

Copyright Reserved



KC5 – Corporate Strategy and Contemporary Issues
December 2015

Pre-seen Case Study Material

Colombo Trading and Industries (CTIL) Group

The beginning of a long journey

Colombo Trading and Industries (Pvt) Limited (CTIL) is a large, predominantly trading organisation having several divisions conducting business. It mostly deals with industrial products but also supplies a few prestigious brands of consumer durables. CTIL was founded by Charlie Senadeera, the Chairman. He is a self-made entrepreneur and the fifth born of a large, prominent family in the down south of Sri Lanka. Charlie was never interested in pursuing higher studies and found a clerical position working for a commercial lawyer in Colombo. Making inroads to the world of business in the 1960s when he was in his late twenties, Charlie made a modest entry to the business world by commencing a buying and selling operation of used automobiles.

The first major breakthrough in Charlie's business life came about when he got an opportunity in the early 1970s to obtain a distributorship from the internationally renowned manufacture of rammers in the category of small construction equipment from Sweden. Colombo Trading and Industries (Pvt) Limited (CTIL) was subsequently incorporated as a private limited company. Sri Lanka's construction and road building industry was at its lowest ebb during this period and the slow pace of growth ideally suited Charlie as this gave him sufficient time to gain the much needed experience as well as organise his finances. He obtained the agency rights from one of his influential friends who was utterly frustrated with the incidence of low sales as a result with economic climate that prevailed during this period and along with this takeover Charlie had to invest in the left over stocks and some collectibles. Charlie was a hard working, self-motivated individual who steadily developed relationships with construction companies. He made regular visits to personally obtain orders, supplied with minimum delays and thereby became the market leader within a short period of time. Within a year of incorporation, CTIL was awarded the distribution rights in the country for a prestigious finish brand of industrial bearings and Charlie believed his successful import record with rammers was one major influential factor behind this achievement.

Serving international principals require excellent financing arrangements with banking institutions. Operating in an environment that favour buyer power, the equipment has to be supplied ex-stock needing comprehensive packages of import finance such as letters of credit, import loans as well as local working capital facilities. With sharp business instincts, Charlie realised that the capability to obtain bank finance was essential for success in the business world. He quickly sold one of his family's ancestral properties to invest in a spacious building in the Dehiwala area with ample land for expansion. This building was to be offered as security to obtain bank funding to finance the working capital needs of the business. The move paid rich dividends as banks were quite appreciative of Charlie's commitment to his business and that enabled him to secure sufficient financial backing for his business needs in the future.

Growth, expansion and entrepreneurship at its best

With the advent of the political turnaround in 1977 came an era of enormous dynamism in economic activity. Charlie and his company CTIL was well poised to exploit this post 1977 growth era. As a businessman with a vision Charlie realised the opportunities that will come by the construction industry and the importance of distribution rights/agencies for quality construction equipment. Never hesitating to travel overseas to meet his principals, Charlie regularly attended conferences held by his foreign principals and these gatherings provided him ample opportunities to develop relationships with other reputed manufacturers. By the early 1980s CTIL had several island-wide distribution rights for several prestigious construction equipment manufacturers of European origin that were considered to be of extremely high quality. By the mid-1980s, the product range of light and heavy construction equipment included some flagship continental brands in earth-moving equipment, industrial compressors, concrete mixers, rammers and industrial bearings. CTIL initially supplied heavy construction equipment on indent basis where the customer established letters of credit from CTIL's foreign principals.

After-sales service is an important success factor in marketing industrial goods such as heavy construction equipment. This brought about the need to establish comprehensive workshop facilities. Initially, after-sales services of CTIL were provided at a rear section of the Dehiwala building that could only accommodate repair facilities for light construction equipment. Industrial bearings on the other hand do not require any after-sales facilities and is a profitable business with a high gross profit margin. Nevertheless, the customers for this product are mostly from the manufacturing industry where supply lead time is extremely crucial as any downtime results in work stoppage and idle resources. Hence customers require excellent services from their supplier in terms of stock availability with minimum supply lead time. In the field of industrial bearings, the predictability of bearing failure is extremely difficult. Effective and efficient inventory to meet required customer demand management for a bearing supplier is an extremely difficult task as the complexity is further affected by the product variety of models with many subtle variations.

