

Bright Lights and Services Co. (BLSC)

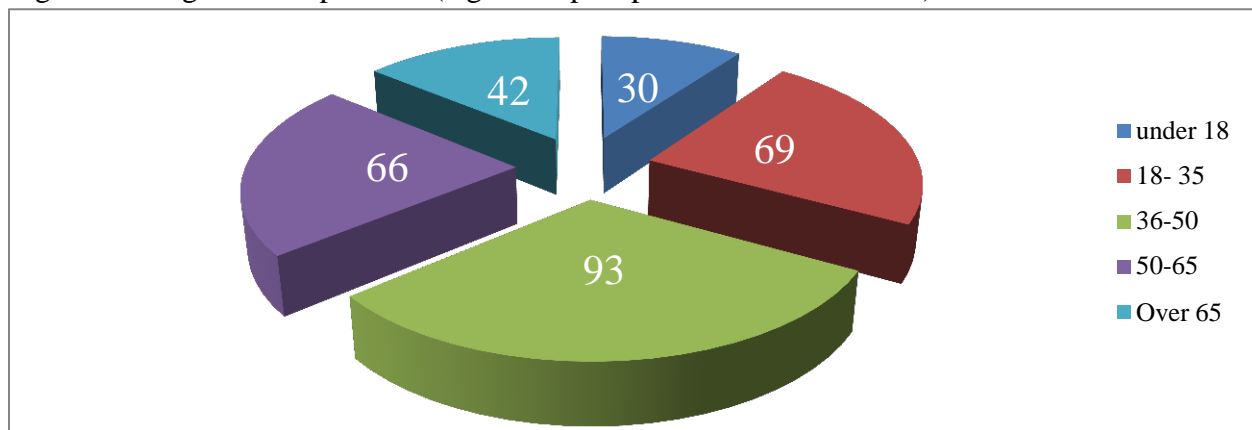
BLSC is a holding company and runs diverse businesses, such as banking operations, electric utility, insurance and shipping operations in Brightland. On September 22, 2012, Alec Smith was driving to his office along the picturesque road skirting the ocean, but his mind was on the upcoming meeting with his strategic planning group. Alec Smith had called a meeting with his strategic planning/business development group to examine the current situation and look for alternatives to grow the business/increase income stream. Smith was hired in 2005 and was tasked with growing the company revenues, and the results to date have been mixed. In the last five years of Smith's tenure, the firm had pursued three new areas and only one was successful. The Board of Directors of BSLC has asked Smith to provide an outline of the strategy for the next five years. Smith wanted his strategic planning group to develop an executive summary to outline:

1. Current situation
2. SWOT Analysis
3. Identification of businesses to pursue
4. An action plan for business growth

Bright Lights and Services Co. (A)

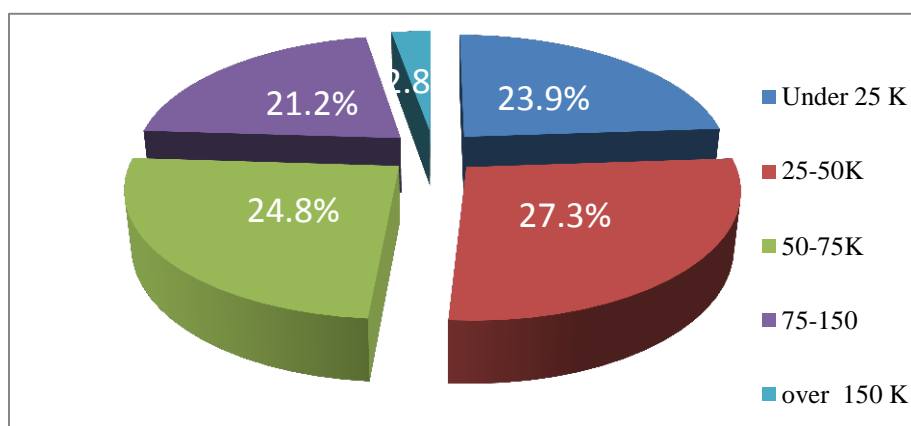
Bright Lights and Services Co. (BLSC) conducts business in Brightland about 2,500 miles southeast of Boston. Brightland is a two-island (BigBright and SmallBright) chain separated by 20 miles of ocean between them, and is administered by the United States as a territory. Brightland residents are U.S. citizens but are not represented in the Congress. Brightland's location and pristine sandy beaches have made it a major tourist destination for New Englanders wanting to escape harsh winters. The island economy with a population of 300,000 is dependent upon tourism and agriculture. Most of the supplies including food, consumer goods, commodities, fuel, and appliances are all imported from the U.S. mainland.

