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A2 GCE BUSINESS STUDIES

F297/01/CS Strategic Management

PRE-RELEASE CASE STUDY

JUNE 2015



INSTRUCTIONS TO TEACHERS

- This Case Study **must** be opened and given to candidates on receipt.

INFORMATION FOR CANDIDATES

- The information contained within this Case Study is based upon one or more real businesses.
- You **must** make yourself familiar with the Case Study before you sit the examination.
- You **must not** take notes into the examination.
- A clean copy of the Case Study will be given to you with the Question Paper.
- This document consists of **12** pages. Any blank pages are indicated.
- This copy must **not** be taken into the examination room.

Smith & Haddon Ltd (SHL)

Smith and Haddon Ltd (SHL) designs and sells fashion clothing under the brand 'Harvey'. Its extensive product range is aimed at the aspirational, 30-something, fashion-conscious consumer; families who enjoy holidays and 'away days' to UK destinations such as Padstow, Burnham Market, Aldeburgh and Helford, as well as foreign travel. The typical Harvey customer is female who, in addition to buying for herself, will also purchase for children and her partner.

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The business was founded in 1999 by Ian Smith, known to all by his nickname 'Harvey', and Tim Haddon. Initial sales growth was pleasing, and in 2003 the business was incorporated as a private limited company by selling equity to friends. SHL has a sales revenue objective in 2016 of £70m (see Fig. 1).

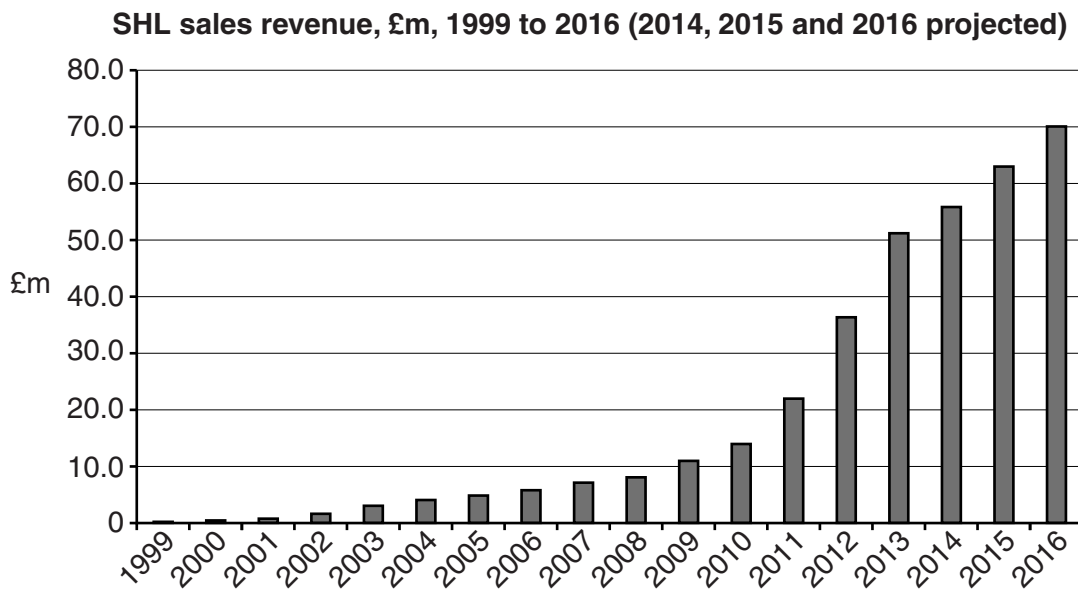


Fig. 1

This stellar growth has only been possible through a combination of hard work and a degree of fortune, but mostly because of clear strategic thinking. Hence, the senior team at SHL creates a rolling three year strategic plan. This plan is reviewed and updated quarterly. Recognising that running what was little more than a market stall is rather different to a multi-million pound turnover business, Ian and Tim have made sure that where they do not have the skills and expertise themselves, they have brought in people who do. Thus, for example, Sharon Walker, SHL's latest Finance Director, joined the business two years ago having previously worked for a major UK book retailer.

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SHL has a number of other strategic objectives in addition to its sales revenue objective. Its highest priority is to further diversify from the UK market. In 2013 SHL sold £2.6m to non-UK customers, particularly in the USA, Germany, Italy and Australia. The objective is for exports to grow to 10% of sales revenue by 2016. Similarly, by 2016 the objective for 'Harveydirect', SHL's e-business, is 40% of total sales revenue. A further objective is to reduce risk, and pursue aggressive growth through the sale of Harvey franchises, i.e. channel diversification. Sharon believes that each Harvey franchise could be sold for £300 000, and generate a gross profit of £50 000 pa. Currently SHL sells via five channels (see Fig. 2).

