T4 - Part B – Case Study

N Multi-channel retailer case - September 2013

REPORT

To: Finance Director of N

From: Management Accountant

Date: 28 August 2013

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1.0 Introduction

N is a profitable company but is facing fierce competition in a tough economic environment.

The over-riding problem for N is that its financial performance, whilst still profitable, is declining and is not forecast to improve in the next three years unless action is taken. Doing more of the same is not an option for N, 4J and the other institutional investors will be looking for a stock market flotation at some time in the near future.

N does not appear to be meeting some of its customers' expectations. It is falling behind its competitors, particularly in its online sales and is faced with a number of problems both in its value chain and in some of its international operations.

Home sales in country Z are also affected both by the recession and by increasing competition.

As the PESTEL analysis in Appendix 1 indicates, the political and economic situation in Europe is a major threat to the future profitability and growth of retailers like N because the economic recession is reducing the amount of consumers' discretionary income.

The Five Forces analysis in Appendix 2 suggests that while the threat from suppliers, buyers and substitutes is low and that from new entrant's only moderate, competitive rivalry is fierce as the battle for market share becomes ever more intense amongst the big players in the industry.

The SWOT analysis in Appendix 3 indicates that while N enjoys a strong brand and opportunities for further growth in emerging markets (provided appropriate strategies are adopted) and potential gains from the development of its, 'click and collect' business are exploited, it suffers from a number of potential threats and current weaknesses. If successful this would be an example of Ansoff's, existing products, new channel, and Porter's differentiation of service offering.

The economic and competitive threats have been noted above but threats also arise from operational weaknesses within N itself. These include problems and issues arising from the lack of integration of its multi-channels that have led to its need to acquire out-of-town outlets and weaknesses in merchandising that have required extra spend on promotional activities. More generally however, N's inability to add value has necessitated an examination of its value chain to determine the exact causes of its relatively weak performance.

In many ways N does not appear to have moved forward. Retail organisations operate in a fiercely competitive market place, and must continually innovate, otherwise they will end up like Lewis's a large well known chain of UK department stores which had successfully traded for nearly 140 years but then went into administration in 1991.

The key issues are prioritised in section 3 of this report, and discussed and evaluated in section 4. Section 6 then summarises the main findings and makes recommendations.

2.0 Terms of reference

I am the Management Accountant appointed to write a report to the Finance Director which prioritises analyses and evaluates the issues facing N and makes appropriate recommendations.

I have also been asked to prepare an e-mail for the FD explaining the strategic, financial, and operational factors which need to be taken into account in deciding whether or not to make a bid for P.
3.0 Prioritisation of the issues facing N

The priority listing has been arrived at following an evaluation of the essential timing of each issue and in terms of an issue’s ultimate importance to the organisation.

3.1 Top Priority – Improvements in the Value Chain

Value chain analysis and co-ordinated procedures to improve systems and add value should become part of a continual improvement and development process.

The reasons why this has been made the first priority is because it addresses a number of urgent weaknesses that N faces, and in particular its poor performance in the increasingly important online sales channel.

In the case of N it appears that considerable profit improvement can be achieved with relatively modest improvements in co-ordination and improvements to some of the value chain activities. These should be facilitated on an on-going basis.

3.2 Second priority – Expansion by acquisition (P)

This is an essential strategic move, which is financially viable. If N fails to take this opportunity it will find it difficult to develop and compete with businesses that have invested in the on-line multi-channel model.

The reason for considering this as a high priority are two-fold; firstly it provides N with a mechanism for market expansion in its own country of Z, and secondly provides a platform for N to grow its online sales channel.

3.3 Third priority – Marketing proposal

This is considered as the third issue as it involves a considerable increase in the marketing budget which if acted on promptly will improve sales and profitability. Initial indications are that it is worth N investing in additional marketing in order to maintain and improve its competitive position. This will more than pay for itself. However there may be doubts concerning the validity of the forecast or the assumptions on which the forecast is based, so therefore a thorough review is required.

3.4 Fourth priority – International Markets

Continual business development needs to be an essential part of medium / long term strategy. The method of development needs careful consideration but where there are opportunities they should be investigated and pursued. The undertaking in Country G and the relevant findings will be an important part of the development strategy.

3.5 Ethical issues

The ethical issues of health and safety and staff participation need to be attended to directly but these can be managed alongside the other issues.

4.0 Discussion of the issues facing N

Overview

The Company is facing an increasingly competitive trading environment as the traditional market environment and customer behaviour change and communication technology becomes an increasingly important factor in all aspects of society.

Improvements in the value adding activities and the links between these activities are required to ensure N is organised and prepared for all aspects of the rapidly changing retail environment.
This is particularly relevant to customer purchasing trends where ease of access to information regarding purchases and the ease of ordering goods and services on-line has resulted in a shift away from traditional retailing methods.

This means that products must be up to the standards required by the market both in terms of quality and price and that they are easily comparable using on-line technology.

Products must also be easy to access via N’s customer interface as seamlessly as possible.

There is also a necessity to maintain traditional retailing operational strategies, countering the competition through traditional media and by strategies of global expansion to enable access to overseas markets. Whilst needing to adapt, N must do so by incorporating a determination to add value in all aspects of its operations.

4.1 Improvements in Value Chain

Relatively small increases and efficiencies which can be highlighted by the value chain can lead to large profit improvements. If the management team can achieve its 1% improvements then operating profit could improve by 18.6%, for the year in the next 6 months (Appendix 4).

Nevertheless this is a very demanding challenge for N, but Porter’s Value Chain does help provide a structured approach to identifying the main business processes in the Company.

As can be seen in Appendix 4 the operating profit improvement is expected to come in part from increases in sales, both price and volume.

However increasing sales prices and volumes in markets affected by recession and competition will be difficult. Using Porter’s 5 Forces Framework, we can see that N is exposed to some particularly powerful forces. In particular the choice of distribution channels that are available to customers and the relatively low barriers to entry into the industry. This is supported by Z government’s policy of encouraging competition.

In order to achieve the required sales growth N will need to convince customers of its product offerings. The primary activities in the value chain are likely to be the key here, but in themselves will not be sufficient.

