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## **KC5 - Corporate Strategy and Contemporary Issues**

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**Pre-seen**

## **Herbz & Fusionz (Pvt) Ltd (H&F)**

Nipuna Sanjaya was born in a remote village in the Anuradhapura District in 1985. In a family of five siblings he was the eldest. His father was a practitioner of traditional medicine. They had a large garden with many precious herbs cultivated in it, which the father used in his medical practice. Nipuna's father was also engaged in the cultivation of paddy (but only during the Maha season) and his mother was a devoted housewife who struggled immensely to nourish the family with their limited income. Since his early childhood Nipuna helped his father prepare herbal medicine at home, thereby acquiring practical knowledge of traditional herbal medicine.

With his outstanding Grade 5 Scholarship examination results Nipuna secured admission to a central college near his village. There he did extremely well in his GCE Ordinary Level (O Level) examination. Having heard of Nipuna's excellent O Level results as well as his family's financial plight, an old boy of his school gave him a scholarship of Rs. 2,500 per month to complete his GCE Advanced Level (A Level) examination and also support the family. Nipuna chose to study commerce for his A Levels, which he successfully completed obtaining a high ranking in the island.

Nipuna entered the management faculty of a leading state university in the country in 2005, where again (unsurprisingly) he performed exceptionally well. His enthusiasm for sports led him to join the university volleyball team in his first year. Later he captained the university team and even represented Sri Lanka at international tournaments. Nipuna was very passionate about volleyball and attended practices almost every day. There he met three of his best friends at university: Ganesh, Madushanka and Amal. Ganesh, a student of the Faculty of Science came from an affluent family in Colombo. Madushanka, whose hometown was Badulla, was a student of Indigenous Medicine, and Amal, a Political Science student from the Faculty of Arts, hailed from Ampara.

On 27 June 2007, on their way back after volleyball practices, the four friends saw a poster about a national competition for an innovative business idea displayed on the university sports complex noticeboard. The prize money was Rs. 10 million. They were excited about this opportunity and discussed the possibility of submitting a business plan to this competition. The group decided to think over it and meet up after a week to

discuss their ideas and finalise on which one to submit to the competition. Accordingly on 2 July 2007, after volleyball practices they met up, and Nipuna (with his practical knowledge of traditional medicine acquired through helping his father prepare herbal concoctions) and Madushanka (with his academic knowledge in the area) proposed an idea for a nutrition drink made out of three locally available herbs. Ganesh and Amal agreed to their friends' idea and the four worked together enthusiastically and developed a business plan, which was submitted to the competition. Nipuna took the leadership role in this initiative, as it was partly his innovative idea and also because he had business insight by being a Management undergraduate. Madushanka was the advisor with his theoretical knowledge of the subject. Ganesh grounded them with his logical and analytical thinking when ideas became too unrealistic, and Amal was the 'writer'. After three rounds of evaluation, which included two presentations and a demonstration, their idea was chosen as the winner. The four proud friends attended the award ceremony with their families on 10 March 2008. They opened a joint fixed deposit and invested their prize money, after which they got very busy with their studies as most of them were then in their final year at university.

Upon completion of their degrees, and after much discussion, the four friends decided to put their award winning business idea into practice. They used the prize money as the initial capital to buy the required equipment and other supplies needed. In April 2009, they started producing some sample products at Nipuna's home in Anuradhapura considering the wide availability of traditional herbs in the area and the opportunity to get guidance from Nipuna's father. Madushanka also joined Nipuna in this process. In the meantime, Ganesh and Amal worked on getting the required legal and health clearances and quality certifications, as well as establishing links with potential sales outlets. During this time they realised the need for forming a company to facilitate production, packaging and distribution of the product, and formed a private limited company by the name of Herbz & Fusionz (Pvt) Ltd (H&F) on 1 July 2011. The four friends who were the only shareholders held an equal stake in the company. They also served as the directors of H&F, and managed the various functional areas of the company (Annexure 1). At this initial phase they employed an administrative assistant and a production assistant. In addition, two youths from Nipuna's village who had passed their A Level examination in the commerce stream were recruited and entrusted

to carry out the accounting work of H&F, which was largely limited to maintaining financial records and preparing basic financial statements.

