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Scak Textiles: The Way Forward for Next-generation Entrepreneurs

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In January 2020, Ajay Jain, the chief executive officer (CEO) of Scak Textiles LLP (Scak), a family-run business, was incredibly happy reflecting on the events that had led to the growth of Scak from a tiny store in Hisar[[1]](#footnote-1) to its current prominent status in the industry. In financial year 2019–2020,[[2]](#footnote-2) Scak surpassed ₹250 million[[3]](#footnote-3) in revenue after two years of rather depressed performance. However, Ajay’s ambition was to achieve a new milestone of ₹500 million by March 2025. He wondered why the company, after having come so far, could not achieve that number with a sustainable margin. What else could he do to help Scak reach this target, and how could he solve the bottleneck of resource constraints?

Despite these concerns, he felt assured by recent developments. The bright next-generation (next-gen) entrepreneurs of the family were actively taking an interest in the business. With their ambitious minds, they often presented strategic plans for enhancing the effectiveness of both business and revenue models while navigating the ever-changing business ecosystem. Their energy and innovative drive had so far resulted in a huge increase in both the scale and scope of the business. Moreover, Ajay was never skeptical about the dilution of ethical business values. Over the years, he had remained confident in the simple lifestyle of these next-gen entrepreneurs and their longstanding family value system, which drove the governing principles of the family business. Ajay was particularly confident about his son Ayaan, who had joined the company after finishing his MBA at a premier Indian business school and a two-year stint working for a large multinational corporation.

Ajay himself was a confident businessman, supported by his younger brother, Anupam, who possessed equally sharp business acumen. However, Ajay was fully aware that achieving the ambitious goal he had set for Scak in the contemporary business ecosystem required directional changes. The traditional way of conducting business would not help the family reach that milestone. He was particularly worried about the limitations of a family business being conducted from a C-Class city (i.e., with a population under 500,000). Moreover, he was concerned with the ever-changing dimensions of volatility, uncertainty, complexity, ambiguity, and fear in the business environment and the unexpected nature of that environment; the disruptive business practices of certain market players; and the scarcity of resources. He was also concerned that the family might not like the idea of relocating to a metropolitan city (i.e., with a population over 1 million).

The Business

Since its establishment in 1988, Scak had become a market leader in the wholesale cloth business in Hisar, Haryana State. Hisar, which had a rich history of trade in steel and textiles, was founded in 1354 AD by the Mughal ruler Firuz Shah Tughlaq. Scak originally began as a tiny shop selling woollen blankets within the new cloth market of Hisar (NCMH), which was highly competitive. By March 2020, Scak had grown into a full-fledged wholesale business, expanded its product range to include ready-to-wear apparel for men and women, and established its position in the garment industry (see Exhibit 1).

Reasonably priced merchandise, ethical business practices, persistent customer focus, and word-of-mouth publicity helped Scak develop a large and loyal community of customers. From the initial customer base of residents of the neighbouring areas, its customer base expanded to include intermediaries and retail stores in small towns and villages within a 240-kilometre radius of Hisar. Until recently, the two brothers, Ajay and Anupam, aside from being owner–partners, had shared responsibility for all functional areas. Ajay handled finance and sourcing merchandise; Anupam managed sales, customer relationships, logistics, and shop management. The next-gen entrepreneurs, Ayaan and his two siblings—Shubham and Shivam—had just started supplementing the brothers’ activities.

Hisar’s New Cloth Market (NCMH)

Since its inception in 1980, the NCMH had slowly evolved into a fast-growing hub for retailers. Located in the heart of Hisar about 100 metres from the city bus stand, the cloth market had witnessed high footfall from customers located within the city and nearby places. The market was comprised of about 80 stores selling a wide range of products, including stitched and unstitched apparel for men and women, bedding, linens, blankets, drapes for drawing rooms, and other similar items.

Due to the lack of differentiation in the products offered by all of these shops, the market was characterized by cut-throat competition, which often resulted in price wars. Over the years, as the population grew, most of the establishments operating out of the NCMH evolved into wholesale outlets. The primary objective was to become an intermediary and cater to the demands of the adjoining smaller retail markets. Such a situation continued until 2010. However, persistent fierce competition and declining margins forced many of those neo-wholesalers to reposition themselves as retailers directly targeting the end consumers. This transition provided an opportunity for some establishments with better capital power to emerge as major market players in the wholesale segment. Scak was agile enough to capitalize on such a rewarding opportunity.

