Transfer of experiential and innovative teaching methods for business education

Leonardo da Vinci Project

Transfer of Innovation

2010-1-PL1-LEO05-11462

Sphinx

Teaching notes

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The project has been funded with support from the European Commission under the Lifelong Learning Programme. This publication reflects the views only of the authors, and the Commission cannot be held responsible for any use which may be made of the information contained therein.

The case study is designed to consist of two parts to be discussed one after another. The target group of students are MBA and postgraduate students. The principal subject areas that the case study explores are:

1. Strategic financial management – how to design a development programme for a firm and how to collect enough funds to finance growth.
2. Mergers and acquisitions – when is it profitable to take over another company.

To take part in the discussion student should have completed the following courses:

1. Principles of corporate finance
2. Principles of financial accounting
3. Principles of capital markets

Sphinx's riddle I:

The discussion within part one can be started by posing the following questions:

What would you do if you were Morawski?

What would you do if you were McGovern?

The students can be divided into two groups. Members of the first group take the role of Mr Morawski to consider such issues as – Would you sell your stock or not? If yes how much? What are the arguments for and against selling?

Members of the McGovern group would be asked to consider – Would you try to persuade Morawski or not? What are the arguments for and against buying Sfinks stock?

Students should pay close attention to the individual characteristics of Morawski and McGovern during the discussion.

Sfinks S.A. is a growing company, but smart students should identify some risks and doubts:

1. Is the management able to control a rapidly growing organisation that operates on a franchise basis?
2. Is the Sphinx franchise network organisation efficient?
3. Do you think the Sfinks company would able to gather the necessary funds to support further growth at a reasonable price?
4. Was the decision to buy *Chłopskie Jadło* a good choice?
5. Was the decision on entering foreign markets a good choice?

Sphinx's riddle II:

The discussion in part II can begin with a summary of the basic facts from part I and the actual history of the purchase of Sfinks's stock by American Restaurants. The situation after the raiding firm took control of Sfinks was different to the expectations of both sides. Mr Morawski was left with a considerable stake in Sfinks S.A. and no control over his creation; Mr McGovern finds himself managing a firm in an unexpectedly bad financial situation.

Should Mr Morawski have felt cheated?

Should Mr McGovern have felt disappointed?

The first part of the debate should lead to various conclusions defining the mistakes made by Tomasz Morawski and Henry McGovern.

Afterwards the question "What to do next?" should be posed.

The students can again be divided into two groups, one playing the role of Morawski, and one playing the role of McGovern. Morawski's group should decide whether to try to sell the rest of the stock or try to reconquer the company. McGovern's dilemma is whether to sell the Sfinks stock and incur a considerable loss or try and hold on to control and conduct deep restructuring.

The actual story was as follows. It is suggested that the information below be presented after the discussion. Teachers are free to use some of these facts during the discussion:

Mr Morawski reconquers Sfinks

In Tomasz Morawski's opinion the financial situation of Sfinks S.A. was not so disastrous. At the beginning of January 2009, Mr Morawski, still possessing 28% of the company's shares, applied for the convening of an Extraordinary General Assembly, during which the changes to the Supervisory Board would be decided. His main goal was to become the CEO of the company. He had never run Sfinks S.A. as company CEO before.

The Extraordinary General Assembly (EGA) that was convened on the initiative of Mr Morawski was to be held on 18th February 2009. After the announcement of his plans the price of Sfinks stock fell to 7.8 zł. Analysts stated that the behaviour of the Commercial Union OFE (11.8% of shares) would be crucial in what would happen to the Sfinks company. On

12th January 2009, the Fund announced that it wanted to call in an extraordinary auditor, who would check the books of Sfinks S.A. and decide whose opinion was right. Expectations regarding the EGA seemed to be very promising for the market, and the price of Sfinks stock rose to 11.67 zł by the end of January. February 2009 began with the offer by Tomasz Morawski, addressed to American Restaurants and other investment funds, to purchase Sfinks stock at 10.9 zł. There was no response to this offer, but it held the market price slightly below 11 zł. It did not last long. On 17th February 2009 the Management Board of Sfinks S.A. filed a bankruptcy petition at court based on composition agreements. It stated that company was not able to repay its bank loans.

