

OXFORD CAMBRIDGE AND RSA EXAMINATIONS

Advanced GCE

BUSINESS STUDIES

Business Strategy

CASE STUDY

JANUARY 2006

2880/CS

May be opened and given to candidates upon receipt.

INSTRUCTIONS TO CANDIDATES

This copy may **not** be taken into the examination room.

The business described in this case study is entirely fictitious.

This question paper consists of 8 printed pages.

Rural Radio Group plc – 2RG

Lesley Sharples had always dreamt of being famous. Although she had enjoyed some success as a musician in her younger years, she now feels fame is most likely to emerge as a successful businesswoman. Lesley is Managing Director and Chair of the Rural Radio Group plc, 2RG, the holding company for six local commercial radio stations. Each radio station is a wholly owned subsidiary of 2RG, the Group providing essential strategic business services to each in return for a fee. 2RG is a member of the Commercial Radio Companies Association, CRCA. Established as a public limited company five years ago, 2RG now employs just over one hundred staff at its head office, see Table 1.

Table 1

2RG Staff levels and employment costs

	2004	2005
Management	8	10
Sales and commercial activities	34	35
News and programming	40	41
Administration	15	16
	97	102
Wages and salaries	£1,603,091	£1,722,578
Social security costs	£153,623	£181,786
Other employment costs	£103,324	£107,822
	£1,860,038	£2,012,186

Each of the six radio stations within the Group is a separate private limited company, each being named after a river within its broadcast area. A station will typically employ about 15 staff, giving annual employment costs of about £300,000. The station managers are employed directly by the Group. This employment structure confers a number of important advantages on 2RG with regard to staff, but it is recognised that it can hinder the staff's willingness to move from one radio station to another.

In three days' time Lesley will be attending a prestigious media award ceremony in London. The rumour within the broadcast industry is that one of 2RG's stations, Chater FM, will win "Commercial Radio Station of the Year" in the category for stations with audiences of less than 300,000. Chater FM has been nominated because, in the words of one of the judges, "It's really quirky and driven entirely by local news and community involvement, it has amazing ambition - it even carries its own drama - and it never short-changes on quality or fun. If you want to see multi-tasking working to the n'th degree, go to Chater FM."

Chater FM is typical of the other five stations in the 2RG portfolio. It is located on the high street of a regional market town and has two state of the art broadcast studios. Its 24 hours of broadcasting are split between seven programmes, each with its own presenter, see Table 2.

40

Table 2

Chater FM
Weekday programme timetable

Time	Title	Presenter
00.00 – 06.00	Tunes for the twilight	Oliver Saul
06.00 – 09.00	Up and at 'em	Jordan Lee
09.00 – 13.00	Sarah's slot	Sarah Scott
13.00 – 14.00	Chater's chatter and charts	Jimmy Wyatt
14.00 – 18.00	PM tunes	Simran Bhullar
18.00 – 20.00	Geoff's juke box	Geoff Green
20.00 – 00.00	Rural romance; records for relaxation	Gemma Stafford

45

50

The music selected by each station is drawn from 2RG's play list, with the target audience being 25 to 55 year olds. The play list is decided at a weekly meeting chaired by Lesley and attended by all station managers. Consequently, Chater FM tends to play 'oldies' and newer music which is already established in the charts. The exception is the occasional featuring of up-and-coming local talent. Advertising is restricted to no more than eight minutes per hour. Chater FM's own research suggests that, out of a population of 50,000 within its broadcast area, over 20,000 will listen at some time during the day. The largest segment of this audience is females aged between 35 and 44. The targeting of the major purchase decision maker in the household is of particular interest to many local businesses. The blend of 'hits and memories', local news and features has broad community appeal.

55

60

The award, if won, would be a tremendous boost for everyone's morale at 2RG, as it is currently going through a period of considerable business and artistic uncertainty. Although there are several current issues, the tensions centre around ownership, artistic direction and external environmental change.

65

Without doubt it is Lesley who is the visionary and creative driving force behind 2RG. However, creating a commercially viable holding company also required financial resources, particularly in the initial years. Consequently, Lesley needed investors to turn her embryonic dream into a reality. After much searching and several presentations to institutional investors, she gained backing from a venture capital company, Murray House Finance, MHF. In return for 75% of the issued equity, MHF invested £600,000 at £1 per share. Lesley and six other shareholders own the remaining 25% of equity. With 2RG now a well-established business, the directors of MHF, Mukesh and Amit Gupta, want to sell their stake and so realise a considerable financial return. The Guptas' desire to sell comes as no surprise to Lesley; she has long recognised that their objectives are wholly financial; for example, they require a Return on Equity of 8%. This focus is at odds with Lesley's desire to create a series of truly vibrant and exciting independent radio stations at the very heart of the communities they serve. On a previous occasion when the Guptas had raised

70

75

80

the issue of selling, Lesley reluctantly conceded several cost saving measures. This time Lesley is unsure whether the new changes Mukesh is demanding, as an alternative to selling, do not risk the integrity of the radio stations. With the restriction of non-EU ownership removed by the 2003 Communication Act, Lesley is aware that MHF's holding has potentially risen in value.

