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## Introduction

### Module Aim and Structure

This module will enable you to handle ethical dilemmas and financial matters and appreciate the following four key financial roles which are common to commercial organisations.

- The executive management role to provide leadership and direction;
- The management reporting role to provide operational and financial information for decision making;
- The treasury operations role to manage cash flows both present and future and its related financial risks; and
- The corporate finance role to advise on the restructuring and expansion of business.

The module is structured in such a way that it can achieve the module aim. The structure provides the framework for grouping related topics together in a systematic way to facilitate your understanding of the relationship between different topics. This module structure also applies to both the Learning Pack and the module workshops to ensure a linkage between the module study materials and the workshop materials.

### Overall Structure of Module B (Corporate Financing)



## Workshop Structure and Format

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In line with the module aim, the workshop is structured in a five-step approach as listed below.

- Ethics in business;
- Executive management;
- Management reporting;
- Treasury operations; and
- Corporate finance.

You will be working case exercises during the workshops. Through group work and discussion, you will appreciate how to apply commonly used ethical models in deciding on ethics issues, and various models in leading and managing an organisation.

## Workshop Objectives

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The workshops aim to enable you to understand:

- how to recognise situations where possible ethics issues arise and apply commonly used models in handling ethical dilemmas;
- how to apply various models in data gathering and analysing on an organisation's market environment and position, in order to evaluate and recommend strategic choices;
- how to apply various models in costing and performance measurement in order to evaluate the operational performance and make recommendations to address the issues;
- how to evaluate the liquidity and funding position of an organisation to identify financial risks and make recommendations to address the issues;
- how to apply various models in business valuation and recommend the best option for raising finance;
- the key elements of effective teamwork;
- the key elements in listening attentively and asking probing questions; and
- the consideration of different perspectives of a group before selecting feasible solutions or courses of action.

## Development Indicators for Generic and Technical Competencies

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The focus of the workshops is on formative development of skills, i.e. to train students to become future CPAs. A set of development indicators has been designed to encourage students to participate in the workshops and demonstrate the development of the intended learning objectives.

The purpose of the development indicators is to encourage you to:

- prepare for the workshops;
- actively participate and be engaged in the workshops; and
- achieve the learning objectives by developing the technical and generic competencies.

It also allows the workshop facilitators to monitor the development of the students so that appropriate actions or counselling can be done.

As the learning objectives of each module are different, there will be different development indicators or criteria for different modules. There are core criteria, i.e. criteria that are common to all four modules, as well as some criteria which are specific to an individual module.

You are expected to demonstrate the following core criteria at each workshop:

- Be well prepared for the workshop by demonstrating reasonable level of knowledge of technical content (i.e. contribute to discussion by offering relevant facts or information);
- Be punctual (i.e. arrive at the workshop on time and do not leave early except with the approval of the Institute or workshop facilitators);
- Work well with team members and workshop facilitators (i.e. interact with them in a constructive manner);
- Proactive participation (i.e. show willingness to take up roles in group discussion and raise questions or express ideas/opinions appropriately); and
- Adhere to an ethical mindset and professional behaviour.

You are also expected to demonstrate the development of the following specific criteria for Module B:

- Ability to identify and resolve business ethics issues;
- Reasonable understanding of the roles of executive management and management reporting, and the ability to apply key models;
- Reasonable understanding of the roles of treasury and corporate finance, and the ability to apply key models;
- Possess an enquiring mind;
- Ability to evaluate options and draw conclusion after considering all the pros and cons of each option; and
- Ability to structure your own presentation and to deliver clear presentation.

## Passing Criteria for Workshops

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A two-scale system of performance comprising 'yes for demonstrated' (i.e. 'green light') and 'no for not demonstrated' (i.e. 'red light') is set up for each development indicator. Students must achieve at least 70% of the available indicators obtaining 'green light' for satisfactory completion of workshops. In quantitative terms, a student will need to retake the two full-day workshops of a module if more than 4 out of the 16 development indicators for two workshops have been marked as 'no for not demonstrated' i.e. 'red light'.

**Satisfactory completion of workshops is a prerequisite to sitting the module examination i.e. students who fail to complete the workshop satisfactorily are not allowed to take the relevant module examination.** In order to complete the workshop satisfactorily, you are required to attend the two full-day workshops and demonstrate your successful accomplishment of the workshop objectives, via active participation.

## Your Role and Responsibilities as a Workshop Student

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You are expected to:

- follow your study plan, study the Learning Pack chapters (and other reference materials where appropriate) in accordance with the workshop coverage and prepare well for the workshops;
- read the case materials and complete the pre-workshop exercises, if any, prior to attending the workshops;
- be proactive in discussion and participation in group activities during the workshops;
- develop your technical and generic skills through active participation in group discussion and activities; and
- observe relevant rules of the workshops (e.g. be punctual for workshops and follow the instructions of workshop facilitators).

## Workshop Materials for Students

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Prior to the workshops, you will be given:

- This introduction booklet, providing general information on the workshops in particular the topic coverage and the corresponding chapter list in the Learning Pack, which are listed under Workshop Outline and Learning Methodologies below;
- Pre-workshop cases background and exercises (if any); and
- The module Learning Pack.

During the workshops, you will be given:

- Additional case information; and
- Handouts (i.e. questions) for class work, which will be collected back at the end of each workshop.