In a dynamic trading environment, one of the key success factors is to develop the capability to source appropriate items that complement each other and bring about synergistic advantages. Charlie employed a few commercially savvy, experienced sales personnel to spend a fair amount of time in sourcing new products in addition to their other substantive responsibilities. This move, which had paid rich dividends in the past too, achieved yet another success when CTIL was offered the distribution rights to market a range of high quality electrical switchgear of German origin. Colombo Sales (Pvt) Limited (CSL) was incorporated in the year 1982 to handle this product range. Distributors and middlemen across the world experience slow stock turnaround when marketing construction equipment and all reputed equipment manufacturers offer supplier credit as a part of their trade terms. Constrained by access to capital markets Charlie personally negotiated two to three months of usance credit facilities for most of the items marketed under the CTIL umbrella.

CTIL by this time was also participating in most of the major government tenders for large projects such as the Mahaweli Development project. This afforded the company excellent

opportunities to market high quality construction equipment. It was also successful in being awarded many other tenders of large financial value. This mode of business not only preserved the precious working capital facilities of the company but was also quite appreciated by the foreign principals due to the high magnitudes of financial value. Charlie, a clever businessman with superior negotiating skills, earned high indent income from orders placed with the foreign principals by CTIL's customers. At this juncture CTIL acquired a business premises in Colombo that soon became the corporate headquarters of the group.

Chairman and the corporate level SBU structure: Advent of a 'holding company'

Charlie, himself a salesman of distinction, invested quite a lot of his time in building not only a layer of competent top management but also developing a persevering sales force to sell his ever growing range of industrial goods. Adam and Bernard were two senior marketing managers who joined CTIL in the early 1980s. They were able to add considerable marketing flair to the company with their network of contacts and impressive sales and marketing experience. Being a self-made man, Charlie never placed too much emphasis on paper qualifications, a term widely mentioned in the CTIL boardroom in particular when conducting interviews for sales personnel. "Experience is a tough teacher. She gives the test first and the lesson after", commented Charlie. It was an interesting quotation he had come across in the Readers Digest magazine. This philosophy seemed to be the thinking of Charlie when he decided to carry out an induction program for his two sons immediately after they completed their school education. He believed that this will give them enough opportunity to get an overall view of the diverse activities of his business. Even though he did not have any formal managerial education and qualifications, Charlie never underestimated the importance of finance as a major function in his business. This was perhaps driven by his experience of finance being a scarce resource and a limiting factor for growth in a family business of import related activities, and more importantly because of the necessity to control working capital in the form of stocks and debtors. A qualified accountant, Chohona, with some previous commercial experience was appointed to manage the company's accounting and financial responsibilities. He quickly gained Charlie's confidence and appreciation as a hardworking, disciplined and honest manager and was held in high esteem by all other managers as well.

As a visionary leader Charlie had great ambitions to grow his company into an industrial trading powerhouse in the country and was steadily on a mission to acquire one agency after another. Proving the notion "success begets success" the company Colombo Industries Limited (CIL) was incorporated in 1986 to handle heavy machinery with a range of related products such as earth-moving equipment like dozers, and compressors. CIL soon commenced importing such equipment. Since the customers demand ex-stock supply, that brought about the need to expand organisational, infra-structural, human resources and financial facilities. The award of the sole distribution rights in the country for the "Everest" brand of prestigious automobiles was yet another milestone in the development story of CTIL. The growth prospects, entrepreneurial qualities of Charlie and the top management and their many capabilities including financial strength displayed in holding and serving a range of internationally recognised industrial brands and the respective favourable references from a host of foreign principals allowed CTIL to be awarded this agency. It

