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BUSINESS AND MANAGEMENT
CASE STUDY: GLADRAGS LTD

For use in May and November 2007

INSTRUCTIONS TO CANDIDATES

- Case study booklet required for Higher Level Paper 1 and Standard Level Paper 1 Business and Management examinations.

GLADRAGS LTD

History

Gladrags manufactures clothing and is based in the United Kingdom (UK). The firm was founded in 1965 by Naseem Singh, an Indian immigrant. As a teenager, Naseem was impressed by the range of business opportunities in the UK. He left college well-qualified, but unsure of what he wanted to do. He managed, through an uncle, to get an apprenticeship in a clothing firm and for five years he worked his way up through the firm becoming production manager. During this time he saved the majority of his earnings with the intention of setting up his own business. He lived in the East End of London in an area called Mile End where there were a number of small firms making and distributing clothes, many of them owned and run by members of the immigrant Indian community.

Naseem was never quite satisfied working for someone else. By 1965 he had saved $4000 and felt ready to launch his own business. He identified a gap in the clothing market. Most of the firms in the East End focused on large production runs, aiming to benefit from economies of scale, so there was an opportunity for a firm producing small batches of more individualised clothing. He believed there was a significant group of older Indian immigrants who were looking for the more traditional styles of clothing they previously bought when living in India. Naseem decided to manufacture and distribute his own clothes and therefore looked for a location appropriate for both production and retail sales. After a long search he found suitable premises in the East End of London and opened *Gladrags*, producing specialised Indian clothing from locally sourced (UK) fabrics and selling the clothing through a factory shop. He chose this location because the area offered a pool of highly skilled labour and support services. On startup Naseem immediately introduced technologically-advanced sewing and cutting equipment. He believed new technologies to be the way for a small firm to be competitive.

For the first few years *Gladrags* failed to break-even, but Naseem was determined to succeed. The breakthrough came in 1973 when Naseem met Tom Palmer, an ambitious young designer. Tom's vision was to create a more fashionable clothing range for younger men and women, although still based around traditional Indian-style fabrics. Naseem agreed to go into partnership with Tom. They drew up a partnership agreement to share the profits 60% for Naseem and 40% for Tom. By 1974 they were ready to launch their new range. As well as selling the clothes in their shop, they secured a distribution deal with a chain of London department stores.

Rising incomes and increased spending on clothing in the middle to late 1980s led to the growth of the firm. The brand loyalty that *Gladrags* had built up helped them to survive the recession of the early 1990s and they were well placed to take advantage of the upturn in economic activity in the mid 1990s. This prompted them to build a second production facility close to the original factory in the East End of London to provide additional capacity. At the same time they converted the partnership into a private limited company. Naseem took a 30% shareholding becoming chief executive officer and Tom 20% becoming operations director. Naseem's two children Anjay and Saswati joined the business and each took a 15% shareholding. Anjay became the marketing manager while Saswati joined the design department. Tom's two children each took a 10% shareholding but did not work for the firm. By 2001, the firm's turnover had risen to $2.4 million and though margins were narrow, the firm was earning a healthy level of profit, with the original *Gladrags* shop in Mile End now contributing less than 10% of the turnover.

After 2001, world economic growth slowed affecting the clothing industry, particularly in the market segments that *Gladrags Ltd* targeted. The relationship between Naseem and Tom became increasingly strained with arguments over the future strategic direction of the business. Tom made the decision to focus his energies on the manufacturing side of the business.

Marketing

In 2003, in response to falling demand for traditional style clothing, *Gladrags Ltd* decided to extend their product range by producing exclusive designer clothing. These new designs were created by Saswati who was keen to have greater influence in the business. This designer range targeted increasing numbers of high-income earners in the Indian population in the UK. The fabrics for this range were imported from India at a relatively low unit cost. This allowed higher profit margins for this range with customers prepared to pay premium prices for original designs. Sales grew quickly and *Gladrags Ltd* gained a significant share of this niche market. Profits rose significantly.

During 2005 and again in 2006, the sales growth of *Gladrags Ltd* slowed. Competition had been growing for some time with new producers entering the market offering designer clothes at lower prices. *Gladrags Ltd's* distributors are demanding that they match these lower prices. Naseem, concerned about the resulting reduction of profit margins, decided to review the firm's product ranges and marketing approaches, looking for ways to cut costs and to modernize the firm's image.

This review is still ongoing. Naseem invited Anjay, Saswati and the shop manager, Sinita, who has run the shop for 15 years, to examine potential changes. They have already commissioned market research into the *Gladrags* target market and customers' perception of the *Gladrags* brand. The research highlighted that *Gladrags Ltd's* core market is relatively older consumers in low socio-economic groups and that the *Gladrags* brand is associated with terms like "value for money", "everyday", "consistent" and "traditional". Anjay does not believe that this reflects the image required for their designer ranges. Sinita reported that the average age of customers entering the firm's shop has been increasing because young customers preferred more western clothing to the Indian style clothing offered by *Gladrags*. She believes they should specialise in clothes more likely to appeal to these younger customers.

