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ADVANCE INFORMATION

Sancloth (Private) Limited

Niwtan Gajanayake is one of the best known corporate leaders in Sri Lanka and his wife Silvia Gajanayake worked as a teacher attached to a reputed school in Colombo. Their two sons, Ashen and Rushan, are respected professionals in the Sri Lankan corporate sector.

Niwtan and Silvia also have a lovely daughter named Sandra who was born on 22 February 1971 in Rathmalana. She was an outstanding character in her young age in school and she represented her school in athletics and swimming and the country in high jump and hurdles. Little did the striking young girl know that her tall, lean frame would soon catapult her from the starting blocks onto the catwalk, leading her into the glamour world of modelling. Sandra graduated from a reputed university in Canada specialising in garment designing and creative clothing.

Coming from such an educational background and dynamic family, Sandra's life took an unexpected turn when she entered the garment retailing industry in 1996. A chance request by an apparel manufacturer to help him dispose of an assortment of export surplus garments led to the start of her retailing career. Sandra started selling the export surplus garments to her family and friends from the boot of her trusty blue station wagon. Her mother was enthusiastic about her entrepreneurship skill in taking the risk of self-employment without working as a subordinate in the private or government sector. Therefore she resigned from her job and helped Sandra develop her own clothing retail store. Sandra's friends were her first regular clientele and she consolidated this early success by selling to other stores in Colombo as well. With the rapid development of the business, a few of the friends are still in the business holding top positions such as senior manager purchasing, senior manager payments, senior manager finance etc.

In the first few years of operations Sandra met lots of financial difficulties due to liberalised credit terms provided to her customers. Also as a young lady entrepreneur she encountered many cultural difficulties as a businesswoman, wife, and mother. In 2000, a new fashion brand for clothing "Sancloth" was born at a trendy commercial space in Colombo 3 with the business name of Sancloth (Private) Limited (SPL) and the flagship store on Barns Place, Colombo 7 opened its doors for shopping. In 2005, after experiencing five years in garment retailing, SPL unveiled its new brand identity under the theme "max for beauty". The same year, Sandra was bestowed with the honour of being made the country's new Goodwill Ambassador for Hax Humanities[1]. After a few years of running the business, a new collection of fashion accessories were launched under different popular brands.

By this time, the seeds of entrepreneurship had begun to take root and Sandra realised she could take the Sancloth brand to greater heights. The response to SPL's offerings was so great that in no time Sandra felt compelled to expand the number of outlets. A business which was started by Sandra, with just 2 staff members, a little over 1,000 sq ft and one store had now expanded to over 700 staff members, over 130,000 sq ft of shopping complex and 13 retail clothing stores around the country.

Making a superlative effort to translate her vision for a world-class department store into reality, she painstakingly created what could be considered a model retail store for the Asian region. In 2011, she outshone leading female entrepreneurs from around the world to bring honour to her motherland by winning a prestigious award in the fashion industry. Today, as the chief executive officer (CEO) of SPL, Sandra is proud to see that Sancloth is considered a forerunner in retail excellence in Sri Lanka and indeed the region.

Sancloth (Private) Limited (SPL)

Sancloth (Private) Limited was originated for fashion and is synonymous with Sri Lankan fashion. It is defined by a unique identity and is a destination in itself. Sancloth is a brand loved, followed and enjoyed by many.

Over the last two decades, it inspired people to embrace fashion in ways that best fit them. SPL opened the world of fashion to Sri Lankans across the country. This catalytic change commenced from the inspired action of one individual and her vision and entrepreneurship. The commercial success of SPL has inspired many others to dream and chase those dreams. SPL continues to

[1] Hax Humanities is a world class Non-Governmental Organisation that works around differently abled people.

strive towards reinventing the retail experience by offering to customers an array of diverse products and services that are in style, distinctive and constantly evolving.

SPL nurtured its supporting companies to help its growing business. Sancloth Properties (Private) Limited is a BOI approved company which owns a 52 perch property in Rajagiriya containing a 31,000 sq ft building. This has been leased to SPL to carry out its logistics and head office operations.

Sancloth Information Technology Services (Private) Limited is a BOI approved company which provides IT infrastructure and maintenance services. Sancloth Apparel (Private) Limited is a garment factory which manufactures T-shirts for SPL and undertakes special orders. Sancloth Lanka (Private) Limited is a BOI approved company which will in the medium term undertake the construction and management of a shopping mall of SPL that is currently in the preliminary stages of planning.