became cynosure of many reputed auto dealers who aggressively competed to obtain this agency in their favour. Charlie later informed his top management that he had to undertake a personal commitment to set up a state-of-the-art workshop to repair and provide after-sales services to their prestigious clientele. CTIL acquired the spacious premises of a garment factory in Ratmalana that has got into financial difficulties, and was able to create state-of-the-art workshop facilities within a short period of time. Charlie was extremely lucky in this instance as he was able to finance this acquisition through the transfer of the previous company's financial obligations as CTIL had the financial capability with a healthy free cash flow.

With the award of the "Everest" automobile brand in 1996, and the expansion of the range of construction equipment, there was an acute need to have in place workshop facilities for "Everest" as well as the mechanical engineering needs of the ever expanding range of construction equipment. Accordingly, the Ratmalana premises was converted to house workshop and repair facility for both automobile and machinery and equipment with dedicated sections named 'Automobile workshop' and 'Mechanical and Engineering (M&E)workshop'. David, a qualified mechanical engineer with proven overseas experience, joined the senior managerial cadre in 1985 and was later promoted as director technical to oversee both these sections.

At an overseas international dealer conference, Charlie had the opportunity to meet some senior industrialists and bankers. He was intrigued by hearing the concept of a 'holding company' that seemed to be synonymous with large corporates involved with a diverse range of activities. On his return, obsessed with the holding company idea, in 2008 Charlie put forward his blueprint for a corporate structure for his business empire. After consulting his trusted legal advisor and being made aware of company law requirements and implications, CTIL was to mostly own all real estate of the group and be the wealthiest, and the shareholding was to be structured in a manner that it will control all constituting companies in the group. This requirement was to be achieved through a complex web of cross holdings between the member companies.

Charlie held ninety percent of CTIL. His wife and the two sons, Xavior and Yohan, the joint managing directors, were the remaining shareholders. With minimum operating expenses, CTIL became a very profitable and valuable company earning rental income from the constituting group companies.

Current corporate level and SBU structure of CTIL

With an excellent performance record (that exceeded the expectations of most of CTIL's overseas principals), continual interactions and regular bi-lateral visits between officials, Charlie wielded considerable power with his foreign partners and was successful in re-assigning agency rights amongst the constituent group companies. This facilitated Charlie's move to come up with a corporate level structure to his liking. Appendix 1 depicts the current corporate and business unit level structures of CTIL group consequent to the restructuring efforts that took place in 2008.

Along with the re-organisation mentioned above, both senior marketing managers Adam and Bernard were appointed as directors of CTIL and Chohona was appointed as the finance director. Chohona was also appointed as the director finance of all companies within the group whereas Adam and Bernard were appointed as directors of companies with their respective involvement.

Colombo Sales (Pvt) Limited (CSL) was established and organised into four divisions (1 to 4) to handle rammers, industrial bearings, compressors and electrical switchgear, respectively. Adam was appointed as a director of CSL to overlook all divisions of the company. Each division operated under the leadership of a senior marketing manager who managed the divisional sales manager and the rest of the sales and marketing staff.

Colombo Industries (Pvt) Limited (CIL), other than the automobile division, comprised of two divisions mostly dedicated to the categories of heavy machinery in the form of earth-moving equipment/dozer trucks in Division 5 and a range of concrete mixers handled under Division 6. As a later addition to the group's product range, the "Everest" luxury automobile brand, which occupies a special position and has added a lot of flair and image to the group, was operated under an experienced auto marketing manager in Division 7.

