

**Chartered Institute of  
Management Accountants**

**CIMA**

## **February 2016 Strategic case study examination**

### **Pre-seen materials**

**Rio**

### **Contents**

	<b>Page</b>
Rio and Retail fashion industry setting	2
Rio company overview and history	3
Routes to market	5
Supplier management	8
Rio's supply chain	10
Rio's Information systems and communications technology	14
Business aims for 2016	15
Rio's 5-year business plan	16
Risks facing Rio	17
Appendices:	
Appendix 1 – Rio's Board and senior management team	19
Appendix 2 – Organisation chart	21
Appendix 3 – Press report	22
Appendix 4 – Extracts from Rio's financial statements	23
Appendix 5 – Rio's key statistics	27
Appendix 6 – Rio's share price	28
Appendix 7 – Extract from Rio's 5-year plan	29
Appendix 8 – Extract from Rio's CSR report	30
Appendix 9 – Press report	31
Appendix 10 – Rio's Value Chain	32

## **Rio**

You are a senior finance manager who works for Rio Fashions ('Rio'). You report directly to the Finance Director and your role includes giving advice on special projects and strategic matters.

Rio operates a large number of retail stores across several European and Asian countries which sell fashion clothing and accessories. The Rio group operates in 36 different countries. Rio designs, manufactures and retails fashion clothing and accessories but the majority of its manufacturing is outsourced.

### **Retail fashion industry setting**

The retail fashion industry is very dynamic and competitive. There are a large number of retailers using different brand names, operating across multiple countries and continents. These fashion retailers compete using different generic strategies and target different market sectors. Some retailers compete mainly on price and have large ranges of items which are designed to appeal to specific types of customers. However, many fashion retailers have built strong brand names which reflect a mix of product quality, pricing strategy and the retailer's ethos towards managing its supply chain and the environment in which the company operates.

The retail fashion industry has been criticised for the poor treatment of its suppliers, especially in some Asian countries. However, the majority of European retail fashion companies have now addressed some of the problems in their supply chains and they operate in a much more responsible and sustainable way. Many fashion companies now insist that their outsourced suppliers adhere to a Code of Conduct.

Customers are becoming increasingly interested in the 'green credentials' of the retail fashion companies. Customers want the products they purchase to have been sustainably sourced and responsibly manufactured. However, whilst price is still an important determinant of customers' buying behaviour, the most important factor continues to be the design of the product and whether it is considered to be fashionable. The retail fashion industry in general has met much criticism for its non-sustainable business practices.

Customers' buying trends have been changing over the last 10 years, with an increasing number of clothing purchases being made over the internet. However, the sale of clothing is still dominated by sales in stores, rather than online. Research has shown that customers still prefer to see, feel and try on clothes before they purchase. Most retail fashion companies regularly re-design their stores and refit them to ensure customers feel comfortable and that their stores continue to appeal to their target market.

The need to build and maintain brand awareness and retain customer loyalty is a key strategy for most retail fashion companies because of the fickle nature of customers' changing tastes.

## Rio company overview and history

### *Overview of Rio's operations*

Rio is principally a fashion retailer, but a key part of its business model is managing a complex distribution network. The majority of Rio's products are manufactured by carefully selected outsourced suppliers, but it also has its own production factory based in northern Europe. Rio also operates its own distribution centres and manages a road haulage fleet of trucks in Europe and in Asia.

### *Rio's history*

The first Rio store, named after its founder Rita Irina Oliviera, opened in the capital city of Sealand, a northern European country, in May 1990. Its innovative designs and good quality products were an immediate success, and sales were much higher than originally planned. This demonstrated to Rita Oliviera, that the company had huge potential for expansion.

The company grew slowly for the next 12 years. It used mainly cash generated from operations and additional bank loans to expand into new locations in Europe. However, by 2001, it was clear that shortages of long-term finance and the lack of senior management skills were slowing the rate of expansion.

A new team of designers and a more experienced management team were put in place over the next few years. Rio also raised additional loan finance to help fund some of its expansion plans. This led up to the flotation of Rio eight years ago on a major European stock exchange in August 2007. The flotation enabled the company's existing debt to be repaid and also raised funds for expansion both in Europe and also to the Asian markets. The company has since secured new debt finance at more competitive interest rates.

Rio issued 50 million shares in 2007 and has not issued any further shares since its Initial Public Offering (IPO). Rio has an authorised share capital of 250 million shares. Rio's issued shares are held as follows:

	Number of shares held at 31 December 2015	Percentage shareholding
	Million	
Rita Oliviera	10.0	20.0%
Other Executive Board Directors	6.0	12.0%
Employee share scheme	2.0	4.0%
Institutional investors	32.0	64.0%
<b>Total</b>	<b>50.0</b>	<b>100.0%</b>

Following the flotation, the company established the required committees in accordance with the code of the stock exchange on which Rio is listed.

At 31 December 2015, Rio had 976 stores in operation across several European and Asian countries. The 976 stores comprise a mix of managed stores and franchised stores (see "Rio's stores" on page 5). All of Rio's managed stores are leased. In addition, Rio operates two distribution centres in Europe and one distribution centre in Asia, all of which are leased. Rio owns its Head Office building and its production factory, both of which are located in northern Europe.

### *Rio's 'fast fashion' business model*

Rio's stores sell well designed, quality products. Rio differentiates itself from other fashion retailers by its innovative, up-to-date designs. Rio also provides an excellent customer experience, due to attractive stores and high levels of customer service. Rio does not compete on price. The prices charged by Rio reflect the reputation which the brand has established.

Rio sells only its own designs under the 'Rio' label in its own stores, which range from high street stores to out of town and city centre shopping malls. Rio does not currently rent space in department stores to have a 'shop within a shop' format.

Rio's basic business model is based on the 'fast fashion' concept, whereby designs are prepared and approved within Rio. These designs are then offered for tender to suitable outsourced suppliers for manufacturing. This enables Rio to achieve high sales of the latest fashion trends. This business model also attracts young, fashion-conscious, stylish customers to the Rio brand. The time taken from design to finished products in store is a critical success factor for Rio.

Rio does not operate the traditional four fashion seasons each year based on the four north European seasons, but instead, its 'fast fashion' concept is based around a continual flow of new products arriving in stores each week. The 'fast fashion' concept is driven by the importance of the speed to market, from a design inception at the design board through to the finished product arriving in store. Rio very rarely manufactures the same design twice but based on customer feedback, slight design modifications will result in similar products arriving into stores. This continual and fast flow of new and updated products into stores and the high expectation of customers for new designs, means that any delay in products arriving in stores could have a detrimental effect on sales and customer satisfaction.

Rio's focus on shorter lead times has allowed it to develop its high fashion principle and the scarcity of supply provides an image of exclusivity amongst its customers. Over 90% of Rio's sales revenue is generated by full price products.

Rio monitors a range of key performance indicators which include 'footfall', which is defined as the number of customers entering all of its stores, irrespective of whether a purchase is made or not.

Feedback from store managers and customer responses enables Rio to adapt, update and amend individual designs to meet customers' ever changing fashion demands. This demonstrates that it is highly responsive to the fashion market. Rio's success, measured in growth of stores and company share price, is due to its responsiveness to meet its customers' desires for the latest trends.