Wholesale Business Segment

In the wholesale segment, Scak served as a facilitator between garment manufacturers and retailers who bought in bulk from wholesalers like Scak and sold the items piecemeal to end consumers. Scak’s sales from the wholesale business accounted for about 86.5 per cent of its total sales in 2019–2020, with a gross margin of about 7 per cent (see Exhibits 2A and 2B). This business entailed large working capital, which only a few players in the NCMH could afford. Consequently, Scak had a near-unbeatable competitive advantage because the market was not large enough to allow for the entry of another major player.

Retailers generally visited Scak’s store in the afternoon hours and preferred to spend as little time there as possible. They would place orders quickly and depart immediately, leaving the end-to-end forward logistics arrangements to Scak’s sales and distribution team.

The Retail Business Segment

In the retail segment, Scak’s own wholesale segment enabled it to bypass intermediaries in the supply chain and sell merchandise directly to end consumers. This part of the business obviously had a relatively better gross margin, varying between 10–14 per cent depending on the product type. All such sales were in cash (see Exhibits 2A and 2B). Although word-of-mouth publicity had led Scak to grow its end-consumer base over the years, the next-gen promoters wanted to come up with a different strategy for this segment to particularly target Scak’s millennial customers.

current Conflicts with next-gen Entrepreneurs

At a family gathering, Ayaan asked his father Ajay why he appeared to be worried. Ayaan thought his father’s reply was a challenge to him and his siblings: Ajay mentioned that he was happy to note from the management information system submitted by Ayaan the night before that the turnover for 2019–2020 had surpassed ₹250 million(see Exhibits 2A, 3, and 4). However, when he tried to extrapolate, his goal of achieving a ₹500 million profit with sustainable margins by March 2025 appeared to be unrealistic. Ajay was most concerned about whether the wholesale business in such a limited market area could help the company reach that goal. He commented candidly:

Scak’s past revenue, profit trends, and other major financial indicators were worth nothing. . . . Downward movements in revenue and profit in the recent past could be caused by external factors, such as demonetization,[[4]](#footnote-4) introduction of new indirect tax regime of GST [goods and services tax], etc., but there is a need to introspect. We cannot just remain at that level. Our family is growing. You must chart a steady growth path with well-planned initiatives for both near- and longer-term horizons. The big question is: How can we achieve this dream by March 2025?

Ayaan thought further about this question. Scak had expanded sources for procurement in the last two years, and the majority of the merchandise was now procured directly from manufacturers of several neighbouring states, unlike before when the business had procured from only two cities—Surat in Gujarat, and Bhilwara in Rajasthan. In addition, while almost all traders of the NCMH leveraged 60 days’ credit extended by suppliers, Ajay followed a payment policy of 30 days. Ayaan tried to convince his father to make payments even before they were asked for, but Ajay replied that he was not convinced of any benefit for Scak from this possible strategy.

Generally, Scak allowed wholesale customers 60 days’ credit and did not follow up, which often caused further delays in payments. Ayaan was not in favour of granting free credit beyond 30 to a maximum of 45 days. He believed these customers were being financed by cash credit loans from banks and unsecured loans from non-banking sources at relatively higher costs.Ajay reacted to Ayaan’s proposal by explaining, “We can afford to borrow, but our customers cannot.”

Having attended a premier business school, Ayaan was keen to use the theory and practice he had been exposed to there. He continued to argue that banks needed to be convinced to also accept receivables as collateral instead of only inventories for assessing the working capital financing. Ajay did not try to convince him otherwise; his reply was that Scak must accept the policy followed by the banks.

Ayaan recalled a classroom lecture on export transactions supported by a letter of credit. He thus reiterated to his father that Scak would be able to save interest on such loans if exports were added as a line of business, for which purpose receivables would be treated as collateral. Ajay looked at Ayaan’s bright eyes, his face brimming with ideas, and said:

Well, please complete the task of writing a white paper for me and uncle Anupam. We need to know your thoughts on Scak’s future operating policies and financing arrangements to be proposed to banks with justifications. However, please ensure that Scak’s brand image is not impaired. Aside from plans for exports, we must implement your strategies so that we can achieve our dream.

