SUGGESTED SOLUTIONS

27510 - TOP CA CASE STUDY EXAMINATION

DECEMBER 2014

Internal Memorandum

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To: Mr. Vishal Modi
Subject: Matters pertaining to Western Region operations

Overall summary

- Two leaders who had key positions in the Western Region (COO and Head of Retail operations - MaxCity) changed two years ago. Performance of the region, specially with regard to MaxCity, showed negative trends after the change.
- Considering the current year performance and sales downturn in the Western Region, there are several initiatives to be taken to achieve budgeted KPIs and turnaround operations.
- Mainly with the current poor performance of MaxCity operations (on which CLG had placed heavy reliance over the years), many experienced staff resigning, and external competition, it has become a real challenge for the management to turnaround performance.
- One of the main concerns of CLG are the gifted stores that have become a burden to the group's bottom line. The project "Top 100 and Bottom 100" is to be implemented specially for MaxCity with immediate effect.
- Strategies such as proper catchment area analysis, appointment of separate teams to make location decisions and buying decisions, improving the value propositions of existing stores, changing/restructuring centralised procurement department to properly link with regions, centralising core functions, closing down non-viable stores, downsizing some stores, need to be considered to overcome the business failures.
- To overcome weaknesses and inefficiencies in the current cash management system, the proposed lockbox system should be adopted given the financial feasibility and non-financial benefits.
- The company at KSA level should adopt a sound organisational structure such as a "Matrix Structure" which is a permanent organisation structure designed to achieve results by using a team of specialists from different functional areas within the organisation.
- To improve the current budgetary control system, it is suggested that a combined approach (Top to bottom, bottom to top) is followed.

Section 1: Regaining market confidence - MaxCity

General Comment – the Examiner expected students to draft a short answer by pointing out the key areas to regain market confidence – MaxCity concept. Most of the information required to draft key points was provided in both the Advance and Impact Information. Accordingly, more marks were allocated for assimilating and using the information.

Overview:

- MaxCity has been the main contributor to the overall CLG profitability among all the concepts.
- With its unique selling strategy of value retailing, MaxCity gained market confidence and established a significant customer base in KSA, especially in the Western Region.
- But, recent performance shows that MaxCity, Western Region is currently having tremendous pressure to maintain market share.
- Due to some internal failures which were further supported by external environmental factors, MaxCity,Western Region was unable to achieve its budgeted sales.
- GP margin has already been eroded showing a decrease of 4% (from 36% to 32%) during the last two year period.
- NP margin has decreased from 18% to 1% within the two years due to significant increase in overhead costs.

Key issues identified:

Internal environment

- There was a leadership change in the Western Region (both COO and Head of Retail Operations - MaxCity)
- Loss of key experienced staff due to unexpected resignations (e.g. Area Manager – Mr Mohammad Shakeel and a few other experienced employees)
- New competition from internal concepts such as Flash4Fashion
- No proper customer loyalty programme especially focused on MaxCity
- Buying mismatch and GP margin erosion;
    - still continues with central buying team and no local buying team
    - already failed in ladies' department due to recent buying mismatch
    - failed to meet demands for children's and men's departments during Ramadan period
    - significant pile-up of long outstanding stock
    - GP margin has significantly decreased during the last two years
- No proper monitoring of overhead cost control and allocation among concepts
    - Significant increase in administrative expenses and staff cost
- Retail staff demotivation due to incentive issues and leadership failures
    - Labour turnover is very high with increased staff cost
    - Store level productivity has come down significantly

- Location issues – already committed with the landlord for opening new stores while having significant number of loss making stores. It seems that there is no proper catchment area analysis/location analysis done when opening a new store.
- No separate marketing department (or at least a marketing professional) at regional level to identify customer needs and promote retailing with MaxCity

External factors

- Competition in industry due to new entrants
- Changes to customer preference from value retailing to fashion retailing due to demographic changes
- New labour laws mainly with Nitaqat programme
- Structural changes like women employment restrictions
- New regulations in retail accessories
- High discount offered during seasons

Measures to be taken to overcome above issues and re-gain market confidence for MaxCity