## Routes to market

Rio operates a number of routes to market which are:

1. Rio managed stores
2. Internet sales
3. Franchising

### *Rio's stores*

All of Rio's stores in Europe are managed by Rio. However, since expanding into Asia, Rio has identified the need to operate franchised stores. The table below shows the number of managed and franchised stores.

	Number of stores at 31 December 2015	Number of stores at 31 December 2014	% growth
Managed stores	886	806	9.9%
Franchised stores	90	74	21.6%
Total stores	976	880	10.9%

**Rio**



The geographical analysis of stores is as follows:

	Number of stores at 31 December 2015	Number of stores at 31 December 2014	% growth
Europe	838	776	8.0%
Asia	138	104	32.7%
Total stores	976	880	10.9%

Rio's European stores are predominately in northern and central Europe. It does not currently have many stores in southern Europe.

### Internet Sales

In 2010, Rio invested over €25 million on the launch of its website to offer online shopping to its customers within the European market. At the end of 2015 Rio's website was fully operational across 20 of the 30 European countries in which Rio currently operates stores.



Rio's website allows customers to view and order the full range of products they could otherwise find in its stores. The website is directly linked to the design database and is automatically updated on a daily basis to reflect the latest products that are available in-store.

In the year ended 31 December 2015, Rio achieved internet sales of €202 million. This was less than 8% of Rio's total sales revenue. However Rio's senior management team is aware of the need to expand its internet sales in both existing markets and into other international markets.

### *Franchising*

Franchised stores are managed and run by the franchisee who retains all of the profit generated by the franchised stores but must pay Rio a franchising fee and also pay Rio for supplying the products sold. The capital expenditure to establish a franchised store is the responsibility of the franchisee. The franchisee is also responsible for working capital management, running the franchised store and all revenues and operating costs associated with running the store, such as employing store staff.

The franchising fee paid to Rio by the franchisee is based on a percentage of the sales revenue (before any local sales tax). The franchising fee is payable based on a sliding scale, which is dependent on the level of sales revenue. A reduced percentage franchising fee is payable to Rio for higher levels of sales revenue, and is based on the total annual revenues generated by each franchisee. Some franchisees operate more than one store and it will be the total of the revenue for all that franchisee's stores that will be used to determine the percentage franchising fee payable.

The franchised stores are allowed to sell only Rio branded products. Rio provides the franchisee with support, the use of the Rio brand name, all of the products it can sell and also some marketing support. Franchisees pay Rio directly for the inventory supplied. The charges made to franchisees for the supply of inventory include a small mark-up on the total cost of each product, taking into account the cost of production, distribution and design costs.

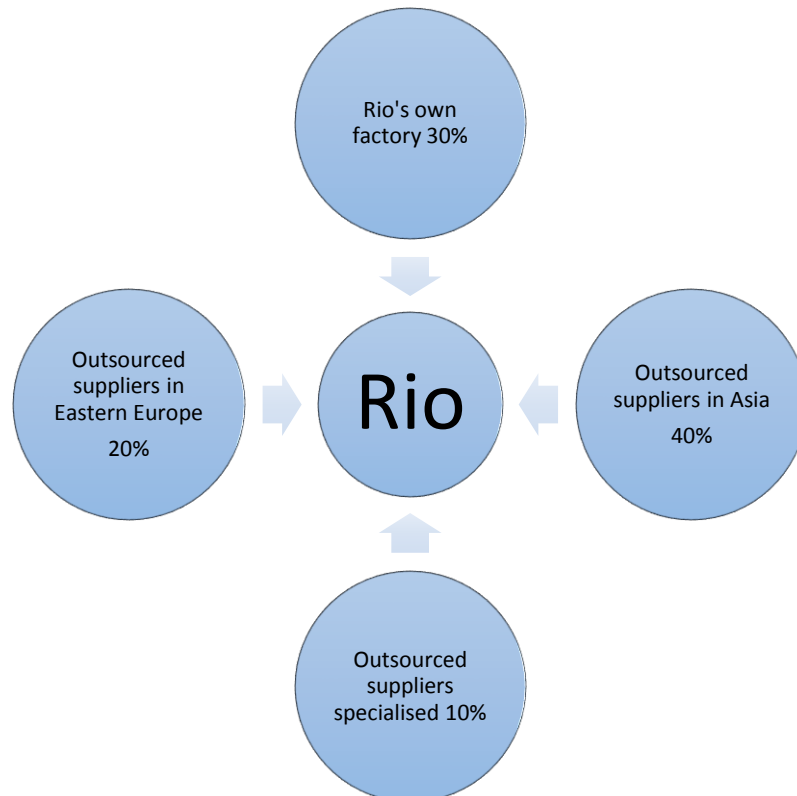
The revenue reported in Rio's accounts comprises three different revenue streams:

1. Revenue from customers for sales of products made in Rio's managed stores and internet sales.
2. Franchising fee paid to Rio, which represent the agreed percentage fee paid by franchisees, based on the sliding scale of fees payable depending on the level of revenue generated by each franchisee.
3. The mark-up on inventory supplied to Rio's franchisees.

## Supplier management

Rio operates a mixed manufacturing strategy. Rio's own production factory manufactures 30% of the total sales volume, 40% is outsourced to suppliers in Asia and 20% is outsourced to suppliers in eastern Europe. The remaining 10% of Rio's production is manufactured by highly specialist outsourced suppliers which produce the high value, labour intensive items such as hand-knitted garments and those which require detailed hand-stitching and finishing. All of these specialist outsourced suppliers are located in Europe.

The diagram below shows the analysis of where Rio's products were manufactured last year. A total of over 91 million individual items were manufactured.



At the end of 2015, Rio had a total of 350 outsourced suppliers. Each of them must adhere to Rio's Code of Conduct in order to retain their status as an outsourced supplier to Rio.

### *Rio's Code of Conduct for Outsourced Suppliers*

All outsourced suppliers working for Rio must sign and adhere to Rio's strict 'Code of Conduct for Outsourced Suppliers'. The Code of Conduct sets out the minimum standards of ethical and responsible behaviour which must be met. Rio employs a team of highly trained compliance managers, whose job it is to ensure that all outsourced suppliers understand and fully comply with the Code of Conduct. Rio's own factory abides by and meets all of the guidelines in the Code of Conduct and Rio's management insists that all of its outsourced suppliers do the same.



The Code of Conduct presents outsourced suppliers with rigorous guidelines in the following areas:

- Workplace health and safety systems
- Fair remuneration and working hours
- Zero tolerance on exploitation of the work force, such as the use of child labour, forced labour or discrimination
- Documented employment records
- Product and material traceability
- Environmental protection activities and adherence to environmental policies
- Exclusivity of design (i.e. outsourced suppliers cannot reproduce Rio's designs for their own purposes)



Rio's Outsourced Supplier Compliance team works closely with all outsourced suppliers. Rio sets a number of targets for its outsourced suppliers in all of the above areas of the Code of Conduct, to regularly achieve and report on. Rio's aim is to audit them at least twice per year and also to carry out additional spot-check audits. Any that do not adhere to Rio's Code of Conduct could lose their status as an outsourced supplier.