Meanwhile, Ajay was not in favour of expanding retail because of the low volume and fiercely competitive nature of the business value chain. The end consumers usually visited the store between 10 a.m. and 6 p.m. in groups of five to 10. They demanded complete attention from the over-the-counter salespersons when they browsed through a large variety of products before making choices. Yet, the average bill for this group was about one-fifth of that of Scak’s “retailer customers”—those small shop owners who were handled through Scak’s wholesale segment. While end consumers usually bought one or two pieces from a typical set of four colours, retailers always purchased in sets of four. This discrepancy posed a problem because selling the remaining pieces of similar garments was difficult once a pack of four to five colours of the same type of garment was sold separately.

Anupam, who led customer-facing operations, appreciated the contributions of Ayaan and his siblings in streamlining Scak’s multi-storied shop. They simplified, automated, and integrated systems, which helped reduce human intervention and reduced the time required for customer turnouts. Such innovations enabled Scak to score one more point of appreciation from customers without increasing the number of over-the-counter salespersons. The firm employed a total of 15 permanent salespersons on monthly salaries varying between ₹15,000 and ₹20,000, which were quite reasonable within the local job market.

The Way Forward

Ajay and Anupam were proud to have successfully achieved company milestones, one after another, over the past 32 years. Their dream was to achieve the new milestone Ajay had set, but the store’s employees had started facing space constraints and a shortage of sales assistants. Sales continued growing in two disparate segments, tapping these two limited resources. However, the addition of labour was not considered a viable solution due to the space shortage.

The next-gen entrepreneurs decided that they would maximize the time available since they were in a lockdown at home due to the COVID-19 pandemic. They would have to introspect, explore, evaluate, and frame immediate and long-term business strategies, and plan execution tactics. By pulling together their individual ideas, they came to a consensus—the CEO had yet to visualize the idea that scaling up operations would entail an injection of additional equity. Ajay was, perhaps, hopeful that expanding retail outlets and getting additional space for the wholesale business would help achieve his dream in the next five years. The question the siblings debated was whether a meagre trading margin from both would generate enough internal resources to maintain the desirable debt to equity (DE) proportion or whether the situation would worsen when capital assets were procured for business expansion.

Shubham believed the company should critically examine the option of allowing an external party to invest in the company, but since it had to continue operating within the limitations of family members injecting capital, it would have to proceed with the traditional model. Shubham did support Ayaan’s proposal that liberal payment terms for vendors might be followed even though the benefits were uncertain.

Ayaan was trying to ascertain the saturation point for Scak’s existing business model while operating from the NCMH. Since he could not assess how long it would be before operators in a virtual marketplace disrupted Scak, he asked for the others’ opinions.

Ayaan tried to convince Ajay that achieving his 2025 target might be unrealistic if the existing business and revenue models were followed. The implementation of liberal payment terms for vendors could be just one small step toward this goal. Ayaan explained, “We definitely need to think outside the box and find answers to one simple question: How can we convert the drawing rooms of each existing and target customer’s house into a virtual retail showroom for Scak?”

Shubham immediately asked Ayaan about his outside-the-box thoughts regarding exports and whether he wanted to export these usual garments overseas. Ayaan’s reply was absolutely unexpected:

We would export handcrafted ethnic his-and-her ready-to-wear apparel, sarees, and unstitched items, such as stoles, linens, drawing room drapes, etc. Diversification would be possible if we added various metal and non-metal artefacts. There is large demand for all of these in Western countries. However, the prime question would be: How much market share would we be able to have?

Shivam believed that no business today could be insulated from competitive pressures, saying,

It will not be right on our part to remain in the cocoon of the NCMH and expect that Scak will not be disrupted by those market operators who do not run physical shops. We must be aggressive to do everything we can to reap the full benefit of Scak’s physical business unit, long-standing goodwill, and large customer base. The big question we must answer is how to do this.

At this point, Ayaan stated,

Let us not tax our tired brains anymore. As COVID-19 has forced the government to lock us down for 19 more days, let us bolt up tomorrow in our study room and introspect further. We must innovate strategies, evaluate impacts, and then build narratives around our strategic recommendations. Our white paper should serve as the guiding path for Scak’s success moving forward. But guys, before that, let us first take an extremely close look at the past few years’ financial numbers and analyze them.

