An analysis of the financial situation marketing essay

Upon the successful completion of ACCA's fundamental level, I met the eligibility criteria of BSc Honours Programme, offered by Oxford Brookes University in partnership with ACCA for ACCA students. I had to select a topic from a vast variety of more than twenty topics to embark upon. After short listing them one by one, I decided to choose Topic 8 " The business and financial performance of an organisation over a three year period" for my research project.

There were several reasons for choosing this particular topic. Apart from my personal interest, I wanted to apply my academic learning into a real world scenario as studying F7, Financial Reporting in the fundamental level of ACCA and P2, Corporate Reporting in the Professional Level, gave me high conceptual grip of financial analysis. It would also prove helpful to me in the future as I have a strong desire to invest into Plc's through the stock exchange once I start my career as an Investment Banker.

I wanted to analyze on an organisation that operated in a highly competitive environment so that I would be able to compare its results with a competitor to see the financial and operational performance and the relation to the proposed strategy. This would also help make the report more interesting for the readers. Increasing trend in fashion, new clothing brands being introduced and the rapidly changing style sense of people, brought me to the conclusion to select an organization in the clothing retail industry.

After researching on a few of the leading brands in the clothing industry of UK, I decided to analyse the financial performance of Next Plc and to compare it with Marks and Spencers.

United Kingdom Clothing Market:

In 1992, the United Kingdom clothing market emerged from the recession of the late 1980â€²s and has continued to benefit from the renaissance of High Street spending throughout the 1990â€²s. In late 1996, early 1997, the clothing retail industry showed signs of being boosted by the continued growth in personal spending, aided most recently by the payments consumers received from the building society conversion. In order to prevent economic overheating, the United Kingdom government and its major financial institutions were keen to dampen consumer spending. This occurred with the Bank of Englandâ€²s decision to raise interest rates.

The introduction of new entrants into the clothing market and their, expansion, growth and diversification of outlets both in the chain and independent sector at all ends of the market i. e high, mid, and low were also important factors in the development of the United Kingdom clothing industry. Furthermore the retailers, revolutionized and thought to introduce new ways to sell their products. One of the popular methods was via the mail-order catalogues. This has now been super seeded by the arrival of television and Internet-based clothing outlets. There are in excess of 25, 000 clothes retailing businesses in the United Kingdom, with a combined outlet total of 45, 500 outlets.

1. 2 Company Profile

“ The Next retail chain was launched in February 1982 and the first store opened with an exclusive coordinated collection of stylish clothes, shoes and accessories for women. Collections for men, children and the home quickly followed. Next clothes are styled by the in-house design team to offer consistency of style, quality and value for money with a contemporary fashion edge.”

(Next Plc, Business Overview, The Next Brand [online])

Next Plc is a brand name in the United Kingdom clothing market for stylish, trendy men and women between 20 and 40 years of age. Menswear, womenswear, childrenswear and babywear is part ot the expansion into all the sectors of the clothing market under the NEXT brand label.

Today Next Plc employees over 30, 000 people and operates from more than 500 stores in the UK and Eire and over 170 franchise stores overseas, including Europe, Asia and Middle East. This makes Next Plc, one of the biggest High Street retailers in the United Kingdom. Over the last few years several larger format stores have opened across the UK and, in October 2005, Next opened the anchor store at the Manchester Arndale Centre with a store in excess of 80, 000 square feet.

Next Plc mainly operates through 5 basic divisions:

Next Retail operates the high street shops through more than 330 stores covering the UK and Ireland;

Next Directory is the mail order division which also contain the e-commerce platform;

Next Overseas operates retail outlets in the United States, Asia, Europe, and the Middle East through franchise agreements;

The company also provides home shopping and financial services, that make up the other 2 divisions:

Ventura runs the financial services division by providing customer services management to clients wishing to outsource their customer contact administration and fulfilment activities

Other activities include telecommunications software services and property management.

For the first time in August 1985, Next launched its interiors range of soft furnishings for the home. Following the success of this diversification and the introduction of Next directory and home shopping, later in 1993, Next Plc announced its brand strategy, of “ One Brand Two Ways of Shopping”, bringing together the common ranges across both retail and home shopping formats.

1. 3 AIMS AND OBJECTIVES OF THE REPORT

The primary aim of this report is to evaluate the business and financial performance of Next plc between, the three years ended, from 28th January 2006 to 24th January 2009.

The main focus of this report can be summarized into:

To understand Next Plc’s Business Strategy; and how it has facilitated Next Plc to achieve success.

