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Top Consulting Interview Prep

Harvard Business School
Management Consulting Club

Case Interview Guide
2011

Cases contributed by Management Consulting Club and consulting companies.

Company Provided Case – Telecom Co. (pg. 1 of 11)

Bain & Co.

Case summary for facilitator only

Industry	Primary issue	Other topics
Telecom	Market entry	Investment business case, break even analysis

Situation

Client provides satellite TV services (DBS) nationally

Complication

Customer base being threatened by telcos and cable companies (triple play)

Consider deploying wireless network (WiMAX) to offer broadband internet

Key questions

Should the client go into the WiMAX business?

Key components

Suggested framework: quantify revenues and costs; analyze risks

Quantitative: analyze costs and revenue of new venture

Answer

The investment is too high and would take years to break even; client should focus on defending core business (satellite TV)

Company Provided Case – Telecom Co. (pg. 2 of 11)

Bain & Co.

Case summary for facilitator only

Additional Background

- Our client is a provider of satellite TV services
- Client facing increased pressure on its customer base from telcos and cable companies offering "triple play" bundles of TV, internet, and phone services
- Client considering deploying WiMAX wireless networks across the USA to offer its customers broadband internet (and potentially phone service - VoIP)
  - Offering triple play will allow the client to compete with telcos and cable companies
- Deploying WiMAX is extremely expensive, driven by:
  - Spectrum costs: acquiring frequencies from the federal government
  - Base stations,: tower that send/receive wireless signal (similar to cellular)
  - CPE: customer premise equipment
  - Additional SG&A
- Revenue upside consists of 6M subscribers in the USA (based on mgm't estimates of 5% market share) paying $20/mo
- Total investment $2.6B; potential revenue upside: $2.44B; since most costs are variable (per customer) could not break even in year 1
- Client should focus on defending its core market of satellite TV

Market share (mgm't estimate)	5 %
Base station bandwidth	80,000 kbps
Bandwidth require per household	320 kbps
% of concurrent connections*	50 %
Broadband internet service price	$20 per mo

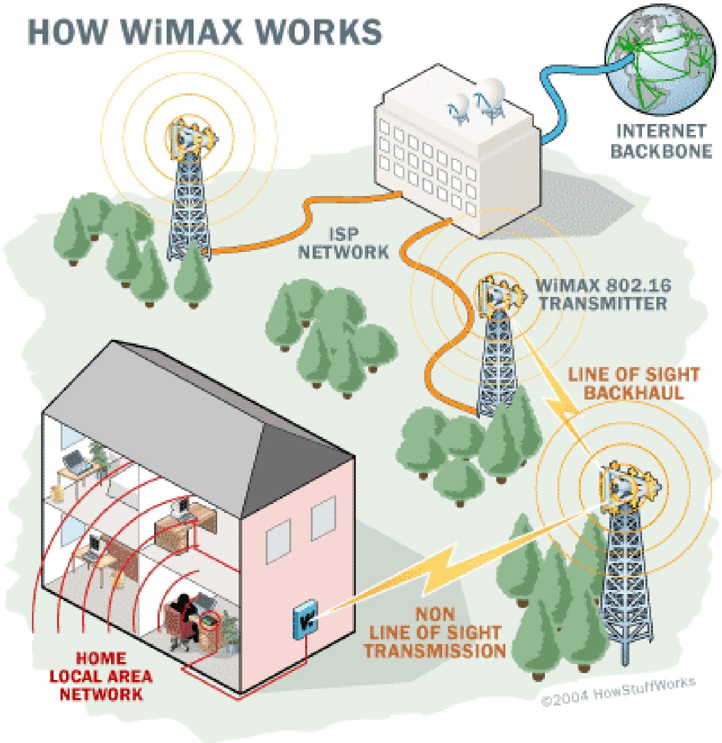
* Telecom companies balance the cost per subscriber and required bandwidth per sub by estimating the % of subs who are online at any point in time

Company Provided Case – Telecom Co. (pg. 3 of 11)

Bain & Co.

Question

- Our client provides satellite TV service nationwide. The customer base is being threatened by telcos and cable companies offering “triple play,” so our client is considering deploying wireless network (WiMAX) to offer broadband internet. Should our client go into the broadband business?



Company Provided Case – Telecom Co. (pg. 4 of 11)

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Recommended Solution

<u>Frame the Problem</u>

Costs:

- Capital expenditures
  - Base stations (towers)
  - Getting the licenses
  - Additional equipment
- Operational excellence/ongoing costs
  - Maintenance
  - Leases etc.
- SG&A
  - Additional sales and marketing efforts

Potential Revenues:

- Market share
  - How big is the market?
  - What is a reasonable market share assumption?
- Pricing
  - Market price for broadband services?
  - How price sensitive are consumers?

Key issues/challenges:

- Buy vs. build?
- Competitive moves?
- Regulatory issues?

Total cost

- **Network cost**
  - **Spectrum**
    - How much would the spectrum (license) be?
      - What can historic data tell us?
  - **Base Stations**
    - Should we buy or lease base stations?
      - # of towers are required?
      - Capex associated with building/leasing base stations?
      - What are the operational (ongoing) expenses?
  - **Customer Premise Equipment***
    - What is the cost of the equipment that is required on the customer's premises?
    - What % of the cost could be passed on to the customer?
- **SG&A**
  - Do we have to invest in marketing and sales?

Assume these costs are minimal initially and focus on network costs

Company Provided Case – Telecom Co. (pg. 5 of 11)

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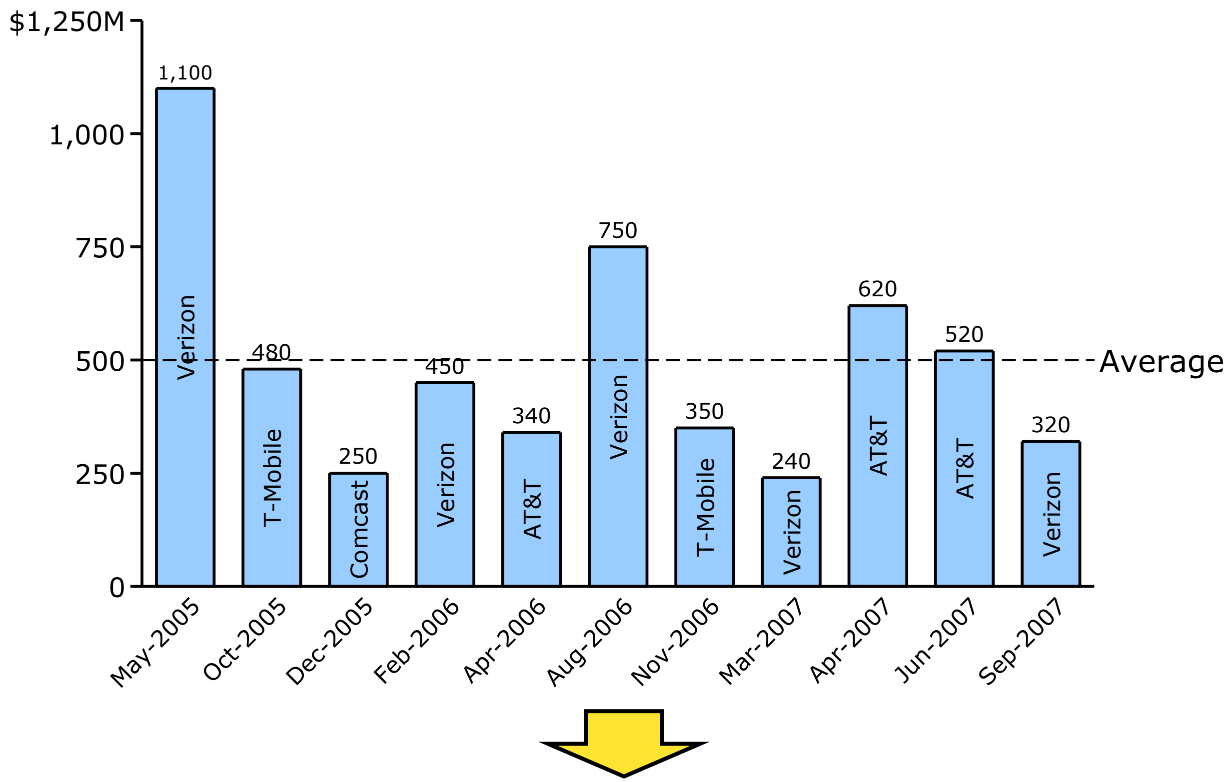
Recommended Solution

Dig deeper

Costs:

- Spectrum

Spectrum auction price



Assume spectrum price average of $500M

Company Provided Case – Telecom Co. (pg. 6 of 11)

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Recommended Solution

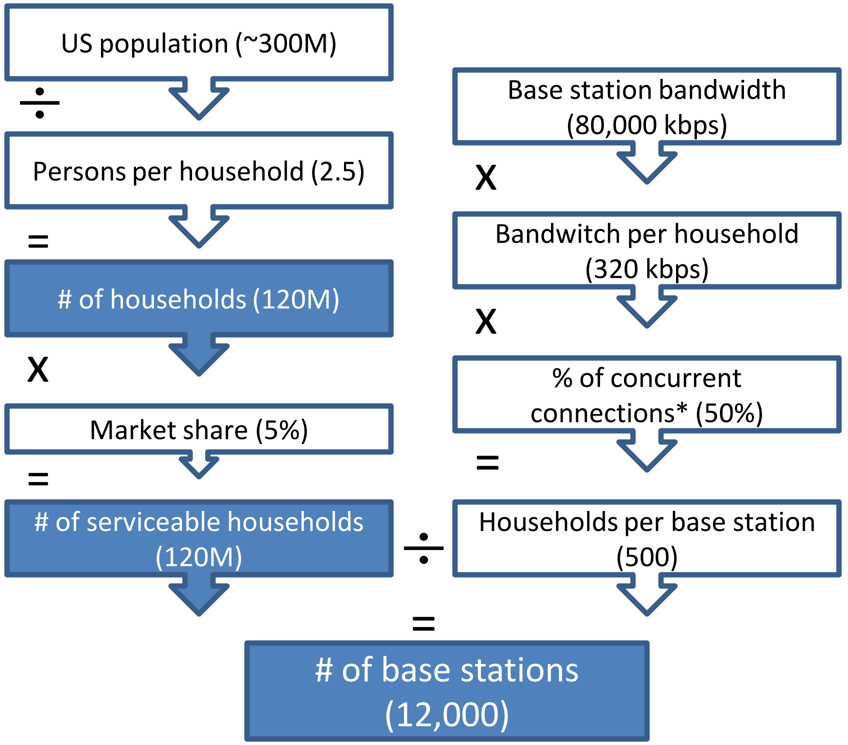
<u>Dig deeper</u>

Costs:

- Base stations

Base station cost = # of base stations * Cost per base station

Determine # of base stations



* Telecom companies balance the cost per subscriber and required bandwidth per sub by estimating the % of subs who are online at any point in time

Company Provided Case – Telecom Co. (pg. 7 of 11)

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Recommended Solution

<u>Dig deeper</u>

Costs:

- Base stations

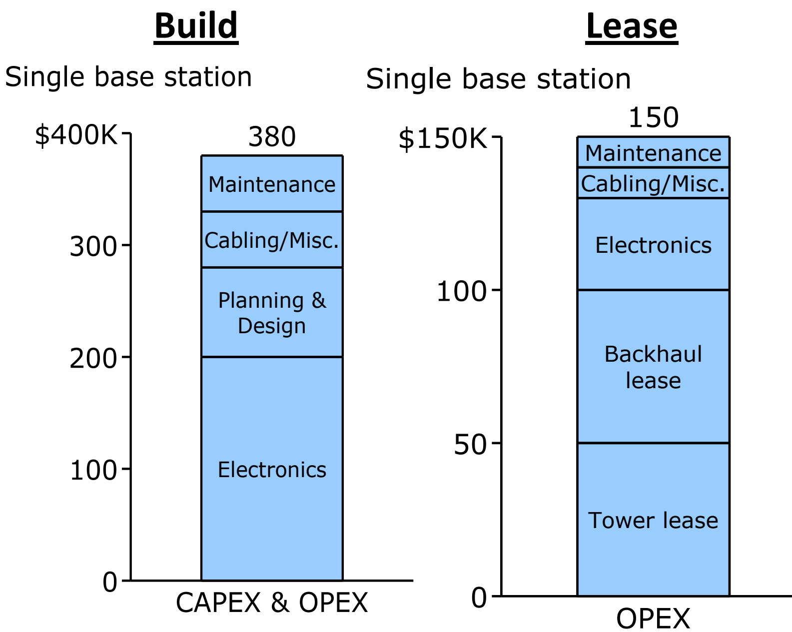
Base station cost = # of base stations * Cost per base station

Determine cost per base station

Qualitative

	Build (Own & Operate)	Lease
Description	• Completely plan, construct, and operate a proprietary network of towers	• Lease towers and bandwidth for a rental and maintenance fee
Advantages	• Complete control over network footprint • Best tower real estate can be used for network - Higher location on tower preferable	• Smaller up-front investment • Time-to-market advantage as towers already exist
Disadvantages	• Very costly to own & operate • Longer time-to-market	• Availability of towers - Coverage not possible if tower real estate unavailable in given location

Quantiative



<u>Leasing</u> will require lower initial investment and allow faster time to market

Company Provided Case – Telecom Co. (pg. 8 of 11)

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Recommended Solution

<u>Dig deeper</u>

Costs:

- Base stations

Base station cost = # of base stations * Cost per base station

# of base stations (12,000)	x	Cost per base station ($150k)	=	Total base station cost ($1.8B)

* Telecom companies balance the cost per subscriber and required bandwidth per sub by estimating the % of subs who are online at any point in time

Company Provided Case – Telecom Co. (pg. 9 of 11)

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Recommended Solution

<u>Dig deeper</u>

Costs:

- Customer premise equipment

<u>Additional Information upon asking</u>

CPE cost is $150 per household

Client estimates 2/3 of costs could be passed through to customer

CPE Net cost to the client $300M

Company Provided Case – Telecom Co. (pg. 10 of 11)

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Recommended Solution

Dig deeper

Incremental Revenue vs. Costs

Revenues

Broadband internet only | Internet and voice (phone) | Triple play (defending core)

- To be conservative, assume internet only
- Assume price is $20 per month

6M subscribers x $20/mo x 12mo = $1,440M

Total revenue: $1.4B

Costs

Total cost

- **Network cost**
  - **Spectrum**: $500M
  - **Base Stations**: $1,800M
  - **Customer Premise Equipment***: $300M
- **SG&A**: Assumed minimal

Total cost: $2.6B

Company Provided Case – Telecom Co. (pg. 11 of 11)

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Recommended Solution

<u>Key Findings</u>

- Deploying a WiMAX network solution across the USA is extremely expensive; even with leasing base stations, the network cost amounts to $2.6B
- Revenue uplift from broadband service would total $1.44B and would not enable the client to break even in year 1
- Additional costs may be incurred
- Some risks concerning timing of deploying and market pricing need to be addressed

<u>Recommendation</u>

- **Investment in a WiMAX solution probably does not make sense** due to high up-front costs and lower revenue uplift
- The client should focus on **defending the core business** of satellite TV; client should consider the following:
  - **Segment customers** and increase share with most profitable segments
  - **Grow scale** to reduce cost per subscriber
  - **Go into content:** look for acquisition/ partnership to drive differentiated content
  - **Technology innovation:**
    - Offer DVR to compete with cables' VOD
    - Increase number of local and national HD channels
  - **Partner for broadband.** E.g., partner with telcos where they are not building video infrastructure

Company Provided Case – Brand Builders Inc. (pg. 1 of 11)

Bain & Co.

Case summary for facilitator only

Industry	Primary issue	Other topics
Consumer Products/ Retail	Portfolio management	Cost benchmarks, profit margins

Situation

Apparel manufacturer, Brand Builders Inc., owns a portfolio of apparel brands
Historic growth has been in line with market

Complication

Management wants to invest to drive growth

Key questions

How should management select brands for investment?

Key components

Suggested framework: size, growth, profitability, strategic fit
Quantitative: internal benchmarks, calculate cost savings

Answer

Management should prioritize the five largest, fastest growing brands for investment. There is an opportunity to reduce costs on Brand E, which is currently unprofitable

Company Provided Case – Brand Builders Inc. (pg. 2 of 11)

Bain & Co.

Case summary for facilitator only

Additional Background

- An **apparel manufacturer**, Brand Builders Inc., owns a **portfolio of fifteen brands**
- Historic **growth has been in line with the market**, and portfolio profitability is sound
- Management wants to **invest to grow the portfolio** but is unsure about how to **prioritize their investment**
- The brands are categorized in **two segments: Classic and Contemporary**
  - Classic is slow-growing: projected 5-yr CAGR 1%
  - Contemporary is fast-growing: projected 5-yr CAGR 4%
- The brands are of **varying sizes and growth rates**
  - Brands E and H are the largest Classic brands, and have growth rates in line with or ahead of the market
  - Brands B, K, and M are the largest Contemporary brands, and have lagged the market
- **Four of the top 5 brands are profitable**: H, B, K, and M
  - Brand E is not profitable
- Brand Builders should also **consider brands in its portfolio for strategic investment**: access to customers, channels, or organizational learning
- **Brand E is not profitable**
  - Internal benchmarking shows **E overspending, driven by Design and Supply Chain**
  - Reducing costs in Brand E would lead to **$6M savings, and a 20% profit margin**
- **Brand Builders should invest in its largest brands, and should reduce costs in Brand E to drive profitability**

Company Provided Case – Brand Builders Inc. (pg. 3 of 11)

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Question

- Apparel manufacturer, Brand Builders Inc., owns a portfolio of apparel brands. Historic growth has been in line with market. Management wants to invest to drive growth. How should management select brands for investment?

Recommended Solution

Frame the Problem

Approach:

- Consider the size and growth of the brands
- Screen the largest, fastest growing brands for profitability
- Review the smaller brands for strategic investment

Brand size	Brand growth potential	Brand profitability

Company Provided Case – Brand Builders Inc. (pg. 4 of 11)

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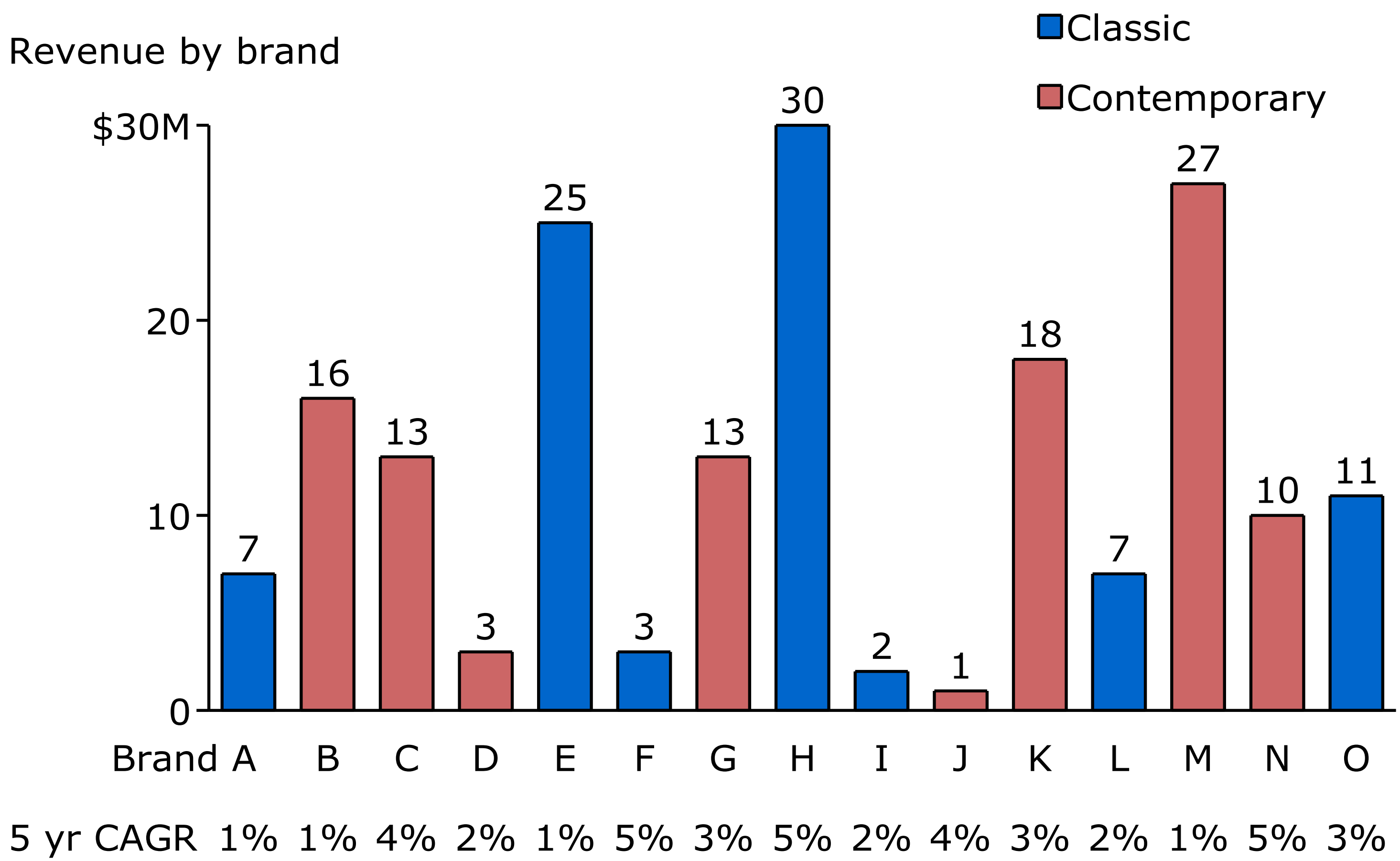
Available Data