The White Paper Day

The three next-gen family members gathered in another room and continued the discussion. Shubham asked the others whether they thought Scak would be able to maintain predominance in the wholesale business of the NCMH. Ayaan immediately responded:

The assessment of our past financial performance from both businesses should separately be reviewed before evaluating those two lines of business, and for that matter, all our business proposals for future. Merely saying that the margin [is] not commensurate [with] the fund deployed may not be right.

Shubham thought that before they made any strategic business plans to reach their goal based on the estimation of cash flows from 2021 onwards, they should obtain the CEO’s views. Based on this idea, assumptions were required for a pre-money valuation (see Exhibit 5). Shubham also wondered whether the required cost of capital could be computed based on similar comparable businesses (see Exhibit 6). Scak’s borrowings included cash credits, which represented loans offered against the fixed deposits with the bank. Thus, the net debt (unsecured loan and cash credit) for the year 2020 was ₹43 million, and the cost of debt was 9.3 per cent. Based on experience, Ayaan assumed a 5.5 per cent risk-free rate of return and a 10 per cent market rate of return,[[5]](#footnote-5) but he wondered what the business value of Scak was at the take-off point. Shubham supported this calculation, saying that the valuation of Scak on a pre-money basis in its present business track should not be a problem.

Even before finishing the debate on wholesale-and-retail versus wholesale-only business, Ayaan suddenly raised the following point:

Why don’t we see the big picture on a larger canvas instead of moving within the whirl of wholesale and retail? Can we not extrapolate to find what could be the worth of Scak as a business in its present form vis-à-vis if we go for backward integration? Why should we not look for the entire margin offered by the garments industry within the value chain?

Ayaan also proposed evaluating options for third-party toll manufacturing of traditional handcrafted clothes and garments produced by village artisans.

Shivam was skeptical of this proposal and questioned Ayaan, saying, “Our parents are growing older. Who will manage the entire value chain of procurement to pay, order to cash, not to speak of setting up a manufacturing plant and handling the whole range of governance and regulatory compliance issues related to running a plant?”

A more important question for Ayaan to consider was whether the company should bring in an equity investor—someone who could be checked out as soon as Scak stabilized on the next track of manufacturing operations. Scak could issue a quasi-equity instrument with different terms and options for settlement, depending upon a business valuation. However, for deriving a broader idea for all of these, the company needed to initiate its business valuation, assuming that the feasibility study for the manufacturing project was approved by the CEO. Ayaan wanted to call this “Project Shikhar” (see Exhibit 7).

Ayaan replied to Shivam, saying,

I have already done my homework by consulting with Mr. Chitrakar Sen, a senior professional who had experience in leading a garment manufacturing plant and organizing village-level weavers and handcrafting artisans. This will facilitate the process of defining a business model for exports. Mr. Sen has already submitted an assumption sheet. [see Exhibit 7]

The question that bothered Shivam most was why Scak should continue with the retail business through its present physical store. His study of the numbers did not encourage him and, in fact, suggested an alternative model, such as e-commerce (see Exhibit 7).

Shivam felt encouraged by what Ayaan had been suggesting. He guessed that the preparation of the feasibility report for the manufacturing option was part of Project Shikhar and that its predictive valuation should no longer be an issue (see Exhibit 7). Promoters generally aimed to maintain a capital structure with a DE ratio of 2:1. According to Ayaan, the manufacturing option required an additional investment of ₹100 million in the first year. In the future, the company would have options for offering equity instruments to high-net-worth individuals, family friends, or any willing private equity fund with multi-stage valuation, starting with pre-money. Promoters could also bring additional equity capital and should not have any issues with land, as the plant could be constructed on the family property, located about 10 kilometres from Hisar.[[6]](#footnote-6) The company had to include the land in Scak’s balance sheet by considering equity contribution in kind. However, to do so, it had to change the incorporation status of Scak to that of a corporate citizen. The debt would have to be raised from banks, and the combined entity’s capital structure would have to be at a DE[[7]](#footnote-7) ratio of 2:1. Shubham observed that Shivam’s eyes were shining⎯he had likely already thought about considering the issuance of those shares at a premium.

