CONFIDENTIAL

UNIVERSITI KUALA LUMPUR BUSINESS SCHOOL

FINAL EXAMINATION

JANUARY 2016 SEMESTER

SUBJECT CODE	:	EAB 41403
SUBJECT TITLE	:	INTEGRATED CASE STUDY
LEVEL	:	BACHELOR
TIME / DURATION	:	2.00 PM - 5.00 PM / 3 HOURS
DATE	:	25th MAY 2016

INSTRUCTIONS TO CANDIDATES

CASE STUDY

1. **China Dolls.**
2. **Safiyya Sdn Bhd.**

THERE ARE TWENTY SIX (26) PAGES OF CASE STUDY, EXCLUDING THIS PAGE.

Case No. 1: China Dolls

Jeffrey Cheong picked up the folder marked "URGENT", which his secretary had just placed on his table and looked at its content. The folder contained letters from two of his major clients, KiKi and Houida. Both KiKi and Houida, two European fashion houses, were Haute Couture Fashion Berhad (HCF)'s first customers and have been with HCF since its inception. They were writing to Jeffrey to inform him that they may be looking to China to "contract manufacture" for them as the prices there were very competitive.

Jeffrey stared out of his window in contemplation. He was in a dilemma. Loss of its two major clients would be disastrous to HCF. As it stood, HCF had been experiencing falling margins and profits over the last few years as evidenced in the financial statements enclosed. Loss of Kiki and Houida would mean that HCF would then be incurring losses.

As soon as his other clients heard of this new development, they too would be taking similar steps. Jeffrey realised he had to review his strategy quickly if he wanted to retain the present clientele. He knew the inevitable. During the late 1990's and into the early 21st century, China had made inroads into the textile industry and was forecasted to grow further. Following the relaxation of trade barriers, many of the European and American fashion houses were looking at importing clothes from China at very low prices. This was mainly due to its low operating costs. This had a massive negative impact on many companies operating at higher costs and based elsewhere. The previous adverse perception of "Made in China" labels had slowly changed as China now manufactured clothes that are higher quality at substantially lower operating costs.

If Jeffrey wanted to survive in this industry, he too must consider moving his operations to China.

Haute Couture Fashions Bhd (HCF)

Houte Couture Fashions Bhd was established in the 1974 by the Tan family. Tan Boon Kheong, the patriarch of the Tan family was a skilled master cutter, trained by British cutters in 1950s in Penang. He ran a small but successful business tailoring men's clothing in Argyll Road, Penang until his retirement in 1980.

Peter Tan, the oldest son of Tan Boon Kheong, initially under his father as a young 17-year-old but after three years left for Europe as he was interested in creating for both men and women's fashion, rather than merely tailoring men's suits and pants. His sojourn in Europe saw him training at Yves St Laurent and Gucci. He had a keen eye on women's silhouette and soon established himself as a talented designer. Many of the fashion houses were happy to employ him into their team. He returned to Malaysia with a wealth of experience, eager to put his newly acquired knowledge into use. His return to Malaysia coincided with the trend of European clothes' manufacturers looking at Asia for outsourcing. Peter saw this as an opportunity to kick-start his business venture, especially with his contacts with the European fashion houses.

HCF started out as a family owned business with all of its shares being held by the Tan family. Peter prepared to bid for contract manufacturing deals with the European fashion houses. With the help of his contacts and excellent track record with the fashion houses, he soon managed to convince three of them to sign outsourcing deals with him. These fashion houses were keen on doing business with the people known to them as they set-off their new venture.

HCF's Growth

HCF started its first fully equipped factory in Penang in November1974. Under Peter's helm, HCF very quickly established itself as a high quality manufacturer of both men's and women's clothes. It had no difficulty meeting the demand of the fashion houses as Peter had recruited several European-trained Malaysian designers to join his team.

By late of 1970s, HCF's turnover had reached RM10 million. Over the ensuing five years since its inception, HCF had managed to add two more European fashion houses into its customer base. HCF's talented designers were providing inputs toward the development of the ready-to-wear designs and were well received by the fashion houses. HCF was now faced with a problem. The factory located in Penang was no longer big enough to cope with the production capacity. Peter quickly sourced a large plot of land in mainland Penang - Butterworth and began building a new and much larger state-of-the-art factory to cater for the growing demand.

In July 1980, HCF opened its new factory in Butterworth. Peter, then the Managing Director of HCF, decided not to shut down the Penang factory but operated both factories. HCF then employed between 80 to 100, mostly tailors in the Penang factory, while the Butterworth factory employed about 300 employees.