While achieving high levels of customer service and satisfaction is critical, the starting point is increasing potential customers’ awareness of N’s products. This needs to begin with a major review of the effectiveness of N’s marketing strategy. As an example, N could reflect on a successful UK company like Marks & Spencer which until fairly recently thought it didn’t need to advertise at all.

However, having attracted customers it is then essential to meet their expectations, and this is where N is demonstrating a number of weaknesses. N has had some instances of slow deliveries from suppliers, stock-outs, and the inability of some customers to return online purchases to their local stores. This indicates that a coordinated approach is urgently required between inbound logistics and stores operations.

N’s main support activities are also crucial in achieving high levels of customer satisfaction, but again N has some weaknesses here. In particular there appears to be a lack of a consistent strategy for procurement, sometimes buying on price and at other times using preferred suppliers. If the cost of goods purchased and overhead costs fall by 1% then this infers savings of Z$ 19.16 million in a full year, (Z$ 9.58 for the 6 months to 31.03.2014) in the purchase of goods for resale and other overhead costs (Appendix 4).

Whilst purchasing from the cheapest suppliers has an appeal in the short-term, many companies, such as Nissan Cars for example, developed longer-term strategic alliances with their main suppliers as a route to improving cost effectiveness.
Other support activities that are impeding an improvement in N’s performance are briefly, the Company’s infrastructure with too few stores to support the return of any online sales, and the lack of technology development compared with competitors’ integrated multi-channel structure.

A more detailed view of the value chain and its potential application to N is as follows

- Value chain analysis describes and evaluates the activities within and around an organisation together with the links between activities and relates them to an analysis of the competitive strength of the organisation. Therefore, it considers the value each particular activity adds to the organisation’s products or services and provides a basis for how the activities and the links between activities can be improved. Porter argues that the ability to perform particular activities and to manage the linkages between these activities is a source of competitive advantage.

- The primary and support activities of an organisation are indicated in the diagram above as set out in Porter’s model of the value chain. Porter devised his model to help in the analysis of the value adding activities of a typical manufacturing company but it is possible to apply the model to a retailing organisation like N.

- Beginning with the primary activities and making use of expert opinion from our senior executive directors during the recent strategic review of the Company we offer below a summary of N’s main strengths and weaknesses.

- Starting with inbound logistics it is evident from the IT Director’s presentation that N has back office logistical problems which prevent smooth and reliable delivery of product from manufacturers/suppliers to N’s central and regional warehouses and to stores on time and in the required quantity. N suffered a number of stock outs running up to national seasonal celebrations and this points up the urgent need for a modernisation of the product ordering and communication system more generally. Even a cursory comparison with N’s competitors suggests that N has a major weakness in this area.

- Operations and outbound logistics have rather different meanings in a service based retail organisation than in a manufacturing context. In a retail organisation the term ‘operations’ can be
taken to mean all the activities usually covered in merchandising while ‘outbound logistics’ can include the actual sale of goods in-store or on line and the packaging and parcelling/wrapping of goods for the customer to take from the store or to be forwarded by courier to the customer’s home. In terms of its product assortment it is clear that there is a major weakness in this area with the sale of women’s fashion items being very slow moving. The Merchandising Director’s plans will hopefully rectify this but it will be some time before N will catch up with the competition in this area.

- It is evident from the reviews undertaken by the Merchandising Director and the Estates Management Director that modernisation of N’s stores is going well and that customers find the new format attractive. This suggests that the investment in modernisation of the stores is paying off and that N has now caught up with the competition in this respect; this suggests strength in this area.

- In marketing and sales, N Company appears to be struggling with sales of some items and the request for extra funds to promote these products is not a good sign. Indeed it seems to bear out the Merchandising Director’s belief that some of the products N has in stock are not the ones that customers want to buy. White goods and electrical items do seem to be selling well although as the Sales and Marketing Director pointed out in his presentation, now is a good time for N to increase its own brands, spend more on the promotion of some lines and to seek agreement with its manufacturing suppliers to provide N with own label electrical and white goods.

- The term ‘service’ in the value chain model often refers to after-sales service in the manufacturing context. In the retail context however, it has a much broader meaning and includes the quality of personal service offered to N’s customers in-store as well as on N’s online help-line. It also covers how efficiently N manages its customer service operation on return of goods both in-store and online. As the HR director has explained, the excellent customer service that had formed one of the cornerstones of N’s competitive strategy had continued to be a differentiating factor but competitors are catching up and it is essential that N maintains its investment. She also believed that it is as essential to train local managers and staff working in overseas subsidiaries as thoroughly as staff in the home country if N’s brand is to be maintained in its international businesses.

- The infrastructure of N has to do with the companywide context within which all other value creation activities take place. It thus includes the organisational structure, control systems and culture of the Company. Since top management can exert considerable influence on shaping these aspects of the Company, the senior management can also be viewed as part of the infrastructure. The recent changes in some of the senior positions within N can be seen as a signal of intent by the board of the Company that the existing infrastructure is not fit for purpose and that an upgrading of the infrastructure to make N more competitive is underway. More particularly the decentralised multi-channel structure in N appears outdated when compared with the integrated structure employed by N’s major competitors. The fact that customers are experiencing the frustration of being unable to return goods to many of N’s stores is just one manifestation of the problems that N’s decentralised multi-channel structure is causing.

- Aspects of human resource management have already been referred to when talking about service support but as the HR Director pointed out in her recent presentation, continuing investment is needed in recruitment and training if N’s reputation for personal service is to be maintained as a source of competitive advantage.

- Technology development in a retailing operation such as that in N is a dispersed activity and involves not only on-going measures to improve the technical systems of hardware and software involved in accounting and control, delivery of product to stores, and of product to online customers but covers all innovation whether this be in design of new products, improvements in the assortment and display of goods and so on. Reports from the strategic review suggest N is lagging in so many respects that a review of how N could improve the way it conducts its technical development process should be undertaken.