## Workshop Outline and Learning Methodologies

Session	Methodologies	Chapters covered
<b>Workshop 1</b>		
1. Introduction	<ul style="list-style-type: none"> <li>• Presentation</li> <li>• Group discussion</li> </ul>	
2. Ethics in business	<ul style="list-style-type: none"> <li>• Case study</li> <li>• Group Discussion</li> </ul>	Ch. 1 & 15
3. Executive management	<ul style="list-style-type: none"> <li>• Case study</li> <li>• Formal presentations</li> </ul>	Ch. 2
4. Management reporting	<ul style="list-style-type: none"> <li>• Case study</li> <li>• Formal presentations</li> </ul>	Ch. 4 & 5
<b>Workshop 2</b>		
5. Reboot	<ul style="list-style-type: none"> <li>• Presentation</li> <li>• Group discussion</li> </ul>	
6. Treasury operations	<ul style="list-style-type: none"> <li>• Case study</li> <li>• Formal presentations</li> </ul>	Ch. 8, 10 & 11
7. Corporate finance	<ul style="list-style-type: none"> <li>• Case study</li> <li>• Formal presentations</li> </ul>	Ch. 16, 17 & 18
8. Conclusion	<ul style="list-style-type: none"> <li>• Presentation</li> <li>• Group discussion</li> </ul>	

You are expected to have studied the relevant chapters of the Learning Pack and completed the pre-workshop materials thoroughly prior to attending the workshops. It is important for you to become familiar with the workshop materials as they will be raised for discussion throughout the workshops.

**Please remember to bring a calculator with you to the Module B Workshops.**

# Pre-Workshop Materials

## Workshops 1 and 2

### Case Background

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#### Zodiac Fashion Company Limited

##### Overview and Company history

**Zodiac Fashion Company Limited ('ZFC')** is a company based in Hong Kong which produces the internationally-successful **Zodiac Fashion** and **ZF Libra** brands of fashion clothes. It has a global reputation for good quality, affordable and fashionable clothes.

The company was established, and then owned for over 100 years, by a famous European family that established a global reputation in the clothing fashion industry. In 2005, it was acquired by a wealthy Hong Kong investor, who then sold most of his shares when the company was listed on the Hong Kong Stock Exchange (SEHK) in 2007.

The corporate head office was transferred from France to Hong Kong in 2006.

The company specialises in the design and sale of high-fashion clothing, and the Zodiac Fashion brand has a very strong and positive image world-wide. During the course of one year, the company produces over 15,000 new fashion designs, mainly for well-established items of clothing, and it has a large in-house team of fashion designers. The company's top designers have an international reputation.

ZFC has spent considerable amounts of money to develop the global reputation of the Zodiac Fashion brand each year. It has co-ordinated advertising campaigns, using top fashion models, with extensive advertising in premium and high circulation magazines and other media. Management believe that its advertising campaigns are effective in promoting the strong image of the Zodiac Fashion brand name.

##### Company operations

ZFC has a large design team, based mainly in Hong Kong. Most designers work on producing new fashions for the company's main product ranges. For most products, there are four fashion seasons in each year, and new fashion items are produced for each season. The four seasons are:

- January to March (spring season)
- April to June (summer season)
- July to September (autumn season)
- October to December (winter season)

Due to the nature of fashion clothing, product items that remain unsold at the end of each season are difficult to dispose of.

##### Distribution and sales

The company's products are sold mainly through stores. Some of these ('retail stores') are managed by ZFC itself and sell only goods that have the Zodiac Fashion or ZF Libra brand. Other sales are made through other department stores ('wholesale stores'), where ZFC is given space for selling its products. There are currently about 800 retail stores and about 7,000 wholesale stores, although the number of retail stores is increasing and wholesale stores have been falling in number.

Most of the stores are in Europe, particularly the countries of the eurozone. There are also wholesale stores and a small number of retail stores selling Zodiac Fashion and ZF Libra fashion product in the People's Republic of China (PRC) but these currently account for less than 10% of



sales. There are also some stores in Hong Kong, Japan and the east coast of the USA. A large 'flagship' store was opened in New York in 2012. A small proportion of goods are sold through the internet, and ZFC has established 'e-shops' in several countries.

### Production and purchasing

Although all products are designed by the company's own design staff, most manufacturing is outsourced. The company uses a large number of small manufacturing companies and most of these manufacturers are located in Asia, including the PRC. The policy of relying on large numbers of small suppliers has been successful in the past, but ZFC has been experiencing difficulties recently in negotiating prices, due to rising costs in manufacturing.

All contracts for the supply of manufactured goods are priced in HK dollars.

The company also has its own manufacturing subsidiary, located in the PRC, but this produces less than 5% of the company's total annual requirements by volume.

### From pre-ordering to just-in-time purchasing

The company's reputation has been built largely on the success of its fashion designs. It has a design team in Hong Kong. The company displays its fashions regularly at the major fashion fairs around the world, and its design team members are continually searching for new fashion ideas. Most fashion products are designed in advance of each season, orders are placed with manufacturers and the manufactured items are delivered to the retail and wholesale outlets for the start of the season. However, many wholesale outlets reduced their pre-orders of items in 2013, and placed additional orders with ZFC when they knew what sales demand for the season would be.

The design team in Hong Kong have been experimenting with a new just-in-time system of purchasing and production, similar to the system used by the Spain-based fashion goods producer Zara. With this system, only limited quantities of products are manufactured for the start of each season. Members of the sales team in each region check the strength of demand for each product and inform Head Office in Hong Kong which products are selling well and which are selling badly. Orders for additional quantities of the popular items are then placed with manufacturers, and distributed as quickly as possible to meet the sales demand.

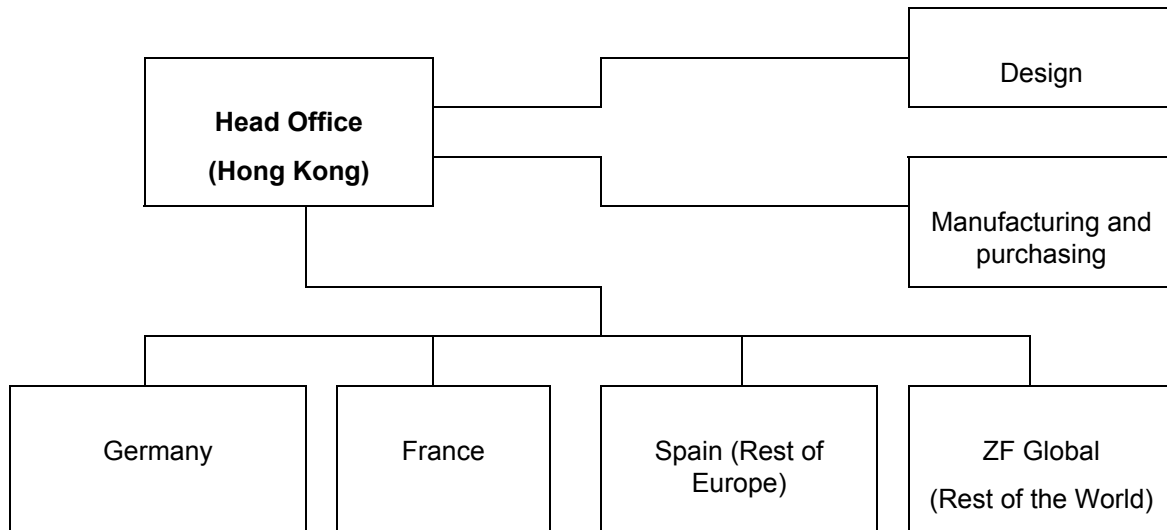
Experiments with this just-in-time purchasing/manufacturing system have been only partially successful, due to the long time taken by external manufacturers to respond to orders for additional quantities of products.

