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BUSINESS CASES



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Oxford University Press is a department of the University of Oxford.
It furthers the University's objective of excellence in research, scholarship, and education by publishing worldwide. Oxford is a registered trade mark of Oxford University Press in the UK and in certain other countries

Published in South Africa by
Oxford University Press Southern Africa (Pty) Limited

Vasco Boulevard, Goodwood, N1 City, Cape Town, South Africa, 7460
P O Box 12119, N1 City, Cape Town, South Africa, 7463

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First published 2012
Second Edition published in 2015

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Business Cases

Print ISBN: 978-0-190404-92-5
ePUB ISBN: 978-0-190401-54-2

First impression 2015

Typeset in ITC Stone Serif 9.5 pt on 13 pt
Printed on [insert paper quality e.g. acid-free paper]

Acknowledgements
Publishing manager: Alida Terblanche
Publisher: Janine Loedolff
Editor: Sarah Floor
Designer: Ian Norris and Oswald Kurten
Reproduction by: Name Surname
Cover reproduction by: Name Surname
Printed and bound by: XYZ Printing Company

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Table of contents

How to use case studies
Preface
Business cases topics
1. Entrepreneurship: MXit
Elana Swanepoel
2. Establishing a business: Kiph
Alex Antonites
3. The business environment: The airline industry
Johan Strydom
4. Corporate social responsibility: South African Breweries
Hannie Badenhorst-Weiss
5. General management: Edcon
Sharon Rudansky-Kloppers
6. Planning: Tsogo Sun
Nadine de Metz
7. Organising: The Nike matrix
Petri Bester
8. Leading and controlling: South African business leadership in action
Natasha da Silva Esclana
9. Operations management: Air traffic operations excellence
Rigard Steenkamp
10. Human Resources Management:
Derby Departmental Stores
Barney Erasmus
11. Marketing management: Heineken and SABMiller's beer war
Johan Strydom and Sharon Rudansky-Kloppers
12. Financial management: IBM
Tersia Brevis-Landsberg
13. Purchasing and supply chain management: Toyota
Hannie Badenhorst-Weiss

How to use case studies

What is a case study?

- A case study is a real-life example of a business scenario.
- Case studies provide detailed information about a company, industry, person, or project over a certain period.
- A case study may include information about company goals and objectives, plans and strategies, problems and challenges, achievements and results, recommendations, etc.
- Case studies are a useful way of learning about how things operate in the business world if you have not yet had first-hand experience.
- Reading case studies, and discussing the issues that they highlight, will show you how people in business have applied the theories that you will learn about during your course.
- Using case studies will develop your ability to analyse, think, communicate, and organise.

How do I use a case study?

- The first step is to read the whole case study and any questions related to the case study carefully in order to familiarise yourself with the scenario.
- Next, read through the case study again, making a list of words or concepts that you do not fully understand.
- Either look up the words and concepts yourself, using your textbook, the library, or the internet, or ask someone to explain them to you, e.g. your tutor or your lecturer.
- When you feel confident that you understand the content, read the case study again, looking for issues that relate to the questions. It may be useful to use a highlighter to highlight the key issues, or you can jot them down.
- Now that you have sifted through the information and highlighted all the relevant facts, i.e. the ones that relate to the questions, you are well equipped to answer the questions.
- Read the questions again, and answer them one by one.
- Number your answers using the same numbering system as the questions. If you do not have access to a computer and printer, write as neatly as possible.
- Make sure that you include only the relevant facts, and form the answers using your own words. Do not simply copy from the case study – your lecturer wants to know what you think.

- Hand in your work when you are 100% happy with the effort you have made.

Sources

Greenwald, D. 2006. *Case studies*. [Online]. Available: http://www.business.bgsu.edu/faculty_staff/greenwald/casestudies.htm [7 September 2009].

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Preface

This book is a collection of real-life South African business management case studies. It addresses many of the important management issues in today's business environment such as sustainability, adapting to changing circumstances, and how to survive and grow in a declining marketplace amongst others.

Each of the case studies looks at the culture of a particular company in a particular industry, in the primary, secondary or tertiary industry. It provides readers with an extensive and in-depth background to the management issues covered and presents real examples of the strategies and tactics used by successful businesses. It further shows the dynamic business environment in which these South African businesses operate and how they counteract some of the threats that would most probably sink other businesses in a similar situation.

The authors of the case studies are all lecturers with many years of teaching experience in the field of business management. They have found that the main problem most students experience is to link the theory they are studying to actual practical business examples. This book thus aims to eliminate this gap between theory and practice and to provide real-life examples of management decisions taken by some of the major South African companies and brands.

The book comprises a total of thirteen case studies that provide the crucial link between the theory found in textbooks and practice. The case studies focus on all the important management issues surrounding business, namely:

- Entrepreneurship
- Establishing a business
- The changing business environment
- Corporate social responsibility and sustainability
- General management principles
- Planning
- Organising
- Leading and Controlling
- Operations management
- Human-resources management
- Marketing management
- Financial management
- Purchasing and supply chain management

This collection of case studies can be used as a hands-on guide to see how real business people developed and pursued their entrepreneurial dreams and will hopefully provide deeper insight to students regarding the dynamic business world in which South African organisations operate.

Sharon Rudansky-Kloppers

Business cases topics

Business management issues	Relevant case study	Key concepts covered
Entrepreneurship	Entrepreneurship: MXit	*advertising* *business models* *competitive advantage* *continuous innovation* *corporate citizenship* *customer satisfaction* *demographics* *desired services* *discontinuous innovations* *disruptive technology* *entrepreneur* *expansion strategy* *feasible strategy* *field* *financial investment* *forecast* *human resources* *hyperlink* *incremental innovations* *infrastructure* *investment vehicle* *lean organisation* *long-term sustainability* *needs and wants of customers* *niche market* *participative management* *physical resources*

		product development *psychographics* *range of services* *sense of urgency* *serial entrepreneur* *services mix* *social behaviour* *start-up financing* *target market* *viral marketing* *vision*
Establishing a business	Establishing a business: Kiph	*bootstrapping process* *entrepreneurial and business skills* *entrepreneurial team* *growth establishment* *innovation* *new venture* *opportunity identification process*
The business environment	The business environment: The airline industry	*aircraft utilisation* *cartel* *commercial airlines* *cost advantage* *cost leadership* *deregulation* *differentiation strategy* *economies of scale* *first-time flyers* *focus strategy* *full-service airlines* *'good enough' quality* *load factor* *low-cost airlines*

		low-cost strategy *monopoly* *national flag carrier* *overhead cost* *oligopoly* *price elasticity of demand* *quality perceptions* *secondary airports* *superior productivity increases* *value-based airlines*
Corporate social responsibility	Corporate social responsibility: South African Breweries	*code of ethics* *corporate citizenship* *corporate governance* *corporate social responsibility* *economic accountability* *environmental sustainability* *ethical conduct* *ethical leadership* *ethics* *governance* *social responsibility* *sustainability* *triple bottom line*
Introduction to general management	General management: Edcon	*authority* *communication* *competitors* *corporate governance* *culture* *divisional structure* *employee equity* *employee wellness* *growth strategy*

		leadership skills *logos* *markets* *market environment* *mission* *motivate* *purpose statement* *socially responsible* *vision*
Planning	Planning: Tsogo Sun	*alternative plans* *culture* *developing plans* *effective goals* *environment* *external opportunities and threats* *growth strategies* *hospitality industry* *innovation* *manager's experience* *manager's values* *mission* *organisation's values* *planning context* *planning process* *product development* *project plan* *purpose* *reactive planning* *rebranding* *statement vision* *sustainability* *vision*
Organising	Organising: The Nike matrix	*centralised authority*

		chain of command *coordinating* *decentralisation of authority* *delegating* *departmentalisation* *functional departmentalisation* *geographic units* *goals* *line authority* *lines of authority* *management hierarchy* *matrix model* *matrix structure* *multiple responsibilities* *organisational culture* *organising* *product departmentalisation* *reporting lines* *span of management* *strategic plan*
Leading	Leading and controlling: South African business leadership in action	*accountability* *attributes* *behavioural theory of leadership* *delegation* *democratic leadership style* *employee and customer feedback* *employee orientated leadership style* *failure*
Controlling the management process		*focus on people* *future of business profit is purpose*

		human capital development programme *lead from the front* *leadership style* *listen* *luck* *morale* *motivation* *production orientated leadership style* *recruitment process* *relegation* *responsibility* *strategic balance sheet management* *teamwork* *transformational leadership* *trust*
Operations management	Operations management: Air traffic operations excellence	*air traffic* *capacity planning* *design function* *ergonomics* *fail-safe* *flight events* *hazards* *hearing protection device* *human error* *infrastructure* *line balancing* *loading, sequencing and scheduling* *maintenance* *mass service operation*

		master production schedule *NIHL (noise-induced hearing loss)* *operations system* *performance objectives* *personal protection equipment* *process technologies* *quality* *safety* *safety risk management* *service industry* *serviceability* *simulations* *system design* *take-off* *tower controllers* *tower controllers* *traffic cops* *transformation process* *types of failures* *value-adding* *zero defects*
Human resource management and the SA labour legislative framework	Human resource management: Derby Departmental Stores	*customer service* *deputy directors* *derby departmental stores* *director: human resources* *employee relations and wellness* *growth strategy* *high-performing departmental* *human resources* *labour legislation*

		labour relations *leadership and motivation* *organisation development* *organisational structures* *recruitment and screening* *talent development* *talent development and retention*
Marketing management	Marketing management: Heineken and SABMiller's beer war	*advertising* *competitive advantage* *competitive structure* *consumer tastes* *diversified* *joint venture* *long-term strategy* *monopoly* *oligopoly* *opportunities* *premium beer brand* *price* *related and unrelated diversification* *repackage* *segments* *social responsibility* *socio-economic problems* *strengths* *sustainability* *threats* *vertically integrated* *vision* *weaknesses*
Financial management	Financial management: IBM	*asset* *acid test ratio* *budget* *cash flow statement* *costs*

		current ratio *financial management* *financing structure* *future value* *gross profit margin* *income* *internal rate of return* *liquidity ratio* *net present value* *net profit* *present value* *profit* *return on owners' equity* *return on shareholders' interest* *return on total capital* *risk-return principle* *statement of financial position* *statement of income and expenses* *time value of money*
Purchasing and supply chain management	Purchasing and supply chain management: Toyota	*automotive component manufacturers (ACMS)* *automotive (motor) industry* *bottom line* *continuous improvement (CI)* *early suppler involvement (ESI)* *first-tier suppliers* *gross domestic product (GDP)* *integrated supply chain*

		inventory management *just-in-time* *key performance indicators* *lean production* *long-term relationships* *original equipment manufacturers* *(OEMS)* *outsource* *purchasing function* *subassemblies* *sub-tier suppliers* *suppliers* *supply chain management* *sustainability* *Toyota production system* *vehicle assemblers* *vendor managed inventory system (VMI)*

1 Entrepreneurship: MXit

KEY TERMS

ADVERTISING

BUSINESS MODELS

COMPETITIVE ADVANTAGE

CONTINUOUS INNOVATION

CORPORATE CITIZENSHIP

CUSTOMER SATISFACTION

DEMOGRAPHICS

DESIRED SERVICES

DISCONTINUOUS INNOVATIONS

DISRUPTIVE TECHNOLOGY

ENTREPRENEUR

EXPANSION STRATEGY

FEASIBLE STRATEGY

FIELD

FINANCIAL INVESTMENT

FORECAST

HUMAN RESOURCES

HYPERLINK

INCREMENTAL INNOVATIONS

INFRASTRUCTURE

INVESTMENT VEHICLE

LEAN ORGANISATION

LONG-TERM SUSTAINABILITY

NEEDS AND WANTS OF CUSTOMERS

NICHE MARKET

PARTICIPATIVE MANAGEMENT

PHYSICAL RESOURCES

PRODUCT DEVELOPMENT

PSYCHOGRAPHICS

RANGE OF SERVICES

SENSE OF URGENCY

SERIAL ENTREPRENEUR

SERVICES MIX

SOCIAL BEHAVIOUR

START-UP FINANCING

TARGET MARKET

VIRAL MARKETING

VISION

Introduction

'The mobile phone is the remote control of the Universe', said Herman Heunis, in recognition of the mobile phone's importance to the youth, for whom mobile phones are the main communication channel.[1] Heunis, the Chief Executive Officer (CEO) and founder of MXit, was speaking at the NetProphet 2009 conference. This view is reiterated by Katherine Van Wyk, who said that MXit is more accessible to young South Africans than newspapers, television and radio. 'It's the only medium that could allow us to have a two-way conversation with young adults,' says Van Wyk, Director at Ever1Mobile, the company that developed the platform SmrtCitizen which is part of a larger educational initiative on MXit called Bsmrt, which has more than 150 000 users across South Africa and the rest of Africa (Staff reporter, TechCentral).[2]



Figure 1.1 Youths using their cellular phones to chat

The founder/entrepreneur

Herman Heunis is not your typical social media start-up **entrepreneur**. He is 50 years old, was born and raised on a sheep farm in Namibia, and is a veteran of the South African Navy. He graduated from Stellenbosch University with a B.Com and studied Datametrics at the University of South Africa (Unisa). He started his career as a computer programmer in 1980 and then became a technical specialist and consultant. He has been called a 'shaggy-haired South African of Dutch descent'.[3]



Figure 1.2 Herman Heunis – Chief Executive Officer of MXit Lifestyle (Pty) Ltd

MXit – Start-up and growth

In 1990, Heunis, an opportunity entrepreneur, started his own information and communication technology (ICT) consultancy, and then in 1997/98 he established Swist Group Technologies, which focused primarily on the mobile telecommunications industry, developing software and providing systems support to large telecommunication companies, outsourcing system support. On the way back from attending a conference in Asia, Heunis came up with the idea to create a global community. Subsequently, in 2000, Clockspeed Mobile (Pty) Ltd, a research and development division of Swist Group Technologies, developed a Massive Multiplayer Mobile game named Alaya. Users across the world could play the short-message-service (SMS) based game, but it proved to be unsuccessful owing to the high cost of SMS and the idea being too foreign to the users. At the time general packet radio service (GPRS) had not yet been widely implemented. By 2002/2003 the game was reassessed and Heunis realised that only communication was needed to create a global community. The MXit concept was an innovation of the Swist's Research and Development department. Heunis evaluated it as a viable business opportunity and took a calculated risk. For **start-up financing** he used his own money – some of it generated from sales of earlier start-up businesses. Heunis can be described as a **serial entrepreneur**, having started several new ventures.

In January 2005 MXit was launched as a subscription service, which Heunis knew would not work, but decided to try anyway. By the end of April 2005 MXit had only 40 subscribers – not exactly a success. At the end of May 2005, it was launched as a free service and the user numbers started skyrocketing.

On 1 July 2006, Clockspeed Mobile (Pty) Ltd changed its name to MXit Lifestyle (Pty) Ltd, based in Stellenbosch, South Africa and Port Louis, Mauritius. The name of the company stands for 'message exchange it'. Serious deliberation went into selecting the right name as a major consideration was that the name should become entrenched in the English language. Successful adoption of the name has been achieved – it appears on the back of taxis, in songs, in poetry, and is used as a noun, adjective, and verb. The word 'MXit' is even listed in the second edition (2010) of the Oxford South African Concise Dictionary.

MXit is described as a lifestyle company with a **disruptive technology** (an innovation that helps create a new market and value network) offering a range of services including free instant messaging application for mobile phones and computers, mobile voice clips, community-based applications and entertainment. Heunis explains using disruptive technology as 'using innovative approaches to build new mobile service models that go against the grain'.[4]

The **vision** of MXit is: 'Provide people with free messaging to connect with people, products, services, information and entertainment relevant to their lifestyles'.[5]

Mission: To secure a significant proportion of the 4 billion mobile phone users in the world.[5]

Philosophy: We do not compete, we create.[5]

Slogan: 'Join the evolution; Exit the ordinary'.[5]

Factors that played a role during the start-up and growth were: timing, marketing, publicity, software, funding, resources, mindset (it will work) and strategy. The launch was well timed: it was just after GPRS had been announced; there was no competition in South Africa in the market of mobile phone instant messaging; and internationally there was limited competition. **Viral marketing** was used and the total budget for marketing in the first year was R100 000.

Challenges that had to be overcome were user challenges, technical obstacles, monetisation challenges, staff, funding, social changes and press. The press was particularly hostile, blaming MXit for societal problems, such as children not doing homework.

MXit is an innovative organisation. They were the first to have **hyperlinks** within text, first to sell virtual goods and develop an economy via **advertising**. They did not own open-source software and had to build systems to make it work and developed their own software. They have the software, creativity and mindset to secure a large proportion of the world's mobile phone users – about 200 million.

Some of the lessons that were learnt during the start-up phase were:

- Analysis paralysis – it is not possible to obtain all the answers to all the questions and decisions have to be made on incomplete data.
- Right partners/team – the right partners, from shareholders to staff, with the right mind set are vital. Staff need to have a passion and the stomach for software development.
- Competition – do not try to compete because then the company can fall into catch-up mode; rather spend energy to create.

MXit has evolved to become a major instant messaging (IM) player in the South African arena, yet in its second year of operation the company nearly went bankrupt. The research and development company, Swist Group Technologies, had its first ever financial loss in 2006, owing to a late payment from a large project, and MXit was draining money from it. To top it off, shareholders walked out. But the prevailing mindset – it will work – was unshakeable and later that year the company broke even.

Without disclosing financial specifics, Heunis – an astute businessman – has indicated that MXit earns half its revenue from the sales of products such as music, games and digital accessories and half from the advertising that accompanies the products. MXit's growth has been so phenomenal that in January 2007 the South African multinational media group, Naspers, acquired a 30% stake in MXit for an undisclosed amount. Naspers has invested in print, pay-TV and internet operations in Africa, Brazil, Russia, India, China and Greece. For Heunis, partnering with Naspers meant that he could pursue his **vision** of expanding into other countries at a faster rate than previously planned. Heunis demonstrated a **sense of urgency**, a characteristic of a company focusing on **long-term sustainability** in a highly competitive market. By 26 February 2007, MXit had 400 000 international users and their goal was to have 50 million users internationally by the end of 2008.[6]

According to a company statement, MXit registered its three-millionth user on 29 January 2007, was growing at a rate of between 9 000 and 12 000 new users a day, and was one of the largest generators of GPRS traffic in South Africa. 'Our user base currently logs on to our servers more than six million times per day and the total traffic between our servers, mobile phones and other gateways is well over 500 million packets a day,' said Heunis.[7]

In order to accommodate the meteoric rise in the user base, MXit continually upgrades their **physical resources**, such as their servers, and their **financial investment** in **infrastructure** growth is huge and ongoing. Heunis's **forecast** was that once the company rolled out its foreign operations, the number of users per day would increase rapidly.

A typical characteristic of an entrepreneur is the ability to negotiate. Heunis has demonstrated this skill in negotiating a premium-rated payment gateway in the United Kingdom, as well as a permanent infrastructure in United States (US) to secure extended international presence by the end of 2007.

By 2010, MXit had a registered user base of over 19 million, about 20 million log-ons per day and over 250 million messages sent and received per day – around 35 000 messages per second during peak times.[8] The application is distributed internationally and used by users in over 120 countries daily, but the bulk of its user base is in South Africa and Indonesia, with fast growth in 123 other countries.

MXit features

MXit Lifestyle (Pty) Ltd operates an internet community who discover and share chat rooms, games, movie clips, music and sports. MXit is a mobile-phone-based instant messaging (IM) application that transmits messages through mobile data services like 3G and GPRS. In essence, it offers a range of mobile social networking tools, primarily to youth. It differentiates itself by not charging users to register, as some of its rivals do. Not only does it allow users to send and receive one-on-one text and multimedia messages to and from other MXit users, but also to communicate in general chat rooms.

MXit Lifestyle offers a **range of services**:

- Moola is a virtual currency to download music, play games, connect with new and old friends in chat zones, obtain wallpapers and skins and shop.[11]
- Tradepost allows members to buy skins, wallpapers, ringtones and music; visit chat zones; play games; enter competitions and fill in questionnaires; and find out the latest weather, news, and sports results.[11]
- MXit Xchange offers a personal trading place that allows members to post or view items for sale, and communicate with potential buyers or sellers via own inbox before finalising a deal; it offers advertising programs, such as an opportunity to extend brand, and access and promote brand to this mammoth community, as well as the ability to communicate with consumers and position advertising in their pockets. Micro transactions where mobile users pay for specialised services seem to be a growing segment of the business' profitability.[11] Tixi offers a multiplayer word game; chess games; ability to add Facebook as a contact and browse, and to Tweet on Twitter account on the go; Childline initiative to provide a professional counselling service for users; birthday service that reminds the user of contact's birthdays by sending a reminder notification before the actual day; and dating game to visit the mall, the park, or the gym, as well as find fun, friendship, and romance. The company is experimenting with a dating service.
- MXit Cares focuses on educational initiatives such as lessons in mathematics, HIV/Aids awareness and counselling through Childline and for drug addiction.

MXit supports gateways to other instant messaging platforms such as MSN Messenger, ICQ and Google Talk. Although MXit does not charge for one-on-one messages, mobile operators may charge for data usage. A number of pay-services are available, including chatrooms.



Figure 1.3 MXit Logo

In 2011, MXit was available on 2 500 mobile phones. To run MXit requires Java and internet connectivity via CSD, GPRS, 3G or wifi. Tailored versions have been released for the Apple iPhone (via the iTunes App Store), Android, BlackBerry and Windows Mobile devices.

MXit as an instrument of change – unique differentiator

MXit can play a key role in 'unleashing the educational potential of Africa,' Heunis says. 'For a true entrepreneur, the satisfaction of creating outweighs the money rewards.'[12] MXit includes in its **services mix** a range of civic-minded services, such as educational tools for children, low-cost book downloads and even real-time drug counselling – a social network with a social conscience. Such an approach to services and products is evidence of good **corporate citizenship**. In countries where large numbers of people are still not connected to the World Wide Web, MXit can make a difference. In some parts of Africa, in-home high-speed internet access can cost as much as eight times more than web connections over wireless networks.

'I don't know of any other (company) that has focused its strategy on being a community-cause network first, entertainment second,' says Christine Perey, a mobile social networking consultant in Montreux, Switzerland. 'It's a unique differentiator.'[13]

The presence of MXit in Africa is so pervasive that in 2009 the US Embassy in South Africa signed a year-long partnership with MXit to broaden the US government outreach in Africa. When US President Barack Obama visited Africa in July 2009, he made extensive use of MXit to connect with Africa's youth. 'We were very happy to be engaging in the newest of new media on the mobile phone,' said Mark Davidson, the State Department official who coordinated the effort. MXit users sent more than 200 000 messages to Obama.[14]

Competition

MXit competes in the **field** of mobile social networking against more established and bigger social networking companies that have more money and better technology, such as Facebook and Twitter. Instead of taking the competition head on, Heunis in his **feasible strategy**, focused on a **niche market**, South Africa. Once he had

achieved success in this market, he could embark on an **expansion strategy**, expanding into the rest of Africa and into developing countries in the world, and then the rest of the world.

Heunis, however, does not view his company as competing against the other players in the field. Instead of 'competing' per se, he focuses on creating new **business models**.

In South Africa, the country's biggest telecommunications providers, Vodacom and MTN, are trying to create MXit copycats, but apparently to little avail, so far. Heunis posits that MXit has a **competitive advantage** over telecommunication providers in understanding its market, in particular, the **social behaviour** of its market because it is 'the core' of its business. 'The telcos battle with these mind shifts and mistakenly believe they can do it as well since they own the airwaves,' he says.[15] Apart from understanding the **needs and wants of its customers** and welcoming input from its users, MXit has another competitive advantage – it operates a **lean organisation**. With only about 130 employees, MXit is nimbler than the big telecommunication providers. In addition, at MXit **participative management** is practised – everyone from within the company, from the receptionist upwards, has a say in how the business is run. This approach is evident of optimum utilisation of available **human resources**.

Another competitive advantage is its focus on **continuous innovation** as part of its **long-term sustainability** strategy. For example, MXit continues to roll out new community initiatives. In April 2009, MXit partnered with the South African Education Department, Nokia South Africa and a Finnish funding agency to create a pilot mathematics program that allows students access to online tutoring and quizzes. About three weeks later, MXit launched a channel that allows users to download books for less than $2. This was followed by MXit advertising an application that assists young people preparing for their driver's license test – a process that is quite challenging in South Africa.

Not only does MXit generate a continuous stream of **incremental innovations**, the company also releases **discontinuous innovations** – out-of-the-ordinary tools. For example, in December 2007, the company launched a unique greeting card service, offering the only service in South Africa where users can send greeting cards from their mobile phones via an IM system.

Customer satisfaction

Heunis attaches great value to **customer satisfaction** and identifies the main challenge as that of measuring and monitoring customer satisfaction and their **desired services** in order to keep pace with his **target markets**. He believes that the customer in the market of mobile networks desires 'value'.

When customers experience problems with the service, MXit invests capital in addressing the problem. For example, some years ago some MXit users complained that the service was crash-prone. This problem was abated after two years of costly

software upgrades which ended in February 2009.

Going global

MXit can be described as service that creates communities across the globe. It is available in 127 countries, from Latin America to Asia. However, to adapt its platform to each of these countries, MXit faces a stiff challenge from local rivals, such as China's Tencent QQ that caters primarily to a specific language and culture and has 300 million users. MXit's range of services is oriented toward African issues and analysts question whether this would be acceptable in Latin America and Asia.

Although MXit does not promote social services at the exclusion of the widerappealing entertainment features, a warning is sounded by Frost & Sullivan's Vikrant Gandhi. 'To be a global network, you simply can't have just one strategy,' Gandhi says.[16]

The concern of this analyst seems tenuous considering how Heunis, a strong believer in viral marketing, grew the subscribers in Indonesia to 500 000 through strong social networking. Describing the IM user in terms of **demographics** and **psychographics**, Heunis identifies them as typically young people who rebel against traditional media models but would accept mobile advertising that is relevant to them and not overtly intrusive. Such advertising is selective and targeted to users of specific channels and services.

Location

MXit has offices in Stellenbosch (about 100 employees) and Mauritius (about 30 employees). It has data centres in Stellenbosch and Frankfurt. The challenge of hosting a local data centre is that in South Africa we pay for bandwidth, while in Frankfurt this is not the case. In Frankfurt the company only pays for power, rack space and air conditioning.

2011 – Exit Heunis, enter Knott-Craig - another type of entrepreneur

In 2011, Alan Knott-Craig Junior's **investment vehicle**, World of Avatar, purchased Heunis's 60% share in MXit together with Naspers' 30%, with 10% remaining in the hands of MXit's staff via a trust set up by Heunis in 2005[17]. Why did Heunis sell? 'Creating and building MXit has been an enormously interesting journey for me, and I have had a lot of fun, but it is time to inject new and young energy into the company, and I believe that Alan and his team will do a superb job,' says Heunis[17]. Heunis acknowledges that he is better suited to starting technology companies than managing big businesses (MXit has a staff of 150)[18]. Heunis leaves as a successful entrepreneur and technology visionary, having created jobs for 150 people.



Figure 1.4 Alan Knott-Craig Jr[17]

Enter the big guns – BBM, WhatsApp, Facebook, Google

At the time of the sale, MXit had 4.3 million users, handling 700 million messages per day, with 50 000 new registrations per day[18]. Although MXit pioneered the IM business and took an early lead over most of its rivals, the market is fast maturing. Several large international companies are competing. For example, BlackBerry developer Research in Motion (RIM) and the US firm WhatsApp have already made strong inroads into the rapidly-growing smartphone messaging market. Multinational giants, such as Facebook and Google, move aggressively into MXit's market of mobile social media, with MXit providing entertainment, games and payment services on the back of its messaging facilities[18]. According to a South African 2013 study[19], MXit faces competition from instant messaging services like WhatsApp and the growing use of social networking applications on mobile phones in South Africa. However, Knott-Craig points out that MXit has become much more than a messaging or communications tool and has developed a whole ecosystem, not only for its users, but for a range of companies that supply developers, advertising, content and other services[20].

MXit reinvented

Although MXit went through a tough year, it focused on **product development** and 'totally redefined'[21] its software development methodology and philosophy, to push into the smartphone world. By November 2013 it had regrouped under a new leadership team, with Michael Jordan as Chairman and Francois Swart as CEO, and launched their new innovation, MXit7[21], seeking to deepen the smartphone experience and push into other emerging markets, with the goal of becoming bigger than Facebook. MXit7 is an app that reinvigorates its user interface, while aiming to drive deeper penetration into the growing smartphone market. MXit7, already available for feature phones, is now also available for iOS, downloadable from the Apple App store, Android, BlackBerry and the Windows Phone app. MXit7 supports more than 8 000 handset devices, including tablets. Thus, MXit caters for all potential

customers, with a primary need to chat by creating an 'immersive chat experience to younger users in emerging markets'[21].

MXit expanding to India – 2014

With a **strategy** to move into emerging markets, MXit considered India, with 900 million mobile phone connections, currently the world's largest feature phone market. Of these 750 million are potentially MXit-capable. In January 2014, MXit expanded to India to provide the growing 550 million feature-phone users across India with the ability to affordably use their basic data-enabled feature phone like a smartphone, with advanced functionality for chat and accessing apps and games[22]. The application is both fast and data light allowing users with even the most basic 2G connection to benefit from an immersive social mobile chat experience, at a much lower cost than the average SMS[22]. By end 2014, MXit's goal is 10 million active Indian users[23].

Conclusion

The growth of MXit since its launch in 2005 has been astronomical and it can only be contributed to an exceptionally visionary entrepreneur, Herman Heunis. With his life totally consumed by MXit, Heunis was ready to sell to the right team when Knott-Craig Junior knocked at his door. With a new team, MXit was reinvented and kept growing, expanding to India. As Heunis predicted in 2011 when he sold MXit: 'The opportunities for MXit are endless. I can think of at least five ideas that could be real game-changers. Why compete with smartphones, for example? Embrace them, utilise their power and capabilities and create something so irresistible that users cannot wait to engage with the platform.'[24] And that is what MXit has done, under new management.

Self-assessment questions

Easy questions

1. Herman Heunis can be described as an entrepreneur. Which one of the following characteristics does not describe Herman Heunis?
   a. He has innovative ideas.
   b. He identifies opportunities.
   c. He avoids taking financial risks.
   d. He finds resources.

2. Herman Heunis started MXit because _____
   a. He had been retrenched from a large company.
   b. He wanted to be independent.
   c. A large organisation outsourced the task to him.
   d. He had identified an opportunity in the market.

3. In what type of South African growth industry is MXit operating?
   a. Communication
   b. Education
   c. Health care
   d. Tourism

4. When Herman Heunis first launched MXit, they charged users to subscribe to the service. At that stage, which one of the following fundamental requirements for a good investment opportunity did they **not** comply with?
   a. The timing of the opportunity was right.
   b. They understood what the customers wanted.
   c. The opportunity had the potential to grow.
   d. The opportunity had to achieve a sustainable competitive advantage.

5. What type of enterprise is MXit?
   a. A public company
   b. A partnership
   c. A close corporation
   d. A private company

Challenging questions

1. When Herman Heunis decided that MXit Lifestyle (Pty) Ltd should be a private company, he considered the advantages and disadvantages of the different legal

forms of enterprises. Which one of the following statements applies to his company?

a. The owner is personally liable without limitation.
b. The possibility of lack of continuity exists.
c. The public can be invited to buy shares.
d. Only one director is sufficient.

2. When Herman Heunis re-evaluated the potential of the Alaya game and developed the MXit concept, he probably drew up a business plan. Which one of the following reasons would be the reason why he compiled a business plan?
   a. To obtain bank financing
   b. To arrange strategic alliances
   c. To sell the business to himself
   d. To obtain large contracts

3. During the concept development stage, Herman Heunis's business plan would have been of interest to a specific stakeholder group, namely _____.
   a. Customers
   b. Investors
   c. New venture management
   d. Banks

4. A business plan typically has seven components. The description of the MXit mobile phone-based instant messaging service and its features would have been part of which component?
   a. Marketing plan
   b. Products and/or services
   c. General company description
   d. Operating plan

5. MXit currently has data centres located in Stellenbosch and Frankfurt, Germany. Why would the company choose to locate a data centre in Frankfurt?
   a. Availability of skilled labour
   b. Low communications/operating costs
   c. Proximity of and access to the market
   d. The social environment

Essay questions

1. Entrepreneurship is a complex concept. Explain why Herman Heunis can be called an entrepreneur by focusing on the traits and characteristics that he displayed.

Key points to discuss:
Heunis's achievement motivation, internal locus of control, innovation and creativity and his risk-taking propensity. Heunis invested his own money in starting MXit.

2. A good idea is not necessarily a good investment opportunity. Explain why MXit was a good investment opportunity, for both Herman Heunis and Alan Knott-Craig Junior.

   Key points to discuss:
   Heunis identified a clearly defined market need for the service; the sustainable competitive advantage of MXit; the potential of MXit to grow; the rewarding nature of the opportunity for Herman Heunis; and the timing of the opportunity. Knott-Craig Junior saw the potential of buying an existing business, MXit, one of the great success stories of the South African technology industry. His company, World of Avatar, operated as the holding company for about 14 other companies that develop and supply services and products for mobile phones. Thus, synergy could be achieved. In addition, MXit had millions of users in Africa with excellent growth potential.

3. Differences exist between a public company and a private company. Why would Herman Heunis prefer the private company legal form to the public company legal form?

   Key points to discuss:
   The difference in the number of members (shareholders); the difference in the number of directors; the transferability of shares; the subscription to shares by the general public; the name of the company; the extent of legal regulations.

4. The business plan is a planning tool. Draw up a business plan for MXit.

   Key points to discuss:
   In the MXit business plan you should at least cover the eight components: the executive summary, the general description of the venture, the products-and-services plan, the marketing plan, the management plan, the operating plan, the financial plan and then finally the supporting materials. You would have difficulty drawing up the financial plan, as no financial information about the company has been provided. MXit is a private company and does not have to disclose its financial status. Thus no financial statements were available for inclusion in the case.

5. The choice of geographic location takes into consideration several factors. Discuss the factors that MXit would have considered in choosing to locate in Stellenbosch,

Mauritius and Frankfurt.

Key points to discuss:
Access to raw materials would not have been a consideration as raw materials are not required for MXit. Availability of information technology specialists would be a consideration but these can be sourced from anywhere. Proximity to the market would not be a consideration as the market is spread all over the world. Access to the market is a consideration as access is achieved through the mobile phone and the cost of bandwidth becomes a serious consideration. In Frankfurt the company does not pay for bandwidth while in South African it does. Availability and cost of transport facilities would not be a consideration. Availability and reliability of power should be a consideration as the company cannot be disconnected from its users as a result of a power failure. Availability of capital is a consideration and that is why MXit sold 30% to Naspers. Attitude, regulations and tariffs of local authorities, in particular the telecommunication companies' mobile phone rates are a consideration. The personal preferences of Herman Heunis, who studied in Stellenbosch and loves the winelands would be a consideration. Stellenbosch has also become an IT hub. With regard to Mauritius, the favourable tax rates for companies are well known and Heunis jokes that the fishing is very good.

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2 Establishing a business: Kiph

KEY TERMS

BOOTSTRAPPING PROCESS

ENTREPRENEURIAL AND BUSINESS SKILLS

ENTREPRENEURIAL TEAM

GROWTH ESTABLISHMENT

INNOVATION

NEW VENTURE

OPPORTUNITY IDENTIFICATION PROCESS

Bootstrapping the Boot – The Kiph way to establish a business Background

A vast percentage of individuals in South Africa have the intent to start their own businesses at a certain point in time. Some are pushed (e.g. due to high unemployment rates, retrenchment or even just being tired of their current jobs), others are pulled (e.g. due to the identification of a gap in the market or lucrative opportunity). In both these cases several obstacles exist to starting and establishing a **new venture**. Some complain about the high risk involved, others about their lack of **entrepreneurial or business skills**. It is also evident that the majority will indicate, prior to start up, that a lack of capital hampers engagement in the entire entrepreneurial process.

The case of Kiph is a clear example of how all the factors of starting and establishing a new venture are encapsulated in a **bootstrapping process**.

Bootstrapping *v*. Start up (an internet-based business or other enterprise) with minimal financial resources.

A methodical discussion amongst the three entrepreneurial musketeers from Kiph, Wesley Rosslyn-Smith, Dane and Nathan van Zyl (twin brothers), aka Wes, Dane and Nate, opens this door:

'We somehow always knew that employment at a corporate wouldn't cut the cheese… All our mates were drafting and shaping their CVs, ready to tick the corporate open days and explicitly dreaming the BMW dream working at big consulting houses. Not us, we

realised even during primary school, the entrepreneurial route seems the best, our parents did it, so no other alternatives exist in our frame of reference'[1]*…*

The economic reality of enhanced entrepreneurial activity and its socioeconomic benefits were always close to their hearts. Whilst other students engaged in generic forms of social interaction, these three regularly and philosophically discussed how they would eventually contribute to the overall entrepreneurial ecosystem (yes, with a beer in the hand, not boring nerds at all).



Figure 2.1

A main question always was: What should we start? *'We know how (all three studied commerce degrees with entrepreneurship and business management as majors), we also painstakingly comprehend the critical mistakes our family businesses made, from cash flows to trusting the wrong people'*. The entrepreneurial link between idea and opportunity somehow battled to merge, but mentally they were ready to start.



Figure 2.2 The Kiph team at graduation



Figure 2.3



Figure 2.4

After completing honours degrees in business management the three had severe idea-generation-blocks as to which opportunity to exploit, and so many ideas surfaced over time (in incredibly diverse areas, from selling meat in containers in rural areas, to establishing a web platform where young entrepreneurs and investors could meet).

Their propensity to take risks and unremitting effort to find the sweet spot resulted in a critical decision in the entrepreneurial process, *'let's fetch it abroad'*. In 2011 international exposure was a decision that influenced their eventual route to market. The **entrepreneurial team** decided to explore the East. They ventured into and worked in China and Taiwan to learn one basic principle in an enormous market space: *Young people just love independent brands in apparel to stand out and individualise their existence*.



Figure 2.5 Kiph's slogan

This basic market fact ignited the **opportunity identification process** and likewise a clear understanding of the need for independent apparel designs. Another bonus was the coincidental fact that the principle talked to their passion for men's fashion.

In-depth market analysis moreover showed the increasing role of online shopping in this segment, with specific reference to the young male target market (18–35 years). That is how Kiph was born, an online men's apparel store selling independent brands, with a indicative slogan: Reject the ordinary (www.kiph.co.za).

The opportunity

Kiph and its reason to exist were driven by a feasible opportunity and not the mere raw idea to start a business or create a new online platform. Their idea generation process was inspired by *firstly* a passion for fashion and apparel, *secondly* technology adoption, and *thirdly* existing gaps in online offerings for South African market.

Wes mentioned recently, *'…we had this Creativity and* ***Innovation*** *subject in our second year, continuously comprehending the fact that an idea on its own means absolutely nothing. Understanding and exploiting the parameters of an opportunity spells success… We measure pretty high on creative awesomeness, but understanding the market requires much more analytics, especially in the online space…'.*

A vast amount of time was dedicated to feasibility and viability research in order to not only understand the following key components of establishing a winning recipe, but also linking the start-up process with almost no start-up capital (bootstrapping).

The structure of the market environment

How was this market environment structured? Various themes of investigation arose:

barriers to entry; the exact customer segments and targets; competitive structure and players in the same market, to name a few. It was quite a concern to determine the exact target market for their online offering. With reference to sex, should they select men only or a combination of men and women; also what type of apparel will this market accept and buy? Does this target market align them with an online value proposition that offers independent brands only?

Favourable business environment

Is the South African market really adopting the e-commerce scene, especially when it comes to buying clothes online? Our market environment still appreciates the physical shopping experience, the retail look and feel as well as payment over the counter (to a person rather than in a virtual format). Kiph's secondary market analysis showed the following evidence:

- The South African apparel retail industry generated total revenues of $6.1 billion in 2008, representing a compound annual growth rate (CAGR) of 8.3% for the period spanning 2004–2008.
- The South African footwear market generated total revenues of $1.56 billion in 2008, representing a compound annual growth rate (CAGR) of 6.9% for the period spanning 2004–2008.
- The South African menswear market generated total revenues of $1.7 billion in 2008, representing a compound annual growth rate (CAGR) of 7.8% for the period spanning 2004–2008.

The Kiph team's skill sets, and other resources

The three entrepreneurs all grew up in a business environment and got qualifications to postgraduate level in this sphere, but an online business requires a well-designed business model and specific technical skills (e.g. programming and development, which not one of them had, hence making it necessary to obtain these skills themselves, as it is extremely expensive to outsource). On the question of what other resources are required? *'…well basically their intellect and insight as well as determination and drive to make a long-term success of Kiph. We gave birth to it and had to make it work, every day of the week!'*. Part time jobs here and there and precisely all their savings were sourced as start-up capital. They literally boot-strapped for three years (and luckily had the opportunity to stay with their parents).

Identifying independent suppliers

A core competitive advantage of the planned offering was found in the uniqueness factor. They planned, from the outset, to sell apparel that would not be available in any brick-and-mortar store. The independence of the supplier was critical and the team also made a decision to not play the volume game, but rather attract a niche

market based on innovative designs. These suppliers should be an international mix to expand the unique variety of apparel.



Figure 2.6 A selection of independent apparel

Their criteria for selecting suppliers were:

- National or international
- Exclusivity
- Limited quantities
- Trending fashion.

All of these elements contribute to the core principle of independence as a brand.

Profit

A big concern of starting up was the margins involved in selling apparel online. Individuals are used to buying clothes in a store, trying them on and looking in the mirror. It's quite a gamble to assume that someone will follow the analogy of: seeing a picture of a shirt on a website; clicking to select (without fitting it on); providing credit card details to an unknown business; and relying on logistics to deliver to their

door. So, to keep stock the market does not want could eat vehemently into profit margins. Secondly, selecting a reliable courier company, which acts as a massive cost driver. Also a lot of money needs to be allocated to advertising, creating awareness and persuading the target market that the offering is unique and the business reliable. For the record, since 2011, Kiph has only had two returns!

Value proposition

The sweet spot, or final opportunity was formed by a combination of in-depth research, experience, exposure to international environments, new skill acquisitions, technology enablement and involvement coupled with focused passion. The three sat around a small table in a coffee shop in Hatfield, Pretoria and summarised the creation of a sound value proposition as follows:

'reject the ordinary…this all started with a simple idea: create a space that gives guys access to the best independent brands and designers from around the world. We wanted to find products and brands that strayed from the norm and didn't censor their approach to design no matter how wild or crazy. We looked for a sense of personality that can only be created by people who truly love what they do. It is that personality, and the individuality that goes along with it, that creates the true value. Style is about more than just the name on the label. It is about the freedom to be different, to step out of the cookie cutter and define who you are. It is that ability to be independent and to choose what defines you, that we wanted to create…'.

The offering: KIPH /pronounced kif/, *n.* a curated online space for independent men's design.

The entrepreneurial team

As mentioned, the three studied more or less the same degrees and all of a sudden had to apply diverse and non-schooled skills and experience in a totally unfamiliar business set-up. A key principle of bootstrapping a start-up is to do everything yourselves, from strategy to operational efficiencies. That is exactly what the team did to save money and even more so establish a well-designed organisational structure. One gigantic issue was the lack of knowledge, skills and experience in programming and web development, particularly with reference to creating an e-commerce site. Wes jumped in and taught himself both basic and advanced elements of programming, saving the company literally thousands of rands. Nate fulfilled the job of identifying, recruiting and managing independent suppliers. He also manages the entire logistical process (where timely and accurate delivery is a fundamental driver). Dane got the marketing and sales responsibility. A general misconception around online businesses is that they don't apply generic or specific marketing principles (it's on the internet, feet will just automatically swerve into the virtual shop). Dane realised from the beginning that their existence requires strong awareness and market

presence as well as continuous exposure. He also started a very popular fashion blog that gradually introduced their offerings to a focused target market.

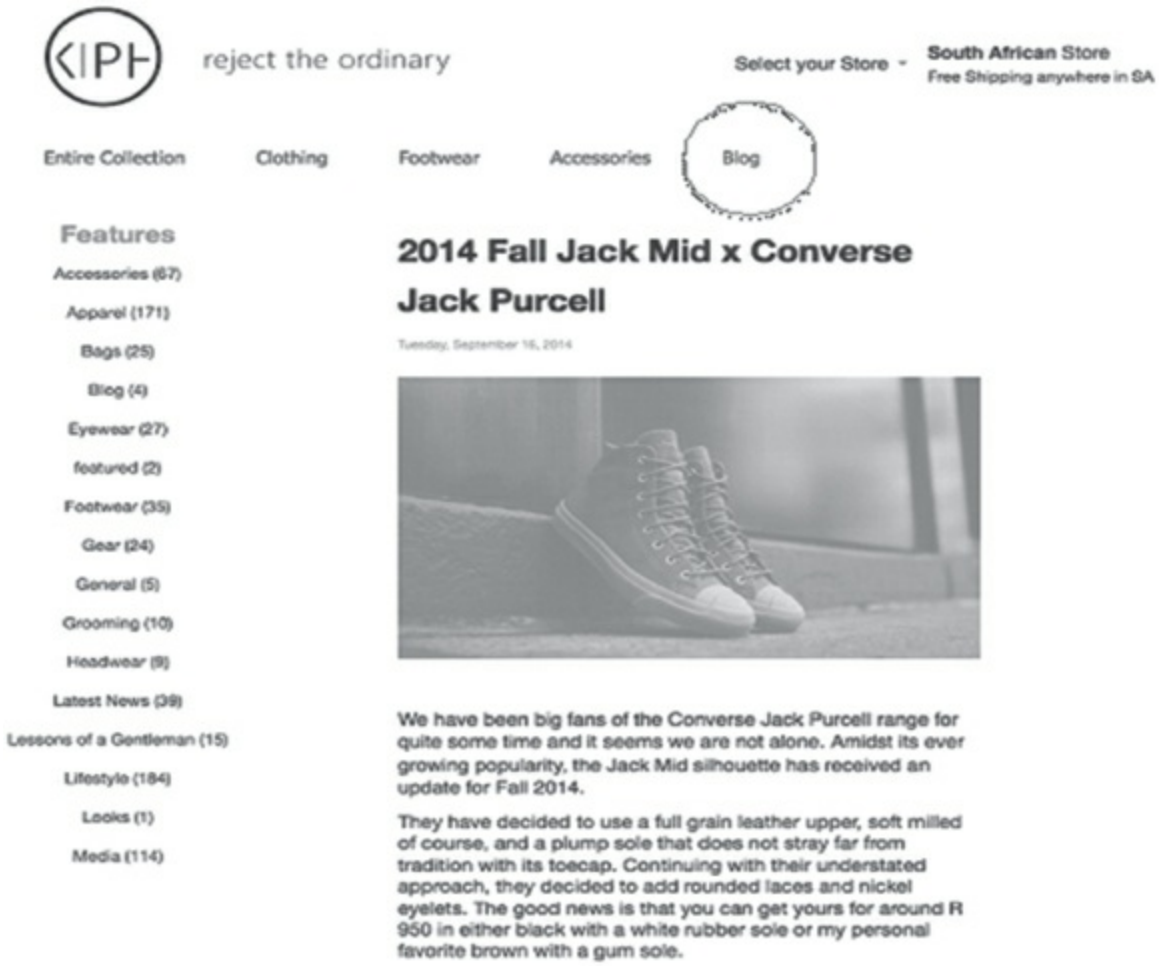


Figure 2.7 A screenshot from the Kiph blog

Dane correctly encapsulates the purpose of a blog: *'if the Kiph store is the brain then the blog is the heart and soul of what we do. It provides guys with the ultimate source of inspiration to step out of the cookie cutter and be who they are. Whether it be style advice and introducing new brands or articles about adventure, food and just plain living the dream, the blog sets out to curate all the things that guys love. It is a space dedicated entirely to them, a haven of the things that make men…men!'*

Establishing for growth

Nate summarises the start-up and establishment phase as follows: *'…we also realised that we didn't want to be just another online store. We wanted to help designers become real players in the SA market so we created a platform that would introduce them to the market as well as develop opportunities to make their products more accessible through distribution.'* Three years down the line a very unique online shop has evolved with a clear offering with the inclusion of:

- Language and currency customisation

- Worldwide shipping
- Brand specific pages
- Multiple product shots
- Product specific size guides
- Customer support via Facebook, Twitter, Skype and email.

Two fundamental and functional obstacles were highlighted so far in terms of **establishing for growth**: bridging capital and marketing. Financiers and even private equity investors don't really value the web-based business as a solid opportunity for financing or investment. The risk is too high, there are no physical assets and customer take is slow in South Africa. Coupled with this the three realised that the local market is rather small, especially with a niche market orientation. To overcome the latter they decided to branch into specific international market environments in, for instance, Europe, still bootstrapping but with immense exchange rate benefits and more volume. The international expansion is only possible because of the current national market penetration rate. Figure 2.8 summarises their national exposure.

The marketing function, including sales, embedded in an online store is overall a burning issue. It takes a number of trial and error attempts, normally costly ones, to refine the awareness and attraction elements of marketing. Again, a massive myth exists, especially among youth entrepreneurs, that online spells automatic streaming of customers. Instead, all the basic marketing principles still apply to the online space. The Kiph team tried, with varying degrees of success, the following marketing routes:

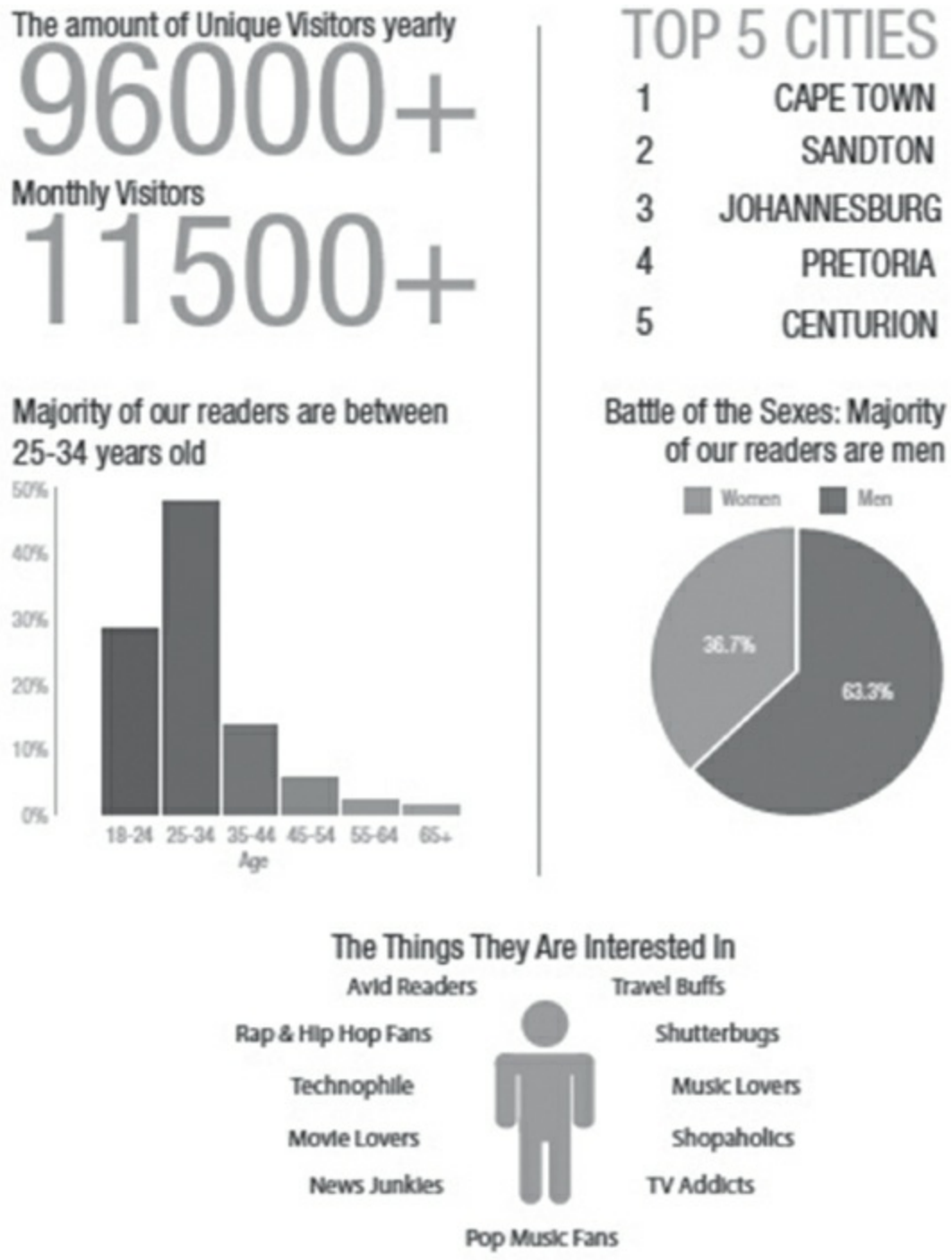


Figure 2.8 Kiph's market exposure in South Africa

- Google AdWords (e.g. Pay Per Click – PPC)
- Facebook group
- Blogging
- Advertorial in men's magazines (e.g. Men's Health)
- Guest speakers at several business school events
- Word-of-mouth (especially via their regular customers).

