# TPE 2023 – Case Study Sample Solution

# Modni

# Briefing Paper

To: Jess Sharp

From: Charlie Tarazi

Date: October 2021

This briefing paper has been drafted to facilitate discussion regarding Modni and will cover the following points as requested.

1. Review of the recent financial performance of Modni

2. Evaluation of the current financial position of Modni

3. Other relevant observations

The content of this paper is intended only for the addressees and should not be relied upon by any other third parties without our prior written consent. In producing this paper, we have relied on the information provided to us to produce our advice, and should any of this information be incorrect, we are not responsible for any consequent errors in our advice. This paper should not be released to any third party without our prior written consent.

The tax advice is based on legislation at today's date. If any actions take place in the future it will be necessary to confirm the tax position at that time.

## 1. Review of the recent financial performance of Modni

## 1.1 – KPI analysis

### Retail KPI

***Revenue***

Modni has reduced their retail square footage by 31% as a result of COVID-19 between 2019 and 2020, this is due to the stores being required to close and customer preferences changing, this is also highlighted by the reduction in the number of own stores and number of concessions. The number of concessions has reduced by half. This is due to the loss of 2 major customers. This shows that the business is heavily reliant on a number of larger businesses therefore we would recommend you look to attract more income sources to replace the sources which were lost as a result of covid, this could be through marketing or management could utilise their contacts to do this.

When comparing the revenue per square foot to Joe Dexter, a competitor, the revenue per square foot has been consistently higher for Joe Dexter. They are a comparable company when looking at their retail stores with similar quality goods being produced, therefore it should be analysed if the store sizes could be reduced and hence rental costs would be lower, and if this would increase the revenue.

Stores should also be analysed to see if they are profit making, and if not they should be closed, this could be another reason for Joe Dexter having higher revenue per square foot. We understand that this task is currently being carried out, and it would be useful to see how the results for 2021 compare to Joe Dexter once this information is available.

***Operating costs – Retail own stores***

Operating costs have increased significantly per square foot, these costs have been fluctuating each year however there does appear to be a steady increase. Operating costs include all direct operating costs and a share of distribution centre overheads. It should be further analysed to ascertain if the increase is due to general operating costs or the share of overheads. If this is due to the share of overheads then it could be that the group allocation could be reviewed, if this is due to the general operating costs we would recommend an urgent review is carried out to ascertain why these costs have been increasing and hey should look to reduce these.

## Wholesale KPIs

There has been no benchmark to compare the performance to competitors for wholesale, it would be useful if a competitor could be found to benchmark this data against.

***Number of retail partners***

The number of retail partners for both key accounts and independent retailers is reducing each year. It has been noted that in 2020-21 this was due to the economic decline however the trend before this shows a reduction of 3%, there is clearly an ongoing trend of this. Although the reduction is small this could have an impact on revenue. We would recommend that Modni should look to attract more income sources, this could be via attracting clients via diversification of product/service offerings where a gap can be identified in the market. Clearly, the business is very reliant on these customers and, if a recent marketing exercise has not already been undertaken, then a campaign to attract new customers should be considered. Any legal contract with the main customers should be reviewed to ensure the company does not breach any restrictions of business clauses, if they exist.

***Average revenue per customer***

Average revenue per customer has been steadily increasing, especially for the key accounts, up to 2019. This then dropped in 2020 and 2021 which is assumed to be due to COVID. The position appears to be improving in 2021 which suggests that the revenue is back on the rise. We would recommend that going forward further emphasis is also on returning the revenue per customer to the higher levels, this could be by offering special discounts to the customers if they were to bulk buy products. This could also help with inventory obsolescence problems.

***Operating costs***

Operating costs both in terms of the total cost and the cost per retail partner have been increasing. These costs are made up of an allocation of distribution centre overheads, delivery costs and account management. Similarly to the retail KPIs, it should be further analysed to ascertain if the increase is due to general operating costs or the share of overheads. If this is due to the share of overheads then it could be that the group allocation could be reviewed, if this is due to the general operating costs and distribution costs we would recommend an urgent review is carried out to ascertain why these costs have been increasing and hey should look to reduce these.

## Working capital and liquidity

***Current and quick ratios***

The current ratio looks at the working capital of the organisation. It assesses the organisation's ability to meet it short-term debts as, in theory, the organisation could sell its current assets to pay for its current liabilities. Rather than focusing on the actual number it is more important to consider the trend of the ratio over time. If the number is continually falling this could mean that the company is, in the worst case, heading for insolvency. If the number is continually rising management may not be properly managing the working capital of the organisation. Too much money tied up in inventory and/or trade receivables can result in the unnecessary costs of deteriorating and obsolete inventory and bad debts. An increase in current ratio could indicate poor working capital management or impairment of trade receivables.

The quick ratio is calculated as current assets, less stock divided by current liabilities.

The analysis of the current and quick ratio show that the business is holding less current assets compared to liabilities each year, the largest reduction was in 2020 which is likely as a result of decreasing cash used to fund the operations whilst COVID-19 resulted in less revenue.

In comparison to Joe Dexter this is still very high and should be reduced, the company are not managing their working capital effectively and appear to have too much money tied up in inventory and cash, if this was reduced it could be used to fund other operations.

***Receivable days***

Receivable days appear very high, especially for retail partners. This is significantly higher than Joe Dexters receivable days. This ratio measures the effectiveness of the business in collecting its debts. The ratio calculates the approximate number of days that credit customers are taking to pay their debts. There should be a relationship between days trade receivables and the numbers of days credit offered by a business. The trend of this number is important and if the ratio is seen to be continually increasing over time without an organisation extending its credit terms this could indicate problems with credit control and bad debts. An increase in debtor days could indicate that there are possible bad debts which have not been provided for.

It would be useful to understand the credit terms offered to customers to draw a proper analysis. The days for retail partners seems extremely high however this could be due to concession stock being offered.

Potential efficiencies could involve changing the payment plan to speed up the collection process and release some of the cash that is currently tied up in debtors. You should look at what terms are charged by competitors and compare this to yours. Customers could be given financial incentives to pay early, e.g. a discount. If the debtor days were to reduce the release of cash could be used to fund expansions such as into the website.

***Payable days***

In theory, this ratio calculates an approximation of the number of days' credit the business is taking from its suppliers. A steady increase may highlight the fact that the company is making better use of interest free credit or it could be because the organisation has no cash with which to pay its suppliers (we note that Modni has been noted to have high cash therefore we would recommend this is due to them making full use of credit terms). It may also indicate that the business is taking longer to pay its debts and therefore risking its credit worthiness. The creditor days should be compared to the credit terms offered by suppliers, if this is above the terms offered, there is a risk supplier relationships could be damaged or the company could obtain penalties for late payment.

Given that the terms for Joe Dexter are higher we would recommend analysing the current terms with suppliers and seeing if the number of days can be extended in line with industry average, however you must be careful not to allow supplier relations to deteriorate due to this.

***Inventory days***

This ratio calculates an approximation of the number of days it takes to sell inventory (convert into cash). A continual increase in this number could indicate liquidity problems.

Inventory days has been continually increasing which could indicate further stock obsolescence. The risk of stock obsolescence in this industry is high, therefore we understand in 2018 a policy was introduced by having flash sales to sell stock. There are still however high inventory days and this is increasing, despite Modni donating inventory and writing off lots of inventory in the period.

We understand total inventory is now £190 million whereas it was £210 million in 2020. This suggests that less purchases have been being made in 2021 and this is the reason for the change in days. This could suggest that the number of days should reduce in 2022 when the operations return to normal.

Modni should consider doing a sale to dispose of some of the inventory and ensure it doesn't need to be written down, especially due to the fast changing fashions resulting in stock becoming obsolete more quickly.

Joe Dexter has much lower inventory days even given their inventory was overstated in the 2020 accounts, this could be however due to them having a website so they may find it easier to sell their stock which is becoming dated. This could be improved by the implementation of a website as suggested by the board.