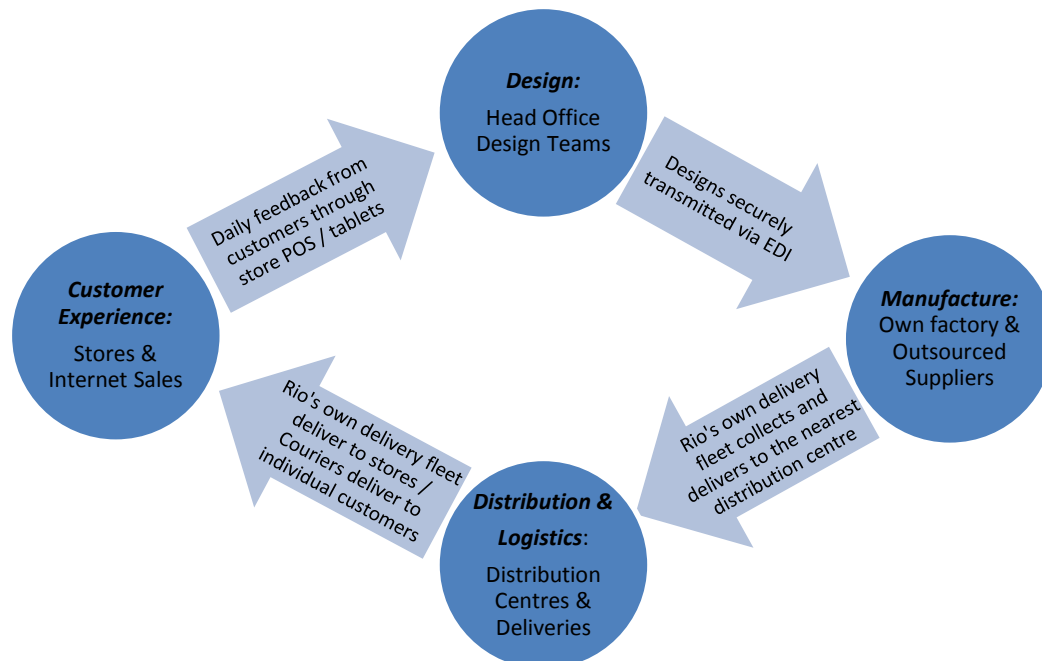
All outsourced suppliers and their employees are provided with regular training updates by Rio on all aspects of production and social responsibility expectations.

Rio uses a 'Star' (\*) rating system to evaluate the performance of its outsourced suppliers against its Code of Conduct. The highest rating that a supplier can achieve, and which all suppliers are strongly encouraged to strive for, is a five star (5\*) rating. The lowest rating is one star (1\*).

Only those outsourced suppliers which can consistently achieve a three star (3\*) rating or higher, are considered suitable as outsourced suppliers for Rio.

## Rio's Supply Chain

### Summary of Rio's Supply Chain



### Design

Rio employs over 100 in-house fashion designers located in its Head Office. Rita Oliveira insists on employing only the most talented young designers. Inspiration for new fashion designs comes from a diverse variety of sources: the latest couture fashion shows, celebrity styling, street fashion and even visits to university campuses.



An additional source of information about the latest customer trends comes directly from Rio's own stores on a daily basis. Each store manager, using a tablet device and through the Point of Sales (POS) system within each store, feeds back the store's daily sales data.

Feedback comes from customer questionnaires, sales assistants and the store managers' assessments of customer trends and buying behaviour. This is fed back to the design teams on a daily basis. For the majority of the feedback comments, the design teams adapt or recreate new designs based on this extremely useful information. This rapid response to Rio's own customer needs is a unique selling point for Rio. Rio aims to have any new design or modification of an existing design in the stores within three weeks.

### *Manufacture*

New and updated product designs from Rio's design teams are downloaded daily, via a secure Electronic Data Interchange (EDI) system to the selected outsourced supplier's Information System. All outsourced suppliers are in regular communication with the design teams through email and telephone. Rio's outsourced suppliers have formed a long-term relationship of trust with Rio and are only awarded work, based on tenders submitted, if they meet all requirements of Rio's Code of Conduct.

The tendering process involves the offering of a design to a small number of selected outsourced suppliers, to enable them to prepare a tender price based on the detailed specification of the design and the number of items to be manufactured. The outsourced suppliers will identify suitable materials that are immediately available to their factories and prepare their tender based on the price of locally sourced materials together with their own manufacturing costs. Rio's design team will place a firm order based on a mixture of criteria including price, quality of material and delivery times.

Manufactured products are then delivered to the distribution centre nearest to the outsourced supplier. One of the initial checks on all new deliveries into the distribution centre is the quality control sampling of all products. Due to the close working relationships with its outsourced suppliers, Rio experiences very few quality control problems. As speed to market is critical in this 'fast fashion' business, unless Rio identifies a significant quality problem with a product, the products are then processed in the distribution centre as set out below.

Some of the outsourced suppliers located in eastern Europe are responsible for the production of the fashion 'staple' items for Rio. These staple items are those products that rarely change and are basic items of clothing, such as white shirts, plain cotton t-shirts and standard cut trousers and jackets. The style and design of these products change far less frequently than the rest of Rio's fashion items.

### *Distribution and logistics*

Rio operates a sophisticated Management Information System (MIS) which records the movement of all products, from the collection of newly manufactured goods, inbound logistics to Rio's three distribution centres and the outbound logistics from distribution centres to stores and internet sales customers. The MIS controls and reports on the movement of all products at all stages through to when they are sold.

Rio's products are moved by rail, shipping, air freight and by road. Rio operates its own road haulage trucks in Europe and in Asia.

Newly manufactured products are initially collected by truck from wherever they have been manufactured and transported by road to the nearest distribution centre. The majority of

products are transported by Rio's own delivery trucks wherever practical, although some courier companies are used.

The outsourced suppliers do not iron, price tag or package the products. All products are processed (for price tagging, ironing etc.) at the distribution centre at which they first arrive. Although they may be sent on to another distribution centre, they will not normally be processed again.

All products are transported from the place of manufacture to Rio's nearest distribution centre and then the products are moved to stores, to fulfil internet customer orders or to another distribution centre. For example, products manufactured in Asia are transported from the Asian distribution centre by containerised shipping, or sometimes by air freight, to the central European distribution centre, from where products are allocated and transported to stores by road or rail.

Similarly, products manufactured in Europe are processed by the European distribution centre and then shipped to the Asian distribution centre, for onward transportation to Asian stores.

The eastern European and Asian distribution centres both use the latest warehouse management technologies, including automated loading and unloading technology where appropriate. Rio also uses the latest robotics technology which can locate and pick items with limited human intervention. Processes such as ironing and price tagging are also fully automated. Most of the staff employed at these centres are responsible for controlling and managing the technological systems and are highly skilled. Low-skilled manual staff are still required for some tasks, such as the initial quality control sampling outlined above.

The central European distribution centre, which is over 20 years old, employs a large number of staff to load and unload the delivery trucks, to pick orders manually and to iron and add price tags to all products by hand. This distribution centre is the original distribution centre used by Rio when it first went into business and has not received the same level of investment in technology as Rio's other two distribution centres. Most of the staff employed in the central European distribution centre are low-skilled. However, a number of the supervisors and the management team are highly experienced and have worked here since the distribution centre was set up.