### Organisation structure and leadership

In 2009, ZFC changed its organisation structure.

Before the restructuring, its operations were structured around regional divisions, which were responsible for sales of all ZFC's products within their geographical region. Head Office had responsibility for purchasing and manufacturing operations and for product design operations, but divisional sales managers controlled all aspects of marketing and local public relations. Proposals about opening retail stores were made by the divisional management and submitted to Head Office for budgetary approval.

Previous operating structure – prior to 2009 changes

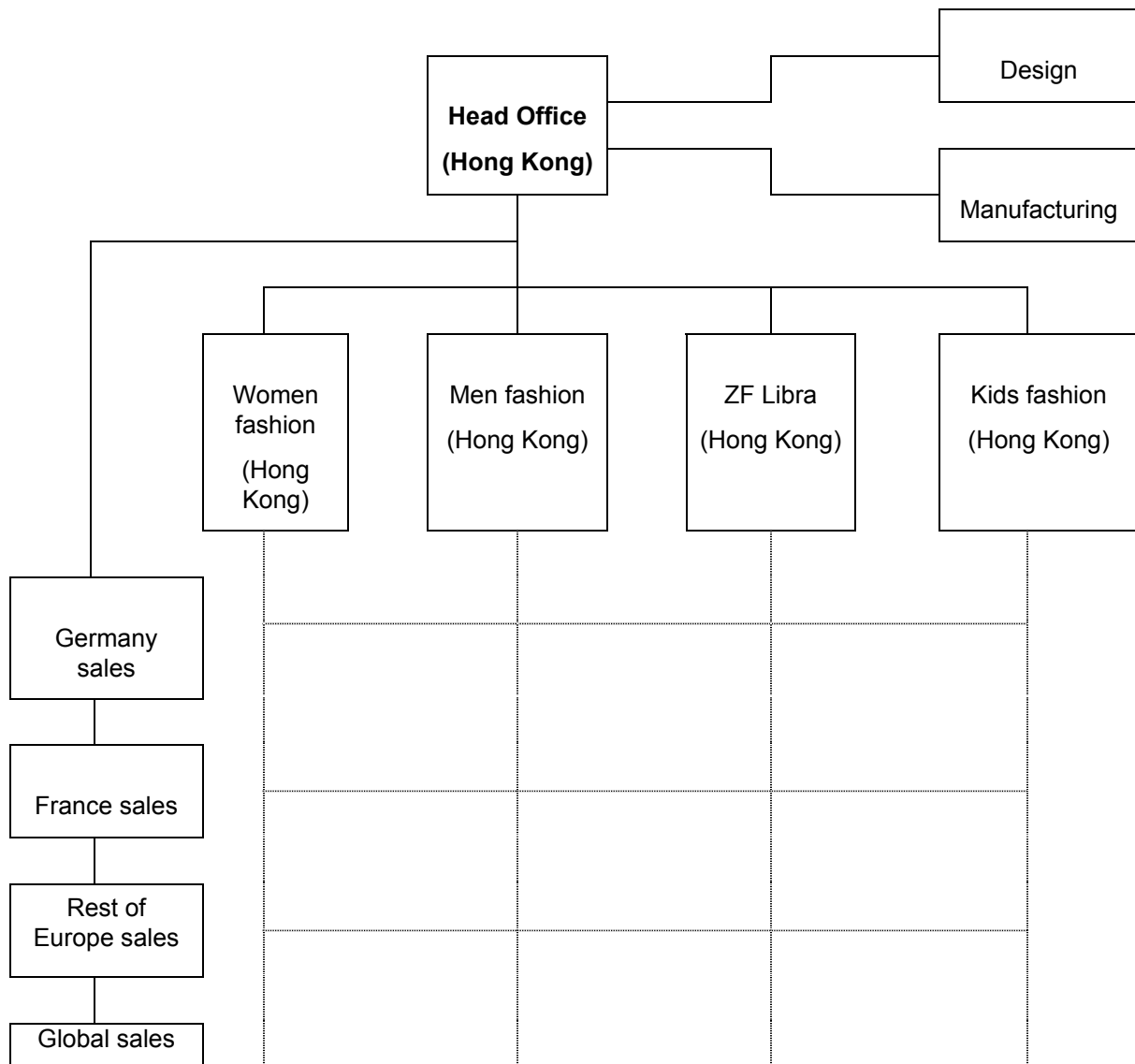


It was then decided to change the management structure, and to give more recognition to the importance of product management. After the restructuring, the company has operated with a matrix organisation structure. It has sales divisions that are organised on a regional basis, but there are now four product divisions, each with a manager responsible for the sales and profitability of a product range. Each product division is based in Hong Kong and their managers are responsible for worldwide sales of a specific range of products. The product managers are responsible for setting the prices in ZFC's retail outlets, and for recommending prices to other retailers (wholesale distribution outlets). The four product divisions are:

- (1) Women's fashion
- (2) Men's fashion
- (3) ZF Libra: fashion range for 18 – 25 year olds
- (4) Kids' fashion.