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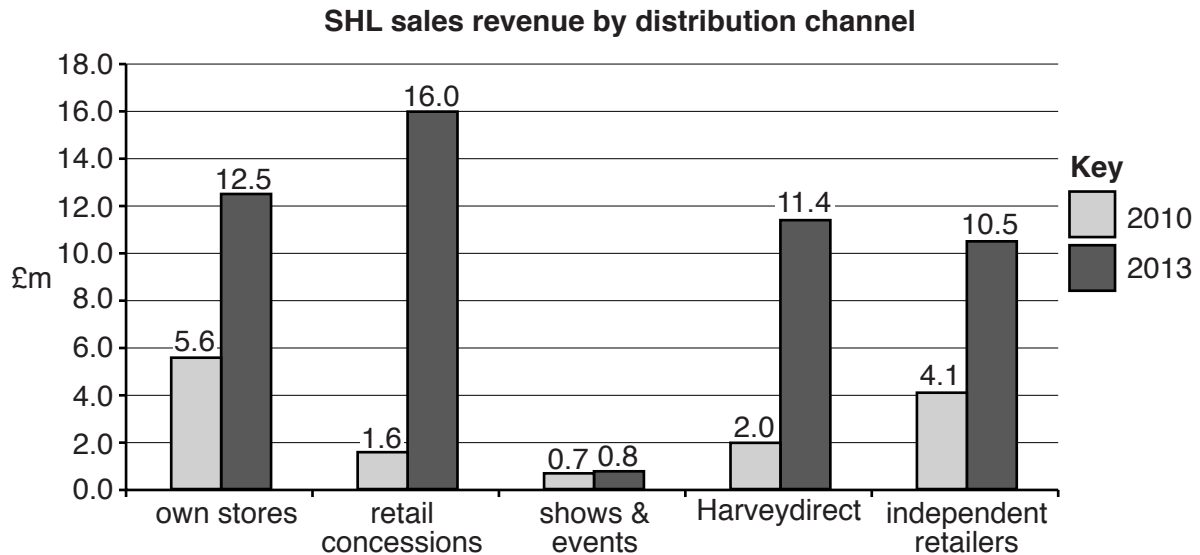


Fig. 2

Ian and Tim met whilst they were both students at the Royal Agricultural College, Cirencester. The business began in a relatively informal way, as a stall selling equine-themed clothing at county and horse shows throughout the UK. The clothing they sold was slightly quirky: functional yet fashionable at a time when tweeds and greens seemed to be the only choices available. A particularly good seller in the early days of the business was a blue polo shirt, decorated with a floral paisley trim on the collar, hem and sleeves. To keep overheads down, they employed fellow students, paying them on a commission basis. 30

True to its countryside roots, SHL is still located in the Cotswolds market town where Ian grew up. At its head office SHL employs 108 staff. These staff do a wide variety of tasks from garment design, creating marketing campaigns and routine administration. The staff enjoy the 'creative buzz' that pervades head office. SHL also has a warehouse facility about 60 miles away at Avonmouth. The warehouse is used as the base for Harveydirect. It also doubles as a storage facility for imported garments. Garments, designed in the UK by SHL, are manufactured in the Far-East, primarily in China, Bangladesh and India. A small, but growing, number of items are sourced from East European suppliers, mainly in Romania. Sourcing offshore has additional complications over and above any manufacturing issues, not least exchange rate movements and agreeing in which country's courts any contractual disputes would be settled. However, UK manufacturers are only able to supply a small proportion of the volume SHL demands. This is largely because of the decline in UK manufacturing skills. So, although Tim may be keen to enhance the Harvey brand by labelling goods as 'made in the UK' this is only likely to be possible for a relatively small part of the product portfolio. 35 40 45

The fashion market is, almost by definition, in constant flux. Particular 'looks' come and go, and the key for businesses such as SHL is to make sure that their product offering meets the needs of an increasingly discerning buyer, in a highly competitive industry. Some industry commentators put the fashion market's value to the UK economy at over £21bn p.a., employing about 820 000 people. Over and above this value is the 'spill over' effect on other industries, notably tourism and IT. It has been estimated that this third party benefit is worth a further £16bn to UK GDP. Part of the size of the market is due to economic conditions, but much is also attributable to changes in the UK social environment. Factors here include both demographics and lifestyle, a trend supported by coverage in the broadcast media, as well as in a plethora of print and web-based fashion titles. Hence, the market can be driven by the appearance in the media of a few highly influential individuals. These range from rock stars to royalty. For example, a boost in 2012 fashion industry sales was attributed to the 'Kate effect'. Reflecting the Harvey brand values, SHL currently sponsors one male and one female high profile British equestrian rider. Further, Tim is actively involved in discussions with 50 55

two England rugby players, both based in the West Country, in advance of the Rugby World Cup to be held in the UK in September 2015. Whilst SHL would not claim to be in any way a sporting goods manufacturer, its customers are interested in sport and exercise, either as spectators or participants. 60