- Detailed level store analysis to be done especially for MaxCity stores as suggested in the transformation project "Top 100 and Bottom 100".
- Closure (or downsizing) of loss making and no potential stores subject to negotiation with the respective landlord with regard to already committed future rent.
- Detailed level OPEX analysis is required at CLG Western Region level.
    - In this regard, it is better to identify core functions at regional level and non-core activities
    - Identify activities (non-core) which can be aligned at head office level by way of a shared service department
    - Detailed level understanding is required for overhead cost allocation among concepts at regional level and how to control cost by introducing proper KPIs for stores/concepts/region etc.
- A proper incentive scheme to be introduced which is based on sales performance as well as overall store level performance, and the incentive to be allocated to all levels in an equitable manner.
- Proper coordination among concept heads is required to avoid internal competition to achieve budgeted performance.
- Proper coordination with the central buying team is required to meet regional level demand requirement. It is better to have separate merchandisers/or buying teams at regional level (in this case MaxCity, Western Region) who are responsible for analysing customer buying preference and meeting the same regularly with no delays.
- Selling off or transferring of long outstanding non-moving stock to other regions to be considered (discount offers can be considered as a sell-through strategy to clear the stock).
- Introducing training and development programmes for floor level staff by focusing on productivity improvement.
- Introducing a special customer loyalty programme for MaxCity, focusing on regular customers to enhance footfalls and ATV.
- Proper marketing strategy at regional level is required with recruitment of experienced marketing professionals.

- ➢ A proper catchment areas analysis is required for both new and existing locations by considering demographic, economic, infrastructural, cultural, environmental factors etc.

Having analysed the MaxCity operations, it is concluded that the market confidence can be gained by MaxCity. However, the following need to be implemented with immediate effect;

- ✓ "Top 100 and Bottom 100" plan to be implemented especially for MaCity
- ✓ Regarding inappropriate locations and uneconomical sizing of the stores having no potential which had lead to higher overhead cost, the following strategies would be helpful (subject to managing with already committed rent);
  - Rent or lease excess space
  - Close down some stores
- ✓ Staff motivation programme to be implemented especially for retail staff
- ✓ Sell-through for stock clearance in order to increase the GP margin
- ✓ Appointment of experienced key employees and if possible consider changing the existing head of MaxCity, Western Region. This is a critical issue and needs top management intervention (if possible, Vinod can be hired temporarily to restructure operations of MaxCity, Western Region and Andrew can be guided and trained under Vinod).

Section 2: Financial feasibility of the Lockbox arrangement

General comment by the Examiner;

- *A cost benefit analysis was expected including advantages and disadvantages of the proposed project.*
- *A simple financial management theory like payback period was adequate to support the conclusion.*
- *A simple assumption like "Time Value of Money" was not taken into consideration.*
- *As per the financial feasibility, the answer would be to suggest adopting the proposed Lockbox arrangement.*
- *Alternatively, candidates may suggest the current cash pick up service to be continued and stop the Lockbox arrangement. However, the answer can be accepted only based on the financial evaluations and assumptions made.*

Background

Cash sales constitute approximately 60% of total sales. Managing the cash collections has historically been a problem area given the service level issues with cash in transit companies. With a view to reduce dependencies on the traditional cash pickup mechanism, CLG Western Region had initiated a pilot Lockbox – a product from AlRaije Bank. The amounts deposited are instantly credited to the company's bank account. The advantages of the Lockbox are the following:

1. Reduces dependency on cash in transit companies which are unreliable
2. Instant credit of the amount to the company's bank account
3. Eases the pressure at the store level as there is no need to hold a high level of cash with the stores cash register
4. Reduces disputes with banks on counting discrepancies.

The price for the pilot Lockbox is SR 11,800 per month with a one-time installation charge of SR 35,000 related to a Lockbox.

Accounting treatment

The one-time fee of SR 35,000*50(number of locations) would be amortised over the contract period of 3 years. The monthly recurring charges are to be expensed in the same month.

Key decision points

A decision needs to be arrived at if a commitment of 50 Lockboxes can be given to AlRaije for implementation w.e.f 1 January 2015. The key points involved in the decision making are:

1. Increase in cash pick up charges to the company
2 Likelihood of increase in cash pickup charges due to cartelisation of cash in transit service providers.

3. Key benefits of Lockbox in terms of reducing risk in the event of high cash balance held in the store due to failures in cash pickup and instant credit to bank account.
4. Other banks launching similar products and at a competitive price.