Figure 1: Brightland Population (Age Groups represented in thousands).



Brightland's economy provides employment for a big portion of the island population. Other major employers are the Government, BSLC, local banks, supermarkets, department stores, Brightland University, and a military base. The median salary in the islands is about \$60 K and many work in professional jobs in the tourism-related industries, local banks, and businesses. The island population of about 300,000 was distributed among 93,000 housing units with an average person per household of 3.2, reflecting the tendency of young, unmarried sons and daughters who stay with their parents due to a housing shortage and high housing prices. A little over half the island population is between the ages of 18 and 50 years, about 30% were over 50 years and the rest under 18 years. About 11% of the households are vacation homes and belong to individuals from New England who spent their winters in Brightland. To address the housing shortage and high housing prices, the local government is encouraging builders to build affordable housing and was designating large areas of the island for new residential construction.

Figure 2: Income Levels



The government officials and businesses are aware of island's dependency on tourism from the U.S. and Europe and is looking at ways to diversify the economy to reduce this dependence. The

Brightland Chamber of Commerce is spearheading the efforts to position the islands as a premier tourist destination. In addition to the traditional United States and European markets, the newly emerging markets and rich Middle Eastern countries are seen as potential target markets, particularly during the off season months of April, May, and June. In addition, the Chamber of Commerce is spearheading the efforts to attract businesses to locate in the islands. Lately, Brightland has been attracting software developers who like the island lifestyle and are opening small operations on BigBright.

While BigBright has an international airport and several hotel chains catering to tourists, SmallBright has only two major hotels and shops. The two hotels employ about 1,000 workers, the majority of whom commute daily from BigBright. SmallBright is deliberately left in pristine condition and depends completely on tourism. It does not have an airport or public transportation. Tourists fly to BigBright and take the ferry to SmallBright. All the supplies and hotel employees who live on BigBright use ferries to reach SmallBright. SmallBright hotels have positioned themselves as exclusive resorts and cater to the very rich who are willing to pay the premium prices. Ordinary tourists who stay on BigBright take the ferry to see the historic sights on SmallBright.

History of the Brightlands

The Brightland chain was settled in during 1600s by pirates who are rumored to have buried their treasures here. In 1901, the U.S. acquisitioned the islands and has been administering them as a United States territory. Soon after the acquisition, several Christian missionaries from Boston travelled to spread the religion and convert the islanders who believed in Ashitoo, a God worshipped by the pirates. The islanders are a very close-knit community with a chief believed to be a descendent of the pirate, Captain Morgan. Boston missionaries were able to convert the islanders and systematically took over the land and business by trading, coercion, and often by marrying the chief's relatives. Thus, most of the agricultural land and businesses are owned by the families of missionaries. When the United States acquired the islands, they abolished the chief's position and provided the chief (and his descendants) a yearly pension as an acknowledgement of their historical claim to the islands.

There are several forts and remnants of settlements from earlier days on both islands. However, BigBright is more modern with some light manufacturing and commerce that provides employment, even though most of the employment is related to the tourism industry. The local Brightland University offers undergraduate degrees and is planning to offer graduate degrees in several disciplines. Brightland University's undergraduate degree in marine science is well-regarded and is beginning to attract students from the New England area.

In recent years, many baby boomers have been buying properties on BigBright. A large portion of these homes are vacation homes and investment properties. Vacation home owners are "snow birds" from the New England area spending their winter months on the warm islands. The major advances in communication technology in the last decade has made it very conducive to

conducting business from the island, and hence increased interest in acquiring homes on the island. Reflecting this in-migration, property values are rising and there is a boom in the construction business. New homes and higher population have increased business opportunities for businesses on BigBright, including BSLC and its subsidiaries.