HCF continued to experience growth in sales throughout the early 1980s to mid 1990s, charted annual sales of around RM100 million. Its customer base had also increased, drawing in customers from Europe as well as America. Profits were also riding high. HCF opened two more factories. In 1990, it opened its third factory in Jitra, Kedah. The factory had a capacity of producing 1 million garments a year with a strength of 300 employees. In 1995, due to even increasing demand for its clothes, HCF decided to open its fourth factory with a production capacity of 2 million garments a year. This time, it looked to Thailand, as labour was very cheap. HCF set up a wholly owned subsidiary Haute Couture (Thailand) Pte. Ltd to operate the Chieng Mai based factory. It recruited about 500 employees.

In 1997, Malaysia was facing financial crisis, with foreign exchange market volatility being the main issue. Manufacturers with foreign customers were unable to honour their contract price as exchange rates fluctuated. HCF was caught unaware. HCF had to tender for a contract six months before the delivery of the consignment. Fluctuation in the exchange rates made it impossible to predict the cost of material that HCF had to purchase form the fashion houses. HCF found itself selling its garments at very low margins for the very first time. 1998 saw HCF suffering its first loss since its inception. Many of its competitors also suffered losses and some even had to cease manufacturing. In a bid to survive the financial tsunami that had hit Malaysia, Peter Tan consolidated HCF's position by deciding to cut operating costs. HCF's major cost apart from the cost of imported material was labour cost. Peter Tan made the decision to shut down the Penang factory, much to the dissent of his father. HCF was still able to meet the demand while still operating the other three factories in Butterworth, Jitra and Chieng Mai. He also decided to shift as much of the production to Chieng Mai, as the labour cost was a quarter of the labour cost incurred in the Malaysian factories. Moreover, HCF was facing labour shortage problems in Malaysia, as many of the labour force were moving to the cities for better prospects. As a result of this consolidation exercise, about 300 of HCF's employees were made redundant, many of whom had been with HCF since its inception.

Over the next few years, its profitability increased gradually and HCF slowly pulled itself out of the loss making situation. HCF managed this difficult feat because of its customer base as well as its reputation for high quality clothes, which commanded premium prices with its customers. The financial crisis had not affected Europe much, and as such, demand for the clothes continued.

HCF's Contract Manufacturing Structure

The contract manufacturing deals signed with the European fashion houses were such that the designs were provided by the fashion houses and HCF had to adhere to the designs when producing the respective labels. The fashion houses welcomed suggestions from HCF's designers but were particular that the designs were not crossed between the various labels that HCF was producing. Cross producing design between labels would be disastrous for HCF as it would immediately lose the contract for the labels involved.

Further, the European fashion houses would supply the material for the clothes as they wanted to maintain the quality of the output. HCF purchased the material, sourced for appropriate accessories locally and produced the clothes. The fashion houses would contract for "a specific quantity of a specific design at a specific quality" to be delivered at a specific time. Any variation outside the contract stipulation would have to be borne by HCF itself.

Usually, the contracts were for delivery of clothes one season ahead. This meant that summer's design clothes would have to be delivered by the beginning of spring. HCF would sell the manufactured clothes at a contracted price. The fashion houses allowed HCF to tender for the contract price based on the design, quantity and price of material supplied. The contract tendering process usually took place about six months before the due date for the delivery of a season's batch.

HCF's Customers

HCF manufactured ready-to-wear clothes for a number of European and American fashion houses. Its clothes were well-sought after for its modern designs and high quality finishing. HCF's customers have remained loyal over the last three decades, although its major coup was the securing of 2 major American fashion houses as its customers within the last 5 years. All of HCF's clothing was manufactured under the customer's own label.

The customers of HCF can be analysed as follows:
(2008 figures)

CUSTOMER	TURNOVER (RM million)	SALES (%)
Kiki	32.0	26.7
Houida	21.0	17.5
McCaffery	17.4	14.5
Jesse	9.4	7.8
Freuline	8.3	6.9
Elegance	11.3	9.4
TommyH	8.0	6.7
Balli	6.5	5.4
Zubri	6.1	5.1
TOTAL	**120.0**	**100**

HCF's Shareholders

HCF was successfully listed in early 2007 and at the end of 2008, its shares were held as followed:

SHAREHOLDER	SHAREHOLDING (%)
Tan Boon Kheong	19
Peter Tan	25
Daniel Tan	10
Elaine Tan	5
Beverly Tan	5
Elvis Lee	3
Lee Teck Choon	2
Andrian Lim	2
Employee-held shares	4
Public-held shares	25
TOTAL	100

The company had 57 million shares in issue at a par value of RM1 each. The share price at the time of floating was RM2.50 per share. Market price as at 31st December 2008 was RM1.80 per share.