Conclusion

Kiph is more than an established online business. It has become a movement where

the independent designer may showcase newness (if they qualify), where the fashion-conscious thrive, and more so where South Africa will soon make an entrepreneurial mark in the international business arena.

Self-assessment questions

Easy questions

1. What ignited the startup of Kiph?
   a. Passion; technology; niche market for independent brands
   b. Passion; market size; capital availability
   c. Determination to start; development know-how; needs in the fashion industry
   d. b and c

2. Which entrepreneurial traits drove the start-up and establishment phases?
   a. Marketing know-how; experience; creativity
   b. Qualifications; passion; determination
   c. Creativity; risk propensity; opportunity identification
   d. None of the above

3. What criteria where used to select independent suppliers?
   a. Price; availability; timely delivery
   b. Quality; authenticity; proximity to Kiph
   c. Reputation; volume; delivery cost
   d. Exclusivity; limited quantities; trending fashion

4. Identify any three marketing channels applied in the establishment phase of Kiph:
   a. Google AdWords; Twitter; MySpace
   b. Facebook; newspapers; magazines
   c. Radio; Facebook; word-of-mouth
   d. Google AdWords; Facebook group; word-of-mouth

Challenging questions

1. The establishment phase of the entrepreneurial process in an online store has two critical issues at hand. Which ones are normally present?
   a. Technical knowledge and collateral
   b. Strategic planning and outsourcing
   c. Marketing and bridging capital
   d. Commitment from partners and book keeping skills.

2. A key element of the bootstrapping principle is:
   a. Do everything yourselves
   b. Outsource every non-core function
   c. Obtain debt finance to cover cash flow issues from the outset
   d. Make money with other people's money.

3. A strong value proposition was built at Kiph by _____:
   a. In-depth research; experience; exposure to international environments; new skill acquisitions
   b. In-depth research; experience; exposure to international environments; outsourcing skills they don't have
   c. Gut feel; experience; exposure to international environments; new skill acquisitions
   d. All of the above.

4. Which factors influence the assessment of the structure of market?
   a. Capital; the exact customer segments and targets; competitive structure and players in the same market
   b. Barriers to entry; the exact customer segments and targets; competitive structure and players in the same market
   c. Barriers to entry; the exact customer segments and targets; online presence
   d. Barriers to entry; word-of-mouth advertising; competitive structure and players in the same market.

5. What obstacles exist in persuading customers to buy apparel at an online store?
   a. Trust in the company in terms of payment
   b. No physical experience in fitting the clothes
   c. Quality of the products not visible online
   d. All of the above.

Essay questions

1. Discuss the three entrepreneurs in terms of their traits and skills as contributors to the establishment of an entrepreneurial business.

   Key points: passion; experience; relevant skills; exposure to markets; determination to bootstrap

2. Explain the term 'bootstrapping' by identifying key points and examples from the case.

Key points: strategic and operational involvement; capital contribution; skills distribution; internationalisation

3. What spells 'entrepreneurial opportunity'?

   Key points: structure of the market; market size; profit; skill sets; favourable context; profit; other resources

4. What advice could you provide to the Kiph entrepreneurs in order to over-come the two core establishment obstacles: marketing and bridging capital?

   Key points: insight!

5. Why would a company like Kiph explore and exploit international markets? Which specific international geographical target markets should they penetrate?

   Key points: local market too small; exchange rate benefits; exposing local independent suppliers to international markets; profitability

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1. All quotes obtained by the author from personal interviews with Wesley Rosslyn-Smith, Dane van Zyl and Nathan van Zyl.

3 The business environment: The airline industry

KEY TERMS

AIRCRAFT UTILISATION
CARTEL
COMMERCIAL AIRLINES
COST ADVANTAGE
COST LEADERSHIP
DEREGULATION
DIFFERENTIATION STRATEGY
ECONOMIES OF SCALE
FIRST-TIME FLYERS
FOCUS STRATEGY
FULL-SERVICE AIRLINES
'GOOD ENOUGH' QUALITY
LOAD FACTOR
LOW-COST AIRLINES
LOW-COST STRATEGY
MONOPOLY
NATIONAL FLAG CARRIER
OVERHEAD COST
OLIGOPOLY
PRICE ELASTICITY OF DEMAND
QUALITY PERCEPTIONS
SECONDARY AIRPORTS
SUPERIOR PRODUCTIVITY INCREASES
VALUE-BASED AIRLINES

Introduction

Commercial airline development has come a long way since the early days of air travel that started with the short flight by Wilber and Orville Wright at Kittyhawk, North Carolina on 17 December 1907 in the USA. By 1908 the Wright brothers had modified their plane to carry one passenger and so the air passenger business began.[1] Some of the pioneers in the field of commercial airline development were therefore from the USA and surprisingly also from the Netherlands. In South Africa the quest to fly commenced when the first aircraft was built at the small town of Brandfort near Bloemfontein by Admiral John Weston. The plane was however never flown at Brandfort and only flew in 1911 in South Africa[2]. The precursor to South African Airways was the Union Airways, which was registered on 29 July 1929 as an airmail and passenger service connecting all the major cities in South Africa at that stage. The main purpose was to deliver mail to the cities of Cape Town and Durban for international postage to be taken on board by the passenger ships operating between South Africa and Europe. This airline however ran into trouble when their newest plane crashed with the loss of life of passengers.

With the help of the Junkers Aircraft Company of Germany, Union Airways started operating again. On 1 February 1934 the national Union Government took over the assets and liabilities of the Union airways, which included some Junkers JU.52 aeroplanes that were the state of the art for that period, and so South African Airways was born[3].



Figure 3.1 The only South African JU 52 still in operation in South Africa.

In the early days of flying, before the Second World War, there was only one type of air travel called the **full-service airline** model. Passengers were transported in small numbers with frequent stops at a hefty price to make it financially viable for the airline operators of the day. The period before the war was also the era of the air balloon as a means of mass air transport until the tragic and fiery crash of the Hindenburg dirigible (air balloon) where most of the passengers on board were killed.

The commercial airline business globally started in earnest after the Second World War when surplus military transport planes were sold off en masse. The aeroplanes were mostly transport aircraft such as the DC-4, which were freely available and were converted into passenger carriers, albeit not in the comfort that we are accustomed to today. In most instances the business model followed by these airlines was the full-service model that is still in use today. This includes an extensive flying network, flying passengers to all the continents of the world. This model has a high fixed cost due to the massive capital investment needed to obtain aeroplanes and related equipment. There are also entrenched work-place agreements usually with a highly unionised workforce. Lastly, this model is usually used to carry the responsibility of being the **national flag carrier**[4] for the country, as in the case of South African Airways (discussed in more detail later), which is the second-oldest airline in the world after KLM Royal Dutch airlines.

Since its inception, the commercial airline business with its full-service model has struggled to survive and grow in the dynamic business environment in which it operates. Some of the biggest problems have been changing aircraft technology, a rapid increase in capital outlay to obtain top-of-the-range aircraft and the changing priorities of governments all of which have repeatedly forced commercial airlines to adapt to a dynamic business environment where politics plays an important role. Worldwide, full-service airlines have struggled with a number of problems that have changed the way in which this sector operates. One of the biggest problems was the first drastic spike in the oil price in 1973 that led to the first major fuel-price problem for international airlines. Other problems that full-service airlines have faced were complacency, inefficiencies and high cost structures under government protection. In the last few decades however, the whole playing field has changed with a massive increase in new entrants (competition) and the resultant price cutting that has occurred in Europe and North America. This was due to the **deregulation** of the airways business (a macro-variable in the business environment) which came about after a period of worldwide monopolies or an oligopolistic competitive situation. A **monopoly** occurs when one airway such as South African Airways is the only airway allowed to operate and service national and international routes. The development of a monopoly situation can be traced back to the Paris Convention of 1919 where the government of each country obtained the exclusive rights to govern its own airspace. Obviously this paved the way for state sponsored monopolies. Later on this monopoly situation changed to that of an **oligopoly**. An oligopoly exists when there are only a few airlines that control price and make it difficult for a new competitor to enter the market. They usually compete on nonprice issues such as additional service

and air routes travelled.

Deregulation started in the USA in the 1990s and brought drastic changes to the global airways business. It basically transformed the cartel-like aviation market to open up to competition. A **cartel** is an agreement between a group of airlines to regulate the supply of service provided to the public so as to control or manipulate prices. The difference between a cartel and a monopoly is that in the case of a monopoly a single airline owns about all the market share of the passenger market, whereas in a cartel a group of airlines would own the market share. The impact of deregulation brought the following changes to the American airline industry[5]:

- It created a hub-and-spoke system of airports where the hub is the major airport that all the airlines feed passengers to so that they accumulate and from where they are flown to other hubs or to international cities such as London, New York or Sao Paulo. On the spoke routes smaller aeroplanes were used which resulted in heavily congested hubs such as can be seen in London (Heathrow) and New York (JFK).
- Deregulation meant that new airlines usually started out competing with lower ticket prices. With the introduction of these new competitors the risk of failure grew as most of the new entries were under-capitalised and could not afford the increases in aviation fuel prices or were caught out when the larger established airlines retaliated with lowering their own ticket prices.
- The use of underutilised **secondary airports** in the USA. Secondary airports are found in larger towns and are typically less than 100 km from the national or international airports. These airports usually have all the facilities needed but on a smaller scale to the national and international airports as charter companies utilise them. The use of secondary airports resulted in lower costs for the low fare airlines, growth in the utilisation of air travel by new customer groups and more price competition.

In the same manner deregulation brought changes to the competitive models used by airlines and countries in Europe and the Americas. In a classic case of dog-eats-dog, numerous newly established **low-cost airlines** (also called value-based airlines) started to compete with the well-established full-fare airlines and this has resulted in a changed business environment for the global airline industry.

The development of low-cost airlines

The theoretical foundation of low-cost airlines can be found in the basic competitive strategies of cost leadership, differentiation and focus as propagated by Michael Porter (who is seen as the definitive author to contribute to the development of the theory of the competitive advantages of organisations and countries). Low-cost airlines basically followed the strategy of **cost leadership** or **low-cost strategy** which in practical terms was attained by flying a single aircraft type, fast turnaround time,

cabin staff cleaning the cabin and checking-in the passengers, increasing the number of seats in the plane, limiting luggage allowances, contracting out and paying less for personnel, cutting overheads by selling tickets online, no fixed investment in ticket offices and cutting the accommodation costs of crew by returning them to the home-base each night.

The full-service airlines on the other hand follow a **differentiation strategy** by using separate check-in facilities for the different segments of customers such as business class passengers. They provide airport lounges, spacious seating and convertible sleeper beds, complimentary cuisine, and extra luggage arrangements for this category of customer. Both the full-service and low-cost airlines make use of a **focus strategy**, with the full-service airlines targeting business, first-class and economy class passengers and the low-cost airlines targeting mostly **first-time fliers** and people visiting family and friends, a growth sector in the airline industry.

The first airline which flirted with a low-cost business model started just after the Second World War when Pan American (Pan Am) airlines started operating a tourist class air service between Florida, USA and San Juan, Puerto Rico. Passengers were handed boxed lunches for the trip, not dissimilar to the way in which the low-cost airlines operate today!

The first entrepreneur to develop mass low-cost travel between the UK and the USA was Sir Freddy Laker who established Skytrain in 1977, a low-cost, no-frills business model that charged about $100 per one-way trip between the UK and the USA. The low-cost alternative was helped by developments in aircraft technology such as the introduction of the Boeing 747 Jumbo aircraft, which was instrumental in making transatlantic mass air transportation possible. The Boeing 747 Jumbo can be seen as the Big Bang-moment in aircraft development. It meant a massive advance in carrying large passenger numbers. Previous aircraft types carried just over 100 passengers while the Boeing 747 could carry more than double that number of passengers with up to 400 passengers able to travel per flight in a special configuration. This **economies of scale** advantage resulted in a drastic increase in the capacity for air travel with an increase in sales of passenger seats. It opened the international travel market to a new category of customer who could now afford to travel to the USA and back to Europe. This development obviously led to a price war with the full-service airlines trying to protect their market share, resulting in massive financial losses for most airlines. It also led to the financial bankruptcy of Skytrain in 1982, which could not compete with national air carriers, most of who were directly financed by national governments.[6]

Two decades later better airline management, better access to capital sources and the liberalisation of protective measures by governments (deregulation) set the scene for the development of a sustainable new air transport model, namely low-cost airlines.

When low-cost airlines were first launched in Europe after the liberalisation of Europe's domestic airline market in 1997, Ryanair and easyJet, the pioneers, explicitly and expertly mimicked American budget airlines such as Southwest and ValuJet. The

essential elements of the modern low-cost business model were: a single-type fleet of planes; fast turnaround time; use of cheap secondary airports; no frills service – definitely no moisturiser in the toilets; internet distribution with most tickets bought online; and enticingly low fares that rose only as a flight filled up (the demand management pricing model). The target market for European low-cost airlines was the 18 to 30 age group who were mostly first-time flyers.[7]

Let us take a careful look at the business model used by these low-cost carriers.

The business model of low-cost airlines

The following aspects form the basis for the emergence and success of low-cost airlines:

The role of price elasticity of demand

The fundamental theory of **price elasticity of demand** provides an economic explanation as to why passengers are interested in flying with low-fare airlines and why these airlines are in a position to charge lower fares. The price elasticity of demand refers to the percentage change in the quantity demanded from a change in the price.[8] If a decline of 50% in the price results in an increase in demand of 100%, we say that the price for the service is elastic within the price range. This is also the price principle being followed by domestic low-cost airlines in their assault on the South African passenger market.

What is of further interest is the fact that South African airlines are following the same strategy as some of the now famous European and American low-cost airline icons such as Ryanair and Southwest Airlines.[9] These two airlines have as a strategy a powerful combination of low airfares and good service to win the hearts and minds of passengers in their respective countries and can be described as truly value-based players in the airline industry of their continents.

Value-based players' competitive edge[10]

The power of value-based airlines is centred in a few areas, namely having a **cost advantage** in the airline industry and in the relentless way in which this cost advantage is pursued. Furthermore their competitive strength is based on the potency of the shift in consumer perceptions regarding the quality of the service that they offer. These two aspects will now be discussed in greater detail, following which some additional reasons that contributed to the value-based airlines' success will be discussed.

Cost advantage

Ryanair has a cost advantage over its competitors. For instance, it charges lower fares

by departing from lower-cost airports (e.g. departing from Gerona which is 60 km from Barcelona while the national carriers depart from the Barcelona city airport), utilising aircraft more optimally by flying them more hours a day (called 'sweating the assets'), keeping labour costs low, selling tickets online and providing no in-flight frills. The current state of operations by Ryanair is described in the following excerpt.

Operations by Ryanair in 2014

Ryanair operates more than 1 600 daily flights (over 500 000 per year) from 69 bases in Europe, across 1 600 low fare routes, connecting 186 destinations in 30 countries and operating a fleet of 300 new Boeing 737-800 aircraft. Ryanair currently employs more than 9 500 highly skilled professionals, which will carry approximately 84.6 million customers in 2014. Ryanair has an outstanding 30-year safety record in the airlines business.

The financial and operational performance of Ryanair during the period 2014 shows that the load factor (the number of passengers carried) was 84%, which is extremely good.[11] Although the load factor was good there was a decrease in net profit for the period. Some of the reasons for the decline are the drastic increase in fuel prices and increased competition in the low-cost segment of the market. In order to keep abreast to changes in the market, Ryanair is also trying to improve on their customer experience which as explained previously was a bare-bones service where the customer was allowed minimal luggage and first-come-first-seating. Ryanair are renowned for the lowest fares, on-time flights and having a fleet of state-of-the-art Boeing 737-800 aeroplanes. In addition they have introduced services such as allocated seating, an easier to use reservation website, a free small second carry-on bag, a 24 hour grace period to correct minor booking errors when booked online, reduced boarding card and airport bag fees, and a new service to cater for groups and corporate travellers. They also introduced a new family service which allows children (when travelling with their family) to receive discounts on allocated seats and baggage while frequent-flyer families can qualify for discounts on future flights. From this it would seem that even Ryanair, which was seen as the purest form of low cost airline in operation, has moved with the times by operating what is called a hybrid model business (hybrid means neither full-service nor pure low-cost air service).

Southwest Airlines in the USA are following the same business model with a load factor of 81.4% for 2013. The cost advantage of Southwest Airlines is explained in the following excerpt.

The cost advantage of Southwest Airlines

Low costs have given Southwest Airlines in the USA the competitive advantage of having America's lowest fares. This advantage has created a phenomenon known in the airline industry as the 'Southwest effect'. Airports served by Southwest have lower average fares than those that are not because competitors feel compelled to match Southwest's fares.

In 2011 Southwest and AirTran, which was a competitor in the market, merged[12]. The fleet of Southwest's aeroplanes consists of the new Boeing 737-800, Boeing 737-700 and 737-300, combining both old and cutting edge aeroplanes and thus a bit different from Ryanair's fleet. Despite the difference in aircraft they are still all Boeing 737's, making the fleet more cost-effective to maintain. Southwest also started flying outside mainland America with a service to San Juan (Puerto Rico). As in previous years Southwest kept its employees' jobs secure and kept its record of profitability intact (41 years in a row!) which is a record in the history of USA aviation. The vision of Southwest is expounded in the following excerpt:

Vision of Southwest airlines

Our passion for a triple bottom line approach that takes into account our performance and productivity, the importance of our people and the communities we serve, and our commitment to efficiency and the planet has made us one of the most honoured airlines in the world. As of December 31, 2013, our 44 831 employees operated more than 3 600 daily flights, serving 96 destinations in 41 states, the District of Columbia, the Commonwealth of Puerto Rico, and five near-international countries (previously serviced by AirTran). On May 2, 2011, we completed the acquisition of AirTran Airways and now operate AirTran as a wholly owned subsidiary of Southwest.

No difference in the quality perceptions offered by the low-cost airlines

Customers do not encounter a big difference in quality between full-service and low-cost airlines. Although passengers flying with Ryanair could not reserve seats in advance in the past, the quality gap between Ryanair and British Airways (the official UK carrier) is perceived to be closing, particularly with regards to service, convenience and the buying experience.

Value-based airlines attract large numbers of passengers with the winning combination of low prices and **'good enough' quality**. With the large number of passengers these airlines obtain economies of scale, which translate into **superior productivity increases**, something that is unattainable by traditional airlines.

Both Southwest and Ryanair have a major advantage regarding cost-per-available-

seat-mile. With this saving they can offer the cheapest possible fares, thereby generating above-average customer loyalty as well as profitability, which in turn generates a virtuous cycle whereby the company can charge even lower fares, open up more routes, and stimulate even more traffic.

Another reason for the success of Southwest lies in the treatment of the airline's personnel.[13] Management believes that when employees are treated well, they will treat customers well, creating a beneficial situation for all stakeholders. This does not mean that the personnel get fat pay cheques. In fact, Southwest Airlines wages are generally lower than those of competitors but the company sweetens the deal by making stock options available to employees, enabling them to benefit from the airline's financial success. What further endears Southwest to its employees is a no-layoff policy, even in the darkest days after September 11 (the attack on the World Trade Centre in the USA) and the years following the 2008 recession that impacted on the global economy and reduced disposable income, impacting negatively on air travel passenger numbers.

Additional reasons for success for a low-cost airline[14]

The following are additional reasons for the success of the low-cost airlines industry:

- Strict cost control (especially in operations, technology and marketing) to lower the **overhead cost**. The use of the internet from the late 1990s onwards created the opportunity for the low-cost airlines to reduce distribution costs. Consumers gained confidence in using the internet for air travel with enough information enabling them to book travel without the aid of an airline representative or travel agent. This resulted in a more informed and powerful consumer creating a fundamental shift in power between consumers, the airline and the travel agency. The consumer now had access to information and pricing of multiple airlines without the filter of an intermediary. This new technology further helped to commoditise airline products as air travellers were able to more easily compare price and time-tables.[15]
- A flexible and fast Revenue Management Component (the management of revenue managers to promptly and accurately determine the yield of any flight so as to ascertain if it is profitable to fly the route).

The low-cost airline business model in South Africa

As the national flag carrier, South African Airways (SAA) was protected from competition for over 40 years following the promulgation of the International Air Services Act, also known as the Air Services Act No. 51 of 1949. During this period SAA was the only service provider on the main domestic airline routes as well as the international airline routes. Any airline that wanted to compete with SAA had to provide evidence to the government that a need existed that was not adequately

serviced by SAA[16]. Obviously this requirement made it almost impossible for a fledgling airline to compete against SAA on any of the main routes that it serviced. SAA thus had a total monopoly on the high-density routes and any private airline was consigned to fly on the feeder routes to gather passengers for SAA to transport on the main routes.

When deregulation was introduced in South Africa in 1991 there were four active airlines operating in South Africa, namely[17]:

- South African Airways (SAA), established in 1934 serving high density routes such as the 'Golden Triangle' (this is the three flying legs between the cities of Johannesburg, Cape Town and Durban which carries the majority of passengers in South Africa) as well as international routes.
- Comair, established in 1945 and serving secondary routes.
- Link Airways (later called SA Airlink), established in 1978 and serving secondary routes. SA Airlink (in alliance with SAA since 1993 and SA Express from 1994) commenced operations in 1992 following the collapse of Link Airways, due to financial problems. This airline is still operating today on feeder routes to the main cities of South Africa as well as supplying regional air services to countries outside the South African borders. SA Express started operations in late 1993 and has SAA as a major shareholder through Transnet. SA Express still flies some of the lower-density domestic routes such as Bloemfontein, Kimberley, East London and regional routes.
- Bop Air (later called Sun Air), established in 1979 with its head office in the Bantustan Bophuthatswana in what is today the North West province of South Africa. They subsequently went out of business as will be discussed below.

With the advent of deregulation, SAA as the monopoly national carrier had an estimated domestic market share of more than 90% of all scheduled passengers with about 75% of these passengers travelling the 'Golden Triangle' routes between the cities of Johannesburg, Cape Town and Durban. What is clear from the above discussion was that SAA was the dominant airline in South Africa with only Comair as a very distant second competitor in the market place.

The first decade after deregulation resulted in a wave of low cost airline competitors such as Flitestar, Sun Air, Phoenix Air, Nationwide, 1time and Velvet Sky entering the domestic market, with most of these new entrants failing spectacularly within a few years[18]. The list of airlines that competed in the market and failed after deregulation warrants a discussion commencing with Flitestar.

Flitestar

This was the first privately owned domestic airline to enter the market following deregulation. It commenced services in October 1991 and focussed on operating the Golden Triangle routes. In April 1994 Flitestar discontinued services after two and a half years in operations. The reasons provided were high fuel costs as a result of a

weakening exchange rate and the expensive lease agreement of the fleet that was to be settled in US dollars.

Sun Air

Sun Air started operations in 1994 and employed most of the redundant Flitestar staff using old DC9 aeroplanes. It operated the Golden Triangle and other domestic routes in South Africa. In 1999 SAA announced that it had taken over the airline and subsequently closed it down thus taking a direct competitor out of the market.

Phoenix Airways

The airline commenced operations in December 1994 and also focussed on the Golden Triangle routes as its primary market. It used old Boeing 727 aircraft that were fuel-inefficient during a time when the price of fuel skyrocketed. The maintenance on the planes was high and Phoenix encountered intense competition in a market that was populated by Comair, Sun Air and SAA[19]. It was therefore never a viable long-term business proposition.

Nationwide

Nationwide Airlines started out in 1992 using old Boeing 727s and Boeing 737-200s and various smaller aircraft to compete on the Golden Triangle and other routes in South Africa as well as to countries around South Africa. It also had a regular international flight service to London. It previously operated as Care Air and had a code share agreement with Sabena (the former national carrier of Belgium) as competitive advantage. The airline was however closed down in 2007 after a Nationwide Boeing 737-200 lost its right engine minutes after take-off from Cape Town airport.

1time[20]

1time started operating in February 2004. One of the reasons for the start-up of 1time was the low aircraft acquisition cost due to the aftermath of the September 11, 2001 disaster (the World Trade centre attack) in the USA which made aircraft more freely available. There were also cost savings due to the use of a standardised fleet of aircraft (the MD80). Management was also convinced that the domestic market had grown rapidly and that there was ample room for future growth as more South Africans were using air travel as a viable alternative for domestic travel. Their logo says it all: 'more nice, less price', clearly indicating the low price for airfare angle. The name, 1time ('one time') is a colloquial word meaning 'just like that' or 'for real!' This name was chosen to echo the South African roots of the airline.

1time ensured that it followed the objectives and targets of the Aviation Transport Charter. One such objective is to include a targeted 25% black empowerment

shareholding. 1time holdings was listed on the AltX part of the JSE stock exchange on 14 August 2007 with 100% shareholding of the business units 1time Airline, 1time Charters, Aeronexus Corporate and Aeronexus Technical. The last business unit maintained the single type aircraft used by 1time for its flights in South and Southern Africa making 1time holdings a vertically integrated business model.

In the period that it operated 1time had three main partners, also referred to as its leading and preferred suppliers. These included Avis Rent a Car, City Lodge Hotel Group (1time passengers had the advantage of between 5% and 20% off rack rates) and AA Travel Guides which at that time offered a real-time booking service with bed & breakfasts and guest houses. Each partner had a visible link from 1time's website and vice versa.

Originally, 1time flew between Johannesburg and Cape Town and also operated additional return flights from Durban, East London, Port Elizabeth and George. By 2011 1time was heavily involved in the regional expansion of its services into southern Africa with regular flights between Johannesburg and Livingstone, Maputo and Zanzibar. Its target market was business travellers, leisure travellers as well as those travelling to visit friends and relatives (VFR). The airline was also innovative in its marketing campaign that introduced on-board advertising, the first of its kind in South Africa. This type of advertising medium conveyed tailored messages on the back of 1time's seats as well as on the tray tables, which complemented the travel environment.

Despite all these marketing activities 1time went into business rescue in 2011 until it was liquidated with short-term debt of R320m in 2012. 1time was taken over by a BEE consortium in 2011 that was funded by the Industrial Development Corporation (IDC). Management consultants who worked on a financial rescue plan before liquidation occurred were of the opinion that both the old and new management of 1time had no clue about running a budget airline. They stated that important managerial aspects such as corporate risk and cash flow management were left on the backburner while management complained and blamed the uneconomical MD80 aircraft that it was using for the airline's failure. Management was also paying itself annual management incentives despite not having structured performance measurement or any real accountability[21]!

Velvet Sky

Velvet Sky started operations in March 2011. Within hours of being available to take reservations, the Velvet Sky website had over a million hits, and nearly 60 plane loads of passengers bought tickets online on the first day. Velvet Sky operated out of Durban and flew the Golden Triangle between Durban, Cape Town and Johannesburg. Opening specials on a single flight from Durban to Johannesburg were R200, and R400 between Durban and Cape Town. These fares were below cost but were used to announce the new service and to build Velvet Sky's brand name. Its point of differentiation was the claim to be the cheapest airline and to provide good

customer service to its passengers. A week after the launch Velvet Sky was already in the news, albeit for negative reasons, as its only aircraft at the time encountered a technical fault with massive delays for passengers. In May 2012 Velvet Sky was put under provisional liquidation and the order for permanent liquidation was finalised in June 2012. During the hearings it was established that Velvet Sky owed almost R100 million to its creditors[22].

In summary it can be stated that like in other countries of the world, South African entrepreneurs who ventured into the low-cost airline business after deregulation also encountered the same problems as their international counterparts with the majority going bankrupt as described above.

Currently the low-cost airline market in South Africa consists of two or possibly three competitors, namely kulula.com, Mango, and Fly Safair. Let us take a look at these current airlines that compete for a market share in this dynamic market.

Current low-cost airlines operating in South Africa

kulula.com

kulula.com is one of the brands that is operated by Comair Limited in South Africa. Comair also operates the British Airways brand under license from British Airways Plc in the UK. Kulula is the Zulu word for 'easy'. The directors of Comair realised that there was a gap in the market for a low-fare airline, especially after the demise of various airlines such as Sun Air and Nationwide. They followed the same business model as their overseas counterparts, with Novick, then CEO of kulula.com confirming a cost advantage in South Africa as they 'sweat the assets' – flying among others up to six sectors a day on the Johannesburg to Cape Town route, utilising each of the planes for up to 12 to 14 hours a day.[23] kulula.com initially did not offer additional services that cost money such as frequent-flyer programmes, complimentary meals on board, pre-seating customers and paying commission to travel agents and tour operators. Novick stated that safety standards were non-negotiable and that kulula.com had a strong customer base and a strong brand.[24] They also won the ACSA-Airports Company's award for best domestic airline in 2002 for the first time and have since won this award together with many others, strengthening the positive **quality perception** of customers.

kulula.com was introduced in August 2001 with a limited number of flights daily between Johannesburg and Cape Town. Customers suddenly had a drastically cheaper option to fly between Johannesburg, Cape Town and Durban, making air travel affordable to many more South Africans and hence stimulating the market for air travel. Airfares of R400 per one-way trip between Johannesburg and Cape Town rocked South African Airways, starting a price war with customers being the main beneficiaries and broadening the passenger market. kulula.com currently flies from Johannesburg (OR Tambo and Lanseria) to Cape Town, Durban, George and East London, and between Cape Town and Durban, and has recently entered into a code

share arrangement with Kenya Airways. It was also the first airline to make use of a secondary airport similar to the success recipe of overseas low-cost airlines. Lanseria is situated 40 km northwest of OR Tambo and is smaller and less congested than the national gateway airport. It provides scope for all the low-cost airlines to expand their operations and is the only secondary airport in South Africa that fulfills the criteria of an airport that can be used by low-cost airlines such as is being done in the USA and Europe.[25]

kulula's mission statement is not the run-of-the-mill statement that you find in the annual report of most companies. It reflects something of the corporate culture of the airline. The mission statement reveals the image of a down-to-earth company. Their mission statement reads as follows:

kulula.com's mission statement

'To deliver an awesome travel experience in the most efficient way.'

Safe and professional

At no time is our dedication compromised. Our most important principle is 'safety first'.

The easiest around

This means that not only can people fly with us; you can hire a car, get a room or book a chauffeur-driven cab to the airport. We'll always aim to provide the easiest way to book, the easiest way to pay, and above all, the easiest to afford.

Simple

We don't complicate things. We don't use high-and-mighty language or overly wordy descriptions. We get to the point and that's that.

Totally honest

This means we tell it like it is. We're not shy of being straight and down-to-earth. There are no hidden costs. What you see is what you get.

Great fun

We help people lighten up. Smiles and jokes are free. We always want to be genuinely friendly and provide the right environment for our staff's natural talent to shine.

Inspirational

Wherever possible, we provide our staff with the best opportunities to develop their skills, and take their abilities to new heights in the service of our customers. We are more than just an airline… we're an entire travel experience. Wherever our customers see the kulula. com brand, they can expect these values.

kulula.com also is quite open about its airfare pricing and released the following comprehensive picture explaining the way in which their pricing is structured. The sizable chunk of government taxes in various forms described on the following page is an eye-opener![26]

Services offered by kulula.com

The entire kulula.com fleet had been upgraded to state-of-the-art Boeing 737-800s which provide higher seating capacity, lower operating cost and greater economies of scale through the extended daily utilisation of the aircraft (economies of scale in the airline context means that the current aircraft can be used on more flights per day). kulula.com offers additional services to its customers: flights between the major destinations in South Africa, hotel reservations, car rental and holiday packages and a frequent flyer programme. It also has a kulula.com credit card in conjunction with FirstRand Bank. The logo of kulula.com flights includes the slogans 'Now anyone can fly', and 'full-on travel' thereby appealing to the widest possible target market. The kulula.com/cars service was launched in August 2002. These services complement one another. When passengers buy an online return air ticket from kulula.com they may also rent a car or book a hotel. kulula.com also offers a reasonably-priced shuttle service to and from the airport.

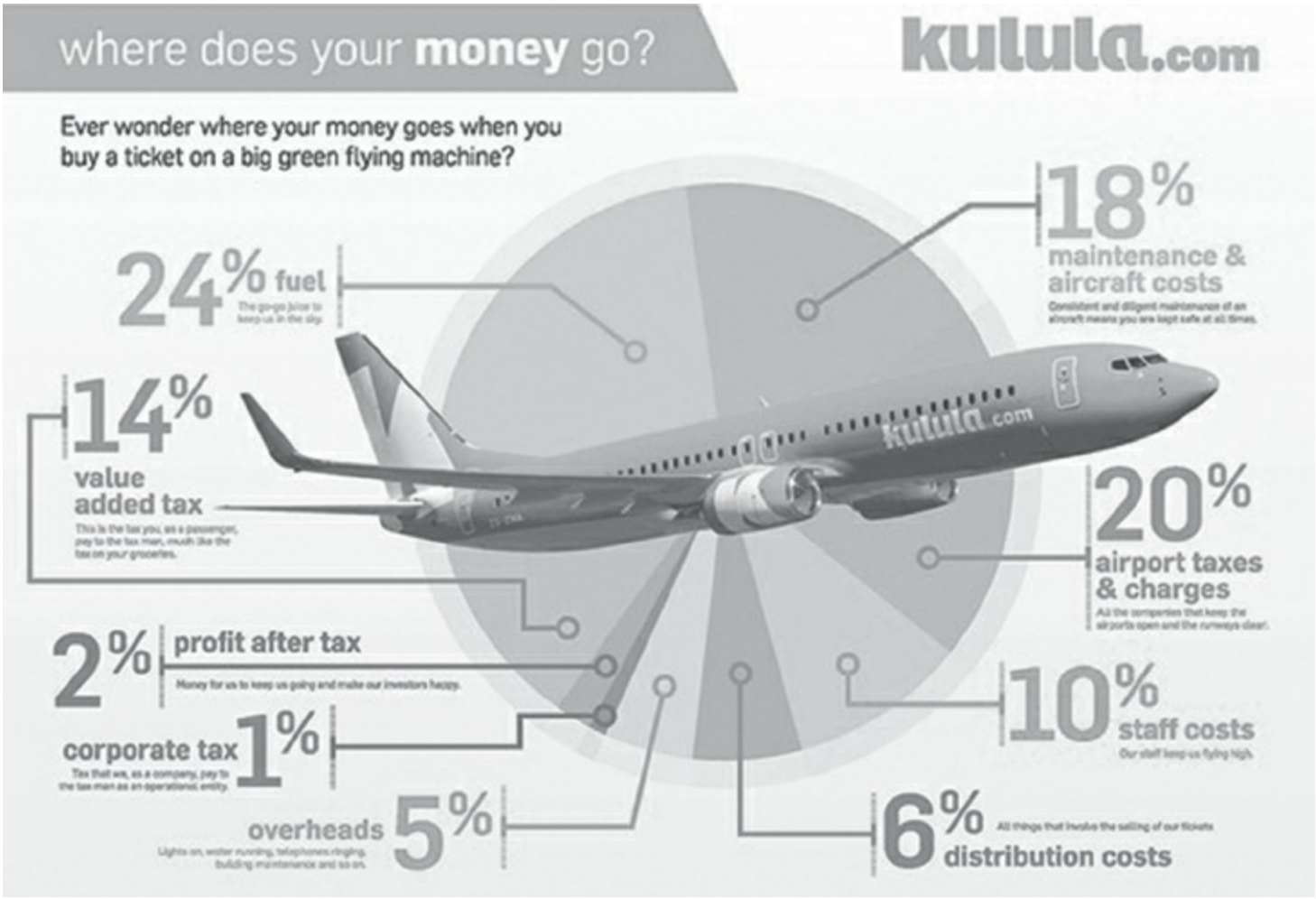


Figure 3.2 A breakdown of kulula.com's pricing

In January 2011 kulula.com once more showed their innovation by introducing an online check-in system where customers can print boarding passes in their homes and offices and jump the long queues at the major airports in South Africa. Passengers with luggage can drop their luggage off at the 'fast bag drop off' points at

the major airports and proceed to security. Passengers without luggage can walk straight to the security points.[27] The financial reporting system of the Comair group does not show kulula.com's individual performance but in the report it is indicated that the **load factor** remains at 80%.[28] Future growth is seen to come from regional expansion of kulula.com into Africa as well as diversified growth in lounges at major airports and business centres, all of which will be catering for business passengers.[29] These latest developments seem to indicate that kulula.com is reconsidering their original low-cost recipe as these services will add cost to the bottom line of the company. In the process of developing its business model kulula.com became South Africa's largest online retailer by annual sales value[30].

kulula.com is also growing more aggressive in its advertising by taking the mickey out of its national carrier competitor SAA. The advertisement below which shows some of the hallmark aspects of SAA's livery depicted on a kulula aircraft (e.g. the tail which depicts the South African flag (although slightly different) is a hallmark of all SAA planes, as well as the wording in the same font that is also found on all SAA planes). Naturally SAA complained to the Advertising Standards Authority, who ruled at the end of July 2013 there was no breach of the Advertising's Code of Good Practice. The catchline of the advertisement, 'coming and going soon', indicates that kulula.com was sure that their actions would exert negative reaction from the competition. They have over the years won numerous awards for their witty advertising campaigns.



Figure 3.3 kulula.com's advertising

Mango

South Africa's low-cost airline, Mango, was launched in October 2006 and its first

flight took off on November 15 of that year. Mango is owned by South Africa's national carrier, South African Airways (SAA). Mango received its start-up funds from SAA in the form of a R100 million loan. Low-cost competitor kulula.com accused Mango of using taxpayer's money from SAA to subsidise its operations[31] and that Mango will not be obliged to be profitable. Mango, however, is operated completely separately from SAA and has developed a reputation for punctual service. The slogan of Mango says a lot about what this airline stands for, namely 'Why not today?', implying the regular use of flying as commodity decision for customers.

During the first week of operations, Mango was selling flights at the low price of R169 per one-way ticket and as celebration of its first six months of success, Mango had a promotion where it sold a number of tickets at only R1 per ticket. kulula.com accused Mango of only doing this because it was subsidised by South Africa's national carrier,[32] which is a government enterprise. The competing low-cost carriers felt that this was unfair and that it put extra pressure on them.[33] Mango's then chief executive, Nico Bezuidenhout, said that the extent of SAA's involvement was the R100-million shareholders loan and that Mango had complied with competition regulations.[34] Bezuidenhout stated that Mango could afford to charge so little because of the fuel efficiency of the fleet of Boeing 737-800s, which are at least 10% cheaper to operate than other aircraft, and have a higher seat density of 186 seats compared to their competitor's aircraft (157 seats).[35] He also said that Mango has high **aircraft utilisation** of 12.5 hours a day, which help keep costs down, compared to kulula.com who operate fewer hours per day.[36] Contributing to Mango's success is the fact that the carrier has an average load factor of above 80%, which compares well with its competitors.[37]

In the financial year 2012/2013 Mango achieved the highest turnover and bottom-line profitability during its time in operation. Mango turnover reached R1.36 billion resulting in a net profit of R39.1 million. This was achieved during a financial period where there was a decline in domestic passenger numbers of 4.6%, resulting in the demise of two opposing domestic low cost carriers[38]. Mango is also continuing its focus on innovation with the launch of the first African on-board Wi-Fi service. The G-Connect In-flight Wi-Fi service was an immediate success with a take-up of more than 6%[39].

Currently Mango is flying domestic flights between Johannesburg, Cape Town, Durban, Port Elizabeth, Lanseria and Bloemfontein as well as regional flights to Zanzibar. Mango's commitment to making low-cost air travel more accessible to all South Africans is evident by the partnership formed with Edcon (the major fashion and lifestyle retail chain) and Shoprite/Checkers, the major FGTC retailing group in South Africa. Edcon is the brand owner of Edgars, CNA, Boardmans, Legit, Prato, Red Square, Temptations, Jet, Jet Mark and Jet Shoes amongst others. This partnership enables Mango to offer more affordable flights and more convenient ways to pay for flights for customers who have a store charge card at one of the Edcon retail chains mentioned above. At Shoprite/Checkers customers can book and buy Mango flights. Mango also has a partnership with Tempest (a car rental company that awards Mango

travellers generous savings), Tsogo Sun Hotel Group (offers Mango flyers preferential rates), AIG (preferential travel insurance) and Momentum Multiply that is a rewards programme offering Momentum clients excellent discounts flying on Mango[40].

What is interesting in the Mango business model is that contrary to what other low-cost airlines are doing, they also cater for the business class passenger with the Mango Plus and Mango Flex corporate fares, providing additional benefits such as complimentary refreshments on board, 10kg extra baggage allowance, access to lounges at the airports and free changes to flight bookings.[41] This raises the point that Mango, in catering for business class passengers in this manner, is reverting to the full-service model, making it not a classic low-cost airline but more of a hybrid operating in-between the full-service and low-cost airline models.

Fly Safair

Fly Safair was established in August 2013 and obtained approval from the South African Air Service Licensing Council to introduce ten daily services between Johannesburg's OR Tambo International Airport and Cape Town International Airport. The granting of the license was however challenged by Comair group who objected to the fact that the ownership profile was not all South African. The mother company Safair has more than 50 years' experience in South Africa in the freight business. By July 2014 Fly Safair was still not operating but advertisements were placed recruiting experienced cabin crew for possible launch in September 2014. The first flights launched in mid-October 2014 from Cape Town to Johannesburg, with a Cape Town to Port Elizabeth route following shortly thereafter.

Rumours are also doing the round that more low-cost airlines want to enter the highly competitive airline market. SkyWise was one such proposed airline of the South African National Taxi Alliance Company, but nothing was realised. Lonrho Plc-owned Fastjet is flying in other parts of Africa and has also spent two years trying to obtain a domestic operating license, but ran into problems with regulatory requirements regarding local shareholding[42].

Having covered the low-cost airlines and to complete the competitive business environment of commercial airlines in South Africa we will now briefly look at the two full-service airlines operating in South Africa.

Full-service airlines operating in South Africa

Comair

The only real competitor to SAA in the early days before deregulation was Comair. Comair Limited started in 1946 when a few South African pilots with Second World War experience and ex-military aircraft decided to start an airfreight business that later broadened to carry passengers, also using the full-service concept. Comair was one of the four airlines operating before deregulation occurred in South Africa but it

was relegated to serving feeder routes only. After deregulation Comair started in August 1992 with services between Johannesburg and Cape Town and quickly proceed to service the Golden Triangle routes. In 1996 it became a franchise holder of British Airways and was allowed to use the British Airways brand name in South and southern Africa. In 2000 British Airways obtained a minority shareholding in the Comair group. Currently the Comair group flies between Johannesburg, Cape Town, Durban, Port Elizabeth, Livingstone, Mauritius, Mozambique, Lusaka, Harare, Windhoek and Victoria Falls. Comair is probably the only airline to have achieved operating profits for 68 consecutive years whilst having a safety record which is internationally recognised[43].

The Comair group operates its scheduled airline services under two brands, namely, the low-cost kulula brand (already discussed) and the British Airways brand, the latter under licence from British Airways Plc. Their fleet of aeroplanes consists of 26 aircraft, all Boeing 737s ranging from the most recent B737-800s to the older B737-400s and B737-300s. Comair is currently in a legal fight with SAA regarding the financial bailouts that SAA received. The most recent legal wrangle is a challenge against the South African government's R5 billion guarantee to keep SAA financially afloat. The main argument from Comair is that government agreed with deregulation to level the playing field for all competitors in the South African airlines businesses. The competitive market of Comair is directly influenced by SAA which is owned by the South African government, making the government a player and referee in the market.

Comair's turnover however increased by 29%, mostly as a result of increased ticket prices in response to exchange rate related cost inflation and less competition in the market place (with the demise of two low cost competitors). The weak South African economy also influenced the turnover, which is 5% down on the 2012 financial year while the 2008 record passenger figures are still far from being reached. Comair also reported that it was worried about damage to the reputation of the airline industry due to the demise of several low-cost airlines. It reported that the demise resulted in state infrastructure suppliers writing off over R250 million in debt, with private sector suppliers incurring losses of over R100 million and that the banks (with passenger credit card payments) took the hardest knock being liable to passengers who paid up front for flights that did not occur. To put current industry profitability in perspective it was reported by Comair that in the domestic industry average ticket prices have only increased by 14% since 2001, while operating costs have increased by 163% and the consumer inflation index increased by 98%[44].

South African Airways

SAA is the national flag carrier airline of South Africa and has been so for the past 80 years. With the South African government as the single shareholder SAA had a tenuous balancing act to perform. On the one side it must bow to the dictates of government regarding national strategy in which there a good dollop of political

manoeuvring involved. Having to be the airline to carry the South African flag implies being involved in operations and flying to destinations where it is not really economically profitable to do so. A case in mind is the current dictate to connect with all the BRIC countries. Obviously these actions must impact on the bottom-line of the airline. On the other hand it is reassuring to have a shareholder where if you run into financial trouble you could take out the begging bowl to ask for a capital injection. Let us briefly look at the current management philosophy of SAA as depicted in the following excerpt.

Management philosophy of SAA

Mission

To deliver sustainable profits and grow market share through world-class service to customers internally and externally.

Vision

An African airline with a global reach.

Core business

The movement of people and goods by air.

In 2006 SAA split from Transnet, its former parent company, to operate as an independent business entity. SAA has established links with other domestic airlines such as SAA Airlink and South African Express Airlines as previously discussed. SAA also owns Mango Airlines, a low cost South African airline that competes in the low cost airline market domestically against kulula.com and Fly Safair.

SAA carries a lot of status in the African market as it is a member of the Star Alliance, the biggest airline alliance in the world. It has a prestigious Skytrax 4-star airline ranking and earned the Skytrax best African Airline award for numerous years. From its international hub at OR Tambo it flies to 38 domestic, regional and international locations. With all these positives there is also a downside to SAA and the way that it operates in the South African market place. In the financial year to March 2013, SAA reported a net loss of R1.17bn. In the 2012 financial year its lost was R843m. Over the past 13 years the South African government had to provide 'equity injections' of more than R16bn to buy or lease aeroplanes and to keep SAA running[45]. Over a ten year period SAA has had four chairmen, three CEOs and two acting CEOs, and a massive turnover in board members[46].

The question therefore arises…what is wrong at SAA? Some of the problems facing SAA include:

- SAA as a business entity does not depend on a bottom line of profitability. All SAA top management have to develop strategic plans and run to their sole shareholder for capital[47].
- SAA lacks a coherent international strategy. They don't know what their

international strategy is and which international routes to fly so they do not really know what type of aircraft to buy which could be the reason why SAA not making money on international routes[48].

- A range of four-engine Airbus aeroplanes on international routes that are perceived to be obsolete[49].
- A lack of a strategic management plans and a lack of continuity in top management positions.

To conclude this section on SAA it will be enlightening to juxtapose their performance with that of their private funded competitor Comair. Comair had two chairmen and two CEOs during its existence. It was founded in 1946 and listed in the JSE in 1998, making an operating profit in every year of its 68-year existence. Compare this with the losses of SAA. SAA blames the weaker rand but Comair buys the same fuel with the same weak rand so this argument does not fly. The airline industry is tough, the fuel price and poor exchange rate is beyond the airlines control, competition is strong and long term investments must be made. The irony is that Comair shareholders are partially financing their rival by means of paying company tax and dividend tax, and that Comair's personnel are also paying taxes that are indirectly being used to fund a rival that would take Comair out of business if it could[50].

Conclusion

The aviation industry in South Africa was monopolized for eight decades by the state carrier South African Airways. The earlier introduction of a number of low-cost airlines was not a success for the various reasons stated in this case study. However, it would seem that the most recent low-cost airlines are providing more stringent competition to the state carrier and the other full-service carrier, Comair. Only time will tell if these low-fare airlines will be as successful as their European and American counterparts. What is certain is that these low-cost airlines are here to stay and that they were instrumental in opening the market for air travel by more South African citizens who could not previously afford air travel.

Self-assessment questions

Easy questions

1. Southwest airlines has a business philosophy regarding their employees which states: 'When employees are treated well, they will treat customers well'. In which part of the business environment of Southwest is this philosophy applicable?
   a. Micro-environment

b. Market environment
c. Macro-environment
d. In all three of these sub environments

2. Which of the following is not an example of technological innovation in the airlines industry?
   a. The development of the Boeing 747 aircraft
   b. The use of the internet to sell tickets
   c. The partnership between Shoprite and Mango airlines
   d. The increased sophistication of aircraft engines and global navigational equipment

3. South African Airlines (SAA) is the national flag carrier airline for South Africa. Which one of the following statements regarding SAA is **incorrect**?
   a. The operations of SAA are directly influenced by the South African government
   b. The South African government forms part of SAA's institutional-governmental environment
   c. When SAA incurs a loss this loss is offset from government funds
   d. There is no connection between SAA and SA Express

4. Mango airlines are a worthy competitor in the South African low-cost airline market. Which one of the following is not a reason for their success?
   a. The fuel efficiency of their fleet of Boeing 737-800s
   b. Their average load factor that is higher than 80%
   c. A R1 start-up ticket promotion that covers the cost of flying passengers between inter alia Johannesburg and Cape Town
   d. Winning awards such as 'Africa's Best Budget Airline' at the World Travel Awards

5. The world's airline industry has been influenced by the various macro-environmental variables. Which one of the following is not one of these macro-variables?
   a. Mango's relationship with Shoprite retailers
   b. The high cost of avionic fuel
   c. The responsibility of being the national flag carrier airline
   d. Rapidly changing aircraft technology

Challenging questions

1. Which one of the following options is correct?
   a. Full-service airlines follow the strategy of cost leadership

b. The following excerpt describes the core principles of a low-cost airline model: 'flying more than one aircraft type, having different classes of passengers and different check-in procedures'
c. Full-service airlines are following a hybrid option as part of their strategy
d. South African Airways is the second oldest airline in the world

2. The competitive force in the airline industry that impacts the most on the continued survival of airlines is:
   a. Bargaining power of the suppliers
   b. Bargaining power of the buyers
   c. The threat of substitutes
   d. The threat of new entrants

3. Deregulation has been mentioned as having made a major impact on the global airline industry. Deregulation forms part of which business sub-environment?
   a. Micro-environment
   b. Market environment
   c. Macro environment
   d. All three these sub environments

4. Which one of the following do not relate to the use of an intermediary in the airline business:
   a. A travel agent
   b. The use of the internet
   c. The ticket sales desk at the airport
   d. The cabin personnel in the aeroplane

5. What is the biggest competitive threat in the South African airline industry?
   a. Suppliers
   b. Buyers
   c. Existing competitors
   d. New entrants

Essay questions

1. Discuss how technology is used in the airline industry.

   Key points to discuss:
   History of flight; rapidly changing technology; improved fuel technology; aircraft standardisation (the Boeing 737-800); the Boeing 747 Jumbo as vehicle of mass transportation (the Airbus A380 is even bigger with 40% more capacity than the

747); economies of scale; the internet; online check-in.

2. Describe the competitive environment in which the South African low-cost airlines operate.

   Key points to discuss:
   The five-forces competitive model of Porter; potential threat of new entrants; existing competition between existing low-cost airlines, for example Mango, kulula.com and possibly Fly SAfair; the influence of SAA and BA and government backing of SAA; the link between Mango and SAA and its competitive advantage against the privately funded Comair airlines group.