While BigBright has modern buildings and highways, SmallBright is kept in pristine condition with no vehicular traffic. Horses and buggies are used to take tourists around the island. The two hotels owned by the chief's family were designed to give the impression of an old castle but are equipped with all the amenities of a 5-star hotel. The rooms match Ritz Carlton in their décor, and all amenities such as air conditioning, pool, sauna, bars, and restaurants are available. Most of the SmallBright residents are employed as tour guides, hotel staff, and cooks, while most of the managerial staff come from BigBright and from Boston. The hotel restaurants serve only island food from piracy days, but there is one McDonald's and one Burger King on SmallBright. Passenger boats start at 5:30 a.m. and run every hour until 9 a.m., and then run in two-hour intervals from 10 a.m. to 3 p.m. and one-hour intervals from 4-9 p.m. to take tourists from BigBright hotels to SmallBright on day tours. BOATS is one of the two companies that provide the shipping and transport service. They own one large supply ship and three passenger ferry boats. Its competitor owns two supply ships and five ferry boats to provide passenger service. Both companies charge \$20 per round trip for economy class and \$100 for the luxurious upper deck. The island residents are allowed to buy a monthly pass for \$100.

Tourists come in droves from New England as well as from Europe, attracted by the blue waters, hiking trails, horse riding, castle ruins, and its pristine condition. A visit to the ancient Ashitoa Temple is a must for all the tourists who hike the trail to the temple and are treated with a sumptuous lunch with goat meat and rum. The peak tourist season runs year round – from November to March – for visitors from New England and the U.S. East Coast, and April to September for European tourists.

Bright Lights and Services Co. (BLSC)

BLSC was formed as a diversified company and evolved out of BIEGO, established in 1915 to provide electricity to Brightland residents. BIEGO is a regulated monopoly with rights to supply the electricity needs of both islands. Electricity is generated on BigBright and is transmitted by undersea cable to SmallBright. BIEGO generators use imported low sulfur fuel oil for power generation. The fuel oil comes from Venezuela, the only source of low sulfur fuel oil in the western hemisphere. The only other source for this low sulfur oil is Iran, which is expensive because of shipping costs. In addition, the trade embargo in place for the last few years prohibits Iranian imports.

Like many other power generators, BIEGO is exploring the possibility of switching from fuel oil to gas as a fuel. Gas is a cleaner fuel to burn and has lower pollution compared to fuel oil.

Brightland politicians and population have been concerned about the damage caused by the emissions from power plants to the pristine environment of the islands. The local newspaper has been publishing articles urging BIEGO to be sensitive to the future of the islands and its responsibility as a corporate citizen. BIEGO believed switching to gas would be welcomed by the islanders. In addition, abundant availability of shale gas in the United States through fracking has lowered the cost of gas for power generation. A report by McKinsey Consultants showed the cost of producing power using gas was about 20% less compared to fuel oil. This is after factoring in the higher cost of shipping liquefied natural gas (LNG) from ports on the East Coast to Brightland. To convert the plant from fuel oil to gas feed requires a capital investment of \$65 million for installing new advanced technology gas turbines. BIEGO has secured the necessary approval (as a regulated utility, rate changes need approval from local government administrators) to increase the electricity rate by 5% to recover capital expenses.

Brightland customers pay one of the highest rates in the United States, and price increases are not going to be received well. BIEGO is worried about customer resentment influencing the local administrators who are up for reelection in two years. Since 1990, there has been increased pressure by the administrators for BIEGO to encourage conservation programs to reduce electricity bills by reducing consumption. Providing rebates to consumers for installing new energy-efficient appliances has been found to be a successful conservation program elsewhere in the country. Bowing to the pressure, BIEGO started implementing an energy conservation program in 2004 and started providing rebates to consumers who buy high-efficient appliances. Rebates are necessary because energy-efficient appliances are priced higher than regular appliances. When fully implemented, this program is expected to reduce energy consumption by about by 20% over a 10-year period.