All products are sold through the same distribution channels, retail and wholesale.

## Current operating structure – 2009 onwards



The board of directors has a chairman and a chief executive officer (CEO). The chairman, Herman Tam, has extensive experience in the fashion industry and is highly regarded. The CEO, David Hardiman, has been an executive with the company for many years, and moved to Hong Kong when he was appointed as CEO in 2005. He has stated that his intention is to retire in two or three years' time. Herman Tam has expressed his view that the company's Operations Director, Eric Kam, would be an excellent successor as CEO.

## Corporate values and ethics

The company does not have a formal mission statement. However its board of directors have tried to develop the company's reputation for social and environmental responsibility. The company's stated policies include a commitment to sustainable business practices, and recognition of employee rights, social justice and human rights. The company has recently publicised a new design policy that none of its products will be made from fur or the skin of wild animals, and it is expected that this policy will enhance the reputation of ZFC among its customers, especially young customers in Europe.

Market research has shown that customers for ZFC branded products are often socially and environmentally aware themselves, and many of them buy Zodiac Fashion and ZF Libra goods because of the company's reputation for ethical standards. In 2013, the company received several awards from international bodies in recognition of its ethical policies.

## Year to 30 June 2013: financial highlights

The company had mixed fortunes in the year to 30 June 2013 ('2013'). It continued to develop its retail stores, opening new stores in Europe and the east coast of the USA, but it also closed some loss-making retail stores in Europe.

The company's annual sales revenue and profit have been falling since the global financial crisis in 2008 and the subsequent economic depression in Europe. Although there has been some recovery in the global economy, economic growth remains low in some European countries, such as Italy, Spain and the UK. In 2013, the company achieved an increase in the total volume of items sold, but total sales measured in Hong Kong dollars fell due to the weakness of the euro.

Sales turnover from retail stores increased by 10% in 2013, although turnover from wholesale 'point of sale outlets' (POS) fell. Difficult economic conditions, particularly in Europe, meant that consumers had less money to spend on fashion goods and were resistant to price increases.

Although prices of fashion goods to the consumer were stable, ZFC had to pay more to its suppliers. Suppliers suffered from a combination of wage increases, particularly suppliers in the PRC, and much higher prices for raw materials such as cotton. Cotton prices rose during the year by 15% for lower-quality cotton, to 25% for high quality cotton. Wages costs for suppliers rose by over 10%. The management are aware that some suppliers and customers are experiencing financial difficulty and may become insolvent and run into liquidation. Looking ahead, costs for suppliers in the PRC are expected to continue rising next year, due to the generally high rate of price and cost inflation.

There were also some losses from adverse exchange rate movements. Most of ZFC's costs are in HK dollars, and most of its income is in euros.

Profit fell from HK\$5,108 million in 2012 to just HK\$2,255 million in 2013.

The decline in profitability in 2013 was due to a combination of causes – higher prices from suppliers, who experienced large increases in employment costs and materials costs; higher occupancy costs and higher depreciation costs due to the stores expansion and refurbishment programme; and a large impairment of assets, caused largely by stores closures in Europe.

Between 30 June 2012 and 30 June 2013, the euro fell in value against the HK dollar by 9%. The decline in value was not gradual, and at times of the year the euro was down in value by more than 15%. The Chief Financial Officer, Wayne Tsai, has expressed his concern about the company's exposures to the euro as a major source of financial risk.

Operations managers have been looking for ways to reduce costs by improving efficiency, but results to date have been insignificant.

Summary financial statements for 2013 (and 2012) are shown in Appendix 1, together with some other performance data.

## Sales

An analysis of sales turnover in 2013, and comparisons with previous years, is shown below:

Product line	2013		2012	2011
	HK\$ million	% of sales	% of sales	% of sales
Women's fashion	12,880	41.5	40	44
Men's fashion	5,096	16.4	15	13
ZF Libra	7,483	24.1	24	21
Kids' fashion	5,591	18.0	21	22
	<u>31,050</u>	<u>100.0</u>	<u>100</u>	<u>100</u>

Region	2013		2012	2011
	HK\$ million	% of sales	% of sales	% of sales
China (PRC)	3,012	9.7	7	6
Europe	25,181	81.1	85	85
Other	2,857	9.2	8	9
	<u>31,050</u>	<u>100.0</u>	<u>100</u>	<u>100</u>

Distribution channel	2013		2012	2011
	HK\$ million	% of sales	% of sales	% of sales
Retail	16,836	54.2	48	44
Wholesale	14,214	45.8	52	56
	<u>31,050</u>	<u>100.0</u>	<u>100</u>	<u>100</u>

During 2013 some wholesale customers in Europe became insolvent and went into liquidation. The increase in retail sales in 2013 was attributable mainly to the opening of new stores. During 2013, 100 new stores were opened, although 25 loss-making stores in Europe were closed.

There was a change in the mix of sales to wholesale customers during 2013. Fewer sales were pre-orders by customers, purchasing goods at the start of each season in anticipation of sales demand. More sales were obtained through short lead time orders, as wholesale customers responded to demand in their stores.

## Competitor

The main competitor in the PRC is **Platinum Fashions Limited**. This is a Hong Kong based company that has retail outlets in more than 50 cities, where its brands are well-established and popular. This company has a 25% share of the total market for fashion clothes in China. Most of its sales are in low-priced fashion goods, but it has now begun to develop a new brand range where the emphasis is much more on quality and fashion. The new brand was launched two years ago and already accounts for about 8% of the company's total annual turnover. If ZFC decides to enter the PRC market, Platinum Fashions will be a major competitor.

## Cash and dividends

Although profits have fallen in recent years, the company has generated more cash than it has been able to re-invest within its business. As a consequence, the board of directors for each of the three years 2010 to 2012 decided to increase the dividend payout ratio from its normal level of 40%. Special dividends have increased the dividend payout ratio in these years to 75% or 80%. For the year to 30 June 2013, the board of directors has decided to set a new dividend payout ratio of 60%, which will be continued in future years.