Revenue by brand



Company Provided Case – Brand Builders Inc. (pg. 5 of 11)

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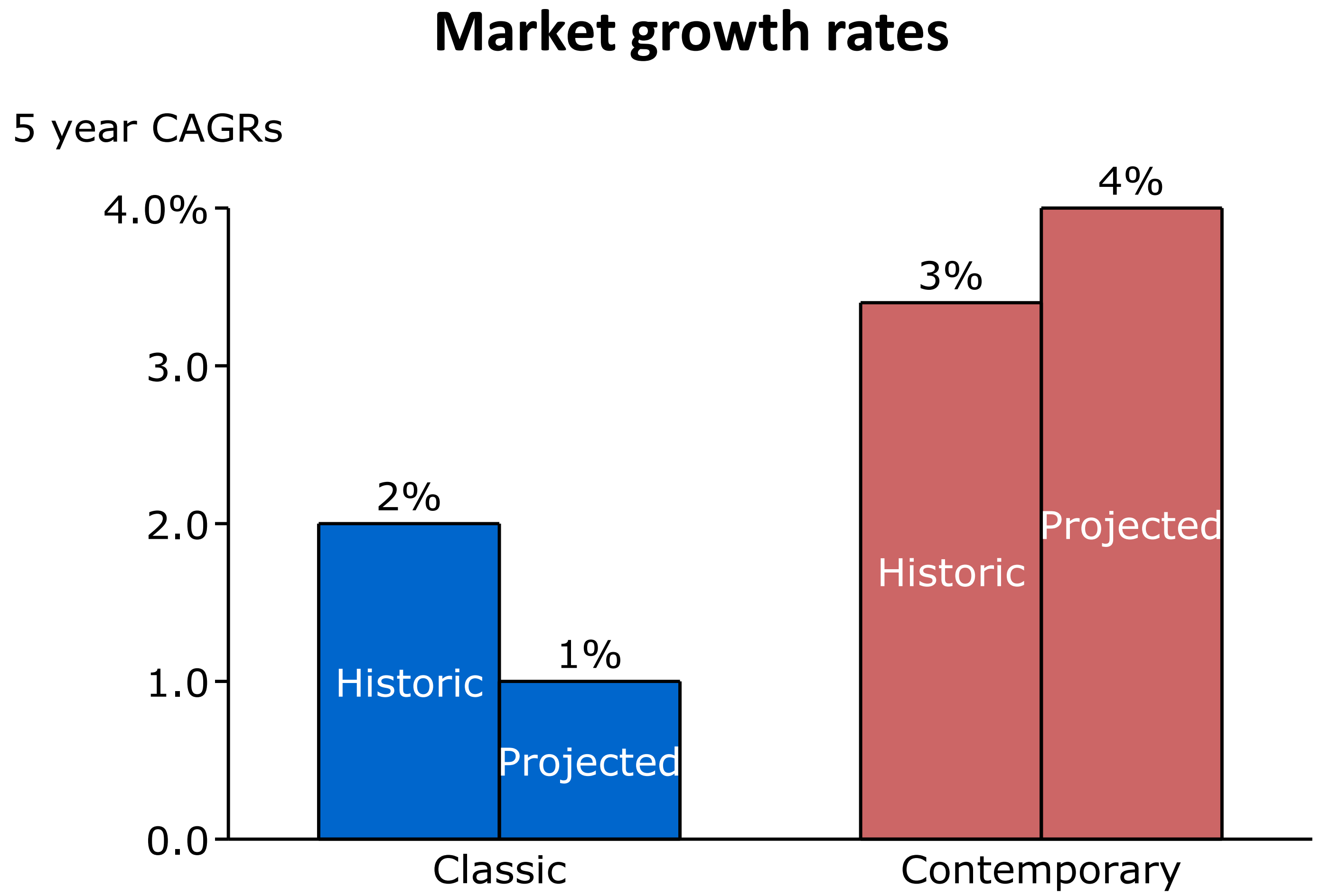
Available Data



Company Provided Case – Brand Builders Inc. (pg. 6 of 11)

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Recommended Solution

<u>Dig Deeper</u>

Form a hypothesis about what you will recommend based on the initial data

	Brand size	Brand growth potential	Brand profitability
Hypothesis:	• Brand sizes vary significantly, even within segments	• The brands have historically grown at different growth rates • The Contemporary segment is projected to grow more quickly than Classic	• Brands B, E, H, K, and M are the largest, fastest growing brands • **Need to understand the profitability of the various brands**

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Company Provided Case – Brand Builders Inc. (pg. 7 of 11)

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Available Data

Financials for selected brands

	B	E	H	K	M
Gross sales	**$ 16 M**	**$ 25 M**	**$ 30 M**	**$ 18 M**	**$ 27 M**
COGS	6	9	11	6	10
Net sales	**10**	**16**	**19**	**12**	**17**
Design	3	6	5	3	4
Supply chain	2	5	4	2	4
Sales	2	3	3	1	2
G&A	1	3	3	1	3
Profit	**2**	**(1)**	**4**	**5**	**4**
Profit margin	*13%*	*-4%*	*13%*	*28%*	*15%*

Company Provided Case – Brand Builders Inc. (pg. 8 of 11)

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Recommended Solution

Key Findings

- In the Brand Builders portfolio, we selected the top 5 brands by revenue: B, E, H, K, M
- The top 5 brands are growing at different rates, varying from 1-5%
- The brands are in two main segments, Classic and Contemporary
  - Classic is expected to grow more slowly than Contemporary (1% vs 4%)
- Segment growth does not appear to be a good predictor of brand growth
- Four of the top 5 brands are profitable
  - Brand E is not profitable

Dig Deeper

- **Brand E is the only unprofitable brand**
- Need to understand if Brand E can be turned around
- Benchmarking against the other brands will reveal source of losses

[Need to benchmark cost against a temporary and a classic brand]

Company Provided Case – Brand Builders Inc. (pg. 9 of 11)

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Recommended Solution

Dig Deeper

Why is Brand E unprofitable?

[Candidate should calculate financials as a percent of net sales to compare across brands]

	B		E		H	
	$M	% net sales	$M	% net sales	$M	% net sales
Gross sales	**16**		**25**		**30**	
Net sales	**10**		**16**		**19**	
Design	3	30%	6	~40%	5	~25%
Supply chain	2	20%	5	~30%	4	~20%
Sales	2	20%	3	~20%	3	~15%
G&A	1	10%	3	~20%	3	~15%
Profit	**2**		**(1)**		**4**	
Profit margin	*13%*		*-4%*		*13%*	

Company Provided Case – Brand Builders Inc. (pg. 10 of 11)

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Recommended Solution

Dig Deeper

Need to calculate impact of achieving internal benchmarks

	B	E		H	Savings potential for E	
	% net sales	$M	% net sales	% net sales	Calculation	$M
Gross sales		**25**				
Net sales		**16**				
Design	30%	6	~40%	~25%	6M–(25% of 16) =	2M
Supply chain	20%	5	~30%	~20%	5M–(20% of 16) =	2M
Sales	20%	3	~20%	~15%	3M–(15% of 16) =	.5M
G&A	10%	3	~20%	~15%	3M-(10% of 16) =	1.5M
Profit		**(1)**			**Total**	**6M**
Profit margin		*-4%*			*Profit margin with savings*	*20%*

Company Provided Case – Brand Builders Inc. (pg. 11 of 11)

Bain & Co.

Recommended Solution

Key Findings

- The **top 5 largest brands by revenue are B, E, H, K, M**
- The top 5 brands are **growing at different rates,** varying from 1-5%
- The brands are in **two main segments, Classic and Contemporary**
  - Classic is expected to grow more slowly than Contemporary (1% vs 4%)
  - Segment **growth rates are not a good predictor of brand growth**
- **4 of the top 5 brands are profitable**
  - Brand E has a profit margin of -4%
- **Brand E is overspending on all costs**, especially Design and Supply Chain
  - Reducing costs to benchmark levels would **save $6M**

Key Recommendations

- **Brand Builders Inc should focus its investment on the largest, fastest growing brands in its portfolio**
  - Contemporary brands B, K, and M
  - Classic brands E and H
- The largest brands are profitable, except brand E
- Brand Builders should **reduce costs in Brand E**
  - Brand E is overspending on Design and Supply Chain
  - Reducing all costs to benchmark levels would **save $6M** and increase Brand E profit margin to 20%

Company Provided Case – Video game case (pg. 1 of 4)

Booz & Co.

Question

The CEO of a large, diversified entertainment corporation has asked a team to examine the operations of a subsidiary of his corporation that manufactures video games. Specifically, he needs to know if he should approve a $200 million capital request for tripling the division's capacity.

You are a member of the team assigned to this project. Assume you and I are at the first team meeting. What are the critical issues we should plan to examine to determine if the industry is an attractive one for the CEO to continue to invest and why?

Additional Background - *Only to be provided if candidate inquires*

Market share

- Division is 3rd largest manufacturer of hardware in industry (10 percent market share)
- Top two producers have 40 and 35 percent market share
- Remainder is divided by small producers
- Division sell to broad range of consumers

Sales

- Division sales have increased rapidly over last year from a relatively small base
- Current estimate is annual sales of 500,000 units
- Current estimate of industry hardware sales is 5,000,000 units annually
- Industry growth has been strong though over last few months
- Sales growth has slowed
- Divisions current sales price for the basic unit is $45 per unit
- Division remains less than 20 percent company sales

Company Provided Case – Video game case (pg. 2 of 4)

Booz & Co.

Question

Additional Background – *only to be provided if candidate inquires*

Sales
- Industry growth of software continues to increase
- Top two competitors also develop, manufacture and sell software/games though division sells only licensed software

Cost
- Division estimates current cost is $30 fully loaded. Requested expansion should reduce the cost by 5 to 7 percent and triple production of the hardware unit
- Top two competitors are estimated to have a 10 to 15 percent cost advantage currently
- Main costs are assembly components and labor

Current
- Division estimates much of initial target market (young families) has now purchased the video game hardware
- No large new user segments have been identified

Distribution
- Primarily outlets of distribution are top and electronics stores

Profitability
- Division currently exceeds corporate return requirements, however, margins have recently been falling

Product
- Hardware standards have been established by the industry leaders
- Product features are constantly developed (e.g., new type of remote joy stick), to appeal to segments of the market

Company Provided Case – Video game case (pg. 3 of 4)

Booz & Co.

Recommended Solution

Minimum Requirements: the following issues would need to be covered for candidate to have done an acceptable job:

1) What is future market potential?

   The candidate needs to question the continuation of overall industry growth. She/he might ask about the saturation of markets, competitive products (home computers), and declining "per capita" usage.

2) What is the competitive outlook?

   The candidate should at least recognize the need to examine competitive dynamics. Issue areas might include: concentration of market shares; control of retail channels; and R&D capabilities (rate of new product introductions, etc.).

3) What will be the price/volume relationships in the future?

   Issues of prices need to be considered.

Better/Outstanding Answers: no bounds on creativity, but better answers would address:

Market Potential

- Recognize that there is a relationship between market penetration and growth in new users which, when combined, yields an industry volume estimate
- Address the shifting mix of product purchases, in this case from hardware (player unit) to software
- Seek to look at buyer behavior in key buyer segments, i.e., "fad" potential of product

Software

- Recognize technology standards are set by industry leaders. In this situation, the division as a secondary player will have to follow these standards
- Recognize that different distribution needs may exist for different products (in this case, hardware versus software)

Company Provided Case – Video game case (pg. 4 of 4)

Booz & Co.

Recommended Solution

Price/Volume Relationships

- Discuss the effect capacity additions can have on overall industry price/volume relationships and on industry price levels

Company Ability to Compete

- Should ask what the capacity expansion is designed to do
- Explore the cost position of the client division relative to that of other competitors
- Seek to understand reasons for poor profit performance of division

<u>Reflecting on the analysis</u>

The primary issue of the case is to **determine if the industry is attractive** and, especially, if our client's **position in that industry is sustainable**. The candidate should identify issues which are necessary for assessing both the industry and our client's position, but should not be expected to solve the problem.

If the candidate begins to discuss too deeply a specific issue, before having covered the key issues overall, he/she will probably be brought back to discuss the industry more broadly by questions such as "what other issues must be examined?"

If the candidate is discussing issues which seem irrelevant to the attractiveness of the industry, he/she may be asked "how will that analysis help to assess the attractiveness of the industry or our client's position?"

Company Provided Case – Pen manufacturer case (pg. 1 of 10)

Booz & Co.

Question

Penco is a global leading manufacturer of writing products, with divisions in North-America, Europe and South-East Asia. Penco's global sales equals € 50 million whereas its profit amounts to € 25 million. The mayor activities of Penco's European division are within the manufacturing and sales of disposable pens. Within the European region, sales are flattening and profit is decreasing. Penco's CEO has asked you to determine the cause of the decreasing profit in the European pen division, and to come forward with suggestions to bring it back up.

Recommended strategy

High level plan of attack

First, discuss the mayor aspects you would like to study in order to understand the decrease in profit.

[In a case interview, this step is crucial. Verify whether you understood the objective of the case and write down the main question. During the interview, take the time to determine your structure and make sure to communicate your plan clearly]

Layout your thoughts

Profit is defined by sales minus costs. Penco's decreasing profit within the European pen division is caused by flattening sales on one hand, and this could be accumulated by increasing costs on the other.

Possible causes for flattening sales

- The number of pens sold is decreasing
- The price per pen is decreasing
- An unfavorable shift is taking place within the product mix

Company Provided Case – Pen manufacturer case (pg. 2 of 10)

Booz & Co.

Possible causes for increasing costs
- Increasing direct costs
- Material costs
- Direct wages

Increasing indirect costs
- Production costs
- Transportation costs
- Indirect wages
- Marketing & Sales costs
- Overhead costs

Excellent additional remark
Within the cost-price of a pen, the share of indirect costs is substantial. For a great part, these indirect costs are determined by the utilization of the production capacity. When production utilization increases, the indirect costs can be distributed over a greater number of products, such that the costs per product diminishes. Therefore, we should test the hypothesis that utilization of the production capacity could be increased.

Study the means to increase sales in further detail
Before looking into possibilities of reducing costs, let's first study the opportunities on the sales side a little more.

[In an interview, if you think you need more information, do not hesitate to ask for it. However, make sure you are asking for a specific answer. For example: "Would you want me to look at the sales of pens or would you also be interested in sales of other writing products?" The answer in this case is: "We are only interested in the sales of various kinds of pens".]

Company Provided Case – Pen manufacturer case (pg. 3 of 10)

Booz & Co.

In order to provide a delicate answer to the question, the candidate could request the following information
- What are the segments in which Penco is operational?
- How aggressive is the competition within these segments?
- What is the current stage of the pen market?

Suggested answer

I would like to identify a few possible means to increase sales:
- Increase sales to existing customers: for example, attach sales of accessories *or fillings* to pen sales
- Initiate sales to new customers: for example by increasing the number of distribution channels and/or intensifying marketing
- Selectively increase the prices
- Launch new products: for example, premium pens
- Get rid of unprofitable pens within the existing product mix, such that sales will shift from unprofitable pens towards more profitable pens
- Cut a deal with retailers: for example, attach a pen to a specific notebook within their assortment

Excellent additional remark

The pen market is highly competitive, especially within the segment of disposable pens –in which Penco is operational. Therefore, to Penco price is extremely important. This makes the sales increase by means of an increase in prices fairly unrealistic. If we would have been looking at premium products (i.e., products with added value which customers are willing to pay for), price would be of minor importance.

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Company Provided Case – Pen manufacturer case (pg. 4 of 10)

Booz & Co.

Study the launch of new products in order to increase sales in further detail
There seem to be opportunities within the market of premium pens. In this example, we will assume fountain-pens which are produced in vast volumes, with minimum selling price € 10. Penco does not yet operate within this segment. Let's look into this in some further detail.

1. Estimate the market for premium pens in Europe
[This means: Provide an estimate of the number of premium pens sold per annum within Europe - Be prepared to be solving mathematical problems during the case. It is expected that you will do calculations without the use of a calculator. In client situations, there will often not be a calculator either. Make assumptions and round numbers such that multiplying and dividing is easier. Also, make sure to perform a sanity check after deriving an answer]

Suggested answer
I will start with some assumptions, and then calculate the estimated number of premium pens sold per annum within Europe:

- The number of inhabitants of Europe is 400 million
- Persons below the age of 12 do not possess premium pens
- This category represents about 15% of the European population (12/80≈15%)
- On average, 1 out of 4 persons possesses a premium pen
- On average, a premium pen is utilized over a period of 5 years

Over a period of 5 years, the number of premium pens sold in Europe is:
400 million * (100% - 15%) persons * 0.25 pens = 85 million premium pens.

This corresponds to a **market of 85 million pens over 5 years** /5 years = 17 million pens per annum. Let's assume the total market of premium pens within Europe equals 15 million pens. We round down because the assumed average of 1 out of 4 persons possessing a premium pen seems a bit high.

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Company Provided Case – Pen manufacturer case (pg. 5 of 10)

Booz & Co.

2. Consider entry barriers for Penco

As Penco is not yet operational within the premium pen segment, Penco will have to enter this market as a new player. In order to determine whether launching premium pens is a successful strategy, we first have to consider the barriers to entry.

Suggested answer

There are a few considerations regarding barriers to entry:

- Access to distribution channels

  Penco holds a distribution network for the current assortment. However, in addition to these channels, premium pens are sold through distribution channels Penco does not yet have access to, such as specialty stores. Therefore, Penco will need to invest in these distribution channels.
- Market consolidation in the segment of premium pens

  The size of the market for premium pens is relatively small and highly consolidated by established strong brand names, such as Waterman, Mont Blanc, Cartier and Dunhill. A successful launch of a new premium brand name seems impossible unless great risks are taken by mayor investments in marketing and sales.
- Access to resources

  Penco is a global leading company, such that access to resources is not expected to be a problem
- Image/ reputation of the brand ‘Penco’

  The main obstacle for Penco is the image it has a manufacturer of disposable pens. This existing image makes it extremely difficult to position itself within the market of premium pens.

In conclusion, it is difficult for Penco to launch premium pens because the market seems consolidated and dominated by strong brand names

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Company Provided Case – Pen manufacturer case (pg. 6 of 10)

Booz & Co.

3. Consider the financial attractiveness of entering the market

As consultant, it is important to support the advice you deliver by analyses. From the previous answers, it became clear that launching premium pens is difficult, but it could still be profitable. Would you advice the client to extend the assortment with premium pens?

Suggested answer

In order to derive a conclusion on the financial attractiveness of entering the market of premium pens, I will estimate Penco's possible market share, its corresponding sales and the resulting profit within premium pens:

- Penco's market share within premium pens
  - Assume the strong brand names cover a consolidated market share of 80%
  - Assume Penco would indeed be able to position itself and capture a 2% market share
- Penco's sales in premium pens
  - With its **2% market share** and a market size of 15 million pens, **Penco could sell 300.000 pens**. With an assumed average selling price of € 20, this results in **€6 million sales**.
- Penco's profit in premium pens
  - The reason people are willing to pay more for premium pens, is the added value of a special design or a brand name. Premium products usually have a **gross profit margin of over 25%** (this is the difference between the sales and fixed and variable production costs).
  - The costs of premium pens are mainly determined by the marketing and sales of the product, instead of the manufacturing. Penco will need to major marketing & sales expenses in order to gain market share. Assuming the profit margin after the marketing & sales expenses to be about 5% **results in €300.000 annual profit**.
  - Compared to the € 25 million total profit, this is extremely small.

In conclusion, launching premium pens is financially not attractive. It seems sensible to study further other possibilities for increasing the sales, or look into the possible means of reducing the costs.

Company Provided Case – Pen manufacturer case (pg. 7 of 10)

Booz & Co.

4. Study the means to decrease costs in further detail

In order to resolve Penco's main problem- that is, its decrease in profit- in the beginning we concluded that there are two sub problems we need to analyze. Increasing sales, reducing the costs. In the previous analysis, we looked into the optimization of sales. We would now like to proceed and question whether we could realize a cost reduction.

Suggested answer

I will first create a cost breakdown, and then discuss the possible means to decrease those costs

Penco's main costs

- Direct costs
  - Material costs (both for the pens and packaging)
  - Direct wages (wages of e.g. temporary employees)
- Indirect costs
  - Production costs (machinery, buildings, maintenance of production lines)
  - Transportation costs (both inbound and outbound)
  - Indirect wages (supervision, administration)
  - Marketing & Sales costs
  - Overhead costs

Continued on next page

Company Provided Case – Pen manufacturer case (pg. 8 of 10)

Booz & Co.