- Procurement is more than a support function in the retail industry, it is a vital primary activity and as the Director for Procurement made clear in his presentation the policies and procedures in this...
function need to be reviewed as this is an area in which much value could be added. To date, N
does not seem to have a consistent policy on procurement and this fact together with the IT
Director’s assertion that N’s delivery system of goods to stores is less efficient than that of
competitors suggests significant weakness in this area.

- As a final comment on N’s value chain, it could usefully consider adopting a framework such as
  the Balanced Scorecard which emphasises that good financial performance can only come from
  success in marketing, operations, and learning and growth (including HR and IT in particular), and
develop some key metrics of performance in each of these areas.

4.2 Expansion by acquisition

- This represents an opportunity to diversify the business, and develop other sales channels.

- The top priority is to ensure that the business is able to expand and compete in all sales
  channels, the acquisition is also an opportunity to expand and diversify for the future and appeal
to a wider customer base. In the short term this will enable profitability to be improved, and in the
long term will ensure the continued survival and development of the Company.

- The Company is facing a number of challenges as discussed below and needs to meet the
  expectations in particular of its institutional investors.

- Venture capital Company 4J is willing to support this investment and it will just meet its criterion of
  a 5 year discounted cash flow payback (see Appendix 4).

- An important point to note is that the amount of information available at present is limited. In
  forecasting the profit (cash flow) from operations of P, for discounting purposes, it is assumed that
  depreciation is offset by capital asset replacement and that any working capital implications
  resulting from the integration with N are neutral.

- Knowledge of the business and the reliability of the financial information are key to the success of
  the acquisition. The accuracy of forecast benefits is dependent on the predicted growth rates
  being achieved. The most recent results appear to show a decline in P’s profit from operations
  between 2012 and 2013.

- Integration issues will need to be considered, proposed management structure, time and costs
  must be taken into account.

This issue can be evaluated using Johnson, Scholes and Whittington’s SAF framework. As with any
major acquisition N would have to ensure an adequate due diligence of P. Ms. Bilder has already
stated that she considers N’s management of risk to be inadequate. Acquisitions can create a number
of problems, such as managing the larger business and achieving forecasted synergy benefits.

It is a well-known fact that the major beneficiaries in many takeovers are the shareholders of the
business taken over. There is always a danger in paying too much.

Suitability – the purchase of Company P would be a useful one for N. There are a number of benefits
to the acquisition; it enables N to grow market share in its home country of Z and addresses one of
N’s weaknesses in not having enough stores in out-of-town or city sites. Having more out-of-town
stores would support N’s online sales initiatives, which is where the market is growing. It also offers
an opportunity to expand into food retailing, broadening the customer experience.

Acceptability – the venture capitalist are looking to recover their investment in P within 5 years, and it
can be seen from Appendix 4 that this target will be achieved in terms of discounted operating profits.
The proposed investment appears to be Z$ 1078 million, whilst the discounted return over the next 5
years is forecast to be Z$ 1084.5 million.
Another way of looking at the potential financial benefits of the acquisition would be to consider the undiscounted after tax cash flows expected over the 5 year period. These are forecast to be Z$1292.6 million less N’s current tax rate of 28% i.e. Z$ 930.7 million.

Feasibility – 4J has the finance available. The acquisition of P would of course be expected to provide N with financial benefits well after the next 5 years. An alternative that could be considered would be to negotiate a lower purchase price for P. Assuming a tax rate for P of 28%, P’s valuation of their business is over 11.5 times their 2013 profit after tax (i.e. Z$1078/ (Z$130x72%). Negotiation may be feasible.

Could N itself contribute towards the investment? This would need to be discussed with N’s bankers who are an important stakeholder in the business (using Mendelow’s framework). N’s loan position at the end of March 2013 was a debt of Z$ 530.1 million, which is within the current bank finance agreement of Z$ 600 million, but well below the funding level required. Additional bank support may be limited in the current economic climate.

A further feasibility issue for N to consider is whether or not the government in Z may wish to review the takeover of P. Z has a competition policy in place, and N would need to ensure that it would not breach any regulations in force.

4.3 Marketing proposals

The investment in the campaign of Z$ 45.0 million would if successful result in increased sales of Z$ 84.8 million generating an increased contribution of Z$ 53.6 million and generating a positive contribution of Z$ 8.6 million as a result of the campaign.

If the Sales & Marketing Director’s predictions are correct it is imperative that the Company maintains and improves its position in the clothing sector, further campaigns should be planned if the results are reasonably certain. These should be designed to target sectors where volume increases and margin improvement can be achieved.

There may be doubts however; recent sales forecasts have not come up to expectations and there are other market/product issues which the Merchandising Director has referred to, namely racks of unsold garments, and gaps in the range of clothing offered.

Despite the apparent time pressures as much information as possible concerning the costs and focus of the campaign needs to be made available. Z$ 45 million represents a 30% increase in the promotional budget compared to 2012/2013; the forecast sales increase is Z$ 84.8 million. The cut off point for success is 84% of the forecast increase in sales, anything lower than this will not produce any financial benefit and will reduce profits, (Appendix 4). The confidence level of success needs to be ascertained.

Discussion will be required to negotiate the details of the campaign with the Sales and Marketing Director. Within the marketing mix of 4 Ps, it is necessary to ascertain if this campaign is the most effective way of moving forward. Are there other means of increasing perceived value? Where are these products in the product lifecycle; should they be promoted or new ranges introduced and promoted?

This is an example of promoting existing products, in existing markets (Ansoff). Using this model, due consideration needs to be given to other marketing options. These may be a more effective use of resources.

4.4 International Markets

Ms. Bilder is “very concerned” about N’s failure to achieve the expected returns from Country G. However it would appear that this problem is also common to N’s competitors.

My (the Management Accountant’s) comments are as follows:
Ms. Bilder already considers that N’s approach to risk management is inadequate, and N’s approach to investing in G would appear to be an example of this. In particular N has made two significant errors of judgement i.e. a failure to address the specific retail market in G, and a failure to adequately research the business environment in G. Investing in overseas markets is fraught with danger; for example even well-established UK companies such as Tesco with their ‘Fresh and Easy’ in America, and Marks & Spencer in France had the embarrassment, and cost, of investing and then withdrawing from these markets. Marks and Spencer are having a go again with one flagship store in France. It would appear that N has been very naïve in assuming that what works in one country must work in another.