In spite of its strong cash position, the company borrowed money for the first time since its listing on the Hong Kong Stock Exchange, as a way of developing relationships with its banks. In the year to 30 June 2013, the company borrowed HK\$2,355 million. Much of this was used to pay the special dividend for the year ended 30 June 2012.

## Future strategy

In 2008, the board of directors of ZFC established a financial target of achieving a minimum ratio of operating profit before depreciation and amortisation to sales of 20% each year, and it is disappointed that this target has not been achieved. It is considering alternative strategies to improve financial performance.

The PRC has been identified as an important region for future growth, but there are possibilities for further expansion in Europe and the United States as their national economies recover. The design director believes that the company should review its product range, and change the emphasis of its sales efforts from some products to others.

ZFC estimates that its own share of the fashion clothes market in China was 6% in 2013.

The directors of the company believe that in spite of the disappointing year in 2013, the prospects for the future are exciting. The board is considering a number of alternative strategies to improve company performance.

- (1) **Expand business in the PRC as rapidly as possible**, and aim to acquire a 25% share of the market for fashion goods within five years. A strategic problem with expanding into the PRC is that customers are used to paying lower prices for their clothes, and it may be necessary to develop a new line of products with a new brand name, to sell at lower prices. The market for fashion goods is relatively new and is still developing, as levels of wealth among consumers in the PRC rises. In order to gain market share in China, ZFC will probably have to enter into a strategic alliance or a merger with a local partner in the country, which has an established brand name and an extensive distribution network.
- (2) **Expand business in Europe with the company's existing product ranges**. There are several ways in which this might be done. One approach would be to improve the shopping experience for customers by investing more in stores and customer service, in order to increase sales volume. Alternatively, the company could develop new methods of sales and distribution, particularly online sales.

- (3) **Developing new product ranges for existing markets.** Senior members of the design team are excited about the sales potential for 'environmentally-friendly fashion' or 'sustainable fashion', and for other product ranges such as denim fashion goods, which the company only recently began to design and sell. Sunglasses and swimwear are also considered to be potential areas for new product development.
- (4) **Consolidation strategy based on improving efficiency and reducing costs.** There are several ways in which this might be achieved. One strategy would be to consolidate the sourcing of goods, and using a smaller number of suppliers, in order to achieve lower prices in return for bigger orders.

The board intends to discuss these strategy options when it receives a report from the CEO.

## Appendix 1: Summary financial statements for 2013 and 2012 for ZFC

### ZFC Limited

#### Consolidated income statement for the year ended 30 June

(All figures are in HK\$ millions)

	<b>2013</b>	<b>2012</b>
Turnover	31,050	33,750
Cost of goods sold	<u>(15,835)</u>	<u>(15,702)</u>
<b>Gross profit</b>	<b>15,215</b>	<b>18,048</b>
Staff costs	(4,186)	(3,730)
Occupancy costs	(3,625)	(3,240)
Distribution costs	(1,150)	(1,146)
Advertising costs	(674)	(598)
Depreciation	(816)	(714)
Other operating costs	<u>(2,074)</u>	<u>(2,330)</u>
<b>Operating profit</b>	<b>2,690</b>	<b>6,290</b>
Interest income	89	86
Finance costs	<u>(28)</u>	<u>-</u>
<b>Profit before taxation</b>	<b>2,751</b>	<b>6,376</b>
Taxation	<u>(496)</u>	<u>(1,268)</u>
<b>Profit after taxation (attributable to shareholders)</b>	<b><u>2,255</u></b>	<b><u>5,108</u></b>
Dividends: interim paid and final proposed	1,353	4,070
EPS (basic)	HK\$2.05	HK\$4.64



**ZFC Limited****Consolidated statement of financial position for the year ended 30 June**

(All figures are in HK\$ millions)

	<b>2013</b>	<b>2012</b>
<b>Non-current assets</b>		
Intangible assets	1,030	1,045
Property, plant and equipment	<u>4,217</u>	<u>3,946</u>
	<u>5,247</u>	<u>4,991</u>
<b>Current assets</b>		
Inventory	3,037	2,757
Receivables and prepayments	3,488	3,403
Cash and cash equivalents	<u>5,170</u>	<u>4,461</u>
	<u>11,695</u>	<u>10,621</u>
<b>Total assets</b>	<u>16,942</u>	<u>15,612</u>
<b>Equity and liabilities</b>		
Equity attributable to owners of the parent company		
Share capital	110	110
Reserves	<u>9,969</u>	<u>10,679</u>
<b>Total equity</b>	<u>10,079</u>	<u>10,789</u>
<b>Non-current liabilities</b>		
Bank loans	1,900	0
Deferred taxation	<u>256</u>	<u>270</u>
	<u>2,156</u>	<u>270</u>
<b>Current liabilities</b>		
Trade payables and accrued expenses	3,720	3,541
Taxation	512	1,012
Bank loans repayable within 12 months	<u>475</u>	<u>0</u>
	<u>4,707</u>	<u>4,553</u>
<b>Total equity and liabilities</b>	<u>16,942</u>	<u>15,612</u>

**ZFC Limited****Consolidated statement of cash flows for the year ended 30 June**

(All figures are in HK\$ millions)

**Cash flows from operating activities**

Profit before tax	2,751	
Depreciation	816	
Interest income	(89)	
Finance costs	28	
Impairment of property, plant and equipment	580	
Impairment of intangible asset	15	
Loss on disposal of property, plant and equipment	22	
	<u>4,123</u>	
Increase in inventory	(280)	
Increase in receivables and prepayments	(85)	
Increase in trade payables and accrued expenses	179	
Effect of changes in foreign exchange rates	(84)	
	<u>3,853</u>	
Taxation paid (HK and overseas)	<u>(1,026)</u>	2,827
<b>Cash flows from investing activities</b>		
Purchases of property, plant and equipment	(1,707)	
Disposal of property, plant and equipment	18	
Interest received	89	
	<u>89</u>	(1,600)
<b>Cash flows from financing activities</b>		
Dividends paid	(2,695)	
Interest paid	(28)	
Proceeds from bank loans	<u>2,375</u>	
		<u>(348)</u>
<b>Net increase in cash and cash equivalents</b>		879
<b>Cash and cash equivalents at the beginning of the year</b>		4,461
Effect of changes in foreign exchange rates		<u>(170)</u>
<b>Cash and cash equivalents at the end of the year</b>		<u><u>5,170</u></u>

