

ZODIAC FASHION COMPANY



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Business Proposal Catalogue

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1 Summary of the Report

ZFC is a fashion firm with a positive reputation worldwide, grappling with the **hit delivered by COVID-19** as well as the difficulty of facing a **post-pandemic environment**. Higher pricing from suppliers, decreased consumption capability, city lockdown and adverse currency rate movements result in **lowering revenue and profit**, while its purchasing and manufacturing system as well as sales channels have to be addressed. Therefore, our suggestion comprises a **market expansion plan** in Chinese mainland, **e-shop development**, **just-in-time purchasing auxiliary system**, **credit reevaluation** and **comprehensive foreign exchange risk management** in response to the hit and changing environment. **Empirical method** is used to support our idea. In addition, new product production decisions are made based on the sales growth of ZFC's products and their global markets.

For the ethical dilemma, ZFC should make public the facts on the bribery in compliance with the rules, holding a press conference in response to investors' worries. Besides, an **anti-corruption system** should be formed.

To sum up, our report helps ZFC not only recover from the shock of the pandemic, but also conform to the changing environment, aimed at accomplishing shareholder value maximization.

2 Business Analysis

2.1 External Analysis— PEST

Politics

- More stringent **environment protection policy**
- The "14th Five-Year Plan" Development Outline of the Textile Industry
- Standardization in the business field
- Increasing support for small and medium-sized enterprises

Economy

- Major cities locked down during the COVID-19 pandemic
- **Economic downturn** and increasing trade barriers
- Accelerated **integration** of fashion industry and released market share due to **bankruptcy**

Society

- Insufficient consumer demand and a reduced ability to pay
- Consumption **revitalization** and **personalization**
- Cultural diversity
- More attention to the concept of **sustainable development**

Technology

- A higher ratio of **e-commerce**
- **5G** and **cloud computing** influence system construction deeply
- New materials are widely used in green production

2.2 Internal Analysis— SWOT

<p>Strengths</p> <ul style="list-style-type: none"> • Good reputation: undertake environmental protection and social responsibility • Strong brand influence: extensive media and magazine coverage • High-quality products • An experienced internal clothing design team 	<p>Weaknesses</p> <ul style="list-style-type: none"> • Overcapacity, resulting in a lower product sales rate • Constrained distribution channels • Fluctuating exchange rate resulting exchange losses • Weak cost control
<p>Opportunities</p> <ul style="list-style-type: none"> • Enter China's vast market • Some products command a sizable market share 	<p>Threats</p> <ul style="list-style-type: none"> • Upstream and downstream companies fall into bankruptcy and liquidation • PFL, a strong rival in the Chinese market

2.3 Financial Analysis

Current ratio and quick ratio	dropped significantly, which are significantly lower than those of Zara and Uniqlo, mainly due to inventory backlog and loss of cash and cash equivalents.
The debt-to-asset ratio	rose from 0.309 to 0.540, long-term debt solvency fell, and long-term loans first appeared in 2020.
Operating capacity	longer inventory turnover period and working capital return days.
Profitability	ZFC suffered huge losses, and costs rose sharply, due to high employee salaries, depreciation and amortization, etc.

3 Solutions

<ul style="list-style-type: none"> • Reuse and recycle the inventory. • Carry out new product decisions. 	<p><i>Urgency</i></p>	<ul style="list-style-type: none"> • Aging analysis of accounts receivable. • Bargaining with manufacturers. • Establish the JIT auxiliary system • Develop e-shops. • Make general disclosure on bribery.
<ul style="list-style-type: none"> • Follow environmental protection policy and develop social reputation. • Converted some retail stores to outlets. • Pricing strategy • Product selection and tests in US 	<p><i>Importance</i></p>	<ul style="list-style-type: none"> • Anti-corruption system establishment. • Reduce exchange losses. • Expanding the Chinese Market: localization and product strategy.

3.1 Business Strategy

💡 **The advisory department** in our CPA firm can offer the future strategic alternatives to solidify core competitiveness by professional analyzing tools, reducing the risk in market expansion.

PART 2 ANALYSIS

3.1.1 Expanding the Chinese Market

Given the challenging economic conditions in Europe, where consumers were less willing to pay more for fashion, the corporation could investigate the Chinese market, where pandemic control is well-managed and the government is actively encouraging consumption.