To analyze and present financial information in a manner which will enable to evaluate the overall financial performance of Next Plc from the year-ended 28/01/2006 to 24/01/2009.

To analyze the nature of clothing retail industry and the competitive environment in which Next Plc operates, and the affects it had on the company.

1. 4 Executive Summary

” Exciting, beautifully designed, excellent quality clothing and homeware; presented in collections that reflect the aspirations and means of our customers” (Annual Report 06)

Next Plc’s aim is to provide its customers with good quality clothing at a reasonable price. According to Michael Porter, in terms of Porter’s Generic Strategies this would be more of a ‘ stuck in the middle’ position, as it is competing with the market cost leaders as well as product differentiators. However, the success of Next Plc has shown that it has successfully operated in such a mid-market position and has done very well to implement its strategy.

The overall business strategy has been successful. Despite an ongoing programme of expansion over the last few years, the company has continued to increase profits, besides the decline in 2009 due to the unstable economy of United Kingdom. It has been forced to close only four outlets due to poor performance over the past years.

The above chart shows a steady increase of 32. 3% during the years 2004 to2008. This followed brand-strengthening strategies and a new perspective in overseas development.

During the three fiscal year's ended, the performance of the group can be summarised as follows;

Turnover increased by 7. 17%

Profit before tax increased by 10. 91%

Earnings per share incresed by 32. 41%

Dividends increased by 25%

Overall the figures are not much high, but they look promising and have shown a steady improvement over the years except in 2009 when the figures declined steeply.

The group has set a target to increase its sales turnover in the years to come and increse its earnings per share, that is one of the most important financial objective. Uncertain economic outlook, rising tax rates and weakinig pound against euro and dollar may act as barriers to this target, but it is highly probable that it will be achieved, by better and efficicient stock, margins, costs, including overhead and administration cost controls.

2 INFORMATION GATHERING

2. 1 Sources used and their reasons

2. 1. 1 Primary Research

Primary research is the research in which the researcher collects original data directly about the product, market and organization by whatever means appropriate to answer the research questions i. e it is specificially related to a particular Research Project. It is data that did not exist before.

Due to the availability of sufficient information from secondary sources, I felt that there was no need of primary data. Hence, most of my work is based on secondary sources.

2. 1. 2 Secondary research

I used two main sources for the secondary research.

Library

I went through various books in the College library. I used BPP study text ‘ Success in your research and analysis project’ which gave me an initial outline, approach, and structuring for the project.

Studying the Bsc Oxford Brookes Information Pack gave me the essential information on how to go about the project.

The study texts published for ACCA examinations provided me with an array of analytical tools to use in achieving the aims of this report.

Electronic research

I mainly relied on the Internet to formulate this report, as there was vast information available on the internet, needed for this report. The various databases and search engines to collect the information I needed for the report were:

Next Plc’s website was the most important and authentic source of information. It provided me with the annual reports, company profile, its history and all the other information I needed for this report which includes the audited financial statements aswell. The website also had an archive of company news which gave me a hindsight of the more immediate matters faced by the company.

Competitor websites (for the same reasons)

Reuter’s website (http://stocks. us. reuters. com), this provided me with the financial statements of Sainsbury’s and Tesco for the past five years along with ratios of both companies and the industry averages for the current period.

London Stock Exchange website, providing details of historic share performance and relevant industry and competitor news

Using internet search engines (Google, and Wikipedia) to gather information related to Next Plc’s and the UK clothing retail industry.

Other business related databases used to obtain relevant industry and competitor news are:

Financial Times (www. ft. com)

Accountancy age (www. accountancyage. com)

Business Week (www. businessweek. com)

BBC (www. bbc. co. uk)

2. 2 Methods Used

Information gathering is a critical and crutial phase, as the whole of the research is based on the information gathered, so it should be done in an organized and systematic way.

Information access has become simpler with extensive details and volume available online and offline therefore a plan has to be made beforehand to be able to extract the relevant and accurate material in order to form a well-structured and organized report, which is easy to understand to the users of the report.

Main method I used to collect the information was to use the GOOGLE search engine. By just entering a few key words in the search bar it provided me with the links of numerious different websites, that contained loads of information, which was both relevant and irrelevant for this report,. So I went through all the information and chose the one that was relevant and necesaary to formulate this report.

I wanted to have the relevant material in hand before I actually started the report writing process. I started my research way before I actually started to write the report, so as I used to browse different websites, I bookmarked the web pages which had the relevant articles so that I would not have any problems referencing the information if I had chosen to quote it in my report. I printed the Financial Statements of Next Plc that I downloaded from its website and had also imported it into MS Excel to perform the ratio analysis on.

