TCS Online

Suggested Answers for Mini Mock Exam

Management Case Study – November 2021 / February 2022

Section 1

Hi Taras,

Please find below my response to your queries.

Ways we can approach formulating a digital strategy in line with the business model of a smart device manufacturer

Of the ways in which a digital strategy can be formulated, the following approaches can be adopted separately or in combination with each other.

Firstly, we may look to ***build*** the business model of a smart device manufacturer (i.e. build ourselves from scratch as a smart device manufacturer). This in my opinion would not be a recommended approach as it is not part of our core business, and would involve a huge downside. Despite the benefit of this strategy being the maximisation of control, this would involve Frinta having to spend a huge amount of resources to go into waters that are quite diverse (albeit complementary) to the current business of heating and ventilation controls/smart speakers.

Secondly, ***buying*** another company is also an option. This is normally done when there is a strategic imperative to 'own' a market. It may also be the only viable option if there is significant change that is imminent in the market, hiring the right talent is not possible, and the new opportunity bears little relation to the firm's current business model. This is also not the approach I would recommend, as Frinta cannot own the market due to size and complexity, and the fact that the smart device industry is an evolutionised *result of imminent change in the mechanical device* industry, and is complementary to Frinta's current product portfolio.

Thirdly, Frinta can ***partner*** with a smart device manufacturer to learn more about the market and its partner's model. A partnering approach is sensible when it makes sense to learn about emergent opportunities, with an eye toward deeper partnerships or acquisitions in the future.

Finally, Frinta can look to ***invest*** or ***incubate/accelerate.*** The approaches are quite similar – both involving start-up firms in the chosen industry (i.e. smart devices in this instance), except that the latter however represents a closer relationship to the funding company (Frinta), who deploys corporate internal capabilities, infrastructure and resources. These two approaches will allow an established entity like ours to connect with the right skills and capabilities.

Recommended approach

Given the dynamics of the smart device industry as explained above, I would recommend adopting a 'partnering' approach that can help us incrementally deepen our hold through deeper partnerships or acquisitions once we establish ourselves in the market. This approach is of lower risk, and given the size and scale of Frinta's operations, an investment/incubation in a startup might not be worth the effort, burning out management time and resources. Moreover, considering issues like cyber-security and privacy concerns associated with smart devices (based on the article attached), it furthers the case for us to partner with a business that already complies and understands the issues around data security and privacy, as opposed to plunging headfirst by building our own smart device brand or investing/incubating in startup that does not have that expertise.

(Note: Marks will be awarded on merit based on the quality of candidate's justification for selected strategy)

<u>Main business risks with mitigation strategies with regards to us selling smart devices</u>

One of the main business risks we could face is ***reputational damage*** to the Frinta brand in the case of a failure of this new smart device venture we plan to undertake.

In order to mitigate this, we may look at a different brand name to distinguish our smart devices from Frinta, and/or ensuring that we give extra attention into monitoring various channels to gauge how the brand is being perceived amongst key stakeholders like shareholders, consumers, retailers etc.

Further, there will also be ***operational risks*** that involve all risks from the stages of sourcing raw material required, the process of manufacturing the smart devices, and the distribution of these devices to respective retailers for sale. These can be inferior raw material quality, inadequate levels of skilled staff (from product designers to factory staff), distribution related issues such as not delivering goods on time to retailers, delivering physically damaged goods etc.

These risks can be mitigated by taking proactive measures such as adopting quality management procedures, ensuring staff have the necessary experience/exposure and skill set before putting them on the lines, doing scenario planning for logistical issues involving distribution, and ensuring quality checks throughout all key milestones during operations to avoid faulty products being sent to retailers.

Moreover, ***competitive risks*** are also something we may face, as smart device players already in the industry will now view us as a direct threat. With our existing portfolio of smart speakers, we currently stand as being a complementary product to smart devices, and with us stepping forward into selling our own products, there is a risk that competitors might take hostile action towards us entering their field. For example, they may change their operating softwares to ensure their devices aren't compatible with Frinta Friend speakers. This could result in them entering our current market of manufacturing smart speakers. Other competitive stances such as price wars, and even coming together to fend a new player from entering the industry are also risks we could face in this sphere.

Such competitive risks can be mitigated only to a certain extent, as we can only try and influence competitor actions. We may have to adopt a pricing strategy that doesn't trigger a war, nor gives the message that our products are inferior. Careful study has to be done to mitigate any negative pricing implications. Moreover, a product re-engineering and analysis can be carried out to build in some competitive advantage over rivals in order to mitigate this risk.