Meanwhile, Shubham worked on the assumptions required for valuing manufacturing, e-commerce, and export market operations (see Exhibit 7). Based on these results, Ayaan started working on the estimation of cash flow for the next five years. The target capital structure for the combined entity would be a DE ratio of 2:1, and the cost of debt would be 10 per cent. The promoters would expect a 15 per cent return on the additional capital invested, and the corporate tax rate would be 30 per cent. As such, the value of Scak with manufacturing and e-commerce options was in question, as were the following:

* the value of export market operations, which the siblings assumed would start from 2021–2022;
* the value of Scak with all three options; and
* the valuation change depending on the valuation models.[[8]](#footnote-8)

Shivam finally concluded, “We shall cross this bridge when we have to lay out the plant. At least by now, we [have] reflected on all possible aspects of planning for Scak, as we want to see it five years from now. At present, we need to decide the framework and propose the narratives so that we can finish the task.” Shubham proposed that they reconvene and draft the white paper.

Exhibit 1: VALUE CHAIN ILLUSTRATIONS

Value Chain of the Garment Industry

Value Chain of the Wholesale Business & Scak Textiles Positioning

Value Chain of the Retail Business & Scak Textiles Positioning

Source: Company documents.

Exhibit 2A: Income Statement of Scak TextileS—Consolidated (in ₹ million)

Financial Year ended March 31

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **2020** | **2019** | **2018** | **2017** | **2016** |
| Sales | 255.60 | 179.31 | 196.23 | 246.83 | 253.37 |
| Other Income | 0.79 | 0.41 | 0.24 | 0.60 | 1.05 |
| Revenue | 256.39 | 179.72 | 196.47 | 247.43 | 254.42 |
| Cost of Goods Sold (COGS) | 237.00 | 164.55 | 182.55 | 232.07 | 237.87 |
| Gross Profit | 19.39 | 15.17 | 13.92 | 15.36 | 16.55 |
| SD&A | 7.28 | 5.91 | 4.15 | 5.16 | 5.59 |
| Depreciation | 0.69 | 0.63 | 0.59 | 0.71 | 0.75 |
| Interest | 1.69 | 1.31 | 1.14 | 1.50 | 1.95 |
| Profit before Tax (PBT) | 9.73 | 7.33 | 8.04 | 7.99 | 8.27 |
| Tax | 2.92 | 2.20 | 2.41 | 2.40 | 2.48 |
| Net Income or Profit after Tax (PAT) | 6.81 | 5.13 | 5.63 | 5.59 | 5.79 |

Note: SD&A = selling, distributing, and advertising expenses.

Source: Company files.

Exhibit 2B: Composition of Key variables of Wholesale and Retail Businesses to consolidated Income Statement of Scak Textiles

Financial Year ended March 31

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **2020** | **2019** | **2018** | **2017** | **2016** |
| W Sales | 86.5% | 85.1% | 86.1% | 85.2% | 85.8% |
| R Sales | 13.5% | 14.9% | 13.9% | 14.8% | 14.2% |
| W Gross Profit | 6.7% | 7.5% | 6.1% | 5.6% | 5.8% |
| R Gross Profit | 13.4% | 14.2% | 13.4% | 9.6% | 11.2% |
| W SD&A | 2.6% | 2.9% | 1.6% | 1.8% | 2.0% |
| R SD&A | 4.6% | 5.6% | 5.2% | 3.7% | 3.5% |
| W PAT | 2.2% | 2.4% | 2.5% | 2.0% | 1.8% |
| R PAT | 5.7% | 5.5% | 5.3% | 3.7% | 5.0% |

Note: W = wholesale; R = retail; SD&A = selling, distribution, and advertising expenses; PAT = profit after tax.

Source: Authors’ calculations.

Exhibit 3: Balance Sheet of Scak TextileS—Consolidated (In ₹ million)