3. Compare the full-service airline model with the low-cost model.

   Key points to discuss:
   - Full service: Extensive flying network, different aircraft types; flying passengers to all the continents of the world, high fixed cost due to the massive capital investment needed to obtain aeroplanes and related equipment, entrenched workplace agreements usually with a highly unionised work-force and in a number of instances carrying the responsibility of being the national flag carrier. All these aspects carry an additional cost burden that must be recovered in the form of higher ticket prices and the dependence on government subsidies as in the case of SAA.
   - Low cost: Flying one aircraft type, usually the Boeing 737-800 or the Airbus equivalent A320 series, fast turnarounds for optimal aircraft utilisation, cabin staff cleaning the cabin and checking-in the passengers, increasing the number of seats, limiting luggage allowances, contracting out and paying less for personnel, cutting overheads by selling tickets online and not having ticket offices and cutting accommodation costs of crew.

4. It would seem that the pure low-cost business model is being adapted by some of the South African low-cost airlines. Why would they consider moving away from the low-cost option?

   Key points to discuss:
   Mango and kulula.com are adopting this practice; some reasons for this could be to increase the size of the market and to cater for passengers that are willing to discard the full-service airlines. Another point is that both have a full-service association namely Mango and SAA, and kulula.com and BA Comair. The counterpoint is that they are diluting the simplicity of the business model by adding costs that will have to be recovered.

5. Discuss the variables in the macro-environment that are impacting on the South

African low-cost airline industry.

Key points to discuss:
Technological environment e.g. the use of the internet and more fuel-efficient aeroplanes; economic environment, e.g. disposable income; social environment e.g. demographic changes; physical environment, e.g. fuel efficiency and pollution; institutional-political environment e.g. legislation such as BEE; international environment, e.g. African country destabilisation and the need to fly to the BRIC countries and the effect on the crude oil price on air fuel prices.

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4 Corporate social responsibility: South African Breweries

KEY TERMS

CODE OF ETHICS
CORPORATE CITIZENSHIP
CORPORATE GOVERNANCE
CORPORATE SOCIAL RESPONSIBILITY
ECONOMIC ACCOUNTABILITY
ENVIRONMENTAL SUSTAINABILITY
ETHICAL CONDUCT
ETHICAL LEADERSHIP
ETHICS
GOVERNANCE
SOCIAL RESPONSIBILITY
SUSTAINABILITY
TRIPLE BOTTOM LINE

Introduction

South African Breweries (SAB) is listed on the Johannesburg Stock Exchange and the parent company, SABMiller is listed on London Stock Exchange. As such the SABMiller group companies must comply with corporate governance rules set out for listed companies in various countries.

In South Africa listed companies should comply with rules as outlined by the *King Report on Corporate Governance*, issued in 1994 (*King I*), 2002 (*King II*) and 2009 (*King III*). *King III* builds on the principles of *King II* by emphasising sustainability and providing a list of best practice principles to assist directors to make the right choice for their company.[1] These principles have become an indispensable guide on **corporate governance** for directors, executives and regulators alike. *King III* provides guidance to all corporate entities on various **governance** related aspects, including **ethical leadership** and **corporate citizenship**; boards and directors; audit committees; the governance of risks; the governance of information technology; compliance with laws, rules, codes and standards; internal audits; governing stakeholder relationships; and integrated reporting and disclosure.[2]

According to *King III* senior managers should take responsibility for ethical (or unethical) conduct in their organisations. The key requirements stipulated by *King III* in this regard are as follows:[3]

- The company board should ensure that the company is and is seen to be a responsible corporate citizen through the development and implementation of strategies and policies in relation to economic, social and environmental impacts.
- Leadership should be effective and based on an ethical foundation.
- The board should ensure that management cultivates a culture of **ethical conduct** through the creation of an ethical risk profile, the establishment of a code of conduct, the integration of **ethics** into all company practices, procedures, policies and conduct, and through the assessment, monitoring, reporting and disclosure of the company's ethics performance.
- The assurance of the company's ethics performance supported by an assurance statement in the integrated report is recommended.

In conclusion, directors have an **economic accountability** and an obligation to all stakeholders (government, shareholders, employees, and community) to ensure that the company's resources are utilised so as to ensure the continuing viability of the company. This involves not only **environmental sustainability** (resource management with an eye on future needs), but also issues such as **social responsibility** (ensuring a positive impact on the community within which the company operates), respect for human rights, and the effective management of stakeholder relationships. In conclusion, *King III* points out that the economic value of a company can no longer be based only on the balance sheet. Rather, the economic value will be impacted by a range of non-financial issues such as brand and reputation, stakeholder relationships and goodwill, an evolving and forward looking strategy, environmental sustainability, social responsibility and quality of governance.[4]

The liquor industry in South Africa

The South African liquor industry has developed into a major player in the South African economy, providing employment and income to thousands of households and making a substantial contribution to government tax revenue and export earnings in South Africa.

In the process of manufacturing, packaging, marketing and delivering alcoholic beverages, the liquor industry stimulates economic activity throughout the entire beverage value chain. The chain consists of a wide range of producers and suppliers (upstream linkages), retailers, distributors, and the hospitality industry (downstream linkages).

The industry spans across the primary, secondary and tertiary sectors of the South African economy – from agriculture (grapes, malt, hops and sugar cane) to

manufacturing (wine making, distilling and brewing) to marketing, distribution and retail. In this multiplier effect the liquor industry plays an important part in the South African economy. The liquor industry:[5]

- Is responsible for sustained production to the value of R333 billion throughout the economy
- Supports more than 548 000 jobs throughout the economy
- Generates R41.8 billion in government tax revenue (6.7% of total tax revenue) – direct impact R19.5 billion
- Sales of R1.00 adds R2.08 to the country's GDP
- Creates 6.3 additional jobs throughout the economy for each direct job in the industry
- Creates mostly positions for unskilled workers
- Direct suppliers create most employment opportunities for disadvantages individuals (88%).

SABMiller and SAB

SABMiller started in 1895 as Castle Breweries in Johannesburg, South Africa, and through acquisitions changed the company's name to South African Breweries (SAB) and was listed on the Johannesburg Stock Exchange in 1987 and London Stock Exchange in 1999. SAB continued with acquisitions throughout the world and its name changed to SABMiller (after acquiring Miller Breweries in the USA in 2002) when it became the world's largest brewery with more than 200 brands of beer, employing 70 000 individuals and with interests and distribution agreements in 75 countries on six continents. SABMiller is dominant in many developed and emerging countries.

Beer is a relative local product, because it is perishable, bulky to transport, and subject to specific consumer tastes. Consequently, SABMiller operates in a decentralised manner, with the managing directors of its local businesses focussed on the issues and activities most material to their markets. This allows the company to take advantage of local knowledge, relationships, cost advantages, and consumer loyalty as well as global efficiency and best practices.[6]

SABMiller is a listed company on several stock exchanges and should therefore comply with the regulations set by the stock exchanges regarding corporate governance, **corporate social responsibility** and sustainability.

South African Breweries (SAB) is the South African subsidiary of SABMiller. SAB is the second largest listed company on the Johannesburg Stock Exchange, South Africa's leading producer and distributor of alcoholic and non-alcoholic beverages and one of South Africa's largest manufacturing firms. The company operates seven breweries (three in Gauteng, one each in Limpopo, KwaZulu-Natal, Western Cape and Eastern Cape) with 42 depots in South Africa. SAB's soft drinks division, Amalgamated

Beverage Industries, is the largest producer and distributor of Coca-Cola brands in South Africa, with five manufacturing plants in South Africa. SAB also owns a hop production company, The South African Breweries Hop Farms (PTY) Ltd; a barley farming company, The South African Breweries Barley Farms (Pty) Ltd; and 60 per cent share of the metal crown manufacturer, Coleus Packaging (Pty) Ltd.

SAB's contribution to South Africa's GDP amounted to R66.2 billion or 3.1 percent in 2009. SAB contributed R10.2 billion (1.7% of total tax income in South Africa) directly and indirectly to tax income of the government. SAB has a workforce of 9 390 and sustains 355 000 jobs in South Africa through its supply chain[7].

Corporate governance and ethical conduct at SAB

As previously indicated, corporate governance includes issues such as ethical leadership, corporate citizenship, accountability, leadership and management through boards and directors, effective audit committees, proper identification and management of risks, the governance of information technology, compliance with laws, rules, codes and standards, internal audits, governing stakeholder relationships, and integrated reporting and disclosure.

In accordance with the above corporate governance rules, SABMiller's group values are[8]:

- Our people are our enduring advantage
- Accountability is clear and personal
- We work and win in teams
- We understand and respect our customers and consumers
- Our reputation is indivisible.

Although corporate governance is the responsibility of every employee in the company the following structures are particularly responsible for corporate governance in the SABMiller group: The Board of Directors, the Executive Committee, Audit Committee and Chief Financial Officer.

In SABMiller the board sets strategic objectives of the group, determines investment policies, agrees on performance criteria, and delegates to management the detailed planning and implementation of the objectives and policies in accordance with appropriate risk parameters. The board monitors compliance with policies and achievement against objectives by holding management accountable for its activities through monthly and quarterly performance reports and budget updates. The board receives regular briefings from the Chief Executive and the Chief Financial Officer and from general council on legal, regulatory and corporate governance matters. Other members of the executive committee (regional managing directors and the directors of the key group functions – corporate affairs; corporate finance and development; marketing; supply chain and human resources) make regular presentations to the board, enabling directors to explore and interrogate specific

issues and developments in greater detail.[9]

In line with the group values, board and committee meetings are held in an atmosphere of intellectual honesty of purpose, integrity, and mutual respect, requiring reporting of the highest standards by management and direct, robust and constructive challenge and debate among board and committee members.

Corporate social responsibility leads to sustainability

As indicated in the introduction, corporate social responsibility can be viewed as the organisation's consideration of, and response to, issues beyond the narrow economic, technical and legal requirements of the organisation. Corporate social responsibilities can be defined as meeting the discretionary responsibilities expected by society. This definition encompasses the responsibility relating to community development, diversity, environmental impact, ethical conduct, financial responsibility, respecting human rights and assuring safety.

'The South African Breweries (SAB) has longed played a role as one of South Africa's most socially progressive and innovative enterprises. The company understands that its business is not separate from society – it is an employer, a customer, a supplier and a taxpayer. The long-term interest of SAB and the wider community are therefore inextricably linked'.[10] SAB also understood, decades before the political changes in the country, that transformation and black economic empowerment were essential for the future stability of South Africa and made its first moves to empower disadvantaged people in the 1970s. The SAB Zenele BBBEE-transaction announced in June 2009 and worth R7.3 billion, placed 8.45% of the company's shares under black ownership. The stakeholders of the company were the beneficiaries of the transaction.[11]

SAB's rigorous compliance process ensures that the company operates and competes ethically, legitimately and transparently. The company's Code of Competitive Practice and **Code of Ethics** form part of every employment contract. In addition, Competition Act Compliance training is provided as part of the induction of new employees. Annual training is compulsory for all senior executives and their colleagues in marketing, sales and distribution.[12]

If an organisation acts in a responsible way towards the above areas of corporate social responsibility it contributes to sustainable development. SABMiller is regarded as a leader in embedding sustainability into its operations. In June 2010 SABMiller (SAB's parent company) brought aspects of their sustainable development projects and priorities together under the banner 'Ten Priorities, One Future'. With this, sustainable development is integrated into the day-to-day operations of the business.[13]

The ten priorities are:

- Making more beer using less water
- Discouraging irresponsible drinking
- Reducing energy use and carbon footprint
- Reducing the weight of packaging, reusing bottles and encouraging recycling

- Working to zero waste operations
- Building supply chains that reflect the company's values and commitment
- Benefiting its communities
- Contributing to the reduction of HIV/Aids
- Respecting human rights
- Transparency in reporting the company's progress.

We will look at each of these priorities in more detail.

1. Making more beer using less water

By its nature, brewing beer is a water-intensive process. Making more beer, but using less water, is one of SABMiller's three global focus areas for sustainable development, and it is of particular importance for SAB's operations in South Africa, a semi-arid, water-scarce country. SAB's water strategy is based on the 5Rs (pRotect, Reduce, Reuse, Recycle and Redistribute), a comprehensive risk-based approach to managing water in its business and in the supply chain.

SAB has already made good progress. The company's water efficiency has improved by 8% over the past two years to an average water efficiency of 4.1 litres of water per litre of beer produced.

Key imperatives in driving water consumption efficiency include:

- Reducing water ratio from 4.13 to 3.6 by 2015, a 13% reduction
- Improving effluent discharge quality to meet legislation by investing at brewery level or improving municipal operations
- Engaging with key suppliers to understand their manufacturing water efficiency relative to best-in-class and their improvement plans.

Where SAB has control over water management practices, that is, inside its brewery gates, it ranks amongst the world's leaders in terms of responsible water management during the brewing process. Additionally, SAB exercises strict control and management of the quality of discharged water at the end of the production cycle. Efficiency targets are continually increased and new technology is explored and introduced to effect changes where they are required. When a new brewery is built, its efficiency is much higher due to the advantage of the installation of a modern infrastructure.[14]

2. Responsible consumption

As South Africa's leading alcoholic beverage company, SAB has a responsibility to lead the attack on alcohol abuse. The company spends in excess of R40 million annually on initiatives that aim to combat the abuse of drinking and encourage responsible consumption. Initiatives include those of leading by example such as codes of conduct for employees in which responsible drinking is promoted, and

sensitivity in dealing with marketing campaigns (e.g. marketing in poor areas). SAB works with government on getting unlicensed outlets (shebeens) registered. In addition they invest in programmes to educate people about driving under the influence of alcohol; the dangers of foetal alcohol syndrome (in unborn babies); underage drinking; The Tavern Intervention Programme (where the focus is on the education of men to prevent gender-based violence, child abuse and HIV and Aids); and the Sports Diversion Programme (where children are encouraged to take up sport instead of becoming involved in alcohol use). SAB has many other outreach programmes.[15]

3. Reducing energy and carbon footprints

Climate change, greenhouse gases and carbon footprint are issues of global concern. SAB also embraces the question of how it can help to reduce greenhouse gas emissions across the entire supply chain regarding packaging, manufacture, transport and refrigeration. SAB endeavours to minimise the impact of operations, customers and consumers through practical, proactive strategic interventions; improve on energy conservation targets and reporting on them; educate people in energy conservation; and engage with authorities and suppliers on possible initiatives.[16]

4. Reducing the weight of packaging, reusing bottles and encouraging recycling

'Promoting a vibrant packaging reuse and recycling economy, and working towards zero waste operations, are key components of SAB's sustainable strategy'.[17] SAB in South Africa has reduced the weight of its packaging, reused bottles and encouraged recycling, thereby saving money and raw materials and reducing pressure on local waste services. More than 80% of the beer sold by SAB in South Africa is packaged in returnable containers. The remaining 20% is sold in convenience packs, in order to meet consumer demands.

SAB also works on decreasing the weight of product packaging by reducing the amount of materials used while maintaining the integrity of the packaging itself. Lighter packaging uses fewer raw materials and less energy to manufacture. For example, the 340 ml 'Giraffe'' bottle used in South Africa was redesigned to reduce its weight by almost 10%.

SAB actively promotes education programmes and recycling through organisations like The Glass Recycling Association and Collect-a-Can.

5. Working towards zero waste operations

SAB aims to use its resources efficiently and limit the disposal of waste to landfill. Less than two-thirds of SAB's waste is organic material produced as a by-product of the brewing process. This includes spent grains, waste yeast and trub (a residual created from brewing). The remaining waste is made up of damaged packaging (broken bottles, caps, cardboard, etc.), filtration medium, and effluent sludge from wastewater

treatments, boiler ash and other non-recyclable waste.

SAB processes solid waste on a cradle-to-grave basis and opportunities for waste to be reused or recycled are actively sought. For example, spent yeast is sold to manufacturers of health foods and savoury spreads; farmers purchase spent grain for animal feed; spent grain is donated to local black farmers in the eastern Cape; kieselguhr (a filtration medium) is recycled in cement and compost; malt dust, spent gains and other organic waste is sold for pet food; segregated broken glass bottles are recycled and turned into new bottles; and waste water is used to generate energy and produce fertiliser.[18]

6. Building supply chains that reflect the company's values and commitment

SAB manages its supply chains (particularly suppliers) with a view to the long-term benefits to its operations. Encouraging enterprise development in the value chain is a key sustainable development priority and activities in this area are numerous and well integrated into the day-to-day business. The strategy runs through SAB's procurement process and supply chain. SAB's owner-driver initiative sees about 70% of deliveries carried out through former employees who have set up their own businesses, supported by SAB; while the Taung Barley-project supports 120 small holding farmers to generate a guaranteed income and improve their lives. SAB's KickStart initiative, into which SAB has invested R51 million, has benefitted 22 900 people through fifteen years of promoting business awareness, provision of training and mentorship, and supplying of grants to young entrepreneurs.[19]

7. Bringing benefits to the communities we serve

SAB's corporate social investment activities aim to improve the quality of life of local people, helping to build strong relationships with suppliers, consumers and employees. The social investment activities are grouped into flagship programmes, 'soul' programmes and employee volunteerism:

- Flagship programmes directly support business imperatives. The focus is on sports development, enriching communities and enterprise development. The SAB Under 21 Regional Soccer League identifies and harnesses new soccer talent.
- The Tavern Intervention Programme is a monitoring initiative for men who have been identified by communities as perpetrators of crime linked to alcohol abuse and focuses on changing their perceptions and behaviour around gender violence, child abuse, HIV/Aids and alcohol consumption.
- SAB's 'soul' investment concerns ad hoc donations and support for disaster and humanitarian relief. A budget is allocated to address welfare issues and is purely an outreach response to day-to-day requests for donations and disaster relief.
- Employee volunteerism allows employees to play an active part in the transformation of communities. Employees are invited to make applications for funding projects that they are passionate about, and they are encouraged to

participate in company-funded corporate social responsibility days.

SAB allocated R14 million on these activities in the 2011 financial year.[20]

8. Contributing to the reduction of HIV/Aids

SAB is committed to the fight against HIV/Aids, as it affects its workforce, erodes the disposable income of consumers, damages the supply of raw materials, and ultimately weakens the economic development and stability of the communities in which SAB operates.[21] SAB provides education and awareness programmes to all its employees, including access to voluntary counselling and testing. SAB partnered with the Department of Health and SABCOHA to utilise its distribution network to distribute free condoms to taverns.

9. Respecting human rights

SAB conducts business with respect for different cultures, laws, norms and traditions. It uses the guidelines provided by the Universal Declaration of Human Rights, including freedom of association and recognition of the right of collective bargaining; prohibition of forced and compulsory labour; abolition of child labour; intolerance of discrimination; establishing fair and competitive wages and benefits; providing a safe and healthy environment; employee security; community commitment; and guiding principles for suppliers.

SAB promotes human rights throughout its supply chain and take positive steps such as staff training, a compliance system and a robust whistleblowing policy to help prevent breaches and abuse of the priciples.[22]

10. Transparency in reporting the company's progress

SAB is committed to the transparent reporting of sustainable development and high ethical standards.

Transparency and open reporting on its activities are important to SAB because consumers want to know that its beers and soft drinks are of consistent high quality; its employees are proud to work for an honest and responsible company; its suppliers and business partners trust the company for a fair relationship; and the communities in which SAB works want to know that it operates in a responsible way towards the environment and their quality of life.[23]

Specific targets for improvement of sustainable development

In line with a pledge on a global scale by SABMiller, SAB South Africa has pledged to:[24]

- Small businesses: Support over 56 000 small businesses to enhance their business growth and family livelihoods. Through its existing enterprise development

programmes SAB has to date impacted 25 000 small businesses.

- Moderation: Reach beer consumers with effective communication campaigns and partnerships to encourage moderate and responsible beer consumption.
- Water: Reduce water use to 3 litres of water per litre of beer and 1.8 litres of water per soft drink at its soft drinks division Amalgamated Beverage Industries (ABI). SAB's current water efficiency performance is 3.6 litres of water per litre of beer and 1.92 litres per litre of soft drink. The company also aims to secure water supplies to all of its facilities through a detailed site risk assessment and partnerships to tackle water risks shared with local communities.
- Waste: Reduce its carbon footprint per litre of beer by 25% across the value chain.
- Land: Improve the amount of malting barley grown and other key brewing crops per hectare, while reducing inputs such as water, energy and fertiliser in key areas. SAB will also aim to improve food security for small-scale farmers who supply the company by helping with income generation and increased production.

This new programme, branded 'Prosper' is the latest evolution of the company's approach to sustainable development, which is a key element of SABMiller's business strategy. At its heart is supporting the role small businesses play around the world in generating economic growth and reducing poverty. SABMiller is using its supply chains from farmers to retailers to drive inclusive growth, sustainable resource use and alcohol responsibility.

Conclusion

It is clear from the above that SABMiller and SAB in South Africa take a holistic view with regard to governance and economic, environmental and social responsibilities. In terms of its economics, SAB's contribution is clear in the number of employment opportunities created and the contribution to taxes and export earnings. With regard to environmental and social responsibility they make their intentions clear in their strategic objectives and management commitment, and pull it through to operational level by means of employee commitment and tangible programmes.

Self-assessment questions

Easy questions

1. ____ can be viewed as the organisation's consideration of, and response to, issues beyond the narrow economic, technical and legal requirements of the organisation.
   a. Risk management

b. Corporate social responsibility
c. Ethical conduct
d. Environmental management

2. Identify the false statement with regard to environmental sustainability:
   a. Packaging is an important source of recycling in the liquor industry.
   b. SAB's contribution to water quality is company-wide.
   c. SAB involves suppliers, municipalities and NGOs in environmental sustainability.
   d. SAB selects suppliers based also on environmental criteria.
   e. SAB takes care of water quality released from their operational processes.

3. Identify the false statement:
   a. Financial responsibility is closely connected to ethical conduct.
   b. SAB develops suppliers.
   c. SAB includes their employees in their programme on alcohol abuse.
   d. The main purpose of a code of ethical conduct is to prevent fraud.

4. Broad-based black economic empowerment forms part of the ____ dimension of corporate social responsibility.
   a. Human rights
   b. Community development
   c. Diversity
   d. Ethics
   e. Financial responsibility

5. Consumers are interested in transparency and high ethical standards at SAB because of ____.
   a. The community development efforts
   b. Quality consistency of product
   c. Quality of packaging
   d. Quality of life.

Challenging questions

1. SAB improve their water sustainability performance by ____ and ____.
   a. Increasing efficiency targets; benchmarking
   b. New technology; code of conduct
   c. Increasing efficiency targets; new technology
   d. Benchmarking; commitment

2. Choose the correct option. To whom are the *King Reports* principally directed?
   a. All stakeholders
   b. All staff
   c. Regulators
   d. Directors
   e. Executives

   i. a
   ii. b
   iii. a & b
   iv. c, d and e
   v. all of the above

3. 'Charity begins at home' transpires from which one of the following areas of corporate social responsibility:
   a. Diversity
   b. Environment
   c. Community
   d. Human rights

4. An organisation such as SAB's responsibility with regard to corporate governance does not start and end at the boundaries of the organisation because ____.
   a. They must encourage all stakeholders to uphold the guidelines of the King Reports.
   b. They must act as regulator in the supply chain because of their powerful position.
   c. They must take responsibility for the alcohol abuse in the country.
   d. They must develop their suppliers.

5. SAB's leadership role in their supply chain becomes clear through its ____ and ____.
   a. Sports Diversion; Tavern Intervention Programme
   b. SAB Zenele initiative; Code of Competitive Practise
   c. Owner-driver initiative; Taung Barley-project
   d. KickStart initiative; Ten Priorities, One Future projects

Essay questions

1. Briefly explain the scope of expectations for organisations since the acceptance of the *King Reports* on corporate governance.

Key points to discuss:
Organisations (their management) have an **economic accountability** and an obligation to all stakeholders to ensure that the company's resources are utilised so as to ensure the continuing viability of the company. This involves not only **environmental sustainability** (resource management with an eye on future needs), but also issues such as **social responsibility** (ensuring a positive impact on the community within which the company operates), respect for human rights, and the effective management of **stakeholder relationships**.

2. Identify and explain the environmental efforts of any organisation you are involved in. What more can you do to improve the environment?

   Key points to discuss:
   The environmental efforts and possible suggestions for future opportunities in environmental management should include examples of protection, reduction, reusing, recycling and redistribution.

3. Briefly discuss the efforts of any organisation you are involved in on the following areas of social responsibility: (1) Community; (2) Diversity; (3) Ethics; (4) Financial responsibility; (5) Human rights; and (6) Safety.

   Key points to discuss:
   - **Community**: Support local suppliers, donate to local development campaigns for poverty alleviation in local communities.
   - **Diversity**: Any efforts with regard to the principles of BBBEE.
   - **Ethics**: Any efforts with regard to ethical conduct.
   - **Financial responsibility**: Follow applicable financial standards, requirements, sound financial practices and ensure transparency in financial dealings.
   - **Human rights**: Dignity, respect, fairness and humane working conditions.
   - **Safety**: Safe working environment and safety practices.

4. Do you think South African Breweries uphold human rights? Fully motivate you answer.

   Key points to discuss:
   Respect; development of community; involvement in alcohol abuse campaign; sensitive marketing efforts.

5. Briefly discuss three key elements of SAB's corporate social responsibility strategy.

   Key points to discuss:
   Flagship programme; Soul programmes; Employee volunteerism

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5 General management: Edcon

KEY TERMS

AUTHORITY
BOARDMANS
CNA
COMMUNICATION
COMPETITORS
CORPORATE GOVERNANCE
CULTURE
DIVISIONAL STRUCTURE
EDGARS
EMPLOYEE EQUITY
EMPLOYEE WELLNESS
GROWTH STRATEGY
JET
JET MART
LEADERSHIP SKILLS
LEGIT
LOGOS
MARKETS
MARKET ENVIRONMENT
MISSION
MOTIVATE
PURPOSE STATEMENT
RED SQUARE
SOCIALLY RESPONSIBLE
VISION

Introduction

On 6 September 1929 two brothers, Morris and Eli Ross, opened Edgars in Joubert Street, Johannesburg. Eli Ross is credited with being the first to offer 'six-months-to-pay' credit during a spring sale.

In 1935 the Johannesburg store moved to Long Market Street, Cape Town and the 17-year-old Sydney Press joined the company as a Christmas casual worker. Press gave up his scholarship at UCT to get into Edgars and never looked back. In 1937 he opened the Eloff Street store and gradually expanded along the Reef area, which is today called Gauteng, and then around the country.

Edgars Stores Limited was listed on the JSE in 1946, just after the end of the Second World War. The directors were then Sydney Press, Hubert Press, Eli Ross and Alan Leon. In 1999 the name changed to Edgars Consolidated Stores Limited, trading on the JSE as Edcon. In 2007 Bain Capital bought the Edcon group for R25 billion and de-listed it. After 47 years with the company Sydney Press resigned in 1982. He attributed his success to his small team's zeal and customer sovereignty and said: 'We simply approached each customer as if our living depended on her – as indeed it did'.[1]

The Edcon group today[2]

Today, Edgars is part of Edcon's (Edgars Consolidated Stores Ltd) Departmental Store Division, which is the leading clothing, footwear and textiles (CFT) retailing group in South Africa. Since the first Edgars store opened in 1929 the company has grown to eight retail brands trading in over 1 403 stores in South Africa and 169 stores in 7 countries outside South Africa. Edcon employs over 20 000 permanent and 25 000 temporary staff.

Through acquisitions over the years, Edcon's retail business added top stationary and houseware brands as well as general merchandise to its CFT portfolio.

Edcon is organised into the three divisions indicated in Figure 5.1, namely the Departmental Store Division, the Discount Store Division and CNA Division. The Departmental Store Division focuses on the middle to upper income markets and includes Edgars, Edgars Active, Edgars Shoe Gallery, Boardmans and Red Square. The Discount Store Division targets the middle to lower income markets and includes Jet, Jet Mart, and Legit.

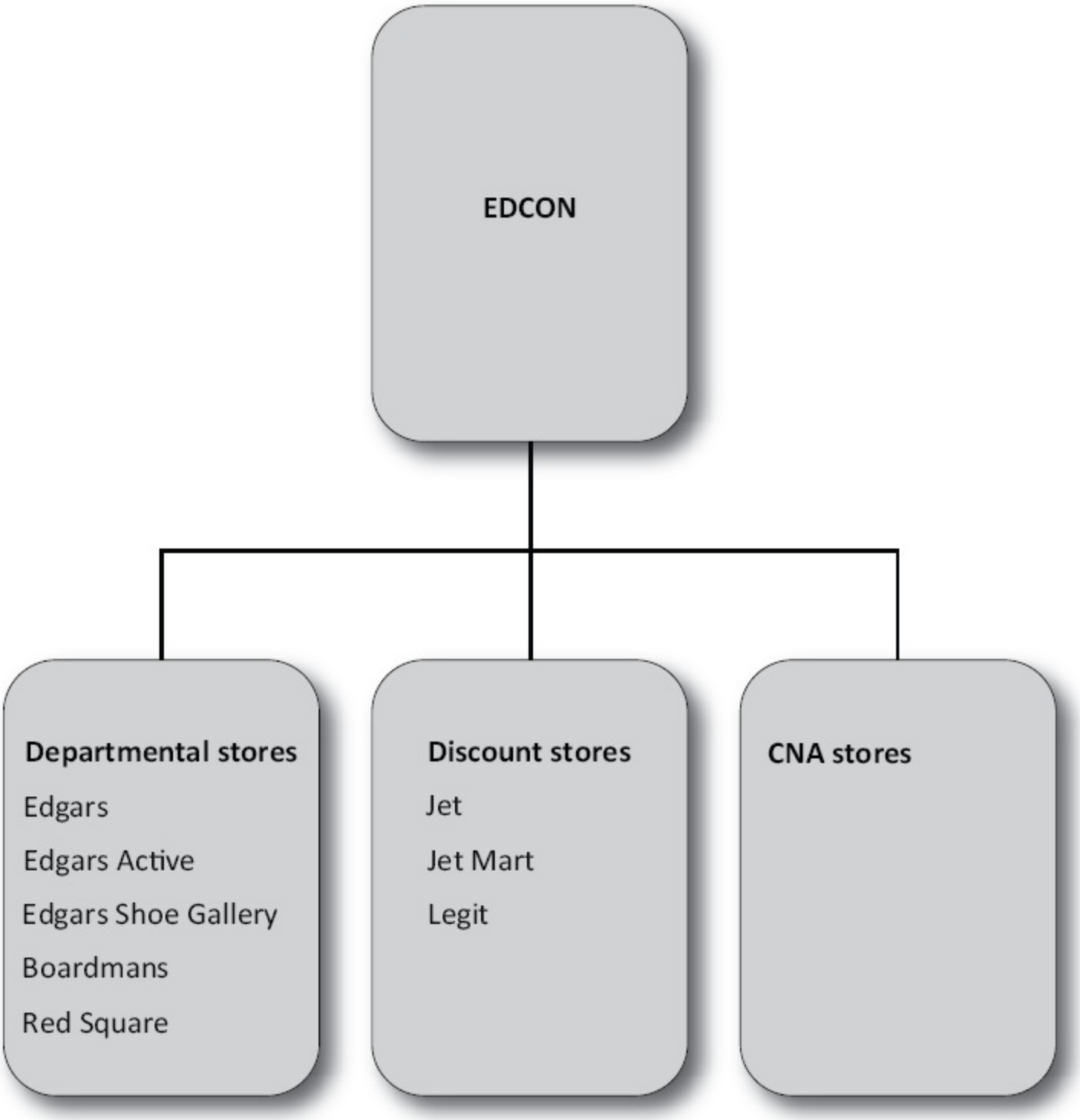


Figure 5.1 Divisional structure

The CNA Division is a stationery, educational and entertainment business for middle to upper income **markets**. There are currently 191 stores in this division. The Edcon group logo and some of the well-known **logos** of the Edcon stores are indicated in Figure 5.2.



Figure 5.2 Well-known Edcon logos[3]

The Edcon Financial Services businewss unit, which forms part of the Corporate Services Division, provides banking and insurance products to the Group's over four million store cardholders across all the income groups. The banking products consist of branded private-label store cards and co-branded Edgars and Jet MasterCards. Edcon Financial Services insurance products include the main product categories of Credit Life, Funeral, Personal Accident and cellphone insurance. The Group's store cards are also a valid form of tender at a network of non Edcon merchants in the healthcare, optometry and travel industries.[4]

The brands[5]

Edgars, which targets the LSM 6–10 groups and all ages, is the leading retailer of clothing, footwear, textiles, cosmetics, accessories and cellular products in southern Africa. It is the leading national distributor of top global brands and merchandise ranges that are exclusive to Edgars. The brand has also launched, for example 'By Caprice' lingerie, Bobby Brown cosmetics and Tom Ford's Estee Lauder Youth Dew Amber Nude. Edgars Active is a sportswear chain with a product range also available in Edgars departmental stores. It focusses on LSM 4–7 groups and currently has 155 stores. Edgars Shoe Gallery targets the LSM 5–10 groups, was launched in 2013 and currently has six stores. **Boardmans** was purchased by Edcon from Pick n Pay in

April 2004 and focusses on LSM groups 7–10. Boardmans now has 34 stores in prime locations, selling mainly kitchenware, outdoor, bedroom, bathroom, and home decor goods and soft goods (bedding, towels, curtains and the like).

Red Square sells international and national branded beauty, fragrance, skincare and cosmetics to middle and upper income men and women in LSM groups 5–10. It also offers services such as skin analysis, a beauty hotline, facials, waxing, manicures, pedicures and body treatments. **Jet** offers clothing, footwear and cellular products to the middle to lower income markets in LSM groups 4–7 and has had a challenging task as it has had to deal with catering to a market that is in transition. It has the largest loyalty club in the country and has 1.3 million members with a readership of 5.8 million for the *Club* magazine. **Jet Mart**, which has 131 stores, is a discount homeware and DIY retailer that sells appliances, plastics, paint, stationary, the Jet range of clothing, music and health and beauty products. Their aim is to serve people who have a limited budget in LSM groups 4–7. **Legit** is aimed at young, fashionable women. It provides fashionable clothing to fashion conscious women between the ages of 16 and 24 who work with a shoestring budget in LSM groups 5–8. **CNA**, which has 195 stores, provides reading, listening, learning and communication consumables to middle and upper income families in southern Africa. CNA is expanding its range of everyday hi-tech electronics and mobile products.

Edcon recently secured exclusive rights to a number of international brands such as Topshop, Topman, T.M. Lewin, Lucky Brand, Tom Tailor, Lipsy, Salsa, River Island, GEOX, One Green Elephant, Doc Martins, Vince Camuto, Jessica Simpson, CR7, Dune and Gosh. They also acquired a controlling stake in the companies that have the exclusive right to Accessorize, La Senza and Inglot in South Africa.

Vision and mission[6]

Edcon's **vision** and **mission** is consolidated into the Edcon **purpose statement**, which reads as follows:

'Our Edcon group of retail brands drives sustainable value and growth. We create lifetime loyalty by delighting our customers, inspiring our employees and contributing to our communities.'

Values and culture[7]

The Edcon **culture** is built on the following four values: people (who we are), integrity (how we behave), performance (what we do) and professionalism (how we do it). Figure 5.3 clearly explains the four cornerstones of the company culture.[8] Edcon view these values as more important than financial numbers.

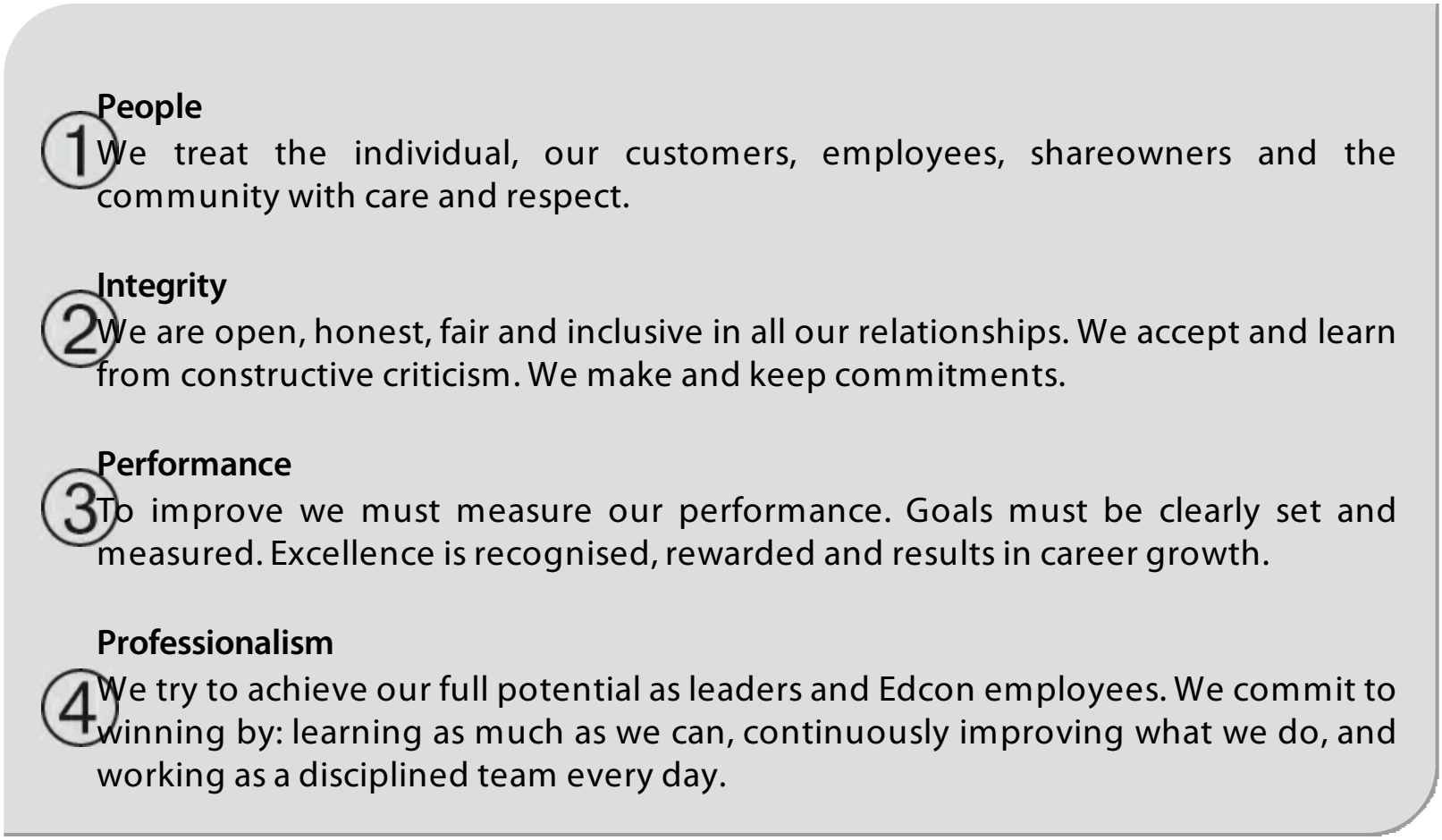


Figure 5.3 The four cornerstones of Edcon's culture

The Edcon culture is driven by the following imperatives: a constructive leadership style; an aspiration to remain an employer of choice, critical awareness to attract and retain employees from designated groups; incentivised customer-focused employees; a sustainable high performance environment; intertwining organisational growth with individual growth; and life-long learning. It is believed that this culture also creates conditions for effective employment equity implementation.

Edcon takes the issue of gender equality seriously. Edcon has established gender sub-committees that focus on issues that women face in the workplace and give women within the company a voice to drive gender specific initiatives. Edcon's **employee equity** strategy rests on the following seven main pillars:[9]

1. Appropriate structures and resources to coordinate and monitor the implementation of employment equity.
2. Ensuring that the composition of the organisation begins to reflect regional and/or national economically active demographics at all job levels.
3. Equitable policies, procedures, practices and facilities; an organisational culture that is conducive to employment equity, diversity and sustainable business.
4. An equal opportunity situation for all women.
5. The elimination of unfair discrimination against, and promotion of reasonable accommodation for people with disabilities.
6. Retaining, promoting and developing employees from designated groups through focused and appropriate recruitment, retention and development initiatives.

7. To retain, promote and develop employees from designated groups through focused and appropriate recruitment, retention and development initiatives.

In order to **motivate** employees Edcon offers competitive remuneration packages and recognition schemes. Remuneration is influenced by individual performance and Edcon make use of the Golden Hearts recognition scheme to recognise employees nominated by colleagues for living the Edcon values. In order to recognise employees who have worked for Edcon for 10, 15, 20, 25, 35 and 40 years, Edcon Long Service Awards are awarded to these employees at an annual Circle of Stars events. These employees receive long service gifts, certificates and photographs. The McFarlane Cup is used to recognise Merchandising and Operations teams within Edcon who demonstrate superior sales performance. In addition to this, Edcon also offers a performance reward incentive that is based on the individual's performance as well as that of the Group.

In the past financial year Edcon invested 4.6% of their payroll in learning and development. They offer staff bursaries to permanent employees to encourage them to further their qualifications. In order to facilitate learning at Edcon the company operates its own Retail Academy that offers a range of learning opportunities, from technical, financial, management and leadership training to graduate and internship programmes for industrial psychologists, as well as a beauty technology certification. The Retail Academy is accredited by SETA as a training provider.

The Edcon culture also incorporates a holistic approach to **employee wellness**. Some of the wellness initiatives include:[10]

- The Edcon Care Centre, which is located at Edcon's Head Office. The Centre provides staff with free access to lawyers, medical practitioners, psychologists and financial advisors.
- The Edcon Care Centre also consists of a Mobile Clinic; this is travelling bus that offers some of the above services to staff members countrywide.
- The Wellness Centre reinforces health issues by creating awareness around regular health days, such as Breast Cancer month, which is observed nationally in October, and World Aids Day.
- Networking with other organisations as well as NGOs to share information and key lessons.
- The Employee Care Line, which provides employees with a comprehensive group of services. The strategic objective of this initiative is to ensure that the wellness services are accessible to as many employees in the Edcon Group as possible, irrespective of their geographic location.

One of the vehicles used for internal **communication** within Edcon that contributes to a healthy culture is the monthly magazine, the *Edcon Vibe*, which keeps employees informed of all-important happenings within the group. It is known for its open and honest communication with employees.

Leadership

Edcon Holdings (Proprietary) Limited has a unitary board structure consisting of three executive directors, three non-executive directors and four independent non-executive directors. They have delegated **authority** for the day-to-day affairs of each of the Departmental Store, Discount, CNA and Group Services Divisions. The executive management team is mandated to assist in reviewing the operations of and performance of Edcon Holdings (Proprietary) Limited and its subsidiaries, for developing strategy and policy proposals which are considered by the board of directors and for implementing the directives of the board.[11] Jurgen Schreiber, a German national, who has 20 years' international experience in the retail industry is Edcon's CEO.[12]

Edcon has a well-defined leadership framework.[13] In addition to a 360-degree review process, up to 15% of the performance goals of supervisors and managers are based on leadership. **Leadership skills** have been divided into four main areas, namely:

- **Personal characteristics**. This refers to the kind of person, how he/she makes the best of what he/she has to offer to help the company achieve its goals.
- **People management**. This defines the way the person works with others, how he/she helps to bring out the best in everyone and inspires them to take responsibility for good performance.
- **Process management**. This is about how the person manages the processes that are in place and the solutions he/she finds as well as the decisions taken to sustain and continuously improve performance.
- **Strategic management**. This refers to the person's understanding of the world and the industry trends, how he/she influences customer expectations and how this affects Edcon's business strategies.

Figure 5.4 below explains the meaning of each of these areas of leadership and the important aspects that make up each one.

Personal characteristics (Me)	People management (We)	Process management (Work)	Strategic management (World)
◣ Achievement orientation ◣ Integrity ◣ Organisational commitment ◣ Analytical thinking	◣ Coaching and developing others ◣ Team leadership ◣ Communication and influence ◣ Valuing diversity	◣ Building organisational capacity ◣ Problem solving	◣ Strategic orientation ◣ Change leadership ◣ Customer insight and focus ◣ Developing ideas

Figure 5.4 Areas of leadership[14]

Edcon describes its five pillars of leadership as being transformational, transactional, tactical, technical and operational.

Competitors

Edcon trades in a **market environment** where many other clothing retail stores operate against a backdrop of uncertain economic growth. Conditions are expected to remain challenging as consumers encounter increasing food, electricity, utility and transport costs which have started to erode their purchasing power. Bad debts thus remain a challenge to all the players in this competitive environment.

Edcon's **competitors** include Woolworths, Mr Price, Ackermans and PEP, Truworths and Foschini. Woolworths Holdings Limited is a South African based retail group listed on the JSE. The group which focusses on the upper and middle income groups, trading through Woolworths (Proprietary) Limited, is a chain of retail stores selling a selected range of quality clothing, food, homeware, beauty and financial services, which it offers mainly under its own brand name. Woolworths differentiates itself from other stores by emphasising the quality of its products. It operates mainly through two subsidiaries, Woolworths (Proprietary) Limited (Woolworths) and Country Road Limited (Country Road) and through a joint venture, Woolworths Financial Services (Proprietary) Limited (Woolworths Financial Services). Country Road consists of a retail chain of stores and concession retail outlets in Australia, New Zealand and South Africa. It offers a range of clothing and homeware under its own brand name. It is listed on the Australian stock exchange (ASX). Woolworths Financial Services is operated jointly with Absa. Woolworths Financial Services offerings include a credit card, personal loans and insurance products.[15] Woolworths acquired Australian retailer David Jones in 2014 for R21.4 billion and plans to sell its own brands in the David Jones stores[16]. Woolworths' mission and values are indicated below. [17]

Mission statement

We, as passionate committed retailers, understand and lead our customers through excellence and a deep knowledge of our products and services and the world we live in.

Values

Quality and style	– deliver the best
Value	– a simple and fair deal
Service	– think customer
Innovation	– discover the difference
Integrity	– do what you say you will do
Energy	– be passionate and deliver
Sustainability	– build for a better future

Mr Price Group Limited is also one of Edcon's competitors. It is a fashion value retailer with predominantly cash sales. It consists of various divisions selling different products, namely Mr Price (clothing, footwear and accessories), Mr Price Home (homeware and furniture), Mr Price Sport (sport apparel, footwear and equipment), Milady's (apparel and footwear aimed at older women) and Sheet Street (home textiles and accessories).

Pepkor is another of Edcon's competitors. It is a South African based investment holding company with retail interests in Africa (where it trades in eleven countries), Australia and Poland.[18] The group sells mostly clothing, footwear and textiles. Its main operating subsidiaries are Ackermans and Pep in South Africa, Best & Less in Australia and Pepco in Poland. When Pepkor acquired Ackermans in 1984 there were 34 stores across the country. Pepkor were quick to realise that the strategy of adding value to the low price formula would better Ackerman's position. Today, the group has more than 3 400 stores in southern Africa, including Botswana, Namibia, Swaziland, Mozambique, Zimbabwe and Malawi, and employs close to 32 000 people. The stores sell affordable family clothing and footwear, textiles, cellular phones, homeware, accessories and financial products.[19] PEP, also a major competitor in the market, operates more than 1 600 retail stores in southern Africa and employs more than 13 500 people. It keeps its margins to the minimum and has a low-cost culture. As well as clothing and footwear, PEP sells homeware, FMCG, beauty, cellular and airtime products and also offers a range of financial products. PEP's vision, mission and values are indicated below.[20]

PEP's vision: Delighted customers: our focus and pleasure
PEP's mission: We strive to be the friendliest and most exciting retailer offering up-to-date and durable products at the best prices
PEP's values: Honesty, Passion, Resourcefulness

Truworths International is also part of Edcon's market environment and is an investment holding company listed on the JSE which has more than 400 stores in South Africa. Its companies are engaged in the retailing of fashion apparel and accessories. The Truworths International Retail Group also incorporates Identity, YDE and Uzzi.[21] The Foschini Group (TFG) consists of 14 trading brands, dealing in lifestyle products that range from fashion, jewellery, accessories, cosmetics, cellphones, sporting and outdoor apparel and equipment to homeware products and financial services. TFG trades in over 2 000 stores and operates in the following retail divisions: Foschini, Donna-Claire, Fashion Express, Luella, Markham, Exact!, Total Sports, Sportscene, Due South, American Swiss, Sterns, Matrix, @home and @home livingspace.[22] During 2013 TFG extended its customer rewards programme to credit customers, and now has 1.8 million credit rewards customers and a further 1.2 million cash rewards customers on this programme[23]. TFG's mission and values are indicated on the following page.

Mission
The group's mission is to be the leading fashion lifestyle retailer in Africa, by providing innovative, creative products and by leveraging our portfolio of diverse brands to differentiate our customer offering. Our talented and engaged people will always be guided by our values and social conscience.
Values
Professionalism:
We are accountable and drive performance in a creative and innovative way
Resilience:
We have the courage of our convictions and the boldness to constructively challenge
Integrity:
Our word is our honour, we are honest and ethical
Dignity and respect:
We treat everyone like we want to be treated
Empowerment:
We have equal opportunity to grow in a supportive environment
Excellent service:
Our customers are our future – we look after them

Strategy

As can be seen in Figure 5.5, Edcon's strategy is underpinned by four key levers, namely comparable store growth, new space growth, margin expansion and credit. Edcon aims to improve revenue by growing comparable store sales and increasing new space growth, as they continue to roll out additional stores in South Africa and other African countries. They strive to leverage the benefit of these increased volumes by improving the sales margin. Their ability to offer credit through their strategic relationship with Absa Bank realises new opportunities.

In the year up to March 2014 Edcon reported a 5% rise in retail sales to R27bn and narrowed its loss from R5bn to R2.5bn. Over this period, cash sales increased 15.3% but credit sales decreased by 4.3%. This can be attributed to the stricter lending criteria of Absa Bank which bought Edcon's private label store card portfolio in 2012. After revamping the top Edgars stores with a R542m makeover in a bid to address market share declines, Edcon is trying to gain credit sales by trying to find a second credit outlet. It is currently negotiating with financial institutions to fulfil this role. Edcon CEO Jürgen Schreiber indicated that because approval rates are declining everywhere, Edcon is pushing cash sales but they are over proportionally hit on credit sales versus the market. He indicated that Edcon has enough applications but their approval rates are half of what they were in the past[25].

In the last year, Edcon focused mainly on the upgrading of existing stores, but in line with its **growth strategy** they have formulated a long-term real estate expansion plan for the future.[26] As part of this plan, Edcon plans to expand further into Africa, into the countries near South Africa.[27] Other growth strategies include a review of merchandise ranges and the flow of goods as well as an analysis of operational processes. On 20 February 2012 Edcon introduced their reward programme in order to increase consumer loyalty.[28] The initiative is called Thank U rewards programme and is used across all brands. Customers earn a minimum of 10 points for every R1 spent at an Edcon store. As soon as customers have accumulated 10 000 points they can redeem these in real time by swiping their loyalty cards. The Thank U programme builds on the other reward initiatives in use, such as the Club Card, which operates at certain Edcon stores. This move has strengthened the brand since people become aware of which stores fall under the Edcon group. Today the Thank U store card loyalty programme has over one million customers.