SPL offers a multitude of services in its stores that continue to be the benchmark for the industry in terms of service excellence. It provides a variety of shopping services to its customers such as a supervised kids play area, foot massage & nail spa, café style snacks at Café Boulevard, gift wrapping, bank & ATM services, as well as customer shuttle services during the holiday seasons. Further, free Wi-Fi services throughout the store, a foreign currency exchange counter, shop & ship facilities, box office services for event information and tickets, access to mobile phone company outlets and car wash are available which enhance the convenience of shopping at SPL stores.

Sri Lanka's retail fashion industry signalled an evolution in 2011 with the entry of selected international fashion brands to the local market. Whilst this only marginally changed the dynamics of the market, it signalled that Sri Lanka's retail industry was maturing. In all probability, the entry of international brands to the market is as a result of the growth in tourism as well as an increase in consumer spending. As the CEO of SPL, Sandra was happy to express that her company was able to grab the opportunity provided by the economy of Sri Lanka.

Sri Lanka’s GDP grew by around 7% in 2014 compared to an average growth of 6.3% in 2013. The per capita GDP reached USD 3,000 in 2014 from USD 2,900 in the previous year. The tourist arrivals reached 1.5 million in 2014, a growth of 30% from the preceding year with earnings from tourism recording an average of USD 1.7 billion. The average spending per tourist per day in 2014 increased to USD 156.5 from USD 103 in 2013. These developments in the macro environment had a beneficial effect on the top line of SPL.

Yet other trends have also started to indicate that the industry is evolving. From a design perspective, Sri Lanka has been producing a large number of fashion designers through well-established design schools. A selected few of these designers have established fashion labels and have had their collections featured at forums such as Colombo Fashion Week as well as in Asian and other international fashion events.

These trends have translated into healthy competition for SPL, and the company perceives this upsurge in talent and the entry of international brands as future promise for the industry. As an aspirational brand, Sancloth lies on the top tier and will look to add retail components to its existing business concept. The expansion strategy will continue to enlarge the marketplace by, bringing sophistication to the semi-urban markets and merging with a compatible garment giant in the field of clothing retailers. SPL will continue to focus on creating vibrancy to the online component of the business, through innovative e-commerce. The company will also continue to be one of the largest players in the domestic retail market, and its positioning as an all-round destination will continue to deliver value and assist it to stand apart in the years ahead.

Aside from domestic demand, tourism will be a key catalyst for Sri Lanka’s retail industry in the upcoming years. With the nation expecting to welcome 2.5 million tourists by 2025, it needs to have in place a sound shopping destination to cater to high-end travelers. In the last few years Sri Lanka witnessed a change in the structure of its tourism arrivals, with neighboring India generating the highest arrivals to the country as opposed to the traditional European tourists. This change in the composition of travelers will also have a marked impact on the retail fashion industry in Sri Lanka, predominantly as Indian travelers are passionate holiday shoppers.

SPL planted the first seeds of retail management in Sri Lanka and will continue to drive the industry momentum. SPL’s intention is clear. The company will lead Sri Lanka to become one of the top fashion retail destinations in the Asian region. But this is not all. SPL will also actively scout for opportunities to take this unique business concept to other international markets.

Retail operations

In instituting measures to enhance its retail operations, SPL carried out a comprehensive analysis of the processes in practice, reviewed their functionality and revised these whilst also adopting new processes and practices that are accepted as focal in the global retail industry. These changes towards retail excellence are expected to deliver results in the medium term, and will assist SPL to comfortably leverage future growth strategies.

The first emphasis therefore was to dedicate an appropriate amount of time to identify key procedures as well as the available infrastructure for maintaining those procedures and their effectiveness. Simultaneously, priority was placed on ascertaining the status of management personnel, their supervisory and regular staff as well as the relationship, responsibility and processes for corporate store operations and communication. Key projects towards retail excellence therefore targeted improvements in efficiency, productivity and standards.

A continuous training programme that is revolving and evolving defines SPL’s movement towards sophistication in merchandising. To ensure that merchandising works hard to deliver a better shopping experience, techniques such as cross merchandising, thematic and lifestyle merchandising were adopted not only to create a vivid image in-store but also to enable customers to visually put together a total look, as opposed to purchasing a single item. Efforts in merchandising therefore were essentially geared towards customer service enhancement through suggestive selling.

Maintaining customer service excellence has always been a priority; during the year 2014, specific standards were instituted to promote extraordinary customer service. Towards this, training guidelines were formalised and numerous training programmes were conducted while customer service champions were identified as a motivational tool to push the retail staff with regard to customer service.