***Bank and cash***

The cash position, although reducing, is still high, we would recommend a review is performed of the cash required for operations going forward, and some of the excess cash could be invested into other areas of the business. Joe Dexter has much lower cash and is in overdraft in 2020 which suggests that a high cash balance is not imperative for this business style (although we do not recommend going into an overdraft as this would incur interest).

## 1.2 – Other analysis of the distribution channels

Please refer to **Appendix 1** for the calculations performed on these figures.

We note that the highest GP% is through the retail own stores which is expected.

***Retail own stores***

Gross profit and contribution percentage is decreasing over time, even pre 2020 this reduced contribution from 13% to 9%. This shows that the costs including cost of sales and overheads are increasing faster than revenue increases. We would recommend a review of overheads to see if these could be minimised and reduced, this should include analysing the lease agreements which are fixed costs. This could be the reason for the reduction, as the lease agreements are fixed it should be discussed if the contracts could be renewed for lower rates or if any of the leases should be exited.

***Retail concessions***

Gross profit % has reduced similarly to the retail own stores, we would recommend a review of the cost of sales is performed to see if any costs could be minimised. It could be that the rental charge which is based on revenue has increased, more than revenue, although this is unlikely unless new contracts were entered. We would recommend a review of suppliers is performed to analyse if you are getting the best deals on the products.

Pre 2020 the contribution % was fairly constant therefore this has not been analysed further.

***Wholesale Key and Independents***

The gross profit margin for wholesale has remained fairly consistent since 2018. Although the gross profit margin has remained constant, the individual cost elements should be examined to see if there is any obvious wastage that can be improved. It is recommended that this review takes into consideration the full cost of the product to further understand the current composition of the cost of sales.

Contribution percentage has also remained fairly constant when you do not include the analysis of 2020 and 2021 due to these including some exceptional costs. There is however a slow decline. Given that the operating costs are made of distribution centre overheads, delivery costs and account management, we would recommend a review is performed to see where the increases re coming from.

## 1.3 – Other relevant financial analysis

***Gross and operating profit margin***

We do not deem it appropriate to analyse the profit margins with kk girl, this is due to them operating only online. Joe Dexter operates both online and in store therefore we have performed an analysis to them.

Overall gross profit margins have a trend of reducing. We understand that a large number of 3rd party manufacturers are used who have to pass checks etc, we would recommend contracts with these companies are analysed to see if any cost savings could be made. We understand however you may not wish to do this because you pride yourselves in being ethical and ensure you are paying fair prices to suppliers. If this is the case you could consider advertising this good CSR to customers and increasing your prices slightly so that increasing costs are met by the customer, not yourselves.

The reason for the reduction further in 2020 appears to be due to the one off payment to suppliers which was made, again we would recommend that you advertise this to customers. The fast fashion industry has a bad reputation for being unethical therefore you should highlight to the customers that you do not take part in these practices and that you treat suppliers fairly, this could generate more sales.

Joe Dexter has higher gross profit margins, again this could be due to you paying the suppliers fairly, it should however be analysed who their suppliers are and a comparison of prices charged should be made.

Operating profit margins are also reducing, this could be as a result of the supplier costs however we would recommend a full review of overheads is undertaken to ascertain the reason for the reduction. This has been reducing whilst Joe Dexter's has been increasing, however this could be due to them selling products online.

## 2.0 – Evaluation of the current financial position of Modni

From analysing the underlying operating profit and the KPIs as analysed above we note that the current financial position appears weak as a result of reducing sales and revenue due to COVID. The trend of retail and wholesale contribution appears to be a downwards one both before and after covid and this needs to be addressed as soon as possible. We have discussed areas for improvement in both sections 1 and 3.

### Gearing

We understand the company's gearing has increased significantly due to the lease liabilities. This is now at 75% which is very high. Gearing, which is concerned with the capital structure of the organisation, has many definitions. The gearing ratio shows what proportion of the assets of the company (i.e., non-current assets and net current assets) have been financed by lenders rather than shareholders. The higher the level of gearing, the greater the risk that there will be insufficient profits available to pay dividends to the shareholders. Highly geared companies are more sensitive to changes in interest rates. The profits of a highly geared company will suffer the most if interest rates are increased, but shareholders gain with highly geared companies in periods of low interest rates.

We understand that the company currently is fully equity financed and therefore does not have any loans, therefore we would recommend this ratio is reviewed and in any loan applications it should be highlighted that the reason for the increase is due to the lease liabilities.

## 3.0 – Other relevant observations

### Teddy's initiatives

It would be useful to have more figures on the initiatives introduced by Teddy to assess the revenue that is being brought in as a result of them.

### Design team

The enhanced design team was recruited with award winning designers, this was in 2018, we saw an increase in revenue from 2018-2019 however this reduced in 2020 due to covid. This should be reviewed to see if they are bringing in additional revenue, they have a high cost and it should be clear if the cost is worth it for the company.

### Celebrity influencers

The influencers receive the products free of charge and post on social media and are paid for their services, most acknowledge this to the followers but Modni don't police this. Modni need to review this, there is new legislation that influencers have to state when something has been gifted / they have been paid for it, this is to ensure fair advertising and if Modni do not review this there is a risk that they could be fined and get a damaged reputation as a result of this.

### Sponsorship of TV program

This is a good initiative and is very topical, we would recommend that the TV programs are reviewed to ensure that they have maximum following and that sponsorship isn't being done on shows which aren't watched.

### KB Sports

This was introduced as a celebrity partnership and receives good returns of 60% gross margins, even after the royalty payments, we would recommend other celebrity influences are looked into to see if more partnerships could be made which could turn around the revenue for the business and result in improved profits.

### Foreign exchange risk

Due to suppliers being in foreign currencies there is a risk that adverse exchange rate movements could impact results. We understand that the whole FX risk is borne by Modni therefore there is a significant risk to the company that adverse changes in the exchange rates significantly increase the cost of sales and purchase prices. This could be mitigated by hedging the risk. Hedging used by businesses to protect it from the risk of changes, particularly unexpected changes, which could impact on the costs and profitability of a company.  The aim is to try and instil some stability in costs. This could be done using forward contracts, futures contracts or call and put options.

## CSR

We have noted throughout our analysis that Modni engages in lots of CSR practices, we would recommend that this is highlighted on the company website and social media channels.

Corporate Social Responsibility should promote the responsibility Modni has to the society in which it operates. There is a heightened need for implementation of CSR strategies in the current climate due to an increasing awareness of global warming and 'saving our planet'.

This has gone on to influence customer demands and needs; market research has shown that consumers are becoming eco-friendlier and their buying habits are changing to reflect this.

Sustainability in (sector) is becoming increasingly important to long-term viability of the industry. This has gone on to influence customer demands and needs; market research has shown that consumers are becoming eco-friendlier and their buying habits are changing to reflect this.

Given the attractive policies with the suppliers and the donations to key workers in COVID, we would recommend this is marketed on the company website to show the benefits the company is having to society. This is especially important in the fast fashion industry which receives lots of criticism due to the fast moving stock and level of stock obsolescence. Competitors such as Boohoo have been significantly impacted by bad CSR in recent months.

## Website

The internet presence is very basic. Given the rapid trend towards the use of internet shopping, this could be restricting the growth of the business. We understand you are looking into implementing a shopping website and we will discuss this with you as needed.

If you would like to discuss any of the matters contained in this briefing paper, please do not hesitate to contact me.