3 ANALYSIS

3. 1 PORTER'S GENERIC STRATEGIES

Next Plc's aim is to " concentrate on the design, quality and value of the product, together with excellent customer service and deliver". (John Barton, Chairman Next Plc, Annual Report 2009)

Michael Porter identified three generic strategies (See Appendix A) by which organizations gain competitive advantage. Porter argued that to be successful an organization should select and implement one of the strategies, i. e. either cost-leadership or differentiation. According to Porter's viewpoint Next Plc would be a classic ' stuck in the middle' whereby it is trying to compete with the Industry Cost Leaders, Primark etc. as well as the Product Differentiators, House Of Fraser

However, the overall success of Next Plc has proved quite the opposite and there exists another viewpoint that a single generic strategy is not always best because within the same product customers often seek multi-dimensional satisfactions such as a combination of quality, style, convenience, and price.

Next Plc seeks to provide its customers with fair price products without compromising on their quality and has been successfully operated in such a mid-market position.

“ When interpreted narrowly as referring to the appeal of a product to its target buyers, the proposition that firms should not be ‘ stuck in the middle’ should not be taken to imply that companies must be down-market or up-market, but nothing in-between. Such a view is belied by the evident success of companies such as Next Plc, which earn substantial economic rents in a mid-market position.”

“ PIMS (Profit impact of marketing strategy) data and other evidence shows, however, that intermediate positions are indeed profitable and are successfully exploited by many firms.”

(Michael Cronshaw, Evan Davis and John Kay (1994), pp. 19-33)

3. 2 SWOT ANALYSIS —– Next Plc

STRENGTHS

Brand Name

Niche strategy

WEAKNESSES

E-Commerce

Concentrated market

OPPORTUNITIES

Expand into EU

Marketing Opportunity

THREATS

Competitor price war

Economy

Strengths

BRAND NAME

Next Plc uses its own label ‘ Next’ to sell its products. Customers of Next associate themselves with the Next label. As they use their own brand it is easier for them to react on customers wishes and to adapt them very quickly keeping control over the quality management.

NICHE STARTEGY

Next Plc adapts a niche strategy and its main target group is between the ages of 20-40. This strategy has worked quite well over the past years and it has emerged as one of the strengths of Next Plc, designing adult fashion wear for the people between 20-40. While some of its competitors have problems to satisfy this segment, NEXT managed it very well in the past, selling their stylish products at reasonable prices.

WEAKNESSES

E-COMMERCE

Although Next Plc introduced it's online shopping in 1999 and the entire collection is available to shop from on the internet, but Next Plc does not invest a significant amount on e-commerce as its competitors do. Debenhams for example invest approximately GBP 5m on internet technology while on the other hand Marks & Spencer spend around GBP 50m on e-commerce and digital TV.

Trend of internet shopping is increasing rapidly; therefore Next Plc should reconsider their IT strategy and invest more into e-commerce to stay in the competition.

CONCENTRATED MARKET

Next operates in a highly competitive retail clothing market, therefore there is concentration of similar type of clothing manufactures, e. g. Marks & Spencer, Arcadia. This can damage Next, if competitors gain the market share or if consumers change their habits and Next does not adapt to these changes quickly.

OPPORTUNITIES

EXPAND INTO EU

More than 90% of the revenue generated by Next Plc is within the UK under the brand names of Next Retail and Next Directory. However there is an opportunity to increase the revenue and sales by expanding its operation into EU countries. Next Plc has already its operations in mainland China, Hong Kong, Romania, Sri Lanka, India, Turkey but if it expands into EU it can diversify the risk of the concentration of UK retail market and the strength of Great Britain Pound over Euro, which currently is not that high due to the recession but in future this can be a good source of income.

MARKETING OPPORTUNITY

Next plc is already running a groundbreaking mail order operation Next Directory, which was launched in 1988 with a hardback, creating the blueprint for catalogue retailing. It is ranked number one among the High Street names that offer mail order clothing. This is an effective marketing techniques added by Next Directory, i. e. the online shopping service for its targeted age group 20-40 as they have little time to do their shopping. This could be a great opportunity for Next to increase its market share.

THREATS

COMPETITOR PRICE WAR

The UK clothing retail industry is a highly competitive industry. Next Plc has over the past few years managed to compete very well and occasionally offering sale and promotions as well. However if cost-leaders retaliate this, it may have serious consequences as the business strategy of Next Plc is different to the cost-leaders, such as Primark, and it may not be able to compete with them in this area. Also indulging in a price war would mean that the quality of its products may have to be compromised.