Design localization

hire Chinese fashion designers to bring fashion styles more in line with the aesthetics of local residents.

Advertising localization

invite local celebrities to be brand spokespersons, combine advertising with fan economy and the internet, such as live commerce. In addition, the company can also release the latest line in its collaboration with Chinese brands.

Human resources localization

establish a talent training system in the Chinese market to ensure that all employees in China receive unified and high-quality training, attracting Chinese talents interested in the fashion industry to join.

3.1.2 Product Strategy

To wrest market share from competitors, it is vital to pay attention to product positioning, level, and quality, all of which contribute to the competitiveness.

Clear **product positioning**

Research primary and secondary target markets. Assume that the product is a mid-range consumer product with great design and quality at a reasonable price.

Improved **product mix**

To meet spending power and maximize product value, post-pandemic era products must be wider and longer than ever before.

① Expand the product **breadth**: increase product categories. People are spending more time at home now, increasing demand for leisure clothing such as home wear, which means the company could launch more casual clothing lines that incorporate fashion trends and functions.

② Extend product **length**: expand the scope and level of a product to meet the needs of different consumers.

Optimize **product development**

① Set up product **R & D Centers** in Beijing, Shanghai, and other **first-tier cities** in China to catch the trend, better position the product design style of the season.

② set up a **simulation store** in the R & D Center to provide a better design environment for designers.

3.1.3 Corporate Values and Social Responsibility

To adapt to consumers' growing awareness of environmental protection and social justice, and to establish a more distinctive brand image, a business must define its own business philosophy and mission, as well as identify appropriate measures to demonstrate corporate values and social responsibility to consumers.

- Measures to build the company's social and environmental reputation:

- (1) Improve employees' **working environment** and provide better **basic service**.
- (2) Obtain celebrity endorsement for products in **environmental advertisements**.
- (3) Sponsor social **welfare activities**.

- Environmental protection policy for fashion industry:

Adhere to a sustainable development business model, so that the company can boost brand recognition, consumer goodwill, and word-of-mouth marketing at the same time as it complies with pollution control policy.

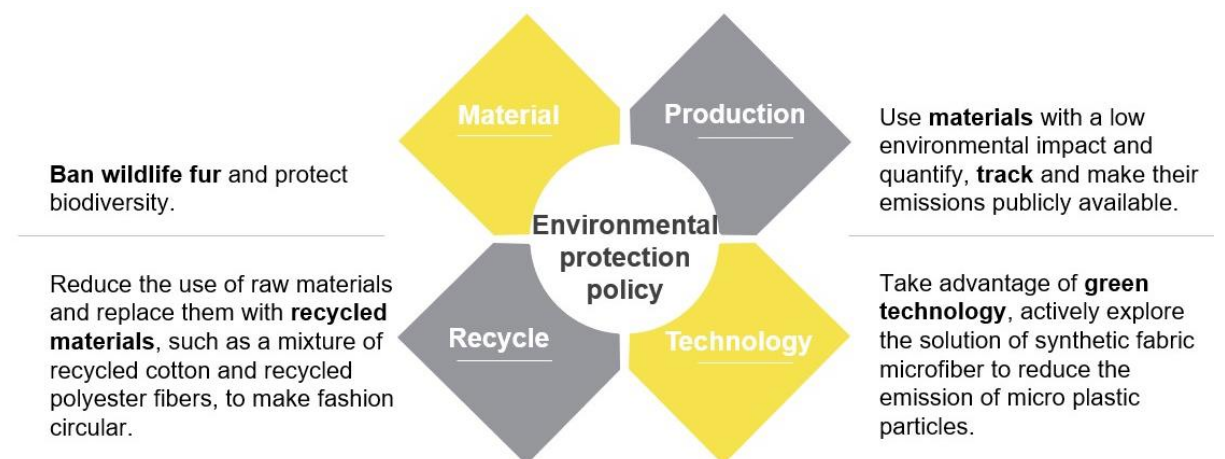
- (1) Improve employees' **working environment** and provide better **basic service**.
- (2) Obtain celebrity endorsement for products in **environmental advertisements**.
- (3) Sponsor social **welfare activities**.

- Environmental protection policy for fashion industry:

Adhere to the business model of sustainable development, so that while responding to the pollution control law, the company can improve brand reputation, consumer goodwill, and develop good word-of-mouth marketing at the same time.