Saswati proposes they sell more European style clothing, but still incorporating Indian fabrics and design influences, to target this younger market. She has contacts with Indian celebrities in the UK, involved in the film and music industries, and believes these could be used to promote new clothing ranges as they are role models to younger and more fashionable customers. Saswati recommends the outsourcing of production to minimise manufacturing costs and to allow competitive pricing. She suggests individually branding this new range under the name "Sassy". This would reflect a more rebellious and youthful approach to the marketplace, while distinguishing the new clothing range from the traditional image of the *Gladrags* brand.

Anjay is developing a marketing plan to support the "Sassy" range and is suggesting outsourcing manufacturing to lower-cost producers in Vietnam and Bangladesh and expanding the potential market by selling into the European Union.

Production

The production manager, Stephen Moffat, was recruited by Tom Palmer to increase efficiency and reduce costs of production. His appointment created concerns among production staff about job security. Tom also failed to consult the human resource manager, Jenny Boulton, who was angry that proper recruitment procedures were not followed.

Fabrics are locally sourced and, to ensure the best prices, a year's worth of fabric is bought all at one time. With increasing sales, storage of this stock has proved a problem. Stephen is planning the introduction of just-in-time (JIT) stock control. The majority of the machinists are very experienced. It takes several months to train machinists, but up to two years before they are fully productive. With 35% of the existing machinists within two years of retirement, Stephen asked Jenny to start a recruitment drive. However, it has proved difficult to hire suitable staff and so far she has failed to meet her recruitment target. Jenny believes the solution is to offer higher wage rates to attract staff, but Stephen disagrees, arguing that this will just raise costs. He is determined to stay within the budgets set for the year and higher wages may well lead to an unfavourable variance.

Quality has always been very important at *Gladrags Ltd* and the clothing is checked by quality controllers before dispatch. Approximately 7% of all finished items are rejected at this stage. Stephen wants to change this system and introduce Total Quality Management (TQM) where all employees are responsible for the quality of their work.

Human resource management

There is a formal organizational structure at *Gladrags Ltd* with a tall hierarchy and a narrow span of control. Production staff are organized in small groups supervised by a team manager. Administration staff are organised in a similar way. Naseem has always encouraged production staff to meet informally, as well as during work time, to create a supportive working environment. This has helped create a positive working atmosphere at *Gladrags Ltd*. As a result, labour turnover has generally been low and with most employees drawn from the local community, labour relations have been very good.

However, recent changes have caused some anxiety among the production workers and labour turnover is increasing as a result. The appointment of Stephen as production manager with a responsibility for cutting costs has created suspicion that *Gladrags Ltd* are planning to downsize their workforce. Production staff have learned that Anjay is proposing moving production overseas and this has led to conflict between the management and production staff. Motivation has worsened leading to falling productivity. Emergency meetings between Jenny and employee representatives have helped prevent strike action, but many staff remain very upset by the proposal and the threat of industrial action remains.

The difficulty replacing machinists who are retiring has put those remaining under increasing pressure to maintain production targets and has required significant amounts of overtime. Jenny has started using employment agencies to find temporary and part-time machinists. These factors have contributed to the rise in direct costs that the firm has been experiencing.

In the past, training has been done on-the-job using experienced staff. In anticipation of a significant number of new, inexperienced staff, Jenny is considering the introduction of a more formal training programme. Jenny is also discussing with the team managers the possibility of introducing more flexible working practices to reduce overtime payments.

Finance

In 2005, Tom persuaded *Gladrags Ltd* to invest in new manufacturing equipment and computer aided design (CAD) software. This investment was funded through a bank loan.

The finance manager, Colin Buckley, has given a positive report to the board of directors, which consists of Naseem, Anjay, Saswati, Tom and his two children, suggesting that the financial situation of *Gladrags Ltd* is secure. However, a recent board meeting put him under increasing pressure with probing questions about the low rate of growth, falling margins and increasing short-term borrowing. Several directors feel that the underlying financial situation, while appearing secure, is deteriorating and they have asked for more detailed budgets to be presented to the board. They have also asked for a detailed variance analysis of recent budgets.

Accounts for the 2004 and 2006 financial years for *Gladrags Ltd* are given in Appendix 1.

External environment

The rapid growth of the textile and clothing industry in the East End of London in the 1970s and 1980s slowed significantly in the 1990s, and the start of the new century has seen increasing numbers of firms closing. This has led to the Mile End area becoming run down and has seen an increase in crime and other social problems. However, the announcement in 2005 that the Olympics are to be held in London in 2012 gave renewed optimism to people in the area, and extensive redevelopment is expected with many events due to be held in the area.

Recently *Gladrags Ltd* has been approached by a property developer, who has made a financially attractive offer for their two production facilities. This offer is due for consideration at the next meeting of the board of directors. The developers intend to build new housing on the site in anticipation of the redevelopment of the area.