Chohona, a strict financial disciplinarian was always quick to spot items of inventory in divisions that carry out ex-stock sales, held beyond the corporate policy. Stock turnaround/holding period of trading items (other than spare equipment marketed by CTIL) is a maximum period of three months from the date of their respective GRN's into inventory. Chohona was unyielding when he had to approve letters of credit to import items of a particular division, when the division was holding more than ten different items of inventory beyond 120 days (4 months). He believed such pressure will instill the necessary financial discipline. The prevailing high rates of interest made holding stocks somewhat an inevitable, expensive opportunity cost. The company has put in place a fully computerised inventory management system that can help track such exceptions. The group inventory controller/head of stores functioned under the overall supervision of the finance director who always stressed his necessity to function in close co-operation with each company's finance managers for better operational efficiency and coordination.

Colombo Engineering Services (Pvt) Limited (CESL) operates under the technical director David. It consists of an automobile workshop and a mechanical engineering workshop. Charlie, a strategist with a long term orientation, always saw the positive aspects of this company and he envisaged after-sales as a key requirement when marketing expensive equipment that require specialised repair and service facilities. However these equipment had to be carefully managed with optimum spares being held, but could be turned into profit making units in addition to the strategic advantages they provide in the form of customer satisfaction and loyalty. Most of the continental brands offer comprehensive warranties as an integral part of their marketing mix and warranty repairs can present profit making opportunities if carefully managed by submitting timely warranty claims to the principals. Charlie made his commercial sentiments quite clear when he commented, "Do not worry of the reported losses of these divisions. You must appreciate some portion of processed warranty claims where we do warranty repairs are accumulated to our credit with our principals. These may be handy when we need to invest to expand into other

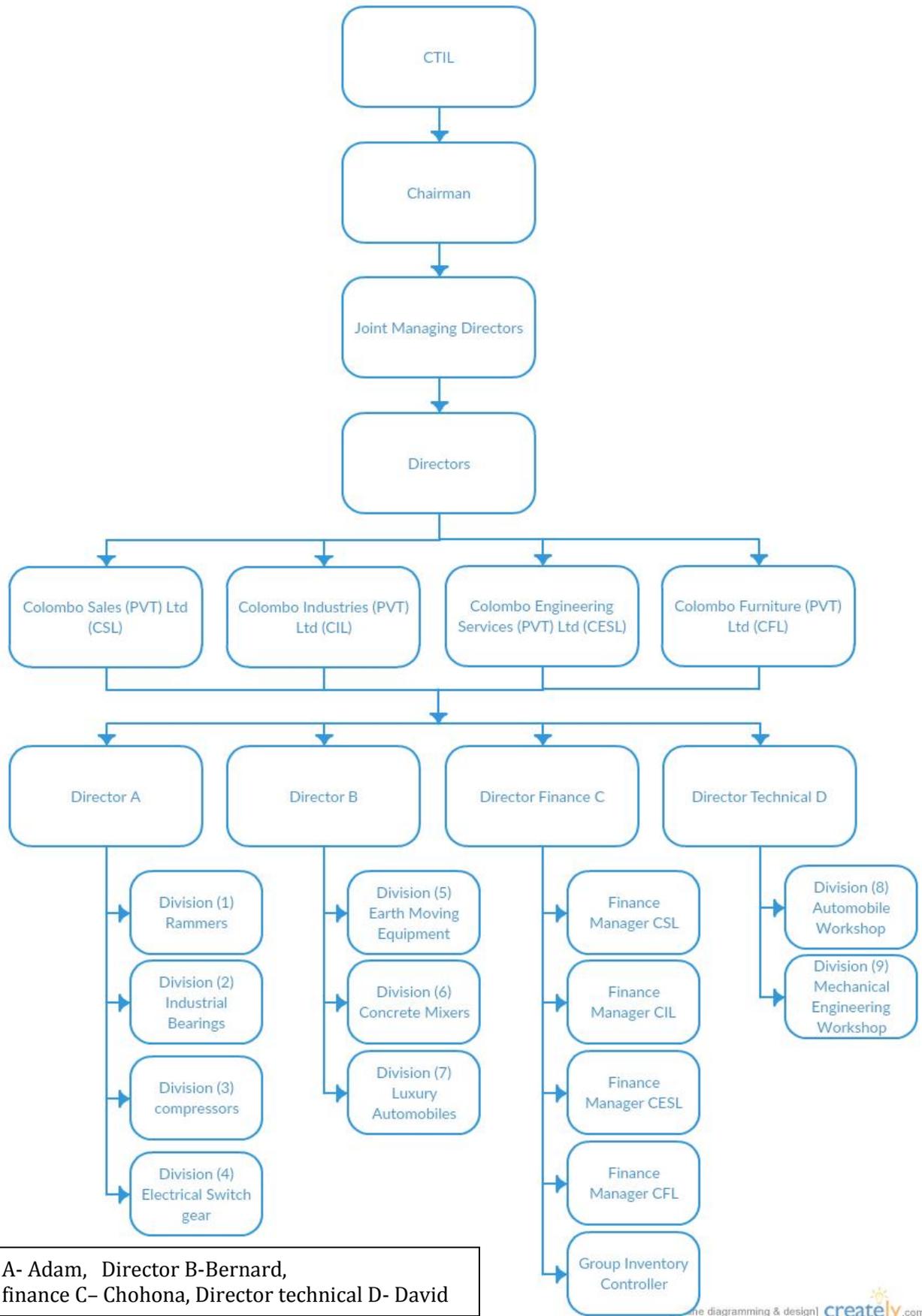
products and acquire real estate”, Charlie mentioned at a board meeting after commencing the automobile workshop of CESL. He instructed Chohona to incorporate such unremitted amounts into the management accounts of CESL presented to the directors at the monthly board meetings. On a lighter note he also winked at Chohona when commenting on possible tax advantages of accumulating such income overseas. He also mentioned the favourable impact on such divisions’ profit due to their practice of overstating warranty claims, taking advantage of the actual lower local labour costs in comparison to equivalent labour charges in the West, as the submitted warranty claims are based on higher western labour charges.