A key business performance measure for each distribution centre is 'cycle time'. This is a measurement of the time it takes to process a product from its delivery into the distribution centre through to it leaving the distribution centre, when it is fully processed and packaged, and put into the delivery truck to be delivered to stores or to individual customers. The average cycle time for products processed in the central European distribution centre is over four times longer than the cycle time for products processed in Rio's other two distribution centres.

Rio's own trucks collect and transport the products that have been ordered, for delivery directly to the stores. The majority of products leaving the Asian distribution centre are transported to the central European distribution centre for onward delivery to European stores. Most of the transportation from the Asian distribution centre is done via containerised shipping, although a small volume of products is transported by air freight to the central European distribution centre before being delivered to European stores, when a particular new design or range is urgently required in stores.

Rio tries to minimise its use of air freight wherever possible and has reduced its use of air freight to transport its products from 20% of output in 2010 to 12% in 2015. Rio aims that all

stores across Europe and Asia will receive deliveries within 48 hours of them leaving the distribution centres. All of Rio's stores receive at least two deliveries per week.

Rio also uses the services of international courier companies to deliver individual customer internet sales orders which have been placed through Rio's website.

### *Customer focus*

Customers value Rio's up-to-date, latest trend image and exclusivity and as such, Rio attracts young, trend-setting customers. These customers have high expectations of Rio to deliver the latest, exclusive fashions before similar fashions appear in rival's stores.

Rio carefully recruits and trains store staff to ensure that the customer experience is optimised. Store staff are constantly available to assist customers and are trained to deal effectively and responsibly with a range of potential customer issues, such as customer fashion advice, complaints, health and safety and emergency procedures. All store managers are trained to encourage team work and to build long-term working relationships with the store staff, to improve the standard of customer care and to improve staff retention. Store managers are required to undertake weekly briefings with store staff to tell them about the current activities and issues within the business.

Rio's customers value the quick turnover of fashion trends in the stores. The quick turnover encourages customers to 'buy when they see' rather than to delay the buying decision. If customers delay and return to the store in ten days' time, it is likely that the garment will no longer be available. This 'fast fashion' concept has provided Rio with an opportunity to maximise its profits by minimising inventory holding and not having to discount large numbers of unsold items in 'end of season' sales.

### *Employee motivation*

High standards of customer care and a focus on the needs of its staff are both core to Rio's strong company culture and ethos. This company ethos is further strengthened by the core CSR principles on which Rio focuses all of its activities (see Appendix 8 page 31, 'Extracts from Rio's CSR Report').

When the company was listed in 2007, it implemented an employee share ownership scheme which was designed to motivate all of Rio's employees. All of Rio's store employees are eligible to receive shares each year based on achieving a range of performance targets based on the Balanced Scorecard, involving financial and non-financial targets. At 31 December 2015, two million shares (4%) were held by Rio's employees as a result of the employee share ownership scheme.

### *Performance review questionnaire*

Rio also undertakes an annual 'Performance Review' questionnaire which is sent to all employees and outsourced suppliers. This questionnaire encourages key stakeholders of Rio to provide feedback on a range of business performance issues and sustainability activities and to play an active role in making suggestions for improvement in Rio.

## **Rio's Information Systems and communications technology**

Rio's 'fast fashion' concept relies on a constant exchange of up-to-date information throughout its supply chain. Over the last 12 years, Rio has invested over €100 million in the design and implementation of a range of integrated Information Systems and a communications infrastructure to ensure the most up-to-date design, procurement and logistics information throughout the business.

Rio employs its own IT staff to manage the day to day running of the systems, but it outsources the specialised design and update work to leading IT companies. This allows Rio to keep up-to-date with technological developments in retail, e-business and inventory management systems.

The specifications for the hand-drawn design sketches are transferred to the design database by the design teams on a daily basis. Rio's design database holds all of the product design information. Within this system, the designers will clearly specify the material requirements for each product and this information is fed directly to the selected outsourced supplier. Every outsourced supplier's Information System is directly linked to Rio's design database through a secure EDI system. When a submitted tender has been agreed and authorised by the design team, the final approved detailed specification of the design order is securely downloaded to the outsourced supplier.

The design database is linked directly to Rio's Financial Information Systems, which automatically sends a purchase order to the outsourced supplier when a tender has been agreed and authorised.

The POS system within each store links directly to Head Office, to provide up to the minute sales and inventory data. The tablet devices used by store managers also link directly to the design database to provide daily information on customer feedback. The design database then also automatically analyses and collates all of this daily feedback from Rio's stores to provide design teams with the information required to create or modify designs.

Rio's integrated Inventory and Logistics Information System links each store to the distribution centres. The Inventory and Logistics Information System also manages and co-ordinates Rio's fleet of delivery vehicles which are responsible for the inward and outward carriage of all products delivered to the distribution centres.

Rio's Financial Information System interfaces directly with the Procurement Information System, which feeds cost of sales data and the value of inventory held by Rio directly into it. It also receives daily sales information from each store. The Financial Information System produces monthly management accounts and annual statutory accounts. This Information System also generates daily and weekly sales revenue and margin information for management to monitor actual against plans.

## **Business aims for 2016**

The Board of Rio has a number of business aims for the future. The approved business aims are:

1. To continue to put focus on manufacturing and delivering fashion designs in a sustainable and socially responsible manner.
2. To improve the management team's focus on ways to improve business performance through improving its value chain activities in order to become more efficient.
3. To increase efforts to enable Rio to implement reporting in the format compliant with the Global Reporting Initiative (GRI) (see below).
4. To deliver growth through the development of new market opportunities.
5. To continue to develop Rio's commitment to an integrated e-business approach.

### *Sustainable reporting*

The Board of Rio is very focussed on the importance of sustainability throughout its business and it currently collects data on many aspects of its business activities, which it currently publishes in its CSR report.

Rio is a responsible group of companies and it wishes to capture and report data on its carbon footprint, to enable it to reduce its carbon emissions. It also wants to work with its key outsourced suppliers to reduce the carbon emissions they produce in the manufacture of garments for Rio.

All aspects of Rio's business model need to be looked at and data captured to enable the company to become more sustainable in each of the thousands of activities across the many countries that Rio operates in.

The Board of Rio would like to introduce the reporting of its operations in the Global Reporting Initiative (GRI) framework in the next few years. A sustainability report is a key platform for the company to communicate its sustainability performance and the impacts of its business behaviour.

When Rio does implement and report its business activities in the format that meets with the GRI, then this will enable the Board to set goals more effectively and to manage the required change to meet those goals.



## **Rio's 5-year business plan**

The management team is keen to expand Rio's sales through both organic and non-organic growth and also through the further use of franchisees. Franchising is a relatively new addition to Rio's business model, but has worked well in achieving fast expansion into the Asian market.

Profitability could be increased through additional economies of scale and further improvements in Rio's value chain, leading to growth in the operating profit margin. Rio's operating profit margin was 15.7% in 2015 and the Board plans that improvements to operational efficiency will go straight through to the 'bottom line' and improve the operating profit margin. Rio's value chain is shown in Appendix 10 on page 33.