Possible means to decrease costs

- Reduce material costs
  - Use economies of scale
  - Purchase in low-wage country such as China
  - Use cheaper material for eg packaging
  - Rationalize the product / packaging design
  - Reduce the complexity of products
- Reduce wages
  - Make use of wage differences among varying groups of employees more efficiently (replace temporary employees by contracted employees, use skilled persons only where necessary)
  - Move production process to low-wage country
- Reorganize the production
  - Consolidate factories
  - Move production process to low-wage country
  - Computerize parts of the production process
- Reduce transportation, Marketing & Sales and Overhead costs
  - Increase efficiency
  - Make use of wage differences among varying groups of employees more efficiently
  - Move production process to low-wage country

Company Provided Case – Pen manufacturer case (pg. 9 of 10)

Booz & Co.

5. Study the move to low-wage countries in order to reduce costs in further detail

What will be the cost reduction when moving the production process to China?

Suggested answer

First, I will assume a cost structure, followed by an assumption on the incorporated differences when moving to China. Next I will use these assumptions to discuss the impact of moving to China.

I assume the following cost structure:
[This could be created with the help of the interviewer]

Indirect Costs	
Production costs	20%
Transportation costs	5%
Indirect wages, marketing & sales, overhead costs:	5%
Direct Costs	
Material costs	50%
Direct wages	20%

I assume wages in China are about 10% of the wages in Europe
[This could be created with the help of the interviewer]

The resulting impact of moving to China is as follows:

- Impact on wages
  The costs per pen attributable to direct wages will decrease by 18% (20% - 10%*20%).
  A decrease in indirect wages will imply an additional cost reduction
- Further impact
  Reduction in costs could be obtained by the local purchase of materials.
  Consolidate factories and better utilize production capacity. This will imply a decrease in production costs, resulting in a smaller amount of indirect costs per product and an increasing profit margin.
  A disadvantage is the increase in costs due to increasing distribution costs.

It will be necessary to further investigate whether the cost reductions above offset the increase in distribution costs

Company Provided Case – Pen manufacturer case (pg. 10 of 10)

Booz & Co.

<u>Recommendation</u>

The goal of the client was to improve the financial performance of the European pen division. The main aspects we investigated are possibilities for an increase in sales and a decrease in costs. A mayor opportunity to reduce costs is to move the production process to a low-wage country such as China- this needs to be investigated further.

1. Possible means to increase sales:

- Price optimization seems impossible
  - The pen market is highly competitive. Especially in the disposable pens' segment, price is extremely important.
- Launch of premium pens seems not worth the effort
  - We studied the possibilities to broaden the Penco's product portfolio by the launch of premium pens. It appeared not to be sensible to enter the market of premium pens, as the market seems consolidated and dominated by strong brand names.
- Other means of increasing sales need further investigation
  - Existing customers: for example, attach sales of accessories *or fillings* to pen sales
  - New customers: for example by increasing the number of distribution channels and/or intensifying marketing
  - Launch new products
  - Get rid of unprofitable pens within the existing product mix

2. Possible means to decrease costs:

- Move production process to a low-wage country such as China captures opportunities
  - With wages 10 times lower than in Europe, at least 18% of the product costs can be saved
  - Moreover, further reduction in costs could be obtained by the local purchase of materials
- Other means of decreasing costs need further investigation
  - Use economies of scale
  - Consolidate factories

Company Provided Case – Great Burger (pg. 1 of 8)

McKinsey & Co.

Question

Our client is Great Burger (GB), a fast food chain that competes head–to-head with McDonald's, Wendy's, Burger King, KFC, etc. GB is the fourth largest fast food chain worldwide, measured by the number of stores in operation. As most of its competitors do, GB offers food and "combos" for the three largest meal occasions: breakfast, lunch and dinner.

Even though GB owns some of its stores, it operates under the franchising business model with 85% of its stores owned by franchisees (individuals own & manage stores, pay franchise fee to GB, but major business decisions e.g., menu, look of store controlled by GB).

As part of its growth strategy GB has analyzed some potential acquisition targets including Heavenly Donuts (HD), a growing doughnut producer with both a US and international store presence. HD operates under the franchising business model too, though a little bit differently than GB. While GB franchises restaurants, HD franchises areas or regions in which the franchisee is required to open a certain number of stores.

GB's CEO has hired McKinsey to advise him on whether they should acquire HD or not.

<u>Additional Background</u>

In most McKinsey & Company cases the interviewer will guide you through the case with a series of questions that will allow you to display a full range of problem solving skills. Below is a series of questions and potential answers that will give you an idea of what a typical case discussion might be like.

The italicized sections are descriptions or instructions to help you navigate through this document. The words in plain bold font are the descriptions and questions an interviewer may give to you during the interview. The sections in regular (non-bold) font are possible answers.

Company Provided Case – Great Burger (pg. 2 of 8)

McKinsey & Co.

Recommended solution

Question 1. What areas would you want to explore to determine whether GB should acquire HD?

*A **good** answer would include the following:*

There are a number of things I would want to look at here:

- I would want to consider what the value of Heavenly Donuts would be to Great Burger.
- I would also want to look at the strategic fit of the companies. Do they complement each other? Can they achieve further benefits (or synergies) from combining their operations?

*A **very good** answer might also include the following:*

- I would want to look at the cultural similarities/differences, to see if the management/employees of the companies would fit in well together
- I would like to have a sense of how well positioned GB is to execute a merger with another company. Have they done this before, for example.

You may choose to dive deeper into some of these issues, or your interviewer may ask you to do this, for example:

To understand the value of HD to GB, I would want to look at a number of things

- Growth in market for doughnuts
- HD's past and projected future sales growth (break down into growth in number of stores, and growth in same store sales)
- Competition – are there any other major national chains that are doing better than HD in terms of growth/profit. What does this imply for future growth?
- Profitability/profit margin
- Investment required to fund growth (capital investment to open new stores, working capital)

Company Provided Case – Great Burger (pg. 3 of 8)

McKinsey & Co.

Recommended solution

Question 2. The team started thinking about potential synergies that could be achieved by acquiring HD

Here are some key facts on GB and HD:

Stores	GB	HD
Total	**5,000**	**1,020**
North America	3,500	1,000
Europe	1,000	20
Asia	400	0
Other	100	0
Annual growth in stores	**10%**	**15%**

Financials	GB	HD
Total store sales	**$5,500M**	**$700M**
Parent company revenues	$1,900M	$200M
Key expenses (% sales)		
Cost of sales*	51%	40%
Restaurant operating costs	24%	26%
Restaurant property & equipment costs	4.6%	8.5%
Corporate general & administrative costs	8%	15%
Profit as % of sales	**6.3%**	**4.9%**

*Variable costs, mostly food costs

What potential synergies can you think of between GB and HD? For your information, a synergy is an area where additional benefits can be captured over and above the sum of the two companies (such as cost savings or additional revenue).

See next page for recommended solution

Company Provided Case – Great Burger (pg. 4 of 8)

McKinsey & Co.

Recommended solution

Question 2. The team started thinking about potential synergies that could be achieved by acquiring HD

*A **good** answer would include the following:*

There appear to be opportunities in cost savings and in revenue gains.

In cost savings:

- There may be an opportunity to save on General & Administrative Expenses through combining management locations/functions
- There may be decreased Cost of Sales (per unit) because the companies are purchasing greater volumes together

In revenues:

- Additional sales can be achieved through selling Donuts in GB stores
- Also GB have a greater global presence which HD could leverage in order to grow outside the US

*A **very good** answer might also include the following:*

- GB appear to manage their property and equipment costs better, which means that they may be able to transfer this skill to HD
- Since GB has greater Sales per Store, they may have better skills in finding good locations for stores, and could transfer this skill to HD
- Since GB is bigger, it probably has more investment capital available to help HD grow at a more rapid rate.

Company Provided Case – Great Burger (pg. 5 of 8)

McKinsey & Co.

Recommended solution

Question 3. The team thinks that, with synergies, it should be possible to double HD's US market share in the next 5 years, and that GB's access to capital will allow it to expand number HD of stores by 2.5 times. What sales per store will HD require in 5 years in order for GB to achieve these goals? You should assume:

- **Doughnut consumption per head in the US is $10/year today, and is projected to grow to $20/year in 5 years**
- **For ease of calculation, assume US population is 300M**
- **Use any data from the earlier table that you need**

*A **good** answer is as follows:*

- HD will require a sales per store of $1.2M
- Today's market share is $700M/$3B = ~25%.

  This is available from the earlier table, and you are encouraged to make sensible, round estimates in a calculation.
- Expected US market in 5 years = $20 *300M = $6B
- If HD double today's market share, the will have a market share of 50%, so their sales will be 50% x $6B = $3B
- They are also expect to have 2,500 stores (= 2.5 x 1,000)
- So sales per store = $3B / 2,500 = $1.2M

A very good observation to make is that this seems like a realistic growth target, because we are requiring stores sales to less than double, while we already know that per head consumption of donuts is likely to double.

Company Provided Case – Great Burger (pg. 6 of 8)

McKinsey & Co.

Recommended solution

Question 4. One of the synergies that the team thinks might have a big potential is the idea of increasing the businesses' overall profitability by selling doughnuts in GB stores. How would you assess the impact of this move on overall profitability?

*A **good** answer is as follows:*

I would try to work out the incremental impact this move would have on profits. To do this I would:

- Calculate the incremental revenues we would get from selling donuts in GB stores (how many, at what price, etc)
- Calculate the additional incremental costs that would be incurred from doing so (for example, additional staff, additional training, additional marketing, additional distribution and purchasing costs)
- I would also look at the additional store investment we would have to make (for example, extra space, new equipment, etc).

*A **good** answer would also include:*

We should also investigate if the additional donut sales would mean lower sales of traditional GB products. For example, breakfast products might be affected as many people have donuts for breakfast. *In case you are unfamiliar with the term, this concept is known as "cannibalization".*

Company Provided Case – Great Burger (pg. 7 of 8)

McKinsey & Co.

Recommended solution

Question 5. What would be the incremental profit per store if we think we are going to sell 50,000 doughnuts per store at a price of $2 per doughnut at a 60% margin with a cannibalization rate of 10% of GB's sales? Note that the cannibalization rate is the percentage of GB products which we think will not be sold because they have been replaced by donut sales. Here is some additional information which will help you:

Current units of GB sold per store	**300,000**
Sales price per unit	**$3 per unit**
Margin	**50%**

*A **good** answer is as follows:*

There will be $15,000 incremental profit per store:

- Donut sales will bring in an additional $60,000 in profit ($2 price x 50,000 x 60% margin)
- However, we will lose $45,000 in the original profit from GB sales (10% cannibalization rate x 300,000 products x $3 price x 50% margin).

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Company Provided Case – Great Burger (pg. 8 of 8)

McKinsey & Co.

Recommended solution

Question 6. You run into the CEO of GB in the hall. He asks you to summarize McKinsey's perspective so far on whether GB should acquire HD. Pretend I am the CEO - What would you say?

*A **good** answer would include the following:*

- Early findings lead us to believe acquiring HD would create significant value for GB, and that GB should acquire HD
- US Growth targets seem achievable given the expected growth in Donut consumption in the US
- There are other opportunities to capture growth from international expansion of HD
- We also believe there are other potential revenue and cost synergies that the team still needs to quantify.

*A **very good** answer might also include the following:*

- We believe HD can add $15k in additional profit per GB store simply by selling donuts in GB stores. This represents a ~25% increase in store profit from this move alone
- We will also provide you with recommendations on the price you should pay for HD, as well as any things you need to think about when considering integrating the two companies.

Company Provided Case – Magna Health (pg. 1 of 8)

McKinsey & Co.

Question

Our client is Magna Health, a health care company in the Midwest. It both insures patients and provides health care services. Employers pay a fixed premium to Magna for each of their employees in return for which Magna covers all necessary health services of the employee (ranging from physician care, and medications to hospitalization)

Magna currently has 300,000 patients enrolled in its plan. It has 300 salaried physician employees who provide a broad range of services to patients in 6 centers. These physicians represent a wide range of specialty areas, but not all areas. When a patient needs medical treatment in a specialty area not covered by a Magna physician, they are referred outside of the Magna network for care, and Magna pays all referral costs on a fee-for-service basis. Magna doesn't own any hospitals itself, instead contracting services from several local hospitals.

Over the past six months, Magna has been experiencing declining profitability. Magna's CEO has retained McKinsey to help determine what is causing the problem and how Magna might fix it.

How can Magna Health improve its financial situation?

Additional Background

In most McKinsey & Company cases the interviewer will guide you through the case with a series of questions that will allow you to display a full range of problem solving skills. Below is a series of questions and potential answers that will give you an idea of what a typical case discussion might be like.

The italicized sections are descriptions or instructions to help you navigate through this document. The words in plain bold font are the descriptions and questions an interviewer may give to you during the interview. The sections in regular (non-bold) font are possible answers.

Company Provided Case – Magna Health (pg. 2 of 8)

McKinsey & Co.

Recommended solution

Question 1. What key areas would you want to explore in order to understand Magna's decline in profitability?

*A **good** answer would include the following:*
I would want to consider Magna's revenues and costs (variable and fixed). In thinking about Magna's main cost components – I would want to consider administrative (or non-medical) and medical costs (e.g. hospital, drugs, outpatient care)

*A **very good** answer might also include the following:*
You may choose to dive deeper into the different costs, for example:

- Outpatient costs could be further split into internal physician costs versus external referral costs.

Or you may decide to explore other factors that affect cost, for example:

- I would also want to understand how Magna's patient base demographics/overall risk profile might affect medical costs

Company Provided Case – Magna Health (pg. 3 of 8)

McKinsey & Co.

Recommended solution

Question 2. After reviewing the basics of Magna's business, your team believes that one of the root causes of Magna's financial problems is how it manages medical costs, particularly the cost of referrals to specialists outside its physician network.

Your team has gathered the following information on Magna and its primary competitor, Sunshine HMO:

	Number of patients	Average cost of referral (per member per month)
Magna Health	300,000	$20
Sunshine HMO	500,000	$15

What are the most likely reasons that the average cost of referral at Magna is higher than at Sunshine? Remember you should feel free to offer hypotheses and ask questions to clarify this information.

*A **good** answer would include the following:*

- Referral Pricing. Magna might be paying more than Sunshine for specialist services (e.g., its outside contracts with oncologists might be at higher rates than Sunshine's contracts).
- Number of referrals. Magna's physicians might have different practice patterns than Sunshine physicians, i.e. they may be less comfortable treating heart disease patients or have different training/ protocols.

*A **very good** answer might also include the following:*

- Mix of specialties. Magna's mix of specialties that require referrals (cardiology and neurosurgery) are probably more expensive specialties (than cardiology and psychiatry, Sunshine's referral specialties).
- Mix of patients. Magna has sicker or older (>65) patients (individuals over 65 are more likely to need medical care in the specialty areas outside of Magna's network, particularly cardiology).

Company Provided Case – Magna Health (pg. 4 of 8)

McKinsey & Co.

Recommended solution

Question 3. Magna's CEO has a hypothesis that Magna is paying too much in cardiology referral costs for its patient population. He asks the McKinsey team to look at Magna's cardiac patient population more closely and tell him how many referrals he should expect on an annual basis. Assume the following:

- Magna has 300,000 patients in any one year
- 20% of its patients are age 65 or older
- In the U.S. patients with serious heart disease visit specialists (cardiologists) on average 5 times per year

[At this point you should realize that you need to know the difference in prevalence rate of serious heart disease in the 65 and over population and the less than 65 population. When you find that you need additional information or clarification of the information you have received, you should not hesitate to ask the interviewer.

- The prevalence rate of serious heart disease in the 65+ population is 30%
- The prevalence rate of serious heart disease in the under age 65 population is 10%]

*A **good** answer is as follows:*
Magna should expect 210,000 cardiac referrals annually based on its patient population

300,000 total patients
20% x 300,000 = 60,000 patients age 65+
60,000 x 30% = 18,000 patients age 65+ with serious heart disease
18,000 x 5 = 90,000 referrals per year
240,000 Magna patients under the age of 65
240,000 patients x 10% = 24,000 patients under age 65 with serious heart disease and 24,000 x 5 visits per year = 120,000 visits per year total
90,000 + 120,000 visits per year = 210,000 total Magna patient external cardiology visits

Company Provided Case – Magna Health (pg. 5 of 8)

McKinsey & Co.

Recommended solution

Question 4. When the team tells Magna's CEO that based on Magna's patient population he should expect about 210,000 cardiology referrals a year he exclaims, "We currently pay for 300,000 annual cardiology referrals for our patient population!"

Why might Magna's annual cardiology referrals be significantly higher than U.S. averages?

*A **good** answer is as follows:*

The prevalence rate of heart disease in Magna's patient population is higher than average

The interviewer might ask a follow on question at this point:

Why would a physician refer a patient who does not have serious heart disease to a specialist?

*A **good** answer would include the following:*

Patients are demanding referrals

*A **very** good answer might also include the following:*

- Primary care physicians are not comfortable (e.g., they are poorly trained or inexperienced) treating cardiac patients, even those with minor problems; they want to avoid malpractice suits
- Magna doesn't have clear guidelines on when physicians should be referring patients to specialists (or if guidelines exist, physicians are not complying with them)
- There are no incentives or penalties to prevent physicians from referring patients with less serious problems to specialists.

Company Provided Case – Magna Health (pg. 6 of 8)

McKinsey & Co.

Recommended solution

Question 5. After some additional investigation, your team thinks that changing the behavior of Magna's primary care physicians has potential to reduce cardiac referral costs while maintaining high quality care. The team believes that introducing some sort of incentive plan for physicians might help reduce the referral rate:

- **The team's idea for a pilot plan is to increase overall fees that Magna pays to primary care physicians to handle more of their patients' basic cardiology needs. Overall fee increases would total $1million**
- **In addition to the team's proposal, Magna's Medical Director wants to pilot the following idea: Magna pays bonuses of $100,000 per year to each of the 10 primary care physicians with the lowest cardiac referral rates consistent with good patient outcomes.**

Although the team mentions to the Medical Director that there are other issues to consider relating to the pilot that are not financial, such as the ethical impact of incentivizing physicians not to refer patients to specialist treatment, he wants the team to do the first calculation including both ideas:

Part A. How many fewer cardiology referrals will Magna need to have in order to recoup the cost of the pilot incentive plan (including the team's and the Medical Director's ideas)? For simplicity's sake assume:

- The cost of a cardiology referral is $200
- Magna currently has 300,000 cardiology referrals per year

*A **good** answer is as follows:*

If the incentive plan reduces cardiology referrals by 3.3% or 10,000 referrals, Magna will recoup the cost of the incentive plan. One potential approach to the calculation is as follows:

$1 million + (10 * $100,000) = $2 million for incentive plan
$2 million/$200 =10,000 referrals
10,000 referrals/300,000 total referrals = 3.3%reduction would pay for incentive program

Company Provided Case – Magna Health (pg. 7 of 8)

McKinsey & Co.

Recommended solution

Part B. Your team projects that the incentive plan has the potential to reduce referrals by 5% in its first year, and an additional 2% in its second year. If these projections are correct, how much referral cost could Magna save in total over the first two years of the incentive plan?

*A **good** answer is as follows:*
Referral costs would be $4.14 million lower in the second year. Over the two years Magna would save $7.14 million. One potential approach to the calculation:

Year 1 Savings with Program
300,000 total referrals
5% reduction in referrals =15,000 referrals
15,000 x $200 = $3.0 million in savings in year 1

Year 2 Savings with Program
285,000 total referrals
2% reduction in referrals = 5,700 referrals
5,700 x $200 = $1.14 million in savings
$3 + $1.14 = $4.14 million in savings

Total cumulative savings over 2 years = Year 1 + Year 2 savings = $3M + $4.14M = $7.14M

Company Provided Case – Magna Health (pg. 8 of 8)

McKinsey & Co.

Recommended solution

Question 6. Your team presents its physician incentive proposal to Magna's CEO. The CEO, in consultation with his Medical Director, agrees that this is feasible and says that they will definitely pilot the overall higher fees to primary care physicians to handle more of the basic cardiology needs and they will think about the idea with the bonuses again due to the ethical concerns the team raised.

At the end of the meeting the CEO says, "I like the work you've done, but even if we did implement the bonus payment it's not enough to address our current financial situation. Physicians are professionals who care deeply about patient care and I think there's a limit to how much cost we can expect to reduce utilizing financial incentives exclusively. Besides cardiac financial incentive programs, what other ideas should we consider to reduce the cost of Magna's specialist referrals?"

Based on what we have discussed today, and any other ideas you might have, how would you respond to the CEO?

A good answer would include the following:

I would pursue additional ways to change physician behavior. For example:

- Provide training on how to treat patients with minor or stable medical problems
- Define and clarify medical guidelines for referrals (e.g., establish a medical committee to define the difference between "serious" and "minor" heart disease)
- Institute peer review committee charged with approving a subset of referrals (e.g., those that are considered "high cost,").