Charlie

(CA)

## Appendix 1

| | 2021 | 2020 | 2019 | 2018 | 2017 |
|---|---|---|---|---|---|
| Retail own store | | | | | |
| Revenue | 450 | 184 | 525 | 510 | 461 |
| Gross profit | 261 | 92 | 299 | 331 | 313 |
| Contribution | 17 | -159 | 45 | 48 | 61 |
| **GP%** | **58%** | **50%** | **57%** | **65%** | **68%** |
| **Contribution %** | **4%** | **-86%** | **9%** | **9%** | **13%** |
| | | | | | |
| Retail concessions | | | | | |
| Revenue | 14 | 6 | 25 | 32 | 18 |
| Gross profit | 6 | 3 | 13 | 18 | 10 |
| Contribution | 2 | -2 | 7 | 10 | 5 |
| **GP%** | **43%** | **50%** | **52%** | **56%** | **56%** |
| **Contribution %** | **14%** | **-33%** | **28%** | **31%** | **28%** |
| | | | | | |
| | | | | | |
| Wholesale key | | | | | |
| Revenue | 36 | 24 | 65 | 66 | 57 |
| Gross profit | 15 | 10 | 27 | 28 | 26 |
| **GP%** | **42%** | **42%** | **42%** | **42%** | **46%** |
| | | | | | |
| Wholesale independents | | | | | |
| Revenue | 144 | 96 | 260 | 264 | 226 |
| Gross profit | 66 | 44 | 120 | 124 | 113 |
| **GP%** | **46%** | **46%** | **46%** | **47%** | **50%** |
| | | | | | |
| Contribution | 38 | 7 | 100 | 106 | 94 |
| **Contribution %** | **21%** | **6%** | **31%** | **32%** | **33%** |

# MEMORANDUM

To: Jess Sharp

From: Charlie Tarazi

Date: October 2021

Subject: Modni launch of new transactional site

As discussed I attach my analysis of the practical operational factors to be considered for the new transactional site for Modni.

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## 1.0 General business considerations

### Competitors

Competitors already offer this service therefore it will need to be assessed what will differentiate you from the competitors, for example kk girl who offer an annual membership allowing you to have free next day delivery for the cost of £10. Global competitors will benefit from economies of scale and there is risk of saturation if too many competitors enter the market simultaneously. You will need to consider if you will also offer deals such as this.

### Market

The market is changing, more people are shopping online especially millennials and generation Z who are the target customer base for the company. The projections are that 95% of purchases will be made online in 2040, if Modni does not enter this distribution network/market there is a risk they will be left behind and the company will become obsolete.

### Improved ability to profit

Modni would also have the ability to make higher profits if they sold online as they wouldn't be paying the high fixed rental costs.

## Market research

A key consideration before embarking on the new venture is if there is demand or not, if there is insufficient demand there is no point in continuing in looking into this further as this will be a waste of time and money. Therefore sufficient market research needs to be performed to understand the demand, this will cost the business in the short term however will have long term gains as it could save them from undertaking an unsuccessful venture.

Once market research has been performed, forecast figures should be drawn up to see the potential profit to be made from the new business.

## Sensitivity analysis

As part of any appraisal, it is highly recommended that a sensitivity analysis is conducted. This is to ensure that the company have analysed a variety of scenarios and have identified key drives affecting the venture. Without such analysis, Modni will not be making effective decisions on the performance of the website as a whole, and may make decisions which could be detrimental to the brand.

## Cash flows

It would also be important to produce cashflow projections due to the significant initial cash outlay for the website. Doing so would enable you to understand better the cash requirements to fund this project and if any short term working capital financing would be required in addition to long term financing.

## Access

For the website to be successful you must be confident in it being operational 24/7, to increase reliability it would be a good idea to get your ISP to host the website, they are more likely to have the capabilities to do this. Crashes will likely lead to lost revenues.

## Website design

This step is crucial to the success of the website. Todays customers are relatively sophisticated and will have little time for poorly designed or unprofessional looking websites, therefore you could lose custom. The site must be logically and intuitively laid out, east to navigate with clear links between pages. This is an expensive step and you will incur running costs per page and programming costs for development. We would recommend market research and customer research is carried out to see which designs work well and which designs customers value.

## E-payments

Payments will commonly be made by credit/debit card, there is a risk that hackers could intercept or steal information. Modni should use a cyber-cash payment system which could link to their bank and automatically credit their account. This will also ensure that customer details are safe. There would however be the hidden cost of banking charges.

## Risk of fraud

One of the main risks of online trading is identity theft and fraud. You must ensure that you have adequate security in place to ensure that customer's personal details are safe, not doing this could result in serious litigation from customers, significant reputational damage and loss of custom. This has been discussed further in **section 2** below.

## GDPR issues

Due to having the website, Modni will have increasing responsibilities under GDPR as a result of having the customer data.

GDPR applies to all organisations collecting and processing personal data of individuals residing in the EU regardless of the organisation's physical location. All such businesses must comply with GPDR where they offer goods or services to individuals within the EU or monitor the activity of people in the UK.

GDPR can result in fines of up to EUR 20,000,000 or 4% of worldwide turnover, whichever is higher. There is also a risk if this is made public of damaged reputation and hence loss of customers. There is a mandatory requirement to notify the Information Commissioners Office within 72 hours of discovering the breach therefore we recommend that you do this as soon as possible.

It is recommended that Modni has a formally designated Data Protection Officer for the future who can provide training to staff and monitor the information security systems.

Modni will need a well-designed system which can store the data securely, this is essential. Audit logs should be introduced within the system to allow amendments to be recorded and unusual attempts to access or copy personal information to be detected.

Authentication controls are also essential to ensure that access to personal date is appropriate and authorised. We understand this happened due to a past employee accessing the system, however their access should have been revoked as soon as they left the business or the relationship turned sour. This needs to be done in the future as part of the process of employees leaving.

A full review of who has access to which information should be performed as soon as possible to identify instances where people may have access to information they do not require for their jobs, or in case there are other instances of past employees still having actions.

Data should also only be held for as long as it is required, this is to ensure that there is not excessive data people could access.

It is important that all staff receive appropriate training and are aware of the GDPR regulations and consequences for the company, and them as individuals.

### Distribution

Distributors should be sought for the delivery of the products and gross margins on these products should be considered including the delivery costs. Given that kk girl has a policy where they are able to deliver next day, to be able to compete with the company the distributors will need to be reliable. Otherwise Modni may struggle to compete and could end up damaging their reputation.

### Detraction from existing business

Expansion takes time. It will be important that sight is not lost of Modni's current objectives as it is a profit-making company (pre COVID). If too much focus is given to the website, customers of the stores could be lost in the process.

### System requirements

New systems will be required to support the website at an extra cost, also as customer details will be required these will need to be managed carefully. General Data Protection Regulation (GDPR) would apply, this is relatively new legislation which has heightened the requirement for companies to protect consumer data.

### Management experience

It should be considered if management have the experience to expand into the website. This will be very different to running the existing operations and management should be made aware of that. A new employee may be required to run the website as management will need sufficient skills and experience for this to be successful. They should consider bringing someone onto the board with experience, possibly a business angel who may be able to help with funding given the reduced liquidity of the company as a result of COVID, however they will expect a return from their investment.

### Staff

New staff will need to be employed which will result in recruitment expenses, training and additional payroll to run the website. This will take time and all staff should undergo proper due diligence and records should be kept to avoid any possible legal fines in the future. The salary offered will need to be competitive with other businesses in the same industry. There could also be conflicts if the new employees do not get along with current employees, it will take time for the new staff to fully settle into the business and get familiar with the culture.

### Foreign exchange

If customers are purchasing from abroad there could be foreign exchange considerations. Expanding the business in other countries introduces a greater currency risk to the business as the exchange rate is likely to fluctuate over time. This could be mitigated by hedging the risk. Hedging used by businesses to protect it from the risk of changes, particularly unexpected changes, which could impact on the costs and profitability of a company.  The aim is to try and instil some stability in costs. This could be done using forward contracts, futures contracts or call and put options.

### Funding

The website will require funding. The company will need to consider where the additional funding will come from. If a bank loan is required this will result in an increase of gearing for the company and it could be difficult to get bank funding in the future. The bank is also likely to request security against the loan, this could come from any owned stores. Additional equity could also be an option from a new investor with industry knowledge, however this would result in loss of control and the new investor should be kept as a minority shareholder. Alternatively, the existing cash in the business could be used, however Modni must be careful not to cause liquidity problems doing this method.

### Insurance/licences

The company will need to ensure it has adequate insurance and security arrangements in place for the delivery of the products to customers, they will also need to ensure that all relevant licences to trade online are obtained. It should be considered how these regulations will differ from the current regulations faced in the business.

