model – the way the firm chooses to compete.

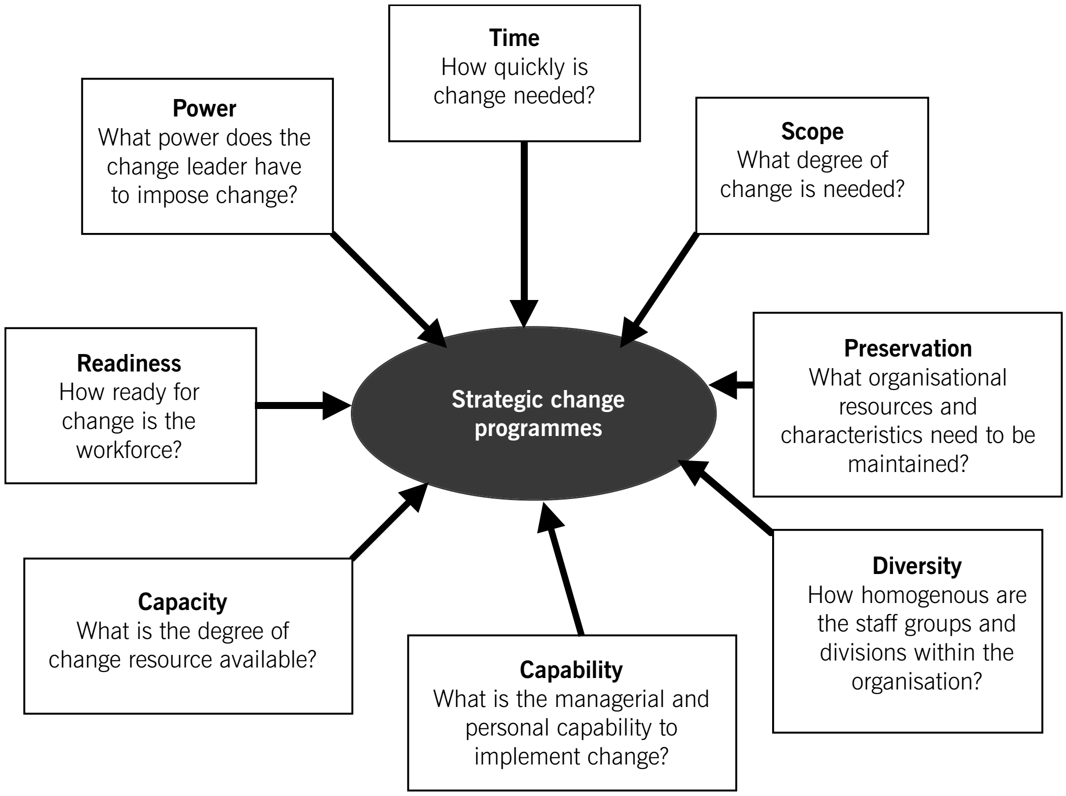
Viewed dispassionately, it appears that PSI's proposed move into the general retail market represents an evolutionary change. It is incremental because it will build on the skills, routines and beliefs of those in the organisation. However, it is transformational because the proposed move away from the current market niche to a market which requires a generic solution is a fundamental change in strategic direction. It is likely that internal processes and activities will need to significantly change for the company to successfully develop and sell the new packages. In PSI's case, the evolution is driven top-down, by the chief executive's desire to create a company which is an attractive acquisition, at which point he can realise some or all of his investment in the company.

Interestingly, the three directors may not all perceive the change as evolutionary. The entrepreneurial chief executive and the sales and marketing director may see the proposal as adaptive change, realigning the company to take advantage of a business opportunity which will lead to realising their personal goals. Indeed they may see the current product as just the specific implementation of a generic retail software solution. In contrast, the software development director is more likely to agree with our assessment of the change as evolutionary.

(b) JSW argue that successfully managing change depends on context. This context is made up of a number of factors or contingencies peculiar to the organisation under consideration. How change is managed in a relatively small privately owned firm like PSI is very different to how it might be managed in a large international firm of accountants with hundreds of partners.

JSW again use the work of Balogun and Hope Hailey to consider the contextual features that need to be taken into account in deciding how a strategic change programme should be managed. These features are shown in the diagram below and are used in the model answer. However candidates could adopt other models and approaches.

Contextual features and their influence on strategic change programmes



Source: Johnson, Scholes and Whittington

In the context of PSI, the following observations could be made.