Alec Smith was appointed as CEO in 2005 and was recruited from NSTAR, in the state of Massachusetts, one of the leading providers of gas and electricity in New England where he was an Executive Vice President. He was aware that BIEGO revenue is dependent on tourism business that drives the economic activity on the islands. Between 2005 and 2010, electric revenues increased by about 4% because of the rate (price) increase, but net income stayed flat in spite of price increases. A steep drop in tourism in the years following the 2007–2008 financial crisis has impacted the economy and hence the consumption of electricity. In addition, the energy conservation program started in 2004 and new efficient appliances have also been reducing the consumption, and hence, electricity sales.

While the electricity sales and revenue were declining, operating costs were increasing due to fuel costs as well as employee costs. BIEGO is a union shop and employees are able to negotiate a good salary and benefit package. As a result, BIEGO employees are among the best-paid employees with good benefits such as all-paid medical insurance, discounted electricity, etc. The only way to increase revenue and net income is to increase the price for electricity and/or by increasing electricity sales. Smith was hoping that the population increase (partly by in bound migration), higher economic activity, and new businesses may increase electricity sales, thus

offsetting revenue loss by conservation programs. But he is aware that while BEIGO provided the bulk of income, opportunities to increase net income just by electricity sales were minimal.

Smith wanted to diversify the company portfolio and thus diversify risk by investing in industries that provided a regular income stream and provided avenues for income growth. He realized that the diversification efforts should focus on businesses that are essential parts of the island economy with growth prospects. A holding company BLSC was formed in 2005 with BIEGO as a major subsidiary. Between 2007 and 2010, BLSC acquired three new businesses.

First was BOATS Inc., one of the two shipping companies that carry products from the United States' East Coast. In addition, BOATS transports food, supplies, and products from BigBright to SmallBright. BOATS also operates a ferry that takes residents and tourists between BigBright and SmallBright. Boston Ships, a well-established maritime company located in Boston, is the only competition to BOATS Inc. Boston Ships has the lion's share of the shipping business between mainland U.S. and Brightland as well as business between the two islands.

BLSC also added a property insurance company (PICO) that offers property insurance. PICO has very tough competition from national insurance providers but manages to hold onto a small share of the insurance market using its local roots as an advantage. PICO's business is limited to home insurances and has to keep insurance premiums low to be able compete with national firms. Unlike PICO, national firms are able to diversify their risk by offering insurance to a number of different market segments as well as different markets in the United States. They also reinsure their risky product portfolios with Lloyds of London to minimize exposure. The low margin and smaller business volume of PICO insurance business make it difficult for PICO to buy reinsurance without hurting profitability. In view of this, PICO thought it could wait until business volume justified the reinsurance premium, thus taking on the risk itself. PICO is hoping that they could expand into life and business insurance and grow the business volume.

The last acquisition was a bank, MoneyMaker (MM) Inc., which has been operating on the islands for the last 50 years. It is the smallest of the three local banks in terms of revenues and offers traditional savings/checking and mortgage business. It has branches all over BigBright and two branches on SmallBright. MM has a 54% market share of the home mortgage market, which accounts for a bulk of MM's net income. MM places a lot of importance on qualifying mortgage loans and carefully targeted middle-income families and professionals. MM's bad loan to total loan ratio is one of the lowest on the islands and was one of the major factors for its successful operation. MM realizes the need to strengthen its non-mortgage part of the business to grow. It wants to target young professionals with soft loans, credit cards, and CDs. Lately, many national banks such as Bank of America and Wells Fargo are entering the market and are planning to offer full services including mortgages and investment products. These banks realized that the property market in BigBright is heating up and see a large market opportunity.

Fearing the tough competition, local banks including MM are lobbying the government to prevent/delay entry of these national banks. National Banks in turn are working with the Chamber of Commerce to outline the benefits to the local economy in terms of increased employment, competitive mortgage market, and their ability to draw investment business from European customers based on their international reputation. Industry reports indicate that these national banks are likely to start operations within the next two years and aggressively pursue market share.