### Marketing

It is recommended that the company invests in marketing and promotional campaigns to ensure that customers and potential customers are aware of this new venture. A marketing strategy will need to be implemented, it is recommended that a marketing specialist is engaged to assist with this.

### Reputation

There is a risk of damaging the reputation of the company if the website doesn’t work and gets negative feedback, this could have a detrimental impact on the other areas of the company. Likewise, however, if the reputation is good, this could generate more sales for other areas of the company by way of association and appropriate marketing.

## 2.0 Risks of e-commerce

The business will also need to consider the risks of e-commerce. There are various risks that an entity may become exposed to through becoming involved in e-business or e-commerce. Broadly, the key risks are as follows, including suggested mitigations to the risks:

**a) Customer identify fraud** - In customer identify fraud, the impersonator can misrepresent themselves as a legitimate customer, enabling them to order goods and services for free or at the expense of another unsuspecting person e.g false credit card details. We would therefore recommend that Modni ensure that they have customer accounts and perform checks on the cards used to pay for the goods.

**b) Organisation identify fraud** - In company identify fraud, the impersonator can misrepresent themselves as a trusted organisation to the customer in order to obtain personal information. We would recommend that Modni ensure that they have a team who constantly review this and if any business appear claiming to be them they should ensure level action is taken.

**c) Server reliability** - Server reliability includes the loss of function of the server from unintentional operational problems within the system as well as malicious attacks where an individual is able to destroy, shutdown, or degrade a computer or network resource.

Loss of function of the server for whatever reason is a risk to the reputation of the site, which may lead to financial or even legal risks. Modni must ensure that they have appropriate firewalls and security in place to ensure that the website is as safe as possible. It is recommended an IT expert is engaged to assist in this.

**d) Denial of service attacks** - A malicious attack on an organisation with the intent of restricting the operation of the server is referred to as a denial of service attack. Again, IT controls will help with this, we would recommend an expert is engaged to make the website as safe as possible.

**e) Virus attacks** - A virus is a program or piece of code that is loaded onto your computer without your knowledge and runs against your wishes. Viruses can also replicate themselves. All computer viruses are manmade. Again, IT controls will help with this, we would recommend an expert is engaged to make the website as safe as possible.

**f) Spyware** - In computing terms, spyware refers to a broad category of malicious software designed to intercept or take partial control of a computer's operation without the informed consent of the machine owner or legitimate user. Can collect user details without their knowledge. Often disguises itself as virus protection software. Again, IT controls will help with this, we would recommend an expert is engaged to make the website as safe as possible.

**g) Data theft and other data issues** - There is an increased risk to the integrity of data being captured, transmitted, stored and retrieved electronically where businesses use electronic commerce. Again, IT controls will help with this, we would recommend an expert is engaged to make the website as safe as possible.

**h) Compliance with tax and legal requirements** - Websites are accessible on a global basis. The legal registration of a client, its base of operations, the country where goods or services are supplied from and where its customers are located may all be in different countries. This may give rise to legal and financial risks such as: not correctly recognising and accounting for taxes due on cross border transactions; and breaches of laws and regulations that affect trading in local and overseas jurisdictions. We would recommend both a tax expert and lawyer are engaged to assist with this and ensure that the company is operating legally.

**i) Repudiation of electronic contracts** -Failure to ensure that electronic contracts are legally binding (eg by not ensuring that all terms and conditions are brought to the third party's attention or by not ensuring the authenticity of the third party entering into the contract) introduces the risk of repudiation, which affects credit risk and the risk of goods being returned. We would recommend that customers are made aware that the email confirmation is the contract and that they are unable to change their order after this. Legal teams should be able to assist with this.

## Conclusion

Given the changes of customer taste as a result of COVID 19 and the fact competitors are already offering this service we would recommend that the new transactional site is created, this will help Modni to keep up in the fast changing industry. There are however a number of considerations they must have first, which have been discussed above, such as the reliability of the website, GDPR issues and the design of the website.

If you would like to discuss any of the matters contained in this memo, please do not hesitate to contact me.

Charlie

To: Ethics Partner

From: Charlie Tarazi

Re: Ethical Considerations in Respect of Modni

Date: 2 November

This e-mail has been prepared to document the ethical concerns I have encountered regarding one of my clients; Modni. These issues are outlined below.

## Internal concerns

## Potential bribery / gift from client

I have a suspicion that there was potential bribery on the engagement, this is just a suspicion however and I have no tangible proof of any wrongdoing.

When I was preparing a briefing paper for the client, Jess mentioned that Teddy was under pressure from shareholders and wanted to board to understand that the poor performance was not due to him, Jess agreed with this and stated in the paper we should reflect this. I did not do this however, I gave a balanced evaluation of the issues. I also wonder if this has happened in the past as Jess stated 'Teddy was always good like that'.

Jess then mentioned that Teddy had given us a gift of store vouchers and she would post them to me because she doesn't want people in the office to see, I am concerned that this was a bribe for us not to write bad things about him.

Bribery shows unprofessional behaviour, and a lack of integrity, this is governed by The Bribery Act 2010. If this constitutes as a bribe under the Bribery Act 2010, then giving or receiving this bribe can result in up to ten years imprisonment for the individuals involved, as well as an unlimited fine for the company. If found out, there will be damage to the reputation of the individual, the profession and the company.

The company should ensure the anti-corruption procedures within the company are robust to prevent offering or acceptance of bribery, training should be provided to all employees including the possible legal consequences, both personally and for the company. This will hopefully deter employees from engaging in such illegal acts.

I will decline this offer. This will ensure that I behave professionally, and the mitigate any self interest threats and therefore lack of objectivity.

The company must ensure that it has sufficient anti-bribery and anti-corruption procedures in place to stop employees from committing bribery. The company must also ensure that Directors/Partners set an ethically sound 'tone from the top' for employees to follow. The company may also want to consider providing training to all employees which sets out the serious nature of the consequences of committing bribery for both individuals and the company. This will hopefully deter employees from engaging in such illegal acts.

The company may also want to ensure that there is a strict policy around any gifts or hospitality received from clients, that is to have a legitimate business reason, to be reasonable in price and nature (not unduly lavish), and to be declared in the company's Gift and Hospitality Register.

Money Laundering Regulations (2019) require us to report on any activities that fall within the not only actual money laundering activities but also an ‘attempt or conspiracy or incitement to commit such an offence’. Consequently, we must agree whether, should the claims be substantiated, to report the situation to our MLRO and the NCA.

If the claims were to be true and we failed to report these occurrences, this would be an offence under the Proceeds of Crime Act (POCA). We may discuss the money laundering legislation with staff  but we must ensure that we do not tip off the client and Jess to our intentions to report. Please note that in accordance with this, I have not included anything to this effect in our documentation for Jess or Modni.

### Intimidation / unprofessional behaviour from Jess

As noted above, Jess mentioned that I should not include anything in my report which would reflect badly on Teddy, I deem this to be unprofessional behaviour. She also mentioned another director at Modini was ‘gorgeous’ which I also deem to be unprofessional. There is an intimidation threat from when Jess requested that I do not include documentation which would reflect badly on Teddy which threatens objectivity and independence and is unprofessional behaviour from Jess. Her comments regarding the director are also unprofessional.

This shows Jess does not have best interest of the business at heart. They would be expected to be setting a tone at the top by demonstrating professional behaviour and sound ethical judgement.

This could lead to other employees engaging in similar activity, they could justifying this as they have seen the Directors doing this as well.

Jess should go to a management training course which focuses on the role of managers and what is considered appropriate behaviours and highlights the ethical impacts for those who hold high positions within an organisation.

### Time to do the engagement

Jess has mentioned that another manager is on sick leave, therefore she has lots of work on her plate at the moment, there is a risk that we do not have the sufficient time to perform the work properly to the highest standards. This is a risk to our professional competence and due care.