Diversification into manufacturing

Colombo Furnitures (Pvt) Limited (CFL) was the latest addition to the corporate portfolio in June 2014. It is in the business of designing and marketing a range of high quality solid wood furniture and is yet to mature as a profit making concern.

Appendix 1

Restructuring of Colombo Trading and Industries (Pvt) Limited (CTIL) and current corporate level and SBU structure



Director A- Adam, Director B-Bernard,
 Director finance C- Chohona, Director technical D- David

Appendix 2

Draft management accounts of CTIL group

Profit & loss account for the year ended 31 March		
	Rs. '000	
	2014	2015
Sales	2,121,895	2,226,951
Cost of sales	(1,623,319)	(1,687,801)
Gross profit	498,576	539,150
Administrative expenses	(154,333)	(164,923)
Selling expenses	(108,911)	(107,617)
Finance cost	(70,115)	(84,121)
Profit before tax	165,217	182,489
Income tax	(56,168)	(62,592)
Profit after tax	109,049	119,897

Balance Sheet as at 31 March		
	Rs. '000	
	2014	2015
Non-current assets		
Land & buildings	870,121	942,941
Accumulated depreciation	(60,326)	(64,982)
	809,795	877,959
Plant & equipment		
Cost	262,132	342,294
Accumulated depreciation	(196,348)	(236,521)
	65,784	105,773
Current assets		
Inventories	664,862	764,012
Accounts receivable	410,640	476,089
Cash and temporary investments	42,121	53,071
	1,117,623	1,293,172
Total assets	1,993,202	2,276,904
Equity and liabilities		
Ordinary shareholding	110,000	110,000
Retained profits	737,243	857,140
Total equity	847,243	967,140
Total long term liabilities	515,000	621,321
Current liabilities		
Accounts payable	391,609	423,112
Taxes payable	36,317	35,991
Deferred tax liability	7,710	8,120
Bank overdrafts	195,323	221,220
	630,959	688,443
Total equity and liabilities	1,993,202	2,276,904