Thus, it is important to weigh the benefits from the Lockbox against the incremental cost in switching over to the Lockbox arrangement.

Recommendation and way forward:

Attached herewith is a feasibility analysis of the Lockbox for Western Region. According to it, there are about 50 locations, where based on the proposed increase of cash pick up charges from Al Rajie, this proposal is financially feasible. The payback period on capital expenditure is around 2 years. (Please refer Annexure I).

We recommend to accept the proposal from AlRaije for 21-50 Lockbox installations in view of it being a strategic shift in the cash pickup arrangement with a positive impact on store level operations.

Section 3: Redesigning organisation structure

Overview:

In my view, the existing organisation structure seems to be complex both at regional and KSA levels. It seems that the existing organisation structure at overall KSA level has not been clearly defined and implemented to cater to dynamic changes in the business environment. Three regions have been separated for operational and reporting purposes where each region has a separate COO who is responsible only for the respective region. Regional COOs have to report to both KSA level as well as head office level. Further, head of MaxCity (regional) retail operations has to report to both the regional COO and Head – MaxCity, KSA. Also, there are GM retail operations, GM agency business, GM finance and Senior Manager HR/Finance/Admin etc. at regional level where separate regional departments have been allocated.

I have listed below some weaknesses due to this complex organisation structure, and their impact:

- Increase overhead cost significantly and decrease the margin due to duplication of duties and unnecessary common functions (e.g. Finance, HR, Admin) as separate departments at regional level.
- Significant delays in decision making. Further, it leads to sub-optimisation of objectives instead of focusing on overall group level corporate strategies.
- Though there are a significant number of outlets which are not performing well, the management failed to identify those until the last moment. In the meantime, the management has already planned and committed for new outlets. This shows that there is no close monitoring and effective internal control to continuously monitor store level performance.
- Since there is no proper link between functions of the country/region and head of each function at corporate level (CLG - Dubai head office), there is communication failure/communication mismatch/expectation gap and duplication of duties.

As such the following have to be considered for a sound organisational structure at KSA Level:

- Ability to make direct and quick decisions
- Proper monitoring of country level and regional level strategies, plans and investments for their suitability, acceptability and feasibility before implementation
- Maintaining less overhead cost
- Ensuring critical and long term strategic decisions at regional and country level are communicated and backed by corporate level.

Having considered all of the above, the company at KSA level should adopt a sound organisational structure such as the Matrix structure which is a permanent organisation structure designed to achieve results by using a team of specialists from different functional areas within the organisation. A new organisation structure for the whole KSA level; e.g. Matrix organisation structure to be considered.

Especially, the following departments should be considered as shared services and kept under KSA corporate office level;

- Finance and HR

Can eliminate GM finance and AGM finance at regional level and maintain only at KSA corporate level. Elimination of Senior Manager – HR at regional level is also possible.

Accordingly, it is recommended to change the existing organisation structure to the Matrix structure as proposed in Annexure II because it reduces duplication of duties at country level, decentralises the decision making at country level/regional level, centralises common functions (Finance, HR etc.) as shared services at country level, provides strong product/concept/project coordination, improves environmental monitoring, allows fast response to change, enables flexible use of resources and efficient use of support systems.

In conclusion, structure changes the strategies of any organisation, where a tight cost budget can be achieved, provided that proper infrastructure is available (or provided) to implement the same.