## Appendix 2: Other performance data, 2013

### Other information

(All monetary figures in HK\$ millions)

<u>Sales through distribution channels</u>	<b>2013</b>	<b>2012</b>
Retail	16,836	17,213
Wholesale	14,214	16,537
Total	<u>31,050</u>	<u>33,750</u>

<u>Inventory at 30 June</u>	<b>2013</b>	<b>2012</b>
Finished goods	2,946	2,637
Consumables	91	120
Total	<u>3,037</u>	<u>2,757</u>

<u>Receivables and prepayments at 30 June</u>	<b>2013</b>	<b>2012</b>
Trade receivables	3,071	2,781
Less: Allowance for non-payment	(343)	(212)
	2,728	2,569
Prepayments	760	834
Total	<u>3,488</u>	<u>3,403</u>

Nearly all trade debtors are wholesale customers. Nearly all sales in retail stores are for cash (immediate payment in full).

<u>Receivables analysis: days since invoice issued</u>	<b>2013</b>
1 – 30 days	1,580
31 – 60 days	635
61 – 90 days	152
Over 90 days	214
Past due but not impaired	490
At 30 June 2013	<u>3,071</u>

The amounts past due but not impaired are amounts receivable that were renegotiated during the year and which would otherwise have been reported as 'bad debts' to write off.

<u>Allowances for non-payment</u>	<b>2013</b>
At 1 July 2012	212
Increase in allowance in 2013	286
Amounts written off as uncollectable	(122)
Effect of changes in foreign exchange rates	(33)
At 30 June 2013	<u>343</u>

## Appendix 3 – ZFC Board of Directors and Senior Management

Some of the members of the board of directors of ZFC and the senior management team are as follows.

### Selection of the Board of Directors

*Herman Tam, 51 – Chairman*

Herman Tam has been Chairman of the Board since it became a listed company in 2007. He has an international reputation as a financial expert and has been involved with companies in the clothing and fashion industry for over 15 years. His reputation as a successful and knowledgeable business man in the industry has earned him the title ‘Sage of the Shopping Malls’ in the world’s financial media. He is a Hong Kong CPA member.

*David Hardiman, 60 – Chief Executive Officer*

David Hardiman has been with the company for many years, having joined as a management trainee from Cambridge University. He became CEO of the company in 2005 since it was listed, but he is expected to retire in two or three years’ time. He wants to hand over a successful company to his successor.

*Eric Kam, 44 – Operations Director*

Eric Kam has been with the company for many years, and joined the Hong Kong office soon after it was opened by the company’s European owners. His main skills and experience are in both fashion design and marketing. He is very ambitious, and hopes to become the next CEO of the company when David Hardiman retires.

*Wayne Tsai, 39- Chief Financial Officer (CFO)*

Wayne Tsai was recently appointed as CFO and member of the board of directors, having previously worked for one of the ‘Big Four’ accountancy firms in Hong Kong. He is a Hong Kong CPA member.

### Member of the Senior Management Team

*Peter Zhou, 39 – Deputy Operations Director*

Although given the title of deputy director, Peter Zhou is not a member of the board of directors of ZFC, but he is a member of senior management team.

He has an MBA qualification from Wharton Business School in the USA, and is a Hong Kong CPA member. His main skills are in accounting and finance, and strategic planning. Like his boss, Eric Kam, he is very ambitious.

### Other characters

*James Ding, 46 – Enforcement Officer for the Stock Exchange of Hong Kong*

James Ding has worked for SEHK for eight years. He is well-regarded as a competent and knowledgeable official. He has worked with Herman Tam in the past on a professional level, and they have great respect for each other’s ability. Herman Tam has consulted him in the past on matters relating to stock exchange rules. He is a keen golfer, and frequently plays golf at weekends with Eric Kam, as they are members of the same golf club.

*Ella Poon, 44, senior manager at Pluto Investments*

Ella Poon has worked in the investment industry for all her career and has risen to a senior position in Pluto Investments, a global investment firm with a large Hong Kong office. She has been with Pluto for over ten years, and has been a strong supporter of ZFC since it obtained its listing in Hong Kong.

## Workshop 1 Session 1

### Pre-workshop exercise 1 (Ethics in Business)

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#### Ethical scenario

Today is Thursday, 22 September 2013.

In March 2013 the operations director of ZFC, Eric Kam, recommended to the board of directors that the company should purchase a fashion design company based in Hong Kong, Ron Fashion Limited. This was a private company with extensive experience in designing fashion clothing for markets in Asia. The full board of ZFC considered this recommendation and decided to make an offer for the company. After friendly negotiations, 100% of the shares in Ron Fashion were purchased in August 2013 for a substantial price, in cash.

The chairman of ZFC, Herman Tam, was visited one week ago by Peter Zhou, the Deputy Operations Director, who said that he had acquired some disturbing information about the acquisition of Ron Fashion, which he had found by accident when searching through the e-mail folders of Eric Kam. It would appear that before recommending the purchase of Ron Fashion to the board of ZFC, Eric Kam had bought a substantial quantity of shares in the company from a retiring director, and had paid a low price for them. He had used a company owned by himself to make the purchase, in order to keep his identity hidden. When ZFC bought Ron Fashion, Eric Kam made a large personal profit from the sale of his shares. Peter Zhou said that he was giving this information to Herman Tam in confidence, and expected his identity as the informer to be kept hidden.

Herman Tam immediately visited Eric Kam in his office, to ask whether this information was correct. He did not tell Eric Kam how he had obtained the information, but Eric Kam suspected that a person in his office must have been the informer. Eric Kam confessed that the information was correct, and that he had been aware when he bought the shares in Ron Fashion that the company's other major shareholders would be pleased to receive a takeover bid from a company such as ZFC.