H&F made a small quantity of its product every month and sold it to selected outlets and the faculty canteens of the university Nipuna and his friends attended (with the approval of university authorities). In the first few years the four friends carried this out part-time, as they were also doing separate jobs in their respective fields of specialisation.

During these early years H&F applied for a patent, which was granted in August 2013. It was valued at Rs. 1 million and taken into accounts at the beginning of 2014/15 financial year. As time went by H&F began expanding on its original idea, and decided to introduce a number of new products in the form of an array of nutrition drinks made from different varieties of tropical vegetables, local fruits and herbs. The company's product portfolio is presented in Annexure 2.

Nipuna and his friends shared the view that they would carry out business in a socially responsible manner, with as little damage as possible to the environment. H&F gradually developed, and through connections with those who were working at various establishments (mostly batchmates of the four friends), including supermarkets, the company was able to expand the locations where its products were sold. In this manner, H&F was able to make its products reach a wide market across Sri Lanka.

As business flourished the four friends left their jobs and took up working at H&F full-time in January 2015. The need was then felt to expand the production facility and move to a more spacious location that was close in proximity to suppliers (who were primarily Nipuna's contacts). Since the company anticipated future shortages in obtaining the required quantities of ingredients to meet growing demand, it wanted to develop its own herb garden. Accordingly, H&F bought a land to grow herbs, vegetables, and fruits. Funds for this purpose were provided by Ganesh's parents, by way of an interest-free loan of Rs. 2 million. The repayment of this loan is expected to commence in 2025. Further, the company decided to apply for a subsidised loan, a credit line funded through state banks for SMEs. This loan was disbursed in June 2015.

By January 2016, H&F employed 10 production assistants. Using retained earnings the company bought new machinery and further increased its production capacity. As a result H&F was able to increase its production substantially. Nipuna and Madushanka were directly involved in supervising production. Ganesh and Amal oversaw the marketing and distribution functions of the company, and recruited six employees to assist them. The duo aggressively engaged in sales promotions through social media advertising to create customer awareness of H&F's product range, and also offered attractive discounts to dealers. With substantial expenditure incurred on these promotional activities, the company was able to rapidly increase its sales. However, it failed to carry out an analysis on market intelligence, its competitors and resources. The company's financial information over the past five years is presented in Annexure 3.

During a casual conversation amongst the four directors in February 2017, encouraged by the favourable financial performance resulting from the increased volume of sales, Nipuna came up with the idea of broadening the product range and moving beyond nutrition drinks. The other three directors had different opinions on this. Ganesh highlighted the need for developing brand awareness, and went on to say, "we should first build our name more strongly in the customers' minds with our current products before thinking of new things". On a similar note Amal said, "we need to go slow and steady, what's the hurry"? However Nipuna wanted to rapidly expand the business spectrum and was confident of his new idea. Madushanka was neutral on this topic.

Following these discussions, by mid-2017 sales from the existing product portfolio of H&F continued to soar, and management of the business understandably became difficult. The two assistants handling the accounting work of the company were struggling to cope with the increased workload, and as a result in December 2017 H&F recruited one accountant (Dilhan Jayaweera) and one finance executive (Namali Peiris). Together they all carried out the external financial reporting work of the company as well. At the outset, the overall responsibility for accounting was vested in the hands of Nipuna, given his higher education in the field of Management. However, he was now preoccupied with his new-found passion for taking the company to greater heights by expanding the business. He therefore placed minimum effort on supervising the accounting and finance division. Amidst the increasing sales volumes, the limited

number of employees engaged in the accounting and finance division did not have sufficient time to devote to management accounting work, as well as scanning of the external environment and planning for the future. Although the other three directors expected Nipuna's technical expertise to be fed into the development of the accounting system of the company, this did not happen to their expectations. Since Nipuna was a management graduate, the other three directors also agreed that any employee grievances should be brought to his attention too. However Nipuna paid scant attention to this area.

In the meantime, the company was approached by Mr. Rama Balachandran. He was an Indian vendor of ERP solutions, which included modules on accounting systems as well as dedicated modules for competitor intelligence and corporate planning. Although the idea of having an ERP solution was appreciated by the directors, no decision was made on how to proceed with it.