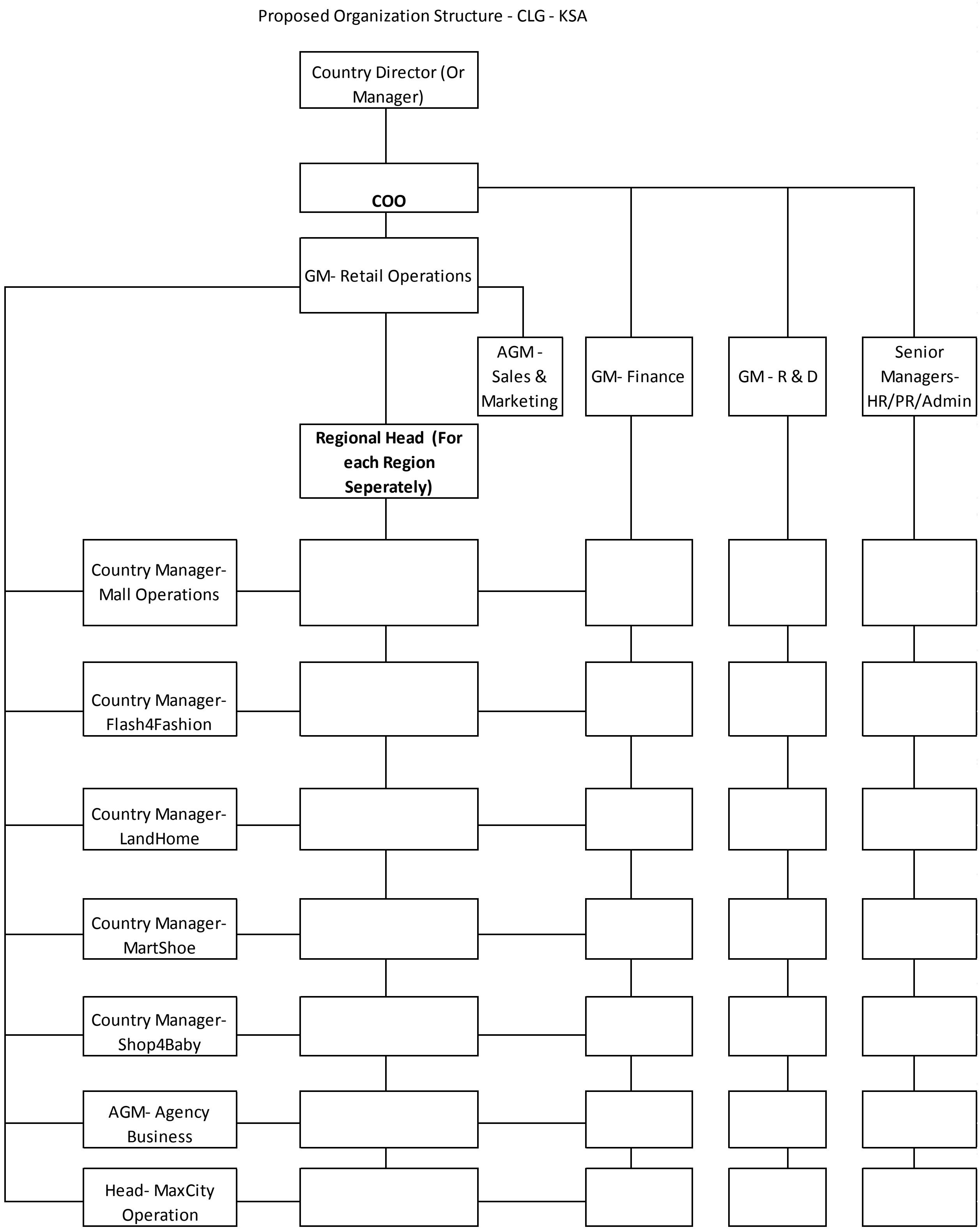
Annexure I - Cost benefit analysis of proposed Lockbox arrangement

		Cash pick up charges			Lockbox	Savings					
Area	**No. of locations**	**2015**	**2016**	**Total**	**2 year charges**	**2015**	**2016**	**2017**	**2018**	**Capex**	**Payback period (yrs)**
D	3	511,500	639,375	1,150,875	849,600						
C	8	1,364,000	1,705,000	3,069,000	2,265,600						
B	22	3,410,000	4,262,500	7,672,500	6,230,400						
A	17	1,581,000	1,976,250	3,557,250	4,814,400						
Total	**50**	**6,866,500**	**8,583,125**	**15,449,625**	**14,160,000**	**(213,500)**	**1,503,125**	**1,878,906**	**2,348,633**	**1,750,000**	**Less than 2 years**

Assumptions:

1. Pilot project will be implemented w.e.f. January 2015
2. Capex assumptions – installation charges of SR. 35,000 per unit
3. Increase of 25% year-on-year on cash pickup charges assumed in line with trend of last 2 years
4. Based on current service level of 85% for pickup trips, it is assumed 310 days for the year
5. Priority for location selection was from D to A.

Annexure II – Organisation structure



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