There are a number of opportunities and threats facing *Gladrags Ltd*, and in 2006 the board of directors asked a management consultancy firm, the Jacaranda Group, to conduct a PEST analysis for them of the clothing and textiles markets. The group recently presented their report and a summary of the main points is given in Appendix 2.

The future

The textiles and clothing markets are changing rapidly and this has led to uncertainty about the future direction of the firm. This uncertainty has been heightened following a takeover bid by an Indian multi-national corporation seeking to expand to the UK. It is clear that a number of important strategic decisions need to be made, but there is resistance to change from some employees.

Anjay has been asked to present a report at the next meeting of the board of directors highlighting the various strategic options open to *Gladrags Ltd*. The options under consideration are:

- sell the entire business as a going concern to the Indian multi-national corporation
- sell the UK production facilities to the property developer and sell the *Gladrags* brand name
- sell the UK production facilities to the property developer and outsource production to Vietnam and Bangladesh
- develop the existing business by refocusing their product range on younger people and target higher socio-economic groups who are less price-sensitive, starting with the "Sassy" product range.

None of these options carry the support of all the directors and shareholders. Naseem and Saswati are strongly in favour of developing the existing business. Tom, supported by Anjay, is proposing to sell the UK production facilities and outsource production. Tom's children, who are not involved with running of the business, are in favour of selling either the entire business to the Indian multinational corporation or selling the production facilities and the brand name.

All these conflicting proposals are being presented at the next board meeting and with no majority for any single proposal, it is likely to be a difficult meeting. An extraordinary general meeting of the shareholders has been called for two months time and the intention of the board is to present these choices to the other shareholders for their consideration.

Appendix 1

Gladrags Ltd
Balance sheet as at 31 May 2004 and 2006

		31 May 2004		31 May 2006
		$000		$000
Fixed assets		870		1200
Current assets				
Cash	300		110	
Debtors	410		325	
Stock	475		550	
Total		1185		985
Current liabilities				
Creditors	595		475	
Short-term borrowing	80		125	
Total		675		600
Net assets		1380		1585
Share capital		350		350
Loan capital		465		595
Retained profit		565		640
Capital employed		1380		1585

Gladrags Ltd
Profit and Loss Account for the years ended 31 May 2004 and 31 May 2006

	Year ended 31 May 2004	Year ended 31 May 2006
	$000	$000
Turnover	2590	2650
Cost of goods sold	1950	2075
Gross profit	640	575
Expenses	340	375
Net profit	300	200
Interest	25	32
Tax	35	28
Profit after tax and interest	240	140
Dividends	135	105
Retained profit	105	35

Appendix 2

PEST analysis – prepared for *Gladrags Ltd* in March 2006. Summary of main points.

Political	
China	The entry of China into the World Trade Organization will lead to a significant expansion of trade between China and Europe.
Multi-fibre agreement	The ending of the multi-fibre agreement (a trading agreement setting quotas) on textiles in 2005 is likely to lead to a considerable expansion of Chinese clothing imports and textiles.
Legislation	A drive to reduce bureaucracy is likely to lead to a reduction in regulations affecting production of clothing.
Economic	
Economic growth	Economic growth in the UK is expected to slow down in the next four years. A number of major countries in Europe, where economic growth has been very low, are expected to recover during 2007-2009.
Labour market	The decline in manufacturing and a reduction in the number of opportunities for apprenticeships has led to shortages of skilled labour in the UK clothing industry.
Taxation	No significant changes in personal tax rates are expected, but there is considerable pressure being placed on European governments to lower corporate tax rates to encourage new investment.
Interest rates	Interest rates in Europe have been very low for a number of years, but are expected to rise over the next few years as consumer spending in Europe grows and inflationary pressures return.
Pattern of spending	As incomes have grown a greater proportion of income has been spent on clothing. While basic clothing ranges are highly price elastic, branded and designer clothing tends to be much more price inelastic and income elastic.
Social	
Aging population	In the UK and the rest of Europe, demographic changes are leading to an aging population. This is likely to lead to changes in the pattern of spending with a larger proportion of sales to customers over the age of 55.
Immigrant populations	In Europe there is a growth of immigrant populations who are increasingly affluent with higher disposable incomes. In particular, spending by Indian immigrants represents an increasing proportion of all spending in the UK.
Social attitudes	With the integration of the former Eastern European countries into the European Union, younger people in these countries are starting to look towards Western brands and clothing manufacturers as they become increasingly materialistic and more concerned about how they look.
Technological	
New production technologies	Significant investment in the clothing industry has helped reduce the cost of production equipment. Production technology has developed considerably in recent years and this offers increased potential for production automation.
Labour versus capital intensive	Clothing production in China and many Far East countries remains very labour intensive, but with the ending of the multi-fibre agreement, much higher levels of investment in automated plant and equipment have been reported there.
CAD	Developments in computing have led to much improved design packages that can be directly linked to textile production and new automated production equipment. This is likely to significantly reduce the overheads associated with offering new clothing ranges.