*A **very good** answer might also include the following:*

Other ideas outside of changing physician behavior might include:

- Spend time investigating "outlier" physicians (i.e., those who seem to refer patients to specialists at much higher rates than others) to determine how widespread the referral problem is and whether simply focusing on a few physicians will dramatically reduce referral costs

Company Provided Case – Footloose (pg. 1 of 14)

Monitor Group

Question

Duraflex is a German footwear company with annual men's footwear sales of approximately 1.0 billion Euro(€). They have always relied on the boot market for the majority of their volume and in this market they compete with three other major competitors.

Together, these four brands represent approximately 72% of the 5.0 billion € German men's boot market. The boots category includes four main sub-categories:

- Work boots, casual boots, field and hunting boots, and winter boots. Work boots is the largest sub-category and is geared to blue collar workers' who purchase these boots primarily for on-the-job purposes.
- Casual boots is the fastest growing sub-category, and is geared more towards white collar workers[2] and students who purchase these boots for week-end / casual wear and light work purposes.

The four key competitors in the market are Badger, Duraflex, Steeler, and Trekker

Additional Background

Badger and Steeler are both well established as work boot companies, having a long history and strong brand recognition and credibility among blue collar workers. At the other extreme is Trekker, a strong player in the casual boot market but a very weak player in work boots. Duraflex, however, is a cross between the other competitors, having a significant share in both work boots and casual boots.

Continued on next page

Blue collar workers: wage earners who generally work in manual or industrial labour and often require special work clothes or protective clothing, which are replaced approximately every 6 months

[2] White collar workers: salaried employees who perform knowledge work, such as those in professional, managerial or administrative positions

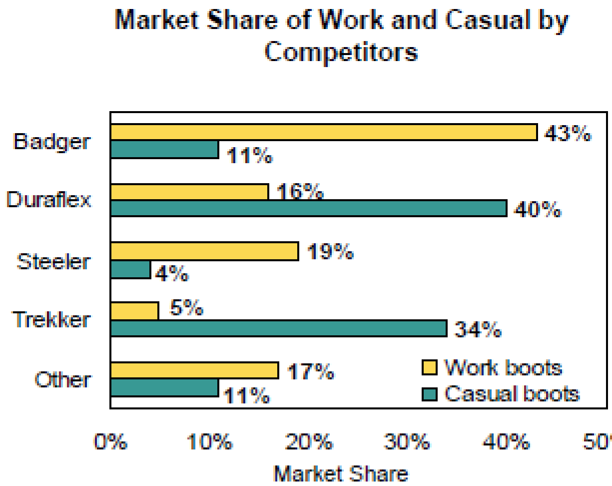
Company Provided Case – Footloose (pg. 2 of 14)

Monitor Group

Additional Background

Historically Duraflex had an even stronger position in the work boot sector. However, since 1996 when the company began selling casual shoes and focusing on the growth opportunity in casual boots, sales of the Duraflex work boot line have steadily declined. Also, around the same time Duraflex shifted its emphasis, Badger became a much more assertive competitor in the work boot market, increasing its market share to 43% in just three years.

In the fall of 1998, Badger launched a new line of aggressively priced work boots. The strong success of this line has caused Duraflex's management to re-evaluate their position in work boots. With limited additional resources, management must now decide if they should focus their efforts on competing with Badger in the work boot sector, or focus their resources on further strengthening their position with casual boots.



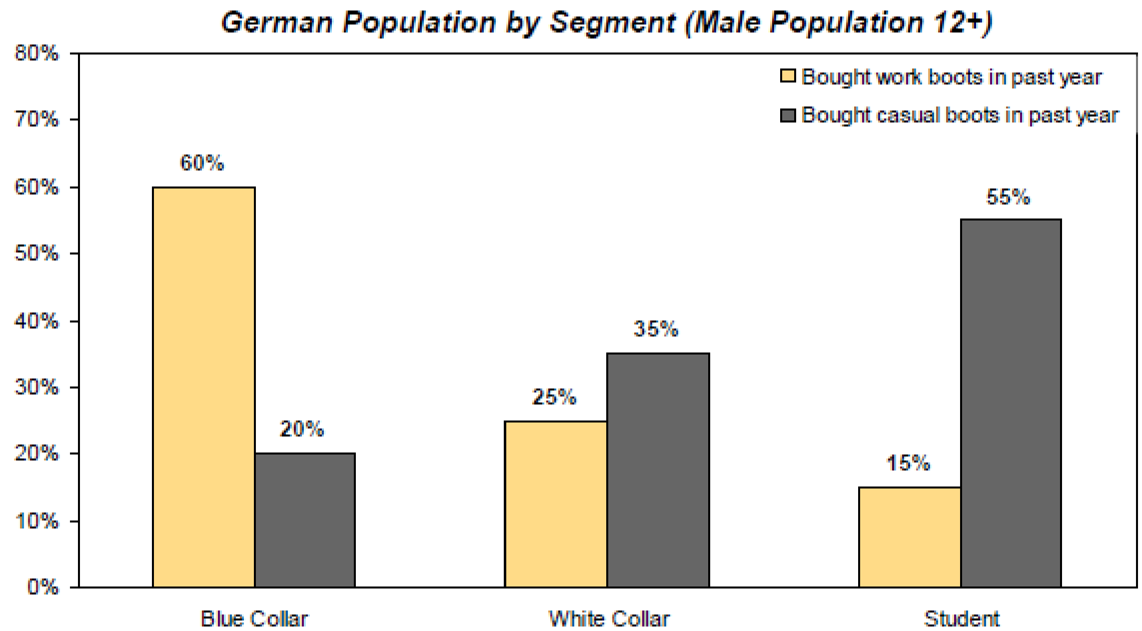
In January of 1999 Duraflex hired a leading consulting firm to conduct research to help management in its decision making. To make an informed recommendation, the consultants realised they needed to collect information that would enable them to size the market and better understand Duraflex's competitive position.

To begin with, the consultants developed a 20 minute quantitative telephone survey that was conducted among 500 randomly dialed consumers across the country's 6 primary regions. In addition, the consultants completed some internal cost and pricing analysis for Duraflex's work and casual boot lines. The market pricing analysis showed Duraflex competing at the premium end of the market for both its casual and work boot lines.

Company Provided Case – Footloose (pg. 3 of 14)

Monitor Group

Exhibit 1

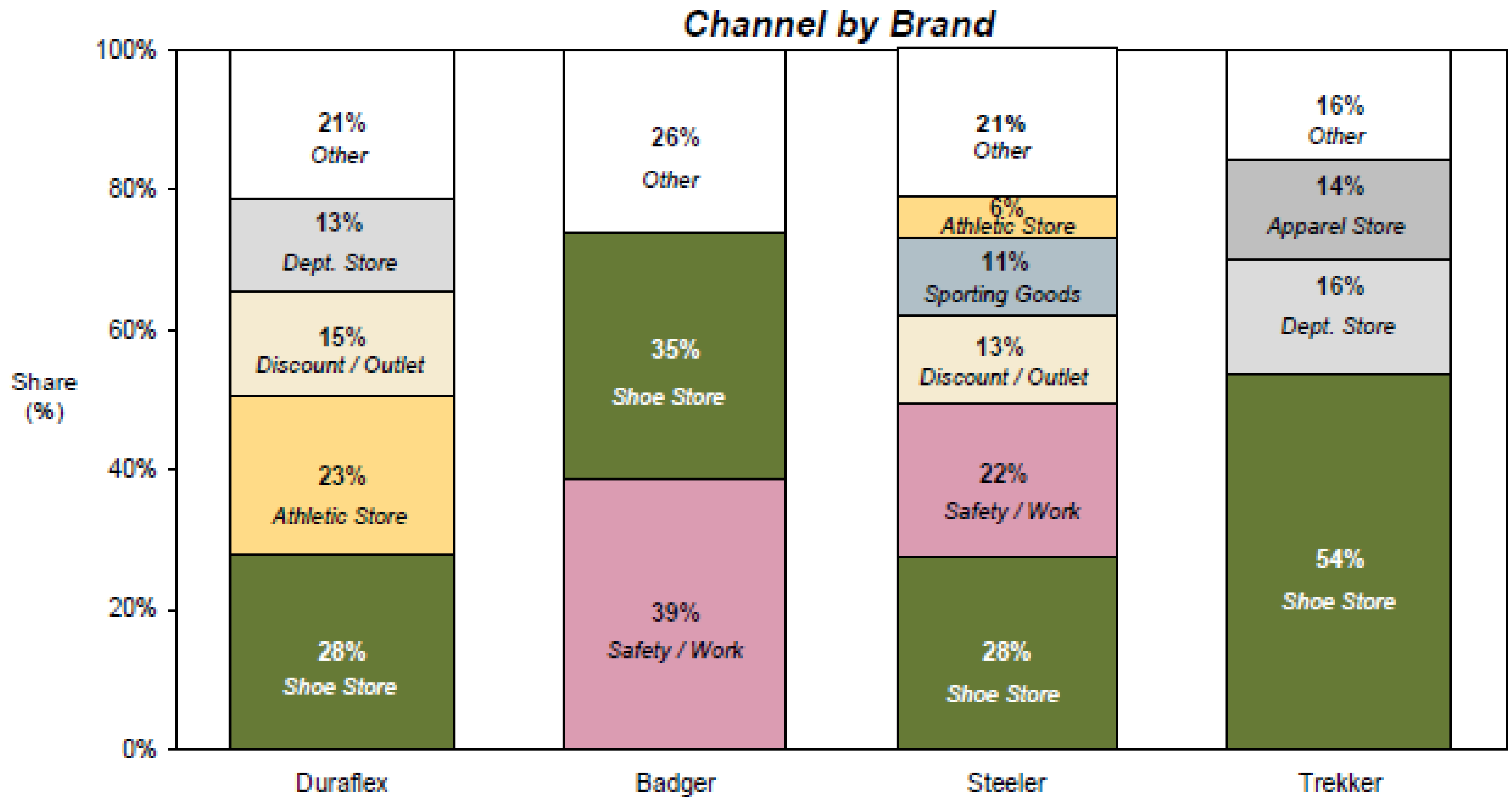


	Blue Collar	White Collar	Student
Population	*11.0 MM*	*12.0 MM*	*7.0 MM*
Average Price Paid for Boots	*140€*	*130€*	*110€*

Company Provided Case – Footloose (pg. 4 of 14)

Monitor Group

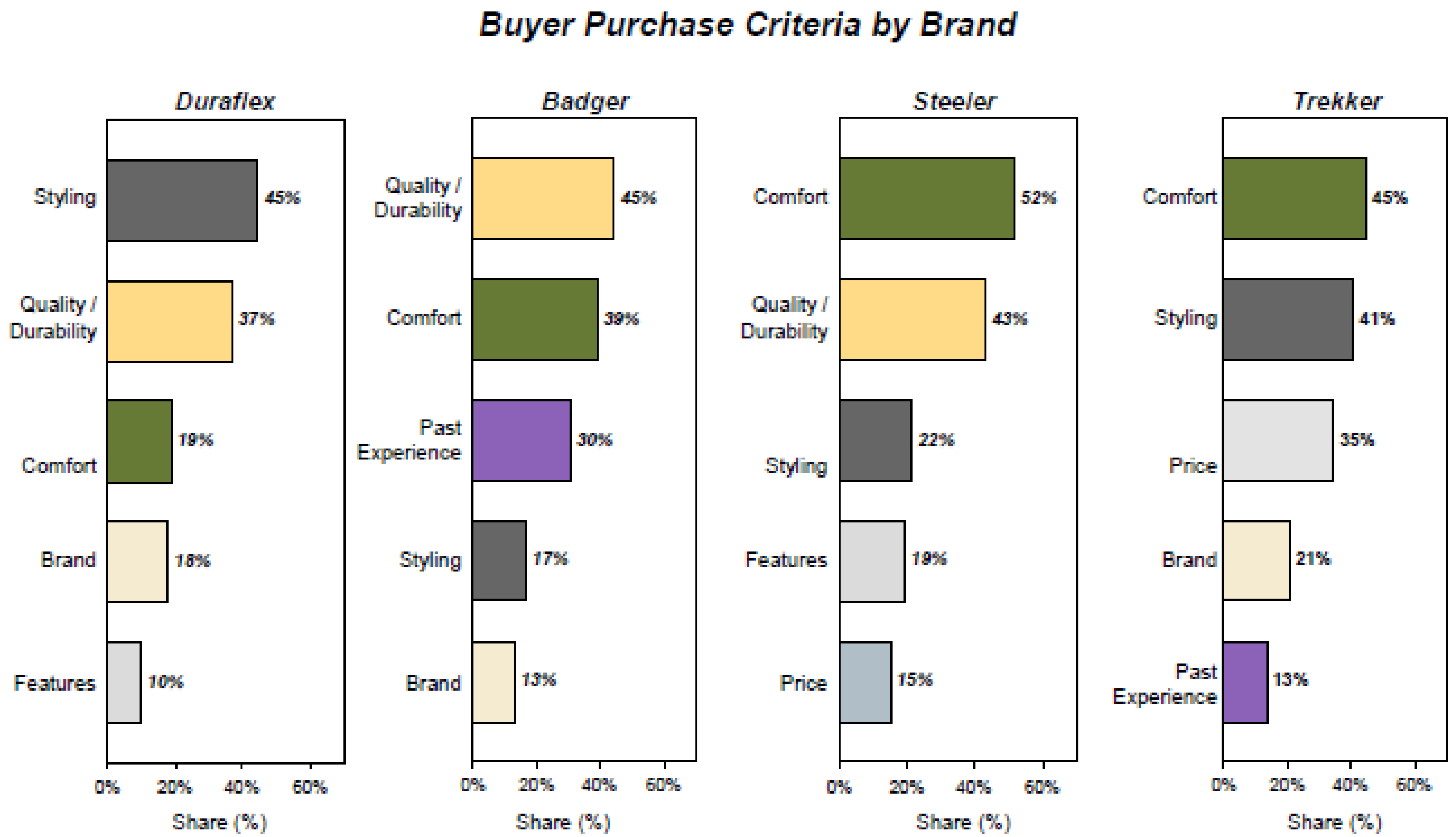
Exhibit 2



Company Provided Case – Footloose (pg. 5 of 14)

Monitor Group

Exhibit 3



Note: Respondents were asked the following question - *What were your reasons for buying a pair of (insert last brand of boots purchased) instead of other brands?* Responses less than 10% included, fashion, availability, good service and versatility

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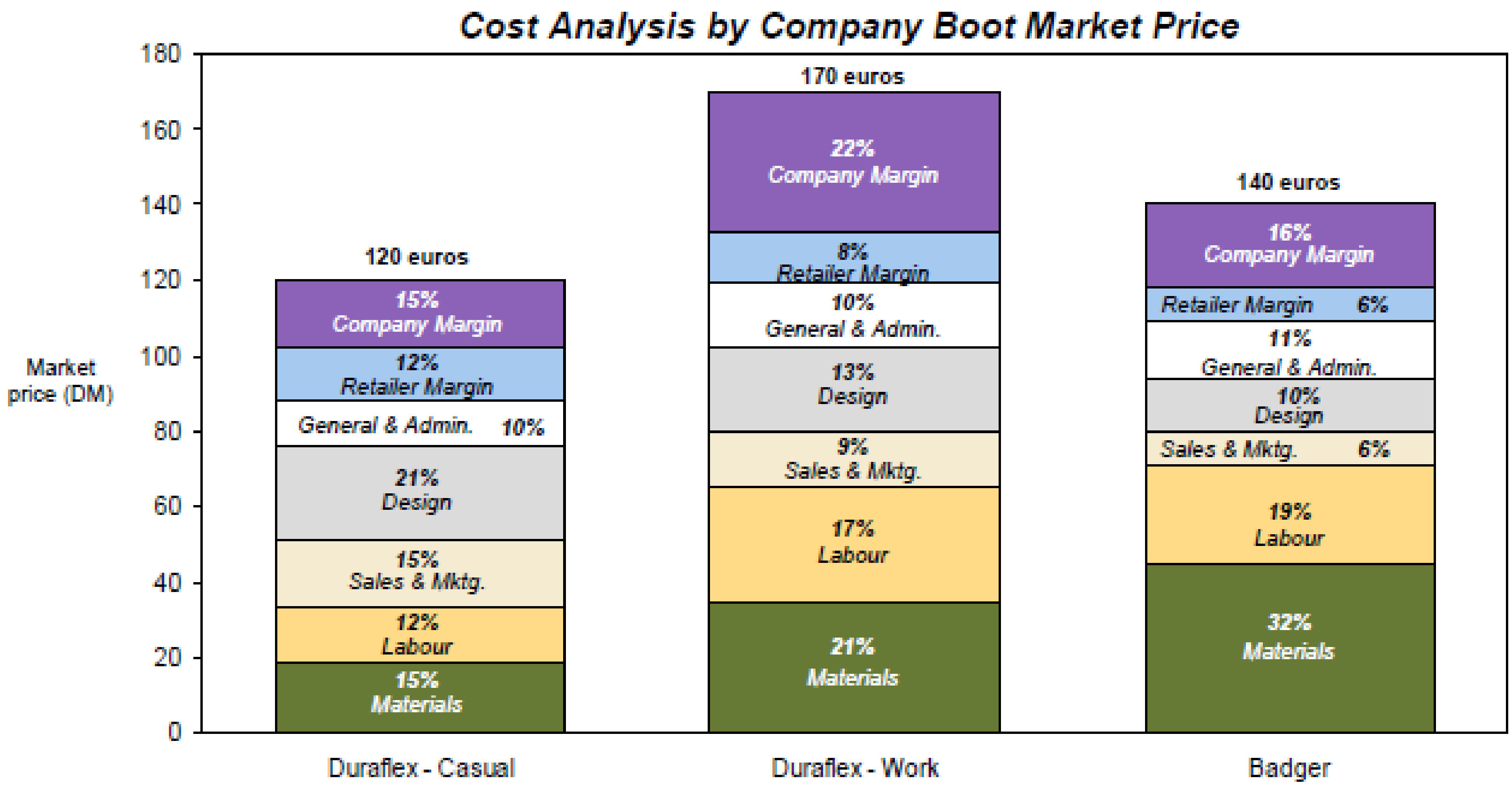
Monitor Group

Exhibit 4



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Monitor Group

Dig Deeper

1. How big is the work boot market (expressed in euros)? Does Duraflex get more of its revenue from work boots or casual boots?
2. Explain why Badger is outperforming Duraflex in the work boot market
3. What changes would you recommend to Duraflex's work boot strategy? Why? Would you recommend they introduce a sub-branded boot line?

Recommended solution

Question 1

To find the size of the market, we can use the following equation:

*(Average Boots Price) * (% of male population that bought work boots in past year) * (total population for the segment) * (number of pairs bought in a year)*

Exhibit One gives us the populations for each segment and the percentages that bought boots. We therefore need to find the number of boots sold and the average price of each pair. For this question, the candidate will need to make some assumptions.

1 Average number of boots purchased per user

- For work boots, we know that blue collar workers purchase an average of 2 pairs per year (from Introduction, Footnote1)
- White collar workers and students who buy work boots probably use less rigorously and less frequently, therefore *probably only 1 pair per year*
- For casual boots, we can make a reasonable assumption, knowing that casual boots are purchased primarily for weekends and light wear (from text) so the average number of pairs should be no more than work boots from Exhibit 1 (i.e. *1 pair per year*)

2 Average price per pair of boots

- Work boots cost more (compare Blue Collar vs. Student) so the average price should be higher than 140 € for all (150 € is reasonable); casual should be lower than student (100-110 € is reasonable).

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Monitor Group

Question 1

The total market value will then be the sum, for each segment, of the following equation:

*(Average Boots Price) * (% of male population that bought work boots in past year) * (total population for the segment) * (number of pairs bought in a year)*

*(€150 * 60%* 11Mill * 2) + (€150 * 25% * 12 Mill * 1) + (€ 150 * 15% * 7 Mill * 1) = **€2,587.5 Mill** or **2.6 Bill***

The following table shows another way to see it:

	Population	% Buying Work Boots	# Pairs work boots bought / year	Price Per Pair (€)	Segment Size (€)
Blue Collar	11.0 Million	60%	2	150	2.0 Billion
White Collar	12.0 Million	25%	1	150	450 Million
Student	7.0 Million	15%	1	150	155 Million
				Total	*2.6 Billion*

Following the same procedure the casual boot market is then:

	Population	% Buying Work Boots	# Pairs work boots bought / year	Price Per Pair (€)	Segment Size (€)
Blue Collar	11.0 Million	20%	1	100	220 Million
White Collar	12.0 Million	35%	1	100	420 Million
Student	7.0 Million	55%	1	100	385 Million
				Total	*1.0 Billion*

Summary

- We know from table 1 that Duraflex has a 16% share of the work boot market and 40% of the casual boot market, therefore:
  - Duraflex's revenue from the **work boot** market = **16% * 2.6 Bill = 416 Mill**
  - Duraflex's revenue from the **casual boot** market = **40% * 1.0 Bill = 400 Mil**
- So Duraflex gets most of its revenue from work boots, even though the revenues are almost evenly split

Answer

The work boot market is 2.6 Billion €. The casual boot market is 1.0 billion €. Duraflex generates 416 Million € from work and 400 Million € from casual. Depending on assumptions, casual may be slightly larger but the two should be relatively close.