The problem with N’s retailing strategy in Country G is that it appears to have been based on an inadequate assessment of the retailing environment in that Country. Like the other multinational retailers that set-up retailing operations in Country G, N seems to have assumed that what worked successfully in its home country and in many other countries around the world would be equally successful in Country G.

The fact that N’s stores in Country G have underperformed indicates that the chosen strategy is not working and given that other foreign entrants using a similar standardised ‘global’ strategy are also underperforming, it does appear that this type of strategy is inappropriate in the Country G retailing context.

The fact that Country G’s consumers differ in their tastes from those of consumers in other countries in which N operates suggests a need for N to tailor its product assortment to match the tastes of Country G’s consumers, a strategy widely referred to as a ‘localisation strategy’.

To date there does not appear to have been any systematic collection and analysis of the available data on the business environment in Country G and some key data is also missing in relation to the retail market in Country G. For instance a systematic PESTEL analysis does not appear to have been conducted so that N has limited information on the political, economic, social, technological, ecological and legal aspects of the prevailing business environment.

As to data on the retail market in Country G, N does not appear to have information on market size, market share or market growth. As no data from any competitive analysis has been made available the question arises as to whether or not this has been conducted. Thus we have no information provided on the number, size and strategies of competitors and cannot therefore make any realistic assessment of the competitive challenge from them.

There is also the question of whether or not an adequate risk assessment has been conducted. The fact that the details from a PESTEL analysis have not been made available suggests that this has not been undertaken and must be a cause for concern.

The root of N’s problems in Country G will inevitably be found in one or more of the 4 P’s in the marketing mix i.e. in the product, place, price and/or promotion of the business.

Taking each in turn:

**Product** – the FD team’s preliminary findings already indicate that there is a problem with the product offering. It would appear that a combination of consumer taste and products failing to reflect the climate are the problems. Perhaps N is trying to sell too high a proportion of its own-branded products.

**Price** – inevitably prices in European countries, even outside of the euro zone like Country Z, will tend to be higher than those in emerging markets like Country G. Has N possibly over-priced its products in the first place, or more likely failed to react promptly to competitors pricing strategies. There would appear to be a number of foreign new-comers in Country G and it is inevitable that local competitors in Country G will have reacted vigorously to the threat to their market share, and will probably have been reducing their prices.
Place — N’s current distribution channel has traditionally been town and city centre stores. However is this where consumers in Country G do their shopping? Inevitably Country G will have a number of major towns and cities, but competition is likely to be fierce here. Perhaps a higher than normal proportion of the population lives in rural areas where population density may not make investment in stores a viable proposition.

Promotion — on investing in Country G it is likely that N will not have been well known to consumers. Has N invested enough in advertising, and promotional discounts?

Careful research of the current and likely market forces would be essential before directly investing in a foreign country. Possibly joint-ventures with local companies could be considered as a lower risk strategy to market entry into a new country.

In particular there needs to be a thorough market research exercise undertaken as to whether or not N’s standard products are likely to be suitable for local country consumers.

4.5 Other Business Issues

Apart from the above four main business issues, N is also facing two other specific issues that have both a business as well as an ethical aspect to them. These are discussed separately in section 5 below.

4.5.1 Store refurbishment

The recommendations on this issue are included in the Ethics Section in 5.

4.5.2 Departmental management

The recommendations on this issue are included in the Ethics Section in 5.

5.0 Ethical issues and recommendations on ethical issues

5.1 Store refurbishment

Harmful material has been discovered, not by N’s Contracts Manager or its contractor, but by one of the government’s H&S Inspectors. This issue has both a business and a reputational aspect. Not only is this embarrassing for N, but from a business perspective it is damaging to its reputation and leaves itself open to potential compensation claims from some customers and employees. N also has a legal duty of care to provide a safe environment for both employees and customers.

This issue is considered to be an ethical one on two grounds. First the contract has been awarded by the Estates Management Director simply on the grounds of cost and without any consideration of the competence of the chosen contractor to carry out the refurbishment in a manner which would ensure the safety of staff and customers in the immediate vicinity of the store undergoing refurbishment.

Secondly, the process involved in the appointment of the Contracts Manager to N appears to have been seriously flawed. The fact that the Contracts Manager has turned out to have limited experience and consequently failed to supervise the refurbishment in a way that ensured the safety of all concerned is an indictment of N’s recruitment procedures.

N and more particularly the Estates Management Director have an ethical duty to behave with professional competence and due care to its customers and employees (one of CIMA’s fundamental principles). By failing to appoint a competent Contracts Manager to supervise the contractor working on site, N, and the Estates Management Director in particular have failed in their duty.

This case strongly suggests that N’s representative, the Estates Management Director, did not take the health and safety of consumers, staff and members of the public into full account when undertaking the refurbishment. Apparently the Estates Management Director did not specify clearly enough in the project requirements to contractors that all possible safety precautions should be taken.
The potential existence of harmful material in building materials has been well publicised for many years and so there was no excuse for not taking precautions.

5.1.1 Recommendations

The incident unfortunately has now happened and there is nothing that N can do about this particular event. However it is clear that N must take swift action to prevent this occurring again. It is therefore recommended that the Estates Management Director has a meeting with the site Contracts Manager and the contractor to determine how this event has happened.

It is then imperative that a meeting is arranged with the H&S Inspectorate to reassure it that this is an unfortunate one-off incident and that N’s policies and procedures for store refurbishment are to be reviewed, and if found lacking to be improved.

It is further recommended that instruction be provided to all of N’s Contract Managers, that adequate supervision of contractors used at the Company’s stores must be maintained at all times, and that if any harmful materials are discovered during refurbishment that the Estates Management Director be informed immediately.

N also needs to review its selection, training and development policies and procedures to ensure that Contracts Managers have the required experience and capability to carry out their role competently.

Though this is an ethical issue, there are also business implications of this breach of Health and Safety rules. First there is the reputational damage to N. Any modern retail organisation that puts the safety of customers and staff in jeopardy will inevitably attract negative press comment and N will need to be ready to provide a press release that shows regret for the incident and spells out the measures taken to reassure customers and staff that it will never happen again.