HCF's Board of Directors and Key Personnel

Board of Directors

Tan Boon Kheong – Founder, Chairman and first Managing Director

Tan Boon Kheong was the founder chairman of HCF Bhd. He started the company as a business venture for his son, Peter, who had return from Europe as a newly qualified designer. He retired as Managing Director in 1980 but kept a close personal interest in the company he founded with his hard-earned money. The Board of Directors still looked upon him for valuable advice in managing the company. He still retained his 19% and was a director of the company.

Peter Tan – Current Chairman

Peter Tan, the oldest son of Tan Boon Kheong was the brains behind the success of HCF. As a newly trained designer in the 19700s, he was the inspiration behind the setting up of HCF. With his contacts with the various fashion houses in Europe, he managed to secure good contracts for HCF. HCF grew from strength-to-strength under his leadership. He took over from his father as Managing Director/Financial Controller in 1980 and continued to lead HCF until his retirement in early 2009. He still sat on the Board of Directors as the Chairman. He held 25% shareholding. He was also the Managing Director of the Thailand operations.

Daniel Tan – Financial Controller

Daniel Tan was the youngest of the Tan children. He had held the position since 1990, when he returned as a qualified accountant from the United Kingdom. He took over the role from his brother Peter Tan, when the latter was bogged down with too much work as a Managing Director. Prior to his return to Malaysia, he worked in the United Kingdom for one of the largest audit firms in the country. He was considered to be a whiz in finance and had a good working relationship with his brother, Peter Tan and the rest of the employees of HCF.

Daniel Tan also had a good working relationship with HCF's bankers and had helped HCF to secure and renegotiate loans and extend credit arrangements whenever needed. He was concerned about HCF's present situation in that he felt HCF would be unable to meet the situation in the same manner it faced during its previous setbacks.

Elaine Tan – Sales & Marketing Director

Elaine, sister to Peter and Daniel had worked with the company for the last 15 years. Prior to her joining HCF, she worked for a large departmental store in Kuala Lumpur as the Chief Purchasing Manager. Her role was to secure clothes for the departmental store. At HCF, she had the challenging task of maintaining a relationship with all of HCF customers – the fashion houses from Europe and America. The designers from these fashion houses were said to be very temperamental. Her time was taken up negotiating and securing contracts with these fashion houses. She now had her hands full with the present situation, trying to keep the customers from cancelling crucial contracts. She sat on the Board of Directors.

Baverly Tan – Human Resource Director

Another one of Tan sisters, Baverly had helped keep the employees at HCF happy by looking after their needs. She had introduced the employees share option scheme to enable employees to own shares in the business. This in turn had created a sense of belonging among the employees as well as enabled them to gain returns. The general working conditions had also improved tremendously. HCF had seen employee efficiency and productivity rose over the years as a result of these new employee schemes.

With the current turn of events, Beverly was concerned for the future of HCF's employees. If the threat by HCF's major customers were to materialise, the employees, most of the tailors were likely to face redundancy. Many of them had been with the company for a long time and were likely to take retrenchment very badly. She also sat on the Board of Directors.

Elvis Lee - Non-Executive Director

Elvis Lee, a nephew to Tan Boon Kheong and cousin to Peter Tan and siblings was a non-executive director of HCF. He held 3% shareholding in the business.

Lee Teck Choon – Non-Executive Director

Lee Teck Choon was a close family friend of Tan Boon Kheong. He was 75 years of age and was tailoring days in Argyll Road, Penang. He had pooled his finances and helped Tan Boon Kheong set up HCF in 1974. In return, Tan Boon Kheong gave him a 2% shareholding in the business.

Adrian Lim - Non-Executive Director

Adrian Lim, a successful businessman and qualified accountant sat on the board of several companies in Malaysia. He was brought into HCF's Board with the intention of appointing him as the Head of the Audit Committee. He held 2% shareholding in the business.

Key Personnel

Jeffrey Cheong - Managing Director

Jeffrey Cheong aged 40, was recruited as Managing Director of HCF upon Peter Tan's retirement in early 2009. A former protégé of Peter during the early days of HCF, Jeffrey had shown a lot of potential as a novice designer and more so as a leader. He was always giving valuable ideas in improving the design skills of the HCF team. He left HCF for greener pastures. He had worked in Thailand for another large clothing manufacturer for several years and then wished to return to Malaysia. Peter Tan had identified him as an ideal candidate as he felt the new blood had to be injected into HCF for its continued success. Although Jeffrey was recruited before the present crisis beset HCF, he then had his hands full trying to keep HCF afloat.