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Monitor Group

Question 2

According to the data we have, and what we know as industry dynamics, the analysis can be split in 4 main areas that would demand further study:

- Distribution
- Buyer Purchase Criteria by Brand (BPCs)
- Pricing
- Cost analysis

Even if you have many good ideas to answer this question, you won't be impressive without STRUCTURE. You don't need a formal framework, just be methodical and organised in your approach — and summarise at the end!

Distribution

- Duraflex is not sold where work boots are being purchased. Exhibit 2 shows that Badger's and Steeler's boots are often purchased in safety / work channels, whereas Duraflex does not have a significant presence in them

  [Therefore, Duraflex will need to broaden distribution if it is to increase its share; it needs to get shelf space in the relevant channels]

Buyer purchase criteria by brand (BPCs)

- Exhibit 3 shows us that Badger's top two associated criteria are: "Quality / Durability" (45%) and "Comfort" (39%). The same holds true for Steeler. Thus, these seem to be critical criteria for work boot market
- However, Duraflex's top criteria are "Styling" (45%) and "Quality / Durability" (37%), with Comfort is a distant 3rd at 19%, far from its competitors figures

  [Duraflex is not meeting the key needs of blue collar workers and will need to strengthen its "comfort" perception]
- Additionally, we should note that Badger has built up a loyal customer base: "past experience" as a criteria represents 30% and is 3rd on its list of associated criteria

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Monitor Group

Question 2

Pricing

- We know that Badger is launching an "aggressively priced" work boot line. Duraflex can alter its pricing strategy, e.g. lower its own boot price
  - However, looking at Exhibit 3, among the stronger work boot market competitors, we see that only Steeler shows price as a top BPC (and then it is the lowest one) —potentially because they are the lower cost option is this market

[Given that price does not appear to be an important criteria for work boot consumers, Duraflex will likely not realise great benefits from this strategy, and will also lower its profits in so doing . We know from the case that Duraflex has premium price positioning, hence lowering its price may lead to perception of lowering quality]

Cost analysis

- Comparing Badger to Duraflex work boots, from Exhibit 4, there is one key area where Badger proportionately and absolutely spends more than Duraflex: "materials". This supports their perception of "quality / durability" and "comfort" among their consumers. Also, they spend more on "labour"
  - Retailer margin is lower for Badger — due to significant presence in safety / work channel
  - Sales & Marketing spend is lower for Badger —potentially driven by lower marketing requirements in safety / work channel as well as established brand name among blue collar workers; Also, Badger has built a loyal customer base, and it is less costly to maintain existing customers than attract new ones

[Badger has lower margins (both absolute and relative); given already higher market price, Duraflex has limited flexibility to raise its boot prices; Duraflex may lower its margin somewhat and shift emphasis to labour and materials]

Company Provided Case – Footloose (pg. 11 of 14)

Monitor Group

Question 2

<u>Key Findings</u>

·Duraflex is not sold where work boots are being purchased

·Duraflex is not meeting the key needs of blue collar workers, as

it is weaker than competitors on the critical 'Comfort' dimension

·Badger prices its boots more competitively, which is likely to be particularly appealing to the large work boot market; this has helped develop a large and loyal consumer base

·Badger has lower retailer margins (both absolute and relative)

and spends less on Sales & Marketing

Company Provided Case – Footloose (pg. 12 of 14)

Monitor Group

Question 3

There are two reasonable answers to this question. The company can either:

- Focus on increasing its work boots activities, or
- Emphasize casual boots

Each option has its own justifications and implications.

[The important thing with a subjective question is not what you answer to the question, but how you answer the question - pick a point of view and support it with critical reasoning!]

Company Provided Case – Footloose (pg. 13 of 14)

Monitor Group

Question 3

Focus on increasing work boot activities

Justification:

- Represents approximately 40% of Duraflex's business (from question 1), making it very difficult to profitably ignore this market
- While Duraflex does have greater market share in the casual boot market, we know from information given in the case that the casual boot market is smaller in size than the work boot market, which may indicate less opportunity for share growth; also, we derive lower margins (15% vs. 21%) from casual boots (from Exhibit 4)
- Given that Badger is introducing a new work line, they may see new growth potential in the market which Duraflex may also want to capitalise on
- Building a stronger image among blue collar workers may entice them to try other Duraflex footwear products

Implications

- Enter safety / work channel — we may be faced with pressure from Badger exerting influence on retailers in this channel
- Build "comfort" and "quality / durability" perception among blue collar workers
- Increase proportion of costs allocated to materials and labour — potentially reducing company margin
- There may be unique / niche positionings for Duraflex (suggestions should be well thought out)
- Introduce sub-brand or increase promotion of brand with a focus on blue collar workers: may include on-site promotions, advertising in industry publications, or advertising in magazines / on television during programmes with a higher blue collar readership / viewership

Company Provided Case – Footloose (pg. 14 of 14)

Monitor Group

Question 3

Emphasize casual boots

Justification:

- Stronghold for Duraflex right now (40% market share)
- Fastest growing market
- Represents approximately 40% of Duraflex's business (from question 1), making it very difficult to profitably ignore this market
- Focusing additional resources on work boot market would risk of alienating casual boot buyers (white collar workers and students)
- "Style" is the top BPC for Duraflex (from Exhibit 3). From the statistics on Badger and Steeler, we know this is likely not an important criteria for the work boot market. By focusing on the casual boot market Duraflex can devote additional resources to keeping up with styles to better appeal to this target

Implications

- Unlikely to be a strong competitor reaction, since Duraflex is already dominant player
- Duraflex will not need to enter new distribution channels
- Candidate should discuss a strategy for work boot market — either winding down, maintenance etc. and implications of this

Practice Case 1 – Retailer (pg. 1 of 3)

Question

A major retailer of clothing and household products has been experiencing sluggish growth and less than expected profits in the last few years. The CEO has hired you to help her increase the company's annual growth rate and ultimately its profitability.

- The retailer has 15 stores located in shopping malls in metropolitan and suburban areas.
- Total revenue from the 15 stores has declined, despite major back-end cost savings

Recommended solution

High Level Plan of Attack

- You need to understand why growth has slowed and profitability has declined despite cost savings.
- Do different stores experience variations in revenue? Do they all have the same approach to selling?
- Is purchasing behavior of the consumer different in the two areas?
- Has there been any new competition on the scene? In one area and not the other?

Lay Out Your Thoughts

Consider using the profitability framework

- The case tells you that cost savings have been achieved. Focus on the revenue side.
- Focus on the fact that the company has 15 different stores, in two different geographical areas. What are the key differences between the two in terms of the consumer, competition, and growth?

Practice Case 1 – Retailer (pg. 2 of 3)

Dig Deeper: Gather Facts

- Are some stores more profitable than others?
  Yes they are. We see variations throughout.
- Are there differences in profitability between the metropolitan and suburban stores?
  Yes there are. We see that the suburban stores are more profitable than the urban ones.
- Is there more competition in the urban areas?
  No, not really. It's proportionally the same.
- Do the stores sell the same products?
  Yes they do. All stores have the same product mix.

[Given that all stores sell the same product mix and some are more profitable than others, this should lead you to look at consumer behavior]

- Do consumers in the suburban areas have different purchasing behavior than the urban dwellers?
  Yes, as a matter of fact, they do. The suburban customer tends to buy more of the major appliances and electronic equipment than the urban consumer. The urban consumer buys mostly items such as clothing, small furniture items, and small appliances.

[You can make the assumption that suburban consumers have higher incomes and are in more need of major appliances given the difference in living quarters between houses versus apartments in the city.]

- Is there a difference in profitability between the goods purchased by the suburban and urban consumers?
  Yes. Major appliances and TVs and stereos are higher profit items than clothing and minor appliances.
- Would you say that the current product mix is more suited for the suburban customer than for the urban?
  Yes. I guess it is.

Practice Case 1 – Retailer (pg. 3 of 3)

Key Findings

- The consumer in the city has different needs and purchasing behavior than the suburban consumer. The stores in the city are not catering to the demographics of its surroundings.
- Unnecessary costs are being incurred through inventory and lost floor space in the city stores, resulting in lost revenue for the retailer.

Recommendations

- Further analyze the customer for each of the stores and differentiate purchasing behavior and income levels.
- Cater the product mix according to the customer research findings.
- Stores that cannot sustain selling low cost items should consider the possibility of closure

Practice Case 2 – Butcher shop (pg. 1 of 3)

Question

A fast food chain recently bought a bovine meat-processing outlet to supply it with fresh hamburgers and other meets. The shop process is: cows enter from one end of the shop, meat gets processed in the middle, and then the meat gets packaged and delivered at the other end.

Cows enter → Meat processed → Meat delivered

The manager of the butcher shop however could not decide whether to have the cows walk or run into the meat processing room. Can you help him?

Recommended solution

<u>High Level Plan of Attack</u>

- The first thing you want to do is to understand how much meat can be processed (the capacity) when the cows walk versus run.
- Then analyze the cost implications of the cows walking versus running.
- Next, calculate the size of the market and demand for the product.
- Finally, match demand with supply.

<u>Lay Out Your Thoughts</u>

- This is a market sizing, operation's cost analysis question. Try to lay your plan of attack on paper in a logical sequence of steps to take.

Practice Case 2 – Butcher shop (pg. 2 of 3)

<u>Dig Deeper: Gather Facts</u>

Shop capacity

- State initial assumptions:
  - Only fresh hamburger meat is processed at the shop.
  - From each cow, you can make 20 hamburgers.
- How many hours per day is the shop open for?

  10 hours, 5 days a week.
- Now, if the cows walk in, 10 cows can be processed in one hour, given current labor.
- This gives us an estimated 2000 hamburgers that can be processed in one day if the cows were to walk (20 hamburgers/cow x 10 cows/hour x 10 hours/day).
- If the cows were to run in, let's assume that 25 cows can be processed in one hour. This gives us 5000 hamburgers per day.

Costs

- Next, we must calculate the costs associated with the two different capacities. Let us assume that labor cost increases proportionally to the increase in processed meats, and overhead increases, but not proportionally due to some sunk costs, for more equipment and other expenses. Here is the breakdown:

	Walk	**Run**
Overhead	$5,000	$10,000
Labor	1,000	2,500
Total Cost	6,000	12,500
Burgers/week	10,000	25,000
Cost per burger	$0.60	$0.50

- This shows that by running, costs drop by 10 cents on each burger.

Practice Case 2 – Butcher shop (pg. 3 of 3)

Market size/Demand

[To estimate revenue, we need to calculate the demand from estimating what the market size would be.]

- Let's assume that the fast food chain has 10 outlets, and the meat-processing factory serves all 10. Each outlet serves a vicinity of about 30,000 people. Now, let's also assume that there are about 3 other competitors in each vicinity, leaving it with a market share of about 25% of the customers in each area, for a total of 75,000 potential customers.
- Of those 75,000, about 40% of them fall within the demographic target, leaving 30,000 desired customers.
- Given the trends in healthy foods, out of the 30,000 desired customers, about a third will be allowed by their parents to frequent any one of the establishment on a regular basis - leaving 10,000.
- Of the 10,000 customers, each will frequent the establishment about twice a week on average - 20,000 visits. Out of these visits, about half order a burger over another item on the menu - for a total of 10,000 burgers a week.

<u>Recommendation</u>

- Even though it's cheaper to produce more burgers, there's no demand to support it.
- Have the cows walk. This meets demand and ensures fresh hamburgers.

Practice Case 3 –Juice producer (pg. 1 of 3)

Question

A major producer of juice is in the business of processing and packaging fruit juice for retail outlets. Traditionally, the producer has packaged the juice in 18-ounce carton containers. Recently, in response to demand from the market, the producer purchased a machine that packages the juice in plastic gallons (36 ounces). Over the next couple of years, sales continued to grow on average of 20% per year. Yet, as sales continued to increase, profits steadily decreased. The owner cannot understand why. He hires you to help out.

Recommended solution

High Level Plan of Attack

- We know that sales have been increasing, so revenue is not an issue. The problem must be costs.
- Because of the change in packaging, the producer has incurred additional costs that are not accounted for, causing profits to decline.

Lay Out Your Thoughts

Consider using the profitability framework

- Gather information on the revenue side, but focus mostly on the cost side.

Dig Deeper: Gather Facts/Make Calculations

- Looking at the revenue side, how much did the producer charge for the 18 oz. carton?
  $2.00 per container.
- For the 36 oz. plastic gallons?
  For twice the size, the producer figured he would provide an incentive to buy by selling them at $3.50 per gallon.

Practice Case 3 –Juice producer (pg. 2 of 3)

- How was the cost of the new equipment accounted for in the price?
  The producer ended up raising prices across the board by $.50 on all packages, both cartons and gallons, selling at $2.50 and $4.00, respectively.
- What about cost of packaging? Does it cost the same to package the juice in cartons as it does in gallons?
  Well, I guess not. Plastic is more expensive than the paper carton we have traditionally used. Also, we had to hire more experienced labor to operate the machine because it is a little more complicated than the carton machine. We figured that because the demand was higher for the gallons – we would cover our costs through increased volume.
- What about overhead costs?
  All costs for the factory are added together and divided by the number of units produced.

[This should raise alarm bells. This is now clearly an issue of cost allocation. The price on the plastic gallons should be higher due to higher costs. Now you need to see to what extent this is affecting the bottom line.]

- Let's try to understand the trend in sales. What percentage of gallons versus cartons is sold?
  The more our customers notice the gallons, the more they like them. As the overall volume is increasing, plastic gallons have comprised 60% of the sales. The owner has been very pleased about that.

- It seems to me that it costs more to package in the gallons, yet the price is not higher on a per ounce basis. In fact, it's lower. Have you done any proper cost allocation to determine which type of product should carry which costs?
  No, we haven't.

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Practice Case 3 –Juice producer (pg. 3 of 3)

<u>Key Findings</u>

- The major finding in this case is the additional costs associated with the plastic gallons were averaged out over all units, including cartons. This resulted in a misallocation of costs and inappropriate pricing.
- The plastic gallon products have been priced at a lower rate than they should have been.
- Result: the more gallons the juice producer sold, the more profit the company lost out on.

<u>Recommendations</u>

- This firm should conduct a thorough analysis of activity based costing to determine the overhead costs and direct costs associated with each item in the product line. They should then use this data to price accordingly.

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Practice Case 4 – Chemical Manufacturer (pg. 1 of 3)

Question

A major chemical manufacturer produces a chemical product used to preserve foods in containers. Despite an increase in market share, the manufacturer has experienced a decline in profits. The CEO of the company is worried about this trend and hires you to investigate.

Recommended solution

<u>High Level Plan of Attack</u>

- The first thing we need to figure out is what does "an increase in market share" mean? Remember, the term "market share" is a percentage, and not an absolute number. It could imply that the company has increased its share of the market by beating out the competition, or the competition exiting the market. It could also mean that the market is actually shrinking, but the sales of the company are decreasing by less than those of its competitors.

<u>Lay Out Your Thoughts</u>

Consider using the profitability framework

- Focus mostly on the revenue side, taking into consideration the economic and competitive landscape

<u>Dig Deeper: Gather Facts/Make Calculations</u>

- Has the company experienced any significant increase in cost in the last couple of years related to any additional fixed or variable cost?

  No, costs have been steady.
- On the revenue side, has there been an increase in the volume of output?

  Slightly, a little bit higher than the industry average.

Practice Case 4 – Chemical Manufacturer (pg. 2 of 3)

- What about the competition. Have there been any new entrants on the scene?
  Actually, competition has decreased. A number of players have exited the industry.
- Why has that been the case?
  They were losing money. They felt that the industry had gotten saturated, so they left.
- Has sales decreased for the industry overall?
  Yes, there has been a general negative trend in the last few years. There certainly has been less demand for the product.
- Are substitute products being used?
  Not really. Preservatives in general are being used less in foods. Fresh food is now the preferred choice for many consumers.
- What about the makers of food? Are they experiencing decreased volume?
  Yes, the entire industry has been slowing.
- Are they forced to lower their prices to survive?
  They certainly are. Additionally, to lower costs, they are using their leverage to renegotiate price structures of raw materials.
- So is the company in question forced to lower its prices?
  Yes. They are gaining market share, but it's because of a number of competitor fallouts.
- But costs have stayed the same?
  Yes.

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Practice Case 4 – Chemical Manufacturer (pg. 3 of 3)

Key Findings
- The industry overall is shrinking. To survive, the company in question has been competing on price. It has gained market share at the expense of its competition, forcing some to exit the industry.
- Its sales have only increased slightly.
- The decrease in price has caused the company to lower its profits, despite the increase in market share.
- Profit margin has been lower on a per volume basis.

Recommendations
- Focus on cost reduction. If price is the only way to compete, then costs must decrease.
- Collaborate with the competition to increase leverage in negotiation.
- Diversify into other chemicals that are in demand. Reduce the risk of market trends via a portfolio of products.

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Practice Case 5 – VieTire (pg. 1 of 3)

Question

A tire manufacturer in Vietnam, VieTire, has been the only player in that market due to high tariffs on imports. They dominate the tire industry. As it stands, the tariff is 50% of the total cost to produce and ship a tire to Vietnam. Because of the forces of globalization and lower consumer prices, the Vietnamese government decided to lower the tariff by 5% a year for the next ten years. VieTire is very concerned about this change, as it will radically alter the landscape of the industry in Vietnam. They hire you to assess the situation and advise them on what steps to take.

Recommended solution

<u>High Level Plan of Attack</u>

- The first thing we need to understand is the current cost structure of VieTire's product.
- Next, we must determine the impending competitive situation.
- Then, Calculate the impact the reduction of tariff will have.
- Finally, recommend specific steps that VieTire can take to protect themselves from increased competition.

<u>Lay Out Your Thoughts</u>

Consider using the profitability framework

- Specify what steps we must take to understand the cost differences now, and in the future, of VieTire and its competitors

<u>Dig Deeper: Gather Facts/Make Calculations</u>

- What would you say are the major costs associated with making a tire?

  Raw material comprise about 20% of the cost, labor 40%, and all other costs such as overhead 40%. The average tire cost about $40 to make.

Practice Case 5 – VieTire (pg. 2 of 3)

- It seems that labor is a major cost, $16 per tire. Why?
  Things are done more manually. Most of technological advances in the industry have not yet been implemented in Vietnam. What about the cost structure of the competition? *An average tire manufacturer in the US produces tires at a cost of $30 each*
- Assuming shipping cost to Vietnam of $4 each tire, and a tariff of 50%, the average cost of an imported tire in Vietnam amounts to $51. So currently, even though the cost to produce a tire in the U.S. is much cheaper due to technological advances, foreign competitors are out of luck because of the tariff.

Year	Tariff	Cost	Result of Competition
Now	50%	$50.00	Will not enter
1	45%	$47.90	Will not enter
2	40%	$46.00	Will not enter
3	35%	$44.50	Will not enter
4	30%	$43.00	Consideration of entrance if willing to take a cut on price
5	25%	$41.30	Preparing to enter
6	20%	$39.60	Entered the market
7	15%	$38.00	Competing on the market

Practice Case 5 – VieTire (pg. 3 of 3)

<u>Key Findings</u>

- Depending on what price they are willing to set, the competition will start to think about entering the market in year four. In year six, the competition will surely enter as their prices become lower than domestically produced tires.
- This analysis assumes that the cost structure for the competition will remain constant. It is important to note that because of the rapid advances in technology, chances are that the costs of producing tires will decrease resulting in competitors entering the market even sooner.

<u>Recommendations</u>

- VieTire needs to benchmark against word class tire manufacturers and reengineer production methods and cost structures.
- They must invest in the latest advances in order to reduce their labor/operations costs.
- The company should focus on increasing the skills of labor while at the same time contain their hourly wage.
- Need to develop loyalty from their customers/consumers in order to lock in a certain percentage of the market share.

Practice Case 6 – World View (pg. 1 of 3)

Question

A cable TV company from Canada, World View, had recently entered the US market in the northeast to expand its market share. World View saw this move as an opportunity to capture a large part of the US market (4MM consumers) in a market with very little competition. However, in the last couple of years, much to the surprise of management, World View has been unable to make a profit. You have been hired to figure out why and advise them on their next move.

Recommended solution

High Level Plan of Attack

- We need to understand why the company is losing money despite the market being uncompetitive.
- We must analyze both the revenue and cost side of the problem.
- We should also analyze the differences in viewing behavior and income between the customer base of World View in Canada and in the northeast.
- We will also determine the strength of any competitors and substitutes.

Lay Out Your Thoughts

Consider using the profitability framework

- Focus on the consumer

Dig Deeper: Gather Facts/Make Calculations

- Let's look at costs first. Did World View incur additional costs per customer on average in the new market?

  No, based on the potential number of subscribers, they have instituted the same system that was in place. Costs associated with cable wire, debt, maintenance costs, etc. are all proportionally the same.