If we do not have the time to do the engagement properly this would damage the reputation of the firm and profession, and could result in incorrect advice being given. We must ensure all work for the client is reviewed and that we have the time to do the work, otherwise we must consider resigning from the work or appointing a different team to work on the client.

## External concerns

### Teddy's reputation

I have noted that Teddy does not have a good reputation. He no longer works at Modni however he did in the past and was a key contact for us. He has had several sexual misconduct allegations made against him which have resulted in him resigning from the engagement. If these allegations are true, this shows unprofessional behaviour of Teddy.

As a firm we need to consider if we want to be associated with clients who act this way, this could damage our reputation by association. We need to re-evaluate whether the firm wants to continue engaging in work for him and his associated companies.

### Non-compliance with corporate governance

After Teddy left the company and Orlando did a vote of no confidence, the board have all decided to leave the company, the CFO has left and many others are on their three month notice period. This means that there are currently only three board members and they don't necessarily have the right experience to run the company. As they are a plc they should be complying with the Corporate Governance Act 2006, and they are not currently due to this. This shows a lack of integrity and professional competence and due care.

Non-compliance will result in fines and a damaged reputation for the company. This could also damage the reputation of us as we should have ensured they are compliant as CA's by acting with professional competence and due care.

We must act with professional behaviour, we should discuss with the client immediately the ways in which they are non compliant and develop a strategy for them to become compliant with all the relevant laws and regulations. We should monitor whether they implement this, if not, we should report this to the FRC and resign from the engagement.

Modni should ensure they have a secretary appointed to analyse the laws and regulations and ensure compliance with these.

We should only act for the client if they agree with the regulations.

### Supplier issues

One of Modini's suppliers has been paying people below the living wage and has been employing children as young as 8. They have been falsifying records to show that this isn't happening. There is currently no evidence that Modini knew about these practices however if they did this shows a lack of integrity and is unprofessional behaviour.

Modni should have been checking their suppliers more carefully to ensure that this didn't take place. We may receive reputational damage by association of a client who engages or is seen to engage in these practices, we are comprising our own integrity and professional behaviour if we continue to work for the client. We should carry out further due diligence to ensure we are acting with integrity and professional behaviour, and if we should continue to act for this client.

## Overall client risk

One way in which we could mitigate against such client risks in the future is to perform due diligence on all prospective clients with a risk-based approach, obtaining more evidence where there is a high degree of risk. We should keep client identification records must be kept for five years then deleted five years after the completion of the engagement. This should be built into our firm's client acceptance procedures.

As CA's, it is also important for us to consider that acting for an unethical client will further damage the reputation of ICAS and the wider accountancy profession given the ethical considerations outlined above. It is apparent from recent events in the news, such as BooHoo.com, Carillion and Parisserie Valerie that a firm's reputation may become damaged by association with an unethical client. Although we may lose income relating to Modni, continuance of work may detriment our firm even further as other existing clients seek their services elsewhere. This also may affect our future income streams as potential prospective clients feel more comfortable engaging with alternate firms who do not have such association with an unethical client. The profession is currently under more scrutiny from the public than ever, so it is important for us to maintain public trust in accountants where possible and minimise any further damage by reporting suspicions of unethical activity through the firm's correct channels.

Should you wish to discuss any of the points that I have raised, please do not hesitate to contact me.

Thank you,

Charlie

**PRIVATE AND CONFIDENTIAL**

# Report to the Board of Directors of Modni Plc

## A report outlining how to improve profitability using product lines and distribution channels and an appraisal of the two investment opportunities

**Prepared by Pemberton LLP**
**Date 2 November**

## Contents

## Introduction

This report has been prepared to facilitate discussion regarding how to improve profitability using product lines and distribution channels and an appraisal of the two investment opportunities.

The contents of this report are intended only for the addressees and should not be relied upon by any other party without our prior written consent. In producing this report, we have relied on the information provided to us in order to produce our advice and should any of this information be incorrect, we are not responsible for any consequent errors in our advice.

The tax advice is based on legislation at today's date. If any actions take place in the future it will be necessary to confirm the tax position at that time.

Where investment advice has been provided, the ultimate investment decision lies solely with the investor.

## Executive Summary

- The group should perform a review of overheads to assess areas where costs can be cut
- They should then analyse the current demand for each brand and assess what it is customers would like with new product lines
- The brands could offer a collaboration, similar to that seen with H&M and Balmain aimed at obtaining new customers
- Distribution channels should combine to save on distribution costs, and the websites should be combined so that Modni is making use of the already established website of Angelo Dimitri
- The group could consider branching into overseas locations to obtain new distribution channels.
- We would recommend that the company do not pursue either investment opportunity until the existing business profitability has improved and the governance issues have been addressed.
- Once this has been done we would recommend option 2 of the stores in Japan is pursued, however this should be done with a lower number of stores to assess the demand and success before more capital is required, this would also help to assess the impact of the key risks of operating in another country.
- The key risk with option 1 is the price of the venture and where funding could come from given the company is already 75% geared, there is a risk if the project was unsuccessful the bank could recall funding and the company could no longer be a going concern

# 1. How to improve the profitability of the new group considering product lines and distribution channels

## 1.1. General recommendations

**Pricing of products**

Prior to commencing any further strategies, it is important that the pricing and costing structure associated with the products is known, if not then ideas to stimulate sales could be detrimental to the profitability of the group as a whole.

Given the price sensitive nature of the product, it is recommended market research is carried out to find out how much customers would be willing to pay in order to identify an ideal selling price for both the budget goods at Modni and the luxury goods at Angelo Dimitri.

It is recommended that a review to cost of sales is made, this will allow a minimum selling price to be determined and compared to what customers would be willing to pay.

Increasing prices would be beneficial to the overall profit position. A small increase of prices, by 5% for example, may reduce the customer numbers but actually increase the profit made by the company. A feasibility study, and projections of future performance, should be drafted to confirm whether this policy should be adopted by the division.

**Offers**

Modni could consider offering a one-off discount for both companies during the new year/black Friday, this would be attractive to those who are on the fence about purchasing products, and could increase revenue pre-Christmas when people are purchasing gifts. It is noted that Modni already has sales however a large marketing campaign could be run around this.

**Analysis of customers**

It is recommended that an online questionnaire is sent to customers to undertake a customer needs value analysis, and to assess the target market that both companies should be aiming at, this should include details about products currently on offer and nor on offer. This will highlight new product lines that can be introduced and also potential products which provide little value so could be removed.

**Marketing**

The group should establish a clear marketing strategy and implement it. Modni could perhaps invest in an advertising agency or hire a sales person to get advice on how to market in a way that is best suited to the company and its overall aims. The budget for market spend should be in accordance of the state both companies in the company life cycle to achieve best results. Modni should then continually monitor the effect the increased advertising has on the income of the business - if this doesn't work the strategy should be revisited.

An increase in the social media presence should also be considered, this could help to attract new customers and is a relatively low cost method of marketing. The website you are already considering should help with this.

**Charity work**

Modni could consider doing charity work to improve knowledge and public perception of the company, this could be via fundraisers or offering one off products where a percentage of profits is donated to charity (see below), this could help to attract new customers and retain existing customers.

**Customer loyalty**

There is a risk that a low retention rate of customers will lead to sharp decline in sales and eventually the company will become insolvent with a net liabilities position. Modni should monitor the market and customer demands and try to reflect this in the company's strategic plan going forward.

**Review of overheads**

A regular review of overheads should take place on a quarterly basis (or at least annually) to identify the causes of any increases in overheads, why they may have occurred and mitigate them e.g. If it is due to a change in contract terms, see whether a different provider can be used.

**COVID-19**

The impact of the Covid 19 virus on certain sectors of economy particularly the fashion brick and mortar businesses may mean that the demand in this sector could be subdued for some time. It is uncertain when this industry will get back to full operation but hopefully the roll out of the vaccine will enable demand to bounce back quickly. We would recommend that the companies continue to look for government support when available.