– *Time* – the company is not facing any immediate financial or business problems and so there is no apparent need for rapid change. Figure 1 suggests a company that is slowly consolidating in its market place. There is no evidence of a crisis that requires urgent remedial action. It is likely that it will take a relatively long time to develop the new generic software package, particularly when the current pressures on the software development team are taken into account. They are already having problems meeting deadlines for the current product. The only urgency is that injected by the impatience of the chief executive who may want to quickly introduce change to achieve the objectives of realising his investment in the company. The natural inclination of the software team and their director will be to use any available time to consolidate the current product and to improve its quality. In contrast, the chief executive will want to use available time to produce the new generic product. This will almost certainly lead to conflict, both within the organisation and with customers pressurising the software team for fault rectification and new requirements. The increased concentration of pharmacies into nationwide chains may also increase the power of certain customers.

– *Scope* – the degree of change should not be underestimated in a relatively small firm like PSI. Supplying a clearly defined segment supported by a vertical marketing strategy is very different to the horizontal marketing strategy required for the proposed move into the general retail market. The company has built up expertise in a niche market. It is unlikely that it will have comparable expertise in the generic retail market as well as in the other niche retail markets that it intends to target with its configurable software package.

– *Preservation* – clearly software development skills are a crucial resource and capability and must be preserved to enable the proposed strategic change. The retention of the software team's expertise and motivation is essential. If they are upset by the proposed change and disturbed by the further pressures it is likely to create then it is unlikely that they will support it. The agreement of the software development director to the change is also vital and some way of securing this must be explored. Although the proposed change is largely based on the competency of current personnel, it is likely that they will be disturbed by the increased pressure imposed on them and so there is a high probability that key employees will leave the company.

– *Diversity* – Change may be helped if there is a diversity of experience. However, change may be hampered if the organisation has followed a particular strategy for a number of years. The relative stability of the last three years and the company's stated objective to be a 'highly skilled professional company providing quality software services to the retail pharmacy industry' seem at odds with the chief executive's vision of expansion. There is also evidence to suggest that the goals of the sales force and those of the software developers are already conflicting and there seems even more opportunity for this to occur in the context of a generic retail software package. Change will be hampered by the current conflict between sales and development.

– *Capability* – The chief executive and sales and marketing director are entrepreneurial in outlook and want change to fuel growth and their personal aspirations. The software development director is much less enthusiastic as he can clearly see the implications of the proposed change in strategic direction. Furthermore, over the last three years the workforce has been relatively settled and has not been subject to much significant change. In some ways the small size of the business may make change easy to facilitate (see power), but there may also be significant barriers to change. The software development director and his staff control and implement the key activity of the new strategy. It may be difficult to overcome their lack of enthusiasm for the proposed change.

– *Capacity* is concerned with resources such as people, finance and information. More detailed analysis will be necessary to see if PSI has the necessary resources to implement the proposed change. However, evidence from the scenario is not encouraging. For example, the company has recently been criticised at a user group conference for failing to meet its proposed release deadlines. The acquisition of necessary resources will take both time and money. There is no evidence that the company has the finances to support the acquisition of new resources. It is a private company and so it will not be able to raise money through the stock market. It will rely on further investments from the current shareholders (and the software development director may be reluctant to participate in this) or on bank finance. Furthermore, it usually takes a long time to integrate software developers into a business. There is a long learning curve during which they have to learn not only how the product works, but how it is designed. Hence they are unlikely to be productive until several months after appointment and this lack of progress might again clash with the impatience of the chief executive.

– *Readiness* – There is no evidence that the organisation is ready for the type of change proposed by the chief executive. In fact the current pressure on the software development team suggests that they may not welcome the proposed new strategy. What they might be ready for is a strategy that leads to a consolidation of the pharmaceutical product so that faults are fixed and new requirements released on time.

– *Power* – the chief executive has the ultimate power in this organisation, reinforced by (through combining with the sales and marketing director) ownership of the majority of the shares. However he must secure the co-operation of the software development director to make progress. The fact that he has power may lead to him forcing through a strategy which is essentially wrong for the organisation.