There is also the chance that N will incur heavy fines for the breach of Health and Safety regulations and there may be associated costs from legal action brought by customers, staff and members of the public exposed to the harmful dust. In this respect it may be in N’s interest to arrange for free medical screening of persons who have been exposed to the dust. It may also be useful to offer added reassurance by arranging for independent specialists to provide advice on the very limited risk of passing exposure to windblown dust of this kind.

5.2 Departmental management

There are two aspects of unethical behaviour here; first is that of the attitude of the clothing department manager to his staff, and secondly that of the store manager who appears to be condoning his clothing department manager’s behaviour.

The reason why these actions are considered to be unethical is that in the first instance the clothing department manager is failing in the principle of professional competence and due care by not considering what may be good suggestions by his staff. However his actions are then compounded by exhibiting a lack of objectivity when dealing with staff making suggestions, even implying that their jobs may be at risk.

In addition C appears to be using his position power as head of the store clothing department to intimidate members of staff. The use of the kind of threats being issued are some of the worst kind in any employment relationship because if implemented they would undermine the future career prospects of the members of staff affected and even the continued employment of some members of N’s staff.

The fact that the senior manager has failed to take the complaints of staff members seriously and labelled such staff as ‘childish’ is also of concern. It is hard to ignore the possibility that the senior manager does not wish to interfere with his departmental manager’s management style and practices because the departmental manager’s performance as measured by the sales figures for the department are so good. In brief, the senior manager is putting the performance of the department before the decent and ethical treatment of his staff. Simply because the clothing department manager has the highest sales per square metre doesn’t mean that his actions should be condoned.
The behaviour of both managers is not only unethical, it is bad for the clothing department they are charged with managing and for N more generally because the kind of threats made will prevent any form of participation by members of staff in the efficient operation of the department.

5.2.1 Recommendations

Before any action is undertaken an investigation should be carried out by a senior member of staff in order to establish the facts of the case.

If the staff members’ complaints turn out to be a correct description of what has occurred it will be necessary for action to be taken by senior members of the Group’s retail operations acting on advice from senior members of the HR team.

Both C and his senior manager should be reprimanded separately by the Sales and Marketing Director and it made clear to them that this kind of behaviour is not acceptable in N Company and will not be tolerated. The consequence of non-compliance also needs to be made clear.

6.0 Recommendations

6.1 Improvements in the Value Chain

6.1.1 Recommendation

The FD to establish in detail how the value chain can be applied to improve operational activities and internal links within the value chain followed by subsequent analysis to determine improvements in links with the wider value system. The revenue generating and cost saving opportunities must be identified in detail. All areas of the Company to be involved, spirit of co-operation to be fostered, ‘team’ to be emphasised.

6.1.2 Justification

Relatively small overall efficiencies can lead to considerable performance and profit improvement. (Appendix 4)

6.1.3 Action to be taken

A number of issues have been discussed in section 4.1. In order to meet Ms. Bilder’s profit improvement target for 2013/14 the following actions are recommended:

A review of promotional spending

This review is necessary in order to gauge its effectiveness and market research is necessary to determine customer needs. The rationale is that in order to achieve the required sales growth N needs to know what customers want, and will need to convince customers of its product offerings. The justification for such a review is that there is evidence of some major weaknesses, particularly in the slow moving sales of women’s fashion clothing. It is imperative that this is promptly resolved.

A review of store operations

The rationale for this is that there have been some instances of slow deliveries from suppliers, stock-outs, and the inability of some customers to return online purchases to their local stores. This indicates that a coordinated approach is urgently required between inbound logistics and stores operations.

In order to achieve the required profit improvement there is an urgent need to review the procurement policy. It is proposed that N seeks a longer term agreement with fewer key suppliers who are able to deliver on-time, to an agreed and consistent quality specification, and to a competitive price. The
rationale is that developing longer-term strategic alliances with suppliers is considered to be a route to improving cost effectiveness.

A review of N’s relatively poor on-line sales performance

This review will need to consider all aspects of online sales including the present poor integration of the online sales system with that of in-store sales. In particular it will be necessary to ensure that the issue of inadequate store locations is addressed. The acquisition of Company P as recommended in section 6.2 will go a long way to provide the capacity for the click and collect system to operate effectively in Country Z.

It will also be necessary for N to ensure that its technology allows mobile users to access its services as easily and as conveniently as conventional desk top computer users.

Finally, N should introduce the Balanced Scorecard as a mechanism for monitoring performance across a number of key areas of the business. The rationale is that good financial performance can only come from success in other areas, and in particular those of merchandising and stores operations.

Recommendations to be implemented and monitored, process of continuous improvement to be encouraged by improved communications links and the encouragement of a task based culture (Handy).

6.2 Expansion by acquisition

6.2.1 Recommendation

The project to acquire P and integrate it into the business should be initiated as soon as possible.

It is recommended that 4J is persuaded to make the investment in P.

The rationale is that the investment, based on the forecasts, meets the requirement of 4J to recover its investment within 5 years. In particular it enables N to grow market share in its home country of Z with more out of town stores supporting N’s online sales initiatives, filling the gap where the market is growing. In addition, this investment in P would be expected to provide improvements in operating profits of over Z$250 million well after 2018/19. This would be very significant compared with the latest forecasted operating profits from N of Z$160.6 million for 2016, and obviously could be critical to a future stock market flotation of N, almost certainly desired by 4J.

6.2.2 Justification

Although forecast to be profitable, N is unable to expand: this is because of the lack of a suitable infrastructure and customer facing facilities, particularly relating to online activities.

The acquisition of P will not only enable the forecast online expansion to be achieved, but will also add a diversified and profitable sales channel, in the form of the supermarket customers.

6.2.3 Actions to be taken

The project approval and sign off to be agreed with 4J.

Once the Company has got 4J’s approval to make a bid for P then N should discuss the potential takeover with the relevant government department in Z to ensure that it would not be in breach of the competition policy in place. Having cleared these hurdles, N should then negotiate the purchase price and premium of 10% with P’s owners. This is particularly relevant considering P’s profit decline between 2012 and 2013.
The plans for effective integration of business into N need to be considered given the size of P. Care must be taken with this; P is operating successfully as it is. New systems will require development to allow online operation in the stores.