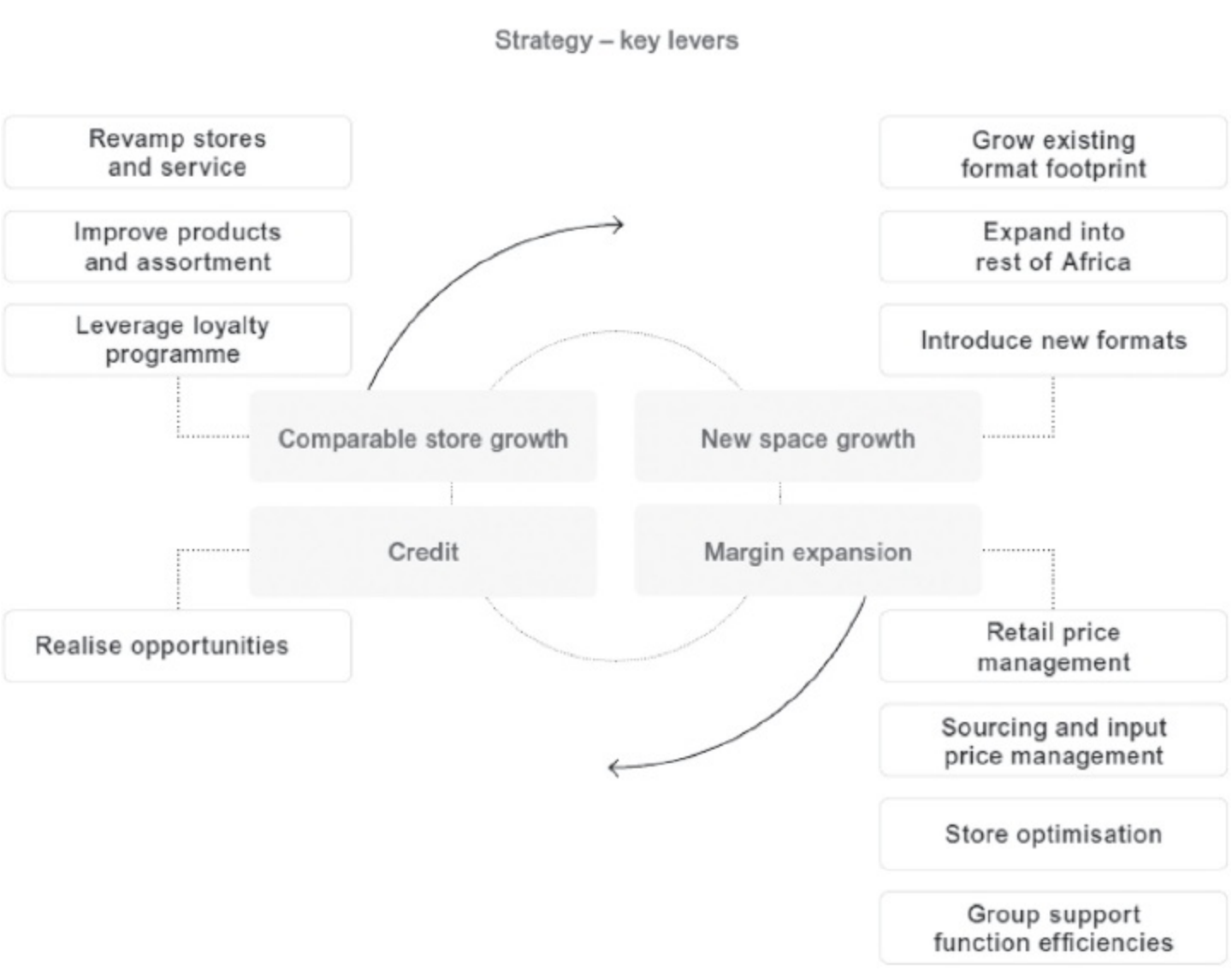


Figure 5.5 Edcon's four strategic key levers[24]

Sustainability

Edcon acknowledges that environmental, social and governance issues have an impact on its operations and similarly the Group's activities have an impact on the environment and society in which it operates. They believe that failing to address issues of non-financial sustainability ultimately affects the business through challenges that may include escalating utility costs, declining staff productivity, regulatory fines or reputational damage. They are involved in a number of social and environmental initiatives where they aim to enhance the communities in which they trade and build a more sustainable future. Edcon's sustainability focus areas are based on the understanding that a sustainability strategy helps the Group innovate to drive competitiveness in a changing world.

	Our commitment	Objectives
People	We are committed to developing a high performance culture in support of national development goals	Develop and maintain a culture of diversity and inclusion
		Enable all Edcon employees to represent the brand on sustainability issues relevant to their work area
Social responsibility	We will endeavour to support community initiatives that align with our social responsibilities and business operations	Align Corporate Social Investment spend with Edcon business operations
		Strengthen Enterprise Development initiatives in alignment with Edcon business operations
Supply chain and sourcing	We will continue to support local merchandise suppliers while using our leverage to encourage ESG awareness across our supply chain	Integrate ESG considerations into supplier contracts and relationships
		Increase the volume of merchandise sourced from local and regional (SADC) suppliers
Optimisation	We will endeavour to reduce our resource footprint by minimising waste across all operations	Decrease energy use at head offices, distribution centres and stores
		Improve the treatment of waste at head offices, distribution centres and stores
Governance	We will ensure effective governance, sound management and application of ESG principles	Track implementation of the sustainability performance management framework via the internal audit system
		Align with global best practice in governance and reporting

Figure 5.6 Edcon's five value drivers[29]

The Edcon sustainability framework consists of five Environmental, Social and Governance (ESG) areas where sustainability initiatives align most strongly with the value drivers of the organisation. Each of the five key areas has two key objectives on which to focus. These five drivers are indicated in Figure 5.6.

Edcon applies **corporate governance** in order to ensure sustainability of the organisation and its business. These principles and practices are applied in line with *King III* guidance. Edcon's corporate governance is managed and monitored by the Board, in conjunction with the Audit and Risk Committee, the Remuneration Committee and the Transformation Committee.[30]

Edcon is a socially responsible organisation and it is committed to the reasonable and cost effective management of its direct and indirect impacts on the environment. It also aims to provide a healthy and safe environment for employees, customers and the society. Edcon demonstrates this social responsibility by sponsoring, together with the *Star*, specialised police trailers that enhance visible policing at beachfronts, hot spots and rural areas in the cities of Cape Town, Durban, Mthatha and Port Elizabeth.[31] The project is an effort to align private businesses with government and support the fight against crime. Edcon, in partnership with the department of police, roads and transport has also donated 39 mobile trailers and two additional vehicles to the police to help in combatting crime in the Free State[32].

Edcon has also invested millions in other social responsibility projects.[33] It supports

the SOS Children's villages (children living in these villages are clothed by Edgars), the Jet Community awards (rewards are given to NGOs for community based initiatives to help those in need), the Readathon (CNA sponsor this national literacy campaign and distribute books to schools, educators and learners), I Choose to give (Edcon employees are given the opportunity to use their skills and to donate goods and cash, matched rand for rand by Edcon, to community projects), Casual Day (funds are raised to support people with disabilities) and Breast Cancer awareness campaigns.

Edcon also collaborates with Ubuntu Pathways (UP), a comprehensive job-readiness program, which helps graduates find stable jobs[34].

Edcon's specific social responsibility environment policies are indicated below.

Edcon aims to be socially responsible by:

- Always meeting relevant legislative requirements
- Conserving its usage of water and energy
- Disposing of waste responsibly
- Promoting recycling wherever economically feasible
- Not offering merchandise/services that have an illegal environmental impact
- Requiring business partners to certify that they meet relevant legislative requirements
- Creating awareness of sound environmental practices amongst staff
- Keeping stakeholders informed about relevant progress via internal and external reporting (the *Edcon Vibe* and *Club* magazines and the Annual Report); and
- Conducting internal audits of its performance in applying these policies and in complying with all applicable laws and regulations.

Conclusion

From its humble beginnings in 1929, Edcon has grown from strength to strength and is today the largest retailer in its category in South Africa. It has more than 1 000 stores and eight retail brands and is the largest provider of credit in southern Africa by customer volume.

Self-assessment questions

Easy questions

1. How many divisions is the Edcon Group divided into?
   a. One

b. Two
c. Three
d. Four

2. Which one of the following stores is an Edcon discount store?
   a. Red Square
   b. Legit
   c. CNA
   d. Edgars Active

3. Edcon leadership skills have been divided into which of the following areas?
   a. Personal characteristics, process management and strategic management
   b. Process management and people management
   c. Personal characteristics, people management, strategic management and process management
   d. People management, HR management, process management and personal characteristics

4. The four cornerstones of Edcon's culture are people, integrity, performance and ____.
   a. Diversity
   b. Planning
   c. Consumers
   d. Professionalism

5. Which one of the following is not one of Edcon's strategic key levers?
   a. Margin expansion
   b. Comparable store growth
   c. New space growth
   d. Limiting credit

Challenging questions

1. Strategic management at Edcon refers to ____.
   a. The way the person works with others
   b. How the person manages the processes that are in place
   c. How the person makes the best of what he/she has to offer
   d. The person's understanding of the world and the industry trends

2. The way the person works with others, how the person helps to bring out the best in everyone and inspires them to take responsibility for good performance refers

to ____.
a. Personal characteristics
b. People management
c. Process management
d. Strategic management

3. At Edcon the McFarlane Cup is used to ____.
   a. Recognise employees nominated for living the Edcon values
   b. Recognise Merchandising and Operations teams who demonstrate superior sales performance
   c. Recognise employees who have worked at Edcon for a long time
   d. Recognise employees who have achieved a qualification

4. 'We are committed to developing a high performance culture in support of national development goals.' To which one of Edcon's value drivers does this refer?
   a. Governance
   b. Optimisation
   c. Social responsibility
   d. People

5. Edcon's monthly magazine, the *Edcon Vibe*, is part of the ____ area of leadership.
   a. Personal characteristics
   b. People management
   c. Process management
   d. Strategic management

Essay questions

1. Discuss the divisional structure in the Edcon Group.

   Key points to discuss:
   Three divisions. Departmental Stores: Edgars, Edgars Active, Boardmans, Red Square and Discount Store Division: Jet, Jet Mart, Legit and CNA Division. The Edcon Financial Services: banking and insurance products falls under Corporate Services.

2. Explain the four areas into which leadership skills have been divided at Edcon.

   Key points to discuss:
   Personal characteristics, people management, process management and strategic

management. Meaning and important aspects of each is required.

3. The Edcon culture is built on four values. Discuss these four values.

   Key points to discuss:
   People, Integrity, Performance and Professionalism. Define each one.

4. Discuss Edcon's competitive environment.

   Key points to discuss:
   Woolworths, Mr Price, Pepkor (Ackermans and PEP), Truworths and Foschini. Explain the structure of each.

5. Explain how Edcon motivate their employees.

   Key points to discuss:
   Remuneration; Recognition Schemes: Golden Heart Awards, Long Service Awards, McFarlane Cup; Learning and Development: Bursaries, Retail Academy and Performance Rewards Programme.

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6

Planning: Tsogo Sun

KEY TERMS

ALTERNATIVE PLANS
CULTURE
DEVELOPING PLANS
EFFECTIVE GOALS
ENVIRONMENT
EXTERNAL OPPORTUNITIES AND THREATS
GROWTH STRATEGIES
HOSPITALITY INDUSTRY
INNOVATION
MANAGER'S EXPERIENCE
MANAGER'S VALUES
MISSION
ORGANISATION'S VALUES
PLANNING CONTEXT
PLANNING PROCESS
PRODUCT DEVELOPMENT
PROJECT PLAN
PURPOSE
REACTIVE PLANNING
REBRANDING
STATEMENT VISION
SUSTAINABILITY
VISION

Introduction

Tsogo Sun has been in the **hospitality industry** for over 44 years and is currently the leading hotel and entertainment group in Africa[1], providing a variety of hospitality, entertainment and leisure experiences[2]. The group proudly encompasses

14 casinos and over 90 hotels in South Africa, Africa, Abu Dhabi and Seychelles,[3] and is acquainted with names such as Montecasino, Suncoast, Gold Reef City, Silverstar Casino, Beverley Hills Hotel, Southern Sun, Garden Court, Stay Easy, Sun One and Sandton Sun. Few realise that these brands are all part of the same company that occupies the position of the largest listed company in the hotel and tourism[4] sector.

A brief history

The Southern Sun Hotel Corporation (Pty) Ltd was founded in 1969 when South African Breweries (now called SABMiller) joined forces with hotel magnate Sol Kerzner to create the largest hotel group in the southern hemisphere[5]. The flamboyant Durban businessman became the first Managing Director of Southern Sun with the first six hotels opening in areas next to the Kruger National Park, the Natal coastal areas, and Johannesburg[6]. In 1983, Sun International Limited ('Sun International') was split out of Southern Sun as a separate gaming business and Southern Sun remained focused on hotels. In 1991 Southern Sun delisted from the JSE with Ron Stringfellow taking over the reins, and became a wholly owned subsidiary of SAB Limited. In the same year, Southern Sun entered into a joint venture with Accor SA, the French hotel group, to develop the Formula 1 and Formula Inn range of hotels in South Africa.[7] From 1995 onwards, many local and international developments followed, with a highlight being the opening of Tsogo Sun's (the Southern Sun holding company) R375 million Sandton Convention Centre in 2000, followed by the R1.4 billion Montecasino leisure and gaming development in 2001.[8]

In 2004, Southern Sun began a journey to reassess their brand portfolio strategy and invigorate their communications with the help of brand development and insight company Added Value and advertising agency Morris Jones. At the time, Southern Sun was pursuing a multi brand strategy with an international flavour. Brands like Holiday Inn, Crown Plaza, and Holiday Inn Garden Court had been introduced to give the hotel chain international flair and recognition, but the marketing team was concerned that the Southern Sun brand was getting lost in the clutter and wanted to assess the effectiveness of their strategy[9]. In May 2005, Southern Sun took one of their most momentous steps with the shift from managing brands to owning brands[10].

As a company, Tsogo Sun has expanded from its foundations as a hotel business and grown into new and exciting industries. They continue to succeed, even under difficult circumstances, due to careful **planning** and ensuring their **strategy** remains relevant. Marcel von Aulock, CEO of Tsogo Sun, attributes their success to their diverse product offerings with 'great properties, great people and a strategy we've spent a long time developing and which we constantly refine.'[11]

Planning and managing risk during the 2010 World Cup

In 2010, the Tsogo Sun Group (TSG) put years of planning and preparations for reaching security goals into play, as thousands of soccer fans converged on South Africa for the 2010 Federation Internationale de Football Association (FIFA) World Cup.[12] Not only would TSG be housing thousands of tourists and soccer fans, they were also selected to provide accommodation for the 'FIFA Family' (all the VIPs and senior officials) at some of their 5-star venues.[13] It thus became critical for TSG to have a well-structured plan in place.

TSG realised that they would be faced with an array of risks during the duration of the 2010 World Cup, including criminal activities, disruption of supplies, potential electricity brownouts and blackouts, as well as other threats to critical services. Tsogo Sun needed a comprehensive strategy and needed to establish **effective goals** focused on avoiding problems. TSG made a decision toward the end of 2009 to evaluate and strengthen its existing security, preparedness, and continuity efforts, and to increase their resilience in preparation of the FIFA World Cup.[14]

After establishing relevant security goals, TSG needed to select the right plan that would be most effective in reaching the security goals that were set. The company first considered implementing the ISO28000 security in the supply chain standard along with the BS25999 business continuity standard. After evaluating these options, TSG concluded that this was an unnecessary duplication of effort, and that implementing two standards was too costly. They decided that the ANSI/ASIS SPC.1-2009 provided a more cost-effective approach by simultaneously addressing security and continuity management, as well as fulfilling all the requirements of the ISO28000 and BS25999.[15] This would ensure an approach that would let them come up with the best balance between security and continuity[16].

In order to implement the selected plan, Tsogo Sun needed to put the selected plan into operation by organising resources for the purpose, by leading subordinates and exercising control. Tsogo Sun decided to do their own rigorous internal assessment of the implementation of the standard and selected six people to form a team that would audit the implementation. The organisation used the phased approach of a maturity model, and this approach consisted of six levels of implementation[17]. An audit and gap analysis was conducted by the project team to ensure that the efforts of the project were aligned with the requirements of the standard. After the project team completed the initial training, the team reviewed their early plans and determined that they had to make revisions and refinements to achieve the level of effectiveness in project management that they desired. A **project plan** was developed and presented to TSG for approval.[18]

The two main challenges experienced by Tsogo Sun was the converting of a generic standard for use by the hospitality industry, and communicating with the rest of the hotel personnel (particularly at the lower levels) about resilience and the specific security goals set for the project. The TSG team realised the importance of communicating and engaging people in the process as buy-in from all levels was key to the success of the project.[19]

The TSG project team understood the importance of involving all the staff of the

organisation and hence began the process of changing the attitudes of the workers and ultimately the **culture** within the organisation. The managers at the various levels of the organisation would also need to follow the steps of the **planning process**, each with their specific focus. The project team developed different presentations according to the audience and level of the organisation to ensure that everyone clearly understood what the process involved from a strategic perspective down to an implementation level. Generating excitement and communicating the importance and value of the work was a crucial element necessary for the success of the project.[20]

Tsogo Sun were able to follow an effective planning process in order to reach their security goals. Figure 6.1 illustrates the steps they followed during the planning process.

The TSG project team had tight timelines to adhere to and the training and initial processes were driven very hard. The objective was to have the basic plan implemented and the first series of standards audits completed at the selected venues at least one month before the World Cup kick-off. Despite tight timelines imposed on them, the TSG team successfully completed their project and all the goals that were set, were achieved.[21]

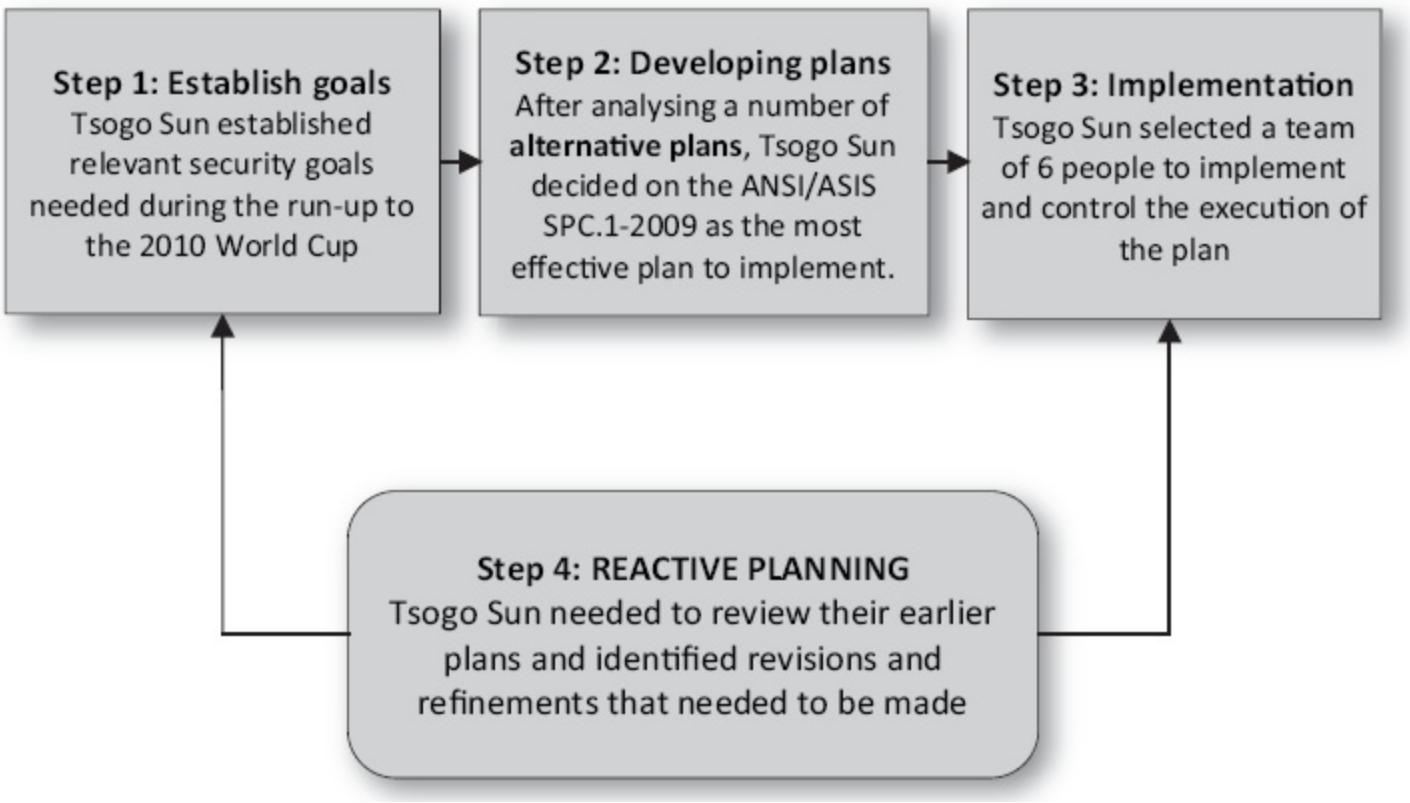


Figure 6.1 Steps in Tsogo Sun's planning process

Rebranding Tsogo Sun and a new vision

In 2012, Tsogo Sun Gaming and Southern Sun announced the consolidation of its

operating divisions under one name. Southern Sun, previously the umbrella brand for the hotel division of Tsogo Sun, and Tsogo Sun Gaming, the group's casino and entertainment division, was incorporated into the Tsogo Sun brand, unifying the company under one name and the 'Sunburst' logo.[22] The major rebranding exercise was intended to assist external stakeholders to better understand the variety of products that the group offers and the group believes it has achieved strong recognition within both the corporate and consumer markets in South Africa. The **rebranding** was also designed to encourage the group's employees in both the gaming and hotel divisions to work together more effectively and to ensure consistency of culture across the Gold Reef legacy casinos and the rest of the Gold Reef legacy casinos and the rest of the gaming business.[23] Tsogo Sun attributes its successful hospitality business to various key dynamics such as **innovation**, relevance, emphasis on ambience and a defined vision. The group believes that it is important to keep competitive by embracing novelty while still keeping to their brand values and integrity.[24]

A new vision and mission

Tsogo Sun's new vision for this diverse large-scale hotel, casino and entertainment offering is clear and all-encompassing and is a goal that every employee can strive to offer every guest they come into contact with.

Their **vision statement** reads as follows:
'Our vision is to provide quality hospitality and leisure experiences at every one of our destinations.'

The **mission** is incorporated into the purpose statement:
'From basic economy through to the finest luxury, our aim is to consistently provide out guests with an experience that meets their needs and exceeds their expectations – regardless of whether they are on business, at leisure, on their own, with colleagues, far from home or just down the road.

Our guests are treated in style…the comfort of a personal space at the end of the long working day; to holidays that relax and rejuvenate; to gaming that thrills and excites; to theatre that enthralls; food that delights and endless opportunities to be entertained.' Slogan: *Experiences shape your life - escape to ours.*[25]

When speaking about the new vision, Marcel von Aulock, CEO of Tsogo Sun explains that their scale has changed and 'we now have a distribution of casino and hotel products that touches many thousands of consumers' lives every day through our 14 casinos, over 90 hotels, and related restaurant and entertainment offerings. Our portfolio enables us to achieve our aim of providing the greatest variety of quality

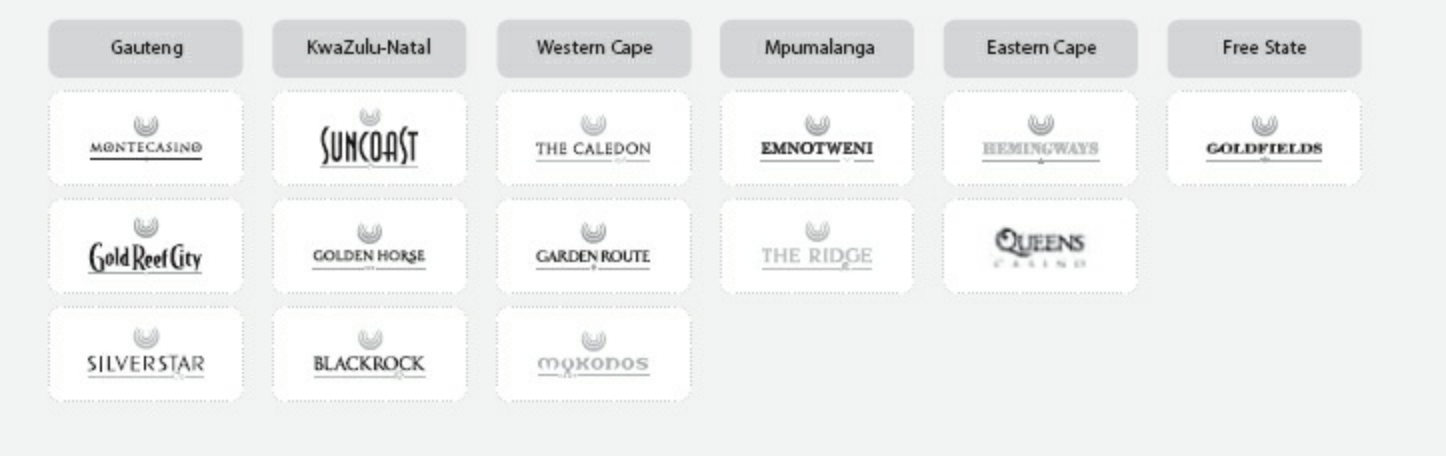
hospitality, entertainment and leisure experiences.'

Further elaborating on its vision, Von Aulock added, 'Our guests are people who choose to spend their time with us, whether they are on leisure or business, alone or with family, friends or colleagues, far from home or just down the road.'[26]

The new logo, comprising the Tsogo name and the Sunburst insignia taken from the historical Southern Sun logo, visually accentuates the company's strength, variety, presence and footprint and represents a uniquely African identity that is steeped in heritage.[27] This new identity enables the company to fully leverage and properly position their extensive intangible assets, namely their brands, under the proudly South African Tsogo Sun brand.[28] Figure 6.2 illustrates the new brands under the Tsogo Sun brand.[29]

Values and culture[30]

The group values of an organisation reflect the values of the top managers and contribute to the **planning context** of organisations such as Tsogo Sun. These values influence and cement the organisation's culture, strategy and structure.



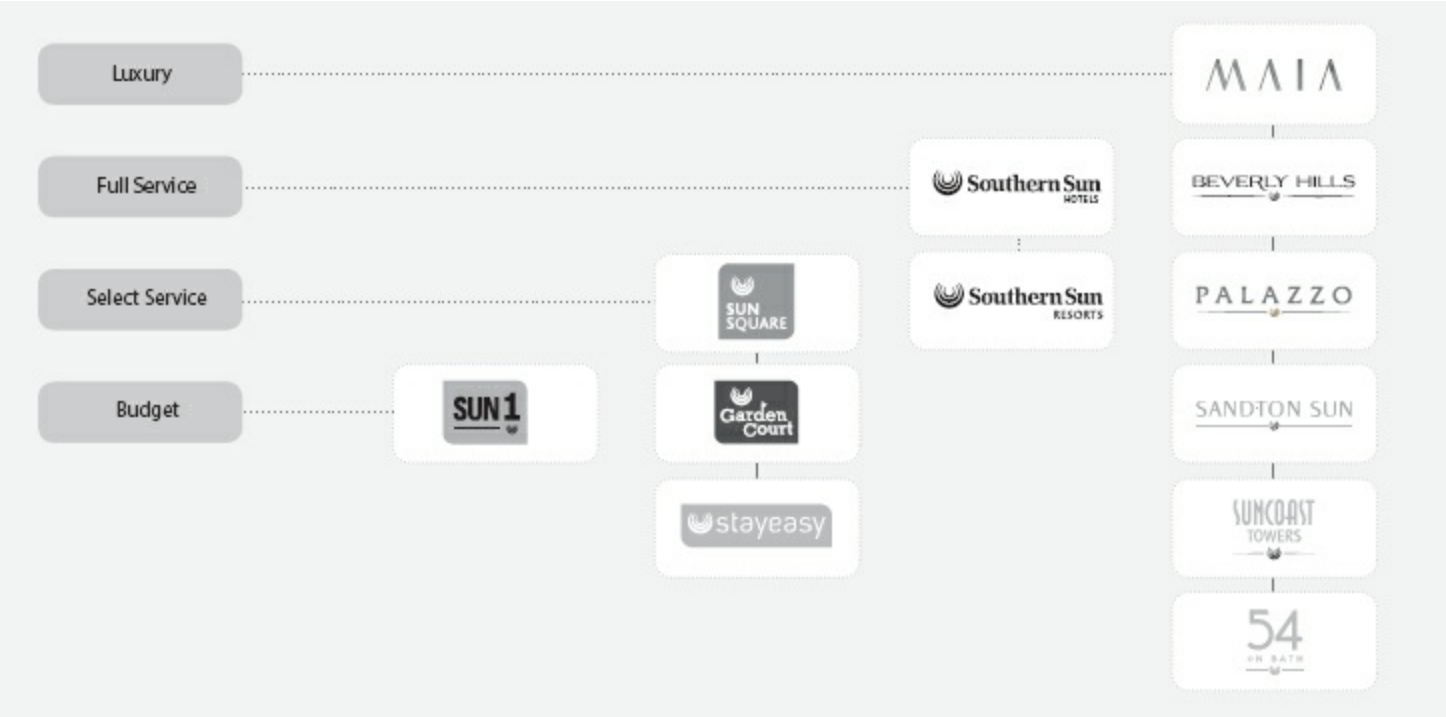


Figure 6.2 The various brands under Tsogo Sun

The Tsogo Sun culture is built on the following organisational five values (derived from each letter of the name 'Tsogo'): **Teamwork**, **Service**, **Opportunity**, **Growth** and **Ownership**. More than 2 500 employees across the broader group were engaged in establishing this new value system from the group.[31] They embraced a values based leadership approach that they refer to as 'livingTSOGO'; employees participate enthusiastically in the different components of the 'living-TSOGO world'. The group is also implementing 'livingTSOGO moments' and 'livingTSOGO measurements' (an employee engagement survey) which forms part of the organisational value system. These are designed to further embed the new organisational values within the business.[32] Figure 6.3 illustrates the five values with supporting behaviours that they encourage their employees to live by.



Figure 6.3 Tsogo Sun's five values

Their overall goal is 'to develop a sustainable advantage through the alignment of employee behaviour with our brand promise and to shape our identity over time and

optimise the potential capacity of employees to deliver distinctive, consistent and compelling guest experiences.'[33]

The environment

The **environment** is one of the most crucial variables that influence the planning context of organisations. In order to plan effectively organisations need to be able to manage and analyse **external opportunities and threats** in the environment. The hospitality industry is faced with many challenges such as financial sustainability, lack of transient corporate demand, inbound arrivals, cost push inflation, skills shortage and commoditisation.[34] The global crunch hit the hospitality industry very hard in South Africa, and one of the key challenges is the crippling shortage of relevant skills at middle management level to ensure **sustainability** and keep jobs in this market.[35]

Tsogo Sun is committed to the wellness of their employees and the principles of empowerment and diversity are entrenched into the ethos of Tsogo Sun. The group has implemented various employee programmes including employee clinics, wellness days and providing wellness programmes on key focus areas such as HIV/Aids. In terms of employee development, Tsogo Sun successfully launched the Tsogo Sun Academy during the 2014 financial year. A specific focus is placed on talent identification and development in order to provide the necessary management skills for the future. A primary focus in the year to come will be on further embedding an integrated approach to learning and development within the broader group, aligning all Academy activities with the growth strategy of the organisation.[36]

The **values of managers** also determine the organisation's commitment to social responsibility. Tsogo Sun provides a good example of a company that integrates its environmental management practices with its operations. The group is committed to introducing initiatives that reduce the impact that the business has on the environment and at the same time encouraging guests to embrace greener behavior for the wellbeing of the environment. In terms of energy usage, during 2014, the group decreased its energy consumption by 6% due to the installation of energy-efficient equipment, consumption measurement and behavioural change initiatives at the various units. Numerous energy reduction solutions have been implemented, for example, replacement of lighting with energy-efficient bulbs, boilers replaced with heat pumps and installation of meters and consumption monitoring. A number of recycling initiatives are also in place at the various properties and efforts are being made to standardise recycling systems and volume monitoring methods across all their properties.[37]

Tsogo Sun not only invests in environmental programmes but also in educational programmes such as the Tsogo Sun Moves for Life National Chess Programme, a project implemented by the Tsogo Sun Sports Academy. The programme presently reaches 16 719 learners and 455 educators across 37 schools, with the objective of improving math, science and literacy skills through the medium of chess. In addition, the Sports Academy supports 1 618 South African children and youth between the

ages of 7 and 17 in soccer, rugby and athletics; and provides a number of training and accreditation programmes for coaches, trainers, mentors and referees. In terms of environmental education, the group implemented the SunCares programme which comprises three specific focus areas: community development, enterprise development and the natural environment. Through this programme, the group strives to create awareness in local communities to encourage a responsible attitude towards the use of electricity and water and the management of waste. The programme also strives to educate people about reducing their impact on the environment through tree planting, food security and the conservation of our natural heritage. Tsogo Sun has partnered with Generation Earth and the Miss Earth SA leadership development programme to further instill awareness and provide education about environmental issues among young South Africans.[38]

All these variables mentioned above: the **purpose** of the organisation, the **mission and vision** of the organisation, the organisation's **environment** and the **organisation's values**, culture and **managers' experience** set the parameters for organisational planning for a business such as Tsogo Sun.

Staying ahead of the game – growth strategies

Business strategies determine how best to compete in a particular industry or market. The hospitality sector is a cut-throat industry and there is need for reinvention to keep the competitive edge and create a sustainable sector. Severely hit by the global crunch, businesses need to always find innovative ways to grow and sustain themselves. This requires plenty of going back to the 'drawing board' for players in the industry as many hotels are closing their doors due to lack of income.[39]

Tsogo Sun creates and maintains long-term sustainable value through a number of key pillars including meeting the reasonable requirements of their stakeholders, financial strength and durability, maintaining product relevance to customer experience, regulatory compliance and adequately skilled human resources. Despite facing a difficult trading environment in recent years, Tsogo Sun continues to deliver a strong performance in adjusted earnings and continues to explore every avenue for development and expansion. Investment projects that have been implemented or initiated include the redevelopment and capacity increases at their Silverstar and Gold Reef properties in Gauteng and the application for a large-scale expansion and development at the Suncoast Casino and Entertainment world. Tsogo Sun has also made use of various business **growth strategies**, competing in various countries across southern Africa. With regards to their sub-Saharan operations, the group has invested in projects totaling US$100 million in Nigeria and Mozambique, and continues to look for opportunities to add to their businesses in these regions.

As part of its strategy, the Tsogo Sun brand has over the last few years acquired and revamped distressed hotels and put them back in business. An example is the defunct Grace Hotel in Rosebank where the TSG group opened a new five-star deluxe Boutique Hotel, 54 on Bath in 2012. This has given them a competitive edge as they

boldly entered into a new market.[40] In 2014 Tsogo Sun launched a newly refurbished Sun Square Hotel aimed at the local economy-class traveller who is looking for comfort and class at an affordable price.[41]

In terms of **product development**, a critical component of the group's business and its plans for organic growth is the development of the casino and hotel real estate. Over the past five years, in excess of R800 million has been invested annually in the expansion, refurbishment and maintenance of the group's existing casinos and hotels.[42] Another growth strategy includes the new addition to the popular economy StayEasy brand with the opening of the new hotel, StayEasy Lusaka in Zambia.[43]

The group acknowledges that in order for a business to stay in business they need to be able to take advantage of the commercial opportunities that are presented to them. After all, good businesses fail when they are fragile, inflexible, unethical and/or poorly managed.

Conclusion

Tsogo Sun continues to shine as the leaders in the hospitality industry. The group's portfolio proudly comprises over 90 hotels with more than 14 200 hotel rooms across all sectors of the market, from luxury to budget in South Africa, the rest of Africa, the United Arab Emirates and the Seychelles; 14 premier gaming and entertainment destinations in six provinces of South Africa; theatres, cinemas, restaurants and bars; and over 240 conference and banqueting facilities, including the Sandton Convention Centre. Tsogo Sun continues to revolutionise the hospitality industry with their innovative spirit, dynamic management and unequalled levels of service to both the local and international markets.[44] In 2014, an array of awards were collected by the various Tsogo Sun properties including two awards for their most luxurious property, MAIA Luxury Resort & Spa in the Seychelles; receiving the 'Country Winner in the Best Luxury Resort Spa' category award; and the Luxe List Award for the 'Most Blissfully Romantic Hotel' for 2013. The Intercontinental Johannesburg OR Tambo Airport hotel and The Palazzo Montecasino also each received a coveted World Travel Award in November 2014 at a ceremony in Thailand. Tsogo Sun believes that in order to survive in a highly competitive market, one needs to develop a strong strategy based on brand values that the target market can emotionally connect with, and ensuring that they live these values in every aspect of their business.[45]

Self-assessment questions

Easy questions

1. The strategic goals and plans would have been formulated by Tsogo Sun's _____.
   a. Lower management
   b. Middle management
   c. Top management
   d. Functional management

2. The long-term strategic goals will be derived from Tsogo Sun's _____.
   a. Mission statement
   b. Vision statement
   c. Values and culture
   d. Business plan

3. The last step in Tsogo Sun's planning process involved _____.
   a. Implementing the security standard decided upon
   b. Controlling the execution of the plan
   c. Reviewing their earlier plans and identifying revisions and refinements
   d. Establishing appropriate security goals

4. Which step in the control process involved choosing between alternative plans of action to reach the goals set?
   a. Goal setting
   b. Developing plans
   c. Implementation
   d. Reactive planning

5. After Tsogo Sun has evaluated all alternative plans, what is the next step in the planning process?
   a. Establish the goals
   b. Select a plan
   c. Implement the plan
   d. Do reactive planning

Challenging questions

1. Tsogo Sun ensures that all the members of the organisation are aware of the goals they have to meet and focuses all activities in one direction to attain the

organisation's goals effectively and efficiently. This is an indication that planning _____.

a. Provides direction
b. Promotes coordination
c. Ensures cohesion
d. Facilitates control

2. The security goals set by Tsogo Sun were challenging but the TSG were able to achieve all the goals that were set and successfully completed the project. This indicates that the goal was _____.
   a. Measurable
   b. Time bound
   c. Attainable
   d. Irrelevant

3. The _____ sets the organisation apart from other organisations operating in the same industry by defining it in terms of products, customers and technology.
   a. Mission statement
   b. Vision statement
   c. Values and culture
   d. Environment

4. In 2014 Tsogo Sun launched a newly refurbished Sun Square Hotel aimed at the local economy-class traveller who is looking for comfort and class at an affordable price. This is an example of a _____ strategy.
   a. Concentration-growth
   b. Market-development
   c. Vertical-integration
   d. Diversification

5. The _____ influence and cement the organisation's culture, strategy and structure.
   a. Purpose of the organisation
   b. Missions statement
   c. Vision statement
   d. Values of managers

Essay questions

1. Discuss the factors that will determine the context in which planning takes place

at Tsogo Sun. Provide examples from the case study.

Key points to discuss:
The purpose of the organisation and the environment, the organisation's mission statement, the organisation's environment, the managers' values and the managers' experience.

2. Discuss the different steps that Tsogo Sun followed in the planning process in their planning and preparations for reaching their security goals leading up to the 2010 FIFA World Cup.

   Key points: Establishing goals, developing alternative plans, evaluating alternative plans, selecting a plan, implementing the plan, doing reactive planning as changes occur in the environment.

3. Discuss the nature of plans and provide examples from the case study.

   Key points: Alternative plans of action, external factors, the organisation's strengths and weaknesses.

4. Identify the different corporate strategies Tsogo Sun made use of in order to expand their product and market offering.

   Key points: market-development strategies, product-development strategies, innovations strategies, join-ventures, diversification

5. Describe the difference between tactical, operational and strategic goals and plans and provide examples from the case study.

   Key points: strategic goals and plans, tactical goals and plans, operational goals and plans.

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7

Organising: The Nike Matrix

KEY TERMS

CENTRALISED AUTHORITY
CHAIN OF COMMAND
COORDINATING
DECENTRALISATION OF AUTHORITY
DELEGATING
DEPARTMENTALISATION
FUNCTIONAL DEPARTMENTALISATION
GEOGRAPHIC UNITS
GOALS
LINE AUTHORITY
LINES OF AUTHORITY
MANAGEMENT HIERARCHY
MATRIX MODEL
MATRIX STRUCTURE
MULTIPLE RESPONSIBILITIES
NIKE INC.
ORGANISATIONAL CULTURE
ORGANISING
PRODUCT DEPARTMENTALISATION
REPORTING LINES
SPAN OF MANAGEMENT
STRATEGIC PLAN

Introduction

Nike Inc. is one of the world's largest suppliers of athletic shoes and apparel. It is also a major manufacturer of sports equipment and engages in the design, development, manufacturing and worldwide marketing and selling of footwear, apparel, equipment, accessories and services. The American multinational corporation's headquarters are

situated in Beaverton, Oregon, and represents to many the 'American Dream', the brand alone being valued at $19 billion in 2014 making it the most valuable sports brand in the world (in 2013 it was valued at $17.3 billion).[1]

The following brand names are owned by Nike: Nike Golf, Nike Pro, Nike+, Air Jordan, Air Force 1, Nike Dunk, Foamposite and Nike Skateboarding. Nike subsidiaries include Brand Jordan, Hurley International and Converse. The Nike brand includes footwear, apparel and equipment in six core categories: running; basketball; football (soccer); women's fitness, golf, and tennis; men's training; and sport culture. Nike branded products are sold through Nike owned stores and independent distributors in over 160 countries. Nike does not produce footwear and apparel within the U.S., but has chosen to outsource production to independent manufacturers outside the country's borders (mostly in Asia). Equipment is produced both within and outside the U.S. Nike works with 137 contract factories in the Americas, 104 in EMEA (Europe, the Middle East and Africa), 252 in North Asia and 238 in South Asia. Nike's retail repertoire consists of 14 Niketowns, over 200 Nike Factory Stores, 12 Nike women stores and over 100 sales and administrative offices around the world, with more being added on a continuous basis.

A short history[2, 3]

The company was founded in 1964, known initially as Blue Ribbon Sports (BRS) and became Nike Inc. in 1971. The company was originally founded by track athlete, Philip Knight, and his coach, Bill Bowerman, and traded as a distributor for the Japanese shoe maker Onitsuka Tiger (now known as ASICS). In 1971, the relationship between BRS and Onitsuka Tiger came to an end and BRS started the preparations for launching its own line of footwear, boasting the iconic 'swoosh' image for the first time on June 18, 1971. Footwear was originally made using Bill Bowerman's wife's waffle iron, earning them the street name 'waffle sneakers'. The 'swoosh' was designed to embody the spirit of the Greek winged goddess of victory, Nike, from which the new name for the company was also taken. The first brand advert for Nike was released in 1977 under the tag line 'There is no finish line' and, interestingly, no Nike product was featured in the ad itself. In 1988 the now-famous slogan 'Just do it' was used for the first time which was based on the last words of Gary Gilmore, 'Let's do it', who was executed in 1977 for committing two murders. By 1980, Nike had attained a 50% market share in the U.S. athletic shoe market. The company then set its sights on the rest of the world and throughout the 1980s the objective became to expand its product line to encompass as many sports and regions as possible.

Since setting their sights on the world in 1980, Nike has grown incrementally. Operating on six continents, the organisation employs more than 30 000 people worldwide with an additional 800 000 factory workers.[5] Global revenue reached $25.3 billion during the fiscal year of 2013. During the first fiscal quarter for 2014, Nike reported $7.98 billion global revenue, a 15% jump in income as reported at the same

time in 2013[6]. It is clear that Nike is not yet done growing and with their new five-year **strategic plan**, **organising** Nike is their key to success. Organising represents the mechanism that organisations such as Nike develop in order to implement the strategy or plans that have been set for the organisation. Nike is no stranger to using this process of **delegating** and **coordinating** tasks, activities and resources in order to achieve their **goals**, and is considered a global example when it comes to organising for success.



Source: Decs of Design. [Online]. Available: https://decsofdesign.wordpress.com/2012/10/17/1980s-just-do-it/. Accessed 12 November 2014.

Figure 7.1 Nike's famous slogan and logo[4]

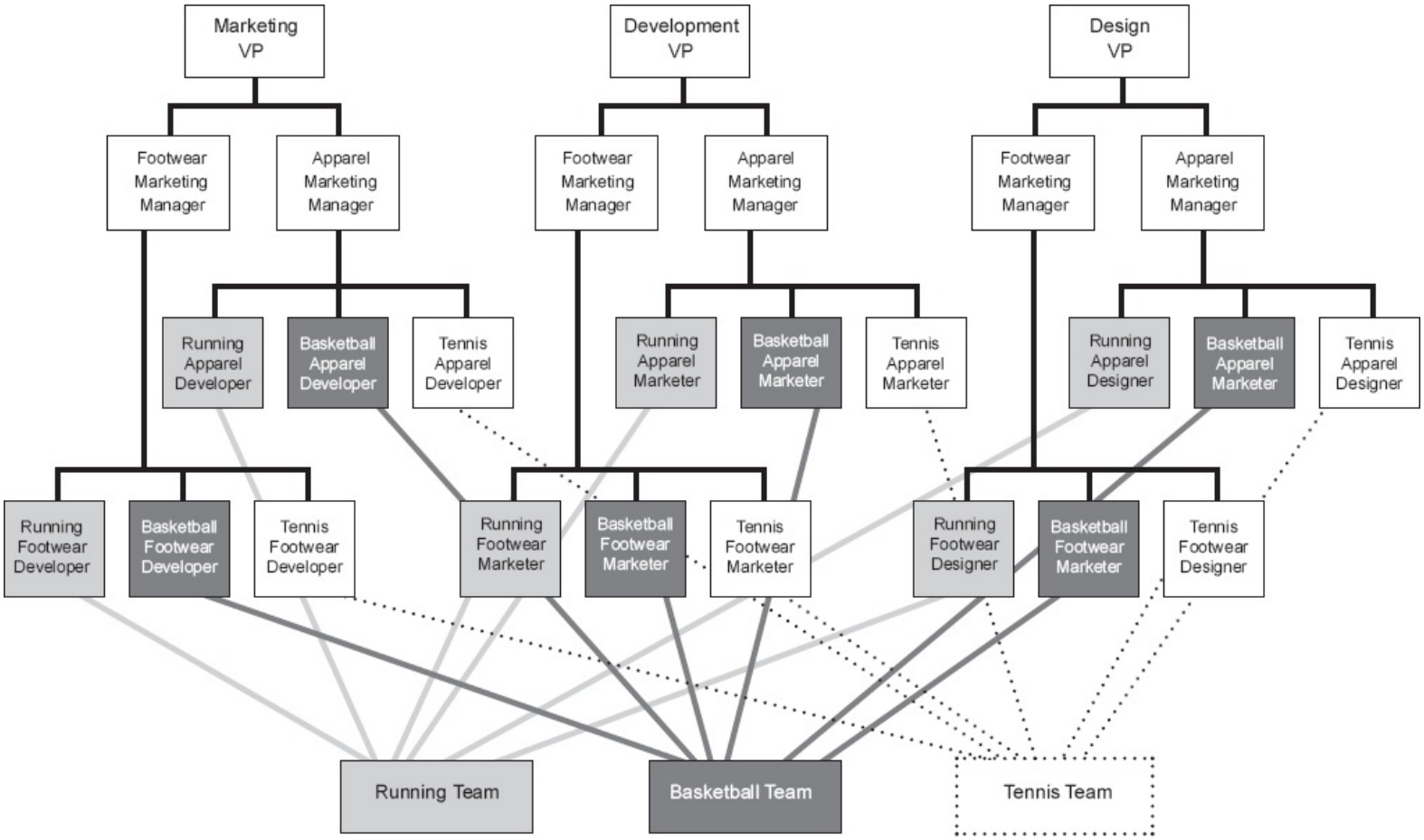
Restructuring a young 'Nikey' into a global player

Nike's organisational structure in the 1980s was based on a general manager orientation where the main divisions were led by a marketing manager[7]. The organisation was primarily organised by using **functional departmentalisation** which is the most basic type of departmentalisation an organisation can have. Known as the classical organisational structure, activities belonging to each management function are grouped together and employees are grouped hierarchically and managed through clear **lines of authority** where such employees report to one person. Although this type of departmentalisation is easy to understand and incorporate, it does not facilitate the management of more complex organisations and with Nike's ventures into the global market, it soon became apparent that this approach was not suitable nor did it encourage the innovation Nike was seeking.

The decision was made move to a **matrix model**, emphasising the functionally orientated divisions that would include sales, marketing, research and development,

production, and operations. The main objective to this approach was to encourage innovation through team-based product development. A basic matrix-like structure was put in place where functional departments occurred in the same structure as the product lines in Nike. A combination then of **functional departmentalisation** and **product departmentalisation** (departments are designed so that all the activities concerned with the manufacturing of a product or a product range are grouped together) was evident, as can be seen in Figure 7.2 overleaf.

By 1993, various teams at Nike performed numerous functions throughout the organisation, complicating communication and interaction from team to team. The organisational structure put in place to encourage innovation now started to hamper innovation instead with the lack of risk-taking by teams and team members. The functional units that Nike had used to establish new ideas now seemed to be doing the exact opposite. This lead to a misalignment of Nike's corporate values and management decided to restructure the organisation again, this time taking on more roles in controlling and monitoring the organisation rather than solely relying on encouraging autonomous innovation. Nike's **span of management** thus became flatter as fewer management levels were evident, with many subordinates per manager.



Source: Sauder Studio. Transforming organisation. [Online]. Available: dstudio.ubc.ca/files/2012/01/3_TSIA_Report_2.pdf. Accessed 12 August 2014.

Figure 7.2 Nike's organisational matrix in the 1980s

Nike wanted to maintain the team-based product development as in the previous

functionally orientated structure, but needed to reduce the degree of complexity in their matrix structure to promote inter-organisational interaction and communication. Strengthening the organisational and strategic links between the functional areas (marketing, merchandising, design and development) was crucial in the decision for a new organisational structure. In order to achieve this management required teams that would become fully focussed category units so that the importance of different product categories would be emphasised. The move was made to do away with the complex web of innovation that undermined the interaction between different teams and Nike embraced a new structure that would encourage team identity, stability and expertise. The new proposed structure led to the creation of several autonomous units that were directly responsible and in control of one specific product type. The units then were organised is such a manner that they acted like small entrepreneurial companies that were able to make decisions, develop visions and run their businesses independently of each other.

Although the units functioned independently from each other, it was important that Nike maintained a shared vision so that all of the units worked together in a general direction. Coordinating the different activities was and still is a crucial management function at Nike as it is the key to keeping each individual business unit focussed on Nike's goals and ensures that, even though the units do function apart from each other, they still form an integrated unit focussed on Nike's mission and vision. Without coordination, it would be easy for departments or individual business units to lose sight of Nike's primary goals and the impact that their individual actions have on the achievement of these goals.

Refining Nike's matrix design[8]

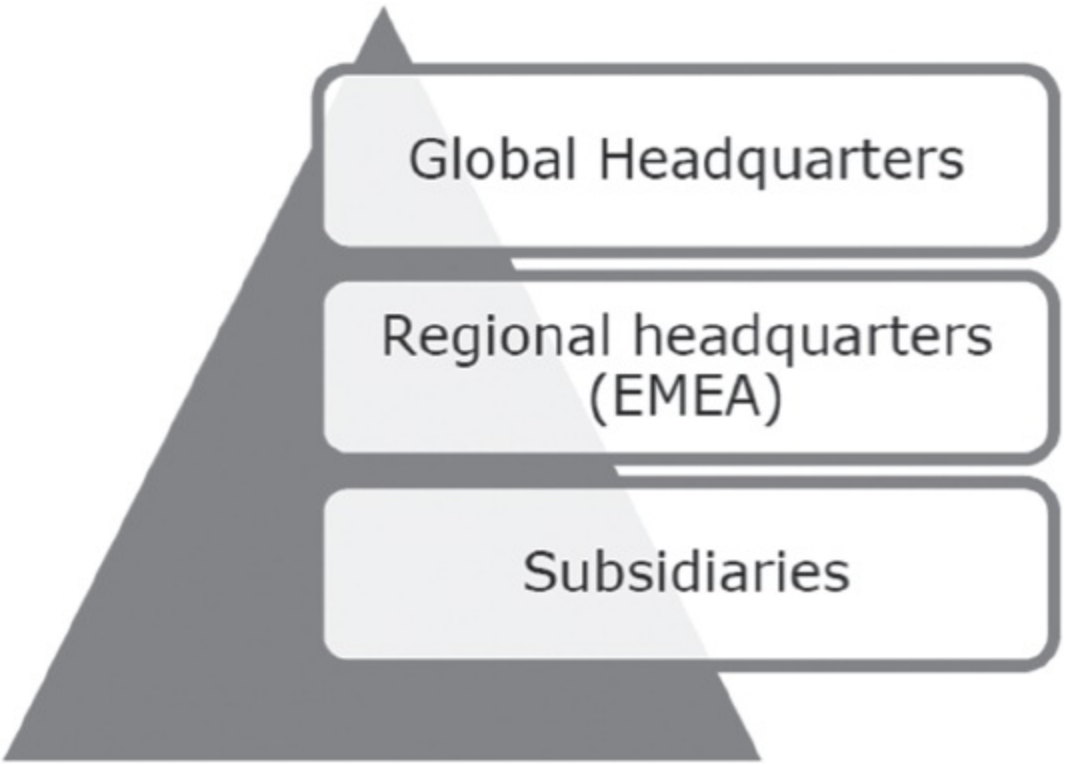
Since the 1980s and the subsequent reorganisation in 1993, Nike has grown into the international player it envisaged. In 2013 Nike Inc. comprised of 44 wholly-owned subsidiaries, of which only seven resided in the U.S. Only three of these subsidiaries (Nike IHM Inc., Triax Insurance Inc., and Nike (Suzhou) Sports Company Ltd.) do not deal with the design, marketing, distribution and sale of athletic and leisure footwear, apparel, accessories and equipment.