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3.2 Manufacturing Strategy

3.2.1 Overall Consideration

Faced with an unfavorable market, we suggest the company **reduce inventory costs** to lessen the strain, and **embrace digitalization** actively to maximize future potential.

Costs of inventory	Countermeasures
Purchasing costs	Refer to "Manufacturer Management"
Ordering costs	① Foster long-term relationships with suppliers to reduce break-in time. ② Template order contracts and standardize the ordering process to reduce ordering time and errors.
Carrying costs	Refer to "Inventory Issue".
Stockout costs	Refer to "Shorten Response Time".

3.2.2 Shorten Response Time

Clarify the purpose

Using PLM, establish a digitized and **uniform procedure** in each process unit to make the production process efficient, visible, and controllable.

Refine requirements

- Daily update sales and inventory data in detail and make weekly **auto forecasts and correspondent warnings** to detect stock shortage in time. Use **RFID tags** to simultaneously produce small quantities, multiple varieties of clothing.

Follow up on regulations

- Set regulations to exert employees' resources. Such as, each store should send at least two replenishment orders per week to urge sales employees to respond quickly to out-of-stock situations.

Give freedom to each sales region

- Flexibility follows freedom. For example, additional orders whose total price does not exceed 25% of the sales volume of this week, could be sent directly to suppliers by the regional sales team, without the permission of the Head Office. This can also reduce the "Bullwhip Effect".

Rationalize the distribution route

- After enough distribution data has been collected, set up a **distribution center** in each region. Then rearrange transportation routes reasonably to reduce distribution costs and delivery time.

We propose establishing a system that collects supply and sales data to accommodate just-in-time purchasing which necessitates high flexibility and multiple data analytics.



3.2.3 Inventory Issue

Due to the high proportion of inventory in total assets, we suggest several measures to **address and prevent high inventory** that contributes to carrying costs, particularly as global demand for apparel shifts from brand-driven toward a more **customer-driven model**.

- To address inventory buildup from previous periods:

(1) Converted certain retail stores into **outlets**, as more than 70% of European and U.S. consumers seek to cut spending on apparel.

(2) **Reuse and recycle** to resolve inventory backlogs of over five years, meanwhile adhering to the 3R Principle.

- To prevent an abundance of leftover products:

(1) The problem of product design

Because the design team is based in Hong Kong, regional preferences may be overlooked. We recommend doing tests in U.S. flagship store to get **multi-ethnic user feedback** and adjusting designs in the respective sales regions.

(2) Product Selection

Continuing the manufacturing arrangement of producing **small quantities** at the start of the season and taking them off the shelves if sales are slow.

3.2.4 Manufacturer Management

Facing the cost inflation, the company still have **bargaining power**. As with Bangladesh, Asian countries that rely heavily on apparel exports have been severely affected by the epidemic. Between March and June, more than half of the \$3.18 billion in cancelled orders came from European countries. The cancellation and postponement of orders raised pressure on manufacturers, allowing the corporation to complain over wage expenses.

3.3 Distribution Strategy

Developing e-shops is not as simple as opening an official website and expanding the range of delivery services. To avoid issues like fierce market

competition between e-shops and retail businesses, the company must integrate the resources of both channels for **mutual development**.

- Channel positioning

While e-shops plays a critical role in the pandemic, retail stores should be redefined as - not just selling offline and offering fitting room, but an extension of the e-shops, building customer relationships, optimizing consumer experience.

- Price differences

E-commerce is often more affordable due to lower rents and wages, which inevitably affects retail store sales. To coordinate development across two channels, promotion strategies for e-shops and retail can be adopted **in different ways**, but the total discount to consumers should be **comparable**, allowing consumers to make purchases based on their shopping habits, available time, and other considerations. For instance, e-shops can set up more free delivery and pre-sale activities, while retails offer coupons to attract traditional consumers.

- Resource allocation

The two channels are not completely cut off, but can complement one another in various ways to **share advantageous resources**. Retailers provide more attentive after-sales care and have a stronger brand presence, whereas internet sales offer a broader advertising scope, allow for a more extensive introduction of each product, and receive straighter feedback.

- Communication

Since managers of e-shops and retails may have disagreements about marketing strategies and plan implementation, communication and intervention from headquarters are essential. In addition, the two channels can use the information sharing platform to facilitate **intra-regional cooperation**, such as prioritizing order fulfillment in retail to assure retail store availability.