Eric Kam has, to date, been an excellent Chief Operations Officer and Herman Tam stated his expectation to the rest of the board and also to the financial media that he wants Eric Kam to be appointed as Chief Executive Officer of the company when the current CEO retires in a few years' time.

Herman Tam was shocked and disappointed by Eric Kam's confession, and was not sure what to do. He did not know whether Eric Kam has acted illegally or was in breach of any regulations or code of conduct, and he was not sure what action (if any) should be taken against Eric Kam. He therefore invited two individuals to a private meeting, to ask for their views and advice. These were people that Herman Tam had known for many years, and respected greatly. One of them is James Ding, an enforcement officer at the Stock Exchange of Hong Kong Limited – SEHK. James Ding is also a friend of Eric Kam, and they play golf together frequently. The other person is Ms Ella Poon, a senior manager in Pluto Investments, an investment organisation that owns shares in ZFC. She has been a great supporter of ZFC and was recently responsible for a decision by Pluto Investments to buy an additional 1% of the equity shares of ZFC.

This meeting was held today. At the meeting, Herman Tam explained the situation in confidence, including details about how the information was obtained from Peter Zhou. It was agreed that if the story was made public, there was some risk that some investors would sell their ZFC shares and the share price might fall. James Ding and Ella Poon were asked for their advice about the action, if any, that Herman Tam should now take.

## Group Discussion

In your workshop group, you will be asked to consider this scenario from the viewpoint of **one** of the following persons:

- (1) Herman Tam, Chairman of the Board of ZFC (and a Hong Kong CPA)
- (2) Peter Zhou, Deputy Operations Director of ZFC (and a Hong Kong CPA)
- (3) James Ding, enforcement officer at the Stock Exchange of Hong Kong Limited – SEHK
- (4) Ella Poon, senior manager with the investment company Pluto Investments

Required

- (a) **What are the key considerations of your allocated person in the scenario? The scenario should be analysed from their perspective.**
- (b) **With reference to the HKICPA Code of Ethics, what are the ethical issues that arise in this scenario?**
- (c) **Broadly following the American Accounting Association (AAA) Model, what does the group consider to be the best solution to resolve the situation? The proposed solution should be assessed from the perspective of the group's allocated person and as a CPA.**

## Workshop 1 Session 3

### Pre-workshop exercise 2 (Executive Management)

David Hardiman is the Chief Executive Officer (CEO) of ZFC. One of his responsibilities is to lead the New Business Development Group, and he has asked you to attend a meeting of the Group where new product strategy and new business development strategy will be discussed.

#### New product strategy

ZFC has a range of well-established products that it designs for the fashion seasons each year, but David Hardiman believes strongly that for the business to remain successful and competitive, it must also seek to develop new products or new ranges of products. He believes that ZFC should have a portfolio of new or fairly new products, and that a proportion of these should have demonstrated their success or should have the potential to be commercially successful.

To help with the analysis of the new product portfolio, the New Business Development Group uses the **Boston Consulting Group (BCG) matrix**, to assess the commercial performance or prospects for new products, and to make decisions about whether to continue with product or whether to stop producing them.

At the meeting, commercial prospects for the following products will be discussed.

- (1) **Umbrellas.** ZFC entered the market for fashion umbrellas two years ago. Annual sales growth has been good – about 20% growth in each year. The total market for fashion umbrellas is thought to be growing at a slower rate, 10% in each year. ZFC has a reasonable share of the market, and its market share is growing. ZFC are not yet making a profit on umbrellas, due to the costs of design, development and advertising, but the product is expected to become profitable next year if the current rate of sales growth continues and if some further investment in advertising is undertaken.
- (2) **Matching outfits for pet animal owners and their pets.** ZFC began to develop this product four years ago, and a considerable amount of money has been spent on development and marketing. The global market for this product is growing at 15% each year, and annual growth of sales for ZFC's products in this range is 10%. The products are making a small profit, but more expenditure on development and marketing will be needed to increase profitability.
- (3) **Kids' sun hats.** ZFC began to design and sell these products five years ago. The global market is growing at about 5% each year, but growth in sales of ZFC was 40% in the first two years. Growth in the most recent three years has been about 5%. Competition in the market for these products is increasing, and profit margins fell slightly last year. Even so, this product range is successful and profitable, and very little ongoing design and marketing expenditure is required.
- (4) **Tennis shirts.** ZFC began to design and sell tennis shirts three years ago. The global market is very large, although growth in the market is low. ZFC has a small share in the market, and growth has been difficult to achieve in spite of large amounts of expenditure on design and marketing. The product is not profitable, and in order to make it profitable, there will have to be further expenditure on design, development and marketing.
- (5) **Local costume in Germany.** In Germany, there is a large market for a local costume for girls and women. These costumes are known as Dirndls, and a large proportion of German women have one or more of these costumes. ZFC began to develop a fashionable version of these costumes two years ago. The total market is not growing at all, but ZFC has achieved a 10% share of the market in two years. The product range is still unprofitable, but it is close to achieving profitability. More expenditure on design will be required to increase market share substantially. The problem appears to be that many German women do not consider Dirndls to be a fashion item.

- (6) **Denim clothes.** ZFC did not design and sell denim clothes until last year. The global market for fashion denim clothes is currently growing at a strong rate, and already ZFC has achieved a large annual sales volume in the first year. Prospects for future growth are very good, and it is considered that with further development, ZFC could have a major new and profitable line of products.
- (7) **Patterned socks for men.** ZFC began to design and market patterned fashion socks for men six years ago. The global market was growing at a fast rate, although annual growth has since fallen to less than 10%. ZFC has a fairly large share of the total market, although this has been falling as more competitors enter the market, and annual sales for ZFC were slightly less in the most recent year than in the previous year. Although profit margins are falling, the product range remains successful and profitable.

### **New business development strategy**

The New Business Development Group also has the task of reviewing the business development strategy for ZFC, and has been asked to produce a range of ideas for future business strategy, which will be discussed by the board of ZFC at its next board meeting.