Nike has established a five-year strategy to encourage the growth of its global operations. In addition, Nike would like to sustain or grow market leadership of the Nike brand and its affiliated brands. Goals included in the new strategy are ongoing product innovation, brand leadership, retail experience and further regional expansions. Nike expects geographical expansions and growth in its home turf, the U.S., and in the U.K., Japan and China. It is also expecting growth in Russia, India and Brazil.

Nike's current organisational structure still resembles the matrix structure where **multiple responsibilities** and **reporting lines** for each unit are evident. Although an extremely complex structure with scope for many problems to arise, Nike has been

able to make it work through years of experience using this particular structure. One of the major disadvantages of using such a structure is the divided authority as often two managers will have authority over the same subordinates. Nike deals with this problem by focusing on leadership within the matrix structure. For many outsiders, it would appear that it is not possible for the Nike matrix structure to work and function effectively. It is evident that there are no clear lines of accountability, which often lead to delays in decision-making. In reality though, Nike's managers are able to make decisions quickly and get employees aligned behind such decisions, creating an environment where support is given in such a manner that Nike is able to not only move quite quickly once a decision has been made, but also where innovation is cultivated.

To further enhance the current reporting relationships at Nike, the decision was taken to introduce an additional management layer in the Nike hierarchy (see Figure 7.3 below). The regional headquarters for the EMEA region have now been included in the **management hierarchy** and the matrix structure is now also replicated on a regional level.



Source: Brenner, B. 2013. Inside the Nike Matrix. *Case series*. Hampshire: Palgrave Macmillan, p.7.

Figure 7.3 Nike's management hierarchy

The first management level: Global headquarters

When looking at Nike's management hierarchy, it is evident that Nike's global headquarters are at the top of the **chain of command**. Nike follows a largely **centralised** system of **authority** where power and authority has largely remained in the hands of top management and higher-level managers. **Line authority** is also evident as authority is delegated down the line of command, starting from the global

headquarters and moving down to the various subsidiaries. The managers in this line are directly responsible for setting and achieving Nike's strategic goals.

Structure is then extremely important at Nike as it largely prioritises where management spend their time. Large organisations like Nike are often inundated with information if the organisational structure is not appropriate. Nike's Vice President for Operations, Mr Alebeek, is of the opinion that the right information flows very quickly if an organisational structure is created in the right way which prioritises information that is disseminated down the chain of command. Nike also believes that structure needs to be supported by a strong organisational culture and corporate identity. **Organisational culture** is a key factor that influences the design of the organisational structure and, at Nike, headquarters are responsible for creating a common identity and culture. The goal here is to create a company culture where employees are able to identify and feel close to their end consumers' needs. Nike management feels that if common understanding is present, streamlined and centralised structures are not barriers, but rather enablers to staying connected with the local consumer, even if the company is run as a global organisation.

The following activities are managed for the group by Nike's global headquarters:

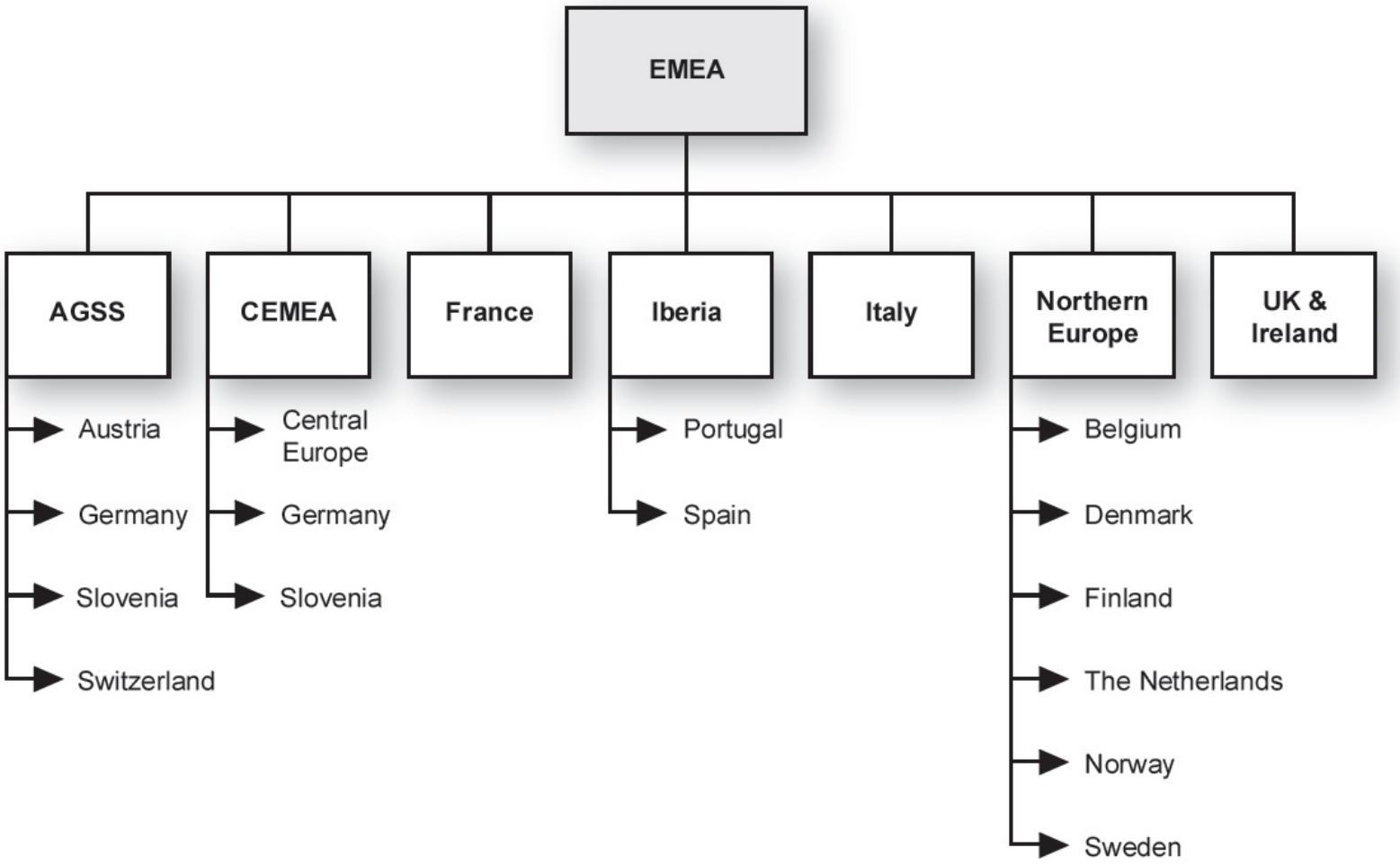
- Research, product development and design remain the responsibility of the global headquarters. It takes Nike an average of 18 months to design and manufacture a product. Between 30 000 and 40 000 new product developments occur on an annual basis which requires the apparel to be designed on a regional level. Footwear design remains the responsibility of the global headquarters with R&D facilities centralised at a single location.
- The sourcing of products is managed globally to tie-in with Nike's production resources which are mainly situated in Asia. Nike has realised that it would not be efficient for regional areas to work with the same factories as competition might arise between regional areas. Instead, Nike plans and forecasts the demand for products regionally, places purchase orders accordingly on a regional basis and then manages purchase orders with the factories on a global level. Planning and forecasting demand and placing orders is thus affected on a regional level whereas purchase orders are managed globally.

The second tier: Regional Headquarters – EMEA

The EMEA regional headquarters is located in the Netherlands and is responsible for the 27 countries in this region. Within the EMEA region, Nike is further departmentalised into **geographic units** as can be seen in Figure 7.4.

The main reason behind Nike's decision to add an additional layer of hierarchy on a regional basis was to reduce the complexity inherent to the matrix structure and to enhance transparency throughout the group. As can be seen from Figure 7.4, the organisational structure for the EMEA region is largely based on geographical location. Whilst big countries like France and Italy report directly to the regional headquarters, most countries are part of a sub-group which reduces the number of

regions reporting to the regional headquarters, enabling more efficient management. Synergies are achievable by grouping countries together in sub-regions and operations are easily streamlined across the group. By reducing the number of reporting lines, coordination is facilitated and decisions can be made quickly. By grouping single markets into regions, Nike is able to filter and funnel local demands and also provide support for individual markets.



Source: Brenner, B. 2013. Inside the Nike Matrix. *Case series*. Hampshire: Palgrave Macmillan, p.10.

Figure 7.4 The EMEA region

Sub-region managers will report local requirements to the EMEA regional headquarters. By using regional structures in such a manner, seemingly unimportant markets can now be amplified and be given more attention than when countries reported directly to the global headquarters. Regional headquarters not only bundle information flows in such a way that synergies are created, but also manage surfacing tensions that come with aggregation.

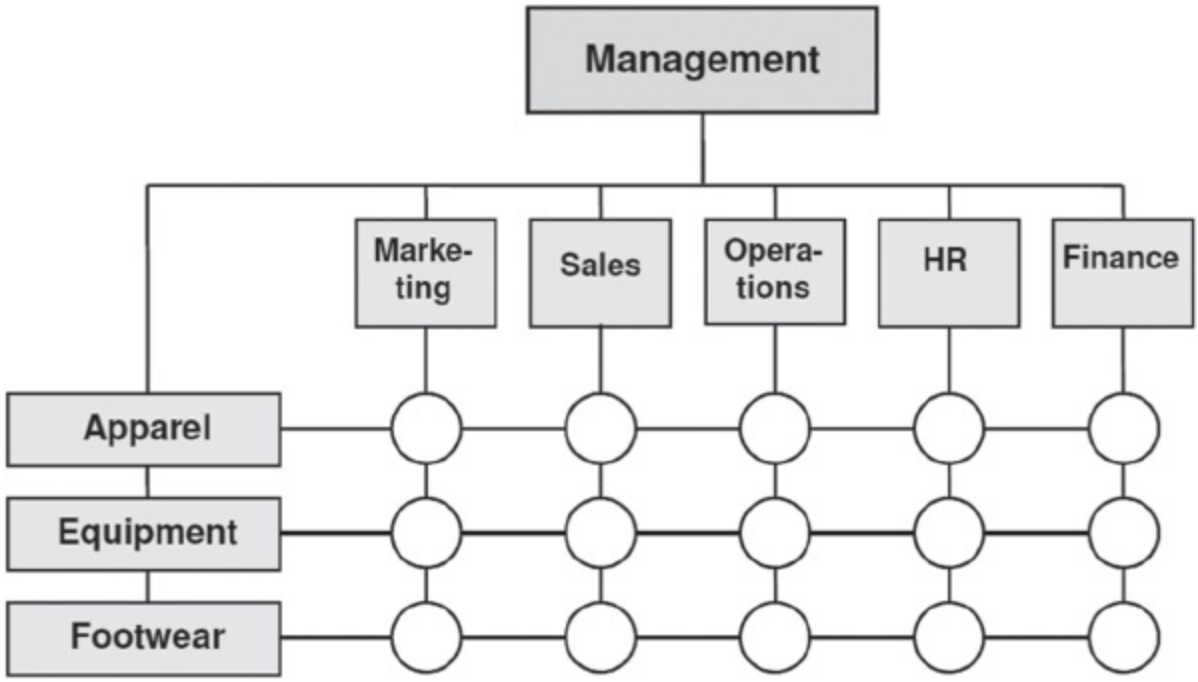
One of the most important principles for organising is the creation of departments, or in Nike's case sub-regions. **Departmentalisation** is necessitated by the logical grouping of activities that belong together. The most logical way to group activities together differs from organisation to organisation and can also differ according to the specific business function. For Nike, the logical grouping of activities for the EMEA was according to geographical location. The reasoning behind this was primarily that

consumers residing in the different countries that were grouped together exhibited similarities. For example, French consumers differed significantly from those in Austria, Germany, Switzerland and Slovenia. Regions were also grouped together based on the likeness of the retail structures present.

Regional areas replicate Nike's organisational structure, the matrix, where managerial responsibility is broken down by business unit and function. An example of this is shown in Figure 7.5 on the following page.

The EMEA regional headquarters plays an integrative role within the region and seeks to coordinate country and regional strategies. It is responsible for pooling resources to increase the efficiency of regional operations. Synergy is achieved by using cooperation on a horizontal level.

Coordination, one of the building blocks of organising, was the main reason for establishing regional headquarters. The aggregation of market knowledge at a regional level was crucial and coordination allowed Nike to achieve leverage effects in financial and management operations. Supply chain management also benefits from the coordination that regional headquarters affords Nike. Product development in particular has benefitted from this additional layer of management. Although new product development, especially for shoes, resides at the global headquarters, regional headquarters are now able provide input for new products by scouting local environments and feeding information back to global headquarters. This calls for a flatter span of management to ensure effective communication.



Source: Brenner, B. 2013. Inside the Nike Matrix. *Case series*. Hampshire: Palgrave Macmillan, p.12.

Figure 7.5 The regional matrix structure

Nike is moving to a structure where its matrix is indispensable. Global and regional designers are working together more often, going into the field to conduct consumer research and analyses. As the European market becomes more important, global

products are being adjusted to suit regional demands. And although countries do not develop any products, over 700 new models per season are hitting the market which originated from the regional product engine. Countries are in charge of filtering consumer demands and reporting local product requirements to their regional headquarter which in turn is forwarded to the global product engine, situated at the global headquarters. It is evident then, despite Nike's strong dependence on its top management levels, that some **decentralisation of authority** has taken place by allowing at least some power to trickle down the chain of command.

When it comes to marketing though, more control is taken by top management in both the regional and global headquarters. Local countries do have individual budgets for local activities, but approval must first be gained from the regional headquarters to ensure that marketing materials are in line with Nike's overall corporate identity. To create a uniform message, marketing campaigns are rather drafted at a regional or global level and then adjusted, where applicable, for local demands. A similar approach is used for pricing strategies, although these tend to occur at a regional level rather than a global level. Countries rarely have the opportunity to decide on their own pricing strategies and any deviations from the strategies set by regional offices require prior approval.

The last frontier: subsidiaries

The last tier of Nike's management hierarchy is their subsidiaries. These enjoy some autonomy, but clearly-set boundaries keep Nike in control. Subsidiaries are allowed to take decisions at country level and may also take local initiative and incorporate adaptions to suit local needs. They are however expected to implement plans as communicated to them by Nike's global headquarters.

Conclusion

In short, Nike has made a success of one of the most complex organisational structures available to companies, the **matrix structure**. It makes use of multiple lines of authority with Nike employees reporting to team managers who report to department managers. At a regional level, each product category has its own manager who reports directly to the regional manager who reports back to the global headquarters in Oregon. By using the matrix structure, Nike is able to make decisions and incorporate those decisions into the organisation in a timely fashion, which encourages continuous innovation. Nike has proven that a combination of functional and divisional structures can be extremely successful, especially when going global.[9]

Self-assessment questions

Easy questions

1. Which one of the following is not a core category for Nike?
   a. Women's fitness
   b. Running
   c. Rugby
   d. Tennis

2. Nike was originally known as _____.
   a. Blue Ribbon Sports
   b. Nike Inc
   c. Onitsuka Tiger
   d. ASICS

3. Nike's logo, the 'Swoosh', was designed to resemble _____.
   a. A winning athlete
   b. The Greek goddess of victory
   c. A piece sign
   d. The slogan does not represent anything

4. The first ever Nike ad ran under the tag line _____.
   a. There is no finish line
   b. Just do it
   c. Let's do it
   d. Winners take it all

5. What type of organisational structure does Nike currently have?
   a. Product departmentalisation
   b. Functional departmentalisation
   c. Geographical departmentalisation
   d. Matrix departmentalisation

Challenging questions

1. During the 1980s Nike made use of the functional departmentalisation. Which one of the following statements describes this type of departmentalisation?
   a. This is a logical structure to use when producing products in different regions.
   b. Activities belonging to each management function are grouped together.

c. Activities belonging to a product are grouped together.
d. The structure concentrates on a special segment of the market.

2. Which one of the following is an advantage of the matrix structure?
   a. Authority lines occur in the same structure so that both horizontal and vertical authority is present.
   b. Autonomy is achieved and it is clear who is responsible for any profits or losses.
   c. Product adaption is possible and local needs can be taken into account.
   d. The specialised knowledge of employees is used to maximum effect and decisions can be made quickly.

3. Nike has adopted a relatively flat span of management. In such a scenario it is possible that _____.
   a. It may be difficult to coordinate tasks
   b. Managers may be underutilised
   c. Excessive control is evident
   d. It may be unclear who is in control

4. _____ is an endeavour by management to develop congruence in the organisation, focusing on the achieving the main goals.
   a. Organising
   b. Control
   c. Coordination
   d. Authority

5. If Nike's global headquarters decide to give regional headquarters the authority to design their own shoes, as per local requirements, _____ of authority has taken place.
   a. Centralisation
   b. Decentralisation
   c. Delegation
   d. Coordination

Essay questions

1. Illustrate and explain functional departmentalisation, the first organisational structure used by Nike.

   Key points to discuss:
   General manager orientation; main divisions management by one manager;

activities and employees are grouped according to management function; clear lines of authority

2. Discuss the authority relationship at Nike.

   Key points to discuss:
   Chain of command flows from global to regional to country; span of management is flat; few management levels with many subordinates per manager

3. Explain how functional areas are management within the regional matrix system.

   Key points to discuss:
   Regional headquarters are responsible for pooling resources and creating synergy among different countries; product development occurs on a global level, although input can be given on regional and country level; marketing is largely controlled at a regional or global level; approval must be gained for local activities; pricing is determined at a global level

4. Discuss the use of a matrix structure on a regional level at Nike.

   Key points to discuss:
   Managerial responsibility is broken down by business unit and function; synergy is created by cooperation on a horizontal level; uniform approach to achieve Nike's goals

5. Organising consists of five fundamentals: designing jobs, grouping jobs, establishing reporting relationships, establishing authority relationships and coordinating activities. Give examples from the case study on how these fundamentals were used to organise Nike.

   Key points to discuss:
   Grouping jobs: Nike uses the matrix system; establishing reporting relationships: Nike uses a flat span of management; establishing authority relationships: Nike uses centralised authority for most of its activities; coordinating activities: coordination is extremely important especially on a regional level where coordination between countries need to be managed carefully

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8 Leading and controlling: South African business leadership in action

KEY TERMS

ACCOUNTABILITY
ATTRIBUTES
BEHAVIOURAL THEORY OF LEADERSHIP
DELEGATION
DEMOCRATIC LEADERSHIP STYLE
EMPLOYEE AND CUSTOMER FEEDBACK
EMPLOYEE ORIENTATED LEADERSHIP STYLE
FAILURE
FOCUS ON PEOPLE
FUTURE OF BUSINESS PROFIT IS PURPOSE
HUMAN CAPITAL DEVELOPMENT PROGRAMME
LEADERSHIP STYLE
LEAD FROM THE FRONT
LISTEN
LUCK
MORALE
MOTIVATION
PRODUCTION-ORIENTATED LEADERSHIP STYLE
PRODUCTION TRUST
RECRUITMENT PROCESS
RELEGATION
RESPONSIBILITY
STRATEGIC BALANCE SHEET MANAGEMENT
TEAMWORK
TRANSFORMATIONAL LEADERSHIP

It always seems impossible until it's done – Nelson Mandela

Introduction

The above quote from South Africa's most iconic leader is also a true testament of some of South Africa's formidable business leaders. It is leadership that gets the seemingly impossible vision into action and achievement. Leadership is perhaps one of the most important variables of business today – as can be seen in *Introduction to Business Management* and various other texts. However, there are more characteristics to leaders than only perseverance and vision. This chapter looks at how business leader Sir Richard Branson views leadership, how some of South Africa's business leaders have changed the leadership landscape of their organisations, and how they have applied leadership theory in practice. By no means is this chapter a 'how to' guide, but merely a glimpse of some leaders in business and a reflection on 'how they did it'.

In addition this chapter will conclude with a brief look at control systems applied in business.

Leadership in the Virgin Group

Sir Richard Branson, founder of the Virgin Group, defines good leadership as the ability to take a venture forward and find viable new avenues where business can evolve and prosper[1]. Strong leaders must have the ability to influence others to follow and support them. Often an organisation is moved into uncharted and risky territory and strong leaders are required to steer the proverbial ship in the right direction. In the dynamic environment of business, keeping the status quo is not an option.

Leadership has a number of components, which include authority, power, responsibility, delegation and accountability. We will have a look at some of the components of leadership and how they have been applied within a business environment in several instances. Let's have a look at what the Virgin Group leaders' attributes are.



Figure 8.1 Sir Richard Branson

Virgin requested staff across all Virgin Group companies to participate in a study to determine the type of leadership style experienced within the company and what they expect from leaders going forward. The following **attributes** have been identified by employees in broad categories[2]:

- Leaders should embrace individuality
- Leaders should have an entrepreneurial spirit
- Leaders should empower people
- Leaders should inspire trust
- Leaders should be 'in it together'
- Leaders should be genuinely caring
- Leaders should be energisingly passionate
- Leaders should be accessibly informal.

Listening

One of the most important attributes that had a vital importance to staff members at Virgin was the ability to truly **listen**. Although strong leaders such as Winston Churchill and Nelson Mandela could inspire nations with their words, the act of listening is one of the often underrated attributes a leader can have. Although this is not mentioned in the communication model it remains one of the most important

facets in communication. Branson[3] emphasises the importance of listening as an attribute of strong leaders. The act of listening is not only focusing on what is said, but often what is not said. In other words, it is important to read between the lines, identifying what is not discussed as well as the body language of people. Leaders should be able to listen to their employees, customers, suppliers and competitors. Employees need to be heard in an informal everyday way in order for business leaders to understand what their challenges are and possibly get hands-on ideas and input on how to solve organisational problems. Visiting staff members as often as possible, in their working environment, makes leaders accessible to their staff. Honest discussions about staff issues, concerns and ideas go beyond the accessibility of management. This is in line with the **democratic leadership style**, which is deemed the most effective style. This is true for every Virgin company where the input of employees at every level is obtained, especially from staff who will actually be providing the service[4]. Let's see how South African and international leaders apply listening in their leadership styles.

In order to listen to customers, Absa Bank Group Chief Executive Maria Ramos often goes to Absa bank branches dressed in casual clothing and gets in queues with customers to understand the customer experience at the bank. In addition she speaks to customers and responds to their concerns directly[5]. Understanding customers starts with listening to them.

Virgin also applied this principle in the development of the Virgin Hotels range. When it determined what women guests might require from a memorable hotel stay it turned to the number of female Virgin executives to provide them with insight[6]. While based in the UK Richard Branson cold called some of Virgin Atlantic's Upper class (business class) passengers on arrival at Heathrow. The limousine drivers could be tracked driving these passengers and were primed to pass the phone to the passengers. Regardless of the initial reactions of passengers, complaints and insights regarding their experiences on a Virgin Atlantic flight have been of tremendous value. Problems could be identified and solved there and then increasing customer loyalty[7].



Figure 8.2 Maria Ramos

Retail giant Pick n Pay's creator and chief executive, Raymond Ackerman has placed people (which include customers and employees) at the very core of the business – it has been the Pick n Pay philosophy since the inception of the business[8]. A good example of listening to the needs of employees at Pick n Pay is the issue of maternity leave. Pick n Pay allows 11 months of maternity leave, nine of which are paid. The retailer gives fathers eight days' paternity leave, even though labour legislation does not make specific allowance for leave for new fathers. The Basic Employment Act makes provision for mothers to take four consecutive months of maternity leave. If both parents work at Pick n Pay they can share the maternity leave. Employees returning from maternity leave are more refreshed as their minds are at ease, because the baby has grown a bit more, than if left in the care of others at four months[9].

As mentioned earlier, listening to competitors is equally important. Not only for an understanding of what the competition is up to and so being able to change your own strategy accordingly, but perhaps for a better solution to the needs of society as a whole.



Figure 8.3 Elon Musk

South African born serial entrepreneur and CEO of Tesla Motors, Inc. and SpaceX, Elon Musk, has changed the playing field by making his company's intellectual property available in an open source format[10]. This is especially true for the development of the new Hyperloop – a high-speed train service between Los Angeles and San Francisco. The reason for such a bold step is the belief that leaders find ways to involve and enlist larger groups of people in solving problems. This is collaboration and in turn, listening, at its best! The philosophy behind this is the understanding that consumers are more socially conscious than ever before and that a commitment toward the greater good, based on the reality of problems that current and future generations will face, is key to the success of organisations and business. To put it more succinctly: the future of profit is purpose. This purpose to solve problems such as a shortage of fossil fuels and the overpopulation of the earth is bigger than what any organisation alone can solve, which makes collaboration among competitors extremely important. In a later section, more detail will be provided on the philosophy of higher purpose. However, with this philosophy in mind, let's see how listening has been extended beyond the internal facets of an organisation.

Terry Volkwyn, CEO of Primedia Broadcasting, encourages management, employees and members of the public to consider societal needs, understanding that satisfied shareholders will be a by-product of an organisation with a higher purpose. Listening to the problems and needs of society has led to successful initiatives such as LeadSA and Crimeline[11]. According to her, leaders should really care about their people and should invest in them as they are the organisations' greatest asset. This belief is clearly seen in the Virgin Group employee attributes of leadership, all of which starts with listening to co-workers.

Employee and customer feedback should reach people that have the authority to act upon it[12]. Feedback from employees and customers could be of huge benefit to organisations as it provides insight to concerns and customer experience. Problems need to be addressed and achievements need to be celebrated to boost staff morale.



Figure 8.4 Terry Volkwyn

Delegation and the right people

Delegation is as much a part of leadership as taking responsibility. **Delegation** is the process of assigning responsibility and authority for achieving organisational goals. Delegation also refers to handing over the responsibility for a situation together with the authority to resolve it. Without trusting those to whom responsibility and authority is delegated, a business leader might focus on the mundane, rather than the strategic aspects, of his or her role. As a result of trust being so important in order for delegation to be purposeful, business leaders should focus on the people delegation will be given or awarded to. Successful business leaders seem to have an innate **focus on people**, whether it be staff or customer satisfaction. Let's have a look various business leaders' focus on people.

Branson[13] emphasises that putting customers and employees ahead of shareholders would have a higher likelihood of greater shareholder interest. This is in line with Terry Volkwyn's approach as well. This seems to have been what Raymond Ackerman has envisaged for Pick n Pay too where the organisational philosophy has been that of looking after people it employs or its customers without being solely driven by financial gain, but understanding that financial rewards would follow anyway in living this philosophy[14]. It is for this reason that Branson suggested that CEO's be involved in the **recruitment process**, especially of seniorlevel management[15].



Figure 8.5 Raymond Ackerman

Former ArcellorMittal SA CEO Nonkululeko Nyembezi-Heita agrees and states: 'I know that talent emerges from the most unexpected places, so in the process of recruitment, a big part of my role as CEO, I actively strive for diversity so I can draw inputs from far and wide'[16]. Elon Musk once said that he has perhaps relied too much on people's talent rather than a person's personality. He believes that it is important for someone to have a 'good heart'[17]. For this reason, the employment of people in an organisation should be of high priority for business leaders. Branson[18] goes on to say that an organisation's people have the greatest influence on the success or failure of a business. The success of the various Virgin companies lies in the service culture of its people[19].



Figure 8.6 Nonkululeko Nyembezi-Heita

Teamwork is of extreme importance for business leaders. Nonkululeko Nyembezi-Heita notes that success depends largely on the quality of the team – and teams are more important today than ever. 'Management systems are traditionally designed for a discreet environment, but we do not live in a discreet environment. We live in a globalised world, where there are countless linkages – and the more linkages you have as a company, the more complex it is to manage. I have to know what steel is trading

at in Turkey, for instance, and keep abreast of the free flow of information that modern technology has made possible. An individual does not have the cognitive ability to handle all these streams of information, so you need teams, and your effectiveness as a CEO is ultimately determined by the degree to which you have built a strong, cohesive and diverse management team'[20].

On the opposite side of delegation is **relegation**. Relegation refers to pushing a problem away (possibly onto someone else) and distancing yourself from the problem. Leaders in business today can no longer relegate themselves from a problem. For this reason accountability is of extreme importance to business leaders. **Accountability** is not only something that occurs in the levels below top management. Business leaders themselves need to be accountable and in the firing line when problems occur. The mere mention of the leadership disasters in the recent past in various South African public enterprises and parastatals such as SAA, Eskom and the SABC is enough to indicate the weak leadership experienced by these enterprises, based on relegation. Accountability is the evaluation of how well individuals meet their responsibilities. In the next section the business leaders' responsibilities will be discussed.

Taking responsibility

Responsibility starts with having vision and passion and putting these into measureable, obtainable and timeous objectives. Maria Ramos feels strongly about leaders having a clear understanding of what their responsibilities are and what they are being held accountable for. At Transnet she obtained her goals by keeping things simple and having clear set targets to become operationally efficient and to steer the business to a sound financial footing[21]. She instilled an ethos that only the highest standards of delivery, performance, transparency, and accountability were acceptable for the company[22].

It is important for business leaders to take responsibility when things go wrong. Maria Ramos and the former deputy CEO of Absa forwent consideration for an annual bonus as a result of Absa Groups' poor performance during the 2012 financial year[23].

Leadership and luck

Branson[24] notes that the people considered luckier than others in business (including himself) are those who prepare to take greater risks. A lot of hard work has played a large part in the success of the Virgin empire. He further notes that good luck and good judgement are elements of leadership which together will be greater than the whole. ArcellorMittal's former CEO, Nonkululeko Nyembezi-Heita, agrees and says 'Luck needs a little helping hand in hard work'[25]. **Luck** will not keep employees satisfied and leaders need to understand what is important to their employees in order to keep them inspired.

Motivation of staff

Branson[26] notes that **motivation** and 'employee recognition' go hand-in-hand. Although fair compensation is important, taking pride in your work is equally important. Leaders should be able to provide ample amounts of gratitude to staff members in person for a job well done. Elon Musk's motivation is of a more critical nature, which keeps his team of employees on the edge of performance. The businesses that Elon Musk heads are based on extreme innovation, be it electric cars, high speed travel or space travel, and for that reason performance is based on the discomfort of employees being outside their comfort zone. The criticism he gives is not of a personal nature, but rather is directed towards the task at hand. This does not mean that **failure** is frowned upon. On the contrary, he is quoted as saying, 'Failure is an option here. If things are not failing you are not innovating enough'[27]. However, for some people the extreme pressure is too much and might lead to burnout[28]. This type of pressure does not motivate everyone and a clear understanding of the business and the leader at the helm might be of value to employees.

Let's have another look at failure in business leadership. Koos Bekker of Naspers has given failure a lot of thought. As CEO of Naspers – which heads well-known brands such as MNet, MWeb and News24, to name a few, failure is equally important as success. Making mistakes and failing quickly seems to be the key for success at Naspers. According to Bekker they have made more mistakes than anyone else. The benefit of mistakes is that you know what does not work. What Naspers typically tries to do is get into something and 'fail fast and cheaply.' They have also failed expensively. They created the second biggest ISP in Beijing in 1998 and lost the battle there. They eventually lost $80-million and had to fire people and close it down because of mistakes they made. That was an expensive failure. According to Bekker, if you are going to fail, get into the market quickly, fail quickly and learn from it. Since then they have learnt a few lessons[29].



Figure 8.7 Koos Bekker

Bekker's advice to young entrepreneurs is to determine whether their business

ideas are solutions to societal problems. This is also true for business leadership today. Leaders and businesses need to look at the bigger picture towards the 'greater good'. In the next section leadership for the greater good will be looked at.

Beyond corporate social responsibility

As mentioned earlier, business leaders today also look at the greater good. So much so that the **future of business profit is purpose**. The philosophy of higher purpose is not unique to Elon Musk as discussed above, but rather a leadership requirement in organisations facing unique challenges today. Organisations today can no longer ignore the effect they have on the environment and society at large. Having a pure focus on the financial bottom-line and shareholders is not good enough any longer. Branson[30] places people and the environment (planet) together with profit and growth as the reasons for business existence. The philosophy at Pick n Pay seems to have been similar as it is based on doing the right thing rather than the most popular. It is also entrenched in looking after people, whether it be employees or customers[31].

At Primedia Broadcasting, CEO Terry Volkwyn not only thinks of the financial returns, but also of what influences all stakeholders and what society needs[32]. In turn, this higher purpose will have shareholder satisfaction as a by-product of the initiatives addressing societal problems. Under her leadership, initiatives such as the Hear for Life trust (which supports cochlear implants), LeadSA and Crimeline have seen the light. LeadSA is a call to every South African to take charge and make positive changes in their communities whether great or small. Started in August 2010, LeadSA has gone to promote the initiatives of ordinary South Africans in their communities with the awarding of a monthly Hero and LeadSA Hero of the year. Crimeline is an independent Primedia Group initiative supported by the South African Police Service which allows citizens to provide anonymous tip-offs in an effort to fight crime.

The business with purpose principle has been business leader Wendy Luhabe's passion for more than 30 years. Wendy has previously been involved with Vanda Cosmetics, BMW and has been the University of Johannesburg's chancellor. Twenty years ago she and a number of other South African women developed a formal model that became the Women's Investment Portfolio Holdings (Wiphold). This incredible innovation was a landmark initiative in women's empowerment specifically, and black economic empowerment in general. 'Our idea was to educate women about how the economy works and help them to become first-time investors in a portfolio of businesses we had acquired. This was a real way for women to become shareholders in the economy. So, we became a proxy for a stock market, but in a safe way.' Through Wiphold, they got more than 18 000 women investing in the economy and they got a 300% return on their investment in the first 10 years. They created a trust, which is now worth more than R1 billion[33].



Figure 8.8 Wendy Luhabe

Besides Wiphold, Wendy has recently adopted a programme called Mama Mimi's where township women and those living in rural areas can bake and sell bread in order to earn a living. The women can extend their baking to pizzas and scones. She says, 'I don't believe in charity and I don't believe in the welfare system we have created in South Africa that keeps people dependent. It takes people's dignity away. A welfare mentality does not build – it keeps people imprisoned and oppressed'[34].

This is what she had to say about modern day leadership: 'We should approach leadership in a different way and use it as a source to create innovation. This world needs multiple-intelligent leaders who can create a global entrepreneur movement capable of creating new industries and new job opportunities during these difficult economic times'[35].

Lead from the front

When considering leading from the front, imagine historical and memorable combat situations where leaders are in the heat of battle and not on the side lines out of sight. They lift the morale of their regiments, by being among them – in the trenches so to speak. This links closely with the Virgin leadership attribute of 'being in it together'. Being strategic is important in leadership, but getting people to follow is crucial. Leading from the front is not only used in military combat, but also in business. It instils positive **morale** among staff members and it sends a strong message to the competition. Leading from the front also requires leaders to have passion and commitment for what they are doing and to be able to share this with the people they work with. We will see in the paragraphs that follow how South African business leaders are leading from the front.

Terry Volkwyn, CEO of Primedia Broadcasting, leads from the front. She cares about her people, society and her business. She has a clear vision with a clear purpose, both of which are communicated well, not only through words, but rather with stronger actions and behaviour. Organisations should have responsible values, good principles and a strong sense of ethics. Although there was a strong suspicion that she would cut her losses when she took over the reins at Primedia Broadcasting, pertaining to the failing 702 Talk Radio station, the station was turned around – so much so that it was awarded the MTN radio station of the year award in 2010 and 2011. The group experienced a compound annual growth rate in 10 years of 18%, a phenomenal return on investment for any shareholder[36].

Another lady leading from the front is former CEO of ArcelorMittal South Africa, Nonkululeko Nyembezi-Heita. She now chairs the Johannesburg Stock Exchange and has been appointed as CEO of IchorCoal[37]. During her time at ArcelorMittal she had to balance shareholder expectations with maintaining the company's position as a globally competitive low-cost steel producer. By focusing on cost-cutting initiatives and company efficiencies, she guided the company through the height of an economic downturn in 2008, and an extremely challenging period for South Africa's construction sector, which fell into a deep slump after the 2010 Soccer World Cup. Under her leadership, the company increased its commitment to environmental conservation, social responsibility and construction safety. Her **leadership style** has often been defined as a subtle blend of hands-on commitment, humour and conscious open-mindedness. With an open-door policy, she is averse to hierarchy and welcomes teamwork and diversity[38].

From the discussions above there are a number of aspects important to the theories of leadership that have been displayed in the examples of South African leaders. There is a distinct behaviour among these strong leaders in the way that they communicate and motivate their employees. As can be seen in the discussions using Terry Volkwyn as an example, she believes that strong leadership is displayed in the way a leader behaves, which coincides with the **behavioural theory of leadership**. For most of the leaders including Maria Ramos, Raymond Ackerman, and Nonkululeko Nyembezi-Heita, the styles of initiating structure and consideration are evident in that their organisations have clear structures and roles for themselves and their employees. This relationship between leadership and employees is based on mutual trust and respect for one another. From examples including Terry Volkwyn and Raymond Ackerman, an **employee-orientated leadership style** experiences higher job satisfaction; however Elon Musk's **production-orientated leadership style** gets employees motivated on the outcome and outputs they achieve. Perhaps one of the most important approaches to leadership is that of trust. **Trust** in leadership is established by means of a leader's integrity, competence, consistency, loyalty and openness. From the various examples provided above it can be seen that these top managers have taken the development of trust to heart. It is not merely top management that should establish trust, however; all levels of management should focus on trust.

From the leadership examples provided, some leaders provide input into how **transformational leadership** is applied. Terry Volkwyn uses organisational behaviour, Richard Branson provides an example of inspirational motivation, Elon Musk exudes an example of intellectual stimulation and Nonkululeko Nyembezi-Heita provides an example of organisational consideration, while Maria Ramos, Raymond Ackerman, Wendy Luhabe and Koos Bekker provide examples of organisational attributes. The end result of transformational leadership is improved employee satisfaction, trust and commitment. It is interesting to note that these transformational styles coincide with attributes the employees at Virgin have provided to the leadership style experienced and needed at Virgin. In the examples of Maria Ramos and Nonkululeko Nyembezi-Heita, transformational leaders are effective in organisations where major change and transformation is taking place. This is true as can be seen in the transformation and turnaround that organisations such as Transnet, the Absa Group and ArcelorMittal experienced under the leadership of these two ladies.

Controlling the management process

For this last section of this chapter let us have a look at how Maria Ramos and her management team at Transnet have dealt with two large problems in the transformation of the organisation. In a presentation Maria Ramos identified four key issues, two of which were related to the control of human resources and financial resources. The problem within human resources at Transnet was low morale and the lack of investment in human capital. The financial concerns included weak financial performance and controls. The solution to the human resources problem was a clearly structured **human capital development programme**. The results of the human capital development plan included skills development planning, talent management and succession plans, leadership development, a reward model, an incentive scheme, and employment equity. The solution to the financial concerns of Transnet was addressed by means of **strategic balance sheet management**, which included the disposal of non-core assets such as Viamax, SAA Metrorail and the V & A Waterfront in Cape Town[39].

Conclusion

From this chapter we can gather that organisations today need to have strong leaders to deal with the dynamic business environment they find themselves in. Merely maintaining the status quo will not provide companies the competitive advantage required to grow in an already tough economy. We have identified what the attributes of leaders should be and how the act of listening is perhaps the most important in the communication model relevant to leaders in business. The act of

listening is not merely to follow sage advice, but also to listen to what customers, employees, suppliers and competitors have to say.

The importance of people in the organisation has been discussed as it is paramount to the leadership activity of delegation. Because the people of an organisation are so integral to the success of the organisation, the way in which they are motivated to function in an environment without the fear of failure is important.

A large portion of this chapter has been dedicated to the leadership view and philosophy of doing business for the greater good. This ties in very closely with corporate social responsibility, but the importance extends to more than the expectation from customers and shareholders – it needs to be the purpose of an organisation's existence. The by-product of this purpose-driven existence is profit and shareholder satisfaction and not the other way around.

Successful business leaders lead from the front. At Virgin the attributes leaders are required to have include not only leading from the front, but also being passionate, embracing individuality, empowering people, inspiring trust, being genuinely caring and being informally accessible. These attributes are not only required at Virgin and its multitude of companies alone, but at all businesses – regardless of their form. These attributes can be seen in the South African leadership examples provided in this chapter.

Self-assessment questions

Easy questions

1. _____ is the process leaders follow when communicating ideas and gaining acceptance for them.
   a. Influencing
   b. Motivation
   c. Delegation
   d. Power

2. Managers can delegate _____ and responsibility, but never their _____.
   a. Power; influence
   b. Tasks; trust
   c. Authority; accountability
   d. Motivation; communication

3. If a leader should delegate authority, involve employees in the decision making, and encourage participation in deciding work methods and goals and provide feedback, this would be known as _____.
   a. Laissez-faire leadership
   b. Contingency leadership
   c. Democratic leadership
   d. Visionary leadership

4. The _____ attempts to determine the best leadership style for a given situation.
   a. Team-management style
   b. Contingency theory
   c. Charismatic leadership style
   d. Behavioural theory

5. In the communication model, the _____ is the source of the message.
   a. Sender
   b. Channel
   c. Receiver
   d. Noise

Challenging questions

1. Nonkukuleko Nyembezi-Heita holds several qualifications. She holds a BSc Honours degree in electrical engineering from the University of Manchester Institute of Science & Technology, a Masters degree in the same discipline from the California Institute of Technology, and an MBA from the Open University in the UK. Beside her qualifications, she has been the non-executive director of many South African companies including Old Mutual; Macsteel and JSE Ltd. This provides her with which type of power:
   a. Coercive power
   b. Reward power
   c. Legitimate power
   d. Expert power

Read the comments on Terry Volkwyn's leadership in the box below and answer the question that follows:

Nick Christelis, who has worked with Volkwyn over the years, gives insight into her leadership style: 'Terry has a great vision and clarity of purpose, which she communicates through her actions and behaviour rather than through rhetoric.'

Katy Katopodis, Eyewitness News editor-in-chief, says: 'She epitomises the leadership required to ensure that the media stands firm against the elements that threaten its independence and freedom. Terry is a formidable woman with unrivalled leadership abilities and an excellent instinct which I have always admired. She just has a 'gut' for what is right and what will work and what won't work. The media is often under attack and the unyielding support that we enjoy from Terry is invaluable. She leads from the front.'

Yusuf Abramjee says: 'Terry is a principles woman; she doesn't bend easily under pressure and sticks to her guns. However, she also listens and weighs the opinions and views of others to eventually make the right decision for the business and for her people. After all, media is about people.'

In conclusion Katy Katopodis trusts Terry Volkwyn's leadership when she says: 'There can be no doubt that the media landscape of the future is in good hands with Terry Volkwyn at the helm of Primedia Broadcasting.'

Source: Adapted from TMO, 2013

1. Terry Volkwyn's leadership style can therefore be defined as which one of the following, based on the effect it has on followers.
   a. Transactional leadership
   b. Charismatic leadership
   c. Visionary leadership
   d. Transformational leadership

2. During the transformation at Transnet, employees might have experienced fear of retrenchment. However, Maria Ramos could have used this type of power to put pressure on employees. Commitment is _____ as a result of this type of power.
   a. Possible
   b. Likely
   c. Confirmed
   d. Very unlikely

3. According to Nonkululeko Nyembezi-Heita, teamwork is more important today than ever before. Which one of the following is a requirement for teams to be successful?
   a. Relationship orientated leadership
   b. Motivation
   c. Referent power
   d. Organisational culture

4. On the ArcelorMittal website the financial reports for the 2013 year are accompanied with messages from the top management of the company which includes Mpho Makwana (the chairman of the board of directors), Nonkululeo Nyembezi-Heita (Chief Executive Officer) and Matthias Wellhausen (Chief Financial Officer). At top management, the principle of control by exception is applied. Which of the following statements correctly describes the principle of control by exception?
   a. There is leniency toward the reliability of financial and other reports as declared by top management.
   b. It is the guidelines that defines and sets standards as part of the control process.
   c. Only important or exceptional disparities between real and planned achievements are reported to top management.
   d. Performance standards are be lowered to make them more realistic in the light of prevailing conditions.

Essay questions

1. Select a company of your choice and discuss how they have dealt with quality control in their organisation.

2. You are the CEO of a prominent toy manufacturer in South Africa. The employees on the production floor are unhappy with their working conditions and are requesting top management to intervene. Discuss the process you will follow to communicate the solutions you have agreed to, by means of the communication model.

3. Discuss all the characteristics of a transformational leader and provide a South African example of this type of leader. You need to motivate your reasons clearly on why the leader you are describing is indeed a transformational leader.

4. The power continuum has two polar points ranging from position power to personal power. Discuss all the forms of power and provide South African business examples of each form of power.

5. Select a business leader of your choice and discuss how (s)he has established trust by discussing the dimensions of trust.

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9 Operations management: Air traffic operations excellence

KEY TERMS

AIR TRAFFIC

CAPACITY PLANNING

DESIGN FUNCTION

ERGONOMICS

FAIL-SAFE

FLIGHT EVENTS

HAZARDS

HEARING PROTECTION DEVICENIHL (NOISE-INDUCED HEARING LOSS)

HUMAN ERROR

INFRASTRUCTURE

LINE BALANCING

LOADING, SEQUENCING AND SCHEDULING

MAINTENANCE

MASS SERVICE OPERATION

MASTER PRODUCTION SCHEDULE

OPERATIONS SYSTEM

PERFORMANCE OBJECTIVES

PERSONAL PROTECTION EQUIPMENT

PROCESS TECHNOLOGIES

QUALITY

SAFETY

SAFETY RISK MANAGEMENT

SERVICE INDUSTRY

SERVICEABILITY

SIMULATIONS

SYSTEM DESIGN

TAKE-OFF

TOWER CONTROLLERS

TRAFFIC COPS

TRANSFORMATION PROCESS

TYPES OF FAILURES

VALUE-ADDING

ZERO DEFECTS

Introduction

Air transport suppliers are in the **service industry** providing a range of services through service operations. The core service is air transport by means of a mass service operation (aeroplanes transporting passengers between airports). Service delivery is not so easy to measure because it is intangible, perishable and not kept in stock. The service package is personal, labour intensive and boils down to the entire customer experience. This determines customer retention, loyalty and sustained growth.

Besides the challenges facing pilots after being airborne, air traffic operations at any airport is certainly of the most complex and challenging examples of operations management. Window-dressing may not suffice for frequent flyers and air traffic operations itself is considered important for an airline to satisfy the primary needs of its customers. Satisfied clients are of crucial importance to any business and operations can also be decisive for the general reputation of the business through their particular operational skills. A well-organised airport without bottlenecks is a good example of a business with multiple operations performance objectives striving to do things right the first time (with no mistakes), do things right every time (consistent and continuous error-free services), offer cost-effective flight packages, do things quickly such as shortest flight routes, making changes quickly when circumstances such as weather causes delays (responsiveness and flexibility) and to continuously strive to do things better.

Picture the scene as you read the following transcript taken from a black box recording of the fatal flight in which Polish President Lech Kaczynski and 95 others lost their lives in May 2010:

'*The conditions for landing do not exist*', an air traffic official tells the Polish crew about 25 minutes before landing.

'*Sir, the fog is increasing. At the moment, under these conditions that we have now, we will not manage to land*', says Captain Arkadiusz Protasiuk to Kazana, the chief of diplomatic protocol, as he enters the cockpit. '*Well, then we have a problem*', is Kazana's reply. '*We can hover around for half an hour and then fly off to a backup airport*', the captain replies, later naming Minsk and Vitebsk, two cities in Belarus, as backup options. The crew was also told by the Russian control tower that a Russian Ilyushin aeroplane had abandoned two landing attempts and had flown to another airport.'[2]

The importance of production and operations management (POM) and the **operations system** becomes clear when your life depends on it. No airline passenger would want to know that some airlines, airports or aircraft are bad and some are good. There should only be one standard of excellence, especially when a plane is airborne. The aviation industry is a complex one and this case study describes many of the associated dimensions, stories and statistics. It also indicates the stress involved in some of the airport jobs. It gives some perspectives on how technology and a well-planned operation can make air transportation much easier. When the operation runs smoothly everyone smiles, but we tend to forget what can go wrong and what actually does go wrong before, during and after flights.

When did the first air crash occur? This happened five years after Orville and Wilbur Wright made their famous flight at Kitty Hawk. In 1908 the Wright brothers were travelling across the United States and Europe to demonstrate their flying machine. Everything went well until a fateful day in September that began with a cheering crowd of 2 000 and ended with pilot Orville Wright severely injured and passenger Lieutenant Thomas Selfridge dead.[3] There is not much relativity in flying. It is either safe or not at all.

This case briefly discusses the importance of excellence and **quality** of airline operations, flight planning and control, an example of excellence (the New York airspace operation), Africa's busiest airspace (striving for excellence), the O.R. Tambo International Airport (ORTIA) operations **system design**, technology and electronic traffic controls, **safety** management excellence, and **maintenance** management excellence.

Being airborne

The entire flying experience depends on many dimensions. Flying also involves several pre- and post-**flight events**. Many of these critical events are stressful for both internal and external customers and there are times of difficult decision-making for airline staff. Increasing flight volumes push human skills to the limit.

The quest for excellence is a logical mindset in this industry since it prevents negative incidents and it implies exceeding expectations and going beyond minimum standards. Excellent airlines depend on many quality dimensions such as professional staff, modern infrastructure, effective and efficient airports operations, safety and security and quality customer service. The quality dimensions include the pilot, the aircraft, the check-in service, parking, the shops, airside capacity, smooth runways, **process technologies** (e.g. trolleys, scales, gadgets, scanners, etc.) and the tower controllers coordinating punctual landing and take-offs. All of these operations need to be coordinated because they are all interdependent. Problems caused by ground controllers can jeopardise the job of the tower controllers. Operations management is at the heart of all **value-adding** processes and these refer to the different airport **transformation processes**. Running (working) operations is the real time when the 'tire hits the road' or, in terms of this case study, 'when the aircraft is airborne'. These value-adding events refer to situations of utilising (burning) energy, impact, contact, mixing ingredients and heat. Error-free planning and control is of utmost importance where human beings are being processed (transported).

These critical events also create stress in the work place. In this case it is not about the airport, but the actual flying, when customers are transported (processed). This occurrence is not only dependent on a good pilot or a luxury aircraft, it is also dependent on weather conditions and continuous assistance from tower controllers and computer systems. Dealing with many aircraft movements means that airport controllers have only a second or split seconds to analyse and react to different situations. A small error can have catastrophic consequences and they need to do everything right the first time. The concept of **zero defects** is easily understood in this context. At certain busy airports there is at least one serious incident (e.g. aircraft running short of fuel) per day. The computers assist with projections and **simulations** and several process technologies are used (e.g. conflict alert buzzers) to **fail-safe** the situation. These signals and means of communication happen quickly and are transmitted directly to the pilots. In certain cases the controllers need to take the decision and transmit it to the pilot. What is the bottom line? Clients do not want to panic, the aircraft must spend less time on the runway burning fuel and passengers want to spend less time on the ground. This makes a pilot's job very demanding in the air and on the ground, but air traffic controllers have one of the most stressful jobs on the planet. Sheer volume pushes their skills to the limit and there are difficult times on the job when they wish they did something else for a living.[4]

Flight planning and control

Airline operations planning and control focus on the inputs-process-output elements of the value chain. Without the careful managing of this value chain the airline operation will not reach its objectives. The main **performance objectives** planned for are safety, economy and customer satisfaction. Customer satisfaction regarding

on-time schedule performance is critical in this highly competitive industry. In addition to this, airlines make large losses if expensive aircraft assets are idle. Flight and crew scheduling and loading is a very complex process and a **master production schedule** (MPS) of flights based on the forecasts and actual orders (bookings) can be exploded (disaggregated) to determine all resources needed to support the MPS. A workforce schedule will always be a priority over other resources in the service industries such as airlines. This staff plan can also be influenced by legal considerations. Air New Zealand,[5] for instance, is required to have at least a minimum number of flight attendants on duty at all times. The same applies to safety personnel and these constraints limit the flexibility of operations managers in developing workforce schedules. Pilots cannot be scheduled for more than 35 hours in a seven-day week and no more than 100 hours in a 28-day cycle and they must have a 36-hour break every seven days and 30 days off in an 84-day cycle. Table 9.1 illustrates the core planning and control elements of the airline value chain.