**Balance Sheet (I**

**)** Financial Year ended March 31

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **2020** | **2019** | **2018** | **2017** | **2016** |
| **ASSETS** |  |  |  |  |  |
| *Non-Current Assets* |  |  |  |  |  |
| Fixed Assets | 4.65 | 3.88 | 3.37 | 3.88 | 4.23 |
| Fixed Deposits with Bank | 13.24 | 6.84 | 4.02 | 10.05 | 17.46 |
| *Current Assets* |  |  |  |  |  |
| Inventory | 18.39 | 18.56 | 17.87 | 17.92 | 11.04 |
| Trade Receivables | 33.00 | 36.84 | 44.30 | 41.84 | 55.78 |
| Cash & Cash Equivalents | 3.25 | 1.21 | 0.46 | 2.73 | 1.95 |
| **Total Assets** | **72.53** | **67.31** | **70.02** | **76.43** | **90.46** |
| **EQUITY & LIABILITIES** |  |  |  |  |  |
| **Liabilities** |  |  |  |  |  |
| *Non-Current Liabilities* |  |  |  |  |  |
| Unsecured Loan | 18.52 | 30.45 | 20.04 | 29.38 | 38.48 |
| *Current Liabilities* |  |  |  |  |  |
| Trade Payables | 13.99 | 16.38 | 29.34 | 19.81 | 31.66 |
| Cash Credit (Secured) | 24.52 | 10.33 | 12.01 | 19.90 | 12.40 |
| **Equity** |  |  |  |  |  |
| Share Capital**\*** | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 |
| Reserves & Surplus | 11.50 | 6.16 | 4.62 | 3.33 | 3.93 |
| **Total Liabilities** | **72.53** | **67.31** | **70.02** | **76.43** | **90.46** |

Note: \*400,000 shares with a face value of ₹10 per share.

Source: Company files.

Exhibit 4: Cash Flow Statement of Scak TextileS (in ₹ million)

Financial Year ended March 31

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **2020** | **2019** | **2018** | **2017** |
| Net Income | 6.81 | 5.13 | 5.63 | 5.59 |
| Add: Depreciation | 0.69 | 0.63 | 0.59 | 0.71 |
| Changes in Receivables | 3.83 | 7.47 | −2.46 | 13.94 |
| Changes in Payables | −2.40 | −12.96 | 9.53 | −11.84 |
| Changes in Inventory | 0.17 | −0.69 | 0.06 | −6.88 |
| **Cash Flow from Operating Activities (A)** | **9.11** | −**0.43** | **13.34** | **1.52** |
|  |  |  |  |  |
| Investments in Fixed Assets | −0.77 | −0.51 | 0.52 | 0.35 |
| Investments in Fixed Deposits | −6.41 | −2.82 | 6.03 | 7.41 |
| **Cash Flow from Investing Activities (B)** | −**7.17** | −**3.33** | **6.55** | **7.76** |
|  |  |  |  |  |
| Unsecured Loan Proceeds | −11.92 | 10.40 | −9.34 | −9.10 |
| Secured Loan Proceeds | 14.19 | −1.69 | −7.89 | 7.50 |
| Drawings by Partners | −2.16 | −4.22 | −4.93 | −6.90 |
| **Cash Flow from Financing Activities (C)** | **0.11** | **4.50** | −**22.16** | −**8.50** |
|  |  |  |  |  |
| **Opening Cash & Cash Equivalent** | **1.21** | **0.46** | **2.73** | **1.95** |
| Net Changes (A + B + C) | 2.05 | 0.74 | −2.26 | 0.77 |
| **Closing Cash & Cash Equivalent** | **3.25** | **1.21** | **0.46** | **2.73** |

Source: Company files.

Exhibit 5: Assumptions for Scak Textiles Pre-Money Valuation

|  |  |  |
| --- | --- | --- |
| **Variable** | **Assumption** | **Rationale** |
| Wholesale Revenue Growth | 20% | Aggressive pricing and a larger store area along with greater variety for customers |
| Retail Revenue Growth | 25% | Entry into the premium segment of apparel and a dedicated floor for retail customers, leading to enhanced customer experience |
| SD&A Expenses as % of Sales | 5% | Mostly semi-variable expenses such as salaries for salespeople, which would rise with an increasing headcount as sales ramp up |
| Tax Rate | 30% | For a partnership business in India |
| Gross Profit % for Wholesale | 6.5% − 8.5% | Lower margins due to aggressive pricing in the initial years will rise in later years after negotiation with vendors on volumes; profit will increase at 0.5% every year and settle at 8.5% at the end of the fifth year |
| Gross Profit % for Retail | GP W% + 10% | 10% premium over GP W |
| Depreciation | Constant at the current level | No significant fixed assets requirement in this trading business; depreciation is assumed to be constant at the current level |
| CAPEX | Same as that of depreciation | Assumption that depreciation = CAPEX; this trading business has no requirement of significant CAPEX |
| Changes in Working Capital | 15% to 13% | Considered as % of wholesale incremental revenue, which will reduce every year by 0.5% and settle at 13% by the end of the projected fifth year. |
| Terminal Growth Rate | 5% | Industry expectations |

Note: SD&A = selling, distribution, and advertising expenses; GP W = gross profit for wholesale; CAPEX = capital expenditure.