Practice Case 6 – World View (pg. 2 of 3)

- What about the number of subscribers. Out of the 4MM potential customers, how many are signed up?
  Only 2.1 MM.
- Are other cable companies capturing the remaining market?
  No, competition is not an issue. Those that we have not acquired as customers simply do not have cable.
- What about substitutes and viewing behavior? How is the consumer in the northeast US different from the one in Canada?
  Well, the Canadian consumer does not rely much on local stations for watching TV. Cable is a major source of entertainment and news coverage. In the northeast US, we tend to see consumers shy away from paying the $40 a month. They settle for watching local stations.
- Does the new market lave a lower income level?
  Yes, they do, by about 20% on average.
- What about the local stations? How many are they? Do they meet most of the needs of the consumer?
  There about 16 local stations that have coverage over the entire northeast. I guess they are doing pretty well by providing programming that the consumer wants. You tend to see the average consumer in the northeast watch regular TV more than Cable when compared with the Canadian consumer.
- Do these stations have good reception and how much do they charge?
  They have a very good reception and they are part of basic TV, so they are free.
- Is World View providing any type of programming that the local stations are not providing?
  Some, but the consumers don't seem to be interested. They don 't feel that it's worth $40.

Practice Case 6 – World View (pg. 3 of 3)

<u>Key Findings</u>

- There is a great deal of competition in the area, not from other cable companies, but local TV stations.
- The consumer in northeast US is quite different from the consumer in Canada with respect to television viewing habits.
- Consumers are not willing to pay $40 for a service that they already get for free.

<u>Recommendations</u>

- World View could try to cater its current channel offering by offering a smaller package for those that would be interested in couple of cable channels.
- Scale back its operations to a specific region.
- Educate the consumer on the extra benefit and new low price.
- If none of these strategies work, move out of that market.

Practice Case 7 – Le Seine (pg. 1 of 3)

Question

A French soft drink company, Le Seine, is looking to diversify its holdings by investing in a new fast food chain in the US. You are hired to determine whether they should pursue this path and, if so, how they should go about execution.

Recommended solution

High Level Plan of Attack

- Understand the company's logic for entering into the fast food industry.
- Examine the overall trends in the fast food industry, and determine which segment is the most promising.
- Assess the overall demographic changes and major trends in eating habits.
- Determine what competencies the company can provide that will help it enter this business and be successful.
- What are some of the high level strategies that the company should consider when entering?

Lay Out Your Thoughts

- We need to understand the industry
- Consider using Porter's 5 forces as a starting point: competition, substitutes, new entrants, suppliers, customers

Dig Deeper: Gather Facts/Make Calculations

- Let's look at costs first. Did World View incur additional costs per customer on average in the new market?

    No, based on the potential number of subscribers, they have instituted the same system that was in place. Costs associated with cable wire, debt, maintenance costs, etc. are all proportionally the same.

Practice Case 7 – Le Seine (pg. 2 of 3)

- Why is the company thinking of investing in the fast food industry and not another?

  The fast food industry has been experiencing sustainable growth for the last few years, and we believe that it will continue to grow.
- Why in the US market and not the French?

  The US is more attractive economically and Le Seine has been present in the country for a few years.
- Does the company know much about the fast food industry and its consumers?

  Not very much. They're not sure where to enter.
- The industry as a whole might be growing, but let's think about which segment is growing the most and where it would make sense for the company to enter. If we look at the traditional burger outfits, that segment is pretty much dominated by three players: McDonalds, Burger King, and Wendy's. I would think that the barriers to entry are pretty high for this segment. You also have pizza, Mexican, chicken, cold cut sandwiches, prepared meals (Boston Market).
- Has the company thought about which to enter?

  No. But what do you think, at a high level, which segment should they enter?

  [Quickly run through the pros and cons of the various segments]

- Well, if we take a look at the company itself, it is more inclined to be in the prepared meals segment, given that it is French and has a European appeal. If we look at the trends, the population is getting older and more families have two working parents. Also, there seems to be a move towards eating more healthy foods. If we consider the competition, the segment seems to be at the growing stages, with only one or two known players. The barriers to entry are certainly not as high as some of the other segments.
- To distinguish itself from the competition, it can make food with a French theme, priced competitively. The company can also set up shop in major grocery stores, as more people are purchasing prepared foods as part of the their grocery shopping.
- It would be a fair assumption to say that Le Seine can capitalize on its distribution and marketing experience in the US.

Practice Case 7 – Le Seine (pg. 3 of 3)

Key Findings

There seems to be potential in the prepared food segment (players like Boston Market).

Le Seine seems to be a good candidate to enter and take advantage of the present opportunity.

Recommendations

Based on this assessment, Le Seine should enter on a large scale. To offer competitive pricing, they must have economies of scale.

Quickly develop strong brand equity. Look at the franchising option. Examine in detail how the most successful fast food outlets operate.

Consider acquiring an existing chain versus starting a brand new one.

Location is extremely important. Know your customers in every region, and focus on convenience.

Practice Case 8 – Beer Brew (pg. 1 of 3)

Question

A major US beer company, Beer Brew, recently entered the UK market. Two years after entry, the company is still losing money. Despite a high per capita consumption of beer in the UK market, sales have been very disappointing. What explains this phenomenon?

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Recommended solution

High Level Plan of Attack

- Evaluate the product mix of the company and compare it to what is selling well in the UK.
- Analyze what type of marketing Beer Brew is using.
- Understand the consumer behavior and tastes, and determine the effect on sales.

Lay Out Your Thoughts

Consider using the profitability framework

- Understand which factor under revenue or costs is driving the decline in profitability.

Dig Deeper: Gather Facts/Make Calculations

•Let's begin with the product mix. What kind of beer has Beer Brew been trying to sell?

Currently, Beer Brew is selling two kinds of beer, a strong tasting and a light beer.

•How have the sales of both been doing?

The strong tasting beer is selling slightly below average and the light beer is not selling at all.

•What about marketing?

The company has spent more on marketing than the industry average for that region.

Practice Case 8 – Beer Brew (pg. 2 of 3)

- Is it a highly competitive industry? *It's about average.*
  The industry is fairly fragmented. There are no dominant players.
- Any problems with distribution channels?
  No.
- What about pricing and placement of the product?
  To be competitive, Beer Brew undercut its price significantly to try to capture customers. Their beer is sold just about everywhere other brands are sold.
- What are the current best sellers of beers in the UK?
  Guinness, Toby, and a few others.
- What kind common characteristics do they have?
  They are all moderate in alcohol level, dark, and strong tasting.
- How does that compare to Beer Brew's products?
  Beer Brew's strong tasting brand is higher in alcohol, and market tests show that it tastes better. The light beer is low in alcohol and calories, and again tastes great.
- Are there any light beers on the market?
  Very few. Mostly locally produced. Beer Brew saw this as an opportunity to cash in on the light beer industry that has taken the US market by storm.
- What about color? Are Beer Brew's two products dark beer?
  No, they are fairly light in color.
- Since most of the beer consumed in the UK is dark, and dark signifies strong beer, does the light color of the beer signal to the consumer that somehow the beer is weak?
  Perhaps, but the company figured that once the consumer tried it, the color wouldn't make any difference.

Practice Case 8 – Beer Brew (pg. 3 of 3)

Key Findings

- It seems that the consumer in the UK has unique drinking habits. After further inquiry, we find that the average British drinker values dark beer over any other factor. It seems that the dark color has a psychological impact on the consumer, relating it to strength, masculinity, getting their money's worth, etc.
- The light beer industry is undeveloped in the UK because the health movement in the US has not mobilized in Europe yet.
- Also, because the price of Beer Brew's products is much cheaper than other brands on the market, it is portrayed as a low quality "American beer." There has been a dilution of the brand equity.

Recommendations

- Change the color of the stronger tasting beer. Make it darker and advertise it as the better tasting darker beer, with more alcohol.
- Match the price to other premium beers that focus on the same market segment.
- Drop the light beer product line. The UK is not ready for it yet.

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Practice Case 9 – Wheeler Dealer (pg. 1 of 3)

Question

A major auto service chain, Wheeler Dealer, has enjoyed healthy returns on its 30-store operation for the past 10 years. However, management feels that the chain needs to expand, as the current geographical areas in which they are based have become saturated.
For the past couple of years, they have aggressively pursued a growth strategy, opening an additional 15 stores. However, it seems that this approach has had negative returns. For the first time in over a decade, the chain's profits dropped into the negative zone. You were hired to figure out why?

Recommended solution

<u>High Level Plan of Attack</u>

- You need to understand the nature of the business. What does the auto service entail?
- Focus on the customer segmentation. Are they serving more than one customer? Any differences?
- What is the profit structure of the different offerings?
- Where did they move? Are the newly formed stores operating differently or serving different markets than before?

<u>Lay Out Your Thoughts</u>

Consider using the profitability framework

- Focus on how revenue has changed given the environment.

<u>Dig Deeper: Gather Facts/Make Calculations</u>

- What type of services has Wheeler Dealer traditionally provided for its customers?

  There are two main businesses under each roof: off-the-shelf car parts and the garage mechanical services.

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Practice Case 9 – Wheeler Dealer (pg. 2 of 3)

- Are these services provided as well in the newly developed chains?
  Yes.
- Have competitors entered the market stealing market share?
  A *few competitors have entered the market, but not too many. The expansion was planned to explore new markets and prevent the competition from growing.*
- What about price? Have prices gone up to help defray some of the costs associated with growth?
  No, they have stayed the same.
- Given the two types of businesses for each chain, do they have the same profit margin?
  No. In fact, because the garage services cost the business a great deal more and the mechanics are very well trained, we charge a premium. Profit margin on servicing cars has twice the profit margin of off-the-shelf products.
- Are the customers the same for both businesses?
  No. The customer that uses the garage service tends to come from a mid-to-high income bracket. Those that use the off the-shelf auto parts tend to be of the lower-income bracket. They fix their cars on their own.
- Where has Wheeler Dealer traditionally been located?
  Mostly in, or very close to the suburbs.
- Has the geographical location changed as they expanded?
  Yes, They saw certain urban areas as very inexpensive. They located more in inner cities where there are a lot of used car sales.
- So, would it be fair to assume that the more profitable business, the garage service, has deteriorated and the sale of off-the-shelf parts has increased, causing overall profitability to go down?
  Yes

Practice Case 9 – Wheeler Dealer (pg. 3 of 3)

Key Findings

- The garage service is the major revenue generator for the business. As they expanded into the inner cities, they began to attract the wrong customer. Profit margin on the off- the-shelf products is not enough to cover costs and make a healthy return for Wheeler Dealer. A price increase is unlikely given price sensitivity.

Recommendations

- Scale back from the urban areas. Focus on geographical areas where you can attract the suburban customers who will use the service aspect of the business. Maintain a healthy return on the car product market from the inner city dwellers.
- Where possible, drop the garage service in under-performing areas to reduce costs and focus on the retail end.

Practice Case 10 – Travel Agency (pg. 1 of 3)

Question

A travel agency makes a 10% commission on all of its travel bookings. Their current profit before taxes is $1MM, while the industry average ranges from $2MM to $3.5MM. Why are they making less than the industry average?

Recommended solution

<u>High Level Plan of Attack</u>

- We need to understand the revenue stream and cost structure of the travel agency and conceptualize how each transaction contributes to the bottom line.
- Focus on the types of customers the agency services and how each type relates to profitability.

<u>Lay Out Your Thoughts</u>

Consider using the profitability framework

- Focus on the cost side of the equation

<u>Dig Deeper: Gather Facts/Make Calculations</u>

- What is the total gross revenue for the agency per annum, on average?
  $10 million.
- How does the revenue compare to other agencies with similar size?
  They are about the same.
- What about the product line? Does the agency handle any bookings other than travel tickets?
  No. They just book tickets for their customers.

Practice Case 10 – Travel Agency (pg. 2 of 3)

- What are the different customer segments that the agency services?
  There's the business traveler segment, which comprises about 40% of *total revenue, and the leisure traveler segment with the remaining 60%.*
- How many total transactions does the agency process and what is the break down for each customer segment?
  The total number of transactions is around one million per year. On average, about 300K go to the business segment, and 700K to the leisure.
- Is there a cost associated with each transaction?
  Yes, each transaction, regardless of which segment, costs $9.

[Now you have all the necessary information to calculate the profitability of transactions for each segment. If you run the numbers, you will find the following information.]

Segment	Share	Volume	Total Revenue	Revenue / Transaction	Cost / Transaction	Profit / Transaction	Gain
Business	60%	300,000	$ 6,000,000	$ 20.00	$ 9.00	$ 11.00	$ 3,300,000
Leisure	40%	700,000	$ 4,000,000	$ 5.71	$ 9.00	$ (3.29)	$ (2,300,000)
			$ 10,000,000				$ 1,000,000

Practice Case 10 – Travel Agency (pg. 3 of 3)

Key Findings

- The leisure travelers are draining your profitability. Either the cost per transaction is too high or the revenue per transaction made on the leisure is too low.

Recommendations

- Benchmark the cost structure of other travel agencies.
- Negotiate with the airlines on the possibility of charging a premium for leisure tickets or capture a larger commission through cost charged to the customer.
- Look into the possibility of reducing cost per transaction for the leisure travelers.
- Offer the leisure traveler other products to increase revenue per transaction such as hotel bookings and travel packages.
- Become a niche player and focus only on the business traveler

Practice Case 11 – Hospital (pg. 1 of 3)

Question

Our client is a 350-bed hospital in a mid-size city. The organization has historically exhibited strong financial performance, and had a 1-3% operating gain each year for the last five years. However, they are projecting a $12 million operating loss this year, and expect this situation to worsen in the future. As a result, the CFO believes that they will be out of cash within five years. They have asked us to identify the source of this sudden downturn, and to come up with alternatives to restore them to a break-even position. They are one of the largest employers in the market, and will not consider layoffs as a possible solution.

Recommended Solution

<u>High Level Plan of Attack</u>

This question addresses company profitability. The interviewer is looking for a candidate's business intuition and ability to apply this intuition to identify potential sources of the problem. In addition, the interviewer is looking for potential solutions to the client's problem.

<u>Candidate Response</u>

Candidate: Profitability is a function of an operation's revenues and costs. The first thing I'd like to focus on is the company's future revenue stream. As I understand the hospital industry, revenues may be fixed for several years due to long-term contracts with insurers. Is this the case for this hospital?

Interviewer: *Your intuition is correct. Revenues have dropped approximately 15% so far this year due to aggressive pricing on capitated managed care contracts that were signed in January and declining admissions and length of stay for their fee-for-service contracts, most of which are still reimbursed on a per diem basis. All contracts are binding for three years, and cannot be renegotiated*.

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Practice Case 11 – Hospital (pg. 2 of 3)

Candidate: Since revenue is declining at a fixed rate and fixed costs are high in the short-term, the hospital will have to analyze its variable cost structure. I would surmise that staffing costs are the main source of variable costs. However, the hospital cannot address this due to its policy concerning layoffs. I would think that the other main driver of variable costs for the hospital lies in its utilization of resources. Am I headed down the right track?

Interviewer: *In fact, you're right. The utilization of diagnostic and therapeutic services during a patient's stay is approximately 15% higher than what was expected when contract pricing was negotiated.*

Candidate: Given that information, the hospital should focus on changing physician behavior since physicians ultimately control the utilization of resources. The hospital may want to align MD incentives with those of the hospital by sharing risk, giving physicians data and education on their use of resources versus the competition. Other ways to reduce expenses could be to sign exclusive contracts with a distributor in order to generate volume discounts and economies in purchasing, or by reducing choice by limiting the pharmacy formulary to generics and decreasing the number of vendors utilized for high volume items such as prosthetics and heart catheters.

Interviewer: *That's a good discussion of cost implications, but have you given up on recommending ways to increase hospital revenue?*

Practice Case 11 – Hospital (pg. 3 of 3)

Candidate: Now that you mention it, the situation is not hopeless in this regard. The hospital may want to increase revenue by signing contracts with additional insurers, by putting salaried physicians on staff to guarantee that they admit to our client's hospital, or by creating an affiliated physician organization to increase their share of admissions. In addition, they can potentially leverage their distinctive competencies by developing Centers of Excellence that can be marketed to managed care contractors as an exclusive provider for those services within the region, and possibly outside the region.

Interviewer:*Are there any other solutions that may be feasible?*

Candidate: One final thought that keeps coming back to me centers on the company's current competitors. What does the local market look like?

Interviewer:*There are two other 350-bed hospitals in the city. One is an academic medical center, the other a catholic hospital recently acquired by a for-profit chain. Additionally, total admissions in the marketplace have dropped by 5% and total patient days have declined 10%.*

Candidate: In that case the hospital may want to consider affiliating with a competitor in the market. This may help to decrease capacity across the city by rationalizing the services offered at each institution. This may allow one hospital to close, thereby reducing fixed costs.

<u>General Summary Comments</u>

The candidate should fully address the components of this issue (profit = revenue - costs) and should be able to demonstrate an understanding of fixed vs. variable costs. Moreover, the candidate should be able to brainstorm possible solutions to the problem, both from a revenue maximization and cost minimization perspective.

Practice Case 12 – E-Grocery (pg. 1 of 4)

Question

The client is a grocery store chain that is considering whether or not they should enter the emerging Internet-based grocery shopping/delivery market in the Boston area. This regional chain is currently one of the leaders in the traditional grocery store market in northern New England. In their core market, two competitors have emerged in the Internet/at-home grocery shopping business, and are rapidly gaining market share. One of the companies that has already entered this new marketplace is the client's primary competitor in the traditional market. The second player is a chain that does not have grocery stores in the target region, but has entered the Boston area with Internet shopping delivery services.

Should the client enter the market? If so, how, and what concerns should they have? If not, how do they protect market share from the emerging market that is threatening to steal business?

Recommended Solution

High Level Plan of Attack

This is a market strategy issue. The interviewer is looking for a discussion of the client's customers, competitors, costs, core competencies and the overall market dynamics. In addition, the candidate should be able to present a solution and identify the key success factors for this solution.

Candidate Response

Candidate: The client must first do some preliminary work examining the market for groceries delivered over the Internet. I would like to get a better sense for the company's current customers, as well as potential customers, to see if the Internet is a viable delivery mechanism for the company. Can you tell me more about the client's customers in the area?

Interviewer: *The client serves primarily upper-middle class customers*.

Practice Case 12 – E-Grocery (pg. 2 of 4)

Candidate: That's important to know. I would guess that prospective users of an Internet-based delivery system are upper-middle class. Can you confirm this and elaborate on the growth prospects for this market?

Interviewer: *Your guess is correct. Users of the Internet delivery system are typically upper-middle class. As far as the market is concerned, home grocery shopping among Internet users is growing rapidly and the percentage of homes with Internet access is also growing.*

Candidate: We've established that the market is an attractive one, however I still need more evidence before presenting a recommendation. I'd like to now turn to the two competitors described in your opening. Can you explain their current market share?

Interviewer: *All three local players (including yourself) have an equal market share - roughly 15%.*

Candidate: And can you address recent growth trends among the competition?

Interviewer: *The competitor without stores in the target region is gaining market share more rapidly than the company with stores in the target region.*

Candidate: We've established pretty convincingly that the market is attractive. I'd like to now focus on our client. Clearly not all companies are prepared to put their operations on the Internet. There are two central issues I'd like to better understand. First, the company's core competencies—does it have the requisite skills to address the Internet user? Secondly, I'd like to understand the company's cost structure. Is such a move feasible for the client? Do you have any information on the company's distribution capabilities? Specifically, is it able to address the Internet market?

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Practice Case 12 – E-Grocery (pg. 3 of 4)

Interviewer: *The company's current distribution facilities are not adequate for the delivery system*

Candidate: How about the company's employees? Are they sufficiently trained to handle delivery tasks associated with the Internet?

Interviewer: *The current employees cannot perform these tasks without more training.*

Candidate: Those are some important considerations to ponder. However, given the market attractiveness for Internet groceries, the client would be crazy to pass up this opportunity. Its customers are Internet users, the competition has already shown a willingness to invest in the market, and the competitor with no stores in the region (i.e. totally reliant on Internet sales) is growing the fastest. That said, the company must be willing to invest in this market to succeed. First, it must improve its distribution capabilities. Further analysis must be done as to whether it should improve its current operations or develop a stand-alone capability exclusively devoted to the Internet market. Next, it must develop an inventory management system so that it can effectively track what it orders from suppliers, what customers are ordering, and where the product is delivered (Internet vs. traditional). Finally, it must spend enough money to cross-train its employees so that tasks associated with Internet delivery can be effectively performed.

Interviewer: *Are there any other considerations?*

Practice Case 12 – E-Grocery (pg. 4 of 4)

Candidate: When the company rolls out its Internet operations, it must not disappoint customers. Many of the Internet-based customers will be cannibalized from the traditional operations. In itself, this is not bad. These customers obviously prefer the alternative, and it's better for the company to retain them versus losing them to competitors. However, failure to deliver on Internet delivery will cause customers to consider switching to the competition. As such, the company must be sure it can effectively deliver on its promises from the moment it enters the Internet market.

<u>General Summary Comments</u>

The candidate does not necessarily have to recommend market-entry for this case. If the candidate believes the company should not enter the market, it must present a compelling business reason why and craft creative alternatives for market share protection. In either case, the key components of market strategy must be understood and addressed.