In furthering customer service, greater communication was fostered across all key areas. Monthly store manager meetings, regular store visits, monthly visual merchandiser meetings and the availability of new financial reports for managers have helped enhance the visibility of core areas for management focus each month.

The revenue of SPL reached Rs. 4.5 billion in 2013/14 which is a growth of 16% from the previous year. The rising per capita income and increasing tourist arrivals are key determinants of this growth. The net profit for the year 2013/14 at Rs. 113 million is an 18% reduction from the previous financial year. The increased costs of operation, profit margin reduction due to VAT and the adjustments made to reflect the impact of LKAS/SLFRS were the main contributors to this (Annexure 1).

Even though the company performance was fairly manageable over the last few years, the CEO was concerned about some audit matters relating to the purchasing system in the business. Several negotiations took place in the business meetings regarding the matter, and some senior managers had the view that the 18% decline of profit was due to the inefficiency of the retail operation system. Accordingly, the CEO appointed one of the senior internal audit managers Mr. Darmawardana to obtain his opinion on the facts relating to the possible frauds or misappropriation of company assets in the purchasing system. Accordingly Mr. Darmawardana agreed to produce a report to the CEO with detailed information within a week.

The future of Sancloth (Private) Limited

The CEO is more concerned about the future strategies of the company as the founder of the growing business. Recently she had an important discussion with the senior management of SPL about the future prospects of the business. At the meeting it was decided to gather information about possible business alternatives to improve the company's sustainable business growth to compete with the market. Most of the senior managers of the company had the view that in the future the garment industry will have high competition, and cost efficiency will provide a competitive advantage for growth. At the meeting, one of the senior managers stated a possible business opportunity suggested by a senior executive of SPL relating to a competitive business in the market. Knitny Mills (Private) Limited (KML) is searching for a prospective business partner to sell their business or to merge with. An informal discussion between the senior executive of SPL and a manager of KML had revealed that a conflict exists among the family shareholders of KML. Further the senior executive had gathered information regarding KML and the industry, the company's performance and financial position. The following report was submitted at the meeting held.

To: Chief Executive Officer
From: Senior Manager

Dear Madam,

Knitny Mills (Private) Limited (KML) is a limited liability company incorporated and domiciled in Sri Lanka. The company's principal activities and nature of operations is the manufacture of knitted fabric.

The 2013/14 financial year ended with a net loss of Rs. 356 million; an improvement of 57% over the loss recorded in the previous financial year. This improvement in performance was due to a steep drop in both the provision for slow moving inventory and impairment of assets year on year. In addition, cost minimisation strategies and reduction in production wastage, contributed to show a positive trend, thereby reducing the net loss.

The Sri Lankan apparel industry performed well over the last few years, recording the highest export revenue despite challenges such as the Eurozone debt crisis. The apparel industry was on a revenue target of USD 4 billion by the end of March 2015, but it has come closer to that target much earlier than planned. Apparel exports increased by 34% to European countries and by 22% to the United States in the year 2013/14.

Company performance

KML posted a turnover of Rs. 4,419 million in year 2013/14, which was a little lower than the turnover of Rs. 4,593 million in the previous year. The reduction of the net loss in 2013/14 was a culmination of several initiatives that were taken during the year. Cost reduction and waste minimisation were some of the key elements of this loss reduction. The controls exercised on inventories and debtors minimised the provisions on slow moving stocks and debtors. The first two quarters of the year 2013/14 showed substantial growth in sales and reduction in losses. Despite the utility cost increase, mainly due to price revisions on furnace oil (which increased cost by 6% in the first quarter of year 2013/14), KML has managed through energy saving initiatives to keep costs down since they could not pass the cost increases to the customers as customer prices are frozen with end buyers. In the last quarters of 2013/14, the company faced a drop in sales from the planned quantities mainly due to unexpected seasonal variations whereby projections made by key customers did not materialise into orders. The reduction in revenue contributed to the increase in operating loss in the last two quarters.