The EGA began with the report of the Management Board explaining the reasons for the bankruptcy announcement. Bank accounts had been blocked, bank loan repayments were interrupted and bailiff seizures were obstructing operating activity. Additionally, Sphinx restaurants were losing customers (-17% in January 2009). At noon, it was revealed that PKO BP had cancelled its credit agreements and demanded full repayment by 27th February. During the debate, Tomasz Morawski announced a plan for new investments in Sfinks S.A. equity and his willingness to take the post of CEO. As the voting began the financial investors became active. Following a proposal by the Commercial Union OFE, the special auditor was called on to review the financial situation of the company. OFE Polsat suggested expanding the range of duties for the auditor to include an examination of the background to the bankruptcy proceedings. The proposition was passed. Then the EGA was suspended to 4th of March. The changes to the Supervisory Board were not voted on.

In the communiqué after the EGA the Management Board of Sfinks S.A. declared its determination to restructure the company. The first steps would be withdrawing from foreign investments, selling Chłopskie Jadło and closing all restaurants generating losses. Also, more determination was needed as far as dealing with the franchise fees was concerned.

Soon, new troubles descended on the Sfinks Management Board. The court refused the petition for bankruptcy because of formal mistakes. ING Bank Śląski cancelled another credit deal and demanded the repayment of 47.9 mln zł by 26th February. Burdened with the problem of insolvency, the management of Sfinks S.A. let Mr Morawski become a creditor of the company. He offered to lend the company money for delayed rent payments on restaurant real estate. He was determined not to lose these sites.

On the 25th February Tomasz Morawski announced an offer to purchase Sfinks stock once again. This time the price was 9.9 zł. In an interview for Parkiet, Mr McGovern declared his *willingness either to sell stock to Mr Morawski or to cooperate with him in taking the necessary actions leading to the recovery of the company.*

On the 27th February 2009 the Management Board of Sfinks S.A. filed its bankruptcy petition based on composition agreements at court once again, with corrected appendices. Additionally, the Management Board announced that the company was not able to pay the special auditor, and the contract with BDO Numerica was not signed. The second offer by Tomasz Morawski, valid until 2nd of March, was not answered positively, either by American Restaurants or by other financial funds. When the EGA reassembled, the debate was postponed by four additional days.

Sunday 8th March 2009 is marked as a turning point in the struggle for control of Sfinks S.A. During the EGA (part 3), American Restaurants declared that it would sell all its Sfinks stock (3 061 786) for the sum of 30 464 771 zł. Five new members, supported by Tomasz Morawski, replaced the representatives of American Restaurants on the Supervisory Board. The support of existing financial investors was encouraged by the declaration of Mr Morawski that he was cooperating with a group of investors willing to raise the equity of Sfinks S.A. by up to 50 mln zł. Two days later the new Board appointed Tomasz Morawski to the position of company CEO.

Who were these mysterious investors? This was revealed on the 26th March 2009. American Restaurants sold all its Sfinks stock to a company called OrsNet controlled by Sylwester Cacek, the founder of Dominet Bank. "My investment in Sfinks at this stage will allow the company to survive this critical moment and restore its credibility towards investors and financial partners", commented Sylwester Cacek, the main shareholder in OrsNet. At the beginning of April 2009 Mr Cacek lent Sfinks S.A. 30 mln zł so it could fulfil its financial obligations. This enabled the company to sign various agreements with the banks on restructuring its loans. PKO BP, Reiffeisen Bank Polska and ING Bank Śląski withdrew their cancellation of credit decisions. The contract with Mr Cacek stated that the sum credited to Sfinks S.A. would be repaid 30 days after completing the agreements with the banks and could be converted into company stock. These days, the situation of Sfinks S.A. can be briefly summarised by the title of a certain article in the press: "Sfinks takes a breather".

P.S. At the end of 2011 Mr Morawski owned 6.47% of Sfinks S.A. stock and was a member of the Supervisory Board. He was helping Mr Cacek to manage the company and lead it through debt and market restructuring. In 2011 Sfinks S.A. achieved a 6% growth in sales which reached 170 mln zł. Unfortunately it was still incurring losses of 16 mln zł.