Jason Dong – Chief Designer

Jason joined HCF about 5 years ago. He was a very telented and like Peter had trained in Europe. He had worked for a top couture company in Europe prior to his return to Malaysia and was very keen in putting his newly acquired skill to use. His forte was efficiency in churning out clothes cutting with very little wastage in material. He was able to maximise material usage in the production of clothes. This was very useful to HCF as it could cut cost on material wastage.

Teoh Chin Teh – Factory Operations Director

He had worked for several clothing manufacturers before he joined HCF in 1999, when he was made redundant from his last company during the financial crisis. He was skilled in managing people, a valuable skill for HCF as many of its employees were actually on the factory floor. He had a wealth of operational experience and was well liked by the factory staff. He had successfully introduced improved working conditions and total quality management skills to the employees. He was a certified TQM operator.

Current Position

Having read the two letters form KiKi and Houida, Jeffrey quickly called for a management meeting with his key personnel to discuss possible strategies to address the situation HCF was currently facing.

During the brainstorming session, Elaine – the Sales and Marketing Director proposed that HCF considered moving its manufacturing to China. This way, HCF would be able to still retain Kiki and Houida as its customers and supply the clothes at lower prices. She also proposed that HCF shut down its existing plants in Butterworth, Jitra and Chieng Mai.

Teoh Chin Teh - Factory Operations Director, on the other hand, was not interested in closing down the Malaysian operations completely. He argued that if HCF were to completely close down the Malaysian operations, a large number of employees would have to be retrenched. Many of them had been with HCF for more than 10 years.

He suggested two alternative options. First - expand manufacturing operations to China to focus on contracts from fashion houses, while retaining the Malaysian operations to develop HCF's own label, to be marketed to the Malaysian and Asean market. Second, he suggested that HCF completely pull-out from the activity of "contract manufacturing" since the remaining customers may also pull out on hearing the news that KiKi and Houida had pulled out. He suggested that HCF concentrate on developing HCF's own label bv producing out of the Malaysian operations.

Jeffrey reiterated that no clothes manufacturer should ignore China's influence and that HCF needed to have a strategy with China. According to his research, almost 30% of the European fashion houses were then selling "Made in China" labels. If HCF were to continue retaining its current customer base, it had to consider moving operations to China. Daniel Tan was assigned to research the possibility of expansion in China. After several weeks of research, Daniel came up with the following information:

Proposal to expand to China

The management team had discussed two possible ways of expanding into China:

- Setting up its own factory in China that was large enough to manufacture clothing for its existing customers.
- Manufacture in China in a joint venture with a Chinese manufacturer.

The first option would require HCF to invest a large sum of money in China. Currently, HCF did not have sufficient funds to fund this expansion. HCF would have to look for alternative sources of funds. Therefore, this option would not be possible without the full support of the Board of Directors of HCF. Peter Tan, the current Chairman of HCF is keen with this option as he felt HCF would lose its independence should it consider a joint venture. However, the option of expanding into China on its own would require careful consideration.

Daniel's research had produced the following information:
Cost of building a factory (fully equipped) - RM15
Net present value (over 5 years) - RM6.3 million
Cost of capital used - 8% p.a.

The new factory would be able to manufacture at a similar capacity as its current operations in Butterworth, Jitra and Chieng Mai in total. The new factory would be ready in about 18 months.

The second option however, would require a much shorter period to become operational. Elaine was in favour of this option. By entering into a joint venture with an existing Chinese manufacturer, HCF would be able to service its customers in about 6 months instead of waiting for 18 months for the factory to be ready. Daniel contacted several Chinese clothing manufacturers who had large factory operations with excess capacity. After evaluating all the proposals, he short-listed Celestial Clothes as a possible partner.

Celestial Clothes has been manufacturing since 1995 for several British High-Street stores and was interested in penetrating the European market. It had already established itself as a high quality clothes manufacturer.

The joint venture proposal would be a 70/30 profit share with Celestial Clothes taking 70% stake. Both HCF and Celestial Clothes would form a separate company under the joint venture agreement. Celestial Clothes would need to build an annexure to its current factory to cater for this new venture as HCF wanted the manufacturing activities to remain separate from Celestial Clothes' existing business. The total cost of this expansion was estimated to be equivalent to RM8 million with HCF's investment at RM2.4 million.

Celestial Clothes would be able to manufacture almost one and half times HCF's current manufacturing capacity. If HCF's Board of Directors agreed to the joint venture proposal, Celestial Clothes would immediately proceed to build the annexure and began manufacturing in 6 months. Daniel had provided details of the cash flow this joint venture company would provide over the next five years. The calculations were provided in Ringgit equivalence, using forecast exchange rates.