Future prospects

With the aim of making the company profitable in the coming years, several initiatives were taken in the year 2013/14 and are to be taken in the years ahead as well to strengthen the financial stability. The company focused on its customer base and made changes to build relationships through enhanced service levels, such as maintaining lead times with better quality levels to ensure that orders will be placed by monitoring performance levels. The product mix offered was widened with more focus on cotton blends. It was imperative that the company focused on re-building customer confidence as a key strategy to meet the overall objective of profitability. The company is fully operational with the new system and controls and reports are managed using the same. Time-to-time updates are done on user requirements to improve performance of output. There have been encouraging improvements but less than industry standards. A technical team from China, comprising of 4 members, has been employed since the third quarter of 2013/14 and they are working closely with the Sri Lankan team in imparting their knowledge and expertise. The teams have over 20 years of experience in the field of dyeing and finishing of knitted fabric and have experience working in renowned companies in the textile industry. KML is confident that the Chinese team can improve the operational efficiency to industry standards.

Staffing levels and productivity improvements were another key focus. Changes made in staffing levels led to demonstrations and disruption to operations in the first quarter. However these were managed and settled within a few days and the company is back into operation with a focus on several areas of activity to bring about greater cohesion.

Energy saving initiatives, especially with the high cost of electricity, and many other cost reduction initiatives are now being planned to mitigate the large impact on the company's electricity costs, which cannot be passed onto customers. Another key area of focus in the ensuing year will be the reduction in process wastage and focusing on procurement methods of raw materials to take advantage of bulk buying based on projections.

Extracts of the financial statements of KML are given below.

Knitny Mills (Private) Limited

Income statement

	Rs. million	
For the year ended 31 March	**2014**	**2013**
Revenue	4,419	4,593
Cost of sales	(4,162)	(4,445)
Gross profit	257	148
Other operating income	30	-
Administrative expenses	(388)	(736)
Selling & distribution expenses	(70)	(54)
Operating profit/(loss)	**(171)**	**(642)**
Finance expenses	(145)	(106)
Profit/(loss) before taxation	**(316)**	**(748)**
Income tax expense	(40)	(79)
Net profit/(loss) for the year	**(356)**	**(827)**

Knitny Mills (Private) Limited

Statement of financial position

	Rs. million	
As at 31 March	**2014**	**2013**
Assets		
Non current assets		
Property, plant and equipment	935	1,074
Total non current assets	935	1,074
Current assets		
Inventory	763	942
Trade and other receivables	243	179
Cash and cash equivalents	363	186
Total current assets	1,369	1,307
Total assets	**2,304**	**2,381**
Equity and liabilities		
Equity		
Stated capital	1,356	654
Other reserves	234	231
Retained earnings	(885)	(531)
Total equity attributable to the equity holders of the company	705	354
Non current liabilities		
Interest bearing loans	580	527
Other non current liabilities	121	128
Total non current liabilities	701	655
Current liabilities		
Trade and other payables	784	851
Other current liabilities	114	521
Total current liabilities	898	1,372
Total liabilities	1,599	2,027
Total equity and liabilities	**2,304**	**2,381**
Number of shares (millions)	113	54.5

Annexure 1

Sancloth (Private) Limited Income statement		
	Rs. million	
For the year ended 31 March	**2014**	**2013**
Revenue	4,533	3,910
Cost of sales	(2,800)	(2,339)
Gross profit	1,733	1,571
Other operating income	9	3
Administrative expenses	(1,263)	(1,040)
Selling & distribution expenses	(231)	(230)
Operating profit/(loss)	**248**	**304**
Finance expenses	(161)	(111)
Finance income	91	3
Profit/(loss) before taxation	**178**	**196**
Income tax expense	(65)	(59)
Net profit/(loss) for the year	**113**	**137**

Sancloth (Private) Limited Statement of financial position		
	Rs. million	
As at 31 March	**2014**	**2013**
Assets		
Non current assets		
Property, plant and equipment	2,051	1,594
Other non current financial assets	409	404
Total non current assets	2,460	1,998
Current assets		
Inventory	1,205	1,055
Trade and other receivables	180	191
Amounts due from related parties	62	46
Other current financial assets	2,009	19
Cash and cash equivalents	115	23
Total current assets	3,571	1,334
Total assets	**6,031**	**3,332**

Equity and liabilities		
Equity		
Stated capital	2,796	251
Other reserves	953	443
Retained earnings	770	749
Total equity attributable to the equity holders of the company	4,519	1,443
Non current liabilities		
Interest bearing loans	462	301
Other non current liabilities	33	56
Total non current liabilities	495	357
Current liabilities		
Trade and other payables	515	404
Amounts due to related parties	206	145
Other current liabilities	296	983
Total current liabilities	1,017	1,532
Total liabilities	1,512	1,889
Total equity and liabilities	**6,031**	**3,332**
Number of shares (millions)	272	145