At this stage of the review, the board has asked for specific suggestions about alternative business strategies for the company.

David Hardiman intends to present alternative strategies to the board using the **Ansoff product-market matrix**, and has asked you to put forward suggestions.

Required

- (a) **Use the Boston Consulting Group (BCG) matrix to categorise the seven products described above, and on the basis of your analysis suggest what decisions might be made about the future of each product. In addition, state the advantages and disadvantages of using the BCG matrix for product development analysis.**
- (b) **Complete an Ansoff product-market matrix of ZFC. In your matrix identify a specific strategy that might be recommended to the board of ZFC.**

**Note for student:** Bring your completed analysis in (a) and (b) to the Workshop. It is recognised that there will be more than one possible item for each type of strategy, and acceptable answers may vary in content.



## Workshop 1 Session 4

### Pre-workshop exercise 3 (Management Reporting)

Wayne Tsai, Chief Finance Officer of ZFC, has been discussing **product profitability and pricing** with David Hardiman, the CEO.

The current policy of the company is to set prices for their products at a level that the design team leaders consider appropriate, subject to a requirement that all products must earn a gross profit, after deducting the cost of goods sold from the selling price.

Wayne Tsai expressed his opinion that all products sold by ZFC should achieve a **minimum profit margin**, after deducting direct costs and a share of overhead costs. To achieve this objective, he argues that in order to decide the minimum prices for each product, a profit margin should be added to cost.

David Hardiman agrees that in the market for Zodiac fashion clothing, companies have some control over the prices that they charge. This is because customers are attracted by the design of clothes and by the brand name. Although competitors offer similar products in the market, customers are willing to pay higher prices for a fashion design or a brand name that they prefer. However, prices are influenced to some extent by competition and the prices that competitors are charging for similar goods.

At the end of their discussion, Wayne Tsai and David Hardiman agree that they should review the company's **pricing policy**. The first step is to assess whether each of the four product groups earns a satisfactory net profit before interest, after deducting overhead costs from gross profit.

Wayne Tsai has asked you to prepare an analysis of product profitability, and measure the profitability of each of the main product groups, using the financial performance in 2013 as the basis for your analysis.

You should refer to the income statement in the Case Study.

The following information, showing the gross profit for each product group in 2013, is also relevant.

2013 figures, in HK millions	Women fashion	Men fashion	ZF Libra	Kids fashion	Total
Sales	12,880	5,096	7,483	5,591	31,050
Cost of goods sold	7,221	2,650	2,777	3,187	15,835
Gross profit	<u>5,659</u>	<u>2,446</u>	<u>4,706</u>	<u>2,404</u>	<u>15,215</u>

Required

- (a) Calculate the net profit (before interest) and the profit to sales ratio for each product group, in two ways:
- (1) Method 1: by allocating overheads in proportion to the sales revenue earned by each product group.
  - (2) Method 2: by allocating overheads in proportion to the cost of goods sold for each product group.
- (b) On the basis of the figures you produce in (a), consider whether the company's current pricing policy is appropriate.

**Note for students:** Remember to bring a calculator with you to the workshop.

## Workshop 2 Session 6

### Pre-workshop exercise 4 (Treasury Operations)

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Wayne Tsai, the CFO of ZFC, is concerned about the deterioration in the financial performance of the company in 2013, compared with the previous year, and he thinks that the financial position should be much better than it is. He is aware that the board of directors is considering alternative strategies for improving profitability, and he has been in discussions with the CEO, David Hardiman, about pricing policy for the company's products.

He also thinks that the **management of working capital** and cash should be investigated, and ways of achieving improvements should be found.

There are several reasons for his concern.

- (1) He had been expecting some improvements in **inventory** levels, because of the growing use of just-in-time procurement from suppliers. He is not aware of any significant improvements in turnover times.
- (2) There had been economic recession in some parts of the world and a slow rate of economic recovery in some other areas in 2013, and he is concerned about the risk of an increase in irrecoverable amounts **receivable** from wholesale customers.
- (3) He is aware that the company has a large amount of **cash**, but he wants to know why the company is not holding even greater amounts of cash.

Required

- (a) **Using the financial statements for 2012 and 2013, calculate the average cash cycle (working capital cycle) in each of these years and any other ratios that might help to assess the quality of working capital management. You should use the year-end figures in the statements of financial position for calculating all ratios, and you should make a distinction between the cash cycle for sales through retail distribution channels and sales through wholesale channels.**
- (b) **Comment on the cash cycle and other ratios you have calculated, and on the company's cash flows, during 2013.**

**Note for students:** Remember to bring a calculator with you to the workshop.

## Workshop 2 Session 7

### Pre-workshop exercise 5 (Corporate Finance)

A strategy review group, led by David Hardiman, has identified a company in the People's Republic of China, that has built up a substantial share of the market for women's and men's clothing. The company is called **Beauty Fashion Limited**, and it has been built up in recent years through a combination of organic growth and takeovers of smaller businesses.

The strategy review group has presented a proposal to the board that ZFC should consider the **acquisition** of Beauty Fashion as a strategy for developing the company's business in the PRC, by gaining an immediate and substantial market share.

Beauty Fashion operates in a similar business to ZFC, although the products that it sells are not considered as 'Zodiac fashion'. It designs its own clothes and has a small team of designers at its head office in Shanghai. It also has a large manufacturing operation, although it also uses small independent suppliers for some of its production work.

The board of directors of Beauty Fashion has been asked whether it would be willing to consider a **friendly takeover bid** from ZFC, and it has indicated that it would be very interested, provided that the offer price was satisfactory and regulatory approval could be obtained.

The board has agreed that the acquisition of Beauty Fashion Limited might be good strategic initiative for ZFC, but before reaching any decision, there must be a thorough and careful **due diligence** exercise.

Required

- (a) **Explain the purpose of a due diligence exercise and why the board of ZFC is correct in its insistence that a due diligence exercise should be carried out on Beauty Fashion Limited.**
- (b) **Set out the matters that should be investigated in a due diligence exercise, and the reasons why they should be investigated.**