Rio has opened new managed stores in new towns and cities in Europe and Asia at the rate of around two new stores every week during 2015. This has required large capital investment funds for establishing and equipping out these new stores to its exacting high standards, reflecting the high quality of the Rio brand.

Rio is also planning to expand its availability for internet sales to all 30 European countries in which it operates and also for the Asian countries in which it has stores in the next two years.

Rio's expansion into Asia, covering only six Asian countries to date, has been through a mix of managed and franchised stores.

Details of Rio's current 5-year plan is shown in Appendix 7 on page 30.

### *Geographical expansion of the Rio brand*

The Board would like to continue to expand further in Asia, by opening additional stores in the Asian countries in which it currently operates, and for expansion into other Asian countries. Rio is sometimes not allowed to have 100% ownership of any of its stores in certain countries, due to local laws on non-resident ownership. Therefore, Rio will have the choice to expand via franchising, as it has in the past, or alternatively to set up joint venture arrangements with local companies, in countries where ownership limits exist.

The Board would also like to expand into new geographical regions including Australia and South America.

### *Target number of stores*

The Board is aiming to increase the number of stores to 1,676 by 31 December 2020, comprising 1,436 managed and 240 franchised stores.



## **Risks facing Rio**

Rio is operating internationally in a fast-paced retail environment and it faces many risks. Rio's Board has established a comprehensive risk management process which it has cascaded down to all employees to understand and adhere to. The risk management process provides the Board with the confidence to achieve the range of targets set. The risk management process also reassures shareholders and other stakeholders that management procedures are in place to protect Rio's brand name and reputation in the market.

The main risks concern the competitive threats from other clothing retailers and the quality and integrity of its clothing manufacturing process.

### *Supply chain risks*

One of the largest risks that Rio faces is the customers' tastes of the changing fashion trends. Fashion trends used to be led only by designers and design houses at annual fashion shows, whereas now trends can change due to famous stars wearing particular types of design. A product that is very fashionable one minute, can quickly be seen to be unfashionable due to the use of social media, especially when Rio's target audience is young people who use social media extensively. The risk here concerns the margin that Rio is able to achieve on its inventory and what proportion will be sold at full retail price and how much will be sold off at substantially reduced prices, recycled or scrapped.

Rio tries to minimise the risks with outsourced suppliers by working closely with each of its 350 outsourced suppliers within an agreed Code of Conduct. However, there are still unforeseen risks such as natural disasters. For example, there was a loss of some outsourced suppliers following an earthquake in an Asian country last year. However, Rio worked with, and supported, these outsourced suppliers and their employees during the disruption caused and most have rebuilt and have resumed supplying Rio with products. This is in contrast to some other outsourced suppliers who lost their supply contracts and were abandoned by major European and American retailers following the earthquake. Rio tries to be loyal and responsible in all of its business activities.

A further risk with Rio's outsourced suppliers concerns the need to meet Rio's specified high quality of the products manufactured, and the need for outsourced suppliers to meet all of the requirements of Rio's imposed Code of Conduct.

Another risk is the possible loss of Rio's young talented designers, who could leave to work for a rival.

The distribution and logistics of moving millions of products from its outsourced suppliers to Rio's three distribution centres and onto stores or direct to customers (for internet sales) is complex and relies heavily on the accuracy and effectiveness of the supply chain and Rio's IT systems to ensure that goods are moved quickly and to the right place. There is a continued need to try to minimise delays in getting products to stores.

### *Management team*

Rio operates in a competitive market place and is aware that it needs to retain and motivate its management team in order to operate and grow in accordance with its plans. A loss of any of its key management team would create a risk for Rio.

### *Currency risks*

Rio is based in the Eurozone, but many of its costs and revenues are incurred, or generated, in other currencies. Therefore it faces currency exposure for the range of currencies in which it purchased its products, and also exposure from sales in non-Euro countries.

Stella Erikson, Finance Director, tries to minimise Rio's exposure to transaction risk by natural hedging methods such as matching where possible and a range of external hedging methods. The current weakness of the Euro has had an adverse effect on the cost of products purchased outside of the Eurozone.

### *Risks of growth*

Due to the very fast expansion of the Rio brand in Europe and Asia, the company has been opening an average of around two new stores every week. This results in the risk of failure to meet opening dates and the inventory holding for all of the required ranges of products, as this often requires new distribution links, which is a major challenge to the management team. The sheer logistics involved in each store opening puts management and logistics under great strain and unforeseen delays can occur.

A further risk of fast expansion concerns the need to ensure that Rio's IT systems and supply chain can cope with increased volumes.

Another risk facing Rio is its plans for expansion into new geographical regions.

### *Franchising risks*

Franchisees need to comply with Rio's franchising agreement and not sell any products that are not supplied by Rio. There is a risk that franchisees may not uphold Rio's good brand name and reputation, including the provision of an excellent customer experience.

There is a risk that Rio will not be able to identify, recruit and train sufficient numbers of new franchisees to meet the targets in its 5-year plan.

Some franchisees may become dissatisfied if they are unable to operate their stores efficiently and make adequate profits, resulting in a possible loss of some franchised stores in future.



### **Rio's Board and senior management team**

#### ***Rita Irina Oliviera - CEO***

Rita is a 58 year old fashion designer and the founder of Rio. She is a graduate of Contemporary Arts and during the first 10 years of her career gained valuable experience in the fashion industry, working for some of the most renowned fashion houses in the world. Rita quickly gained a reputation in the fashion industry as an innovative talent and she displayed her entrepreneurial flair when she began selling her own designs under the 'Rio' brand in her home country of Sealand in northern Europe in 1990. Rita's flair and design skills and her continued ambitions for Rio, has seen the company grow from just one store in 1990 to almost 1,000 stores at the end of December 2015.

#### ***Cedric Pirlo - Non-executive Chairman***

Cedric, aged 56, joined the Board of Rio in 2002. He has held a succession of senior positions for several leading global fashion companies in a career that has spanned 30 years, including the position of Marketing Director of one of Rio's main European competitors, which he held for several years prior to joining Rio.

#### ***Stella Erikson - Finance Director***

Stella is a 52 year old qualified accountant who has gained considerable experience of the fashion industry. Prior to joining Rio in 2003, she spent 10 years as the Finance Director for a large international textile manufacturing company based in northern Europe.

#### ***Mani Kaur - Logistics Director***

Mani is 44 years old and has worked for Rio for the last 22 years. He has a first class degree in Business Management and his first job was with Rio, as a procurement trainee. Over the last twenty years he has worked his way up through the business, developing a vast knowledge and understanding of the procurement and logistics systems of Rio.

#### ***Carly Edmonton - Marketing and Merchandising Director***

Carly is 49 years old with an MBA from a world class European business school. Prior to joining the Board of Rio in 2005, she worked for 12 years in a range of roles for a top fashion design house based in the US, which developed her interest and enthusiasm for the world of fast fashion.

#### ***Diana Templeman - IT Director***

Diana is 42 years old with a first class degree in Mathematics and Computer Science. She joined Rio in 2007 after previously being employed as an IT project manager with an international distribution company. Diana was initially employed at Rio as a senior IT project manager to lead the development in its Information Systems and she has played an integral part in the successful development of Rio's website. Diana's talent and vision for Information Systems' solutions in Rio gained her promotion to Board level 5 years ago.