Practice Case 13 – Formula Producer (pg. 1 of 4)

Question

The client is a manufacturer and distributor of infant formula. They sell their product nationwide, and are in the middle of the pack in terms of market share. They are currently trying to boost their market share while maintaining profitability. There is a government welfare program called WIC (Women, Infants, Children) that allows individuals living below the poverty level to receive vouchers for infant formula for their children. Unlike most welfare programs, this one is subsidized by the actual producers of infant formula. On a state-by-state basis, infant formula producers bid for the right to be the sole supplier of infant formula to welfare recipients in that state. In addition to paying the government for the WIC contract, the client also provides rebates to retailers for WIC sales. As a result, income received from WIC sales is substantially less than that received from normal formula sales. In fact, sales to mothers that remain in the WIC program for more than 12 months result in a net loss.
In trying to determine how much to bid on a WIC contract for a given state, what factors should you consider?

Recommended Solution

<u>High Level Plan of Attack</u>

This case is fairly wide open, and presents an issue that is most likely unfamiliar and ambiguous. One challenge will be for the interviewee to find one or more issues that they can explore more in-depth. The basic focus of their analysis should deal with the relative profitability of a WIC contract.

<u>Candidate Response</u>

Candidate: I think for this case I would first look at who the typical WIC customer is, and the dynamic of the relationship, meaning how long are they a customer, and what kind of loyalty is there. Since I don't have any children, could you tell me more about a typical WIC customer, in regards to buying formula?

Practice Case 13 – Formula Producer (pg. 2 of 4)

Interviewer: *Sure. Obviously the typical WIC customer is poor, since this is a form of welfare. But some things you might not know are that 1) the average WIC recipient stays in the program for less than 12 months, 2) mothers typically remain loyal to a brand through infancy for their first child, but for subsequent children recipients often switch back and forth between brands, and 3) infants typically require formula the first 22 months of their life.*

Candidate: Thanks. With that knowledge, I can start to think about the issues facing this company. In trying to decide the terms for the contract, profitability is the primary driver. There's obviously some issue of social-enterprise here, but even so, I think profitability will drive much of the decision. Since the WIC recipient gets rebates in addition to the subsidized cost of the product, we need to quantify that rebate in order to understand what the profitability per recipient is. Can you tell me that?

Interviewer: *For the purposes of this interview, let's assume that the rebates average an additional 10% (off of the retail price).*

Candidate: OK. So the profit per customer might be determined by (WIC revenue - rebates - COGS). So if the revenue is $100/customer/year, and the rebates are $10, and COGS are $75, we make $15 per customer per year. As long as we're paying less per customer for these rights to be the sole-supplier, we're in the black.

Interviewer: *For the most part, your logic is correct. But is there anything else that might be a factor in determining profit?*

Practice Case 13 – Formula Producer (pg. 3 of 4)

Candidate: Well, related to the actual profitability of the WIC product I'm not sure. But maybe there are some hidden costs or revenues that I'm not thinking about. In fact, maybe there are some synergistic revenues that the company can achieve. If they get the contract, that gets them additional shelf-space in the stores. And not just WIC recipients shop in the stores. So maybe they will be able to increase market-share, just by being on the shelf. Of course, they are getting full retail price for those sales. So I might add in an additional sales minus COGS to the equation. But to try and get an idea of that figure might be tough. How long to these contracts last?

Interviewer: *Typically, several years.*

Candidate: Ok, so knowing that a contract is several years, say 5, we can begin to get a total dollar value for the contract. If we know how many WIC recipients there are in this state that we're bidding, we can calculate expected revenues. Also, if we can get an idea of how much shelf space we would have, we can quantify the synergistic sales.

Interviewer:*Good. I'm not going to make you go through the math on it, because we're about out of time, but you're right. There are 1.2 million WIC recipients in the state, and shelf-space is awarded based on volume sales. So for this company to get the contract, it can help them have more sales volume, and thus more shelf-space, and hopefully then more market share.*

Practice Case 13 – Formula Producer (pg. 4 of 4)

<u>General Summary Comments</u>

Ultimately, they should come up with some sort of explanation for how numbers would be run to estimate an appropriate contract bid. One example might be:

(WIC revenue - rebates - COGS) + (synergistic non-WIC revenue - COGS) >= Contract Bid
COGS takes into account economies of scale.

Real world situation is that synergies are strong, and WIC recipients bounce in and out of program but stay loyal to product for first-borns. Not only are the synergies positive, but also on average WIC recipients are profitable because they pay retail for nearly half of the formula that they purchase over the first 22 months of their child's life.

Practice Case 14 – Pharmaceutical Company (pg. 1 of 7)

Question

Our client is the U.S. pharmaceutical division of a multi-national corporation. In about six months the division will receive FDA approval to launch an anti-depressant drug. Despite this apparent good news from the FDA, the U.S. division is not elated. It has concerns over the market potential for this drug and its ability to reach the key prescribers in this therapeutic category. We have been asked to help determine whether they should
1) launch alone, 2) co-market with a partner, or 3) sell, license or swap the drug.
The concerns over market potential center on whether the drug can gain adequate competitive advantage in a market segment having two dominant, patent-protected competitors and nearly 100 generic competitors. Additionally, a higher technology antidepressant, which appears to offer therapeutic advantages, was recently introduced by a competitor.

Gaining the professional endorsement of psychiatrists is crucial to success in this therapeutic category since they write approximately half of the prescriptions for antidepressants. However, the division has no experience marketing drugs to this physician group. Consequently, it would have to hire a sales force and/or enter into a co-marketing agreement to gain access to psychiatrists through someone else's force. The client would be able to leverage its existing sales force to reach the other half of the prescribers (Internal Medicine Specialist and Family and General Practitioners).

How would you help them decide whether to 1) launch alone, 2) co-market with a partner, or 3) sell, license or swap the drug to a third party?

Recommended Solution

<u>High Level Plan of Attack</u>

Note here what is being asked, "How would you help them decide." What is not being asked is "Which is the correct option to choose?" The Interviewer is looking more for how this problem is approached than for the "correct" answer.

Practice Case 14 – Pharmaceutical Company (pg. 2 of 7)

Candidate Response

Candidate: In helping the client decide which option they should choose, I will want to guide them to the option that will create the most value. To understand main value drivers (i.e., profitability drivers), I will first explore the market attractiveness and our competitive position within that market in order to determine revenue potential. After that, I will explore the major cost issues. Starting with the revenue, I'll want to understand first what the overall market revenue opportunities are for this type of drug in addition to our product specifically. Now, the client expressed concern over the market potential for this drug. How big is the market and what is its potential growth rate?

Interviewer: *The overall antidepressant drug market is relatively attractive at $1.1 billion per year and is growing well in excess of the population growth rate.*

Candidate: You mentioned that concerns over market potential center on whether the drug can gain adequate competitive advantage in a market segment having "two dominant, patent-protected competitors and nearly 100 generic competitors." You also mentioned that a higher technology drug had entered the market. Is the antidepressant market segmented by technology?

Interviewer: *Yes.*

Candidate: And the two patent-protected competitors along with the 100 generic competitors are within our technology segment?

Interviewer: *Correct.*

Candidate: So, the overall antidepressant market is attractive at $1.1 billion, but within that market, there are segments based on different types of technology that may or may not be attractive.

Practice Case 14 – Pharmaceutical Company (pg. 3 of 7)

Interviewer: *That's correct.*

Candidate: What is the technology associated with our client's product?

Interviewer: *Tricyclic antidepressants*.

Candidate: How fast is this technology segment growing?

Interviewer: *As a matter of fact, substitution by the new technology may cause a decline in sales over the next 5 years. Additionally, the existing competitive environment is very intense and will only increase if the market shrinks.*

Candidate: So, the overall segment is not very attractive.

Interviewer: *Correct.*

Candidate: What percent of the volume do the two main competitors have?

Interviewer: *In our own technology segment, the leader has approximately 10% and the number two player has about 4%. The rest of the 100 competitors each has less than a 2% market share. By comparison, the new technology has captured a 20% market share of the total antidepressant market.*

Candidate: How much will our client's product be able to differentiate itself within our technology segment?

Interviewer: *Not much. In a market research study we commissioned, the product was seen as very similar to the number two product in our technology segment, slightly inferior to the number one product, and slightly better than the generic products. The new technology was viewed as far better due to a lower level of sedation.*

Practice Case 14 – Pharmaceutical Company (pg. 4 of 7)

Candidate: So to summarize the market environment, although the anti-depressant market is attractive, the segment that we would be participating in is relatively unattractive and runs the risk of becoming smaller and more competitive over time. Additionally, within this unattractive segment, we have limited ability to differentiate ourselves relative to our competitors, and thus, will not be able to charge a premium price. I would think that this unattractive market and relatively undifferentiated position within that market would translate to a lower market share. I would estimate that our share might be lower than either of the branded products given our new presence in the market, say maybe a 2-4% share and this, like the rest of the segment, would probably decline over the next couple of years.

Interviewer: *That sounds about right.*

Candidate: Knowing that our revenue potential is relatively low puts more pressure on minimizing the costs if we were to market the drug. I want to see what area within the cost structure impacts profitability the most. What percent of net sales is COGS?

Interviewer: *About 20%*

Candidate: And what is the bulk of the remaining line items?

Interviewer: *Most of it is selling expense. There are some overhead/admin and advertising and promotional expenses, but most of it is selling expenses.*

Candidate: So, selling expense is the largest portion of the cost structure, which means that whichever option we choose, launching alone vs. with a partner will certainly impact the selling expense (in addition to the number of prescribers reached, thus revenue potential). In understanding the effect of the co-market agreement on number of prescribers reached, I think it would be helpful if I could get an idea of who makes the purchasing decision.

Practice Case 14 – Pharmaceutical Company (pg. 5 of 7)

Interviewer: *Well, there are four main parties involved. There are the manufacturers (such as our client), the doctors (who prescribe the drug), the druggists (who fill the prescription) and the patient (who initiates the transaction). Selling is concentrated on the doctors, since they are the group that determines if medication is needed and, if so, what type.*

Candidate: Is the growth in managed care going to influence the dynamics of this?

Interviewer: *Yes, but for the purposes of our work, let's not address that.*

Candidate: So, for the purposes of our work, the doctors make the purchasing decisions, this includes two groups of physicians, the Psychiatric group and the Internal Medicine/General Practitioner group.

Interviewer: *Correct.*

Candidate: You noted that we don't currently have connections to psychiatrists. This group prescribes half of the antidepressants. Can we launch the drug by only marketing to IMs and general practitioners and ignoring psychiatrists?

Interviewer: *No, they are at the top of the pyramid of influence and thus must endorse the drug before their colleagues in the IMP/GP will endorse it.*

Candidate: So if we are to market this product, we cannot do so without the Psychiatric group. The weight of the decision then becomes a matter of what is the most efficient and effective way to reach them—either through a newly hired sales force or with a co-marketing agreement.

Interviewer: *Correct.*

Candidate: What are the advantages and disadvantages of marketing the drug ourselves?

Practice Case 14 – Pharmaceutical Company (pg. 6 of 7)

Interviewer: *In terms of having our own sales force, the main benefit would be that we would be concentrating on our product only and this may help sales. On the downside however, the cost of this focus is all attributed completely to our product, and having a dedicated sales force representing only one product would be expensive.*

Candidate: Do you have any other psychotheraputic drugs in development or plans to expand this part of your portfolio through licensing?

Interviewer: *Nothing is planned for the next three years.*

Candidate: So by entering a co-marketing agreement, the costs of the sales force is spread across several products, and, if the co-marketer did not have a competing product, then our product would get the appropriate selling attention warranted. Also, since this sales force has existing relationships with the psychiatrists and doesn't need to take time to further establish these relationships, sales of our product might peak sooner. So, all in all, I would think that if we were to market this product, it would be a less costly and higher value option to enter into a co-marketing agreement rather than go it alone.

Interviewer: *OK, and what about the third option, to sell, license or swap the drug to a third party?*

Candidate: Again, the client would want to choose the option that was more value creating. There could be several reasons for going with the third option: We might sell our drug because the sum of the promotional or overhead costs may make it unprofitable for us to market whereas a company having a similar product line might be able to carry this product at a very small incremental cost. We might license it for the same reasons we would sell it. We might swap it if we could find a company needing this type of drug while having a drug that might fit more with our existing infrastructure. In any case, for the options being considered, I would want to forecast cash flows and discount them back to see what option is more value creating before making a final recommendation.

Interviewer: *OK, thank you for your input on how to approach this problem.*

Practice Case 14 – Pharmaceutical Company (pg. 7 of 7)

<u>General Summary Comments</u>

The Candidate doesn't actually make a final recommendation. This is fine. The Candidate has demonstrated how he would approach the problem, and in doing so, has hit on many of the key issues you would find in a real client case situation.

Recapping the steps the Candidate took into evaluating the client's options:

On the revenue side:

- Segmented the market to the appropriate technology level.
- Determined that the segment was unattractive .
- Determined that the client's product was not significantly differentiated.
- Concluded that for these reasons, the revenue potential was limited.

On the cost side:

- Determined that selling expense was a key component to profitability.
- Determined that the Psychiatric group needed to be included in the selling efforts.
- Determined that it would be less expensive to co-market vs. go it alone.
- Determined that there are other considerations to evaluate when comparing co-marketing vs. selling, licensing, or swapping the product

Another important point to note is that as with most case interviews, the Candidate has the opportunity to go "deep" into an issue. The Candidate chose to do so with one type of cost, the **sales force**. The Interviewer is looking to see if the Candidate can identify some of the key "value" drivers of the function being explored. In the case of the sales force, the Candidate correctly identified the key value drivers as being:

- The ability to spread the cost of a sales call across multiple products.
- The ability to choose a co-marketer that needs this product in their existing product line.
- The ability to leverage an existing psychiatric sales force infrastructure to reach peak sales sooner.

Practice Case 15 – Regional Jet Corporation (pg. 1 of 10)

Question

Regional Jet Corporation is a U.S. manufacturer of regional airplanes-airplanes with 100 seats or less. Its business consists of two types of aircraft: (1) jet engine, 80 to100-seat aircraft and (2) propeller, 20 to 30-seat aircraft. In fiscal year 1999, Regional Jet delivered 100 jet engine aircraft and 150 props. This represented a unit volume increase year-over-year of 10% and 5%, respectively, and revenues of $730 million and $225, million, respectively.
Although overall profitability for Regional Jet in 1999 was a competitive 5% economic profit margin, profitability varied significantly by business. The prop business generated a stellar 30% profit margin, while the jet engine business was unprofitable with a margin of 3%. Over the past several years, Regional Jet has experienced eroding profitability in its jet engine aircraft business. Its prop business, despite being profitable, has been flat in most recent years.

At a January 5th analyst conference (a meeting with the investor community) Regional Jet's senior management team announced that the company was committed to managing for value.

To this end, Regional Jet has hired you and a team of consultants to help the company develop and implement the value-maximizing strategies for its businesses.

For our case discussion today, please focus on the jet engine aircraft business:
How would you go about further analyzing this business?
What recommendations would you like to make to senior management?

Please see handouts #1, #2, & #3 on following pages

Practice Case 15 – Regional Jet Corporation (pg. 2 of 10)

Handout #1

Regional Jet Corporation
Profitability by Business (1999)

	Jet Engine Aircraft Business		Propeller Aircraft Business	
	Amount ($mm)	**% of Total**	**Amount ($mm)**	**% of Total**
Revenues	$730	100%	$225	100%
COGS	$(588)	(8l)%	$(86)	(38)%
SG&A	$(84)	(l2)%	$(l6)	(7)%
Delivery & Other	$(42)	(6)%	$(8)	(4)%
Taxes (40%)	$(15)	(2)%	$(46)	(20)%
Net Income	$1	0%	$69	31%
Capital Charge (10%)	$(21)	(3)%	$(3)	(l)%
Economic Profit	**$(20)**	**(3)%**	**$66**	**30%**

Note: Assume debt-to-total capital of 70%

Practice Case 15 – Regional Jet Corporation (pg. 3 of 10)

Handout #2

Jet Engine Regional Aircraft Business Per Aircraft Economics and Profitability by Customer Segment (1999) Per Aircraft Economics (1999)

(thousands)	**Per Aircraft Cost**
COGS	$(5,880)
SG&A	$(840)
Delivery & Other	$(420)
Taxes	$(504)
Capital Charge	$(214)
Total Economic Cost	**$(7,858)**

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Practice Case 15 – Regional Jet Corporation (pg. 4 of 10)

Handout #3

Profitability by Customer Segment

(millions)	**Customers Who Buy 1 Aircraft**	**Customers Who Buy 3 Aircraft**	**Customers Who Buy 20 Aircraft**
# of Customers	5	11	3
Revenues	$42	$280	$408
COGS	$(29)	$(206)	$(353)
SG&A		$(29)	$(50)
Delivery & Other		$(15)	$(25)
Taxes		$(12)	0
Net Income	$4	$18	$(20)
Capital Charge	$(l)	$(7)	$(13)
Economic Profit	$3	$11	$(33)
# of aircraft delivered	5	35	60
Share by Segment	2%	33%	50%

Practice Case 15 – Regional Jet Corporation (pg. 5 of 10)

Recommended Solution

<u>Interviewer Guide</u>

Case Summary:
Regional Jet Corporation is losing money in one of its two business units: jet engine aircraft. However, the market for jet engine aircraft is profitable. Although Regional Jet has a parity offering and operating position, it has a disadvantaged overall competitive position, driven by a pricing disadvantage in serving its large lessor customer segment. Lessors, in purchasing large volumes of aircraft, have been able to exert significant buying power over our client to achieve large price concessions.

I. Market Economics
An "A " candidate should seek to understand market size, growth and profitability, as well as conduct an indirect structural assessment of the industry, e.g., suppliers, customers. Information to be provided to student if asked, although some may require prompting:

Market Size:	In 1999, the U.S. jet engine, 100 seat or less aircraft market was -$5 billion.
Competitors:	There is no dominant competitor in the jet engine, 100 seat or less market. The market leader has 20% market share. There are 4 other competitors with market share from 12% to 18%. Regional Jet Corporation has -16% share.
Market Growth:	The market has been growing -5% (in units delivered) each year for the past 5 years and is expected to continue to grow 5% over the next decade. In 1999, a total of 625 jet engine regional aircraft were delivered to customers.

Practice Case 15 – Regional Jet Corporation (pg. 6 of 10)

Market Profitability: *Ask the student whether he/she thinks the market is profitable, and how he/she would go about assessing market profitability.* (Answer to be provided post discussion on structural forces below - The market is profitable with the average competitor generating 4% economic profit margins over the past 5 years):

Supplier Power: The supplier base for regional aircraft parts is highly fragmented and Regional Jet uses approximately 50% proprietary parts in its jet engine aircraft. Hence, supplier power is **low**.

Intensity of Competition: *(Direct)* Fairly concentrated market with only 6 jet engine regional aircraft manufacturers. Hence, intensity of direct competition is **low-to-moderate**.

Customer Power: In 1999, there were 225 customers. Types of customers include airlines, aircraft lessors, local and national governments, businesses and private individuals. Hence, customer power **varies by segment**.

~ *Only if the student asks about customer power, share with him/her the following facts:*

Aircraft lessors make large purchases (often 20 or more aircraft) during a buying cycle and hence exploit their negotiating leverage over manufacturers, such as Regional Jet. Hence, aircraft lessors have **high** customer power. All other customers have **low-to-moderate** buying power, depending on their credit worthiness.

Intensity of Competition: *(Indirect)* Larger commercial jets (100 seats or greater) with longer range manufactured by large commercial aerospace and aircraft manufacturers can be used on regional routes. However, these larger aircraft are expensive for customers to operate solely on a regional basis. Hence, intensity of indirect competition is **low**.

Barriers to Entry: Jet engine, regional aircraft manufacturing requires significant capital investment in production facilities and equipment, as well as strong relationships with various labor unions. Hence, barriers to entry are **high**.

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Practice Case 15 – Regional Jet Corporation (pg. 7 of 10)

II. Competitive Position

An "A" candidate should seek to understand competitors and Regional Jet's offering, pricing, and operating position.. Information to be provided to student if asked, although some may require prompting:

Offering position: Overall, the company's offering position is at **parity**.

Commonality: The company's jet engine aircraft has a cockpit that is similar to the industry standard and results in low switching costs for new customers (pilots and flight crew do not need extensive re-training).

Performance: The company's aircraft offers a range of 500 miles, which is similar to the market average.

Maintenance and Asset Life: The majority of the fragmented jet engine aircraft maintenance companies have the capabilities and parts to service Regional Jet's aircraft. For the aircraft customer, maintenance costs over the life of the asset is in line with regional jets of the company's competitors. On average, the life of the aircraft is 20 years.

Pricing Position: *Question for the student: Based on the discussion thus far, what does he/she think that the company's pricing position is relative to competitors?*

Answer: *Regional Jet is pricing below the market average, since it is gaining market share (unit volume is growing at 10% vs. market growth of 5%) with a parity offering. Hence, Regional Jet is pricing for share, i.e., in 1999 it had a* ***disadvantaged*** *pricing position.*

Operating Position: Regional Jet's operating cost per aircraft is at **parity** with the industry. Every jet engine aircraft the company delivered in 1999 cost approximately the same to produce.
The student should recognize that achieving scale is critical to the spreading of fixed costs, and hence, the lowering of per unit costs.

