

# Analysis of scenario: Ruby Dale Ltd

## Key information provided

Please note that this information is not exhaustive and will give you a start on your pre-assessment analysis of the scenario.

## Inventory

### Inventory levels

High levels of inventory (20X5: 41% of current assets figure).

Fashion retail business, with online and high street presence. Mix of products, with recent entry into new products including men's shoes.

### Monitoring of inventory and product lines

Fashion is a fast moving industry and with the introduction of new product lines, there may be inventory which doesn't sell as well (untested new areas for the company, such as menswear). Consider the impact of cost versus net realisable value (IAS 2 Inventories).

As there have been times when stock has sold out, leading to customers having unfulfilled sales, it is possible that Ruby Dale Ltd needs to analyse their faster moving product lines, and consider either a 'just in time' approach or review the inventory control system for these products.

### Key ratios

#### Breakeven point

$$BEP = \frac{\text{Fixed costs}}{\text{Contribution per unit}}$$

#### Contribution/Sales ratio (CS ratio)

$$C/S \text{ ratio} = \frac{\text{Contribution}}{\text{Sales}}$$

#### Required profit calculations

$$\frac{\text{Fixed costs} + \text{Required profit}}{\text{Contribution / unit}}$$

#### Margin of safety

$$\frac{\text{Budgeted SV} - \text{Breakeven SV}}{\text{Budgeted SV}} \times 100$$

## Sales and trade receivables

## Sales

The business has three main revenue streams:

- Wholesale to major high street retailers and independent shops
- Online retail business
- Shop retail business (London, Paris, New York)

## Shop based retail

- Expensive, premium locations. Possible issues with high business rates, long tenancy periods for the leaseholds of the shops (although the business may own the shops, it is unlikely, but no evidence given in the scenario)
- 29 employees work in these shops.
- Costs to cover prior to making a profit in these shops
- Can control the environment and the 'look' that the company is aiming to achieve.
- Customers can view the luxury products in premium surroundings
- Possible opportunity for personal shoppers or VIP shopping experiences
- Possible opportunity to have products bespoke to that location (for example, a New York handbag which can only be bought in that store, to draw customers to the stores). Especially if they cannot be purchased online.

## Online retail

- Accessible to most customers, regardless of location
- Can control the environment and the 'look' that the company is aiming to achieve.

## Wholesale to other stores

- Potentially 'easier' cash flow (notwithstanding the current high street problems) as large inventory can be turned into cash, albeit at a lower sales margin.
- Potential issues with security of credit terms to retail outlets
- Debt factoring a consideration to enable cash quickly, albeit reducing the profit margin.

**Trade receivables  
are high**

These may each have differing sales margins, with direct online sales being the most profitable (in theory).

Ruby Dale Ltd should look at what sales margins they are achieving, and also consider the cash flow impact of each: Although retail sales will offer better profit margins, the cash flow is likely to be lower, whereas the wholesale business to larger stores could offer a more reliable cash flow, but only by offering bulk discounts which will reduce inventory levels and profit margins.

The trade receivables are high (making up 52% of the current assets figure).

The narrative does not mention any issues that Ruby Dale Ltd may have had regarding their collection, but this amount could be down to a number of issues.

- Poor credit control
- Poor controls over which customers are able to obtain credit terms with Ruby Dale Ltd
- A lack of review by management over the trade receivables
- Uncertainty over recoverability of these receivables – there is no mention of an irrecoverable debt provision, so should there be one?
- There could be an issue regarding the customer base – the scenario explains that they supply to major High Street retailers. Recently, there have been issues over large department stores (like House of Fraser and Debenhams) struggling for funding and being under pressure.

## Staff and Directors

### Experienced Management

Ruby is a talented creative person, but she has Jack who is an experienced entrepreneur.

### Training

Opportunity to investigate further the training required by staff to boost morale, encourage staff retention and increase engagement with management.