	2009	2010	2011	2012	2013
HCF's share of Post tax inflow (RM million)	0.4	1.8	2.5	4.1	5.6

Since the joint venture proposal had a higher risk than HCF running its own operations, Daniel was proposing using a higher risk factors of 12% to evaluate this proposal. There was also a risk of the Chinese currency fluctuating against the Ringgit over the next 5 years as the forecasted exchange rates could be assured. Daniel expected the above cash flow may further be affected by a 5% negative variation if exchange rates moved over the next 5 years.

Proposal to close down HCF's factories in Malaysia and Thailand

If HCF's proposal to move to China was a reality, then it would have to consider closing down all of its other factories in Malaysia and Thailand. According to Daniel, the Butterworth and Penang factories would fetch a reasonable resale value as its equipment were only recently renewed in 2007. Moreover, HCF would be able to sell the land for a substantial profit as they were located in a fast developing area. HCF would be able to sell the factories for about RM8.5 million.

The other two factories in Jitra and Chieng Mai had very low resale value as the factories were located in rural areas. HCF would have found difficulty to sell these two factories. Its only option would be to shut down both factories. If HCF were to shut down the factories, it would have to pull down the factory located on the site. Otherwise, the factory would become a haven for drug addicts. The cost of pulling down the factories at both sites would cost HCF RM1.2 million. HCF could choose to simply board up the factories for a cost of RM200,000 but ran the danger of drug addicts breaking the barriers and entering the premises.

Apart from the above expenses, Daniel expected redundancy payments to cost around RM3.0 million at a minimum. Many of its employees had specialised skills and would have found it difficult to seek employment elsewhere if they were to be retrenched.

Manufacturing its own label for the Malaysian and Asean market

This was a fairly new area for HCF. HCF would have to work very hard to survive if it were to consider this option in isolation. If HCF were to terminate all its contracts with the fashion houses in the short-term, it was then dependent on the success of its label to survive.

Jeffrey felt the Board of Directors of HCF would be very reluctant to consider this option unless they saw a good potential in pursuing into this direction. The positive impact of considering this option was that HCF did not need to retrench all its employees. HCF could still operate out of the factories in Butterworth and Jitra, while closing down the Chiang Mai factory.

Jeffrey was concerned on the demand for HCF's own label in Malaysia and Asean region as HCF was a relatively unknown company in this region. It had always been manufacturing for the European and America fashion houses, then again under the fashion houses labels rather that under its own label. Venturing into this business would be an uphill task, creating a brand of its own. HCF would have to price its products relatively low to penetrate the market. Advertising costs would also be high as HCF created its brand. There were uncertainties present in this option.

Jeffrey felt that HCF may not have sufficient demand to sustain its existence. He estimated the uncertainties to be:

	Probability
High success	30%
Low success	70%

With the help of Elaine Tan - the Sales and Marketing Director, Jeffery developed the following targets for the next five years.

	2009	2010	2011	2012	2013
Sales Revenue (RM million)	50	70	100	130	140
Average Gross Margin (%)	28	29.5	32	33	35

Fixed costs were estimated to be RM30 million for the Malaysian factories. Advertising costs were estimated at RM2.1 million per annum. Retrenchment costs of shutting down the Chieng Mai factory was estimated at RM1.8 million.

APPENDIX A

Haute Couture Fashions Bhd's

Income Statement and Balance Sheet

(Consolidated Group Accounts)

Income Statement

	Year ended 30th September 2008 RM'000	***Year ended 30th September 2007*** RM'000
Revenue	120,000	130,000
Cost of Goods Sold	77,250	72,510
Gross Profit	42,750	57,490
Operating Costs	38,150	43,650
Operating Profit	4,600	13,840
Finance Cost	1,300	1,250
Operating Profit after Financing	3,300	12,590
Taxation	858	3,399
Operating Profit for the period	2,442	9,191

Balance Sheet

	As at 30th September 2008		As at 30th September 2007	
	RM'000	RM'000	RM'000	RM'000
Fixed Asset (net)		33,413		36,375
Current Assets				
Inventory	28,420		21,634	
Trade Receivables	43,865		39,734	
Cash/Short-term investments	376		361	
	72,661		61,729	
Current Liabilities				
Trade Payables	13,904		7,250	
Tax Payable	858		3,399	
Bank overdraft	3,058		1,643	
	17,820		12,292	
		54,841		49,437
Net Tangible Assets		88,254		85,812
Financed by :				
Paid up share capital		57,000		57,000
Share Premium Account		10,500		10,500
Retained Earning		16,254		13,812
Long Term Loan *(repayable in 2011)*		4,500		4,500
		88,254		85,812

Case No. 2: Safiyya Sdn Bhd

Safiyya Sdn Bhd is a newly established company that concentrates on affordable and stylish hijab. They offer exclusive designs of hijab called "D'SAFY". The company was incorporated in 2011 and business commenced in January 2012. The company is currently operating from its permanent premise located in Chendering, Terengganu.