**Acquisition from administration**

We need to assess if an entity which has experienced such significant losses and was acquired from administration could be turned profitable, a full and detailed review of contracts held with by the entity and how these would fit into Modni would be essential to assess the synergies. We need to understand why the losses were occurring as there could be a fundamentally flawed business model which you may not be able to turn around.

## 1.2. Product lines

**Eco-friendly/charity product lines**

You could consider introducing an eco-friendly product line to the stores, or one which contributes a percentage of profits to charity. This could attract new customers and could retain existing customers, they would likely be willing to pay a higher price for these goods therefore the business may not lose on any gross margin as a result of this, and would also be seen to have better CSR.

**Increase target market**

The group could attempt to increase the target audience, this could be through introduction of new product lines aimed at older members of the public, for example workwear. This could expand the target market and hence increase revenue. This would also help to diversify the current operations.

**Collaborations between brands**

Modni and Angelo Dimitri could consider doing a collaboration, this could have a risk of cheapening the brand however other brands have done this in the past and it has been very successful for example H&M and Balmain. The pricing of the product should be between the two brands and the quality should also be in between the two brands. This could help to obtain new customers for both brands and improve future profitability.

**Dispose of underperforming brands/product lines**

It has been noted that the Junior and At Home ranges in Modni are not very successful at the moment, the group could consider disposing of these underperforming brands to improve overall profitability. Investing in the wrong products can impact sales and profits, particularly when these products then need to be written off, a proper analysis of new products and sign offs from directors should be performed. In addition existing products should be reviewed to assess if there are other products which are failing.

**Celebrity collaborations**

We understand the collaboration with Kaity Brando could potentially come to an end. This was a profitable area of the business with gross margins of 60%. We would recommend more celebrity collaborations are performed targeting different target markets, there should also be an attempt to retain Kaity.

**One off promotional**

Other one off promotional events could be considered, such as an advent calendar which includes jewellery and items of clothing, this could be used to dispose of old stock whilst customers feel like they are getting good value for money with the goods they are purchasing.

## 1.3. Distribution channels (including new distribution channels)

**Synergies**

Synergies with the distribution channels may be available, the companies should look to combine their distribution channels and utilise cost savings in this way which would lead to increased profit, for example savings on the transport costs. They could also offer discounts to wholesale distribution customers for example, when purchases are made for both brands.

**Website**

The websites could be combined to save costs, this could also help Modni make use of a website that is already in existence rather than creating their own which would save costs.

**Retail**

Stores could stock products for both brands, reducing overheads from the synergies that would occur from this, this could also attract new customers to both brands.

**Overseas**

New contacts and distribution channels could be sourced from overseas, they could attempt to improve their overseas market share by combining brands and tackling this together.

### Recommendation

We would recommend that first customer surveys are completed to assess what is important to the customers, then the brands could combine distribution channels to make savings on costs such as transport costs. New products could be introduced targeted at different markets and the brands could perform a collaboration to attract new customers.

## 2. Appraisal of the two investment opportunities

### 2.1. Considerations for both options

**Market research**

A key consideration before embarking on the new venture is if there is demand or not, if there is insufficient demand there is no point in continuing in looking into this further as this will be a waste of time and money. Therefore sufficient market research needs to be performed to understand the demand, this will cost the business in the short term however will have long term gains as it could save them from undertaking an unsuccessful venture.

Once market research has been performed, forecast figures should be drawn up to see the potential profit to be made from the new business.

**Sensitivity analysis**

As part of any appraisal, it is highly recommended that a sensitivity analysis is conducted. This is to ensure that the company have analysed a variety of scenarios and have identified key drives affecting the venture. Without such analysis, Modni will not be making effective decisions on the performance of the business as a whole.

**Cash flows**

It would also be important to produce cashflow projections due to the significant initial cash outlay for both projects. Doing so would enable you to understand better the cash requirements to fund this project and if any short term working capital financing would be required in addition to long term financing.

## 2.2. Option 1 – Concept store in Birmingham

## Risks

**Free parking**

There is a risk that shoppers will park at the store to benefit from the free parking however wont actually access the store, they may park there and go somewhere else which could take up a space for a legitimate customer. Some kind of parking monitoring system should be put in place.

**Management experience**

It should be considered if management have the experience to expand into these new markets, expansion into a store is likely within managements capabilities, however running a concept store which has food and music events etc is a new industry which management appear to have little experience in. This will be very different to running the existing operations and management should be made aware of that. A new employee may be required to run the concept store as management will need sufficient skills and experience for this to be successful. They should consider bringing someone onto the board with experience, possibly a business angel who may be able to help with funding given the tight cash constraints currently faced, however they will expect a return from their investment.

**New staff**

New staff will need to be employed which will result in recruitment expenses, training and additional payroll. This will take time and all staff should undergo proper due diligence and records should be kept to avoid any possible legal fines in the future. The salary offered will need to be competitive with other businesses in the same industry. There could also be conflicts if the new employees do not get along with current employees, it will take time for the new staff to fully settle into the business and get familiar with the culture.

**Licences**

The company will need to ensure it has adequate insurance and security arrangements in place for the new venture, they will also need to ensure that all relevant licences are obtained for selling food and drink, including alcohol licences if required. Operating the concept store will have health and safety regulations, it should be considered how these regulations will differ from the current regulations faced in the business.

**Stock**

For the store and serving of food as this is food related, stock obsolescence should be considered and a just in time inventory system should be considered due to use by dates on food. This could result in increased costs. The location of the foodstores should also be considered within the store.

## Rewards

**Opportunity for partnership**

As there is opportunity for partnership, there is an opportunity for the group to share the risk of the venture with other businesses, obtaining synergies and benefiting from their expertise. This would also reduce the administrative burden on Modni.

**Profit**

There is opportunity for significant profit to be made, the store would have multiple events etc which would attract new customers who would then see the clothes and hopefully purchase these. As people would be spending the whole day there, there is increased opportunity to profit on sale of the food etc.

**Diversification**

The new venture will diversify the business and mitigate the risk of the market conditions having a significant impact on the business. This will help the business to manage its risk profile to maintain a steadier income stream.

**New customers**

Due to there being leisure within the store and concerts etc, this would likely introduce new customers to the business who could then remain loyal to the company purchasing clothes in the future, this would help to improve future profitability.

**COVID impact on city centres**

This would be for a store in Birmingham, as a result of COVID many customers have moved out of the cities therefore it could be cheaper to do this now, before city living starts to increase again and prices of properties and land in cities increase.

## Financing

This venture costs £40 million, this is a significant cost to the company and they would need to obtain significant financing to fund this. This could be through issuing additional shares or obtaining a loan, we would be happy to help you consider how to do this once a decision has been made. Given that the company is already 75% geared, it may be hard to obtain a bank loan.

There is a risk however that due to the large funding requirement, if the venture was unsuccessful and a bank loan was obtained, there would be a risk that the bank could recall such a large loan which could result in the company no longer being a going concern.

### Accounting/tax

As this is a new build, VAT would be reclaimable as new properties are charged VAT at 0%, this could improve the cash flow of the business.

The value of the new build and the fit out costs would be capitalised on the statement of financial position and depreciated over the life of the product. Capital allowances would then be available on the fit out costs.

## 2.3. Launch own stores in Japan

### Risks

**Accounting systems in Japan**

The company must consider if their current systems would be able to support the new venture of the site in Japan, if not, new systems will be required at an extra cost, also if customer details will be required these will need to be managed carefully. General Data Protection Regulation (GDPR) would apply, this is relatively new legislation which has heightened the requirement for companies to protect consumer data. It may be that this could be done as an extension of existing systems.

**Knowledge of the market**

This is a new market for the company and it should be seriously considered if they have sufficient knowledge of the market. They may need to hire an executive management team which would increase the staff costs. When hiring the new management they should ensure there is clear job specification which highlights a need for knowledge of the Japanese market.

**Competitors**

Modni would need to consider their competitors in Japan and how to differentiate themselves from the competitors. This would be new for them and the clothes may need to be different to in the UK to satisfy this market and obtain a market share from competitors.