TABLE 9.1 Planning and control elements of the airline value chain

Inputs to an airline operation	Airline processes	Airline operation outputs
Passengers	Transport, transfer and parking	Transported passengers, luggage and freight
Freight and luggage	Luggage assistance and storage	Satisfied airport guests
Pilots and other air crew (flight attendants)	Ticketing and bookings	
Tower controllers	Check-in services	
Ground controllers	Security and safety processes	
Process technologies, cranes and trolleys	Board passengers	
Appropriate flow layouts and design	Care for passengers	
Attractive and effective infra-structure	Transfer and fly passengers (and luggage)	
Friendly, helpful trained staff	Maintenance	
Information, communication and security services	Tourism offices and services	

Airlines can be viewed as one large planning challenge. They must be excellent in both proactive and reactive planning and control. Each planning challenge has its own complexities, time horizons and variables. Air France for instance[6] has 80 flight planners working 24-hour shifts at Charles de Gaulle airport. Their goals are safety, economy and customer comfort and their overall responsibility is to optimise flight routes and anticipate potential problems. Some of their considerations are: which type of plane for certain flights; recovery plans for deviations; crew planning; planned maintenance and dealing with gate bottlenecks. These challenges are similar to all airports regardless of the size of the aircraft.

Airport **capacity planning** is a major function of operations management. The less available capacity there is in a workstation, the more queuing is expected. Many airports however use the old and famous **line balancing** technique of work distribution in series as opposed to in parallel. Some of the solutions found were to move the check-in counter upstream to decrease cycle time. Work is therefore done simultaneously to decrease waiting time in such bottlenecks. One example is to weigh baggage as passengers enter the queue. The other obvious option is to increase the number of check-in stations according to predicted volumes.[7]

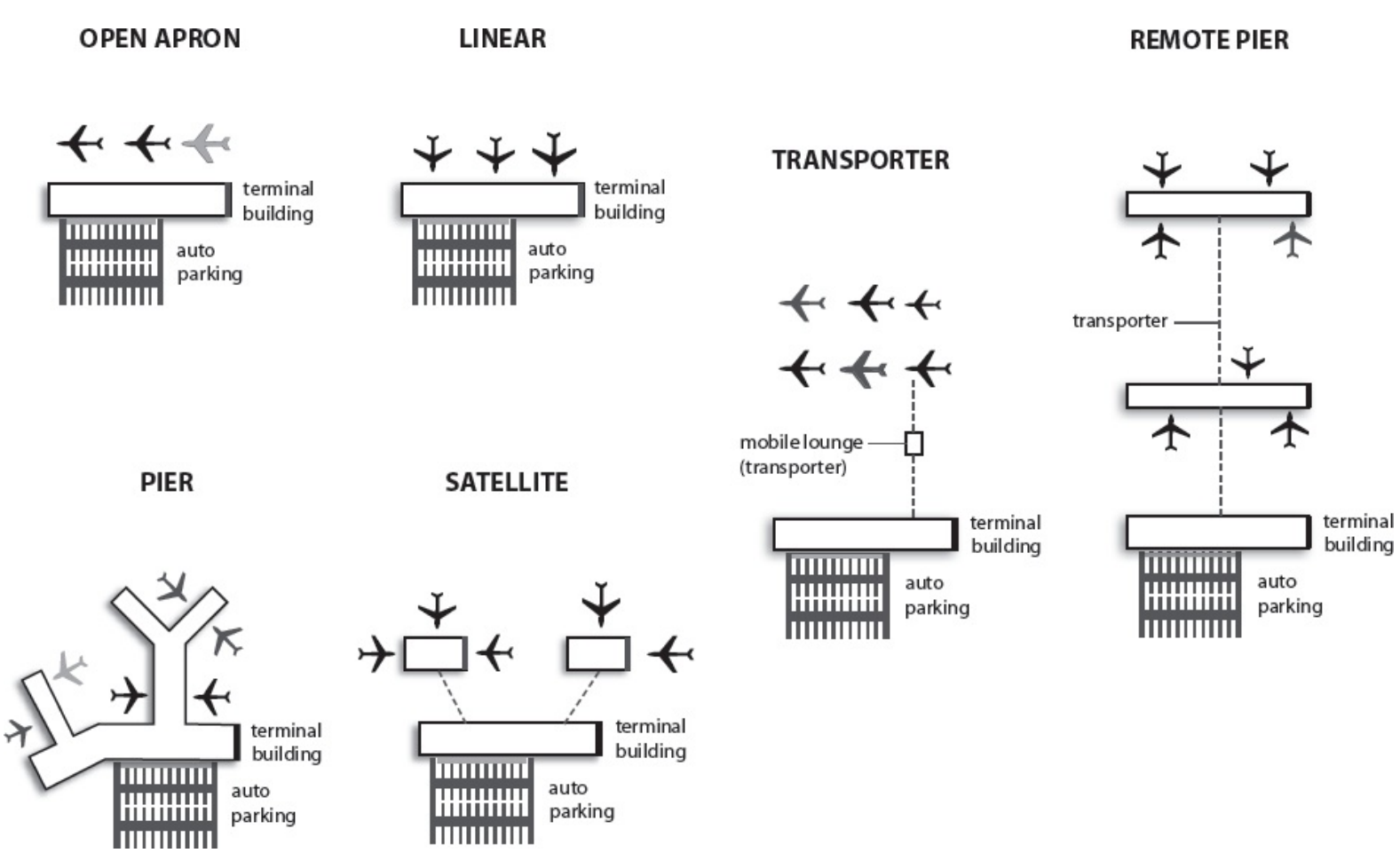
Characteristics of air traffic operations therefore differ in terms of volume, variation and variety of output. Reconciling the supply of services with the demand occurs in terms of dimensions such as volume and timing. The three most important planning activities are **loading**, **sequencing and scheduling** of tasks (e.g. flights).

Excellence at the New York airspace operation

Complacency is certainly the single biggest threat for any airport operation. Nobody should take things for granted and the concept of operations improvement is a common practical principle. The basic science of preventing processes (any technology) from becoming worse, failure prevention and recovery, total quality management (TQM) and making processes better is the common language at airport operations such as the New York airspace.

There are many examples of busy airports and busy airspaces – but perhaps the best example is the busiest one in the world – the airspace above New York. Managing this operation[8] is a world-class 'juggling act' which is necessary when approximately 7 000 planes arrive and depart each day at the three airports in New York. When two planes fly closer than a certain measure, the Conflict Alert buzzers sound. The smooth coordination of this airspace requires precision and clarity regarding traffic patterns, approach and **take-off** routes. They use predetermined 'corridors in the sky' to keep the planes a safe distance from each other. Weather is the biggest 'spanner in the works' – if the wind changes, all three air control stations cooperate to adapt the flight paths. Innovative technology (all variations of process technology and gadgets) is used to streamline flights. Large aircraft are equipped with technology to signal a safe zone around the aircraft. This alerts the pilot should the aircraft get too close to another.

A plane passes through several (about eight) different controllers and the airspace is divided into different sectors. Each sector is controlled by a team such as **tower controllers** (controlling landing and taking off) and ground controllers managing the movements on the ground. Some New York air traffic controllers handle up to 100 landings and take-offs per hour.



Source: www.britannica.com[1]

Figure 9.1 Terminal building aircraft parking layout types

Tower controllers coordinate landings and take-offs. At Newark airport, there can be up to 40 planes an hour coming into land, while about 60 approach departure. This operation demands precision and special skills. In some cases the controllers need to take a gap to get planes to take off in between the stream of landing. This may imply that some planes are allowed to start their take-off, while others are landing. The controllers therefore need to be able to calculate safe take-off intervals in an instant, based on several variables.

Ground controllers are responsible for navigating the plane through the 'foggy mist' of traffic, darkness and different weather conditions. Some pilots may be new to airport layouts and need careful navigation through interconnecting taxiways.

Africa's busiest airspace

The busiest airspace in Africa is above Johannesburg.[9] Here we have the O.R. Tambo International Airport (ORTIA) cooperating with the Rand and Lanseria airports. The ORTIA was recently upgraded and improved to accommodate more flights and customers. There are two runways for take-off and landing and the facilities, layout and infrastructure were improved significantly for the 2010 FIFA World Cup™, but also for increased demand for local and connection flights. The Gautrain project, completed in 2012, has addressed problems related to parking and travel to the

airport.

Some of the most complex projects (unique once-off high-stake events) are related to airports, as in the case of the ORTIA and the Gautrain project. The reason for this is that current operations need to continue while project operations are executed in parallel. All airports have a history of maintenance and related projects. All of these projects relate to capacity planning, although no single capacity measure is applicable to all types of situations. Here we refer to input measures and output measures. Airports use several measures, however output measures in terms of passenger numbers are the usual choice because they 'produce' one 'product' (transport of passengers) in high volumes by means of a **mass service operation**. The world's airlines will continue to juggle between re-equipping their fleets to carry more passengers on existing planes and the decision to buy more passenger jets. The suppliers of planes are also under continuous pressure as their suppliers battle to keep pace. At one stage the aircraft manufacturer McDonnell-Douglas (now Boeing) had a threeyear backlog, and Boeing and Airbus have had similar problems.[10]

Africa represents only 4.5% of global **air traffic**, not nearly enough to ensure the economic development of the continent. Air traffic capacity will therefore always be under pressure. In South Africa, the 2010 FIFA World Cup™ reinforced the urgent need for the expansion and modernisation of the national airport **infrastructure**. The event was the catalyst to address capacity at ORTIA and the work included:

- Additional structural car parking
- Additional fuel tanks
- Runway and taxiways shoulders widening (required for the new Airbus A380 latest jumbo airliner)
- A new central passenger terminal building
- Reconfiguration and upgrade of the existing international terminal building.

The airport needed more than a facelift for the all-important first impression of the airport, and as entry-point to the country for visitors. It was vital to provide a worldclass African airport with modern, cutting-edge international transport facilitation capabilities, technologies and design. The revamp and extended new terminal building is worth R2.2 billion. The extension of the airport is a significant milestone and the vision of a truly international airport has been realised. The new, multi-level terminal links the original domestic and international terminals and therefore improves passenger experience and orientation. The 98 600m^2 facility is the largest Airports Company South Africa (ACSA) has ever built, and embodies the transformation of the airport since the Rugby World Cup in 1995.[11]

With a wide concourse and 75 check-in counters, 33 lifts, 34 escalators and two 90m-long baggage carousels, the building has been expertly designed to speed up luggage collection and passenger movement. The construction of this facility placed emphasis on the creation of spaces designed to ensure efficient and pleasant airport experiences for all the internal and external customers. It also boasts 10 000 m^2 of

shop space as part of the many peripheral services on offer. A new multi-storey parkade (worth R496 million) was also completed. It accommodates about 5 200 vehicles, bringing the total number of parking bays at the airport to 17 500. The aircraft parking was also improved by seven new parking stands worth R154 million.

Airside capacity (part of airport directly involved with arrival and departure of aircraft) increased as a result of the additional aircraft stands. The expansion of apron areas (parking bays) was complemented by the International Pier, and development will accommodate nine contact stands in the form of air bridges linking terminals and aircraft directly. Four of these stands will accommodate an A380, the largest aircraft ever manufactured, and will be equipped with dual air bridges to load and offload passengers to upper and lower levels (two decks make up the A380) of the aircraft at the same time. For passengers who need to be bussed from the aircraft, two remote stands are being developed. One new taxiway will be developed and another will be reconfigured to serve the upgraded apron. Taxiway shoulders, service roads, ramp handling equipment, parking areas, fuel, storm water drainage and water and electricity are other services that are also being upgraded. Fuel storage capacity was improved in terms of two new 6 000m^3 tanks holding 60 million litres of fuel. Given the recent developments, the airport is now able to accommodate about 28 million passengers per year.

The ORTIA operations system design

In the context of operations management, what type of operation is applicable at ORTIA? We have referred to project management and several other types of operations. The airline operation is not a simple job shop or a batch operation. Neither is it a project operation. Although several hybrid operation types can be identified in an airport (like any large airport) it is primarily a mass service operation. The variety of services is small, but transactions are high and customisation is less. Labour is specialised and little judgement is required from front-desk staff. This type of operation is similar to the continuous processes of producing products with high volume and low variety (e.g. endless flow of electricity measured by volume). Several layout types are used in an airport but the typical product layout (such as an assembly line) is the predominant layout type. Each workstation uses several types of process technologies such as scales, computers, scanners, alarms, trolleys, lifts, cranes, electronic **traffic cops** and many more. Other examples of 'customer-processing technologies' are electronic point of sale technology, airline check-in systems, bar code scanners, moving walkways and in-flight entertainment.[12]

Central to an airport's operation are the different types of aircraft and aircraft storage hangers. Some planes are phased out and new ones are phased in. The market dictates the type of aircraft necessary, for example, it would be impractical to use a large Airbus for short transfer flights. In Hawaii, the airline Aloha offers aircraft flexibility. They are geared to service both passengers and cargo markets on and around the island. This also allows them to respond to emergencies.[13]

Technology and electronic traffic cops

The navigation industry uses several new technologies and innovative systems to ease the increasing challenges it faces. Surging passenger numbers, changing security requirements and increasing bottlenecks are all part of the complex challenges facing airport operators in their quest to maximise efficiency. ARINC is a company that is an example of a leading and innovative provider of solutions to the aerospace, aviation and airport industries driven to help airports succeed in transitioning to the forward-thinking, cost-effective technology designed for operational efficiency.[14]

'AirPlan' (a product from ARINC) is an example of an electronic 'traffic cop' that continuously tracks aircraft, gate, and concourse availability. This system connects multiple workstations, and seamlessly interoperates within the entire airport infrastructure. It automatically schedules gate facilities and allows airport personnel to get a step ahead in assigning departure, arrival gates and baggage carousels.[14]

Digital technologies such as the Airplane Information Management System (AIMS) tie airplane systems together with a microprocessor and software.[14] AIMS is an example of process technology that performs a variety of tasks that were previously performed manually. The AIMS architecture acts as the 'brains' of some of the aircraft; it is the centrepiece of an advanced avionics system to meet stringent requirements for functionality, reliability and maintainability.

Safety management excellence

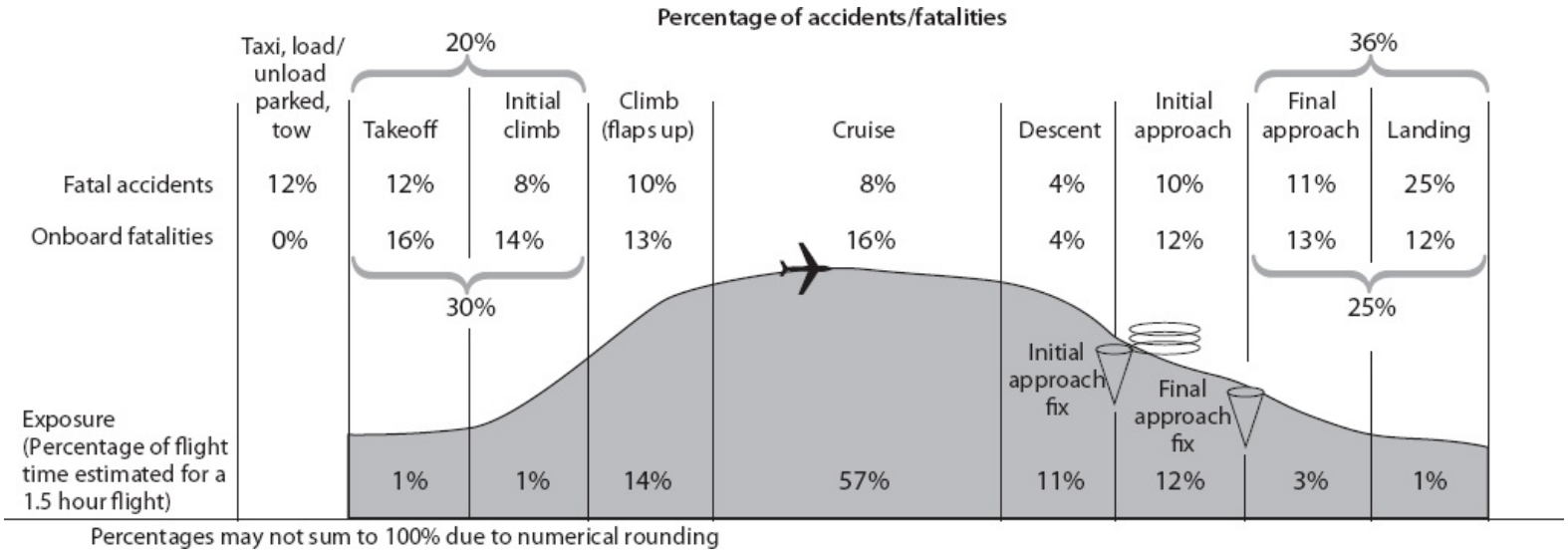
Failures in business do not only affect efficiency and effectiveness, they also cause unsafe working and living conditions. Operations managers and safety managers prevent the following **types of failures:** design failures, facility failures, staff failures, supplier failures and customer failures. Aviation safety is a science on its own and **safety risk management** covers all aspects of safe flying. The operations **design function** is vital to safe flying and it covers a wide spectrum of variables including **serviceability** of aircraft, modern warning systems, airbags in general aviation aircraft, total preventive maintenance (TPM) of aircraft, pilot learning styles (pragmatist, reflector, activist, etc.), intersection take-offs, the management of contract pilots and minimisation of aircraft instruments, to mention but a few. The ideal world will have no accidents and research will continue to adapt aeroplane designs to meet safety and other targets such as lower noise levels, cleaner exhausts and lower fuel consumption.

Operations managers are confronted by many types of risks in different industries, for example, noise-induced-hearing loss (NIHL) is a high risk in the mining industry. Fatal accident statistics[15] are associated with mining too, but they are also associated with the aviation industry, in terms of plane crashes. The 1 300 fatal plane crashes in the world involving large commercial aircraft from 1950 to 2009 were mainly caused by **human error**. In these six decades the primary causes of accidents were as follows:

1 Pilot error 50%
2 Mechanical failure 22%
3 Weather 12%
4 Sabotage 9%[15]

Figure 9.2 shows accident statistics and the longest percentage of safe flight time or cruising time (57%). It is interesting to note that the taxi and loading phase causes 12% of fatal accidents on the ground. As expected, landing causes the highest percentage of fatal accidents (25%) although landing is only 1% of the exposure time.

It may not be such a far-fetched idea to fully automate commercial flights in future. Some in the industry believe that technology could be developed to the point where commercial flights could do entirely without a pilot. Automated flights would increase safety significantly and would cut costs, but nobody is taking bets on it happening soon.[17] The good news is that things are getting better – as the number of people travelling by air has increased, the chances of suffering a fatal accident have fallen substantially.



Source: Boeing, n.d. cited in PlaneCrashInfo.com[16]

Figure 9.2 Percentage of accidents and fatalities by phase of flight (1959–2008)

A culture of safety and safety management excellence are non-negotiable priorities in the aviation industry. Safety, quality and maintenance are integral to its core operations. Human error remains too high on the list of causes of plane crashes. In one case[18] the pilot of an Airbus A320 jet with 200 people on board fought to prevent a crash. The aircraft would not turn left no matter what the pilot tried. After a high-speed emergency landing it was found that engineers had failed to reactivate four of the five spoilers on the right wing. The official report on the incident pointed to a complex chain of human errors, including by the pilots who had failed to notice the problem before departure. The report mentioned many reasons for the incident and concluded that if a check has previously been carried out numerous times without any fault, human nature then anticipates no fault when next the check is carried out.

These functions are not compromised in aviation and international safety regulations and safety management systems are inherent to all airline operations. Some of the elements in such an aviation safety management system include the following:

- Policies and procedures for an international safety management system complying to international system standards and benchmarks.
- Safety training programmes to ensure that all staff and stakeholders are familiar with safety legislation and requirements.
- **Personal protection equipment** (PPE) such as protective clothing (including high visibility clothing) and **hearing protection devices** (HPDs) are compulsory for everybody working at the airport. This also encompasses protective equipment for feet, hands, eyes and knees.
- **Ergonomics** management such as back injury prevention when lifting and moving loads.
- Identifying and eliminating human factors – management must continuously recognise the influence of human factors in safety performance and the elements of human factors that may influence performance include: crew coordination/teamwork, workload management, decision making, fatigue, adequate rest, stress, equipment-human interface, operational pressures, distraction, substance abuse and others.
- A safety management system should include contingency plans in order to ensure proper response. The purpose of contingency planning is to minimise and alleviate the trauma to those directly involved in the emergency. The system must also minimise any negative effect on the organisation and minimise disruption of the operation.

Safety risk management

From a gap analysis point of view, safety risk management refers to two broad steps namely (1) **hazard** identification (and the hazard reporting process) and (2) safety risk assessment and mitigation. In the first phase, a risk is only defined as a risk after the consequences of a hazard have been investigated. Wind can be a hazard but is recorded as a safety risk only after the severity and probabilities have been studied. Hazards must be identified across all the functions of the organisation from policies, machinery, work conditions and behaviour of staff. Hazard information is placed in three categories; reactive hazard information (from occurrence and event reports), proactive hazard information (audit reports, surveys and studies) and predictive hazard information (from databases that records real time and historic information). The second phase (risk assessment and mitigation) is based on risk probability (frequent, occasional remote, etc.) and risk severity (negligible, minor, major etc.). This process determines certain numeric values (e.g. 5A = catastrophic + frequent and 4B = hazardous + occasional, etc.). These numeric values can have certain colours such as green for acceptable region, yellow for tolerable region and red for intolerable

region. If the control defences such as equipment and training are not sufficient, action should be taken to reduce or avoid the risk.[19]

Maintenance management excellence

An airport is part of the Aeronautical Infrastructure and has to meet high safety and related maintenance standards. To conclude this case study we include a few core aspects of maintenance management that are intertwined with all safety measures. Even staff need to be maintained and cared for as already indicated. The required level of safety can only be achieved by professional maintenance of all the components of the airport. Maintenance includes measures to keep or restore the entire operational function as well as measures to check and to evaluate all elements of the POM function.

Airports manage a professional maintenance and engineering function to ensure the safe operation of the civil, mechanical and electrical components of the entire airport building, equipment and facilities. This function is also responsible for compliance to engineering standards, the Occupational Health and Safety Act and the relevant aviation regulations. The basic components of maintenance are: inspection, servicing, overhaul and repair. Some of the main sub-functions of airport maintenance include the following:

- Using standard operating procedures for preventative and other types of maintenance plans for equipment, infrastructure and facilities.
- Airport lighting – manage a maintenance programme for all airport lights that includes cleaning procedures for lights, light measurement and lamp replacement.
- Maintenance of airport electrical systems includes scheduling of maintenance, power cables, distributors, transformers and regulators (including standby units), transformer stations for electric power supply, relay and switch cabinets (including switch cabinets in sub-stations), control cables, monitoring units, control desk and very important secondary power supplies (generators) and fixed 400 Hz ground power supplies.
- Building maintenance also includes aspects such as communication facilities, air conditioning systems, heating facilities, automatic doors, baggage conveyor belts (fixed installations), passenger boarding bridges, airbridge safety devices, elevators, people movers (escalators) and fixed fire protection installations.

Conclusion

This case study provides a broad picture of the POM function in the airport and airline business. It describes an industry that is well known to modern business travellers and tourists in our global economy. Many refer to the world being a ‘small world’ due to increased access to countries in the world by means of more airlines, more flight schedules and a larger variety of aircraft. We have indicated the

complexities of busy airspaces and have linked the issues to the core business management function, namely POM and its sub-functions. We have shown practical examples of real situations and the systems and technologies used to simplify the art of flying, and the basic operations planning and control functions and value chain were briefly introduced. We then concluded by looking at a very relevant aspect and core airline function, namely safety and maintenance management.

Self-assessment questions

Easy questions

1. The main theme of this case study relates to _____.
   a. Air traffic, airports, aircraft, airspace and airlines
   b. Restaurants
   c. Marketing
   d. Flying finance

2. Which of the following are terminal building aircraft parking layout types?
   a. Transporter
   b. Linear
   c. Pier
   d. All of the above

3. Which alternative does **not** indicate typical inputs to an airline operation?
   a. Passengers, freight and luggage
   b. Pilots and other air crew (flight attendants)
   c. Tower controllers, ground controllers, process technologies, cranes and trolleys
   d. Transported passengers

4. Airlines (airports) are a continuous process with high volume and low variety and the primary layout type used is:
   a. Aviation layout
   b. Product layout
   c. Safety layout
   d. Project layout

5. PPE such as protective clothing (including high visibility clothing) is compulsory for everybody working at an airport. Which device is associated with PPE?
   a. Alarm device
   b. Warning device
   c. Hearing protection device (HPD)
   d. Traffic cop device

Challenging questions

1. The quest for excellence is a logical mindset in the aviation industry since the opposite of a successful flight is associated with a disaster and fatalities. Which of the following alternatives is correct?

a. Excellent airlines depends on effective airports, effective and efficient operations and customer service.
b. The quality dimensions at airports include the pilot, the aircraft, the checkin service, parking, the shops, airside capacity, smooth runways, process technologies and the tower controllers coordinating punctual landing and take-offs.
c. All airport operations need to be coordinated because they are all interdependent. Problems caused by ground controllers can jeopardise the job of the tower controllers.
d. Operations management at airports is at the heart of all value-adding processes and this refers to the different transformation processes. Working operations is the moment when the 'tire hits the road' or in terms of this case study 'when the aircraft is airborne'.
e. Working operations are value-adding moments referring to situations of energy utilisation, impact, contact and heat. Error-free control is of utmost importance especially where human beings are being processed.

i. a b c
ii. b c d
iii. d e a
iv. b d e
v. a b c d e

2. Which one of the following options is **incorrect**?
   a. Airline operations planning and control focus on the inputs-process-output elements of the value chain. Without the careful managing of this value chain the airline operation will not reach its objectives.
   b. The main performance objectives of airline operations are safety, economy and customer satisfaction.
   c. Customer satisfaction regarding on-time schedule performance is critical in this highly competitive industry. In addition to this, airlines could make a loss if expensive aircraft assets are idle.
   d. Flight and crew scheduling is a very complex process and a master production schedule (MPS) of flights based on the forecasts and actual orders (bookings) can be exploded (disaggregated) to determine all resources needed to support the airline schedule (MPS).
   e. A workforce schedule will always be a priority over other resources in the service industries such as airlines.

3. Safety risk assessment in aviation is related to two main steps. Which one of the following steps is **incorrect**?
   a. The first step from a gap analysis point of view refers to (1) hazard

identification and the hazard reporting process.

b. Hazards must be identified (part of the first phase) across all the functions of the organisation from policies, machinery, work conditions and behaviour of staff.
c. Hazard information (part of the first step) is placed in three categories such as reactive hazard information (from occurrence and event reports), proactive hazard information (audit reports, surveys and studies) and predictive hazard information (from databases that records real time and historic information).
d. The first phase (step) is associated with quick action. If the control defences such as equipment and training are not sufficient, action should be taken to reduce or avoid the risk.
e. Safety risk assessment and mitigation – the second phase (risk assessment and mitigation phase) is based on risk probability (frequent, occasional remote, etc.) and risk severity (negligible, minor, major etc.). This process determines certain numeric values (e.g. 5A = catastrophic + frequent and 4B = hazardous + occasional, etc.). These numeric values can have certain colours such as green for acceptable region, yellow for tolerable and red for intolerable region.

4. ORTIA was upgraded for several reasons. Which one of the following is correct?
   a. Mobile structural car parking and a new central passenger terminal building were the biggest priorities at the airport.
   b. Runway and taxiway shoulders had to be widened as required for the new Airbus A380, latest jumbo airliner from Airbus.
   c. The airport needed a re-engineering in terms of upgraded facilities for the all-important first impression only, because the airport is the entry-point to South Africa. It was vital to provide a world-class African airport with a modern cutting-edge image, look and feel.
   d. Additional fuel tanks were considered but the reconfiguration and the upgrade of the existing International terminal building and technology was more important.

5. The 1 300 fatal plane crashes in the world involving large commercial aircraft from 1950 to 2009, were mainly caused by _____.
   a. Pilot error 50% and mechanical failure 22%
   b. Mechanical failure 22% and weather 12%
   c. Weather 7%
   d. Bomb threats and sabotage 9%.

Essay questions

1. Discuss the concept ‘being airborne’.

Key points to discuss:
Value-adding moment; transformation process; processing customers; safety and customer satisfaction.

2. Briefly explain the flight planning and control function.

   Key points to discuss:
   Airline operations planning focus on the inputs-process-output elements; the main performance objectives; on-time schedule performance; flight and crew scheduling; master production schedule (MPS) of flights; a workforce schedule.

3. Insert the relevant inputs-process-output elements of an airline.

Inputs to an airline operation	Airline processes	Airline operation outputs

   Key points to discuss:
   Indicate the relevant elements related to the inputs, processes and outputs of airlines.

4. Indicate why the New York airspace operation is regarded as excellent.

   Key points to discuss:
   Approximately 7 000 planes arrive and depart each day; smooth coordination of this airspace requires precision and clarity; predetermined 'corridors in the sky'; wind is a 'spanner in the works'; innovative technology used to streamline flights; large aircraft has technology fitted to signal a safe zone; stress management.

5. Discuss the main components of safety management excellence at airports.

   Key points to discuss:
   Aviation safety is a science; safety risk management; safety management system; a wide spectrum of safety variables; serviceability of aircraft; modern warning systems; airbags in general aviation aircraft; TPM (total preventive maintenance) of aircraft; pilot learning styles (pragmatist, reflector, activist, etc.); intersection takeoffs; the management of contract pilots; minimisation of aircraft instruments and others.

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10 Human Resources Management: Derby Departmental Stores

KEY TERMS

CUSTOMER SERVICE
DEPUTY DIRECTORS
DERBY DEPARTMENTAL STORES
DIRECTOR: HUMAN RESOURCES
EMPLOYEE RELATIONS AND WELLNESS
GROWTH STRATEGY
HIGH-PERFORMING DEPARTMENTAL STORE
HUMAN RESOURCES
LABOUR LEGISLATION
LABOUR RELATIONS
LEADERSHIP AND MOTIVATION
ORGANISATION DEVELOPMENT
ORGANISATIONAL STRUCTURES
RECRUITMENT AND SCREENING
TALENT DEVELOPMENT
TALENT DEVELOPMENT AND RETENTION

Background

Derby Departmental Stores has 40 locations throughout South Africa and the company headquarters are located in Johannesburg. Derby serves a broad customer base in urban and semi-rural areas, marketing fast foods, perishable and non-perishable foods, liquor, furniture, health-care products and clothing. With an annual turnover of R20 billion per annum and a permanent staff complement of 6 000, **Derby Departmental Stores** announced the establishment of six new stores two years ago, but owing to slow economic growth and ongoing industrial unrest in the country, the decision to expand was shelved for an undisclosed period. Notwithstanding these difficulties, Derby surpassed all expectations, and it is generally known in the market that the people working for Derby have been responsible for the company standing out from its competitors. Lately, however, staff

turnover has increased, and after a one-week wage strike, customers began to complain about the quality of the products on the shelves and **customer service** by staff. One headline in a local paper read: 'Derby is not as bright as it used to be – they are cracking.' Shortly after the news report, the CEO announced that there would be renewed focus on customer service and quality in general. A task team would identify problems and recommendations would be made soon. Derby needs to restore its reputation and market as soon as possible. All functional areas would be involved, but **human resources** would play a vital role in the task team.

The Human Resources Department at Derby

The Human Resources (HR) Department is located at Head Office in Johannesburg and is managed by the HR Director, Don Mashego, a seasoned HR practitioner with more than 20 years of experience in the retail sector. Don plans to retire in two years' time, and his institutional knowledge is absolutely phenomenal. His leadership style is sometimes described as somewhat 'old school' because of his 'command-and-control' style. Certain HR staff members at Derby commented that they need a new leadership mind-set in HR, something that the 'boss' should exemplify. It has been said that leaders should have a flexible mind-set and continue to evolve organically with size and time. More importantly, however, HR should drive a new ethos in order to transform and initiate the required changes to restore Derby's status as a **high-performing departmental store**.

The HR departmental structure is depicted in Figure 10.1. The HR Department consists of 62 HR practitioners, and each of the stores in the metropolitan areas is assisted by two HR practitioners.

The purpose and main functions of the **Director: Human Resources** and each of the directorates are outlined below.

Office of the Director: Human Resources

Purpose

To lead the planning and provision of high-quality human resources services in support of the strategic objectives of Derby Departmental Stores.

Functions

- Set the strategic vision for the HR Department
- Lead the planning, provision and maintenance of a quality human resources service for all clients
- Ensure the provision of high-quality human resource advisory services for all clients

- Lead and guide the organisational development agenda
- Provide HR training, development and employee assistance services
- Ensure the effective management of **labour relations**
- Administer cost-effective remuneration and benefit administration.

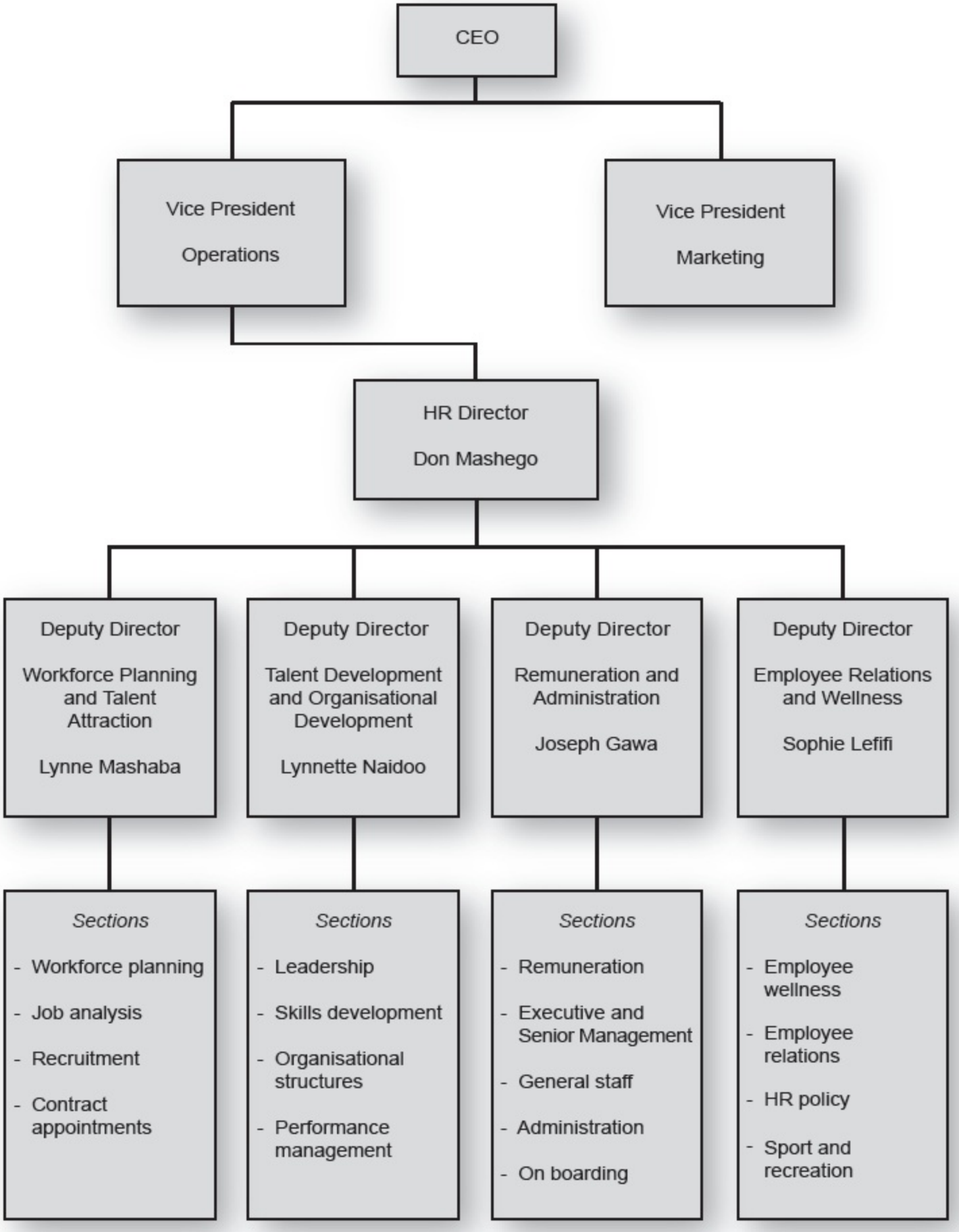


Figure 10.1 HR organisational structure

Deputy Director: Workforce Planning and Talent Attraction

Purpose

To render workforce planning and talent attraction services.

Functions

- Render workforce planning services to the various stores
- Focus on job analysis processes
- Provide HR budgeting and financial services
- Manage client services
- Provide HR services to metropolitan and rural areas
- Develop and assist with recruitment and selection services.

Deputy Director: Talent Development and Organisation Development

Purpose

To render effective **talent development** and **organisation development** services.

Functions

- Determine and maintain **organisational structures** in terms of the company's core and support functions and in alignment with its organisational strategy
- Organise/reorganise the various entities and stores
- Determine the number of personnel (post establishment) required by Derby to perform its functions and activities
- Conduct job analysis and develop job descriptions
- Optimise efficiency through the promotion of the efficient and effective use of personnel and resources
- Optimise efficiency through the simplification and streamlining of work systems, methods and procedures and the elimination of unnecessary functions (including assistance with designing forms and registers)
- Develop and maintain performance management policy and procedures
- Develop and maintain an HR information strategy
- Compile workplace skills development programmes
- Implement workplace skills development programmes
- Develop and implement management development programmes
- Compile training and development course programmes and study guides
- Develop mentorship programmes.

Deputy Director: Employee Relations and Wellness

Purpose

To promote and maintain sound **employee relations and wellness** services.

Functions

- Initiate, develop and implement employee relations policies, procedures and collective agreements
- Provide specialised employee relations support, advice and opinions
- Manage input into and coordinate collective bargaining processes
- Manage misconduct, grievances and incapacity processes
- Manage relations with labour/trade unions
- Manage disputes/CCMA cases (in collaboration with Legal Services)
- Manage quality assurance in HR policies and employee relations
- Develop and manage employee wellness programmes
- Provide and manage HIV/Aids programmes and services.

Deputy Director: Remuneration and Administration

Purpose

To develop and administer an HR remuneration and benefit system that is future directed and ensures the attraction and retention of talented employees.

Functions

- To develop and maintain a cost-effective remuneration policy and system
- To determine the level/grading of the posts on the establishment (job evaluation)
- To develop and maintain effective incentive schemes
- To participate in substantive negotiations relating to HR remuneration and benefits
- To cost projected/forecasted personnel models and link them to remuneration and the benefits model
- To administer service conditions
- To administer salaries, medical aid and retirement fund.

Challenges facing Human Resources

After a two-week holiday, on his first day back in the office, Don was confronted with

a report from the legal department about changing **labour legislation** and its possible impact on Derby. Don decided that he had to brief the CEO as soon as possible about these changes, but referred the report to Sophie with a note: 'Dear Sophie – please study the report and provide me with your feedback as soon as possible.'

Don knew that he had a far more important task to perform, that is, to prepare for the monthly 'Customer service and strategic objectives review' meeting, chaired by the CEO and attended by the other directors at Derby responsible for the different departmental areas, namely operations, marketing, supply chain, quality, merchandising, technology, finances and sales.

It was after 21:00 on the same day that Don left the boardroom, tired and disappointed that he had not been fully prepared for the meeting. However, he realised that the focus of the meeting had been vastly different from previous meetings. During the meeting, the CEO had presented reports from various other directors with various complaints directed to HR, but of more importance had been his announcement that Derby would focus on a **growth strategy**, and he had requested Don to provide him with guidelines on how Derby should approach this matter from an HR perspective. Don decided that he would call his Deputy Directors to his office and request each of them to comment on these challenges. He decided to provide a brief summary of each of the challenges to the various **Deputy Directors**, namely growth strategies, **recruitment and screening**, **talent development and retention**, labour relations and **leadership and motivation**.

Growth strategies

Although the economy was not performing as expected, the CEO and executive team were of the opinion that now would be the best time to consider expanding their business to other metropolitan areas in South Africa. A study had been conducted by the Marketing Director and the preliminary suggestion was that four new 'Derby Mega Stores' should be built, one each on the North and West Coasts, and one each in the Eastern and Western Cape. These mega stores would add another 800 people (200 per store) to the total staff complement and would operate independently of each other. The store managers would report directly to the CEO for the first year. The expectation was that the mega stores, a new concept for Derby, would use the same structure and organisational layout presently in place for the stores in the metropolitan areas. More contract workers would have to be used. Further details would follow later.

Recruitment and screening

In the area of recruitment and selection, mention was made of the fact that when recruiting for lower-level and entry-level jobs, HR used the local private recruitment agency closest to the Derby store, and these agencies were under strict orders to

recruit people within a radius of 50 kilometres from the store in question. The rationale behind this decision was that this approach would lessen the likelihood of absenteeism and high staff turnover, and that people from the same region would enhance higher morale and cohesiveness. It was reported that the unions were complaining about this practice and viewed it as unfair and discriminatory.

A second area of concern was the time it took to appoint middle and senior managers. The complaint was that the process was too cumbersome and there was a suggestion to remove certain steps in the selection process, for example, the reference checking and various other tests before the interview.

Talent development and retention

The development of people and the retention of high-performing staff was an integral element of Derby's DNA. In the light of this, the Operations Director shared his frustration with Don about the performance of the bread deliverers at Derby. Selected Derby stores were equipped with the infrastructure to bake bread products for certain Derby stores. When bread deliverers were hired they were assigned a region in which they were to deliver bread products to certain stores, and ensure that the right quality and quantity were unpacked. New employees received a broad orientation on the mission, vision, values and philosophy of Derby stores, and skills training for one week. This training was in the form of one-on-one training by the various supervisors. On completion of the training, the trainee would join the supervisor on what would become his or her route. The trainee's task would be to observe and remember the activities performed by the supervisor during the various steps. At each step, the trainee's responsibility would be to assist the supervisor in executing his or her task. When driving between the various stores, there would be enough time for the supervisor to discuss the various aspects of the new job such as the paperwork required and how to handle various situations that could arise. During the second week, the trainees were on their own, and could call the supervisor if they experienced any problems. The various store managers mentioned that the bread deliveries were late, the paperwork was incorrect and there might be a training problem.

A further serious problem mentioned by the Operations Director was that an unusually high staff turnover rate had been noted among the warehouse supervisors in Derby's metropolitan stores. The line managers had had a superficial look at the pay scales of warehouse supervisors and it had come to light that Derby's warehouse supervisors were on a job evaluation level 6, with pay ranging from R290 000 to R450 000 per annum cost to company, depending on the person's years of service. They also noted that the warehouse supervisors' jobs were advertised by competitors at a higher job grade level with a starting salary of R350 000 per annum cost to company. This could be the reason for the high staff turnover. The following suggestions were made: HR should investigate and consider other forms of recognition, and determine whether Derby's jobs could be properly evaluated and whether or not there was

internal equity among warehouse supervisors. After all, financial rewards motivate employees to work harder and the new generation of employees does not have any work discipline and needs to realise the difference between right and wrong! This comment was made by the Financial Director, which Don took seriously.

Labour relations

A further challenge was that the chairpersons of disciplinary committees were not adequately aware of their roles and responsibilities, and they needed to know what influence the amended labour laws would have on Derby.

One of the buyers in one of the so-called Derby stores, Mr X, had experienced marital problems and his wife had recently divorced him. Mr X had become depressed and had started drinking alcohol more frequently, had lost weight and was constantly nervous. After starting a new relationship with someone, he felt that he needed counselling to deal with his personal problems. He met for a counselling session with a registered psychologist and after the session the psychologist concluded that Mr X was dangerous to the point of being suicidal and homicidal. The psychologist had also concluded that Mr X could easily be provoked into creating a life-threatening situation in the workplace. Then without Mr X's approval, the psychologist contacted Derby's Deputy Director, Joseph Gawa, and informed him of the situation and recommended that Mr X be discharged. Joseph was extremely upset and decided to immediately discharge Mr X, who was granted one week of severance pay. Mr X had applied to the CCMA, and the company now had a problem.

Don was shocked to hear this story. He suddenly remembered that he had requested Sophie to summarise the implications of the new amendments to the labour laws for Derby. Back in his office he found the following report from Sophie on his desk:

MEMORANDUM
From: Sophie Lefifi
To: Don Mashego

SUMMARY OF AMENDMENTS TO THE EMPLOYMENT EQUITY ACT (55 of 1998), LABOUR RELATIONS ACT (66 of 95) AND BASIC CONDITIONS OF EMPLOYMENT ACT (75 of 1997)

Dear Don

Please find brief summaries of the changes to the various labour laws above for your information. These changes should be read together with the original Act. I would like to caution that no decision should be taken on the basis of these summaries. My advice is that we consult with our legal department. For further comment and information about the amendments consult the following links:

- http://www.cliffedekkerhofmeyr.com/export/sites/cdh/en/ legal/practice-areas/downloads/ Employment-Guide-to-the-Amendments-2014.pdf
- http://www.labourwise.co.za/labour-articles/ee-amendments
- http://www.labourwise.co.za/labour-articles/ee-amendments
- http://www.labour.gov.za/DOL/legislation/acts/basic-conditions-of-employment/read-online/amended-basic-conditions-of-employment-act
- http://polity.org.za/article/the-labour-relations-amendment-act-will-take-effect-on-1-january-2015

EMPLOYMENT EQUITY ACT (EEA)[1]

The president of the Republic of South Africa has signed a proclamation in terms of which the Employment Equity Amendment Act of 2013 effective from 1 August 2014. Some of the important changes that are relevant to Derby include the following:

Definition of designated groups: In terms of section 1, 'Foreigners' are excluded from the definition. This means that foreigners cannot be used to make the Derby's employment equity figures look better.

Prohibition of unfair discrimination: section 6 of the Principal Act:

- Amended subsection 1 to include a further ground for discrimination – *'and any other arbitrary ground'*.
- Added subsection 4 – '*A difference in terms and conditions of employment between employees of the same employer performing the same or substantially the same work or work of equal value that is directly or indirectly based on any one or more of the grounds listed in subsection 1, is unfair discrimination'*.

Psychological testing and other similar assessments: section 8 of the Principal Act: Subsection (d) added in the following terms: *('has been certified by the Health Professions Council of South Africa established by section 2 of the Health Professions Act, 1974 (Act No. 56 of 1974), or any other body which may be authorised by law to certify those tests or assessments')*. This is a new certification requirement for psychological and other similar assessments.

Disputes concerning the prohibition of unfair discrimination: section 10 of the Principal Act:

- 'A dispute can be referred to arbitration if parties agree; or
- Claim concerns sexual harassment; or
- Employee alleging unfair discrimination earns below R205 433.30 per annum (NB: Threshold to be determined by the Minister of Labour from time to time);
- A person affected by the award issued by the commissioner can appeal (not review) to the Labour Court (LC) within fourteen (14) days.'

The amendments herein make it easier for employees to lodge unfair discrimination cases for arbitration with the CCMA.

Burden of proof: section 11 of the Principal Act: The amendments to the above section have the following effects:

- 'Where discrimination is alleged on listed ground (section 6 (1)) – Derby must prove (1) discrimination did not take place or differentiation is rational, not unfair or otherwise justifiable'; and
- Where discrimination is alleged on an arbitrary ground – the complainant or employee must prove that (1) conduct is not rational, (2) conduct amounts to discrimination, and (3) con-duct/discrimination is unfair.'

Income differentials: section 27: Added *'unfair discrimination'* to income differentials section. Other pertinent amendments relating to section 27 are as follows:

- If Derby fails to have employment equity plans or subsequent employment equity plans in place or implemented – (1) the Director General (DG) may apply to the Labour Court to impose a fine on the company; (2) No compliance order or written undertaking prior to the Labour Court process mentioned in (1) above; (3) The fine is linked to the employer's turnover (2 – 10% of turnover); (4) Employment equity reports must be submitted each year irrespective of the size of the employer – failure to submit reports to the Labour Court may impose a turnover fine.

The amendments introduce more stringent reporting on and monitoring of the implementation of EE plans. There has also been a dramatic increase in the size of non-compliance fines which could run into millions.

Under the circumstances, it would appear that Derby now has an obligation to investigate and eradicate income differentials in an attempt to progress towards equal pay for equal value work. Non-compliance will lead to the Derby being fined by the DG and the Labour Court (fine between 2 and 10% of the annual turnover of Derby which could run into millions).

LABOUR RELATIONS ACT[2]

On 1 January 2015 the Labour Relations Amendment Act (No. 6 of 2014) (LRAA) took effect and aims to streamline the country's labour environment and there is no doubt that businesses will have to adjust their employment practices.

1. Fixed-term contracts

1.1 The existing section 186(1)(b) will now become section 186(1)(b)(i). Section 186 of the principal Act is hereby amended –

(*a*) *by the substitution in subsection (1) for paragraphs (a) and (b) of the following paragraphs, respectively:*

(*b*) *an employee employed in terms of a fixed-term contract of employment reasonably expected the employer –*

(i) to renew a fixed-term contract of employment on the same or similar terms but the employer offered to renew it on less favourable terms, or did not renew it; or

(ii) to retain the employee in employment on an indefinite basis but otherwise on the same or similar terms as the fixed-term contract, but the employer offered to retain the employee on less favourable terms, or did not offer to retain the employee; and …

1.2 The amendments propose a new section 186(1)(b)(ii). It stipulates that if an employee reasonably expects the employer to retain him or her on an indefinite basis on the same or similar terms as those contained in the fixed-term contract, but the employer offers to retain the employee on less favourable terms or does not offer to retain the employee, this will constitute a dismissal.

1.3 Consecutive contracts will now play a role in creating an expectation of an indefinite/permanent appointment of the employee rather than merely having an expectation of being offered a further fixed-term contract on the same or similar terms.

1.4 The new section 198B is as follows:

(1) 'Fixed term contract' means a contract that terminates on:
   (a) The occurrence of a specific event;
   (b) The completion of a specified task or project;
   (c) A fixed date, other than an employee's normal or agreed retirement age.

(2) The section does not apply to:
   (a) Employees earning above the threshold in the BCEA (currently set at R 205 233.30)
   (b) Employers employing less than 10 employees, or employers who employ less than 50 employees and whose business has been in operation for less than two years, unless
      (i) The employer conducts more than one business;
      (ii) The business was formed by a division or dissolution of an existing business;
   (c) The fixed-term contract is provided for by statute, sectoral determination or collective agreement.'

1.5 Subsection 3 provides for a maximum fixed-term contract period of three months, or renewed terms to a maximum three months, unless the nature of work is of a limited or definite duration; or the employer can show some other justifiable reason for a longer period. The onus will be on the employer to prove the justifiable reason for the longer period and that the longer period was agreed upon.

1.6 Subsection 4 provides for a non-exhaustive list of justifiable reasons, for example, replacement of an employee who is temporarily absent from work or, in the case of seasonal work or project work, persons who require work experience or who have reached retirement age.

1.7 From the commencement of the Amendment Act, fixed-term employees should have equal access to opportunities to apply for vacancies as permanent employees.

1.8 A new section 200B proposes that employees must be appointed on a permanent basis unless the employer can establish a justification for employment on a fixed-term basis.

2. **Dismissals**

The Amendment Bill contains a new section 188B providing that employers may dismiss employees earning above a specific earnings threshold determined by the Minister of Labour fairly, provided that these employees are given three months' written notice or that they are paid *in lieu* thereof (or any longer period specified in the employee's contract of employment). Such a dismissal is then deemed to be for a fair reason and a fair procedure is deemed to have been followed.

3. **Strikes and pickets**

The Amendment Bill aims to curtail unacceptable levels of unprotected industrial action and unlawful acts in support of industrial action, including violence and intimidation.
The Amendment Bill seeks to amend section 64 of the LRA to introduce the requirement of a ballot as a prerequisite for a protected strike or lock-out. This is intended to avoid industrial action with only minority support. The strike or lock-out will only be protected if there is a majority in favour of industrial action.