85

Lesley is unsure how any sale by the major shareholder might impact upon 2RG's expansion plans. These plans are to set up a new radio station, Blithe FM, so expanding the 2RG portfolio to seven. With preliminary research already carried out by Mardat, an external firm of market researchers, Lesley is loathe to scrap the idea because of its high sunk costs, see Appendix 1. Mukesh believes that the capital cost of establishing the seventh station is in the region of £350,000, but further research is needed, see Table 3.

90

Table 3

Blithe FM investment proposal; projected net cash flows, £000s

95

Year	Optimistic	Neutral	Pessimistic
0	(350)	(350)	(350)
1	0	(100)	(150)
2	100	90	80
3	150	120	100
4	200	150	100
5	250	150	100

100

Mukesh believes that by centralising the sale of on-air advertising it will be possible to boost income whilst at the same time improving the quality of service. Currently, each station has someone responsible for marketing the station to businesses. This function entails identifying customers and negotiating rates and content of the advertisements. All content has to conform to the Radio Advertising Clearance Centre, RACC, code of practice. The minimum production costs for a professional voice-over with background music is £100. As each advertisement is bespoke it is not possible to fix a maximum rate. Broadcast rates then vary depending upon the length of campaign and time of broadcast, see Table 4.

105

110

Table 4

**Chater FM
2006, Qtr 1, advertising rates**

Length of advertisement Seconds of air time	Weekly Peak	Weekly Off peak	12 + weeks Peak	12+ weeks Off peak
40	£9.75	£9.25	£8.75	£8.25
30	£8.00	£7.50	£7.25	£6.50
20	£7.00	£6.75	£6.25	£5.25
10	£5.75	£5.50	£5.25	£4.40

115

120

Mukesh maintains that centralising this function would reduce head count at each station, but boost employment at Group level by three staff. The sale of advertising would then be a Group function that becomes chargeable to each station, as is currently the case with human resources. Centralising the sale of advertising would also enable 2RG to sell airtime to customers for several 2RG stations at one time. This in turn increases the possibility of attracting national customers, rather than smaller, local businesses that have correspondingly smaller marketing budgets. He argues that, although rates for advertising would rise by 4%, they will still be attractive to customers because of increased audience reach. 125

Another feature that Mukesh wants to centralise is night time broadcasting. Currently, each station produces all of its own programmes. Again Mukesh's focus is upon cost; his view is that as the major cost of any programme is salary, it is simply not economic for each station to have its own programme given low night time audience levels. Hence Mukesh wants the Group to produce a programme for the hours of midnight to 6.00am. This would then be sold to each of the subsidiary stations for £1,000 per month. 130 135

The second major concern affecting the potential strategic direction of 2RG centres is the future funding of the BBC. Lesley is concerned that the BBC will become more commercial in its operations. At an extreme this might mean the scrapping of the licence fee, in effect removing from the BBC the nearly £3bn public subsidy it receives each year. In the run up to the review, many commentators have been arguing that the annual licence fee payable by each household is a regressive tax and should be scrapped. Further, some question the role of the BBC in a market place well served by independent commercial businesses, and suggest that the privatisation of the BBC is now overdue. These are views with which Lesley feels more than a little sympathy, but her overall preference is for retention of the licence fee. However, she recognises that her opinion is clouded by the fact that BBC local radio stations, many of which compete with 2RG stations, receive about £175m of public subsidy per year, whilst its national stations, which are also competitors of 2RG, receive almost £300m. Should the licence fee be scrapped then these stations would either close or, more worryingly for 2RG, start to broaden their appeal. How 2RG responds would depend on what replaced the public service broadcaster. The potential implications are enormous, not least of which is an increase in competition for both listeners and advertisers. 140 145 150

Aside from the possible privatisation of the BBC there are other external pressures on 2RG, one of which is competition from other radio and media groups. One example is East Midlands Allied Press, EMAP. Like 2RG, this publicly quoted company operates a number of radio stations across the UK. However, unlike 2RG its approach is to segment the market by music type rather than location, whilst also adopting Digital Audio Broadcasting, DAB. Hence one of its stations, Kerrang!, "...plays everything that is rock". Lesley also believes that TV is a major competitor for 2RG, particularly amongst the younger end of the audience. All UK TV and radio is subject to scrutiny and control by OFCOM. 2RG has already approached OFCOM with regard to the proposed expansion. 155 160