Safiyya Sdn Bhd is proudly owned by Hajjah Aina Sabila, a local resident of Terengganu who has always been innovative and creative with ideas ever since she was a young girl. Using the principle of fulfilling Islam demand of covering the 'aurat', Hajjah Aina Sabila started venturing into the business of manufacturing hijab D'SAFY. Initially, the business was rather on a small scale with limited market exposure. During the first year of business, Safiyya Sdn Bhd only supplied its products to nearby muslim boutiques around Kuala Terengganu area. The business struggled during the early phase of its operation with limited resources but Hajjah Aina Sabila was able to promote her products until "D'SAFY" finally gained the interest of the public. Today, Safiyya's hijab D'SAFY can be found in almost every store in Terengganu.

Hajjah Aina Sabila has several plans for Safiyya Sdn Bhd to succeed in the future. Her vision is to see that Safiyya's hijab D'SAFY is recognised as one of the popular hijabs in Malaysia in the next five years. To achieve this, a long-term strategic plan was laid out covering the activities of the business operations for the following five years.

The first phase is crucial to ensure the success. Instead of concentrating its market share in Terengganu, Hajjah Aina Sabila had a further view of expanding its business into other states of Malaysia. With the concepts of easy, comfortable but fashionable, Hajjah Aina Sabila believes that Safiyya's hijab D'SAFY would be a big hit when introduced in other states.

At this point of time, Hajjah Aina Sabila has identified the northern region of Malaysia, comprising of Perlis, Kedah, Pulau Pinang and Perak to be its focus of expansion plan. In anticipation of future expansion, Safiyya Sdn Bhd has acquired a piece of freehold land in Kawasan Perindustrian Bebas Perai to accommodate its future factory building.

The company has an authorised ordinary share capital of 1.5 million shares with par value of RM1.00 each. Hajah Aina Sabila invested RM200,000 and her husband Haji Mustapha invested RM100,000 as paid up capital.

The process of making hijab

The followings are the processes involved in making hijab D'SAFY.

1. Cutting

The cotton cloth is cut into the form of hijab and the matching "awning" is identified.

2. Sewing

Cuts of cotton clothes will be sewn together with awning.

3. Packaging

The hijab is labeled as D'SAFY and packed into boxes.

The budget for the year ending 30 June 2017

Since Safiyya Sdn Bhd is considered a newly established company, Hajjah Aina Sabila is seriously concerned with the performance of the company. Therefore, the actual performance should not have too high of variances from the budgeted figures especially in terms of sales and production costs. Hajjah Aina Sabila pays more attention to these two areas since these are considered as the most important factors in determining the bottom line as well as the sustainability of the company. In addition, the company needs to ensure the efficiency and effectiveness of its production processes to minimise or even eliminate potential wastage. Therefore, the cost of production should be kept at a minimum and this should lead to the products being priced reasonably. By doing this, Safiyya Sdn Bhd can ensure that it remains competitive within the industry.

Safiyya Sdn. Bhd's master budget for the year 2017 reports the company's accounting period ended on 30th June each year. The expected total sales demand for the year ending 30th June 2017 is 40,400 pieces. Expected sales for each quarter are 7,100 pieces for quarter 1; 7,000 pieces for quarter 2; 18,300 pieces for quarter 3; and 8,000 pieces for the last quarter. The price of each hijab is fixed at RM38. Sales is expected to be 80% in cash sales and the balance will take an additional quarter's credit. Sales for quarter 4 in the financial year ended 30th June 2016 is RM265,000.

The closing inventory for the first quarter is 400 pieces. The ending inventory for the following quarters will increase to 150% for the second quarter and 300% for the third quarter. However in the last quarter, it will be reduced to 400 pieces. It is expected that the demand of D'SAFY is higher in third quarter because of the 'Idul Fitri celebration.