💡 **The consulting department** in our CPA firm, especially tech-service team can assist ZFC in designing the JIT auxiliary system and e-shops.

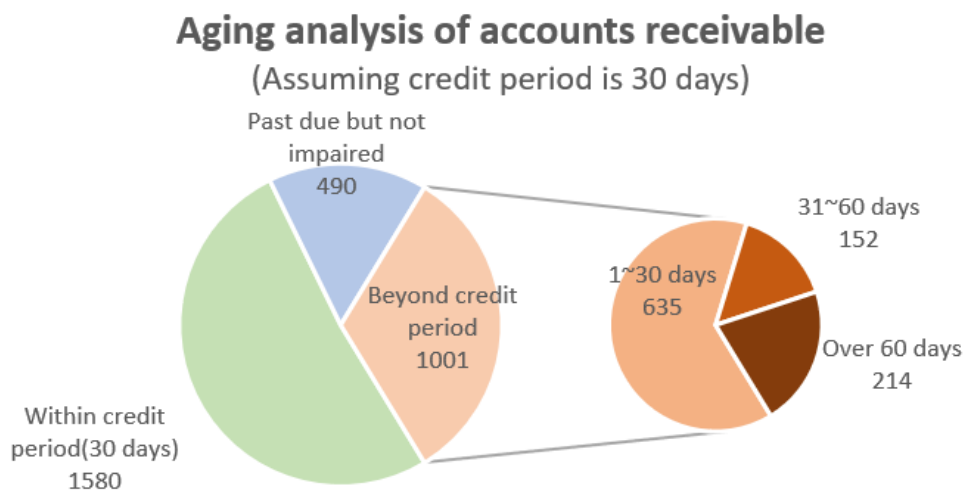
3.4 Financial Strategy

💡 **The consulting department** in our CPA firm can assist ZFC in contacting pricing research institutions and investment companies to implement the pricing and reduce exchange losses strategies.

3.4.1 Aging Analysis of Accounts Receivable

ZFC's 2020 annual report shows that the cash ratio is too low, accounts receivable increased by nearly 3 million HK\$, and direct bad debts amounted to 1.22 million HK\$.

ZFC can use the **5C evaluation method** (character, capacity, capital, collateral, and condition) to evaluate the credit of the company, promptly warn the risk of accounts receivable with excessive age, and tighten **the credit policy** for downstream companies.



We assume the credit period is 30 days.

(1) For the receivables within the 30 days credit period, nothing should be considered.

(2) For those beyond the credit period 1~30 days, it is very likely to recover this part of the receivables. ZFC needs to **negotiate** well with those companies, and tighten the credit policy for them.

(3) As for those beyond the credit period over 60 days, it is unable to recover with a high probability and ZFC has to **accrue credit impairment losses**.

3.4.2 Pricing Strategy

Considering ZFC faces challenges above, the long-term pricing strategy we propose is as follows.

- Implement **differentiated pricing** and launch products at various price points. ZF Libra is targeted at young audiences. This part of the group has the characteristics of pursuing freshness and low economic base, so it can adopt the **low-price strategy**. As for Zodiac Fashion, it can launch exquisite, light, and luxurious products at **relatively high prices**, and conduct timely **cross-industry joint activities** to increase brand awareness.

- Use **the "end with 9" pricing method**, such as 99 yuan, 199 yuan, 299 yuan, etc. This will give customers a wrong feeling of high quality and low price, which can stimulate consumers' desire to buy.

3.4.3 Reduce Exchange Losses

As we can see, ZFC has many exchange losses in its 2020 report. For such a multinational corporation, we suggest that:

- Establish a financial company

Establishment of a financial company contributes to realizing **the centralized deployment and rational use** of funds. It counts to introduce personnel with a **professional background** in foreign exchange management into the financial company, and establish a foreign exchange risk early warning program for continuous monitoring by experts.

- Flexible use of foreign exchange derivatives to hedge exchange rate risks



(1) **Foreign exchange options**: If there is a large fluctuation in the exchange rate, the option can be used to carry out the direction of the amount and result of the

foreign exchange risk exposure. Contribution of the finance company is shown in Appendix 2, where we use the **empirical method** to prove that.