Lesley's journey to London would be an opportunity to think about the future of 2RG as well as her involvement in it. One possibility is to buy MHF's stake and so remove the Guptas from any influence. But if the Guptas' estimate of the share price at £3.50 is correct, the purchase of their holding seems an impossible dream. But, as Lesley has already proved, she has the ability to turn her dreams into reality. An alternative is to cede to the Guptas' views and increasingly centralise 2RG's operations. "I suppose," she thought, "the logical conclusion is to stop all activity at the local level and instead do everything centrally: programming, sales, news, sport, competitions, everything. Radical, but interesting. Now that is something to think about on the train." 165 170

Appendix 1

Expansion Proposal

A table has been removed due to third party copyright restrictions

Details: A table showing an age profile of the target audience, data from ONS

An extract of text has been removed due to third party copyright restrictions

Details: A general overview of area characteristics, adapted from Mardat

A table has been removed due to third party copyright restrictions

Details: A table showing employment status of people aged 16-74, data from Mardat

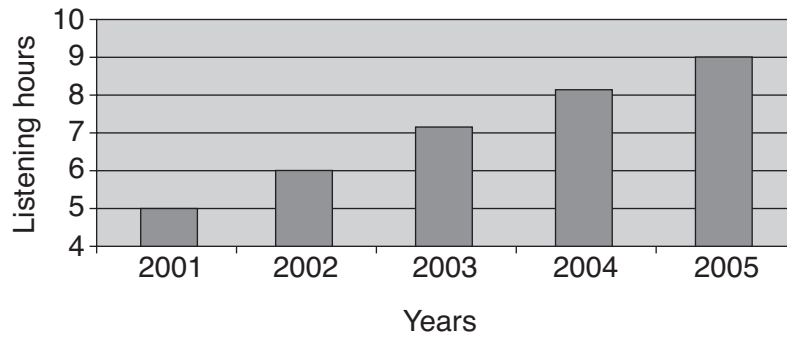
Competition

Area already served by BBC local and national stations. Further, there are two existing commercial stations, both owned by national broadcast chains. Content of their programmes is not typical of 2RG.

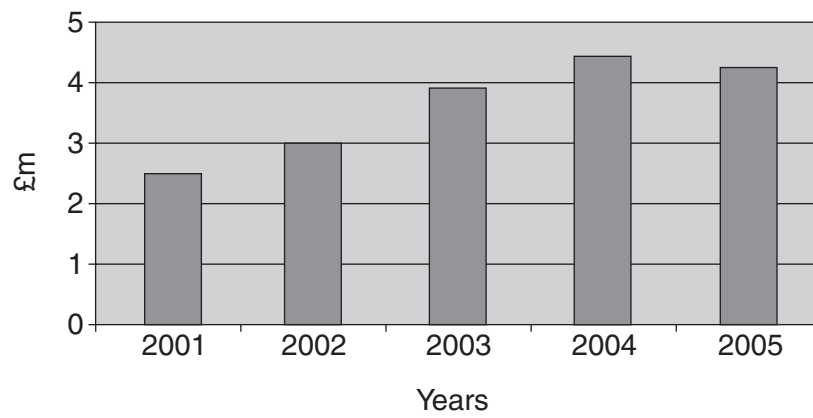
Appendix 2

2RG
Selected data

Weekly listening hours, millions



Annual turnover



Appendix 3

Rural Radio Group plc – 2RG. Final accounts as at end of financial year

Balance sheet		2005 £s	Profit & Loss Account		2005 £s
Fixed assets			Turnover		4,323,699
Tangible assets		564,708	Operating costs		3,991,832
Investments in subsidiaries		366,642	Operating profit		331,867
		<u>931,350</u>			
Current assets			Depreciation		178,070
	Debtors	1,843,549	Net Interest		37,665
	Cash	788			
		<u>1,844,337</u>	Profit before tax		116,132
Current liabilities					
	Creditors	953,011	Dividend		0
			Transferred to reserves		92,906
Net Current assets		891,326			
Total assets less current liabilities		<u>1,822,676</u>			
Creditors due after one year		500,000			
Net assets		<u>1,322,676</u>			
Share capital		800,000			
Profit and loss account		522,676			
Equity shareholders' funds		<u>1,322,676</u>			

Permission to reproduce items where third-party owned material protected by copyright is included has been sought and cleared where possible. Every reasonable effort has been made by the publisher (OCR) to trace copyright holders, but if any items requiring clearance have unwittingly been included, the publisher will be pleased to make amends at the earliest possible opportunity.

OCR is part of the Cambridge Assessment Group. Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.