Practice Case 15 – Regional Jet Corporation (pg. 8 of 10)

III. Regional Jets Customers

Customer Segments: Regional Jet serves 3 types of jet engine aircraft customers:

- o Customers who purchase only 1 aircraft in a buying cycle (approximately every 5 to 15 years, depending on the customer)
- o Customers who purchase 3 aircraft, and
- o Customers who purchase 20 aircraft

At this juncture, the student should inquire about customer segment profitability. Provide the student with the handout: "Jet Engine Regional Aircraft Business - Profitability by Customer Description of Segments:

- o Customers who buy only 1 aircraft during a buying cycle are comprised mostly of small aircraft customers with moderate-to-high credit risk.
- o Customers who buy 3 aircraft are comprised mostly of medium aircraft customers with moderate credit risk. o Customers who buy 20 aircraft are comprised of creditworthy aircraft lessors.

Key Driver of Segment Profitability*:*

If the student has not discussed it already, at this point in the case, he/she should recognize that the 3 aircraft lessors in making large purchases during a buying cycle exploit their negotiating leverage over Regional Jet.

The data to support this can be quickly calculated by the student by referencing the **"Profitability by Customer Segment" handout**: *\$408M/60 aircraft = \$6.8M average sales dollars per aircraft from aircraft lessors, compared to \$8.4M to small aircraft customers and \$8.0M from medium aircraft customers.* [Ask the student to compute average price by customer segment, if he/she has not done so without being prompted.] Of course, the student should be able to conclude that the main driver of profitability between segments is solely price without doing any math, since operating cost per aircraft produced and delivered is the same regardless of the intended customer.

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Practice Case 15 – Regional Jet Corporation (pg. 9 of 10)

IV. Overall Competitive Position

Question for the student: Does he/she think that the company's overall competitive position is advantaged, disadvantaged or at parity?

Answer: Regional Jet is competitively disadvantaged overall with negative profits (compared to a profitable market) driven by a disadvantaged pricing position, particularly to the large lessor customer segment.

V. Alternative Generation

Key Question: What are some strategy alternatives that Regional Jet can pursue in order to improve its jet engine aircraft profitability?

<u>Potential alternative #l:</u> Aggressively pursue new small and medium, non-aircraft lessor customers <u>and</u> do not increase sales to existing aircraft lessor customers.

Ask the student what key questions he/she would seek to answer in the evaluation of this alternative. *Key risks may include a slow road to profitability and unlikely to result in the doubling of the jet engine aircraft business' value.* Ask the student to compute how long it would take for Regional Jet to double the economic profit of the business given the company acquires new small and medium, non aircraft lessor customers at the market growth rate of 5%.

<u>Potential alternative #2:</u> Aggressively pursue new small and medium, non-aircraft lessor customers <u>and</u> do not serve any aircraft lessors.

Ask the student what key questions he/she would seek to answer in the evaluation of this alternative. *Key risk may include the inability to achieve scale (currently at 100 units, with 60% of units purchased by aircraft lessors), and hence, profitability in any customer segment.*

<u>Potential alternative #3:</u> *(see next page)*

Practice Case 15 – Regional Jet Corporation (pg. 10 of 10)

<u>Potential alternative #3:</u> Regional Jet to increase its negotiating leverage vis-a-vis aircraft lessors by entering the aircraft leasing market.

Ask the student what key questions he/she would seek to answer in the evaluation of this alternative

Some facts to share with the student:

- The jet engine, regional aircraft leasing market is large and growing. In 1999, the new aircraft leasing market represented almost 50% of all new aircraft delivered (with operating leases comprising half) and is expected to grow 5% per year.
- The aircraft leasing market is profitable with the average competitor generating ROEs of ~15% (cost of equity ~10%).
- Three aircraft lessors (also Regional Jet's customers) dominate the market wish a combined share of 65%.
- The key driver of profitability is cost of funds.
- Regional Jet currently provides vendor- or manufacturer-financing on a very limited basis in the form of leases.
- Regional Jet would be at parity in terms of cost of funds.
- Regional Jet has marketing relationships with all aircraft end-users who are leasing their aircraft from the company’s aircraft lessor customers. Regional Jet works with these end-users to help them configure the plane during the front end of the sales process.

Practice Case 16 – British Times (pg. 1 of 3)

Question

You're a new senior strategy associate and have just finished your orientation training. You are immediately assigned to our British Times team.

The British Times is an upscale, highly respected newspaper. It is the most widely read newspaper in Great Britain, especially its very strong business and financial section. The paper is a cross between the Wall Street Journal and the New York Times, both in content as well as in reputation.

The team has already had one meeting with the newspaper's online spin-off: BritishTimes.com. You are going to join the team for the second meeting, which will be held with only the CEO of the BritishTimes.com. Currently, their web site is nothing more than an online version of the newspaper, otherwise called brochureware.

The newspaper's and the web spin-off's single biggest asset is the highly respected brand name**: British Times**. The purpose of this second meeting is for the consulting team to present its response to the CEO's current predicament: How to realize greater revenues from their current online spin-off (BritishTimes.com).

<u>Additional Background</u>

- BritishTimes.com conducted a viewer survey, receiving a high enough number of responses to be statistically significant, allowing them to feel comfortable using the following information for planning purposes.
    - Their web site has a large number of hits, only 30% fewer unique visitors than the number 1 site in the UK.
    - Their hits are from viewers in the 75th percentile of customer income.
    - Their viewers are also highly educated: 60% have a university education and 30% of whom have graduate degrees.

Continued on next page

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Practice Case 16 – British Times (pg. 2 of 3)

Candidate: In general, it's fair to say that the bulk of Internet revenues comes from three sources: advertising, subscriptions, and transactions. I think that the key to helping the CEO is to tailor these initiatives to BritishTimes.com core assets.

Interviewer: *Good points. Can you give me more details on each of these sources of revenues?*

Candidate: Well let's look at advertising first. We could suggest two avenues: banner ads and corporate sponsorship. Upscale or corporate banner ads such as insurance companies, banks, or brokerage firms would make a lot of sense with our audience. They are highly educated and more importantly, have the highest level of disposable income. In addition to banner ads, we should look into corporate sponsorship. We should take full advantage of the fact that the strong business section can obtain corporate sponsorships; for example, banks or e-trade companies pay for their section of the site.

Interviewer: *Good. They do some of that already but probably not as much as they could. You also mentioned other sources of revenues. Could you explain your subscription model?*

Candidate: We could imagine a three-tier approach. For example, in tier 1, readers could have access to today's news for free. For a small fee, Tier 2 subscribers could research up to one-week-old articles in the archive. Finally, in the last tier, subscribers could have access to the entire archive.

Interviewer: *Coming from a traditional publishing company, they are fairly familiar with these two models. I would be interested in hearing more about your third option.*

Candidate: One way to "monetize" their attractive audience would be by offering targeted products and services. Some examples could be a tollbooth model. This would clearly require a deep analysis of the competitive landscape and of the company's capability (technical, people...) to start a completely new line of business. These products or services would have to be: High margin, Upscale, Highly profitable vertical businesses; for instance: golf store, tax advice, investment advice, upscale travel (cruises, etc.)

Practice Case 16 – British Times (pg. 3 of 3)

Interviewer: *Golf equipment? This is interesting. How would you go about sizing the market for golf equipment in the UK?*

Candidate: To determine the golf store's (equipment only) first year total revenue, we would have to figure out the following:

- The population of the UK
- The percentage connected to the Internet in the UK
- The number who browse this site
- The number who browse the golf store
- The number who buy from this site: the buy to browse ratio
- The average amount spent per transaction
- The number of times they buy per year
- The commission received by BritishTimes.com

There are approximately 60 million people living in the UK. If we assume that a third of them are connected to the Internet, we have:	60M x 1/3 = 20M
If we assume that 20% of the people connected will visit the British Times site, we now have:	20M x 20% = 4 million visitors
Not all of them will click on the golf site. Probably about 20% will do. We can now estimate the number of people browsing the golf site:	4M x 20% = 800,000 visitors
If we assume that only 10% of them will actually purchase on the site, we now have:	800,000 x 10% = 80,000 buyers.
Each buyer may spend on average $100 each time they visit and they may visit the site 2 times each year. If we assume a 5% margin, we now have a rough idea of the golf equipment first year revenues:	80,000 x $100 x 2 x 5%= $800,000

Practice Case 17 – Children Clothes Retailer (pg. 1 of 4)

Question

It's a Friday afternoon. You've just accepted an offer to join our consulting company as a Senior Associate in the Business Strategy Competency. You've just called in to confirm your start time on your first day and find out you have an excellent opportunity to be the lead business strategist on a high profile project. We have partnered with a leading bricks-and-mortar children's apparel retailer to help them analyze, design, and build their Internet strategy. There will be a kick-off meeting for the project with the client (including the client's CEO) on Monday morning. The Principal/Engagement Leader on this project has asked you to lead a discussion about how the client should think about opportunities on the Internet. Right now, the client only has a marketing and informational presence on the web (a.k.a. "brochureware"). The Principal/ Engagement Leader wants the client to think about the range of opportunities and challenges the Internet presents and whether the client should invest aggressively in pursuing any initiatives.

<u>Additional Background</u>

- The client's web site and some associated articles found on the Internet have provided the following information.
- The client is a publicly traded company with a $3B market cap. The share price has risen from $15 to $45 in the past 12 months.
- The client has 300 stores, mostly east of the Mississippi, and all stores are within the U.S.
- Revenues are approximately $250M, and the firm has average profitability for its industry.
- The client has been on a rapid store expansion program adding about 25 new stores each quarter for the past two years. They claim to expect similar growth going forward.
- The market for this client is clothing for children 12 and under. Sales are roughly split between boys and girls.
- The company is vertically integrated: It designs all its own products, has deep relationships with contract manufacturers in Asia, and distributes all of its products through company owned stores.
- The company sells a high quality product that is priced about 25-30% lower than its chief competitors.
- The company has done only limited marketing. The brand remains relatively unknown.

Practice Case 17 – Children Clothes Retailer (pg. 2 of 3)

<u>Your Challenge</u>

Part I. Plan for the client meeting. Structure the problem at hand. What questions would you ask? Then, work with your interviewer to explore and broaden those questions and brainstorm the client's hypothetical responses.

Recommended Solution

To present the best solution, the candidate must have a better understanding of the customers, the competitors and the client. Some of the important questions to ask are:

Market and Competitive Landscape:

- What are the main trends and dynamics going on in the client's industry?
- What are their competitors doing?
- Who are they?
- What are the brick-and-mortar children's apparel retailers doing?
- How are they using the Internet: Has there been a direct causal relationship to their revenues and/or expenses from their Internet strategy and implementation?
- What are the Internet pure play apparel retailers doing?
- Who could some of the oblique or peripheral competitors be?
- Would they be likely to enter the market?

Customers:

- Who are the client's customers?
- What is the value proposition to the client?
- What are the trends in the customer base over time?

Client:

- What are the client's goals?
  - To increase revenues? To reduce costs? To increase market capitalization?
  - How could different Internet initiatives accomplish each of these goals?

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Practice Case 17 – Children Clothes Retailer (pg. 3 of 4)

<u>Your Challenge</u>

Part 2. Quantitative analysis

After spending part of the weekend preparing for your kick-off meeting and discussion facilitation, you check your voicemail from the airport before hopping onto the shuttle on your way to the client's office for the meeting. The one new message is from your Principal/Engagement Leader asking you to provide an estimate of the size of today's online component of domestic children's apparel sales and how large it might grow in the next 5 years. As you step onto the plane, you realize that you'll have no access to the Internet or other research before the meeting starts. Instead, you will need to create a "back-of-the-envelope" analysis on the plane.

Spend about 5 minutes creating an answer to these two questions:

- What would you estimate the size of today's online component of domestic children's apparel sales today?
- How large do you think it will grow in the next 5 years?

Recommended Solution

<u>Estimation Process</u>

Assume the children's apparel category is dollars spent on clothes for kids ages 12 and under, as stated in the case facts. There are approximately 275M people in the U.S., perhaps 15% are under 12.

Assume the average parents spend $250 on each kid age 12 or under each year.

Of the people who spend this $10B, assume 35% of them have Internet access and have the potential to shop online. Therefore, the theoretical **current maximum potential size of the market is $3.5B**.

<u>Calculation</u>

275M x 15% = approximately 40M kids under the age of 12.

40M kids x $250 = $10B children's apparel industry for kids 12 and under.

Practice Case 17 – Children Clothes Retailer (pg. 4 of 4)

Estimation Process

However, just because people use their online access to buy their kids' clothes doesn't mean they spent all $250 for each child online for their apparel. In fact, only a small fraction of those dollars are spent online today, perhaps 5% (a.k.a. share of wallet).

In the next five years, let's assume the number of kids increases to 42M, average spending goes to $300 per kid age 12 and under, Internet access rises to 55% and share of wallet rises to 20%.

The 5-year growth estimate would be:

Calculation

5% x $3.5B = $175M

42M kids x $300/kid x 55% x 20% = $1.4B

Practice Case 18 – The Video Store (pg. 1 of 4)

Question

Two business school classmates laud their entrepreneurship intentions and mock your interest in entering the management consulting industry. They decide that despite trends that indicate otherwise, what is needed is a video rental store closer to the HBS campus. They try to convince you to join, but in your infinite wisdom you instead join a prominent strategy consulting firm in Boston. Their first two years meet unprecedented success. They buy matching Porches and a townhouse in Beacon Hill. Needless to say, each time you meet up for social occasions, they share with you (mostly with tongue in cheek) their success and a "I told you so" attitude. You handle their jabs well, as you feel you have had a terrific experience at your consulting firm.

The story, however, changes in about 12 months. Despite two and a half years of dramatic profit and revenue growth, profits have dramatically fallen. They call you (with a fair amount of egg on their face) and say "we don't know what happened and our mortgage and car payments are getting tougher to meet. Can you help us? We know that you help CEO's of large companies get to the bottom of their issues." With more than a little satisfaction and justice in your voice you agree to help.

What do you think the problem is?

Recommended Solution

This is an example of a case where the student must probe to get to the heart of the matter. The student needs to ask questions which first diagnose the situation and then (and only then) talk about causes of the situation and then (and only then) talk about areas of improvement.

Practice Case 18 – The Video Store (pg. 2 of 4)

Here are questions that the student should ask to get to the analysis that will help them diagnose the problem:

Have costs increased?
Have revenues declined?
Have prices been changed?
Have new video stores opened in the area?
Are fewer customers coming to the store?
Are customers renting fewer videos?
Have other entertainment venues opened in the area?
Have their been economic changes in the area?

These key questions will get behind what is happening (competitive changes, pricing adjustments, macro factors, people not coming to the store, or people just not renting as many videos, etc.)

Candidate: If profits have declined then I assume that either revenues have declined or costs have increased, what is the case?

Interviewer: *Revenues have decreased. Why would you think that cost is probably not the problem?*

Candidate: Video rental is a high fixed cost business - rent, videos, and labor are all fixed in the context of rental revenue. Thus, the business' profits will be susceptible to changes in revenues (capacity utilization). Revenues are made up of the number of videos we rent in a year and the price we charge. Has the management changed the price of the videos?

Interviewer: *No. What does that tell you?*

Practice Case 18 – The Video Store (pg. 3 of 4)

Candidate: That means that either fewer customers are coming to the store or each customer on average is renting fewer videos. Which is it?

Interviewer: *How would you figure that out?*

Candidate: The security system probably has a counter so that could tell us store traffic, and clearly the register receipts could give us number of videos rented per day. We can look at that data last year versus this year and determine whether there is a traffic problem or share of wallet problem.

Interviewer: *Excellent. If you found out it was a share* of *wallet problem, what would you think might be the problem?*

Candidate: Share of wallet problems are often driven by internal execution problems (bad selection, poor service, etc) whereas, traffic is often external (or market) problems.

Interviewer: *Again, excellent. The data shows that traffic has fallen. What now?*

[Here the student should begin to think about hypothesis development. They have diagnosed the problem... i.e. fewer customers are coming into the store.]

Candidate: If traffic has fallen, it is either a macro factor or a competitive situation. My inclination is that video rentals are not that impacted by economic factors, so it is probably a competitive situation. Has a new store opened in the area?

Interviewer: *No.*

Candidate: Has a new movie theatre opened?

Interviewer: *No.*

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Practice Case 18 – The Video Store (pg. 4 of 4)

Candidate: Hmm... That is surprising. I was sure that this was a competitive situation and we have a fixed pool of rental community (or movie interested community) and that once a new store opened regardless of how good it was, it took share from my client's store.

Interviewer: *Let me ask you something and maybe this will help you along. What business is your client in?*

Candidate: They are in the video rental business or the entertainment business or leisure business... I see there could be other entertainment preference shifts or options, etc.

Interviewer: *That is good intuition, but have you fully defined your client's business? What does your client do? What purpose to they serve?*

Candidate: They rent movies for people to watch at home. They are in the home entertainment business and specifically in the home movie entertainment business. That means that the competitive set is anybody who provides movies in the home. Not just video stores.

Interviewer: *Excellent. What do you think is going on?*

[Here the student has now diagnosed the problem and can make a very good hypothesis that either delivery, cable, PPV, or new Movie on Demand technology has infiltrated the market or is experiencing rapid growth, reducing the market size for video rentals at stores.]

<u>Summary Comments</u>
There is no one right way to approach cases. Structure your case interviews to (1) perform structured analysis and fact gathering to properly diagnose the problem; (2) share your logic and hypothesis whenever you can; (3) drive to an answer/assessment.

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Practice Case 19 – Fast Food Restaurant (pg. 1 of 3)

Question

Six months out of HBS, a frustrated classmate calls you to complain that the fast food burger joint that he bought has been steadily losing money for the last 3 months. He wants to know what you think he should do about it.
Where do you start?

Recommended Solution

This is an example of a case where virtually no information is provided and the student needs to take a minute to figure out where to start probing. In this type of case, the student is evaluated based on the number of factors questioned up front plus the ability to logically pare down that list to get at the heart of the matter.

Here are some of the initial questions the student should ask:

- Have revenues decreased?
- Have costs increased?
- Have prices increased?
- Was the store making money 3 months ago? What has changed?
- Is there new competition?
- Has there been a major economic change in the area?
- Was there a major event like someone getting sick? Health code violation? Crime?

These answers will help to frame the extent of the required analysis.

Practice Case 19 – Fast Food Restaurant (pg. 2 of 3)

Candidate: What do you mean by "losing money"? Have profits declined or is the business in the red?

Interviewer: *Profits have declined.*

Candidate: Have revenues decreased? Costs increased? or both?

Interviewer: *Revenues have decreased.*

Candidate: If revenues have decreased, there are either fewer paying customers or the customers are spending less when they visit. Which is the case?

Interviewer: *While they could both play a role, in this case, there are actually fewer customers.*

Candidate: Fewer customers could be due to external factors like new competition, change in eating habits, local changes like a major business closing in the area. There are also internal factors to consider such as poor food quality, higher prices, or a major event like someone getting sick or a health code violation. Recognizing that there are likely many factors involved, is the issue primarily internal or external?

Interviewer: *The issue is external and is driven by a new competitor that opened across the street.*

Candidate: This new competitor must be offering a better value to have made such an impact on the burger joint. What is their value proposition? Are they offering a different type of food? Is it better quality? Is there a price disparity?

Interviewer: *They serve chicken dinners and appear to offer a completely different experience. How would you get a deeper understanding of their value proposition?*

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Practice Case 19 – Fast Food Restaurant (pg. 3 of 3)

Candidate: First, I would visit and learn everything that I can from what I see and experience first hand. How is the quality of the food? Are the prices reasonable? Do they offer healthier options and more variety? How is the service? Cleanliness? How is the facility laid out? Do they have more parking? Easier access? Once I get a first hand view of the competition, I would take a hard look at the burger business and the value proposition they are offering. The same questions would apply.

Next, I would do some primary research including customer interviews at both locations. The focus of these interviews is to discern the differences in perception between the two locations. I would pay some customers to go to each restaurant and rate the food and experience. I would also determine how many of the customers are former burger customers but now are exclusively chicken customers, versus how many visit both, and how many are completely new to the chicken place but would not visit the burger restaurant.

Armed with the data on what customers' value, I would then create a set of options to evaluate. There are likely a number of areas that need improvement including new menu options, improved facility layout, better taste/quality. Which will drive most traffic back into the restaurant fastest? Which give the largest return on investment? After analyzing the alternatives based on the chosen criteria, I would prioritize them and develop an action plan to include timing and responsibilities.

[At this point, the case could go in several directions from leadership and project management issues, to brand marketing and promotion, to financial decisions about whether to close the facility.]

<u>Summary Comments</u>

This type of case can be very intimidating since it is broad and ill-defined. The interviewer may not provide much guidance or detail; increasing the stress level. When faced with an interview of this type, the student should try to remain calm and methodical. Writing down the alternatives and crossing them out as they are ruled out is a good way to show their thought process.

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