**Language**

Modni will need to be wary of the language differences between the UK and Japan. This will create initial difficulties between UK based teams and Japanese stores and may result in delays to decision making and mistakes being made initially. Modni may need to incur additional costs in order to ensure appropriate communication channels between Japanese teams and the UK are established as a result.

**Employment laws**

Modni will need to review employment laws and regulations in Japan in order to ensure that they can obtain a workforce which will meet the demands of the new stores. It is recommended that a legal specialist in Japanese employment should be consulted in order to ensure this.

**Culture**

In order to bring the new workforce in line with the existing culture, the company will need to consider sending existing staff members to Japan in order to contribute to aligning the culture of new employees. Modni will need to incur costs in order to send these staff members over. It should also be noted that such proceedings may take time in order to bring them up to speed.

**Tax**

Modni will need to review the tax implications of the stores in Japan. Corporation tax rates may differ with the UK and there will need to be consideration of the VAT impacts over the movement of resources from the UK to Japan.

Dependent on how the group structure the transfer of assets, and if the foreign country operations were in a separate subsidiary there could be transfer pricing implications of goods being transferred. There are also transfer pricing implications for groups in the UK, however this is more of an issue if this is with foreign operations. Guidelines for transfer pricing are based on the arm's length principle - that a transfer price should be the same as if the two companies involved were indeed two independents, not part of the same corporate structure. The new venture would be required to apply the arms length standard when making self assessments for corporation tax purposes and ensure that there is evidence to support the arms length standard. If not there could be an adjustment to the taxable profit, and a penalty could be due.

This should be discussed further with a tax specialist.

**General laws and regulations**

Modni will need to review general laws and regulations about setting up business in Japan. Stores may be subject to taxes such as stamp duty or additional taxes relating to setting up trade in this country. The cost of setting up business may be excessive and be counterproductive in their aim to reduce costs. Again, consultation with an expert is advised in order to ensure all costs have been identified and the impact on Modni is established.

**Foreign exchange risks**

Expanding the business in Japan introduces a greater currency risk to the business as the exchange rate is likely to fluctuate over time. This could be mitigated by hedging the risk. Hedging used by businesses to protect it from the risk of changes, particularly unexpected changes, which could impact on the costs and profitability of a company. The aim is to try and instil some stability in costs. This could be done using forward contracts, futures contracts or call and put options.

## Rewards

**New market**

This is a new market where feedback suggests good sales would be made, this is an opportunity to grow the brand and hence increase the revenue and profits. This would be in a new location therefore would help the brand to become more globally recognised.

**Option to further expand**

There would be an option for the business to further expand operations in Japan if the stores went well, this could help significantly improve the profit of the business and the option to expand makes this a safer investment opportunity than if the business was opening all stores possible.

**Diversification**

The new venture in Japan will diversify the business and mitigate the risk of the UK economy having a significant impact on the business. This will help the business to manage its risk profile to maintain a steadier income stream.

**Online sales**

A lot of the online sales are destined for this market, introducing stores in Japan could also help to boost the online sales for the business worldwide.

**Asian market**

This could also be an opportunity to target the Asian market as a whole by starting in Japan, online sales could follow to China and other Asian countries as a result of this increasing the globalisation of the company and increasing profits. This would be a good way to assess the demand and fashion before opening more significant operations in other countries in Asia.

**Financing**

This venture costs £5 million, this is a significant cost to the company however is much less than option 1, a proportion of this could be funded by existing cash resources which would be much less capital intensive on the group. There could also be an option to open less stores which would further reduce the capital requirement.

**Accounting/tax**

As this would be a short term lease, the lease expenses would flow through the profit and loss account, and these would be tax deductible. If it were a longer term lease, then IFRS16 may apply and capital allowances would be available, it is recommended that the length of the lease is discussed with us so that we can help you with the accounting implications.

## Recommendation

We would recommend that the business considers if investment into either strategy is appropriate at the current time. The business are suffering key issues with the directors and have recently seen a significant fall in profitability as a result of COVID-19. Therefore, the business should focus on improving existing operations before they make a decision to expand.

If a decision to expand was being made, we would recommend that you launch a smaller number of stores in Japan, possibly two, this looks to be a promising market for the company and would have the opportunity to expand further in the future with a much lower cost than option 1.

**To: Nick Purcell**

**From: Charlie Tarazi**

**Date: 2 November**

**Subject: Advice on the issues you have discussed with Jess Sharp**

Dear Nick,

In accordance with your instructions, I have included below advice on the following matters:

1. Response to The Post News and actions the business should take
2. Different options of disposing of any obsolete Angelo Dimitri inventory
3. Background information on the environmental and social concerns that surround fast fashion

The contents of this email are intended only for the addressees and should not be relied upon by any other party without our prior written consent. In producing this email, we have relied on the information provided to us in order to produce our advice and should any of this information be incorrect, we are not responsible for any consequent errors in our advice.

Any tax advice is based on legislation at today's date. If any actions take place in the future it will be necessary to confirm the tax position at that time.

## 1. Response to The Post News and actions the business should take

It has been noted that Raj Clothing, based in India, and a supplier to Modni has been employing children as young as eight to work, there are also reports that the living wage has not been applied to the employees as they have been taking the work home. The supplier appear to have been falsifying documentation to make it appear that they are acting in accordance with Modni's policies.

**Reputational issues**

Due to these issues there will be a loss of customers as a result of the tarnished reputation of Modni by association. This means that there will be reduced income and cash reserves will need to be relied upon to support financial commitments.

Due to this staff and supplier requirements will be reduced over the period, the staff and suppliers should be contacted about this and it may be necessary to reduce staffing numbers in an attempt to cut costs.

**Legal advice**

The board are ultimately responsible for the operation of the entity therefore they will be required to prove that they took necessary steps to ensure the company was not knowingly engaging with a supplier with unethical practices, they should contact their lawyers to discuss:

- the contract with Raj Clothing to see if any compensation can be sought for loss of earnings

- if there is any potential legal liability for the company as a result of false advertising to customers stating that they are ethical

- What the process would be to get out of the existing contract

**Press release**

The company should issue a press release distancing themselves from Raj Clothing. It may be necessary to engage a PR agency to ensure that the release is worded appropriately and reaches the correct outlets. Improvements that will be made for the future such as more rigorous checks on suppliers should be highlighted and published as soon as possible. This should also include an apology for any inconvenience caused as a result of this and should inform them that the company are still trading.

This press release should reinforce our ethical values, it should make it clear that the company had no knowledge of the issues at the supplier and will stop trading with the supplier immediately. The customers should also be informed that a full review and audit will be performed of existing suppliers.

**CSR**

Modni could offer for staff to take part in an on-going volunteering programme (as many organisations do) which means there will be no costs to provide for. However, there will be an on-going hidden cost as employees will be giving part of their working time to volunteer.

**Relaunch of products**

The marketing department will need to assess whether a full product relaunch is required. This could be done by including vouchers emails.

**Customers**

Customers should be contacted about this, it is unlikely that they are aware which supplier their clothes have come from, however if they are they need to be reassured that the company did not know about this, they could also be given vouchers / discount codes to retain their business.

**Other existing suppliers**

The other suppliers should all undergo a thorough review. Modni has a policy that they will pay suppliers fair prices and that the suppliers are subject to regular inspection, clearly this has not been enough and stricter policies are required to be introduced. We would recommend performing visits to the suppliers to assess the working conditions and talk to the staff.

Contracts with suppliers should be reviewed to ensure that they include clauses stating that if the supplier is found to be unethical and aren't being fair to their employees, they will receive heavy financial penalties and the contract will be voided.

**Modern day slavery statement**

Modni will need to start issuing a modern day slavery statement, they should also consider only engaging with suppliers who have such statement and have been audited to confirm that they abide by the rules and are fair to their employees.

**Communications to staff**

Staff should be briefed on the situation so that they are able to give consistent and correct information to customers. Staff should get a copy of all external communications so that they can give the consistent message. We should reassure staff that we are taking appropriate actions and investigations and their jobs aren't at risk.