I hope you find this helpful.

Regards,
Finance manager.

(Note: Candidates do not have to necessarily classify/coin business risks as the answer above, as the term covers a broad scope. However, points should be practical and have good business sense along with mitigation strategies to score marks)

Section 2

REPORT

Potential acquisition evaluations

When looking at the financials and non-financials of DigiSmart, its gross margin is around 20% higher than FlikSwitch and Clickvamp, and based on the comparatively low number of new devices introduced/percentage of new product ideas failed to launch, it can be assumed they are focusing on stabilising their margins than rapid innovation and expansion. This is further backed up by their comparatively lower revenue growth rates and debt levels. The company also has a large number of retail channels that have remained constant over the two years.

When looking at the financials and non-financials of FlikSwitch, the gross margin has dropped by 5.5 percentage points in 2020, and this can be attributed to the rapid innovation and expansion indicated by the new devices introduced per year/high rate of new product idea failure, and exponential revenue growth year on year. They also have a debt level above the acceptable threshold of 50%, which has also increased by 3.7 percentage points in 2020. The number of retail channels has also increased more than twofold in the past year, again indicative of rapid expansion.

When looking at the financials and non-financials of Clickvamp, it more or less spells the same story as FlikSwitch, except at a much stable level. Gross margins are in the same range, while Clickvamp's margin has only fallen by 1 percentage point compared to FlikSwitch's 5.5 percentage points. Debt levels are also comparatively lower, while innovation of new devices have been more or less constant with a lower rate of new product ideas failing. Retail channels have also grown steadily over the past year.

DigiSmart is a much more stable company with much less scope for growth, while FlikSwitch and Clickvamp present a much more contrastive picture. Based on the board's preference, DigiSmart doesn't look the ideal fit due to them probably being a much larger company hence we would have to pay a larger sum to acquire them. Moreover, with 40% of their devices compatible with Frinta Friend, this does not give us the diversity we are looking for in our portfolio.

This leaves the choice between FlikSwitch and Clickvamp, from which I would recommend Clickvamp based on their steadiness in expansion, better control over their bottom-line, comparatively better debt levels, and the fact that they have a set scope of product offerings (smart kitchen appliances, and home security devices) compared to FlikSwitch who manufacture 'all sorts' of devices. Moreover, if we come into ownership of the patented software that can function with a large number of devices, it would complement our existing portfolio perfectly as well.

Non-financial performance indicators based on the balances scorecard with justification

Learning and Growth Perspective

Training hours provided – Training is of critical importance to this industry as new technological developments take place rapidly and it is important for the employees to be trained on these aspects. Frequent training programs will also motivate employees as the company adds value to their individual career as well. This can reduce labour turnover rates.

Number of new products in the development pipeline – Your attachment included a non-financial KPI "new devices introduced per annum". It is important to consider the possibility of certain products taking a longer time than expected to be fully developed. Technological products (especially "smart" ones) require proper testing and the R&D should not rush into a launch until technical feasibility is 100% confirmed. Therefore, the new products in the pipeline will give an indication of the potential products that can be expected in future.

Customer Perspective

% of sales returns from retailer/consumer to retailer per quarter/annum – This could give an indication of quality related/logistical issues involved with the company's devices. If this figure is high in a particular year, it may be due to a product recall which should be investigated on detail. Since Frinta places utmost priority on quality, we should ideally select a company which has a very low figure for this KPI.

% of positive online ratings from consumers per quarter/annum – This is indicative of customer satisfaction with regards to the company's devices. As with every industry, customer ratings go a long way as it will result in repeat purchases and encouraging new customers to buy the products. This is also a reflection on the brand value.

Internal Business Perspective

% of waste output scrapped per monthly/quarterly production run – This would give an indication of the company's efficiency to convert waste into bi-products or sell to possible bi-product manufacturers. Ex: metal/aluminum used in smart devices may be resold to a steel company. In addition to the impact on cost, this indicator will also affect environmental related information.

Cycle time (budget vs actual) – This is the average amount of time spent on producing a device. Since the company has to make products available to satisfy the demand, it is important to complete the production on time. If production gets delayed and the sales demand is not satisfied, competitors will take advantage of the situation since this industry is very competitive.

Finance manager