Deciding what products to offer is a key determinant of success for SHL. The creativity and movement in the industry, and the market's inherent seasonality, make fashion an exciting business in which to work; no two days are the same. SHL's designers, many of whom are graduates of the UK's top fashion design universities, are constantly experimenting with fabrics and style, whilst always mindful of their customers' rather conservative taste. If asked to articulate what that is, Tim would say their taste reflects their 'market town values'. A typical product can take about four months from initial conception to being available for distribution via Harveydirect or for dispatch to retailers (see Table 1 and Fig. 3). 65 70

Product development activities

Activity	Activity description	Responsibility	Duration, days
A	Initial concepts and sketches	Design	6
B	Pre-screening and selection	Senior team	2
C	Costing	Finance	3
D	Prototypes	Design	4
E	Final selection	Senior team	2
F	Contracts	Legal compliance	5
G	Photography and merchandising	Marketing	10
H	Manufacture	Supplier	60
J	Update website and pre-orders	Marketing	15
K	Delivery from manufacturer	Supplier	28
L	Launch	Marketing	3

NB There is no activity I.

Table 1

Product development diagram

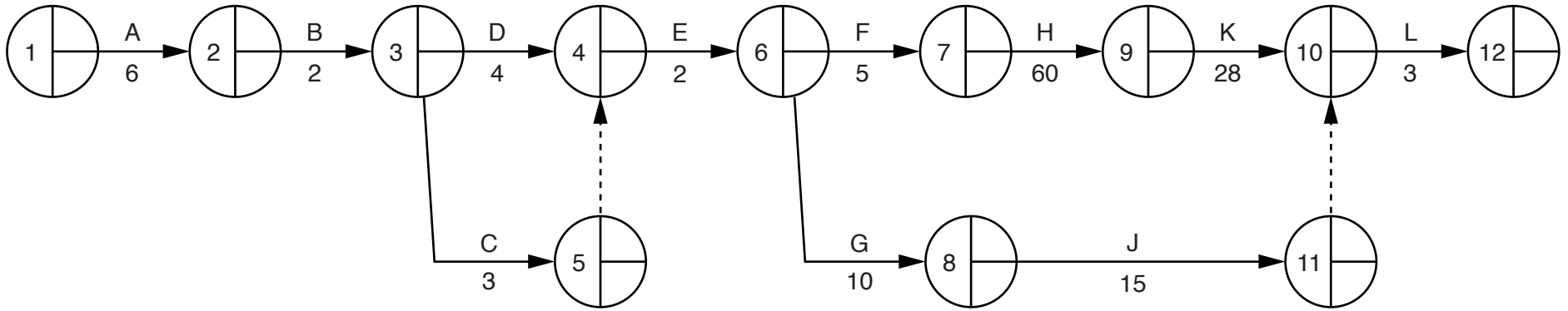


Fig. 3

Gauging how large to make an order of any one garment, and in what sizes, is always a challenge. Hence, contracts always have a clause which enables SHL to increase the order should the Harveydirect website indicate particular interest. The aim is to maximise the sales of high demand items, whilst at the same time not filling the warehouse with stocks of slow moving garments. Slow moving items are subject to monthly review and may be promoted at a discounted price, if necessary, in order to clear space and generate cash flow (see Fig. 4). 75

Selected discount data

	July		August	
	Original price	Sales (volume)	Discounted price	Sales (volume)
Mens' polo shirt; green; small	£45.99	40	£27.59	80
Mens' casual shirt; green check; small	£75.99	15	£37.99	25
Mens' casual shirt; yellow check; small	£75.99	12	£37.99	18
Childs' polo shirt; pink; large	£39.99	25	£19.99	20
Ladies' polo shirt; green; small	£45.99	20	£22.99	24
Ladies' casual shirt; yellow check; extra small	£75.99	12	£30.40	15