4. **Temporary Employment Service (TES)**

In terms of section 21(12) of the Amendment Bill, unions may seek to exercise organisational rights in respect of TES employees at either the workplace of the TES or that of the client. If a union has obtained organisational rights at the workplace of the TES, this union would automatically have organisational rights at the workplace of the client in respect of the TES employee in respect of which organisational rights have been acquired.
It is, however, not anticipated that the organisational rights granted to employees of the TES at the workplace of the TES will be fully applicable to the workplace of the client, for example, deduction of subscriptions will not be applicable whereas access of shop stewards to the workplace may be applicable.

BASIC CONDITIONS OF EMPLOYMENT ACT (BCEA)[3]
The amendments to the Basic Conditions of Employment Act (BCEA) took effect on 1 September 2014. The key changes to the BCEA include the following:

- A prohibition on payment by an employee to the employer to secure

employment, and from requiring employees to purchase goods, services or products from the employer
- Bringing the child labour provisions in line with international standards. This includes making it an offence for anyone to require or permit a child under the age of 15 to perform any work or provide any services that place the child's well-being at risk
- Increasing the Minister of Labour's powers in relation to sectorial determinations
- Streamlining the enforcement process
- Increasing penalties and maximum sentences.

Kind regards
Sophie
Deputy Director: Employee Relations and Wellness

Don was grateful to Sophie for the update and knew that all the Deputy Directors would have to analyse the details. But Don knew he would have to brief the CEO first, and he decided to arrange a meeting with him.

Leadership and motivation

The Marketing Director was of the view that Derby should be moving towards a plan to introduce a system of employee empowerment. He suggested that HR should start exploring how employee involvement could be increased in the workplace. It is a matter of employee participation and workers should have a say about their jobs – the 'old school' approach is simply no longer acceptable. The Director gave Don the following example of what he considered was one way to improve profits and gain more union support: open the books and ask for suggestions on how more profits could be made. A suggestion was also made to closely monitor the number of new recruits – those who stay and those who leave the organisation. The selection committee for new applicants consists of a five-employee panel and is subject to a peer review panel every 60 days for the first year. The problem here is that fellow workers determine whether an employee can stay or should leave the organisation. The employee panel makes the final decision. The second example is where management encourages team members to pretend they own their own franchise. They are totally in charge of completing their tasks. The bonus system would allow employees to increase their pay on the basis of teamwork and productivity. Employees not performing on that day would lose their bonus for the day, while those who do not work or are late would lose their bonus for the week. A great team effort is needed if a team member does not pull his or her weight, to solve the problem and to continue with the work.

Conclusion

Don realised that he had to request the various Deputy Directors to respond to these challenges. The HR Department now has to show what role it can play to effect a change in Derby's culture. Don decided to give his colleagues two weeks to respond.

Self-assessment questions

Easy questions

1. The main theme of this case study relates to _____.
   a. The human resources department
   b. Growth strategies of Derby
   c. Marketing facing human resources practises at Derby

2. Which of the following is not part of Derby's human resource functions?
   a. Set the strategic vision of the human resources Department
   b. The provisioning of HR budgeting and financial services
   c. Development of HR information services
   d. Providing a payroll services to Derby

3. Derby's key strategy focus will be on _____.
   a. Customer service
   b. Quality products
   c. Satisfied customers
   d. Establishing Mega stores

4. Which of the following labour laws have been amended recently and of interest to Derby?
   a. Employment Equity Act (55 of 1988)
   b. Basic Conditions of Employment Act (75 of 1997)
   c. Skills Development Act (97 of 1998)
   d. Labour Relations Act (66 of 1995)
   e. The National Qualification Frame Work Act (67 of 2008)

   i. a,c,d
   ii. b,c,d
   iii. b,d,e
   iv. a,b,d

5. Which of the following are HR challenges at Derby?
   a. Recruitment processes
   b. Retention of talent
   c. Unequal remuneration
   d. Sport facilities
   e. Administration of leave records

i. a,b,e
ii. b,c,d
iii. a,b,c
iv. a,d,e

Challenging questions

1. Which **one** of the following options related to Derby is incorrect?
   a. Derby considers their people to be an essential part of their business.
   b. The Director: Human Resources sets the strategic vision of the HR Department and must lead new HR initiatives to renew the leadership core of Derby.
   c. The new envisaged mega store will mainly report to the CEO and will be a new concept for Derby.
   d. From the commencement of the Labour Relations Amendment Act, fixedterm employees must wait for three months before they can apply for vacancies as permanent employees.

2. Which **one** of the following statements is incorrect:
   a. Derby's financial performance is generally acceptable.
   b. People are considered very important to Derby but lately the performance in certain areas was below expectations.
   c. Dan Mashego is close to retirement.
   d. Human Resources at Derby will play an important role in driving a transformation plan.
   e. The Human Resources departmental organisational structure reflects five specialised directorates.

Essay questions

1. Discuss the role of the Department of Human Resource Management at Derby.

   Key points to discuss:
   The human resource function; human resource management and organisational effectiveness; differentiate between the human resource department and the human resource function of line managers; comment whether the human resources department is optimally structured.

2. Explain what you would recommend to the CEO of Derby to change the leadership mindset at Derby.

   Key points to discuss:
   Don's role in changing the mindset – will he be able to succeed? Changes planned

for Derby – is it the right time? Does Derby need leaders as managers? The influence of teamwork; consider the various leadership approaches and suggest one or a combination of approaches which will change the mindset at Derby.

3. Identify and explain the most important steps in the human resources planning process – what should Don's approach be in light of the planned growth strategy at Derby?

   Key points to discuss:
   The work done or to be done in the future; the type of employees needed for Derby now and in the future; the human resource plan; funding qualified workers and recruitment practices at Derby; high staff turnover at Derby.

4. Discuss how you would respond to the challenge of talent development and retention at Derby.

   Key points to discuss:
   Development methods to address service delivery at Derby; the problem with the bread deliverers; on and off the job naming methods; keeping qualified workers; role of compensation to retain warehouse supervisors at Derby.

5. Explain how Don and his Deputy Directors can motivate staff to increase their performance and contribute to the various human resources challenges at Derby.

   Key points to discuss:
   Role of each Deputy Director and the most appropriate team to address the human resources challenges; briefly identify the main human resources challenges; consider the various factors influencing motivation at the workplace; consider various motivational strategies; suggestion made by the Marketing Director about employee empowerment – will it work at Derby?

6. Explain how to approach the decision made by Deputy Director Joseph Gawa to discuss Mr X and the pending CCMA case?

   Key points to discuss:
   Unfair dismissals; disciplinary procedures; grievance procedures; role of the Commission for Conciliation, Mediation and Arbitration (CCMA).

7. Provide a brief summary of the purpose and scope of the various labour laws affecting Derby with specific reference to the changes as reflected in the memo to Don by Sophie Lefifi.

   Key points to discuss:

Labour Relations Act; Basic Conditions of Employment Act; Employment Equity Act; Skills Development Act; Skills Development Learner Act; National Qualifications Framework Act; Occupational Health and Safety Act; Compensation for Occupational Injuries and Deceases Act; Unemployment Insurance Act.

Endnotes

1. Republic of South Africa, Employment Equity (EEAA) Act, No 47 of 2013, Government Gazette16 January 2014, No: 37238
2. Republic of South Africa, Labour Relations Amendment Act, No. 6 of 2014, Government Gazette August 2014, No: 37921
3. Republic of South Africa, Basic Conditions of Employment (BCEA): Act No. 20 of 2013. Government Gazette August 2014; No: 37955

11 Marketing management: Heineken and SABMiller's beer war

KEY TERMS

ADVERTISING
COMPETITIVE ADVANTAGE
COMPETITIVE STRUCTURE
CONSUMER TASTES
DIVERSIFIED
JOINT VENTURE
LONG-TERM STRATEGY
MONOPOLY
OLIGOPOLY
OPPORTUNITIES
PREMIUM BEER BRAND
PRICE
RELATED AND UNRELATED DIVERSIFICATION
REPACKAGE
SEGMENTS
SOCIAL RESPONSIBILITY
SOCIO-ECONOMIC PROBLEMS
STRENGTHS
SUSTAINABILITY
THREATS
VERTICALLY INTEGRATED
VISION
WEAKNESSES

Introduction

What happens when a multinational brewer has such a competitive comfort zone in

its own backyard that it can quip that 'We are not a monopoly. We are just a temporary sole supplier'?[1] This quip came back to haunt them when another multinational beer brewer took them on directly. In this business case we look at the competitive situation in the South African beer market where two of the largest multinationals are now competing in a life-and-death struggle for a share of the market.

Competitive structure of the liquor industry in South Africa

The South African liquor industry is highly concentrated with just a few liquor manufacturers providing the majority of liquor sales to South Africans. The South African liquor market is divided into four broad **segments**, namely malt beer, commercially manufactured sorghum beer, spirits market and the Ready-To-Drink (RTD) market, also called the Flavoured Alcoholic Beverage (FAB) market. The main operators in the South African liquor market are South African Breweries Ltd (SAB), United National Breweries, Distell and Brandhouse. SAB forms part of multinational beer brewer SABMiller, which manufactures mainly malt beer but also FABs and also owns more than 60% of the market for sales of the Coca-Cola soft drink in South Africa. United National Breweries manufactures sorghum beer; Distell sells spirits, FABs and wines; and SAB's biggest rival, namely Brandhouse (a joint venture between Diageo and Heineken), sells malt beer, spirits and FABs. Total liquor sales in South Africa are dominated by SAB, Brandhouse and Distell, which together sell more than 90% of all the volume of liquor in South Africa[2]. If sales volume per brand is considered, then 80% of liquor volume sales in South Africa can be attributed to ten individual brands of which eight are beer brands and two are cider brands. The market share of the remaining 20% brands are dispersed between a further 1 000 liquor brands, indicating the dominance of a few top brands in the South African market. SAB's total liquor market share in South Africa as reported in 2013 stands at 42.89%, that of Distell at 18.71% and Brandhouse's share is 20.66%[3]. Edward Snell and Company that resides under the 'other smaller independents' in the table below claims a market share of 13% of the South African spirits market making it a major specialist player in this segment.[4] The traditional sorghum beer market has been in decline for a number of years now as consumers' taste moved towards the 'clear' type of malt beers. The various sorghum brands and the places where they are manufactured is indicated in Table 11.1. There are also a vast number of smaller manufacturers in the liquor market, especially in the wine market where the level of concentration is much lower than in the malt beer market. A visual picture of the **competitive structure** of the liquor industry in South Africa is presented in Table 11.1.

TABLE 11.1 The competitive structure of the South African liquor industry

SAB[5]	United National Breweries[6]	Distell[7]	Brandhouse[8]	Other smaller independents
Malt beer	**Sorghum beer**	**Spirits**	**Malt beer**	**Malt beer**
Carling Black Label	iJuba special (Khangela)	Amarula liqueur	Amstel	Draymans Brewery
Hansa Pilsner	iJuba blue (Khangela)	Richelieu	Heineken	Mitchells Brewery
Hansa Marzen Gold	Leopard Special (Phelindaba)	Mainstay cane	Windhoek	Mitchells malt beer
Castle Lager	Chibuku (Butterworth)	Klipdrift brandy, Oude Meester brandy	Guinness	Gillroys
Castle Lite	Tlokwe (Potchefstroom)	Van Ryn's brandy	Kilkenny	Birkenhead breweries
Castle Milk Stout		Viceroy	**Spirits**	**Sorghum beer**
Castle Draught in a bottle		Three ships	Johnnie Walker	Awethu Breweries (Mageu and Sorghum)
Grolsch		Bisquit	J&B whisky	Tiger Brands (King Korn and Mnanti home preparation Sorghum
Miller Genuine Draft		Scottish Leader	Bell's whisky	**Spirits**
Peroni Nastro Azzurro		Bains Cape Mountain	Smirnoff vodka	Edward Snell & Co Ltd
Pilsner Urquell		Black Bottle	Captain Morgan rum	Wellington VO
		Bunnahabhain	Spiced Gold rum	Skyy vodka
		Flight of the Fish Eagle	Montego rum	Glenfiddich whiskey
		Collisons White Gold	Squadron rum	

Fruit flavoured beer Flying fish **FABs (RTD)** Brutal fruit Redds Sarita Select and Ruby dry		**FABs (RTD)** Hunter's Savanna Klipdrift and Cola Wines Allesverloren Autumn Harvest Alto Graca JC le Roux Tassenberg Chateau Libertas Paarl Perle Sedgewicks Old Brown Durbanville Hills Nederburg Fleur du Cap Zonnebloem	Archers Schnapps Baileys cream liqueur Gilbey's gin Tonqueray gin Cape Velvet cream liqueur Lupin Sambucca Bertrams VO brandy **FABs (RTD)** Archers Aqua Smirnoff Spin Strongbow cider Foundry cider Captain Morgan and Cola J&B and Soda	Strettons gin Cinzano Campari Cointreu Stroh Jack Tarr rum Jose Cuervo liquer Piper-Heidsick champagne **Other independent spirit brands** Pernod Ricard Douglas Green KWV Wineries Douglas Green Bellingham (DGB) Private wine estates

Although Table 11.1 provides a simplistic view of the South African liquor market, in actuality the market is quite complex. To illustrate the point SAB and Distell are shown as separate business entities in the table. What must be understood is that SAB holds a 28.9% share of Distell, making it the second biggest shareholder with only Remgro holding a larger (33.4%) share[9]. SAB are not represented on the board of Distell and there is obviously some competition between these two companies, especially in the cider market where the sale of cider is on the increase. This is obviously taking away market share from beer sales which is hurting SAB who owns the majority market share of clear beer in South Africa. In the same vein United National Breweries are owned and managed by subsidiary companies of SABMiller PLC operating in South Africa, Botswana, Zambia, Malawi and Zimbabwe. All this indicates that the competitive situation in the South African liquor market is more dynamic and interwoven than what is commonly understood.

The multinational companies competing in South Africa are SABMiller (competing as SAB inside South Africa) and Brandhouse, which operates in a joint venture between Diageo and Heineken. Let us first look at the history of the two main protagonists in the South African market.

The history of Heineken NV

In 1864 brewer Gerard Adriaan Heineken acquired a small brewery in the heart of Amsterdam, starting the nearly 150 years of history of Heineken the brewery and the brand name. By 1933, Heineken was sold in America and in 1937 the first Heineken beer was brewed outside the Netherlands. Rapid consolidation within the global brewing industry in the late 1990s and early 2000s allowed other companies such as InBev and SABMiller to seize Heineken's crown as the world's most international brewer. As a semi-private company, it was much slower than its rivals to risk transformational deals, although it continued to add to its impressive network with smaller bolt-ons, especially in Russia and China, expanding markets which counterbalanced declines in Heineken's core territories of Western Europe and North America. Nevertheless, profit margins came under intense pressure, leading to a shake-up of the group's management team and reporting structure in 2005. This led to Heineken taking a far more aggressive stance. In 2007 Heineken launched a joint bid to break up the United Kingdom's Scottish and Newcastle foothold in brewing in partnership with Carlsberg. Completion of this deal the following year established Heineken as the leading brewer in the UK. In 2010 it expanded its footprint in Latin America with the acquisition of Mexico's second largest brewer FEMSA, adding SOL, Tecate and Dos Equis to its portfolio. Two years later it also took full control of Singaporean subsidiary[10] Asia Pacific Breweries. It has the widest geographic footprint of all international brewers with over 140 breweries in more than 70 countries. It also licences the operation to other companies where it does not have its own plant.

The focus of Heineken was, however, always in Europe where they are the largest brewer of beer. Heineken has also **diversified** and is today the world's largest cider producer. Heineken is available in almost every country in the world and is recognised as the world's most valuable international **premium beer brand**. This ties in nicely with the formal **vision** as proclaimed by Heineken, which is 'we aim to be a leading brewer in each of the markets in which we operate and to have the world's most prominent brand portfolio'. The premium beer market accounts for about 20% of the total beer market in South Africa, while the beers produced by Heineken and its joint venture partners account for about 56% of this segment.[11]

Heineken is the principal international brand of the Heineken group but the group brews and sells more than 200 international premium, regional, local and specialty beers and ciders, including some of the more recognisable brands, namely:

Amstel
Primus
Birra Moretti
Star
Strongbow
Tiger
Żywiec
Sagres
Ochota
Cruzcampo
Foster's
Kingfisher
Newcastle Brown Ale

The history of SABMiller plc

South African Breweries (SAB) was established in 1895 as Castle Breweries and has a long and colourful history. It has been the leading beverage company in South Africa for more than 100 years. At first its business operations mainly concentrated on southern Africa. It, for instance, formed the Rhodesian Breweries in 1910 and acquired a share in Schweppes carbonated soft drinks in 1925. In 1953–1955 it opened a new Castle Brewery in Isando near Johannesburg, which was not only the largest brewhouse in Africa, but also the most modern. In 1956 Castle Breweries bought out the Ohlsson's and Chandlers Union Breweries group and just after this SAB acquired control of Stellenbosch Farmer's Winery. In 1964 SAB was granted the licence to brew Guinness (an Irish beer) and in 1965 it reached an agreement with Amstel Brouwerij of Amsterdam to produce Amstel Lager in South Africa. It then also took up a minority investment in South West Breweries and in 1966 started the brewing of Carling Black Label under licence to the Carling Brewing Company of Cleveland, Ohio.

In 1967 SAB, through a subsidiary called Food Corporation, expanded into the food sector by taking control of Hind Brothers and International Foods. It also invested in tea and coffee through J Lyons and Glenton and Mitchell. In 1969 it acquired a 38% share in Retco Limited, which was the largest property-owning and development company in South Africa. In 1970 SAB opened South Africa's first carbonated soft drink canning plant and launched the Groovey range which was a huge success. Three years later SAB established breweries in Botswana and Angola and also took control of Afcol and Shoecorp, the furniture and footware interests of the dismantled Barsab. In 1974 SAB acquired OK Bazaars and Groovey Beverages set up a **joint venture** with Schweppes and then acquired the bottling business of Pepsi-Cola. In the next three years SAB acquired Whitbread and Old Dutch as well as Swaziland Breweries and its Pepsi franchise was replaced with Coca-Cola.

In 1979 the South African liquor industry was restructured. SAB agreed to purchase the beer interests of the Rembrandt Group and it was asked to realign its investment in wines and spirits to 30% of Distillers Corporation, while disposing of its retail liquor outlets. In this year SAB also acquired a 49% interest in Appletiser. In the next

two years SAB acquired a controlling interest in Kgalagadi Breweries in Botswana and secured a controlling interest in Lesotho Brewing Company and Maluti Mountain Brewery. During 1982–1994, at the height of the economic sanctions period, SAB opted for a diversification strategy, acquiring amongst others the Edgars fashion group, the Lion Match Company, the Plate Glass group and also took complete control of Appletiser. It also established a joint venture with Ceres Fruit Juices, acquired Hungary's largest brewery, took joint control of the second largest brewery in mainland China and re-entered beer markets in Zambia, Mozambique and Angola.

In 1997–1998 SAB decided to return to its core beverage business and sold off or closed all non-core operations. SAB listed on the London Stock Exchange in 1999 in order to raise capital to develop and expand its international beer and other beverage operations. SAB purchased the Miller Brewing Company in North America from the Altria Group in 2002, and changed its name to SABMiller plc. With this acquisition it became the second largest brewer by volume in the world. In 2003 SABMiller made its first significant investment in Western Europe through the key Italian market when it acquired a majority interest in Birra Peroni S.p.A. In 2004 SAB Ltd acquired 100% of Amalgamated Beverage Industries (famous for its Coca-Cola and other brand name soft drinks products) that became the soft drink division of SAB Ltd. In 2006 SABMiller continued to grow its international business by making new acquisitions in various developing countries. It also introduced various new beers and FABs. It introduced a new apple ale, Sarita, and expanded its range of Brutal Fruit variants. It launched Peroni Nastro Azzurro, the beer with unmistakable Italian style, Hansa Marzen Gold, Grolsch and Dreher Premium Lager. Other innovations included a new BonAqua water range, a lifestyle range, sparkling water and bottles featuring sports nozzles.[12]

Heineken in Africa

The increasing spending power of the middle classes in Africa has also increased the expansion of the beer market. Heineken opened its first brewery in Africa in Congo as early as 1923. Since 2005 Heineken has invested $2.2 billion in Africa. Their aim is to focus on consumers trading up from home brews, rather than compete with the locally manufactured beers. They are even targeting female African drinkers with a sweeter, low-alcohol beer made from malt and lemon in order to persuade the female market to try its other lagers and thus change their perceptions regarding beers. The new drink, called Radler[13], has a 2 – 3 percent alcohol content. The beer market on the African continent is expected to grow by fifty percent in the next ten years.

Heineken currently operates in 20 African countries. The markets in countries such as Nigeria, Kenya, South Africa and Ethiopia have been key drivers of Heineken's growth in Africa. It bought two breweries in Ethiopia in 2011 and is busy with the construction of a third brewery in Kilinto, on the outskirts of Addis Ababa, which will have an annual capacity of 1.5 million hectolitres. Heineken also aims to strengthen

its domestic supply chain by obtaining 60% if its product-related supplies locally in Africa by 2020, an increase of 10% from the 50% being used currently.[14]

The Heineken and Amstel brands were originally marketed in the South African market under a licensing agreement with SAB. In a **long-term strategy** to get out of the licensing agreement with SAB, Heineken first took back the rights of the Heineken brand (in 2003). In 2004 it discontinued the licensing agreement of Amstel, which at the time had a 9% share of the beer turnover in South Africa. For the next few years Heineken was prepared to import Heineken and Amstel beer from its European breweries, obviously at an additional cost due to logistics. This situation continued until the Sedibeng brewery of the Brandhouse group opened in 2010. In the meantime SAB also stepped up the competition in the premium beer market. In 2004, just a few days after the Amstel license lapsed and was taken back by Heineken, SAB announced plans to launch a new premium beer, Hansa Marzen Gold, in South Africa. This was later followed up with other new premium brands that were entered into the market such as Miller Genuine Draft, Grolsh and Peroni.

The vehicle that Heineken used to compete in the South African market was called Brandhouse Beverages Pty Ltd. This company was created in 2004 and was a **joint venture** between three companies, namely Namibia Breweries Limited (a manufacturing company based in Namibia and part of the Olthaver and List Group of Namibia), Heineken International (third largest brewer in the world) and Diageo (the world's largest premium alcohol beverage company). The joint venture came about when it was recognised that the South African market was growing and that there was an emerging new middle class consumer that was ready to upgrade to the premium beer market. Later, after it also reclaimed Amstel from SABMiller, it began importing the Amstel brand from its European breweries as it did not have a domestic brewery to manufacture the beer.

Heineken, who is the second largest brewer in Africa and the Middle East, in a joint venture with Diageo (owned 75% by Heineken and 25% by Diageo) opened its own brewery at Sedibeng in South Africa in March 2010.

Reasons why Heineken withdrew from its association with SABMiller

In March 2007 the 40-year agreement between SABMiller plc and Heineken N.V., which allowed SAB Ltd to brew and distribute Amstel Lager in South Africa, was terminated, starting a war between the two beer giants (who rank numbers 2 and 3 respectively in the global beer sales market). There are several reasons why Heineken wanted to terminate the licensing agreement with SABMiller. Some of these are as follows:[15]

1 The following picture regarding **strengths** and **weaknesses** emerged for Heineken when they started to investigate the **opportunities** and **threats** in the South African beer market.

Strengths	Weaknesses
South Africa is a growing beer market with a stable economy and is one of the fastest growing beer markets in the world. Currently per capita consumption of beer in South Africa is 60 litres (the highest in Africa), which compares favourably with other markets in the world. There has been a change in **consumer tastes** regarding the consumption of beer. With the growth in the middle class there has been a swing away from sorghum-based beer to clear beer as produced by the multinational beer manufacturers.	South Africa has an inconsistent infrastructure, which is outdated in some instances and unreliable to some extent. The electricity shortages experienced and the current struggle to balance demand and supply of electricity is but one example of this problem. There is a big divide between the rural areas and the urban areas regarding the supply and upkeep of infrastructure (e.g. roads), which makes the optimal usage of the domestic supply chain problematic.
The favourable climate in South Africa enhances the production of most of the ingredients of beer locally. This cuts the cost of importing ingredients from overseas and can be used to develop a reliable supply chain for beer production locally. The tradition of beer drinking which is entrenched in the culture of the South African consumer.	The presence of SABMiller as number two global beer manufacturer. The entrenched position of SAB as domestic arm of SABMiller in South Africa creates a formidable barrier of entry for any multinational beer brewer aspiring to enter the South African market. Just looking at the domestic market share of SABMiller (see Table 11.1 and the cross-shareholding of SAB in some of its main competitors) explains this point.
Opportunities	**Threats**
South Africa has a favourable long-term potential for increased beer consumption, seen in the increase in per capita beer consumption, and the increasing preference for clear beer. Multinationals interested in entering this market should initially consider an import strategy because of infrastructure and capacity problems. There is also an opportunity for the long-term investment in beer brewing facilities and vertical integration into the farming activities of beer ingredients (e.g. hops and barley) so that a stable supply chain for beer ingredients can be established.	The health issues in South Africa pose one of the biggest threats to any future investment by any multinational corporation. Aids is shortening the productive lifespan of workers which results in more medical expenses per capita and less money to invest in growing the country and its citizens. The high infant mortality rate also contributes to this problem. Any multinational who wants to enter the South African market will need to be involved in developing **social responsibility** programmes to help the disadvantaged part of the South African population. Obviously this would mean additional costs for such a company.

Socio-economic problems in South Africa are also another big threat with the Gini coefficient being the biggest in the world. The gap between the rich and the poor in this country is widening, creating more and more opportunities for civil unrest, which unfortunately flares up from time-to-time. The persistent high levels of unemployment and the resultant negative influence on disposable income is also a factor to be considered.

2 With the strong growth in the South African economy for more than a decade until 2008 there was a shift in the consumption patterns of South African beer drinkers. Although the absolute volume of beer sales produced a slow increase there was a dramatic increase in the sales of premium beer in South Africa. With the growth in the middle class came a swing to premium branded beers such as Heineken, Amstel and Windhoek lager, all brands not part of the SABMiller product range. This was a wake-up call for both Heineken and SABMiller. Heineken blinked first and in 2003 started to move from being a passive player in the southern Africa market to being an aggressive new entrant when they, together with Diageo, bought Interbrew's share in Namibia Breweries, the producer of Windhoek Lager and Windhoek Lite (both brands were already imported and freely distributed in South Africa). With Heineken brewing beer in neighbouring Namibia, SAB's long-term association with Heineken turned unworkable.

3 With this development in SAB's backyard SAB had no choice but to react aggressively to protect its home turf. This led to the decision to acquire an international beer brand of stature and bring it into South Africa. Hence SAB bought Miller Brewing in the United States and launched the premium beer Miller Genuine Draft (MGD) in South Africa. SABMiller followed this up with the acquisition of another premium international beer, Grolsch, which is closely positioned to Heineken beer in Europe. With a brand name that almost sounds German (which has positive connections for any beer fundi) and an iconic swing-top bottle (unique packaging), this was a winner for SABMiller. The bottom line is that when Heineken started making their first aggressive move, SABMiller reacted quickly to counter Heineken's famous premium beer brands invasion of South Africa by bringing in its own range of international beer brands to fight off the threat.

4 Heineken decided to bring the close working relationship and long-term licensing agreement with SAB to an end when they took SABMiller to the International Court of Arbitration and won the case based on a similar legal precedent when SABMiller bought Colombian brewer Bavaria in 2005. Some of the informed beer

watchers thought that this court case was just a pretext to get out of a stifling agreement with SABMiller in South Africa and in March 2007, SAB were forced to stop the production of Amstel, following Heineken's cancelling of SAB's licence to manufacture the beer locally. Norman Adami of SABMiller stated in 2013 that with the loss of the Amstell brand SAB lost an immediate 9% market share. As part of its strategy to recoup the lost market share it used Castle Lite as its brand product to fight back and using its proven marketing ability won back this market share. Adami stated: 'Castle Lite is now as big as or bigger than all Brandhouse beer brands combined'[16].

5 South Africa is SABMiller's single most profitable market of all its worldwide operations. About one third of revenue and EBIT (earnings before interest and tax) is generated in Africa, primarily from South Africa[17]. To put this in perspective, one dollar out of every three that SABMiller earned was generated in South Africa and Africa. This has been seen by a number of financial analysts as part of the **competitive advantage** of SABMiller. Some of the large multinational breweries started to investigate the opportunity to take on SABMiller in its own backyard as a countermove for SABMiller's own aggressive expansion plans in the world, hence the introduction of Heineken and Diageo and Namibian breweries through the use of the Brandhouse vehicle in South Africa.

There is speculation in the market that Anheuser-Busch (InBev), the Belgium beer company that bought Anheuser-Busch in 2008 to become the largest brewer in the world, could be interested to acquire SABMiller. Some of the advantages of such a move would be the attractive markets in Africa that SABMiller has a **monopoly** on. Other advantages could include economies of scale and more efficient supply chains. The combined output in sales would be 732 million hectolitres, which will nearly be three times more than that of Heineken its nearest rival (200 million hectolitres). The combined global market share of such an amalgamation would be 34% (InBev 20% and SABMiller 12%). One of the biggest threats would be that worldwide countries could object because of the dominance of this entity impacting negatively on prices and competitive behaviour. Only time will tell if this speculation holds any truth but this is obviously a major potential threat for Heineken globally and the Brandhouse group in the domestic market.[18]

Competitive warfare in the South African beer market

In the realm of competitive warfare SAB followed a **related and unrelated diversification** strategy as well as upstream supply chain integration. It has all the makings of a **vertically integrated** group with malt and hops, two of the prime ingredients of beer, forming part of the subsidiaries of the group. SAB's international mother company SABMiller benefited from a first-mover advantage in many countries of Africa, where it currently has monopolistic control over the beer and soft

drinks bottling markets in countries such as Botswana, Mozambique, Swaziland, Zambia, and to a certain extent the South African market. It also still has a related diversified group structure in South Africa with interests in the soft drink market (ABI, Coca-Cola Canners, and the international brand Appletiser); it furthermore has an interest in the liquor and spirits market through Distillers and Stellenbosch Farmers Wineries. It had sold off its unrelated diversified interests in different South African industries that it owned previously when it was a domestic beer manufacturer only (e.g. OK Bazaars, Edgars and the hotel and timeshare industry business (Tsogo Sun)). In the beer market, which is the core business for the SAB group, it has shares in beer companies throughout the world. It also has a substantial interest in the traditional beer market in South Africa.

SABMiller owns four global beer brands, namely Grolsch, Miller Genuine Draft, Peroni and Pilsner Urquell, as well as numerous other beers and beverages such as Aguila, Castle, Miller Lite, Snow (which is the top seller in China), Tyskie, Castle Milk Stout, Hansa, Carling Black Label, Dreher Premium Lager, Peroni Nastro Azzuro, Redd's, Brutal fruit, Sarita and Fosters of Australia[19]. It has expanded its brands from 21 countries to 60 and increased its number of brands from 80 to over 200.[20]

SAB has seven breweries in South Africa and an annual capacity of 3.1 billion litres[21].

SAB's soft drinks division, Amalgamated Beverage Industries (ABI), is one of the largest producers and distributers of Coca-Cola brands in the southern hemisphere, such as Coca-Cola, Coca-Cola Light, Coke Zero, Beat, TAB, Fanta, Fanta Spree, Sprite, Sprite Zero, Lemon Twist, Twist Granadilla, Sparletta Cream Soda, Sparberry, Iron Brew, Appletiser, Grapetiser, Stoney Ginger Beer, Schweppes, Just Juice, Valpré, Powerplay, Minute Maid, BonAqua, Nestea, Powerplay, Powerade and 5 Alive. ABI has five manufacturing plants and manufactures and distributes 32 brands and 20 pack sizes of carbonated soft drinks, energy drinks, bottled water and fruit juices. It has a customer base (resellers) of more than 40 000 that includes tuck shops, spazas, supermarket groups, restaurants and wholesalers. It accounts for approximately 60% of Coca-Cola sales in South Africa.[22]

Brandhouse owns beer brands such as Amstel, Kilkenny, Guinness, Heineken, Tafel Lager and Windhoek. It sells spirits such as Johnnie Walker, Cape Velvet, Smirnoff, Archers, Bayleys, Captain Morgan, Gilbeys, Spiced Gold and various FABs.[23]

Brandhouse opened a R3.5 billion state-of-the-art brewery in Sedipeng, south of Johannesburg to help exploit the growth opportunities in South Africa's premium alcohol beverage market. The brewery brews and bottles a range of premium beers including Amstel, Heineken and Windhoek Lager for the South African market as well as FABs such as Smirnoff Spin and Smirnoff Storm. The brewery is built on an 83-hectare site and includes a brewery, production plant and warehouse. The brewery was later expanded to increase its capacity from 3-million hectolitres to 4-million hectolitres.[24]

One of the advantages of owning their own brewery and bottling plant in South Africa is that Heineken NV could **repackage** its Amstel brand for South Africa. The

brand is available to customers in a 660 ml returnable bottle in order to compete directly with SABMiller's Castle Lite brand. Since SABMiller's licence to brew Amstel was withdrawn in 2007, Amstel was imported and it was impossible to sell it in returnable bottles. The larger bottles are popular in South Africa's townships because they are cheaper per volume for the thirsty drinker. They allow consumers to receive a deposit after use and are therefore more attractive to buy, since consumers pay for the beer and not the container. The use of returnable bottles also makes it more difficult for other beer rivals to enter the market because they require efficient logistical systems to compete.[25]

The war between the beer giants has also extended to their **advertising** campaigns that relate to the larger returnable bottles. Both Brandhouse and SAB submitted applications to the ASA, protesting marketing campaigns aimed at retailers, bars and shebeens. Brandhouse complained about SAB's 'Bigger is Better' campaign for Black Label, which made their smaller beer bottles sound inferior, while SAB complained about Brandhouse's campaign to market the advantages of its new returnable Amstel bottle.[26]

Two weeks before the start of the 2010 FIFA World Cup™, Heineken NV and SABMiller Plc also clashed over the **price** of Amstel beer in South Africa. The Amstel 'Ask Why' advertising campaign was launched to explain a recommended charge of R10 for a 660 ml Amstel beer, compared with about R7 for 330 ml in non-refundable bottles. Amstel responded to a drive by SABMiller that said tavern owners would make lower profits by charging the recommended price. Brandhouse complained to the ASA and accused SABMiller of disparaging Amstel's brand and infringing on its trademark.[27]

SAB also decided to withdraw its 'Grootman of Laaitie? Vra vir die volle 750 ml' advertisement after an outcry by consumers regarding its message. Consumers complained that the advertisement links excessive drinking with masculinity. They felt that the campaign implied that moderate drinkers are weak (like laaities/children) and that 'real' men drink large quantities of alcohol.[28]

SABMiller has recently introduced a branded programme and new targets for 2020 in order to increase its sustainability efforts. The new scheme, branded Prosper, includes plans to launch new marketing campaigns to encourage 'moderate and responsible' alcohol consumption. This will include more global and local communications with the aim of positioning beer as the 'natural choice' for responsible drinkers.[29]

The programme also includes commitments to support half a million small businesses, improve water efficiency and food security and reduce SABMiller's carbon footprint. It will work with partners, including suppliers, customers, consumers and communities, to address the five sustainability goals indicated below.

SABMiller's five sustainability goals[30]

Accelerate growth and social development – by focusing on promoting entrepreneurship, particularly among women and disadvantaged groups.

Make beer a natural choice for moderate and responsible drinkers – by promoting robust standards and guidelines, launching new communications campaigns and supporting programmes to reduce the harmful use of alcohol.

Secure shared water resources for SABMiller's businesses, local communities and ecosystems – by building an understanding of water risks and creating community partnerships to manage them.

Create value by reducing waste and carbon footprint – by driving down emissions from brewing, promoting sustainable packaging and prioritising low energy fridges.

Support responsible, sustainable use of land – by creating secure, sustainable supply chains and helping farmers to increase profitability, productivity and social development.

Heineken also has a similar strategy called Brewing a Better Future and focuses on four areas, namely water, CO_2, sourcing and responsible consumption. These four focus areas are indicated below.

Heineken's four focus areas for Brewing a Better Future[31]

Water. Water scarcity is a pressing global issue and is vital to every single person on the planet. They are doing everything possible to protect water and use it as efficiently as possible. They are committed to reducing the amount of water used in their breweries, minimising usage in the growing of crops and redressing the balance of water we use.

CO_2. It's in everyone's interests to reduce CO_2 emissions, and they are working to reduce theirs across their value chain. Targets have been set to reduce the amount of energy used in brewing, cooling, and distribution and they are using renewable energy sources like solar and wind power. They are also working with suppliers to reduce emissions in the design and production of packaging and with markets to focus on recycling and reusing it after use.

Sourcing. Responsible agriculture and sourcing have never been more important. Heineken wants to guarantee both their supply of raw materials and the supply of local communities. Since beer is brewed from 100% natural ingredients, farmers, co-operatives and the industry all work together to grow, buy and sell these materials in a fair and manageable way.

Responsible Consumption. They believe that it is their responsibility to encourage people to drink responsibly and thus advocate responsible consumption through inspiring global communication campaigns. They build partnerships in each of their markets to address alcohol abuse and also review their portfolio regularly, considering the impact of their products and, if necessary, removing products from the market.

Heineken and SABMiller have recently joined forces with three other beer giants, namely AB InBev, Molson Coors and Carlsberg, to promote beer's versatility. This is obviously an attempt by the major beer producers in the world to grow generic beer consumption (primary demand) in the face of a range of new competitive products such as bottled water and flavoured alcoholic beverages. The campaign is the first fully integrated effort from the beer industry and centres on telling consumers 'There's More to Beer'. According to Jonny Forsyth, global drinks analyst at Mintel, 'it's not just price and branding that are winning over customers in stores. There's a growing demand of people wanting to understand the provenance of beers as well as experience something premium. This depth of category is what will pull women to beer in a way that the previous campaign was unable to.'[32]

According to SABMiller it has not done enough to appeal to women through previous advertising campaigns. It is thus developing lighter beers and non-alcoholic fruit flavoured variants to exploit the shift in drinking habits and appeal to more health conscious drinkers. All these activities are aimed to develop niche markets within the larger beer market. On-pack innovations and increased promotional support for its cheaper brands are also being designed.[33]

A draft bill seeking to ban – or at least strictly regulate – alcohol advertising in South Africa could have a negative effect on beer advertising and the consumption of

beer in general. The bill proposes the banning of alcohol advertising including on-premise signage and branded vehicles. Health minister Aaron Motsoaledi has identified alcohol as a serious social problem and a burden on public health. This department follows guidelines laid out by the World Health Organisation (WHO) and aims to cut per capita alcohol consumption by 20% by 2020.[34]

Conclusion

This study and its implications provide a bit of irony for the ordinary South African beer drinker who always longed for a competitive situation where beer drinkers would reap the benefits of a price war. What happened in reality was that the South African beer market moved from a monopoly situation to an **oligopoly** situation with no remarkable effect on the price that consumers pay for beer, which is contrary to the expectations of the ordinary beer drinker in South Africa.

What is, however, also true is that the days of SAB having a peaceful home market with miniscule competition seem to be gone forever. Only time will tell who will be the winner in this life-and-death competitive situation. Other players previously tried to take on SAB but failed miserably as the late Louis Luyt can attest.

Self-assessment questions

Easy questions

1. Who are the biggest competitors in the South African liquor market?
   a. SAB, United National Breweries, Douglas Green, Tiger brands
   b. Distell, Brandhouse, Douglas Green, KWV
   c. SAB, United National Breweries, Distell, Brandhouse and Edward Snell
   d. Brandhouse, SAB, KWV, Distell

2. Which multinational companies compete in the South African liquor market?
   a. SABMiller and KWV
   b. Heineken and Bertrams
   c. Bavaria Brau and Heineken
   d. SABMiller and Brandhouse

3. SAB was established in 1895 as _____.
   a. Chandlers Union Breweries
   b. Stellenbosch Farmer's Winery
   c. Carling Brewing Company
   d. Castle Breweries

4. Heineken uses a company called _____ to compete in the liquor market in South Africa.
   a. Heineken International
   b. Sedibeng
   c. Brandhouse
   d. Diageo

5. Heineken is the world's largest _____ producer.
   a. Cider
   b. Wine
   c. Sorghum
   d. Cocktail

Challenging questions

1. Which of the following are reasons why Heineken terminated its 40-year agreement with SABMiller and wanted to move into the SA market on its own?
   a. There was a change in consumer tastes regarding the consumption of beer.
   b. South Africa is one of the fastest growing beer markets in the world.
   c. South Africa's favourable climate enhances the production of many of the ingredients of beer.
   d. South Africa has a favourable short-term potential for additional beer consumption.

   i. a b d
   ii. a c
   iii. a b c
   iv. a b c d

2. Malt and hops, which are two of the prime ingredients of beer, form part of the subsidiaries of SAB. In the supply chain, this refers to _____.
   a. Horizontal integration
   b. Vertical integration
   c. Packaging
   d. Competitive warfare

3. SAB's one-time interests in Edgars and Tsogo Sun refer to their _____ strategy.
   a. Related diversification
   b. Unrelated diversification
   c. Upstream supply chain integration
   d. Downstream supply chain integration

4. What has been a contributing factor to the expansion of the beer market in Africa?
   a. The increasing use of bottled water
   b. The increasing awareness of energy drinks
   c. The increasing awareness of cocktail drinks
   d. The increasing spending power of the emerging middle classes

5. SAB started out in a _____ situation, but now finds itself in a _____ situation.
   a. Oligopoly; monopsony
   b. Monopoly; oligopoly
   c. Monopoly; perfect competition
   d. Perfect competition; oligopoly

Essay questions

1. Discuss the competitive structure of the liquor industry in South Africa.

   Key points to discuss:
   Four broad segments: malt beer; commercially manufactured sorghum beer, spirits and FAB's; five main operators: SAB, United National Breweries, Distell, Brandhouse and Edward Snell; smaller manufacturers; multinationals: SABMiller and Heineken through its Brandhouse company locally.

2. Explain the SWOT analysis that influenced Heineken's decision to withdraw from its association with SABMiller.

   Key points to discuss:
   SWOT analysis – strengths, weaknesses, opportunities and threats that influenced Heineken's decision.

3. Discuss SAB's related and unrelated diversification strategy.

   Key points to discuss:
   Related diversification: has interests in soft drinks market as well as the liquor and spirits market.
   Unrelated diversification: interests in the retail industry and the hospitality industry.

4. Why would SABMiller, Heineken and other beer giants join forces to promote the general interests of beer?

   Key points to discuss:
   Because of changes in global consumption patterns and changes in consumer's

tastes. Beer manufacturers must protect and grow the global consumption of beer in a changing marketplace. There are newer products such as bottled water and FAB's that are competing for the same market that these beer giants are in. There are new trends such as a keen sense of taking more care of your health and the worldwide campaign against alcoholism that these beer giants recognised and this is the reason why they are seen to be more socially responsible.

5. Discuss the war between SAB and Brandhouse with regard to their advertising strategies.

   Key points to discuss:
   Brandhouse protested to ASA about SAB's 'Bigger is better' campaign for Black Label. Brandhouse also accused SABMiller of disparaging its Amstel brand and infringing on its trademark. SABMiller said that tavern owners would make lower profits by charging the recommended price.
   SAB complained to ASA about Brandhouse's campaign about their new returnable Amstel bottles. Also complained about the 'Ask why' campaign.

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12

Financial management: IBM

KEY TERMS

ASSET

ACID TEST RATIO

BUDGET

CASH FLOW STATEMENT

COSTS

CURRENT RATIO

FINANCIAL MANAGEMENT

FINANCING STRUCTURE

FUTURE VALUE

GROSS PROFIT MARGIN

INCOME

INTERNAL RATE OF RETURN

LIQUIDITY RATIO

NET PRESENT VALUE

NET PROFIT

PRESENT VALUE

PROFIT

RETURN ON OWNERS' EQUITY

RETURN ON SHAREHOLDERS' INTEREST

RETURN ON TOTAL CAPITAL

RISK-RETURN PRINCIPLE

STATEMENT OF FINANCIAL POSITION

STATEMENT OF INCOME AND EXPENSES

TIME VALUE OF MONEY

Introduction

The Computing-Tabulating-Recording Company (CTR) was created on June 16, 1911, by the merger of three 19th-century companies (the Tabulating Machine Company,

the International Time Recording Company and the Computing Scale Company of America). CTR was the precursor to IBM. In 1914, Thomas J. Watson Sr. joined CTR and played a major role in transforming the company over the following two decades into a growing leader in innovation and technology and a prototype for the newly emergent multinational corporation. In 1924 the company's name changed to International Business Machines Corporation (IBM).[1]

During the early 1980s, IBM positioned itself as the IT industry's – and the business world's – most profitable, admired and iconic corporation. From the magnetic-strip technology used on credit cards, to floppy disks, to the Consumer Transaction Facility (an early form of today's ATM), IBM's ingenuity was felt everywhere. In 1988, IBM was one of the world's most profitable and best-managed companies. They had become the largest computer maker in the world. IBM's revenues were growing steadily and they employed 350 000 people worldwide. In 1991, revenues approached $67 billion. In 1989, IBM was ranked first among all US firms in market value, fourth in total sales and fourth in net profits.[2] Four years later, in 1993, it was one of the biggest loss-makers in corporate history. On January 19, 1993, IBM reported a record $5.46 billion loss for the fourth quarter of 1992, and a deficit for the entire year of $4.97 billion, the biggest annual loss in American corporate history. The human cost, as far as employment was concerned, was also consequential – 42 900 people had been laid off in 1992, and an additional 25 000 were planned to be laid off in 1993. IBM's share price, which was above $100 in 1992, closed at an 11-year low of $48 375.[3]

What went wrong?

When John Akers took over as chairman of IBM in 1985, it looked as if he had won the best job in the American business world. However, IBM's fortunes took a turn for the worse and suddenly Mr Akers' job was no longer so desirable! But what went wrong? And do Mr Akers and his top managers really deserve all the blame? With hindsight, the answers seem clear. Since the mid-1980s the economics of the computer industry have been transformed by the soaring power, declining prices and raging popularity of personal computers (PCs). In the early 1980s, IBM unwittingly helped to create this state of affairs, and then failed miserably to adjust to it.[4]

IBM: The market leader in large mainframe computers

IBM's prosperity had been built on its almost complete control over the market for large, mainframe computers. This was established in the late 1960s with an immense investment in a family of machines called the System 360. IBM, like most of its smaller rivals, built its machines to proprietary standards, so that they were incompatible with those of other makers.

Once committed, corporate customers had little reason – there was very little price competition – to scrap the millions invested in IBM hardware and customised software and to switch to an unfamiliar supplier. Most big customers were committed to IBM, so IBM earned massive profits. For nearly two decades it dominated a computer industry that was lucrative, remarkably stable and growing quickly.

The arrival of the PC

Then disaster struck. The PC took the world by storm, leaving IBM out in the cold with its large mainframe computers. Most PCs are built with the same microprocessor chips, run the same off-the-shelf software, and are compatible with machines made by rivals. This standardisation of PCs opened up the industry to thousands of new entrants, including suppliers of components, fully assembled computers, equipment such as printers, and packaged software. The result has been massive competition at every level. Prices fell, demand soared and technology advanced at a breathless pace. Tens of millions of people who a decade ago would never even have seen a computer, now had one on their desks or in their briefcases. In the late 1980s, new chips made PCs so capable, that they could be linked together in networks as a cheap alternative to minicomputers and mainframes.

When economies in America and Europe slowed in 1991, IBM, along with most other manufacturers of big machines such as DEC, Bull and Siemens, were battered. IBM was struggling to find its feet in an industry characterised by ruthless price competition, many specialised competitors and a huge variety of customers. Even companies that continued to purchase mainframes demanded that they operate to open standards and that they cost less.

IBM enables rivals to produce imitations of the IBM PC

When IBM decided to enter the PC market, it plunged into the market in a way that was later described as a historic blunder. At the time IBM was the world leader both in microprocessor chips and software. Yet, when they put their PC on the market in 1981, IBM decided to buy the key components of their machine from outside companies. They bought the chip from Intel and the operating-system software, which makes the chip work, from a then small, unknown company called Microsoft. Both Intel and Microsoft were free to supply their product to other manufacturers as well IBM made a decision that had monumental long-term consequences. Instead of keeping such developments within its own organisation (an organisation that spent heavily on research and development), IBM gave these small firms a golden opportunity, which both grasped to the fullest. By 1992, Intel and Microsoft had emerged as the computer industry's dominant firms. What happened then? First dozens, then hundreds, of other firms also jumped into the market with imitations of IBM's PC, selling at far lower prices!

For the period 1983 to 1989, IBM's profit as a percentage of revenue decreased from

13.6% to 6%. In 1991 and 1992, the company made a loss. Microsoft and Intel, on the other hand, showed significant increases in their profit as a percentage of revenue. For Microsoft, this figure increased from 12% in 1983 to 25.7% in 1992. In the case of Intel, this figure increased from 10.3 in 1983 to 15.9 in 1992.

Thousands of big companies, using mainframe computers, had been wary of the small new machines, but IBM's entry into the PC market gave them the confidence to buy the small machines, thanks to the company's strong reputation. The market exploded, and IBM became the world's biggest PC maker. However, it had lost control in a highly competitive market. PC sales would eventually have grown anyway, as microprocessor chips became cheaper and more powerful, but if IBM had not set an easily imitated technical standard, PC sales never would have grown so fast, nor attracted so many competitors.

IBM lags behind its smaller, faster-moving rivals in developing new products

Neither IBM's colossal spending on research and development, nor its gigantic marketing staff and sales force alerted it to the technological and commercial trends reshaping the industry. IBM continually lagged behind its smaller, faster-moving rivals in introducing new types of machines such as workstations and laptop computers. It entirely missed out on the growing market for PC software and realised far too late the threat that PCs and workstations posed to its mainframe business. As IBM began losing ground in one market after the other, Intel and Microsoft were gaining dominance.

In the early 1990s, when other computer companies were reporting hefty profit increases and rolling out innovative products, IBM announced traumatic cutbacks. In the period from 1985 to 1992, they experienced five major restructuring processes. They shed unprofitable and ill-fitting **assets** and slashed their workforce. IBM also reorganised its operations into 13 semi-autonomous units. In 1992, IBM made a net loss of about $4.8 billion for the year, the second largest in American corporate history.

The market value of a company reflects the stature of the company in the eyes of investors. IBM has lost badly in the period from 1989 to 1992. In 1989, IBM's market value was US$60 345 million, while this figure decreased to US$30 715 million in 1992. Both Microsoft and Intel showed significant increases in market value. For Microsoft, this figure increased from US$6 018 in 1989 to US$23 605 million in 1992. For Intel, this figure increased from US$7 842 in 1989 to US$24 735 million in 1992.

During this time, IBM also fell behind in computer chip technology and engaged in a self-destructive battle with software powerhouse Microsoft over the direction of desktop-computer programs. Even worse, they began losing money and some market share in two of their vital markets: mainframes and PCs. IBM remained the world leader in the market for mainframes, but the large systems were fading fast in importance. PCs had been the rising star of the company, despite the fact that mainframes still accounted for about $20 billion in revenues. In 1990, market share

again dropped drastically as new competitors offered PCs at much lower prices than IBM. Experts claimed that these clones were at least equal to IBM's PCs in quality.[5]

The new IBM

In 1993, Louis V Gerstner Jr. signed on for a job nobody else would take, namely chief executive officer of IBM. Since then, he has done things nobody thought could be done. Sceptics said he had no vision of how to turn around a technology company. Then they watched him add $20 billion in annual revenue to IBM, restore profits to record levels and lift the stock price by more than 900%.[6] This sensational turnaround is illustrated in IBM's revenue (that increased from US$62 716 million in 1993 to US$71 940 million in 1995); net earnings (that increased from a loss of US$8 101 000 in 1993 to a profit of US$4 178 000 in 1995); and net earnings/loss per share of common stock (that increased from a loss of US$14.22 per share in 1993 to earnings of US$7.23 per share in 1995). The company also succeded in decreasing its total debt from US$27 342 000 in 1993 to US$21 629 000 in 1995. The number of employees were reduced from 256 207 in 1993 to 225 347 in 1995.

In virtually all measures of performance, IBM made a significant turnaround from 1993 to 1995.