ECONOMY

Due to the recent credit crunch, UK economy generally is facing a downturn. This has affected many industry’s including retail. This is one of the main reason for the downfall in the revenue of Next Plc in 2009.

The other worrying factor is the weakning of pound, this affects adversly to Next Plc due to its international suppliers.

According to the analysts, UK economy will improve in 2010, and bringing back the sales for Next Plc.

PEST Analysis

Political:

A stable and sound political environment is the basis for long-term decisions. The United Kingdom, as a Member State of the European Union, fulfils this prerequisite. The government has to act within a definite political framework to achieve the conditions of the European Union and this guarantees Next Plc a higher scope of economic actions.

Another advantage of the European Union is the open transfer of goods. This makes it easier for Next Plc to sell their products in the different European countries. There are no trade barriers that aggravate sales.

Economic

United Kingdom had a stable economy in the last few years but since 2008, it is experiencing one of the worst recession in the history. This has affected almost all of the businesses in the United Kingdom.

Due to this, Pound has become weaker than Euro and Dollar. This can be alarming for Next Plc, as these two are the main purchasing currencies oof the group. Secondly, due to this, foreign investments have become expensive for the group and it may become a hurdle for the group in order to expand overseas. The group now, can not exploit the favourable economic conditions of United Kingdom, when the Pound was exceedingly stong in the past few years where the group expanded its operaions the most.

Social:

The social structure has changed dramatically over the last few years. People are eager to find more convinent way to shop e. g internet shopping and shopping from home, due to the busy life and lack of time to go and shop from the retail stores.

Next's target customers are in the range of 20 to 40. People in this age group are much busier than rest and prefer to shop online, due to their interest in technology.

In order to retain this customer age group, Next Plc must need to understand the needs of people and respond immediately. This will also result in customer satisfaction and an increase in market share for the group if it tends to satisfy its customers .

Techinlogical:

The age of Internet and the reception of new media reveal a lot of potential opportunities for Next Plc to boost profits Therefore the group relies heavily on its sub-brand Next Directory, through which customers can shop online, conveniently from home or through a mail order catalogue and the products are delivered the next day. Using this method the group can react instantly to changes in behaviours of its customers.

3. 4 FINANCIAL PERFORMANCE

The activities of the company in recent years have resulted in an exceptional financial performance.

3. 4. 1 SALES REVENUE

The sales revenue of the group increased reasonablly well in the two years 2006-2008. Revenue incresed from £ 3106. 20m to £ 3283. 80m during the year ended 27th January 2007 resulting in an increase of 5. 71% and in the year ended 28th January 2008, revenue further increased by 1. 37% showing a consistant performance. This was achieved by roburst performance of Next Directory, and an effective cost control system.

” These are good results in a period of economic slowdown and are a reflection of the efforts we have made in building and improving the Next brand.” (John Barton, Chairman Next Plc, Annual Report 2008)

In 2009 the revenue of the group fell by 1. 73% from £ 3329. 10M in 2008 to £ 3271. 50M in 2009.

It was a tough year for the group, mainly because of the unstable economic conditions of UK as a whole, which began by the end of 2008 and still continues to worsen.

Another reason for the decline in the turnover was the weakening of Great Britain Pound against dollar and euro, which are the main purchasing currencies of the group.

But still the group did well to survive in these conditions and the management was pretty much optimistic about the financial conditions of the country.

3. 4. 2 PROFITABLITY RATIOS

Gross Profit Margin

The gross profit margin changed a little over the three years, this is because of the highly effective and efficient cost management of Next Plc. Revenue has increased over the years but the cost of sales hasn't changed much, proving that the group is cutting down its cost to save its customers from higher prices.

In 2009, even under the tense economic conditions, the group has managed to decrease its cost of sales by 0. 7% from £2380m in 2008 to £ 2, 363m in 2009. This became possible due to the effective supplier management and good buying terms with its suppliers, even though pound got weaker against dollar and euro, which are the two main purchasing currencies of the group and higher tax rates, Next Plc aimed at reducing its costs rather than charging its customers with higher prices.

" Their response has been excellent, working hard with our suppliers to protect our customers from unaffordable price increases and our own margins, as far as possible." (John Barton, Chairman Next Plc, Annual Report 2009)

Marks and Spencer's G. P margin was 38. 6%% in 2008 and this decreased to 37. 2% in 2009. This shows that the economic conditions were affecting everyone. But still GP margin of Marks and Spencer’s is better than Next. This is due to the increased amount of revenue generated by Marks and Spencer’s over the years from 2007 to 2009, in contrast with Next Plc.