The staff in both companies will need to be counselled and kept informed of operational changes which will affect them.

6.3 Marketing proposal

6.3.1 Recommendation

The rationale for approving this campaign is that the forecast benefit of the Z$ 45 million investment is expected to be a higher gross margin of Z$ 53.6 million, a net improvement of Z$ 8.6 million giving a reasonable margin of error in the forecast. (Appendix 4)

However before approval is given a meeting should be held with the Sales Director for him/her to justify why such a significant investment is necessary, and in particular the basis for the optimistic 15% forecasted sales increase in womenswear. It is noted that the Merchandising Director has already expressed concerns over current sales performance of some product lines. It is therefore recommended that she also attends this meeting.

Further investigation needs to take place as to the validity and focus of the proposed marketing campaign.

Sensitivity analysis should be produced.

Board approval should be given only after due consideration of all aspects and alternatives.

6.3.2 Justification

The promotion will yield a positive return and maintain market position and customer awareness, and on this basis could be approved.

The campaign requires an 84% success rate just to break even; there is little room for error. Doubts exist however, as to the accuracy of the sales forecasts and the product focus of the campaign. If it is decided to proceed can the campaign be effective on a lower budget?

6.3.3 Actions to be taken

The campaign should be thoroughly reviewed, other directors, particularly merchandising to be involved.

Promotional spend should be monitored, and the possibility of reducing spend for same results should be considered.

Advertising agencies must be approached and competitive quotes obtained for the promotional campaign.

Monitoring of effectiveness should indicate if further campaigns will be required, or if a different approach is more appropriate.

6.4 International Markets

6.4.1 Recommendation

What I, the Management Accountant, would recommend in place of a standardised global strategy would be to form a management team to review any overseas investment. This team should recruit a retail industry consultant from the target country to provide specific country advice. There are a lot of
powerful forces (using Porter’s 5-Forces Framework) in the retail industry, and in particular the power of consumers, competitors and possibly government interventions.

In addition to the recommendations based on information already available that a localisation strategy be adopted, I would recommend that a more systematic assessment of the business environment, the retail market and the competitive situation be undertaken so that N can ground its future strategy in Country G on a firmer foundation.

In the process of adapting N’s strategy to the particular conditions that prevail in the retail market in Country G, however, N must be careful not to sacrifice the advantages which N’s current standardised ‘global’ strategy affords it. These advantages derive from its competences as a modern retailer, the scale advantages that come from its size and resources and its network of contacts with a range of suppliers across the globe.

Some recommendations were discussed in section 4.4 of this report. However to summarise these it is recommended that N does not use a standardised global policy when investing in international markets. The rationale is that the current policy is not successful, as demonstrated by N’s investment in Country G.

Instead it is recommended that careful research of the current and likely market be undertaken before directly investing in a foreign country, and that a retail industry consultant from the target country be recruited to provide advice to N’s Board of Directors.

It is also recommended that the entry strategy be reviewed on a country by country basis, whether this be acquisition of a target company or a joint-venture with a local company.

The rationale for these recommendations is that international investments are more risky than domestic ones and that such investment are likely to be significant. The culture, climate and political environment will be different for each country.

6.4.2 Justification

This is a medium risk strategy enabling the establishment of outlets over a wide geographical area, using local market knowledge. The opportunity to develop further can be judged at an appropriate time.

It will of course be important to keep in mind the cost of tailoring N’s offering to customers in Country G and in this respect N will be offering what theorists in the field refer to as a ‘glocalisation’ strategy which is a shorthand for seeking to obtain economies of scale by operating in a global manner by a process of standardisation wherever this is possible but catering to local demands wherever this is necessary to make a sale.

6.4.3 Actions to be taken

The International team is to conduct a systematic review of the business environment and retail market in Country G and on the basis of such a review to develop a more effective strategy. This should include a detailed analysis of the supply chain, on-going use of local focus groups and input from the local management and employees. This can be used as the basis on which plans can be made for specific actions to implement the strategy.

7. Conclusions

N is at a vital point in its corporate life, consumers in the home market are still demanding the same products but it is essential that modern supply channels are available. To this end the Company must ensure opportunities to expand and develop online ordering by various channels and ensure pick up and return facilities are made available to customers. N needs to provide a seamless ordering and delivery process.
Product lines, particularly clothing need constant review and updating, marketing spend must match opportunities and the best attempts made to accurately forecast demand across the range. Marketing campaigns must be closely monitored to ensure value is achieved.

Overseas opportunities must be monitored and taken advantage of when appropriate methods of acquiring overseas markets are considered viable.

Streamlining the value chain, extracting value and creating margin should be considered as a process of continual improvement; management systems need to be established to coordinate activities to this end throughout the Company.
Appendix: 1  PESTEL Analysis: Department Stores in Country Z

Political
On-going uncertainty about the future operation of the EU. Impact of government austerity measures to counteract debt position of several EC countries including that of Country Z involve threats to all retail businesses.

Economic
Euro-zone crisis manifested in low or zero growth, unemployment, wages freezes, welfare spending cuts—all impacting on consumption demand for goods and pose a threat. Continued growth in emerging markets offers potential opportunities for expansion abroad.

Social/cultural
Relatively affluent ageing population with different lifestyles than younger generation so changing patterns of consumption pose both opportunities and threats depending on retail strategies adopted by stores.

Technological
Developments in Information Communication Technology (ICT) enabling improved logistics of distribution, data collection on customer spending patterns, and speed in allocation of price information to all items pose both opportunities and threats depending on speed of take-up by stores.

Environmental
Concern with sustainability and preservation of the environment involves added costs but also opportunities.

Legal
Restrictions on mergers and acquisitions limit growth possibilities in domestic market but act as driving force to seek markets abroad.
Appendix 2  Five Forces Analysis of Retail Department Stores

New Entrants

Significant capital Requirements so low threat.
Brand image significant in the Department Store sector.
Scale economies in purchasing, distribution & advertising advantage large firms.