One thing, however, has eluded Gerstner's rebuilt IBM – robust growth. Despite a better **statement of financial position** and a renaissance in the laboratories, IBM fell further behind every year. In Unix servers, the backbone of the internet, IBM's sales rose 3% in 1998, but sales of their competitors soared, for example Sun Microsystems grew by 29%. In PCs, IBM slid 2.4% while the sales of their competitors soared, 53% at Dell Computer and 20% at Hewlett-Packard. IBM's software sales rose by 6.3% in 1998, while Microsoft's grew by 23%.

Gerstner clearly needed a new source of wealth, and has embarked on a strategy that was unthinkable in the IBM of old: arming the enemy. He kick-started this by selling some of the world's best technology – tiny disk drives, speedy new chips, and many more – to his fiercest rivals. Four deals could bring in almost $30 billion in sales over seven years. By selling their products and services to competitors, a gigantic amount of new business was created.

The idea of cooperating with your competitors is called 'coopetition' by strategists. Gerstner took the concept to extraordinary and perhaps dangerous lengths, wilfully empowering the big competitors that most threaten IBM's basic business. The company also fundamentally reshaped its culture to refocus on clients and to be more agile, responsive and collaborative. This transformation coincided with the advent of the internet, and IBM was a pioneer in helping clients capitalise on the new possibilities of global networked computing and business – what it dubs 'e-business'. As the 20th century came to a close, IBM stood, once again, at the forefront of global technology and business.[7]

Gerstner's new corporate strategy was an enormous success. By the spring of 1997,

revenues were over $78 billion and net **income** over $6 billion. Louis Gerstner, age 60, stepped down from chairmanship of IBM at the end of 2002, followed by Samuel J. Palmisano.

By 2005, IBM's revenues were $91 billion, and services and consulting revenues were larger than those from manufacturing. The company had been steadily increasing its workforce in developing countries. In May 2005, IBM sold their PC business to a Chinese computer maker Lenovo, though it would still have a 19 per cent stake in Lenovo.

The recession of 2008 to 2010 brought major problems for IBM's high-tech rivals. Microsoft reported its first full-year sales decline. Intel also had their first quarterly loss since the 1980s. Even as revenue fell, IBM's profit increased by 7 per cent to $4 billion. This increase sparked a rally in IBM shares, whose 40 per cent gain for 2009 far outperformed broader stock indexes, giving a market valuation of $155 million. In a period of economic turmoil, IBM climbed to 6th among all US companies from 19th position in 2007.

What was IBM's secret?

The first reason for IBM's success is the fact that they downplayed hardware. Second, they expanded software. Lastly they focused on their giant services business, advising companies and governments on their fundamental operations. This emphasis on service is the result of a key decision taken by Mr Palmisano shortly after he became CEO to spend $3.5 million in buying PricewaterhouseCoopers-Consulting, thus adding strategic consulting to its computer installation and software writing that IBM's services unit already handled.[8]

IBM's **statement of income and expenses** for the years 2008, 2009 and 2010 are given in Table 12.1.

TABLE 12.1 Statement of income and expenses for the year ended 2008, 2009 and 2010

Statement of income and expenses			
	(US$ '000)		
Period Ending	**Dec 31, 2010**	**Dec 31, 2009**	**Dec 31, 2008**
Total Revenue	**99,870,000**	95,758,000	103,630,000
Cost of Revenue	53,857,000	51,973,000	57,969,000
Gross Profit	**46,014,000**	**43,785,000**	**45,661,000**
Operating Expenses			
Research Development	6,026,000	5,820,000	6,337,000
Selling General and Administrative	20,683,000	19,775,000	23,386,000
Non Recurring	-	-	(1,153,000)
Others	-	-	-
Total Operating Expenses	-	-	-
Operating Income or Loss	19,305,000	18,190,000	17,091,000
Income from Continuing Operations			
Total Other Income/Expenses Net	787,000	351,000	297,000
Earnings Before Interest And Taxes	20,091,000	18,540,000	17,388,000
Interest Expense	368,000	402,000	673,000
Income Before Tax	19,723,000	18,138,000	16,715,000
Income Tax Expense	4,890,000	4,713,000	4,381,000
Minority Interest	–	–	–
Net Income From Continuing Ops	**14,833,000**	**13,425,000**	**12,334,000**
Non-recurring Events			
Discontinued Operations	–	–	–
Extraordinary Items	–	–	–
Effect Of Accounting Changes	–	–	–
Other Items	–	–	–
Net Income	14,833,000	13,425,000	12,334,000
Preferred Stock And Other Adjustments	–	–	–
Net Income Applicable To Common Shares	14,833,000	13,425,000	12,334,000

Source: Statement of income and expenses. [Online]. Available: http://finance.yahoo.com/q/is?s=IBM+Income+statement&annual. [12 April 2011].

IBM's statement of income and expenses for the periods 2008, 2009 and 2010, shows a steady growth in their net income during a time that global economies suffered from a recession. We can calculate various financial ratios, based on the information given in the company's statement of income and expenses. For example, the net profit and gross profit margins.

For the year 2010, it is calculated as follows:

Net profit margin = (net income/sales) x 100
= (US$14 833 000/US$99 870 000) x 100
= 14.85%

For the year 2009, the net profit margin is 14.02% and for the year 2008, it is 11.9%.

For the year 2010, the gross profit margin is calculated as follows:

Gross profit margin = gross profit/sales) x 100
= (US$46 014 000/US$99 870 000) x 100
= 46.07%

For the years 2009 and 2008, the gross profit margins are 45.72% and 44.06% respectively.

Both the net profit and gross profit margins indicated stronger financial positions for IBM from 2008 until 2010.

The company's statement of financial position for the same period is given in Table 12.2.

TABLE 12.2 Statement of financial position on Dec 31, 2008, 2009 and 2010

STATEMENT OF FINANCIAL POSITION			
	(US$ '000)		
Period Ending	**Dec 31, 2010**	**Dec 31, 2009**	**Dec 31, 2008**
Assets			
Current Assets			
Cash And Cash Equivalents	10,661,000	12,183,000	12,741,000
Short-Term Investments	990,000	1,791,000	166,000
Net Receivables	29,789,000	28,523,000	29,097,000
Inventory	2,450,000	2,494,000	2,701,000
Other Current Assets	4,226,000	3,946,000	4,299,000
Total Current Assets	**48,116,000**	**48,935,000**	**49,004,000**
Long-Term Investments	16,326,000	16,023,000	12,757,000
Property Plant and Equipment	14,096,000	14,165,000	14,305,000
Goodwill	25,136,000	20,190,000	18,226,000
Intangible Assets	3,488,000	2,513,000	2,878,000
Accumulated Amortization	–	–	–
Other Assets	3,068,000	3,001,000	3,536,000
Deferred Long-Term Asset Charges	3,220,000	4,195,000	8,818,000
Total Assets	**113,452,000**	**109,022,000**	**109,524,000**
Liabilities			
Current Liabilities			
Accounts Payable	22,204,000	20,990,000	20,960,000
Short/Current Long-Term Debt	6,778,000	4,168,000	11,236,000
Other Current Liabilities	11,580,000	10,845,000	10,239,000
Total Current Liabilities	**40,562,000**	**36,002,000**	**42,435,000**
Long Term Debt	21,846,000	21,932,000	23,391,000
Other Liabilities	24,204,000	24,772,000	26,791,000
Deferred Long-Term Liability Charges	3,666,000	3,562,000	3,441,000
Minority Interest	126,000	118,000	–
Negative Goodwill	–	–	–
Total Liabilities	**90,405,000**	**86,385,000**	**96,058,000**

Stockholders' Equity			
Misc Stocks Options Warrants	–	–	–
Redeemable Preferred Stock	–	–	–
Preferred Stock	–	–	–
Common Stock	45,418,000	41,810,000	39,129,000
Retained Earnings	92,532,000	80,900,000	70,353,000
Treasury Stock	(96,161,000)	(81,243,000)	(74,171,000)
Capital Surplus	–	–	–
Other Stockholder Equity	(18,743,000)	(18,830,000)	(21,845,000)
Total Stockholder Equity	**23,046,000**	**22,637,000**	**13,466,000**
Net Tangible Assets	**(5,578,000)**	**(66,000)**	**(7,638,000)**

Source: Statement of financial position. [Online]. Available: http://finance.yahoo.com/q/is?s=IBM+ Balance+sheet&annual. [12 April 2011].

The statement of financial position shows a remarkable increase in the company's common stock and retained earnings for the period indicated. Further financial ratios can be calculated, that confirm this increase, for example the company's current and **acid test ratios**. The **current ratio** for the 2010 year can be calculated as follows:

Current ratio = current assets/current liabilities
= (US$48 116 000/US$40 562 000)
= 1.186:1

The current ratios for the years 2009 and 2008 are 1.359:1 and 1.155:1 respectively.

The company's acid test ratio for 2010 can be calculated as follows:

Acid test ratio = (current assets – inventory)/current liabilities
= (US$48 116 000 – US$2 450 000)/US$40 562 000
= 1.126:1

For the years 2009 and 2008, the acid test ratios are 1.290:1 and 1.091:1 respectively.

The calculation of these ratios also indicate the improvement in the financial position of IBM from 2008 until 2010.

The company's **cash flow statement** for the same period is given in Table 12.3. Table 12.4 illustrates IBM's latest financial highlights.

TABLE 12.3 Cash flow statement on Dec 31, 2008, 2009 and 2010

CASH FLOW			
	(US$ '000)		
Period Ending	**Dec 31, 2010**	**Dec 31, 2009**	**Dec 31, 2008**
Net Income	14,833,000	13,425,000	12,334,000
Operating Activities, Cash Flows Provided By or Used In			
Depreciation	4,831,000	4,994,000	5,450,000
Adjustments To Net Income	1,122,000	1,936,000	2,221,000
Changes In Accounts Receivables	(489,000)	2,131,000	274,000
Changes In Liabilities	(1,789,000)	(2,295,000)	(2,633,000)
Changes In Inventories	92,000	263,000	(102,000)
Changes In Other Operating Activities	949,000	319,000	1,268,000
Total Cash Flow From Operating Activities	**19,549,000**	**20,773,000**	**18,812,000**
Investing Activities, Cash Flows Provided By or Used In			
Capital Expenditures	(4,185,000)	(3,447,000)	(4,171,000)
Investments	1,343,000	(2,189,000)	1,494,000
Other Cash flows from Investing Activities	(5,666,000)	(1,094,000)	(6,608,000)
Total Cash Flows From Investing Activities	(8,507,000)	(6,729,000)	(9,285,000)
Financing Activities, Cash Flows Provided By or Used In			
Dividends Paid	(3,177,000)	(2,860,000)	(2,585,000)
Sale Purchase of Stock	(11,601,000)	(4,377,000)	(6,804,000)
Net Borrowings	2,350,000	(7,463,000)	(2,445,000)
Other Cash Flows from Financing Activities	–	–	–
Total Cash Flows From Financing Activities	**(12,429,000)**	**(14,700,000)**	**(11,834,000)**
Effect Of Exchange Rate Changes	(135,000)	98,000	57,000
Change In Cash and Cash Equivalents	(1,522,000)	(558,000)	(2,250,000)

Source: Yahoo Inc.2011. International Business Machines Corp. (IBM) Cash Flow. [Online]. Available: http://finance.yahoo.com/q/is?s=IBM+Cash+flow&annual. [12 April 2011].

TABLE 12.4 IBM's latest financial highlights

	2010	2009
Revenue	99 870	95 758
Net income	14 833	13 425
Earnings per share of common stock	11.69	10.12
Market capitalisation	180 220	170 869
Stock price per common share	146.76	130.90
Number of employees	426 751	399 409

Source: IBM 2013. Financial highlights. [Online]. Available: http://www.ibm.com/annualreport/2013/financial-highlights.html, [17 October 2014].

IBM in South Africa

In February 2014, IBM announced a 10-year initiative to bring Watson, and other cognitive computing systems to Africa. With 'Project Lucy', IBM intends investing US$100million in the initiative. The announcement marks the first initiative of IBM's newly formed $US1billion Watson Group.

Named after its founder Thomas J Watson, IBM was developed in IBM's research laboratorium. Using natural language processing and analystics, Watson processes data (through systems and software that are not programmed) akin to how people think, representing a major shift in an organisation's ability to quickly analyse, understand and respond to big data. Watson is available as a cloud-based development platform, allowing developers to build applications using cognitive computing intelligence. It provides researchers with resources to help them develop commercial solutions in health care, education, water and sanitation, human mobility and agriculture. The key of the project is to turn data into knowledge and actionable insight.

The developmental **costs** of the Watson is estimated between US$900 million and US$1.8 billion. IBM will also be spending US$10 million per year on the project.

IBM showed remarkable increases in all its main financial indicators from 2008 until 2013 – revenues, net income, earnings per share of common stock, market capitalisation and stock price per common share all showed upward movements. Furthermore, the number of people employed by IBM worldwide also showed a significant increase.

Conclusion

In his 2010 chairperson's letter, Mr Palmisano wrote 'I am pleased to report that IBM had another strong year in 2010. The company continued to outperform the industry and the market at large. We once again achieved record pre-tax earnings, record

earnings per share, record free cash flow and improved profit margins, with increased revenues. At the same time, we continued to deliver superior returns to you, our owners. Most importantly, we are well positioned to grow as the global economy recovers.

These results were made possible by decisions and actions that we undertook a decade ago, based on where we believed the world was shifting. But even more, they are a reflection of the mindset, ambitions and values that have guided IBM since its inception 100 years ago. As such, our performance in 2010 marks a fitting end to our first century as a corporation, and a promising start to our second.'[11]

Since this statement in 2010, the company went from strength to strength, as indicated in their key financial performance indicators and the expected earnings from project Watson.

Self-assessment questions

Easy questions

1. During the early 1980s, IBM positioned itself as the IT industry's – and the business world's – most profitable corporation. **Profit** can be defined as _____.
   a. The monetary value sacrificed in the production of goods and services for the purpose of resale
   b. The favorable difference between the income earned during a specific period and the cost incurred to earn that income
   c. The power of disposal over the goods and services used in an organisation to generate a monetary return
   d. The proceeds resulting from the sale of an organisation's products and/or services

2. In 1989, IBM was ranked first among all US firms in market value, fourth in total sales and fourth in net profits.
   IBM's **net profits** will be reflected in its_____.
   a. Statement of income and expenses
   b. Statement of financial position
   c. **Financial structure**
   d. Funds flow statement

3. Which of the following are sources of own capital for IBM?
   a. Ordinary share capital
   b. Reserves
   c. Debentures
   d. Retained profits

e. Accounts payable

i. a b c d
ii. a b d
iii. c d
iv. c d e

4. John Akers and Louis Gerstner were both _____ managers of IBM who mainly needed _____ skills to perform their managerial functions as productively as possible.
   a. Top; interpersonal
   b. Top; conceptual
   c. Middle; interpersonal
   d. Lower; technical

5. The long-term financial objective of IBM should be to:
   a. Have no lay-offs
   b. Keep the costs of the business as low as possible
   c. Do research and development
   d. Increase the value of the business

Challenging questions

1. IBM needs an indication of their ability to meet short-term obligations as they come due, without curtailing its normal activities. Which of the following ratios can be used for this purpose?
   a. **Current ratio**
   b. Acid test ratio
   c. **Debt ratio**
   d. **Gross profit margin**
   e. **Return on total capital**

i. a b
ii. a c d
iii. c d e
iv. d e

2. To calculate their **net profit margin**, IBM can use the following formula:
   a. (Gross profit/sales) x 100
   b. [(Operating profit – tax)/total capital] x 100
   c. (Net **income**/sales) x 100

d. Earnings before interest and taxes (1 – T) – cost of capital (in $)

3. To calculate the **present value** of a single amount of money, IBM can use the following formula:
   a. $PV = FV\ (1 + i)^n$
   b. $PV = FVn\ (1 - i)$
   c. $PV = FV/n$
   d. $PV = FVn\ [1/(1 + i)]^n$

4. For the period 1987 to 1991, IBM planned to spend 10% of their revenues on research and development activities, in order to achieve their goals with limited resources. This is an example of a(n) _____.
   a. Statement of income and expenses
   b. Funds flow statement
   c. **Budget**
   d. Ratio analysis

5. When Louis Gerstner took the decision to 'arm the enemy', he took a decision under conditions of risk. The **risk-return principle** in **financial management** states that:
   a. Risk and return increase over time.
   b. The greater the risk is, the greater the required rate of return will be.
   c. An inverse relationship between risk and time exists.
   d. Investors will always prefer more risk associated with lesser returns.

Essay questions

1. Differentiate between the terms statement of income and expenses, statement of financial position and **financing structure**. In your answer, you also need to explain the financing structure of IBM.

   Key points to discuss:
   Statement of income and expenses, statement of financial position, financial structure, current liabilities, accounts payable, current debt, long-term debt, deferred long-term liability charges, minority interest, stocks, options, warrants, redeemable preferred stock, preferred stock, common stock, retained earnings, treasury stock, capital surplus, shareholder equity.

2. Explain what is meant by a break-even point and indicate how it can be calculated for IBM.

   Key points to discuss:

Costs, fixed costs, variable costs, income, profits, sales volume, selling price.

3. Explain the concept of the **time value of money** and the different perspectives of the time value of money that a company like IBM can use.

   Key points to discuss:
   Interest, time, opportunity cost, interest, present value, **future value**.

4. Give an overview of the most important **liquidity ratios** that IBM can use to determine their ability to meet short-term obligations as they come due without curtailing or ceasing their normal activities.

   Key points to discuss:
   Current ratio, **acid-test ratio**.

5. Give an overview of the most important profitability ratios that IBM can use as a measure of their financial success.

   Key points to discuss:
   Gross profit margin, net profit margin, return on total capital, **return on shareholders' interest**, **return on owners' equity**.

6. Project Watson involved tremendous costs involved for IBM. Discuss the principles pertaining to the evaluation of investment projects such as this. In your answer, you should also discuss methods that can be used in the evaluation process.

   Key points to discuss:
   Cost-benefit analysis, the time frame in which benefits and costs occur, time value of money, cash flow, **net present value, internal rate of return.**

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13

Purchasing and supply chain management: Toyota

KEY TERMS

AUTOMOTIVE COMPONENT MANUFACTURERS (ACMS)
AUTOMOTIVE (MOTOR) INDUSTRY
BOTTOM LINE
CONTINUOUS IMPROVEMENT (CI)
EARLY SUPPLER INVOLVEMENT (ESI)
FIRST-TIER SUPPLIERS
GROSS DOMESTIC PRODUCT (GDP)
INTEGRATED SUPPLY CHAIN
INVENTORY MANAGEMENT
JUST-IN-TIME
KEY PERFORMANCE INDICATORS
LEAN PRODUCTION
LONG-TERM RELATIONSHIPS
ORIGINAL EQUIPMENT MANUFACTURERS (OEMS)
OUTSOURCE
PURCHASING FUNCTION
SUBASSEMBLIES
SUB-TIER SUPPLIERS
SUPPLIERS
SUPPLY CHAIN MANAGEMENT
SUSTAINABILITY
TOYOTA PRODUCTION SYSTEM
VEHICLE ASSEMBLERS
VENDOR MANAGED INVENTORY SYSTEM (VMI)

Introduction

Toyota's net income per employee is five times greater than that of Ford and Chrysler. Toyota also shines in receivables turnover, inventory turnover, and asset turnover. Ford and General Motors have worked hard at implementing the **inventory management** philosophy that was pioneered by Toyota Japan. True efficiency goes beyond inventory management and requires an integrated product development, sales, manufacturing, and supply system. Toyota is very mature in its approach to these activities, and this clearly shows in its **bottom line**.[1]

Toyota is admired for their systems and their operational performance by competitors and other business institutions worldwide. They are also appreciated by millions of satisfied Toyota vehicle owners. However, even though admired for their efficiency and quality products, the worldwide vehicle recalls from 2010 to 2014 indicate that no organisation's systems and networks are perfect.

In modern organisations like Toyota the purchasing function forms an inherent and integrative part of an integrated supply chain. A supply chain consists of purchasing (inputs or sourcing), the operational process (assembling or transformation) and distribution of half-finished or finished consumer goods. Today's market place is more fiercely competitive than ever before due to globalisation, technological change, and demanding customers. The nature of competition has changed. Companies no longer compete against companies. Supply chains compete against other supply chains for supremacy. '… Toyota and its suppliers will clash with Ford and its suppliers for global competitive advantage'.[2] The purchasing function, which has the important task of finding, keeping and managing relationships with suppliers, and managing incoming goods, is an important part of supply chain management.

Toyota is regarded as the benchmark for best practices in South Africa and throughout the world. This case study will focus on purchasing-related issues, such as systems, inventory, suppliers and quality in Toyota. The case study also briefly refers to Toyota's recall of certain models to demonstrate that no organisational strategy, system and supply chain is perfect, even with the greatest care and efforts of management.

The automotive industry

The global automotive (motor) industry is the largest manufacturing sector in the world, with industry output equivalent to the world's sixth largest economy.[3] The industry is characterised by global mergers and relocation of centres to emerging economies.[4] It draws on a wide range of supplier industries, from raw materials (such as steel, aluminium, plastics and chemicals) through to sophisticated component assemblies, tooling, design and engineering services. The industry is one of the largest investors in research and development (R&D), playing a key role in society-wide technological development.[5] With its skill base and innovative practices, the automotive sector is often seen as providing an effective national training ground for

many manufacturing and engineering employees in very diverse industries.[6] The global automotive industry is currently led by the main manufacturers or **original equipment manufacturers** (OEMs), that is, Toyota, General Motors, Volkswagen, Ford, Honda, PSA, Nissan, BMW and Chrysler, which function in a competitive international market.[7]

The automotive industry supply chain integrates four groups of players: original equipment manufacturers (OEMs), **automotive component manufacturers** (ACMs) (**first-tier suppliers**), **sub-tier suppliers**, and infrastructure **suppliers** in the supply side of auto manufacturing. The supply chain stretches from the producers of raw materials through to the assembly of the most sophisticated electronic and computing technologies.[8] The major components of the supply chain include parts and raw material suppliers (tier 2–3), ACMs, OEMs, distribution centres, dealers and customers. OEMs create 30 to 35 per cent of value internally and delegate the rest to their suppliers (ACMs).[9] OEMs purchase entire **subassemblies**, such as doors, power trains, and electronics from suppliers. The desire to work with partners to **outsource** subassemblies is leading to a radically new infrastructure to support the design, purchasing (also known as procurement), and logistics processes of the manufacturers.[10]

The automotive industry in South Africa

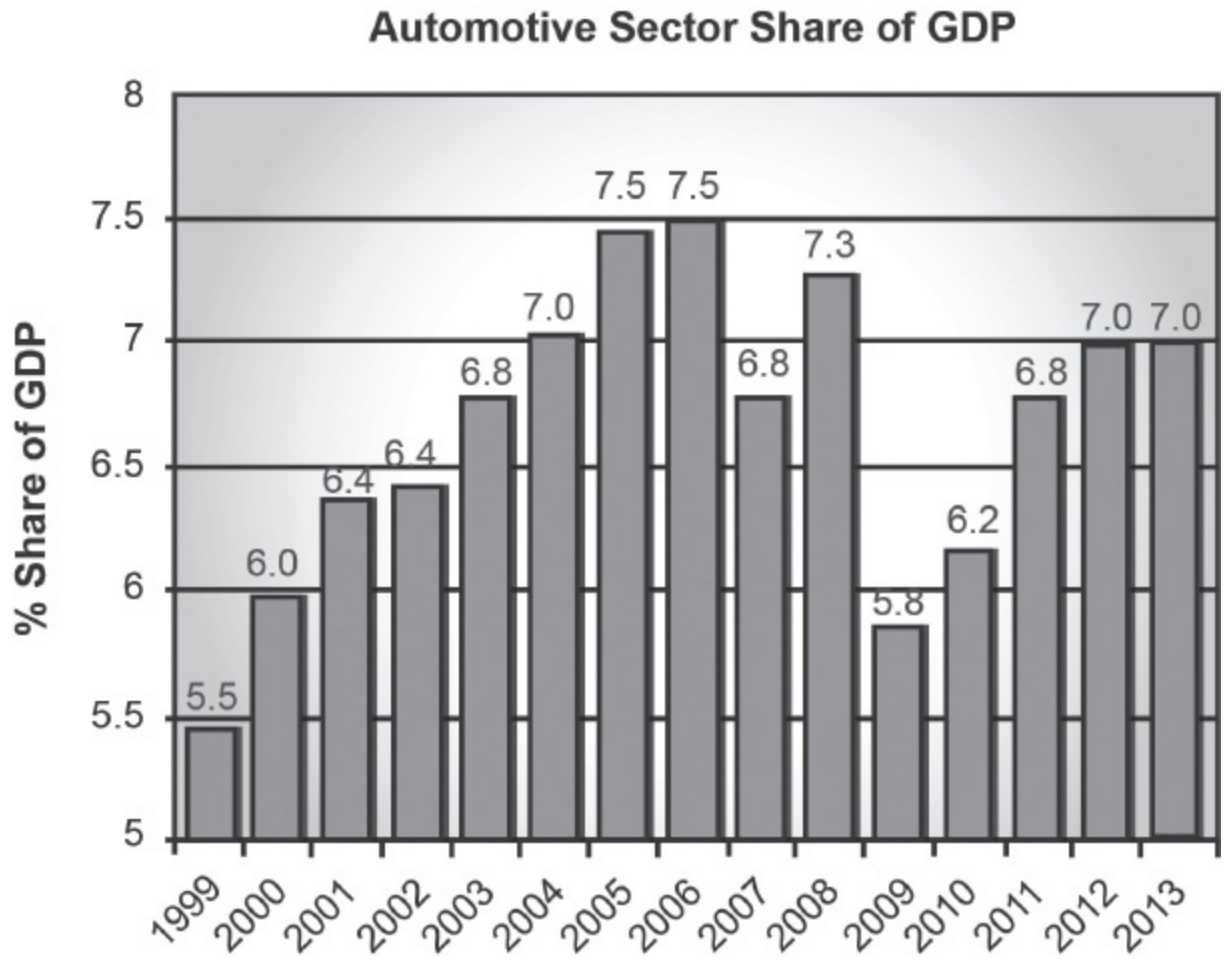
Importance

The **automotive industry** is an important industry for the South African economy. The South African vehicle manufacturing and associated industries have grown to become the major contributor to manufacturing output in South Africa and accounts for about one third of all manufacturing activities in the country.

An overview of economic activities of the automotive industry and the subsequent contribution to the country's economy is clear in Table 13.1.

From Table 13.1 it is clear that the retail part of the automotive industry provides the most employment opportunities and the automotive-parts (ACMs) part of the supply chain the second most employment opportunities. (ACMs are direct suppliers to OEMs such as Toyota Motor Company). The motor retail part (dealers) forms the customer or distribution part of Toyota's supply chain and is responsible for sales and servicing the final customer. (Refer to Figure 13.2 where the different parts of the motor vehicle (automotive) supply chain is shown.)

Figure 13.1 shows the contribution of the automotive industry to the South African **gross domestic product** (GDP).



Source: NAAMSA. 2014[12]

Figure 13.1 The contribution of the automotive industry's contribution to the South African GDP 1999–2013

TABLE 13.1 Economic activities by the South African automotive industry: 1995–2013

Year	Domestic Vehicle Production	Domestic Vehicle Sales	Imports: Vehicles (all units)	Exports: Vehicles (all units)	Exports: Components (Rb)	Trade Deficit (Rb)	Employment			Investment (Rb)
							Components	Retail	NAAMSA	
1995	388 442	399 967	27 289	15 764	3.3	(12.2)	60 800	178 000	38 600	0.8
1996	385 252	421 076	47 377	11 553	4.1	(14.1)	64 100	180 000	38 600	1.2
1997	361 316	399 275	57 528	19 569	5.1	(10.6)	64 300	180 000	37 100	1.3
1998	310 333	351 510	66 373	25 896	7.9	(9.8)	64 400	170 000	33 700	1.3
1999	325 222	325 775	60 269	59 716	9.7	(8.0)	64 700	175 000	32 000	1.5
2000	356 250	354 632	66 413	68 031	12.6	(9.7)	67 600	180 000	32 300	1.6
2001	406 149	382 529	84 673	108 293	18.6	(8.0)	69 700	182 000	32 700	2.1
2002	404 441	363 184	84 049	125 306	22.9	(10.1)	72 000	185 000	32 370	2.7
2003	421 335	382 600	87 926	125 661	21.3	(9.1)	73 000	191 000	31 700	2.3
2004	455 052	481 520	136 975	110 507	21.7	(18.8)	76 900	192 000	33 000	2.2
2005	523 873	617 450	232 091	139 912	23.0	(27.2)	77 000	193 000	33 500	3.6
2006	587 719	714 315	306 455	179 859	30.3	(33.8)	78 000	195 000	37 900	6.2
2007	534 490	676 108	312 855	171 237	39.1	(34.6)	80 000	200 000	38 486	3.1
2008	562 965	533 387	254 633	284 211	44.1	(14.7)	69 000	195 000	35 900	3.3
2009	373 923	395 222	196 246	174 947	27.9	(18.9)	61 000	195 000	28 400	2.5
2010	472 049	492 907	260 301	239 465	22.9*	(30.7)	65 000	200 000	28 100	4.0
2011	532 545	572 241	312 153	272 457	31.6*	(38.6)	68 500	200 000	28 300	3.9
2012	546 074	630 619	362 537	277 893	42.3*	(42.3)	70 000	200 000	29 180	4.7
2013	545 913	650 745	381 210	276 378	24.0**	(24.0)	74 640	200 000	30 120	4.4

Revised to include BLNS country data

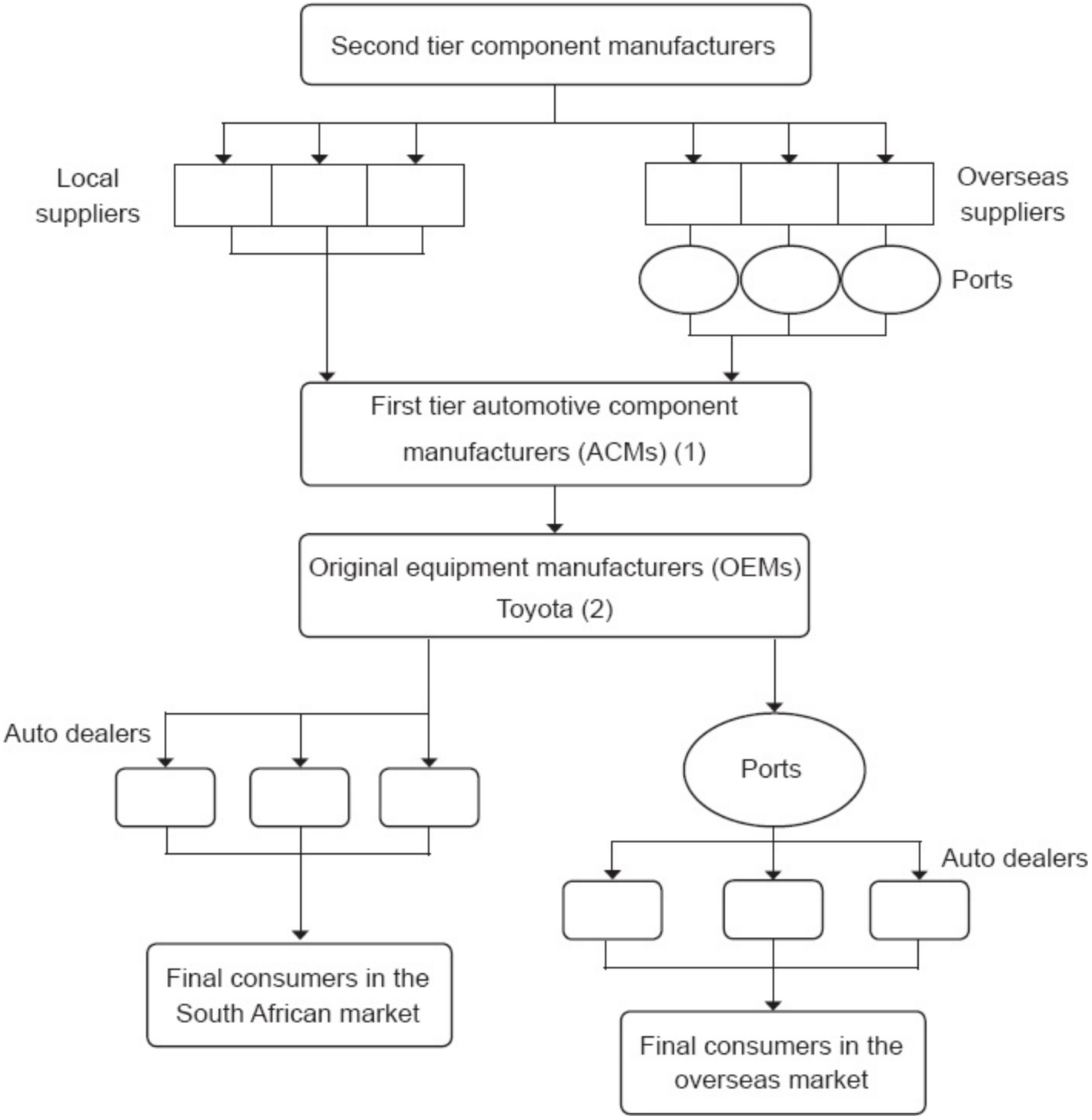
** Including BLNS country data but excluding R39 billion of aftermarket parts not linked to value addition under APDP

Source: NAAMSA. 2015.

From Figure 13.1 it is clear that the automotive industry plays an important role in the economy. It is also clear that the global economic conditions influence the automotive industry's output which is clearly visible in 2007, 2009 and 2010 – since the beginning of the global financial and economic crisis, leading to conditions of a recession world-wide.

Structure

The main role players in the automotive industry are identified below and indicated in Figure 13.2. From the figure it is clear that the supply chain in the motor industry involves many parties, nodes, links and logistical processes to deliver the final product to the final customer.



Source: Naude & Badenhorst-Weiss, 2011, Southern African Business Review[13]

Figure 13.2 Role players in a typical supply chain in the South African motor industry

1. *Automotive component manufacturers (ACMs)*. The ACMs supply components to OEMs, OESs and the independent aftermarket. The ACMs can be seen as the first-tier supplier in the automotive supply chain.
2. *Original equipment manufacturers* (OEMs) or automotive assemblers. This category comprises both passenger and commercial **vehicle assemblers**, for example Toyota and Ford. There are 8 main light vehicle assemblers and 11 producers of medium and heavy commercial vehicles. Toyota is the major producer (in terms of market share) of both cars and light commercial vehicles.
3. *Automotive retail and aftermarket*, which consists of automotive parts and accessory

sales, through independent retailers and repair shops.

Toyota Motor Company – the history[14]

In 1933, in Japan, Toyoda Automatic Loom Works created a new division devoted to the production of motor cars under the direction of Japanese industrialist, Kiichiro Toyoda, the founder's son. In 1936 Toyoda Automatic Loom Works created its first passenger motor car and Toyota's logo was established. Toyota Motor Company was established in 1937. Although the founding name is Toyoda, the company name was changed in order to signify the separation of the founders' work life from home life, to simplify the pronunciation and to give the company a new beginning.[15]

In 1938 Toyota launched '**just-in-time**' on a full-scale basis. Just-in-time is a system that ensures suppliers have intimate knowledge of the production scheduling of Toyota and that they are able to deliver the materials when needed in the production-line. Hence, no stock of the required items, parts and modules need to be kept at Toyota. During the sixties, Toyota established a global presence and in 1965 the Deming prize (highest award on Total Quality Management in the world) was awarded for the first time. In the 1970s, Toyota was awarded the first Japanese Quality Award. Due to the 1973 oil crisis, the US market started to change their demand to small fuel-efficient cars. As a result, Toyota established a strong presence in the USA.[16] Toyota listed itself on the New York and London Stock Exchange in 1999.

Toyota Corporation is a Japanese multinational enterprise. In 2012 Toyota became the world's largest automaker and the eighth largest company in the world.

Toyota's headquarters are in Toyota City, Japan. The company has assembly plants all over the world where vehicles are assembled for both domestic and international markets. Assembly plants are in Japan, Australia, Canada, Indonesia, Poland, South Africa, Turkey, the United Kingdom, the United States, France, Brazil, Pakistan, India, Argentina, Czech Republic, Mexico, Malaysia, Thailand, China, Vietnam, Venezuela, the Philippines and Russia.

Toyota Motor Corporation has 52 manufacturing companies in 26 countries and regions, employs approximately 333 000 people worldwide, markets vehicles in more than 170 countries and averages a global production figure of 10 million vehicles per annum.[17]

As this case study focuses on Toyota South Africa, it is appropriate to give some background information on the company.

Toyota South Africa Motors (Pty) Ltd (TSAM)

Toyota South Africa Motors (Pty) Ltd (TSAM) holds the rights for the importation, assembly, manufacture and distribution of Toyota, Lexus and Hino vehicles and components in the southern Africa region. TSAM is owned by holding company, Toyota South Africa (TSA), who in turn is 100% owned by Toyota Motor Company.[18]

TSAM has been a market leader in South Africa for the past 34 years, and of the 148 203 vehicles produced in 2013, 52 percent was for the export market to 58 countries in Europe and Africa. TSMA employs about 8 000 people who contribute to the manufacturing and marketing of the Corolla, Hilux, Fortuner and Dyna models, which are marketed and sold through 192 dealerships in southern Africa. In 2014 a R1 billion investment to expand the Durban production plant was announced. This will enable TSAM to assemble the new generation Corolla for domestic and export markets.[19]

TSAM ranks among the top ten international distributors of TMC, and is firmly established as the largest vehicle manufacturer in the African continent, and the largest vehicle exporter in South Africa.

Over the past few years TSAM has received national and international awards and accolades for their products, brand, responsible business conduct, community projects, environmental stewardship, customer service, sales and marketing.[20]

Supply chain management – integration of functions and parties

In large organisations, particularly in manufacturing and assembly type organisations such as Toyota, the organisational functions (purchasing, production, marketing, finances, logistics and human resources) are performed in an integrated manner in a supply chain. The functions of purchasing, operations and logistics are particularly integrated in a supply chain and cannot be separated. Not only are the internal business functions performed in an integrated manner, but the suppliers of the organisation are also integrated by means of planning, systems and **long-term relationships**. In the same way, the customers are linked to the supply chain. Information, money and materials flow through the whole supply chain as a unit – as if it is one organisation.

In this case study some purchasing related issues will be highlighted within the **integrated supply chain** of Toyota. In this approach to managing (**supply chain management**) organisations, the **purchasing function** plays an increasingly important role with regards to the selection of and relationship with suppliers. With over 25 000 possible combinations of parts that can be assembled into one Toyota vehicle it becomes clear how complicated the supply chains and particularly the production system, selection of suppliers, inventory control and quality control are. This case study will cover Toyota's production system, inventory, suppliers and quality.

Toyota production system

Toyota is one of the most written about companies in the world, attracting the attention of journalists, researchers and business executives seeking to benchmark its

famous production system.[21] This is because Toyota has repeatedly outperformed its competitors in terms of quality, reliability, production and cost reduction, number of sales, market share growth and market capitalisation. In fact, opinions were expressed that Toyota taught the modern car industry how to make cars properly using the **Toyota Production System** (TPS).[22]

The Toyota Production System (TPS) has become known as the world's premier production system, and the manufacturing process as 'lean manufacturing'. **Lean production** is one of the names given to the manufacturing strategy developed by Taijichi Ohno and Eiji Toyoda of the Toyota Motor Company. Lean production has its roots in the Toyota Automobile Company of Japan where waste was to be avoided at all cost. This means 'getting more done with less'. The process entails the identification and removal of nonvalue-added activities right through the whole supply chain in order to realise quicker customer response, reduced inventories, better quality and improved human resources. 'Lean' means an integrated set of activities designed to obtain the same output from half the resources used by older production methods – in other words, half the resources in terms of: half the number of workers who are multiskilled and work in teams, half the number of design engineers and half the level of inventory. At the same time, this involves the use of half the resources achieving higher levels of quality, more frequent new model launches and more varied product variations.[23] The TPS was developed to improve quality and productivity and has its foundation in the Japanese culture – (1) elimination of waste; and (2) respect for people.

The just-in-time (JIT) philosophy is also incorporated in the TPS. In a system incorporating JIT, items move only when they are needed by a downstream processing step. In other words, supplies and assemblies are 'pulled' through the system when and where they are needed. When problems are encountered, the process is stopped until the problem is sorted out. Since reductions in throughput time allow materials to get where they need to be on time, JIT activities are all connected to this objective. Managers work on this objective by: reducing lot sizes; processing times; safety stocks; waste worker and material movements; inconsistencies; and defects. These are all considered waste in the JIT philosophy.[24]

Continuous improvement (CI), also called Kaizen, was developed by Taichi Ohno, the pioneer of the Kanban system at Toyota. Kanban is the information system perfected by Toyota in Japan to operate the JIT-system. Ohno developed continuous improvement into a viable, tangible management approach. CI seeks for continual improvement of machinery, materials, labour utilisation and production methods through applications of suggestions and ideas of company teams, which might also include suppliers.[25]

Information systems

Toyota uses the Global Toyota System and SAP information systems. SAP is used for commercial applications such as the control of finance and human resources. Data is

shared with suppliers through a domestic website portal and global information such as forecasts and prices are available to the relevant suppliers. Suppliers who supply requirements to Toyota have to subscribe to Toyota's website portal.[26]

Inventory

Toyota aims to keep their inventory to the minimum by using the JIT system. This means nothing is produced until the customer requests a vehicle, and subsequently, nothing is purchased until the production process begins and materials are requested from the supplier. Materials are therefore 'pulled' from their source and never 'pushed' into the process. A pull system works on feedback from the user before materials and components are introduced into the process. Obviously all elements of the supply chain system must be ready and in perfect synchronisation in order to make the 'pull' supply chain work. The objectives of a pull system are to create a flexible system capable of delaying final assembly until a customer places an order. The benefits of such a system are quicker delivery times, reduced inventory levels and improved quality. The JIT system at Toyota SA is complicated by the fact that their suppliers are dispersed throughout South Africa and some of the suppliers are even overseas. Inventories should be kept to provide for risks involved in purchasing from far away suppliers.

Toyota is trying to get their suppliers to move towards a supplier **(vendor) managed inventory system** (VMI). VMI is a JIT technique in which inventory replacement decisions are centralised with upstream suppliers. In VMI, customers no longer pull inventory from suppliers, but inventory is automatically pushed to customers as suppliers check the customers' inventory levels and replenish inventory as and when required. The supplier is therefore responsible for keeping and administering the inventory levels of its manufactured goods at the customer's facility.

Suppliers

Suppliers are referred to as business partners. Toyota prefers long-term relationships with suppliers in order to realise mutual growth based on mutual trust. A long-term mutually beneficial mindset is an important criterion for the selection of suppliers.

Toyota suppliers are also assessed using the standard **key performance indicators** (KPIs). These are cost, quality, delivery and environmental issues. Of those, cost is the most important to Toyota.[27] Environmental issues are becoming increasingly important. Therefore, Toyota expects their suppliers to be ISO14001 compliant. That means that suppliers must apply certain standards to manage their impact on the environment with the materials they use, production processes, waste, scrap, packaging, disposal of the end product and anything that might have an impact on the environment.

The **sustainability** of suppliers is important for Toyota. Sustainability means

firstly, that the supplier must be a viable business and the business must be able to adapt and survive into the future. Therefore, Toyota does not only purchase parts from suppliers, Toyota also develops suppliers' capabilities. They train suppliers in the Toyota Production System (TPS). They use retired employees who have knowledge in production and logistics to work with the supplier.

As part of their long-term mindset Toyota start to involve suppliers early on in the design process. **Early supplier involvement** (ESI) occurs when a strategic supplier provides product and process technology and knowledge to support the buyer's operation.[28] Key strategic suppliers are able to make vital contributions in the areas of quality, cost and timely market availability of new products. For example, the core competency of designing Toyota seats now lies with Toyota Boshoku. Toyota will indicate to Toyota Boshoku how they expect car seats to function and what they want them to look and feel like. Toyota Boshoku will then be responsible for the development, design, procurement of parts and production. Toyota aims to develop a few suppliers (two or three), who can supply a certain part in order to maintain competition within the supplier base.[29]

Supplier innovation within Toyota is critical and the company gives an annual award to the top supplier for innovation.

The playing field for local suppliers (ACMs) has changed over the last few years. OEMs such as Toyota are now sourcing components on a global basis at the lowest possible cost.[30] In order to survive the South African ACMs need to compete with the best in the world from a cost and quality perspective.

Toyota Motor Corporation and Toyota South Africa thus employ world best practices in the management of their supply chain. This includes the Toyota Production System, aimed at waste reduction, lean principles, quality, just-in-time and continuous improvement. Likewise, inventory and suppliers are managed according to best practice. The result is quite clear: in South Africa, Toyota South Africa ranks among the top ten international distributors – they have a good reputation and have received numerous awards over the past decades for product quality and performance in many areas.

Vehicle recalls of 2010 and 2014

When Toyota recalled vehicles worldwide and in South Africa in 2010, despite Toyota's good reputation and the best practices employed, it became clear that perfection or 'zero defects' (a popular concept for the past number of decades) is a goal to strive for and not always a certainty. The Corolla, Auro and Verso (52 546 vehicles) were recalled in South Africa to correct a potentially faulty accelerator pedal mechanism. In other parts of the world cases were reported where the mechanism had deteriorated and become harder to depress, slow to return to idle or was stuck in a partially depressed position. Toyota also recalled 216 Prius models for a software upgrade to the electronic brake system. The brake upgrade will fix problems when

braking on a slippery surface.[31]

In 2014 Toyota Motor Corporation announced two international recalls that also affected locally sold vehicles. The recalls involve the seat fastener spring on previous generation Yaris models and a spiral cable connection to the driver's airbag module in the RAV4, Hilux, Fortuner and Inova models. The seat spring of the Yaris was inspected and replaced if necessary, ensuring that the seat remains firmly locked into place. For the other models mentioned the spiral cable was replaced to prevent any possible wear that could lead to the airbag warning light illuminating.[32]

Discussion

The recall of Toyota vehicles was not good news for Toyota because it hurt their reputation for quality and reliability. Xiaoyuan[33] (a researcher in the USA) is of the opinion that the recalls are the result of Toyota's business strategy 'that sacrifices its customer-first focus in favour of driving shareholder value. Toyota gradually shifted away from the tenet of lean manufacturing. Seeking cost leadership and market leadership has gone too far, and differentiation through quality, reliability and fuel efficiency becomes blurred.' The researcher added that 'the execution of such business strategy the past few years has lured Toyota to rush into relationships with suppliers it has not adequately vetted and to apply questionable security measures as it sourced parts from all around the world. In doing so Toyota has been constantly adding stress to the security of its supply chain. In the end, its risk mitigation capability does not improve and quality standards have lapsed.'

The researcher also feels that the recalls are the result of Toyota's focus that has shifted from the customer and customer satisfaction to market share and lowest cost. Toyota sources parts from suppliers worldwide, based on the cost competitiveness of suppliers – not on a long-term view of good relationships where there is security for the suppliers so that they can focus on quality. This is almost a contradiction of what was stated earlier in terms of Toyota's philosophy about suppliers – *Suppliers are referred to as business partners. Toyota prefers long-term relationships with suppliers in order to realise mutual growth based on mutual trust. A long-term mutually beneficial mindset is an important criterion for selection of suppliers*. However, Toyota admits that cost is the most important key performance indicator – *Toyota suppliers are [also] assessed using the standard key performance indicators (KPIs). These are cost, quality, delivery and environmental issues. Of those cost is the most important to Toyota*.

The question could be asked: Has quality being sacrificed by focusing on lowest cost?

Conclusion

In the above case study certain purchasing-related supply chain practices implemented by Toyota were outlined. Toyota is known as an efficient organisation worldwide, with systems admired and emulated by many other organisations.

Toyota's reputation with its final customers (Toyota vehicle owners) is equally admirable. No wonder the vehicle recalls as explained in the last part of the case study caused hype in the media.

The case study clearly indicates that no matter how good and admirable systems or business operations are, there are still shortcomings. Toyota is known for quality and it is ironic that in this case the quality of one small part could cause a problem of such magnitude. There was no public explanation of where things went wrong. Due to the fact that recalls were done both internationally and in South Africa one can only guess that either one of the international supplier's quality was not up to standard, or the wrong specifications were communicated, or it was a design flaw. It must have caused losses of millions of rands for Toyota. Due to Toyota's long established reputation and the way they handled the recalls it is doubtful whether it has tarnished the Toyota brand reputation. 'Although the Toyota recall caused the brand to lose 16% of its brand value, its long-standing reputation for reliability, efficiency and innovation helped it weather the crises better than expected'.[34]

The last statement is clearly illustrated by Table 13.2, reflecting the findings of research conducted amongst TSAM customers in comparison with industry wide findings.

TABLE 13.2 Competitive customer experience[35]

	SA INDUSTRY		TSAM	
	2012	2013	2012	2013
Brand loyalty	89%	88.9%	90.3%	89%
Relationship	88.9%	89.3%	89.7%	88.7%

It is clear that TSAM still performs well in terms of customer satisfaction.

Self-assessment questions

Easy questions

1. The purchasing function's role has diminished in the supply chain management approach.
   a. True
   b. False

2. The automotive industry is characterised by innovative practices.
   a. True
   b. False

3. Original equipment manufacturers such as Toyota mainly purchase raw materials.
   a. True
   b. False

4. The final consumer of Toyota's vehicles is part of the automotive supply chain.
   a. True
   b. False

5. Suppliers are regarded as partners in a supply chain management approach at Toyota.
   a. True
   b. False

Challenging questions

1. Which one of the following is not part of the Toyota Production System?
   a. Waste elimination
   b. Just-in-time
   c. Continuous improvement
   d. Automation

2. The pull supply chain can only work if _____.
   a. There is continuous improvement of efforts.
   b. Large inventories are held at various places in the supply chain.
   c. There is perfect synchronisation in the supply chain.
   d. Suppliers are ISO140001 compliant.

3. The just-in-time system is complicated by _____.
   a. The use of integrated information systems.

b. Suppliers situated far from the assembly line.
c. More demanding customers.
d. Continuous improvement efforts.

4. Which one of the following statements is correct?
   a. Sustainability of Toyota's suppliers means only that they have to survive to ensure future supply.
   b. Early supplier involvement is a practise to be used for all purchased products at Toyota.
   c. With lean manufacturing workers become only a gear in the Toyota Production System.
   d. Long-term relationships means that suppliers are always assured of orders.

5. Which one of the following KPIs for supplier selection is most important to Toyota?
   a. Cost
   b. Innovation
   c. Quality
   d. Sustainability

Essay questions

1. Illustrate and explain a typical supply chain in an assembly-type industry.

Key points to discuss:
- The parties involved in the supply chain are second-tier suppliers; first-tier suppliers, also known as ACMs; OEMs (such as Toyota); retail market.
- The parties are linked through processes, systems and planning. Materials, funds and information flow through the supply chain.

2. What is meant by the statement 'The automotive industry is sensitive to economic conditions'?

Key points to discuss:
- In difficult economic times (e.g. high interest rates or recession) consumers tend to postpone their decision to buy new motor cars. The sales drop and sometimes necessitate the limitation of production of motor cars and can lead to retrenchments.

3. Identify and explain the most important principles of the Toyota production system.

Key points to discuss:

- Lean production
- Waste avoidance – 'getting more done with less'
- Just-in-time
- Continuous improvement.

4. Explain how inventory is managed in the Toyota supply chain.

Key points to discuss:

- Just-in-time
- Materials 'pulled' from their source
- Benefits
- Supplier (vendor) managed inventory system.

5. Discuss how Toyota manage their suppliers.

Key points to discuss:

- Business partners – long-term relationships
- Assessment criteria cost, quality, delivery and environmental issues
- Sustainability of suppliers – develops suppliers' capabilities
- Early supplier involvement (ESI)
- Supplier innovation
- Sourcing globally – best cost and quality.

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Contents

Cover

Title

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Contents

How to use case studies

Preface

Business cases topics

1. Entrepreneurship: MXit

2. Establishing a business: Kiph

3. The business environment: The airline industry

4. Corporate social responsibility: South African Breweries

5. General management: Edcon

6. Planning: Tsogo Sun

7. Organising: The Nike matrix

8. Leading and controlling: South African business leadership in action

9. Operations management: Air traffic operations excellence

10. Human Resources Management:

11. Marketing management: Heineken and SABMiller's beer war

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13. Purchasing and supply chain management: Toyota

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