By the end of 2017 the company had a workforce of 30 employees, spanning operations and non-operations. The workforce mainly included interns from local universities and vocational training institutes. Nipuna always maintained his ground on the fact that he did not want to recruit any more managerial level staff. Anyone above factory floor supervisors were not employed. He thought that hiring low-ranked employees was a good way of keeping salary costs down. In addition, he was not comfortable delegating authority to his subordinates.

Employees displayed their displeasure with Nipuna's management style. Labour turnover was on the rise, with H&F losing a number of its committed employees. The repercussions of dissatisfied employees were thus beginning to be felt by the company; although it was ignored by Nipuna, who had bigger plans in mind.

In December 2017, at the annual general meeting (which was followed by a party) of the Old Boys' Association (OBA) of the university the four H&F directors attended, Ganesh met one of his past batchmates. Through him Ganesh got to know of a trade exhibition to be held in Tokyo on 15 February 2018. Ganesh was very excited about it and brought it to the attention of the other three directors. As soon as Nipuna heard about it he too became very enthusiastic and thought it would provide a good opportunity for H&F to

venture beyond the shores. Madushanka and Amal did not appear impressed, but after a discussion between all the four directors it was decided that Nipuna and Ganesh would attend the exhibition. They got ready in a big way. Nipuna organised samples of their various products, whilst Ganesh got promotional brochures printed. Once in Tokyo they approached several participants at the exhibition with their products, and were particularly able to establish relations with Mr. Katsui Watanabe. He was a supplier of beverages to supermarkets in Japan and showed a keen interest in H&F's products.

Motivated by the overseas visit and the possibility of expanding sales in time to come, Nipuna called for a meeting on 28 March 2018 with the other three directors in order to discuss future plans. However the meeting took an unexpected turn as some of the directors had different views on what they desired in terms of the company's future. Nipuna took the forefront in presenting his aspirations. Following the visit to Japan and the initial contact established there, Nipuna and Ganesh were both eager to take the company to the next level by exporting products to Japan. With his desire to 'grow big' Nipuna went on to say, "I think with this new contact our company can make a name not only locally, but also internationally. After that, based on our experience in exporting to Japan, we can also look at other overseas markets. Nowadays all over the world people are having busy life-styles and income levels are also rising, so I think ready to drink products will be welcomed". In contrast, Amal was adamant that the company should further develop its local market share before considering global opportunities; he also reminded others that the beverage market is rather competitive, and culturally different countries will prefer certain flavours, stating, "I am not sure whether we can cater to such variations". Madushanka agreed with Amal too. This matter was discussed and debated over several meetings, but a consensus was hard to reach. However, subsequent to a heated argument, Madushanka and Amal reluctantly agreed on the company going global.

A few months later in June 2018, a global beverage giant Fruchtsaft, based in Europe but with a presence in Asia, entered the Sri Lankan market with its products. This took H&F by surprise because until then it did not envisage any danger from competitors. Sales started to decline as customers moved to the competitor's products, which was a renowned brand for beverages. The directors began to realise that the promising future of the company was now under threat. A special board meeting was thus called on

25 January 2019 for Nipuna to discuss the current situation of the company. The accountant Dilhan was also invited to attend this meeting. At this meeting Nipuna presented sales summaries of the company relating to the past nine (09) months, which validated the observation of declining H&F sales.

During the deliberations Nipuna urged the other directors to revisit his earlier idea of broadening the product range beyond nutrition drinks. Clarifying further he explained the possibility of producing other forms of herbal products such as toothpaste, balms, lotions and creams in order to broaden the customer base and regain the lost momentum in performance. Given that H&F has made a name in the business circle as an innovative and quality conscious manufacturer through its careful attention to the selection of herbs and preparation of products under stringent quality controls, Madushanka raised concerns whether they can maintain their high standards by moving to other forms of herbal products.