### Recommendation

We would recommend that these policies are all communicated to The Post News, highlighting that Modni still considers themselves to be an ethical brand and that they had no knowledge of the issues surrounding the Indian supplier. They should highlight work they are doing to rectify this such as CSR strategies and the fact they are reviewing their internal policies to enforce stricter checks on all suppliers, and that this will start immediately.

## 2. Different options of disposing of any obsolete Angelo Dimitri inventory

**Burning the products**

The excess inventory could be burnt, however this would likely receive significant negative press for the brand which could lead to the share price being reduced. This has been seen for Burberry who have been found to be burning inventory worth a total of £100 million. This also has an impact on the environment due to the fumes which would be released from burning the products.

**Landfill**

Landfill could be considered, this however would incur landfill tax and would likely receive bad press similarly to burning the products. There is an argument that this would not devalue the brand in the same way as discounting stock, however it is highly likely if this became public knowledge that the share price and peoples perception of the brand would significantly decrease.

**Offers/discounting products**

The products could be discounted however there is a risk of this devaluing the premium brand name, this would need to be done with careful promotions to ensure the brand wouldn't become known as a 'discount' brand. This could be done for example by having one sale per year to ensure exclusivity.

**Opening an outlet pop up store**

An alternative to discounting with existing operations would be to open an outlet pop up store. Many exclusive brands such as Gucci already do this, therefore there is less chance of this impacting the company reputation in the same way as a general sale in the website.

**Donate the stock**

The stock could be donated to charity shops or to key workers, similarly to how Modni donated the stock in COVID. This would improve public perception of the group which could in the future lead to more sales.

**Sell in collaboration with Modni**

A collaboration could be made between Angelo Dimitri and Modni, this could be using the old Angelo Dimitri stock and slightly modifying it and then selling it at a lower price point. This could then be accessible to more people which could result in new customers for both brands. There is a risk however that due to them not being new products, existing Angelo Dimitri customers who may have purchased these goods last season may be upset and may stop purchasing from the brand as this could be seen to cheapen the brand. If this is done we would recommend it is done with new stock.

**Recommendation**

We would strongly advise against burning the clothes or sending them to landfill. Instead we would recommend some of the very old stock is donated to key workers and this is included on the company social media channels to show that they are doing good things for the community. We would then recommend looking into opening an outlet pop up store when there are significantly high levels of stock, this would allow some revenue to still be recognised from the inventory.

## 3. Background information on the environmental and social concerns that surround fast fashion

Corporate social responsibility is where the company recognises it has a wider group of stakeholders than just shareholders and providers of finance. These include: local communities; civil society; customers; suppliers; employees; and other workers and their representatives.

Over recent years there has been an increase in social awareness of aspects in connection with social matters. Some customers will now only purchase from companies that demonstrate a willingness to embrace social matters. Companies that fail to address these issues may find it harder to attract customers and may find their reputation tarnished. This in turn would harm the profitability of the business in the medium to long term.

The fashion industry produces 20% of global wastewater, 10% of global carbon emissions and a staggering 85% of all textiles go to landfill each year, a high amount of this will be as a result of fast fashion and the general wastage and shipping from abroad involved in the industry.

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### 3.1 Environmental concerns

**Wastage/charity shops**

The current attitude of purchasers is to purchase the goods and wear them once. These are then disposed of which leads to significant wastage in the industry. It has also been reported that some people then try to donate these clothes to charity shops however the quality is so poor, that they cannot then be resold. This has a negative impact on the environment as this clothing is then being disposed of in landfill.

We would recommend that Modni look to improve the quality of their products so that this wastage could be reduced and the clothes could be donated to charity shops. They should do feasibility studies as it is likely customers may be willing to pay slightly more for these goods. They could also implement a policy where customers, rather than disposing of the clothes themselves can return them to a drop point where they would be collected by Modni and the clothes could be disposed of in a sustainable way, or repurposed.

**Shipping from abroad**

Most of the material is imported from abroad so the carbon footprint of the products is high. However, further analysis of this would be useful since bulk purchasing from overseas may be more environmentally friendly as compared to having a greater frequency of purchases from the UK. The impact of differing modes of transport would have to be taken in to consideration. Overall we would recommend that Modni look to source some UK suppliers.

They could also consider purchasing carbon credits to offset the carbon footprint of the brand.

**Packaging**

The packaging material used to import the goods in fast fashion is usually made of plastic, which is notoriously difficult to recycle. Modni could discuss the use of recyclable materials with suppliers and perhaps use this as a supplier selection criterion given that there appear too many suppliers capable of supplying the same products.

### 3.2 Social concerns

**Supplier issues as discovered with Raj Clothing**

Fast fashion has a notorious reputation for engaging with unethical suppliers, such as Raj Clothing. Modni has a duty of care to suppliers employees and should not be operating with supplier that put their staff, employees and anyone at the property in a position of potential danger, or in a position where they are being exploited. We have discussed recommendations to how to combat this in section 1 above. However, the main recommendation is to perform more checks on suppliers to ensure that they are treating employees fairly, and to only engage with suppliers who have certificates authenticating this. Modni's current policy is a big positive for the brand, however if this is not implemented it will mean little to customers.

**Donations to charity**

The company has donated old clothes to key workers during lockdown, this is good and will have been received well provided it was marketed, we recommend policies such as this are continued.

**Supporting changing customer attitudes to fashion and clothing**

Fast fashion can be seen as supporting the customer attitude to products which is that clothes are more disposable. Overall clothing production has roughly doubled in the last 20 years. Companies are making more ranges of products with some brands offering new collections every month, people are buying more clothes, wearing them less and disposing of them more. This has received significantly bad press recently and it is recommended that the Modni look to try and distance themselves from the fast fashion industry.

The bad press has led to many potential customers, especially the older generations, lobbying against fast fashion brands which would significantly damage the company reputation. Modni should be seen to promote re-wearing clothes on social media.

**Purchasing policy**

The purchasing policy seems to be to buy material from the cheapest supplier, irrespective of its source of origin. With most of the supplies coming from abroad there is little in the way of support for local businesses.

Perhaps the company could engage in an exercise of trying to source a greater proportion of the material from local manufactures, possibly by introducing a different line of products for example premium products so as to maintain the margins if the costs from UK is greater than that from abroad.

**Employees / board**

The employees of Modni represent the company, this includes Teddy who was the ex CEO. There are concerns with fast fashion that the employees are unethical, the allegations about Teddy regarding sexual misconduct support this allegation. The public will be increasingly alert of this and hence it will damage the public's perception of Modni as they employed a member of staff who would take part in clearly unethical practices (if it is found to be true). The company must ensure that they do not implicate Teddy where there is no evidence of wrongdoing, however to improve the social attitude towards the company they should distance themselves from him.

The board are also currently ineffective, for CSR to be successful it is imperative that it has the boards full commitment. We would therefore recommend that the issues with the board are addressed as soon as possible so that they can demonstrate strong leadership and a strong company commitment to CSR.

### 3.3 Recommendation and actions Modni could take to improve CSR

Overall we would recommend that Modni looks to move itself away from the fast fashion industry, this industry has a reputation for exploitation of foreign workers, high wastage and high carbon footprint. The industry has come under considerable scrutiny in recent years around this. Some general ways to improve the company CSR include:

- Only source from ethical suppliers, and check credentials
- Look to find some UK suppliers
- Purchase carbon credits to offset carbon footprint
- Improve the quality of products in an attempt to reduce wastage
- Be seen to promote re-wearing of clothes on social media
- Donate clothing to charity and key workers
- Let employees have 3 days off a year where they volunteer in the local community
- Increase sponsorships into the local community
- Participate in Fairtrade sustainable clothing by introducing a sustainable range
- Produce a CSR statement annually showcasing what has been implemented and the positive effect this has had on the environment. It is important that this doesn't just act as an advertising piece for the business, however clearly good CSR will improve customer perception which would the improve revenue.

If you would like to discuss any of the above matters further, please don't hesitate to get in touch.
Yours sincerely
Charlie