#### ***Kamal Singh - Procurement Director***

Kamal who is 53, has a business and engineering degree from a prestigious US university and also has a Masters degree in Procurement and Supply Chain Management. Kamal worked for over 15 years in the US for a leading telecommunications company and then subsequently for an international logistics company. Kamal joined Rio in 2006 and since

then has been instrumental in the development and management of Rio's supply chain management systems.

***Linda Lee - Human Resource Director***

Linda is 34 years old and has been a director of Rio for the last four years. This is Linda's first appointment at Board level. Previously, she was the senior HR manager for a rival fast fashion organisation and was responsible for a hugely successful transformation of its HR policies and focus on training and staff retention. She has an MBA from a leading US university and since her arrival at Rio four years ago, has been inspirational in her approach to team work and building better staff relations through extensive coaching and mentoring programmes.

***Non-Executive Directors***

Rio has seven Non-executive Directors, who together have a wide range of commercial and fashion related experience.

***Other key members of Rio's management team:***

***Sabine Roos - Head of Property***

Sabine is 29 years old and has a Masters Degree in Business and Retail Management. She has worked for Rio for two years, having previously held the position of Senior International Property Manager for a large international estate agency company. She is responsible for identifying, negotiating and managing the fitting-out of Rio's new managed stores to meet Rio's exacting standards. She also supports Ralf Helber (see below) with identifying store locations for franchised stores. Sabine also manages Rio's five other sites, which are Rio's Head Office, its factory and the three distribution centres.

***Ralf Helber - Head of Franchising***

Ralf is a 38 year old graduate with a degree in Financial Management and Strategy. He has worked at Rio for 7 years and has personally played a leading role in the management and development of Rio's successful franchise operations in Asia. He is seen as a key member of the management team who may be considered as a future Director.

***Veronique LeFevre - Head of Design***

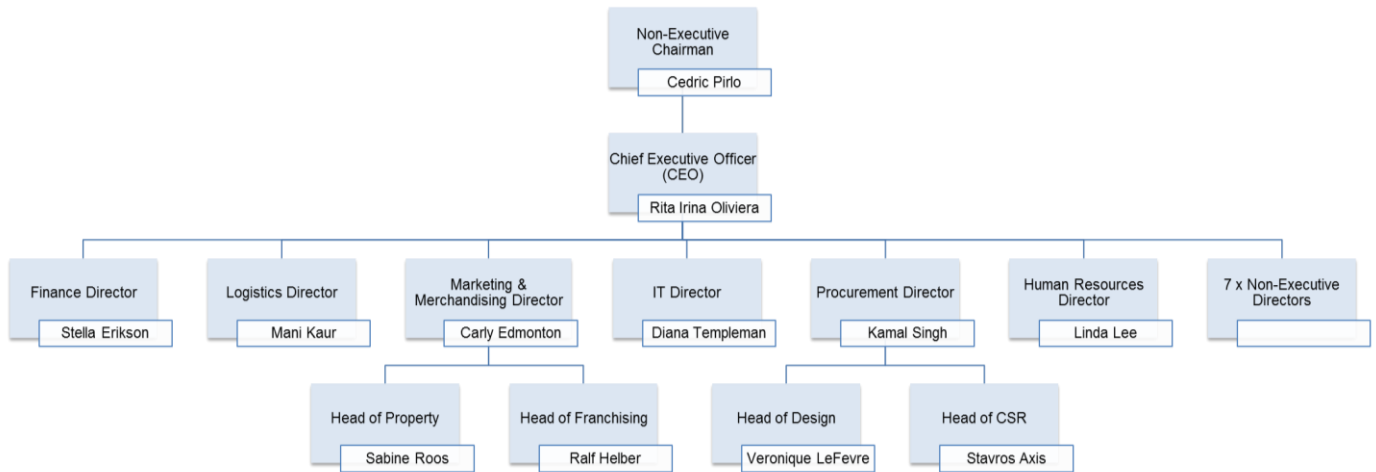
Veronique is a 47 year old fashion designer. She has over 25 years' experience in the fashion industry, working for some of the leading fashion design houses in Europe. In the last 15 years she has become famous in the world of fashion as a 'celebrity stylist', working with some of the world's most famous pop stars, actresses and models. Veronique joined Rio 3 years ago after being approached by Rita, who considers Veronique's fame and reputation in the industry to have a positive influence on the reputation of Rio.

***Stavros Axis - Head of CSR***

Stavros was appointed in 2010 to head the newly created CSR department. He is 39 years old and has a first class honours degree in Textile Engineering. Prior to his appointment with Rio, Stavros was a world renowned researcher and a leading expert in the field of ethical and socially responsible textile production. He was head hunted by Rita after she met him at a textile development conference in London in 2009, and was impressed by his visionary ideas on corporate social responsibility within the fashion industry.

## Appendix 2

### Organisation chart



# STYLE MAGAZINE

## An interview with Rita Oliveira CEO of Rio

### What makes Rio different from other fashion retailers?

When I started Rio back in 1990, I saw that there was an opportunity. Shoppers' tastes were changing. Rather than being dictated to by fashion designers, shoppers were being influenced by a whole range of other things, such as pop stars, film stars and street fashion. My own idea was to aim for the middle ground. High quality products that reflected the constantly changing styles and tastes of the customers. Basically, our philosophy was that we could not get emotionally attached to a particular product line or trend, no matter how successful it was. The focus was on 'fast fashion'. Keeping our customers interested in what the next trend would be. Basically, not letting our fashions become 'unfashionable' and keeping our customers keen for more.



### How does Rio make it all work?

The key to Rio's fast fashion model is the very short time from 'design to production to store'. Our designers are team players, meaning we are very efficient and effective in our design process. Our sophisticated logistics and distribution network is key to our business model. Getting the right product to the right place at the right time is our critical success factor. And the close working relationship with our suppliers is also a key factor in our success. At Rio, we like to think that our suppliers work 'with' us, not 'for' us. But most of all, we listen to our customers feedback and react to it soon as we can. It is this relationship of trust between Rio and its customers which allows us to deliver the latest fashion trends.

### Some people have criticised this approach, calling it 'throw away' fashion. Do you agree?

When the opportunity to produce clothes very cheaply by outsourcing production overseas occurred, the market for fashion changed. Yes, margins improved because costs were significantly reduced. Clothing was much cheaper but their fashion life was shorter. So, yes, to some extent, for some fashion retailers this has led to their clothes being 'throw away'. But this is not the case for Rio. Some people criticise our approach to swift turnover of designs and misinterpret this as 'throw away' fashion. But it is not. By making continual changes to our designs we are able to respond to our customer needs, but still provide them with high quality clothing at a reasonable price. Our customers trust the Rio brand name.

### What is next for Rio?

We have many exciting plans for the future. We continue to look at expanding our sales channels throughout the world. Fundamentally though, Rio will continue to focus and build on its fast fashion principles and put the needs of our customers first.