The company has 160 employees, so taking an average of £28,000 average salary, this brings the approximate annual salary charge to £4.48 million. As companies in the UK with a salary bill of over £3 million must contribute an apprenticeship levy of 0.5%, this means that Ruby Dale Ltd is contributing around £22,400 per annum. Ruby Dale Ltd should look to expand its apprenticeship programme to take advantage of the allowance per apprenticeship to offset the levy.

Apprenticeships can be obtained in the creative industries, such as leather making, as well as business skills like team leader and software roles (potentially useful given the increasingly online nature of the retail sector).

Apprentices will also remain with the business during their training, however, the company will have the apprenticeships attending college once a week in order for their 20% of training time to be accounted for.

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## Liquidity and investment

### Potential stock market issue

Share capital is usually issued to finance capital investment or growth within the company. It is not primarily used to fund general working capital, so the company would need to ensure that they have specific plans for the financing from a listing, rather than just using it to fund general working capital.

You may be given further information, such as comparative data, whereby you can calculate ratios on liquidity to ascertain where the problems may lie.

By issuing new shares, this could dilute existing shareholdings potentially leading to issues with the current shareholders, Ruby and Jack. It is worth looking at the real life cases where entrepreneurs have listed on the stock exchange, only for them to lose their influence in the business and leave it, or those that have stayed on and thrived.

### Key ratios

#### Current ratio

$$\frac{\text{Current assets}}{\text{Current liabilities}} = X : 1$$

$$= \frac{3,780 + 4,762 + 676}{3,150 + 1,126}$$

$$= 2.2:1$$

Although the current liabilities of the business appear to easily cover the liabilities, this ratio does not consider the liquidity of inventory (refer to the quick ratio below) or any potential increase in capital (from a potential share issue) or potential new bank loan (both are longer term liabilities and so stating this ratio alone could be considered to be flawed).

#### Acid/Quick ratio

$$\frac{\text{Current assets} - \text{Inventories}}{\text{Current liabilities}} = X : 1$$

$$\frac{4,762 + 676}{3,150 + 1,126} = 1.3:1$$

The quick ratio suggests that the ability for the business to 'cover' their current liabilities is reasonable, but once again, this is wholly dependent on the business collecting the trade receivables which make up the largest proportion

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of this figure. This ratio is limited by the elements of the current assets figure.

### Gearing

$$\frac{\text{Non-current liabilities}}{\text{Total equity + Non-current liabilities}} \times 100 = X\%$$

$$\frac{20,286}{20,286 + 36,836} = 35\% \text{ gearing}$$

**Gearing** is concerned with the long-term financial stability of the company. It is looking at how much the company is financed by debt. The higher the gearing ratio, the less secure will be the financing of the company and possibly the company's future.

Ensure that you can compare the ratio or discuss it relevant to the scenario. Explain why the gearing ratio may be high, and what the issues may be (financing of debt, attractiveness to other investors, what is it funding exactly?). Also, a high gearing ratio in one industry may not be seen as risky as another, so having a look at industry standards for this type of business is another step you can take. Or compare it, if possible, to prior years or future plans in the real assessment.

### Other ratios to calculate

#### Inventory turnover

$$\frac{\text{Cost of sales}}{\text{Inventories}}$$

#### Trade receivables collection period (debtor days)

$$\frac{\text{Trade receivables}}{\text{Revenue}} \times 365 \text{ days}$$

#### Trade payables payment period

$$\frac{\text{Trade payables}}{\text{Cost of sales}} \times 365 \text{ days}$$

#### Inventory holding period

$$\frac{\text{Inventory}}{\text{Cost of sales}} \times 365 \text{ days}$$

## Environmental and sustainability

<b>Environmental claims</b>	<p>The business has strong commitments to making their business as environmentally friendly and sustainable as possible.</p> <p>Points to note:</p> <ul style="list-style-type: none"> <li>• Donations of returned goods to charity (remember the Burberry scandal where they were found to be burning excess stock?)</li> <li>• Water saving and waste reduction efforts</li> </ul>
<b>Ethics</b>	<p>Ethical treatment of staff and suppliers is also high on their list. This is especially important when planning on outsourcing some of their manufacturing to Asia.</p> <p>Think about the impact on the brand if any adverse publicity is released or the financial impact of using fully audited companies in Asia. Ruby Dale Ltd is a British brand, how do their customers feel about taking the manufacturing overseas?</p>

### Overall analysis of the pre-release material

The scenario has provided a SWOT analysis.