(2) **Forward settlement and sale of foreign exchange**: The enterprise and the bank can reach an agreement to handle the foreign exchange receipt and payment business at the forward exchange rate on a certain date in the future. The key is to accurately predict the future exchange rate trend.

4 Addressing Ethical Issues

4.1 Legal Obligations Violated by Eric

Legal Perspectives	Regulation and Guidelines
★POBO ¹ -- Section 9 Eric committed an agent profiting personally from the sale of his shares in relation to his principal's business, in violation of section 9 (1).	★Listing Rules ² --Rule 3.08; ★The Guide . Eric did not avoid conflicts of interest or duties , nor did he act honestly for a legitimate purpose . And he engaged in transactions in which he had a financial stake without disclosing it.

4.2 Analysis to Ethical Dilemma

4.2.1 Alternatives

Bringing the subject of bribery to light vs. Concealing the issue of bribery

4.2.2 Main Concerns

Legal Requirements	★ESG Guide ³ : ZFC is required to make broad disclosures regarding its compliance with applicable anti-bribery laws and regulations . ★CO ⁴ : As a director, Herman has the duty to exercise reasonable care, skill and diligence .
Rules & Guidelines	★Listing Rules-- Rule 3.08, Rule13.09(1); ★The Guide. ZFC or its directors have the duty to fulfil fiduciary duties .
Professional & Self Values	<ul style="list-style-type: none"> Directors should uphold personal integrity and strive to cultivate an ethical corporate culture. Directors should ensure that rules and guidelines are put in place by the management. Directors has a responsibility to shareholders, employees and future investors to provide them with honest information.

¹ Prevention of Bribery Ordinance (Cap. 201) Corrupt Transactions with Agents (Section 9)

² the Main Board Listing Rules

³ ESG Guide of the Listing Rules

⁴ Companies Ordinance

4.3 Consequences Analysis

	Disclose	Conceal
Enforcement agency	ZFC won't be penalized as the result of the obedience of laws.	If the story is exposed, ZFC will bear legal sanctions .
Shareholders and the investing public	Share price may plummet instantly , because of: <ul style="list-style-type: none"> • the doubts regarding the correctness of the acquisition decision and internal control; • the loss of a potential CEO. • The investors may recognize company's image of law-abiding and transparent operation .	Share price may plummet one day , because if the story is exposed, <ul style="list-style-type: none"> • investors may lose trust in the directors and give up the investment; • legal penalties could affect the company's normal operations; • investors may question all decisions' rationale; • investors may judge that the internal control system is ineffective.
Company	<ul style="list-style-type: none"> • ZFC loses a brilliant director, affecting company operations; • Cultivating an ethical corporate culture; • Coping with public concerns instantly. 	<ul style="list-style-type: none"> • It is not conducive to foster a corporate culture of law-abiding; • Cost to cover up the truth; • The scandal does not have to be faced immediately, but passive exposure of the scandal faces greater PR difficulties.

4.4 Decision and Solutions

On the basis of the foregoing analysis, we recommend **disclosing the bribery** in accordance with the law and notifying ICAC.

1. To further clarify the issue's handling, we urge that Herman convene **a board meeting** to explain Eric's bribery and undertake an **in-depth inquiry**.
2. To avoid such issues in the future, we recommend the following internal control enhancement steps.:
 - Improving the **Anti-corruption Policy**:
 - (1) Stating the company's **whistle-blowing policy** and providing suitable channels for reporting corruption and violations of the anti-corruption policy;
 - (2) Providing assurance of **confidentiality**, prompt handling and non-retaliation to whistle-blowers acting in good faith.
 - Promulgating a **Code of Conduct** for directors and staff to set out the ethical

and probity standard and requirements.

- Establishing a **Corruption Risk Identification and Assessment Mechanism**.

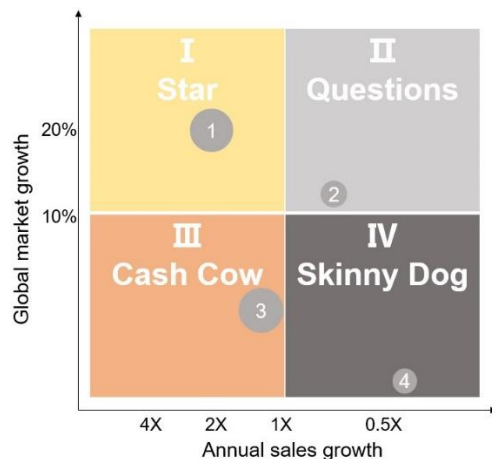
💡 These should desirably include persons with knowledge in specific areas, and we can provide **Legal Advisory Services**, such as the drafting of confidentiality, anti-corruption, and privacy corporate policies.