Overall, an analysis of the context for change at PSI should provide warning signs to the chief executive. Although the chief executive has the power to impose change, there are concerns about the scope and capacity for change which may make it very difficult for the company to preserve its current resources and competencies. There is a real concern that these will actually be destroyed by the proposed change and this will lead to major difficulties in their current market. There is already evidence of this from the scenario. The company has been criticised at a user group conference for quality failures and there are doubts about whether planned new features will be released on time. The product is fundamental to the efficient purchasing and stock control required in contemporary pharmacies. Customers may switch to a competitor if they feel that their emerging requirements are not met with sufficient promptness and quality.

The workforce is neither ready for change nor diverse enough to welcome change. There are current conflicts between sales and development which are likely to be escalated by the proposed strategic change. Finally, there are also grave doubts about the capacity of the company to deliver the proposed change within the likely time scale required by the chief executive.

There is a concern that the chief executive will rely on managing change through coercion, which 'is the imposition of change or the issuing of edicts about change'. This is not unusual in small firms where the chief executive also has a large ownership stake in the business. It is most appropriate in crisis situations where time is of the essence and clear direction is imperative. However, PSI does not appear to be in a crisis situation. Unfortunately, however, it looks like the chief executive is about to create one!

1 **(a)** Up to 5 marks are available for recognising issues concerned with the difficulties facing potential new entrants into this industry.
Up to 4 marks for recognising the very powerful bargaining position of suppliers in this industry.
Up to 3 marks for identifying the bargaining power of customers.
Up to 2 marks for identifying the threat of substitutes to the products offered in the industry.
Up to 4 marks for identifying how competitors in the industry compete with each other.
Up to 2 professional marks for the logical structure and clarity of information in the context of the case study scenario.

(b) Up to 3 marks for recognising the brand recognition implications of moving out of retail sales.
Up to 3 marks for recognising the likely impact on AFDirect and AFInsure
Up to 2 marks for recognising cost implications of exit on leases, staff and stock
Up to 2 marks for recognising that the financial position is not as poor as suggested by the two directors
Up to 2 marks for interpreting the structural changes in the industry
Up to 3 professional marks for using an appropriate style for the report and for the strength of argument and for appropriately utilising evidence from within the context of the case study

(c) Up to 2 marks for recognising the potential conflict between the central business idea and a 'hands-off' approach to monitoring shops
Up to 2 marks for recognising the potential conflict between the central business idea and a reward system substantially based on profit
Up to 4 marks for recognising that business strategy will have to recognise the increasing maturity of the market and the product
Up to 2 marks for discussing potential strategic drift and how it may be tackled
Up to 3 marks for suggestions for changing the reward management system
Up to 3 marks for recognising the ethical dimensions of the question in the context of the case study scenario.
Up to a maximum of 15 marks

2 **(a)** Up to 3 marks for the recommendation and its justification in each of the process areas required by the question
Five process areas required giving a maximum of 15 marks

(b) Up to 2 marks for each appropriate advantage identified by the candidate up to a maximum of 10 marks

3 **(a)** Up to 2 marks for recognising the distinction between push and pull technologies in the context of the scenario
Up to 2 marks for issues concerned with interactivity
Up to 2 marks for issues concerned with intelligence
Up to 2 marks for issues concerned with individualisation
Up to 2 marks for issues concerned with independence

Credit will also be given for candidates who focus on Chaffey's other 'I's – industry restructuring and integration

(b) Up to 4 marks for issues concerned with product
Up to 3 marks for issues concerned with price
Up to 2 marks for issues concerned with place
Up to 4 marks for issues concerned with promotion
Up to 2 marks for issues concerned with process

Credit will also be given for candidates who focus on other 'p's – physical evidence and people

4 **(a)** Up to 2 marks for recognising that PSI is pursuing a diversification strategy
Up to 2 marks for explaining the nature of change
Up to 2 marks for explaining the scope of change
Up to 4 marks for exploring the types of change with particular reference to the situation at PSI

(b) Up to 3 marks for an analysis of each feature that could influence the success or failure of the proposed strategic change at PSI up to a maximum of 15 marks
Eight possible features are described in detail in the model answer
A possible mark allocation (1 mark per point up to a maximum of 3 marks) for one of these features (time) is given below.
– Explanation of possible effect of time
– Recognition that time is not an issue at PSI – there is no evidence of a crisis that requires remedial action
– Relatively long time to develop a new product given current time pressures
– Impatience of the chief executive imposes arbitrary urgency
– Conflict between chief executive and software development director over time allocation.