## Appendix 4



## Extracts from Rio's Financial Statements

## Statement of profit or loss

	Notes	Year ended 31 December 2015 €'million	Year ended 31 December 2014 €'million
Revenue	1	2,557	2,241
Cost of sales	2	1,117	968
Gross profit		1,440	1,273
Operating expenses:			
Employee expenses	3	468	416
Operating lease costs	4	291	259
Other operating expenses	5	280	249
Total operating expenses		1,039	924
Operating profit		401	349
Finance costs (net)		22	22
Profit before tax		379	327
Tax expense		93	80
Profit after tax		286	247

## Statement of changes in equity for the year ended 31 December 2015

		Share capital	Share premium	Retained earnings	Total
		€'million	€'million	€'million	€'million
Balance at 31 December 2014	Note 6	50	350	545	945
Profit for the period		-	-	286	286
Dividends paid		-	-	(100)	(100)
Balance at 31 December 2015		50	350	731	1,131

**Appendix 4 (continued)****Statement of Financial Position**

		<b>Year ended 31 December 2015</b>	<b>Year ended 31 December 2014</b>
		€'million	€'million
Non-current assets	Note 7	810	873
Current assets			
Inventory		322	295
Trade receivables		180	157
Deferred tax	Note 8	41	31
Cash and cash equivalents		497	269
Total current assets		1,040	752
Total assets		1,850	1,625
Equity			
Share capital		50	50
Share premium		350	350
Retained earnings		731	545
Total equity		1,131	945
Non-current liabilities			
Long-term loan		250	250
Other financial liabilities		18	18
Total non-current liabilities		268	268
Current Liabilities			
Trade payables		331	306
Accrued expenses		27	26
Tax		93	80
Total current liabilities		451	412
Total equity and liabilities		1,850	1,625



**Appendix 4 (continued)****Statement of cash flows**

	<b>Year ended 31 December 2015</b>	
	€'million	€'million
<b>Cash flows from operating activities:</b>		
Profit before taxation (after Finance costs)		379
Adjustments:		
Depreciation	149	
Finance costs	22	
		171
(Increase) / decrease in Inventories	(27)	
(Increase) / decrease in Trade receivables	(23)	
(Increase) / decrease in Deferred tax	(10)	
Increase / (decrease) in Trade payables	25	
Increase / (decrease) in Accrued expenses	1	
		(34)
Finance costs paid	(22)	
Taxes paid	(80)	
		(102)
Cash generated from operating activities		414
<b>Cash used in investing activities:</b>		
Purchase of non-current assets		(86)
<b>Cash flows from financing activities:</b>		
Dividends paid		(100)
Net increase in cash and cash equivalents		228
Cash and cash equivalents at 31 December 2014		269
Cash and cash equivalents at 31 December 2015		497

## Appendix 4 (continued)

### Notes to the financial statements

#### *Note 1 – Revenue*

Revenue comprises sales revenue, net of sales taxes, for all products sold in Rio's managed stores and online sales plus the franchise fees charged to franchisees.

#### *Note 2 – Cost of sales*

Cost of sales comprises only the cost of purchasing or manufacturing the products sold in the period. It does not include distribution costs or any employee costs for store staff.

#### *Note 3 – Employee expenses*

This comprises the total employee costs, including taxes, insurance and pensions, for all of Rio's employees. This includes all store staff, together with employees in Rio's factory, distribution centres and Head Office. At 31 December 2015 Rio employed 22,150 employees (year ended 31 December 2014 was 19,747 employees). Many of Rio's store staff work part-time, to meet the peaks in demand, and the number of full-time equivalent (FTE) posts was 14,176 at 31 December 2015 (year ended 31 December 2014 was 12,638 FTE posts).

#### *Note 4 – Operating lease costs*

This comprises the lease costs for the rental, through operating leases, of Rio's commercial premises from which it carries out its retail operations. This includes most of its managed stores and its distribution centres.

#### *Note 5 – Other operating expenses*

This comprises expenses relating to store operations, logistics and distribution costs. This includes electricity, commissions on credit card transactions, travel expenses, support for franchisees, marketing costs, communication costs, all costs related to Rio's vehicle fleet such as fuel and maintenance and all professional services provided to Rio.

#### *Note 6 – Share capital*

Rio's share capital has remained at 50 million issued shares since its flotation in 2007. The shares required to reward Rio's employees under its employee share ownership scheme are purchased in the market.

#### *Note 7 – Non-current assets*

This comprises Rio's Head Office building, fixtures and fittings in all stores, plant, machinery and fixtures at the distribution centres, Rio's vehicle fleet and IT hardware and software. Rio leases all of its stores and distribution centres. Rio does not believe that its lease arrangements give it the risks and rewards of ownership and these are therefore excluded from non-current assets.

#### *Note 8 – Deferred tax*

This comprises tax losses for newly opened Rio stores in countries in which Rio has only recently expanded into, and for which Rio has no other taxable profits to offset them against in that country. These deferred tax assets will be offset against the future taxable profits in each of those specific new countries. There is a good expectation that all stores will be profitable within 18 months of store openings.