In 2008, when all of the acquisitions were in place, the BLSC portfolio of companies looked as follows:

| Company | Revenue | Operating Income | Market Growth | Competition | Market share of Big Island Customers |
|----------------|----------------|-------------------------|----------------------|--------------------|---|
| BIEGO | 71% | 72% | Flat or declining | Regulated monopoly | 100% |
| MM | 20% | 18% | Growing | Intense | 54% * |
| BOATS | 5% | 6% | Growing | Two companies | 25% |
| PICO | 4% | 4% | Growing | Intense | 5% |
| BLSC | 100% | 100% | | | |

* Represents share of the home mortgage market.

Income Statement

| | 2011 | 2010 | 2009 | 2008 |
|-----------------------------------|------------|------------|------------|------------|
| Revenue | | | | |
| BIEGO | 220 | 210 | 188 | 175 |
| MoneyMaker | 63 | 55 | 52 | 45 |
| BOATS | 16 | 16 | 15 | 14 |
| PICO | - | - | 9 | 7 |
| | 299 | 281 | 264 | 241 |
| Expenses | | | | |
| BIEGO | 190 | 169 | 160 | 149 |
| MoneyMaker | 42 | 43 | 41 | 35 |
| BOATS | 16 | 12 | 12 | 11 |
| PICO | | | 7 | 5 |
| | 248 | 224 | 220 | 200 |
| Operating Income | | | | |
| BIEGO | 30 | 41 | 28 | 26 |
| MoneyMaker | 21 | 12 | 11 | 10 |
| BOATS | 0 | 4 | 3 | 3 |
| PICO | | | 2 | 2 |
| | 51 | 57 | 44 | 41 |
| Interest expenses | (15) | (12) | (11) | (11) |
| Income B4 tax | 36 | 45 | 33 | 30 |
| | | | | |
| Income tax | (10) | (13) | (10) | (9) |
| | | | | |
| Income after tax | 26 | 32 | 23 | 22 |
| Loss from discontinued operations | (3) | (18) | 0 | 0 |
| | | | | |
| Net Income | 23 | 14 | 23 | 22 |
| | | | | |
| Capital Expenditures | | | | |
| BEIGO | 53 | 47 | 36 | 33 |
| MoneyMaker | 1 | 1 | 1 | 1 |
| Boats | 1 | 1 | 3 | 1 |
| PICO | - | | | |

Balance Sheet

| (million \$) | 2011 | 2010 | 2009 | 2008 |
|---|------|------|------|------|
| Assets | | | | |
| Cash | 29 | 39 | 39 | 22 |
| Accounts receivable | 44 | 39 | 32 | 37 |
| Inventories | 14 | 13 | 11 | 15 |
| Marketable securities | 366 | 233 | 283 | 288 |
| Other investments | 26 | 26 | 26 | 17 |
| Land | 11 | 11 | 13 | 13 |
| Other investment | 491 | 378 | 298 | 345 |
| | | | | |
| Plant and equipment | 880 | 780 | 658 | 650 |
| Accumulated depreciation | -62 | -52 | -42 | 40 |
| Assets from discontinued operations | 0 | 35 | 0 | 0 |
| | | | | |
| | | | | |
| Total Assets | 1799 | 1502 | 1318 | 1427 |
| | | | | |
| Liabilities | | | | |
| Accounts payable | 32 | 29 | 29 | 60 |
| Deposit liabilities | 710 | 697 | 610 | 623 |
| Short-term borrowings | 112 | 13 | 8 | 5 |
| Securities sold | 41 | 1 | 0 | 0 |
| Advances from Federal Home Loan Bank | 205 | 156 | 110 | 145 |
| Long-term debt, net | 239 | 232 | 202 | 204 |
| Deferred income taxes | 67 | 57 | 57 | 45 |
| Unamortized tax credits | 65 | 55 | 35 | 36 |
| Total Liabilities | 1471 | 1240 | 1051 | 1118 |
| Shareholder Equity | | | | |
| Preferred Stock from Brightland | 3 | 2 | 2 | 2 |
| Shareholder equity | 302 | 249 | 249 | 282 |
| Retained earnings | 23 | 11 | 16 | 25 |
| Total Shareholder Equity | 328 | 262 | 267 | 309 |
| Total Liabilities and Shareholder Equity | 1799 | 1502 | 1318 | 1427 |