In order to produce the hijab D'SAFY, the company uses two kinds of material; awning and cotton cloth that can be purchased directly from local supplier. For the awning, the company uses Just in Time (JIT) inventory control system, the awnings are produced based on the needs of the customers. Hence awning inventory is **nil.**

Safiyya Sdn. Bhd uses direct material cost at a unit-level cost. Each hijab D'SAFY requires one (1) awning and 0.5 meter of cotton cloth. The standard cost for awning is RM4.00 per piece and for cotton cloth is RM18.00 per meter.

The closing inventory of cotton cloth for each quarter in the financial year ended 30th June 2016 is 850 metres; 1,450 metres; 2,200 metres; and 2,100 metres respectively. There was no ending inventory in the last quarter of financial year ended 30th June 2016. Purchase of awning is made using cash term. For cotton cloth, 50% of total purchase is in cash, while the payment for the remaining 50% will be deferred by one quarter. The company has an outstanding balance RM27,800 of cotton cloth for the financial year end 2016.

Direct labour budget is based on each quarter planned production. The company employs 20 workers that are directly involved in production of the hijab D'SAFY. In Cutting Department, direct workers spend 18 minutes to cut the cloth. While in Sewing Department, direct workers spend 15 minutes to sew the hijab D'SAFY. For the year end 2016, the rate per hour in Cutting Department and Sewing Department will be RM9.00 and RM7.00 respectively. Direct workers will be paid at the end of the month.

Budgeted costs for the year end 2017

Factory Overhead:	**RM**
Indirect Materials	12,150
Utilities	6,400
Electricity	28,800
Purchasing and material handling	1,200
Quality control	14,400
Supervisor salaries	18,000
Insurance:	
Sewing machine	800
Cutting machine	440
Building	5000
Maintenance	14,000
Selling and distribution overhead:	
Selling and advertising	5,100
Carriage outwards	1,200
Travelling(business)	3,000
Administrative Overhead:	
Administration wages	6,000
Directors remuneration	62,000
Staff salaries	50,000
Entertainment for staffs	3,000
Donation to approved institution	5,000
Interest on loan	11,400
Hire purchase interest	1083
Miscellaneous	4,500
Zakat	12 500
Tax	80,000
Audit fee	6,000

Saffiya Sdn Bhd allocates the common costs on the basis, ie three quarter (3/4) to the production department and one quarter (1/4) to the administrative department. The expenses that are shared by both departments are utilities, electricity, insurance for building, depreciation for building, interest on loan and maintenance.

All manufacturing overhead costs are shared equally to all quarters except for indirect material that will be allocated based on 3% from the cost of cotton cloth purchased.

Overhead cost absorbed to the cost unit based on the total machines hours of 42 800 machine hours, assuming that one unit product will need one machine hour.

All overhead cost will be settled in the month in which they are incurred.

Actual activities for the year ended 30 June 2016

The demand for hijab increases especially during festive seasons especially Idul Fitri. For the year ended 30 June 2016, the sales quantity had increased by 10% from the budgeted sales quantity and the sales quantity for the fourth quarter was 8,500 pieces. This is because women have the tendency to purchase new hijab to complement the new clothes to be worn during that festive season. Therefore, it can be concluded that the highest demand of hijab will be at its peak during festive season. In order to fulfill this high demand, the company needs to produce more which result in workers working more hours. For the current year, Safiyya Sdn Bhd had produced 44,700 pieces and the purchase of cotton cloth for the fourth quarter was at RM63,000.

Safiyya Sdn Bhd employed 20 workers who are directly involved in the production of D'SAFY. The rate for direct labour had increased to RM10 per hour for Cutting Department while the rate for the Sewing Department remained the same.

Actual Cost for the year ended 30th June 2016

	RM
Factory overhead:	
Indirect Materials	13,250
Utilities	7,600
Electricity	29,000
Purchasing and material handling	1,200
Quality control	14,400
Supervisor salaries	18,000
Insurance:	
Sewing machine	800
Cutting machine	440
Building	5,000
Maintenance	24,000
Selling and distribution overhead:	
Selling and advertising	5,100
Carriage outwards	1,750
Travelling expenses	3,500
Administrative overhead:	
Administration wages	6,000
Directors remuneration	72,000
Staff salaries	54,000
Entertainment for staffs	3,000
Donation to approved institution	5,000
Interest on loan	11,400
Hire purchase interest	1083
Miscellaneous	4,850
Zakat	12,500

Overhead cost is absorbed to the cost unit based on 44,625 machine hours, and each unit of D'SAFY requires one machine hour.