You may be asked to use this information to provide a report to the Board of Directors discussing some of these elements.

Ensure that you are familiar with producing a variety of reports, including a balanced scorecard based on the SWOT analysis. You may also be asked to comment about some of the strengths, weaknesses, opportunities and threats identified.

### Further steps

- Calculate ratios on the pre-release information as far as the information allows.
- Ensure you understand the benefits and issues with using certain ratios and can justify why you have used those particular ratios and not others.
- Review the financial statements of companies in the fashion sector, as this will broaden your knowledge and potentially highlight more issues which businesses in this sector can face, for example, Cath Kidston.
- AAT like to bring current issues in their Level 4 *Professional Diploma of Accounting Synoptic* assessment, so it is advisable to read financial papers, online news or look up financial statements on Companies House website. Some of these useful links will give you some material to start with.
- Please note that this list is not exhaustive and there may be elements for further discussion you have spotted or you think are relevant to the scenario.

### Useful links

Cath Kidston R  
online at: //fa:  
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Ruby Shoo set t  
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<https://www.dishoo-set-to-expand-customer-base/7029651>

Why Western f  
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Australia, Available  
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## Useful links

Cath Kidston Reports Annual Loss of 10.5 million pounds, (2019), Fashion United online at: <https://fashionunited.uk/news/business/cath-kidston-reports-annual-loss-of-10-5-million-pounds/2019011841085> [Accessed 15 May 2019]

Ruby Shoo set to expand its appeal with new casual styles to attract a wider customer base (2018), Drapers, available online at: <https://www.drapersonline.com/product-and-trade-shows/brand-showcase/ruby-shoo-set-to-expand-its-appeal-with-new-casual-styles-to-attract-a-wider-customer-base/7029651.article> [Accessed 15 May 2019]

Why Western fashion brands fail in China and tips on succeeding in a country where millennial consumers are taking over, South China Western Post (2018). Available online at: <https://www.drapersonline.com/product-and-trade-shows/brand-showcase/ruby-shoo-set-to-expand-its-appeal-with-new-casual-styles-to-attract-a-wider-customer-base/7029651.article> [Accessed 15 May 2019]

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Superdry in profit warning ater heat wave hits sales (2018). BBC News, available online at <https://www.bbc.co.uk/news/business-45860769> [Accessed 15 May 2019]

Employing an apprentice (2019), Gov.UK, available online at <https://www.gov.uk/take-on-an-apprentice> [Accessed 15 May 2019]

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UK retailers suffer weaker sales due to Brexit uncertainty (2019), The Guardian, available online at [www.theguardian.com/business/2019/mar/05/uk-retailers-suffer-weaker-sales-due-to-brexit-uncertainty](http://www.theguardian.com/business/2019/mar/05/uk-retailers-suffer-weaker-sales-due-to-brexit-uncertainty)

Three quarters of entrepreneurs stay on after selling business (2018), Business Matters, Available online at: [www.bmmagazine.co.uk/in-business/three-quarters-of-entrepreneurs-stay-on-after-selling-business/](http://www.bmmagazine.co.uk/in-business/three-quarters-of-entrepreneurs-stay-on-after-selling-business/) [Accessed 16 May 2019]

10 global companies that are environmentally friendly (2016), Virgin, available online at [www.virgin.com/virgin-unite/10-global-companies-are-environmentally-friendly](http://www.virgin.com/virgin-unite/10-global-companies-are-environmentally-friendly) [Accessed 16 May 2019]

What is a sweatshop and do fashion brands still use them? (2019), Marie Claire Australia, Available online at [www.marieclaire.com.au/sweat-shop](http://www.marieclaire.com.au/sweat-shop) [Accessed 16 May 2019]