## Annexure 1: Director profiles

Nipuna Sanjaya	Nipuna is the managing director of H&F and holds a bachelor's degree in Business Management. He previously worked as an assistant production manager at a leading FMCG company. In addition to overseeing the operations of H&F he also oversees the accounting and HR functions of the company. Nipuna enjoys novelty and experimenting with new product ideas.
Ganesh Selvarathnam	Ganesh is the marketing and sales director of H&F and holds a bachelor's degree in Chemistry. He previously worked as a chemist at an agro-chemical firm. Currently he is reading for a postgraduate qualification in Marketing. During his leisure time he plays chess. He was the captain of the chess team at university, and now coaches the university chess team.
Amal Kumara	Amal holds a bachelor's degree in Political Science and is an attorney-at-law. He previously worked as a legal officer at a private bank. Whilst acting as the company secretary of H&F he also assists Ganesh with the sales and marketing activities of the company. Amal takes pleasure in writing short stories and has won awards for his literary work at national level. He was actively involved in student politics and was the secretary of the Student Union during his undergraduate days.
Madushanka Indrajith	Madushanka is an ayurvedic medical doctor. He previously worked as a practitioner at an ayurvedic hospital. He heads the operations arm of H&F as the operations director and oversees the production process along with Nipuna. Madushanka enjoys camping and hiking, and was the president of the Environment Conservation Society at university.

## Annexure 2: Product portfolio

Herbal blend	Fusion of 3 local herbs
Tropical blend	Fusion of a tropical fruit, a vegetable and a herb
Spicy blend	Fusion of a fruit and a herb, mixed with spices
Green blend	Fusion of 2 herbs and a vegetable
Fruity blend	Fusion of 2 local fruits and a vegetable

\* All products are ready to drink, and available in 250ml bottles.

### Annexure 03

Summary of income statement (for the year ended 31 March)					
	2015	2016	2017	2018	2019
	Rs.	Rs.	Rs.	Rs.	Rs.
Sales	3,050,000	5,000,000	5,920,000	6,332,000	5,664,000
Less: Cost of sales	(1,220,000)	(2,250,000)	(2,723,200)	(2,406,160)	(2,265,600)
Gross profit	1,830,000	2,750,000	3,196,800	3,925,840	3,398,400
Less: Expenses					
Salaries	(850,000)	(1,250,000)	(1,560,000)	(2,180,000)	(2,650,000)
Office utility bills	(120,000)	(135,000)	(155,000)	(160,000)	(170,000)
Depreciation	(60,000)	(110,000)	(120,000)	(130,000)	(130,000)
Amortization of patent right	(50,000)	(50,000)	(50,000)	(50,000)	(50,000)
Advertising expenses	(25,000)	(60,000)	(90,000)	(500,000)	(110,000)
Distributing expenses	(50,000)	(135,000)	(205,000)	(210,000)	(200,000)
Finance cost	-	(100,000)	(90,000)	(80,000)	(70,000)
<b>Net profit</b>	<b><u>675,000</u></b>	<b><u>910,000</u></b>	<b><u>926,800</u></b>	<b><u>615,840</u></b>	<b><u>18,400</u></b>

Summary of the statement of financial position (as at 31 March)					
	2015	2016	2017	2018	2019
	Rs.	Rs.	Rs.	Rs.	Rs.
<b>Non-current assets</b>					
Property, plant & equipment	6,140,000	9,030,000	9,110,000	9,180,000	9,050,000
Patent right	950,000	900,000	850,000	800,000	750,000
<b>Current assets</b>					
Inventories	1,180,000	1,720,000	1,600,000	2,100,000	2,388,000
Debtors	1,552,500	2,851,000	3,290,000	3,936,800	4,517,640
Cash at bank	<u>1,187,500</u>	<u>1,425,000</u>	<u>1,895,000</u>	<u>1,350,000</u>	<u>845,000</u>
<b>Total assets</b>	<b><u>11,010,000</u></b>	<b><u>15,926,000</u></b>	<b><u>16,745,000</u></b>	<b><u>17,366,800</u></b>	<b><u>17,550,640</u></b>
<b>Equity</b>					
Stated capital	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000
Retained earnings	975,000	1,885,000	2,811,800	3,427,640	3,446,040
<b>Non-current liabilities</b>					
Loans and borrowings	-	3,000,000	2,800,000	2,600,000	2,400,000
<b>Current liabilities</b>					
Creditors	20,000	711,000	753,200	949,160	1,284,600
Outstanding payments	<u>15,000</u>	<u>330,000</u>	<u>380,000</u>	<u>390,000</u>	<u>420,000</u>
<b>Total equity and liabilities</b>	<b><u>11,010,000</u></b>	<b><u>15,926,000</u></b>	<b><u>16,745,000</u></b>	<b><u>17,366,800</u></b>	<b><u>17,550,640</u></b>