Source: Created by the case authors.

Exhibit 6: Comparable Firms (as of fiscal year 2019-2020)

|  |  |  |  |
| --- | --- | --- | --- |
| **Company** | **Equity Beta** | **Debt to Equity Multiple** | **Market Capitalization**  **(in ₹ billion)** |
| Future Retail | 1.83 | 0.66 | 50.66 |
| Shoppers Stop | 1.22 | 0.04 | 35.52 |
| Trent | 1.14 | 0.24 | 33.37 |
| Kewal Kiran Clothing | 0.64 | 0.22 | 9.86 |
| Aditya Birla Fashion | 1.13 | 0.84 | 134.70 |

Source: Centre for Monitoring Indian Economy, “ProwessIQ,” CMIE, accessed October 25, 2020, http://prowessiq.cmie.com.

Exhibit 7: Assumptions for DCF VALUATION OF Scak Textiles with Manufacturing,

e-Commerce, and export business options

|  |  |
| --- | --- |
| ***Assumptions for Project Shikhar—Manufacturing*** | |
| Capacity (in sales value) | Equivalent of sales value—2020−2021: ₹250 million; 2021−2022: ₹350 million; thereafter, YoY growth at 10% per year |
| Cost of Goods Sold | 75% of sales |
| Depreciation Method | Straight line method |
| Average Useful Life of PPE as per Management Estimates (years) | 10 |
| CAPEX (includes PPE, factory buildings, and other assets) | First year ₹100 million and ₹20 million in fourth year for capacity enhancement |
| Logistics Cost | 2% on sales |
| Marketing Cost | ₹0.5 million for first year with an increase of 10% YoY |
| Terminal Growth | 5% |
| Tax Rate | 30% |
| Working Capital Change | 10% of additional sales |
| ***Assumptions for e-Commerce Business*** | |
| Cloud Storage Fees | ₹0.5 million per year |
| Relevant CAPEX | ₹3.5 million in first year and ₹5 million in fourth year |
| Estimated Average Useful Life of IT Assets and Software | 5 years |
| ***Assumptions for Export Business*** | |
| Sales of Ethnic Wear | ₹30 million in 2021−2022 with a YoY growth rate thereafter @ 10% |
| Sales of Traditional Garments | ₹50 million in 2021−2022 with a YoY growth rate thereafter @ 10% |
| EBITDA on Exports | 25% of sales |
| Foreign Travel Expenses | ₹1 million in the initial year with a recurring expense of ₹0.05 million each year |
| Working Capital Change | Difference between the trade receivables and trade payables of the respective year |
| Export Trade Receivables\* | 45 days |
| Trade Payables | 30 days |
| Terminal Growth Rate | 5% |

Note: \* Assume 365 days per year; DCF = Discounted Cash Flow; YoY = year over year; CAPEX = capital expenditure; PPE = property, plant, and equipment; IT = information technology; EBITDA = earnings before interest, taxes, depreciation, and amortization.

Source: Authors’ calculations.

1. Hisar was a city and a district in the state of Haryana in north-western India located approximately 163 kilometres west of Delhi, India’s capital. [↑](#footnote-ref-1)
2. In India, the financial year ran from April 1 to March 31 of the subsequent calendar year. [↑](#footnote-ref-2)
3. ₹ = INR = Indian rupee; all currency amounts are in ₹ unless otherwise specified; ₹1 = US$0.014 in January 2020. [↑](#footnote-ref-3)
4. On November 8, 2016, the government of India announced the demonetization of all ₹500 and ₹1,000 banknotes. [↑](#footnote-ref-4)
5. The change in assumptions could alter the valuation. [↑](#footnote-ref-5)
6. The opportunity cost of the land was estimated at ₹15 million. [↑](#footnote-ref-6)
7. For the year 2020–2021, based on a DE ratio of 2:1, the total capital employed value of Project Shikhar would be ₹158.54 million. [↑](#footnote-ref-7)
8. Assumed price-to-sales multiple of 10x and price-to-earnings multiple of 20x for relative valuation of business. [↑](#footnote-ref-8)