Property, Plant and Equipment

A ***Land and building***

Hajjah Aina Sabila owned a piece of land which was inherited from his father Haji Othman and the cost of the land is RM100 000. The land is located in Kawasan Perindustrian Chendering. In July 2012, the company built a factory building on the land which took about two months to complete. The construction cost of the building was RM300 000 and financed by Bank Islam Malaysia Berhad. The interest rate is 3.8% (flat rate) for a period of 25 years and the installment commenced on 11 July 2012. The building is depreciated on straight line at 5% per annum. Safiyya Sdn Bhd has also allocated one quarter (¼) of the building area to be occupied by the administration department.

B ***Machineries***

Safiyya Sdn Bhd owns two types of machineries, namely: cutting machines and sewing machines. All of these machineries were acquired on 1 July 2012. Safiyya owns 5 units of cutting machines and 20 units of sewing machines. Each cutting machine cost is RM6 000. Sewing machine cost is RM4 000 per unit. All machineries will be depreciated at 10% per annum on straight line method.

C ***Office Equipments***

These assets were acquired in February 2011 at the costs of RM5 000. The office equipment is to be depreciated on reducing balance method at the rate of 10% per annum.

E ***Fixtures and fittings***

The cost of fixtures and fittings is RM18 000 which was acquired in February 2011 and is depreciated using straight line method at 10% per annum.

Summary of assets are as follows:

Fixed Assets	Basis	Method	Rate of depreciation
Land	-	-	-
Building	yearly	Straight Line	5%
Van	yearly	Straight Line	20%
Machinery	yearly	Straight Line	10%
Office equipment	yearly	Reducing Balance	10%
Fixtures and fittings	yearly	Straight Line	10%

Additional information during the year ended 30 June 2016

The audit fees of RM5,000 for the year ended 2014 were paid in the current year. For the year ended 30 June 2016, the company provides audit fees of RM6,000.

In order to fulfil the demand, the company bought additional sewing machine (2 units) at the cost of RM4,800 per unit on 10 August 2015.

The company acquired a Pregio Van bearing registration numbers TBA 1234 costing RM75,000. The vehicle will be depreciated on straight line at 20% per annum. The van was acquired on 23 January 2016 through a hire-purchase agreement with AmBank. The company paid RM10 000 for deposit. The remaining balance is paid by equal monthly instalments for a period of seven years. The bank charges 4% flat interest rate per annum. First instalment commence on 1 February 2016. Since the date of acquiring the commercial vehicles, the company has never failed to meet the obligations of its monthly instalments when it falls due.

The expansion plan

In order to increase production and penetrate a new market, the company is considering to invest in new machinery costing RM300,000. In addition, it will require RM20,000 for installation and RM10,000 for transportation costs. Consistent with its current practices, it is estimated that the machinery will be depreciated using the straight-line method over its useful life of 10 years with zero salvage value.

To finance the acquisition of the machinery, the company has the choice to either:

a) obtain a loan of RM300,000 from a bank, or

b) invite new shareholders to the company and require them to provide the required amount, or

c) obtain a loan of RM150,000 and require new shareholders to provide the remaining amount.

The new machinery will be used in the cutting department as it will speed up the cutting process by 50%. This means that it will only take 9 minutes to cut the cloth for the hijab. The machinery will also incur maintenance cost of RM36,000 per year but will have no effect on the company's fixed cost, as well as the sewing and packaging processes.

APPENDIX 1

Safiyya Sdn. Bhd.
Statement of financial position for the year ended 30 June 2016

ASSETS			
Non current assets	**Cost**	**Accumulated Depreciation**	**Carrying amount**
Land	100,000		100,000
Building	300,000	15,000	285,000
Machineries	110,000	11,000	99,000
office equipment	5,000	500	4,500
Fixtures and fittings	18,000	1800	16,200
	533,000	28,300	504,700
Current assets			
Inventories;			
Raw materials			-
Finished goods			-
Account receivables			**53,000**
Bank			410,100
			463,100
TOTAL ASSETS			**967,800**
EQUITY AND LIABILITIES			
Share capital			300,000
Retained earning			340,000
			640,000
Non -current liabilities			
Loan-RHB			288,000
Current liabilities			
Account payable			**27,800**
Accrued auditor's fees			**5,000**
Tax payable			**7,000**
TOTAL EQUITY AND LIABILITIES			**967,800**

APPENDIX 2

Financial Ratios – Industry Average

	2016
Current Ratio	2.6 times
Quick Ratio	2.1 times
Inventory Turnover Ratio	16.8 times
Average Collection Period	42 days
Fixed Assets Turnover Ratio	0.65 times
Total Assets Turnover Ratio	0.58 times
Debt Ratio	46.8%
Interest Coverage	15.2 times
Gross Profit Margin	48.2%
Net Profit Margin	22.5%
Return on Equity	14.6%
Return on Assets	10.4%