Suppliers

Supplier power is limited because of size and power of retailers.
Retailers buy from a large number of suppliers so not dependent.
Modern transportation allows retailers to source from areas of low cost labour.

Competitive Rivalry

Fierce due to competition from supermarkets, hypermarkets, speciality stores and large online retailers.
Consolidation in the retailing industry generally resulting in closure of smaller stores and competition increasing between larger retailers.

Buyers

Large scale department stores have potentially many buyers so individual buyer relatively weak
Many alternatives to buy from and low switching costs so strengthens hand of consumer.

Substitutes

A substitute for shopping in a department store may be shopping in other retailers with a different format, be these specialty stores, supermarkets or Web-only retailers.
Appendix 3  SWOT analysis of N Company

Strengths

National coverage and with a presence in growing economies such as Asia and the Middle East.
In depth experience in the retail sector with a strong brand.
Store modernisation places N amongst the leaders in store design.

Weaknesses

Value chain
Lack of integration of N’s multi-channels (leading to acquisition of out of town outlets issue).
Recent weakness in merchandising though past record generally good (leading to question of poor merchandising or need for extra spend on promotional activities).
Inbound logistics due to use of outdated technology and systems.
(All above giving rise to concern about N’s value adding activities).
Lack of expertise in environmental, competitive and market research especially in overseas markets.

Opportunities

Acquisition of P
Growth opportunities in overseas markets (involving issue of optimum mode of overseas development).
Demand for own brand products on rise due to current recession.
Trend towards more demand for non-food goods on a ‘click and collect’ basis.
Marketing proposal.

Threats

Economic recession and continuing Eurozone crises with associated unemployment, wage freezes, and cuts in welfare budgets is affecting demand.
Price increases in motor fuel, home fuel bills and higher food prices through bad harvests contributing to lower demand.
Fierce competition from supermarkets now stocking non-food products, specialty stores and big store international online discounters.
Younger consumers have negative image of department stores.
Appendix 4

Supporting calculations

Possible value chain profit improvements on forecast for 1.10.13-31.03.14

<table>
<thead>
<tr>
<th></th>
<th>Z$ million</th>
<th>Z$ million</th>
<th>Z$ million</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>First 6 months</td>
<td>Second 6 months</td>
<td>Year</td>
</tr>
<tr>
<td>Forecast sales</td>
<td>1,040.30</td>
<td>1,040.30</td>
<td>2,080.60</td>
</tr>
<tr>
<td>1% volume increase</td>
<td>10.40</td>
<td>10.40</td>
<td>10.40</td>
</tr>
<tr>
<td></td>
<td>1,050.70</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1% price increase</td>
<td>10.50</td>
<td>10.50</td>
<td>10.50</td>
</tr>
<tr>
<td>Total</td>
<td>1,061.20</td>
<td>2,101.50</td>
<td></td>
</tr>
<tr>
<td>Costs</td>
<td>958.45</td>
<td>958.45</td>
<td>1,916.90</td>
</tr>
<tr>
<td>1% saving</td>
<td>9.58</td>
<td></td>
<td>9.58</td>
</tr>
<tr>
<td>Total</td>
<td>948.87</td>
<td></td>
<td>1,907.32</td>
</tr>
<tr>
<td>Profit</td>
<td>112.33</td>
<td></td>
<td>194.18</td>
</tr>
<tr>
<td>Original operating profit</td>
<td>(2 x 81.85)</td>
<td></td>
<td>163.70</td>
</tr>
</tbody>
</table>

All calculations Z$ million

Profit improvement for the year to 31.03.2014 194.18 - 163.70 = 30.48/163.70 = 18.6%

or

112.33 - 81.85 = 30.48/81.85 = 37.2%

because in the second half they improve by 37.2% which is a measure of what a full year’s saving could be in future years.

An alternative view would be to take the cost of sales of 1,803.90/2 = 901.90 for the second half of the year.

A 1% increase in volume would make this 910.90, but the savings of 1% bring this back down to 901.80.

The overheads of 71.40 + 41.60 = 113.00/2 = 56.50 and with 1% economies will be 55.9. Total costs would therefore be 901.9 + 55.9 = 957.7 giving a profit for the second half of the year of year of 103.5 and 185.35 for the whole year.
Value Chain improvements:

<table>
<thead>
<tr>
<th></th>
<th>Z$ million</th>
<th>Z$ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Per suggested answer:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales volume increase</td>
<td>10.4</td>
<td></td>
</tr>
<tr>
<td>Sales price increase:</td>
<td>10.5</td>
<td></td>
</tr>
<tr>
<td>Cost of sales:</td>
<td>9.02</td>
<td></td>
</tr>
<tr>
<td>Distribution and admin:</td>
<td>0.56</td>
<td>9.6</td>
</tr>
<tr>
<td>Revised increase in operating profit</td>
<td></td>
<td>30.5</td>
</tr>
<tr>
<td>Revised operating profit:</td>
<td></td>
<td>194.2</td>
</tr>
<tr>
<td>Margin increase: 30.5/163.7 = 18.6%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

or:

<table>
<thead>
<tr>
<th></th>
<th>Z$ million</th>
<th>Z$ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales volume increase</td>
<td>10.4</td>
<td></td>
</tr>
<tr>
<td>Sales price increase:</td>
<td>10.5</td>
<td></td>
</tr>
<tr>
<td>Cost of sales:</td>
<td>0.10</td>
<td></td>
</tr>
<tr>
<td>Distribution and admin:</td>
<td>0.56</td>
<td>0.7</td>
</tr>
<tr>
<td>Revised increase in operating profit</td>
<td></td>
<td>21.6</td>
</tr>
<tr>
<td>Revised operating profit:</td>
<td></td>
<td>185.3</td>
</tr>
<tr>
<td>Margin increase: 21.5/163.7 = 13.1%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

If 1 year full effect applied:

<table>
<thead>
<tr>
<th></th>
<th>Z$ million</th>
<th>Z$ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales volume increase</td>
<td>20.8</td>
<td></td>
</tr>
<tr>
<td>Sales price increase:</td>
<td>21.0</td>
<td></td>
</tr>
<tr>
<td>Cost of sales:</td>
<td>18.03</td>
<td></td>
</tr>
<tr>
<td>Distribution and admin:</td>
<td>1.13</td>
<td>19.2</td>
</tr>
<tr>
<td>Revised increase in operating profit</td>
<td></td>
<td>61.0</td>
</tr>
<tr>
<td>Revised operating profit:</td>
<td></td>
<td>224.7</td>
</tr>
<tr>
<td>Margin increase: 61/163.7 = 37.3%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

or:

<table>
<thead>
<tr>
<th></th>
<th>Z$ million</th>
<th>Z$ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales volume increase</td>
<td>20.8</td>
<td></td>
</tr>
<tr>
<td>Sales price increase:</td>
<td>21.0</td>
<td></td>
</tr>
<tr>
<td>Cost of sales:</td>
<td>0.20</td>
<td></td>
</tr>
<tr>
<td>Distribution and admin:</td>
<td>1.13</td>
<td>1.3</td>
</tr>
<tr>
<td>Revised increase in operating profit</td>
<td></td>
<td>43.1</td>
</tr>
<tr>
<td>Revised operating profit:</td>
<td></td>
<td>206.8</td>
</tr>
<tr>
<td>Margin increase: 43.1/163.7 = 26</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Expansion by acquisition

The owners are looking to sell for asset value Z$ 980 million plus 10% Z$ 1078 million

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Extra revenue</td>
<td>208.1</td>
<td>218.5</td>
<td>229.3</td>
<td>240.8</td>
<td>252.9</td>
</tr>
<tr>
<td>Extra margin at 50%</td>
<td>104.0</td>
<td>109.2</td>
<td>114.6</td>
<td>120.4</td>
<td>126.4</td>
</tr>
<tr>
<td>P profits</td>
<td>136.6</td>
<td>140.0</td>
<td>143.5</td>
<td>147.1</td>
<td>150.8</td>
</tr>
<tr>
<td>Gain from acquisition</td>
<td>240.6</td>
<td>249.2</td>
<td>258.1</td>
<td>267.5</td>
<td>277.2</td>
</tr>
<tr>
<td>6% Discount factor</td>
<td>0.943</td>
<td>0.890</td>
<td>0.840</td>
<td>0.792</td>
<td>0.747</td>
</tr>
<tr>
<td>Cumulative disc return</td>
<td>448.7</td>
<td>665.5</td>
<td>877.4</td>
<td>1084.5</td>
<td></td>
</tr>
<tr>
<td>Initial investment</td>
<td>1078.0</td>
<td></td>
<td></td>
<td></td>
<td>6.5</td>
</tr>
</tbody>
</table>

Discounted payback achieved in 5 yrs.

Note the extra revenue is 2013/2014 forecast plus 10%, then a 5% year on year increase.
P profits based on 2013 actuals plus 2.5% per annum year on year increase.
These are profits from operations, depreciation is not added back to reflect the on-going nature of asset investment.

Marketing Campaign

Increase in sales budget All Z$ million
Forecast sales for 2014 2080.6 x 22.5% (womenswear) = 468.2 x 15% = 70.2 x 62% (margin) = 43.5
x1.40% (menswear) = 291.3 x 5% = 14.6 x 69% (margin) = 10.1
84.8 53.6

Given the request for Z$45.0 million the potential gain of Z$8.6 million seems worthwhile, but depends on the reliability of the forecast, (risk of not achieving). The possibility of obtaining the same results but with lower spend should be investigated. This needs to be discussed in depth with the Sales Director.
This generates an average margin 63.2%, given a constant relationship, the sales figure will need to be at least 84.8 – (8.6/63.2x100) 13.6 = 71.2 to break even, 84% of the forecast increase.
If candidates takes values from 2012/13 actuals, i.e. based on the same sales and profitability analysis as for the year ended 31 March 2013:

<table>
<thead>
<tr>
<th>Sales</th>
<th>Increase</th>
<th>Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>Z$m million</td>
<td>Z$m million</td>
<td>Z$m million</td>
</tr>
<tr>
<td><strong>Womenswear:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>456.7 x 0.15 = 68.5 x 0.62 =</td>
<td>42.5</td>
<td></td>
</tr>
<tr>
<td><strong>Menswear:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>284.2 x 0.05 = 14.2 x 0.69 =</td>
<td>9.8</td>
<td></td>
</tr>
<tr>
<td>82.7</td>
<td>52.3</td>
<td></td>
</tr>
</tbody>
</table>

Gain = Z$7.3m (rounded)

Average margin = 52.3/82.7 = 63.2% providing break-even sales revenue of:

Z$82.7 – (Z$7.3m/0.632) = Z$71.2, i.e. 86% of the forecast increase in sales.
Appendix 5 Question 1 part (b): e-mail

To: The Board of N
From: The Management Accountant
Date: 28 August 2013

Re: Factors to consider in whether or not to make a bid for P

Colleagues,
The Finance Director has asked me to prepare an e-mail regarding the strategic, financial and operational factors which need to be taken into account in deciding on whether or not to make a bid for to P.

Accordingly please find below the key issues:

Strategic
- That the proposed acquisition is relevant to the current business strategy, and that it addresses the issue of market growth, and the ability to grow on-line sales.
- Following on from this synergy issues are relevant, do the proposed benefits exist, would an alternative strategy of organic growth be more appropriate?
- Why do the owners want to sell now?

Financial
- That there is confidence in the accuracy of the relevant information and that it is available.
- The trading history will require investigation.
- Consider whether the potential online synergies and integration costs reflect the expected value, the NPV indicates a positive Z$ 6.5 million within 5 years.
- The trading profit is declining; this requires investigation. Is this a short term or long term trend? Is the forecast increase in turnover and profit realistic?

Operational
- Integration issues relative to, the structure and management of the combined businesses need to be considered.
- There must be unimpeded access to company records.
- Because this is a family business, extreme care required; it has not been subject to company legal requirements of a plc.
- Will the existing owners need to be retained for efficient short term operation and if so at what cost?

Management Accountant

......... End of the answer ........