3. To minimize the loss, we recommend holding a **press conference** to respond to investors' concerns and control public opinion:

- Explicitly disclosing the **internal control enhancements** to guarantee that hidden risks of similar situations are minimized;
- Convincing investors that bribery has had **no material adverse effect** on the company's growth and that Ron Fashion Limited is qualified;
- Enhancing the **corporation's image** as a law-abiding and transparent business and emphasizing the mission statement's pursuit.

5 New product production decisions

Based on the market conditions for the four product categories and the commonly used Boston model, we classify these products into four distinct types:



- 1 Umbrella: Star
- 2 Pet Kit: Questions
- 3 Children's Sun Hat: cash cow
- 4 Tennis shirt: Skinny Dog

Production decisions are as follows:

- **Pet Kit:** continue to **support** the business's growth. Continually invest in R&D and marketing costs to attract new users and increase existing users' usage, all with the goal of turning a pet suit into a star business.

- **Umbrellas and Children's Sun Hats:** budget appropriately to preserve the

product's market competitiveness. For the umbrella industry, continue to invest in publicity and vigorously promote marketing activities, such as sales to encourage umbrellas to become a cash cow business. For the children's visor business, provide an adequate amount of capital to the venture, mostly through product enhancements and after-sale service, in order to maintain a stable market position.

- **Tennis Shirts: out of the market.** Aggressively scale back and phase out the lean dog business, reallocating resources to more profitable sectors.

- 💡 **The consulting department** can offer concrete plans to smooth manufacturing process, management process and commercial process.

6 Appendixes

6.1 Appendix 1 Financial Analysis

1. Solvency

	ZFC 2020	ZFC 2019	Zara 2020	Uniqlo 2020
Current ratio	1.583	2.333	1.729	2.556
Quick ratio	0.938	1.727	1.363	1.912
Cash ratio	0.197	0.980	1.167	1.689
Assets and liabilities	0.540	0.309	0.449	0.587

2. Operating capacity

	ZFC2020	ZFC2019	Zara	Uniqlo
Inventory turnover rate	2.733	-	3.927	2.495
Working capital turnover rate	3.523	-	4.676	1.852

3. Profitability

	ZFC2020	ZFC2019	Zara	Uniqlo
ROE	-0.596	-	0.076	0.091
Gross margin	49.00%	53.48%	55.83%	48.58%

Data resource: Inditex, FAST RETAILING 2020 Annual Report

Notice:

①All of them are positioned in the mid-end consumer market.

②Zara's business philosophy is "mid-to-low price but mid-to-high quality". It only sets up specialty stores and does not advertise, with an efficient supply chain system.

③UNIQLO aims to "allow everyone to wear high-quality casual clothes." By opening warehouse-type stores, it can satisfy all kinds of people with casual clothes that can be worn on all kinds of occasions.

6.2 Appendix 2 Empirical Test Results

	(1) <i>OLS</i> <i>FinanceHold%</i> → <i>lnexchange</i>	(2) <i>OLS</i> <i>FinanceHold01</i> → <i>lnexchange</i>
<i>FinanceHold%</i>	0.0269*** (4.04)	
<i>FinanceHold01</i>		0.0232*** (3.98)
<i>Control variables</i>	Yes	Yes
<i>Year FE</i>	Yes	Yes
<i>Industry FE</i>	Yes	Yes
<i>_cons</i>	15.33*** (33.42)	15.33*** (33.17)
<i>N</i>	26136	26136
<i>R</i> ²	0.293	0.293

t statistics in parentheses

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Notes: *FinanceHold%* represents the shareholding proportion of finance companies. For variable *FinanceHold01*, if one company has a finance company, then we give weight 1 to it this year, otherwise give weight 0. We use *lnexchange* to represent exchange gains. From the tables above, we can conclude that the shareholding ratios of finance companies can promote the increase of exchange gains. That is to say, **finance companies help to reduce exchange losses.**

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