## Appendix 5

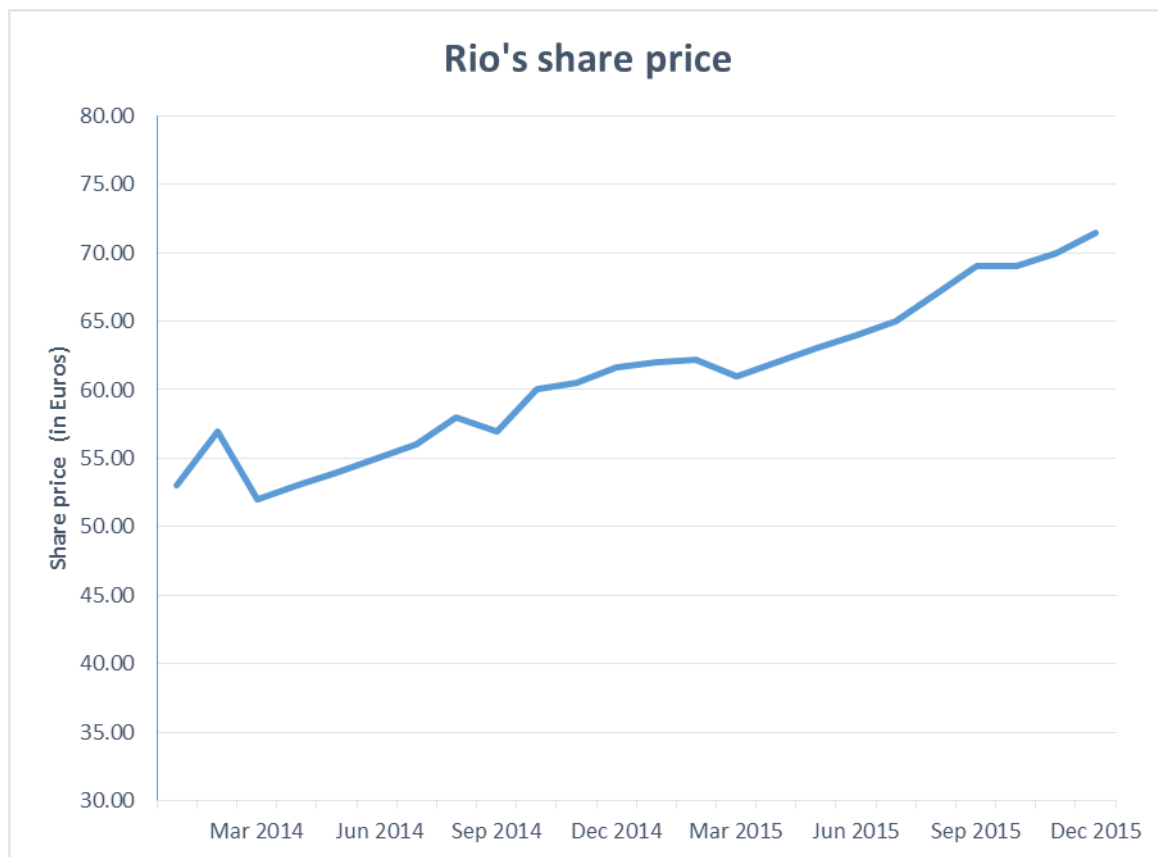
## Rio's key statistics

	Year ended 31 December 2015	Year ended 31 December 2014
Number of stores – end year		
Managed	886	806
Franchised	90	74
Total stores	976	880
Number of stores – average for year		
Managed	846	772
Franchised	82	68
Total stores	928	840
<b>Average revenue per store</b>	€'million	€'million
Rio managed stores	2.75	2.68
Franchised stores *Note 1 below	0.39	0.37
Total revenue per average store	2.54	2.49
<b>Internet sales – average revenue per day</b>	0.55	0.40
<b>Analysis of revenue:</b>	€'million	€'million
Managed stores	2,323	2,070
Franchised stores	32	25
Internet sales	202	146
Total revenue	2,557	2,241
Gross margin %	56.3%	56.8%
Operating profit %	15.7%	15.6%
Total number of products sold	92.1 million	80.1 million

\*Note 1: Average revenue in 'Franchised stores' comprises the franchising fee paid to Rio and the mark-up.

## Appendix 6

### Rio's share price



At 31 December 2015, Rio's share price was €71.46.

## Appendix 7

## Extracts from Rio's 5-year plan

	<b>2015 Actual</b>	<b>2016 Plan</b>	<b>2017 Plan</b>	<b>2018 Plan</b>	<b>2019 Plan</b>	<b>2020 Plan</b>
Number of stores (end year)						
Managed	886	976	1,076	1,186	1,306	1,436
Franchised	90	110	136	165	200	240
Total stores	976	1,086	1,211	1,351	1,506	1,676
Average stores for each year	928	1,031	1,149	1,281	1,429	1,591
	€'millio n	€'millio n	€'millio n	€'million	€'millio n	€'millio n
Revenue	2,557	2,959	3,429	3,975	4,607	5,332
Operating profit	401	482	576	688	819	973
Gross margin %	56.3%	56.8%	57.2%	57.6%	58.0%	58.3%
Operating profit margin %	15.7%	16.3%	16.8%	17.3%	17.8%	18.2%

**Appendix 8****Extract from Rio's CSR report for the year ended 31 December 2015**

Rio is committed to the following five Corporate Social Responsibility (CSR) principles, which are integral to the way it operates its business:

1. To provide up-to-date fashion to customers in a socially responsible manner.
2. To select, train and reward socially responsible partners.
3. To operate ethically in relation to all of those who work for Rio.
4. To minimise its impact on the environment by using resources responsibly.
5. To maximise its systems in order to reduce, re-use and re-cycle wherever possible.

*Extracts of Rio's CSR Performance to date and its aims for 2016 and beyond:*

CSR Action	Achievements 2015	Key Aims 2016 and beyond
<b>Provide up-to-date fashion in a socially responsible manner</b>	<ul style="list-style-type: none"> <li>Increased the use of organic raw materials to 16% in 2015 (from 12% in 2014).</li> </ul>	<ul style="list-style-type: none"> <li>The range of organic raw materials will be expanded by 5% per annum for the next 2 years.</li> </ul>
<b>Select, train and reward socially responsible partners</b>	<ul style="list-style-type: none"> <li>Average number of audits per supplier was 1.5 (1.3 in 2014).</li> <li>68% of outsourced suppliers achieved 5* rating.</li> </ul>	<ul style="list-style-type: none"> <li>Increase supplier audits to at least 2 per year.</li> <li>80% of outsourced suppliers to achieve 5* rating within 2 years.</li> </ul>
<b>Operate ethically in relation to all of those who work for Rio</b>	<ul style="list-style-type: none"> <li>24 investigations of non-compliance of the Code of Conduct (compared to 35 in 2014).</li> <li>68% of store managers undertaken Rio's Ethical and Diversity training programme.</li> </ul>	<ul style="list-style-type: none"> <li>Reduce incidences of ethical non-compliance to less than 10 cases within 2 years.</li> <li>Continue to develop Rio's Ethical and Diversity training focus.</li> </ul>
<b>Minimise Rio's impact on the environment by using resources responsibly</b>	<ul style="list-style-type: none"> <li>Carbon efficiency improved by 16% and total carbon emissions decreased by 4% from 2014.</li> <li>Reduction of air freight carriage of goods by 5% from 2014.</li> </ul>	<ul style="list-style-type: none"> <li>Purchase 80% of all the electricity used from renewable sources by end of 2017 (currently 30%).</li> <li>Reduce air freight carriage by a further 5% over the next 2 years.</li> </ul>
<b>Maximise Rio's systems to reduce, re-use and re-cycle</b>	<ul style="list-style-type: none"> <li>2,000 tonnes of re-cycled garments collected by stores (up 11% from 2014).</li> </ul>	<ul style="list-style-type: none"> <li>Double the tonnes of re-cycled garments collected in stores by 2017.</li> </ul>

# Fashion Forward Monthly

14 December 2015 | No. 269

€9.99

## Truly transparent?

**Jade Casey**, Pan-American Correspondent

*Some retail fashion businesses lack transparency in their labour policies and do not have full knowledge of where their raw materials come from, Fashion Forward Monthly Correspondent, Jade Casey reports.*

Many of the world's top fashion companies lack transparency around their supply chain or do not have full knowledge of where their raw materials are being sourced from, leaving workers, including children, at risk of exploitation, a recently published audit has found.

The 2015 Pan-American Fashion Report, to be released this week, evaluated over 120 Pan-American fashion companies and graded them on the ethics of their supply chain, from the sourcing of raw materials through to final manufacturing. The report states that in South America only 9% of companies surveyed could demonstrate they were paying their outsourced suppliers a living wage, and only 11% had traced their supply process back to the source of raw materials. Furthermore, only 15% of businesses regularly conducted unannounced audits to ensure ethical standards were being achieved at their suppliers' factories.

Lead researcher on the audit, Dr Francis Simha said over 30% of North American fashion retailers and over 70% of South American fashion retailers failed to protect the interests of their suppliers' workers. "For these companies, we could see no information about what they were doing in respect to ensuring fair conditions for outsourced suppliers workers" she said.

It is important for fashion businesses to demonstrate that raw materials are being sourced ethically and that working conditions are improved, the report concludes. "Even though customers may want clothing which is competitively priced, they don't want to purchase a product manufactured as a result of unethical behaviour."

### Rio's Value Chain