Fig. 4

Having garments manufactured offshore brings the benefit of lower unit cost, but in the last three years this cost advantage has narrowed due to inflationary pressures, particularly in China. And manufacturing offshore does have other downsides. These include ethical considerations, as well as the protection of intellectual property rights. Having worked hard for more than a decade to establish 'Harvey' as an intangible asset, SHL will tirelessly pursue those who seek to capitalise on it by counterfeiting garments. For example, SHL ceased placing orders with one Far Eastern supplier when it was found to be producing imitations for sale in the Middle East. The outcome of the legal action being taken by SHL against this former supplier is still pending. 80 85

Fashion can be a fickle business, with many consumers wanting to wear the latest 'look' yet not wanting to seem to conform to a uniform. This tension is most apparent amongst teenagers who quite like 'Harvey' but do not want to be seen wearing the same brand as their parents. To combat this, Ian has been investigating the establishment of a sub-brand, specifically targeted at the teenage market segment. Initial market research suggests that this would present a number of challenges for SHL. First, selling to a market which has notoriously brief product life cycles, which are even shorter than those in the mainstream fashion market. Second, teenagers can be suspicious of any attempt to be 'marketed to' and so a move to viral marketing might be appropriate. The business already makes extensive use of social media in support of the Harvey brand, so SHL has some expertise in this field. But what Ian is worried about is whether SHL has the necessary credibility and creative cunning. 90 95

An alternative is to buy into an emergent brand which appeals to the teenage market segment. One potential target is 'mardidi', a business formed in New England, USA, two years ago. As yet it has no UK retail presence. The 'mardidi' brand has gained recent media exposure by being worn by a leading rap artist. Working through a contact in the USA, Ian has been told that a 25% equity stake in 'mardidi' could be purchased for US\$5m. Its projected net profit as an independent business, for the next five years, are shown in Table 2. 100

'mardidi' projected net profit

Year	US\$m
1	(0.1)
2	0.2
3	1.0
4	2.0
5	4.0

Table 2

The prospect of buying into 'mardidi' excites both Tim and Ian. Sharon, however, is more cautious. Her view is that the venture may not offer an acceptable reward, either financial or non-financial, to SHL's stakeholders.

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Appendix 1

Balance sheet, SHL, as at 31 December	2013	2012
	£000s	£000s
Fixed Assets		
Tangible Assets	6457	3938
Goodwill	<u>97</u>	<u>107</u>
	6554	4045
Current Assets		
Stock	6704	6942
Debtors	10228	8716
Cash	<u>107</u>	<u>4</u>
	17039	15662
Current liabilities		
Trade creditors	(10660)	(9206)
Net current assets	6379	6456
Creditors falling due after one year	(2648)	(1722)
Net Assets	<u>10285</u>	<u>8779</u>
Equity		
Share Capital (1)	114	114
Profit & Loss Account	10171	8665
Equity shareholders' funds	<u>10285</u>	<u>8779</u>

(1) 456 000 £0.25 ordinary shares: Mr I Smith 200 000, Mr T Haddon 180 000, Mr D Torrien 38 000, Mr C Wheeler 28 000, Dr C Lucas 10 000.

Profit & Loss Account SHL, year ending 31 December	2013	2012
	£000s	£000s
Revenue	51 167	36 599
Cost of sales	<u>22 729</u>	<u>16 258</u>
Gross Profit	28 438	20 341
Salaries, administration & overheads	13 405	12 734
Marketing, distribution & product development	<u>10 071</u>	<u>7 319</u>
Operating profit	4 962	288
Depreciation	555	112
Interest	104	57
Profit before taxation	<u>4 303</u>	<u>119</u>
Taxation on ordinary activities	1 291	36
Net Profit	<u>3 012</u>	<u>83</u>
Dividends	1 506	627
Retained profit	1 506	(544)

Appendix 2

UK population, actual and projected, thousands					
Age Group	2011	2016	2021	2026	2031
0–14	11 101	11 674	12 324	12 448	12 234
15–29	12 601	12 527	12 097	12 276	12 985
30–44	12 946	12 595	13 411	14 092	14 013
45–59	12 352	13 152	13 050	12 436	12 391
60–74	9 287	9 853	10 472	11 121	11 940
75 & over	4 896	5 470	6 282	7 446	8 202
All ages	63 183	65 271	67 636	69 819	71 765
UK population, actual and projected, percentages					
Age Group	2011	2016	2021	2026	2031
0–14	17.57	17.89	18.22	17.83	17.05
15–29	19.94	19.19	17.89	17.58	18.09
30–44	20.49	19.30	19.83	20.18	19.53
45–59	19.55	20.15	19.29	17.81	17.27
60–74	14.70	15.10	15.48	15.93	16.64
75 & over	7.75	8.38	9.29	10.66	11.43
All ages	100	100	100	100	100

Some of these figures may not agree as a result of rounding

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