Net Profit Margin

In 2008 net profit increased by 0. 68% from 15. 45% in 2007 to 16. 13% in 2008. This was mailny due to the increase in revenue and effective management of overhead costs. In 2009, net profit declined by 9. 3% from 16. 13% in 2008 to 14. 62% in 2009. Along with the weak economic environment and the decline in sales, another reason for this decline was the 39. 9% increase in the overhead costs since 2008. This increase in the cost was due to the overseas expansion of the operations and the investment to strenghthen the Next brand.

” We are also extending the Next Brand into new overseas markets where we believe there are opportunities to build profitable businesses. If this is successful it will bring new sources of growth over the longer term.” (John Barton, Chairman Next Plc, Annual Report 2008)

” Our goal has been to put a little of the magic back into the Next Brand through our product ranges, marketing and shopfit” (Simon Wolfson, CEO Next Plc, Annual Report 2008)

In contrast to this, the Net Profit Margin of Marks and Spencer’s is quite low as compared to Next Plc. It showed a varied trend over the three year period, being 10. 9% in 2007, increasing to 11. 8% by the year ended March 2008. In 2009, net profit declined by 22. 16% from 11. 8% in 2008 to 9. 6% in 2009. Marks and Spencer’s incurs a very high cost on its admin, selling and general expenses amouting to almost £2400m on average every year where as, Next Plc incurs just £ 345m a year.

Return on Capital Employed

The return on capital employed (ROCE) assesses profits with the amount of funds (capital) employed to make the profits. This increased from 49. 77% in 2007 to -53. 27% in 2008. This represents an increase of 3. 5%. But due to the economic unstability, the group could not maintain its high ROCE over the years and it declined by 9. 85% from 53. 27% in 2008 to 43. 42% in 2009.

On the other hand Marks and Spencer's ROCE in 2008 increased by 0. 44% to 22. 37%. In 2009, it declined by 9. 75% to 12. 62%. This difference shows that Next is managing its resources much better, despite the fact that the revenue generated by Next Plc is approximately 37% lower than Marks and Spencer's. The reason for a low ROCE for Marks and Spencer's is the high overhead costs. It must control its costs in order to generate a higher return and free up additional extra capital invested.

3. 4. 3 LIQUIDITY RATIOS

Current Ratio:

This is a measure of the adequacy of company's current assets to meet short-term liabilities as they fall due, i. e it's a basic liqiudity ratio. A ratio between 1 and 2 thought to be a standard level of liquidity. Next Plc's current ratio was 1. 33, 1. 11 and 1. 50 in 2007, 2008 and 2009 respectively. This shows a healthy situation of the group as it has more current assests than its current liabiliteis as the ratio is greater than 1, therefore there does not seem to be any alarming situation for the group.

If we compare the ratio of 1. 50 in 2009, with the industry average of 1. 93, it is very reasonable for the group but it can be improved by more efficient working capital management.

Comparing the ratio to Marks and Specer's, it was 0. 52, 0. 59, 0. 60 respectively in 2007, 2008 and 2009. This is because Marks and Spencer's have a relatively high amount of current liabilities than Next Plc's, almost 30% more in year 2009.

Quick Ratio:

This differs from current ratio as it eliminates inventory from current assets providing a more useful position of the company to settle its immediate liabilities. Norms for quick ratios range from 0. 7 to 1. Quick ratio of less than this is seen as a signal of illequidity. However, the trend of the ratio over time and comparison with the sector average are the most important indicator, as they are with current ratio aswell.

Next Plc's quick ratio has been 0. 82, 0. 54, 0. 93 for 2007 2008 and 2009 respectively.

The ratio had a sharp decline in 2008 because of the £242. 7m short term debt raised by the company during the year in order to expand internationally.

In 2009, the ratio was 0. 93 which is quite good as compared to the industry average of 1. 35.

In comparison Marks and Spencer’s quick ratio was 0. 22, 0. 25, 0. 30 in 2007, 2008 and 2009. This is quite alraming for the company as compraed to Next or the industry average, as it is very low. This is maily due to the high amount of debt finance invested in the group. This can be an alrming situation for the group as it can lead to illiquidity.

This trend shows that Next Plc’s in a better liquidity position and it may not face any problem settling short-term debts, whereas there may be pressure on Marks’s and Spencer’s suppliers. It indicates that Next Plc is making better use of its working capital.

3. 4. 4 GEARING RATIOS

Capital Gearing Ratio:

This indicates the extent to debt finance involved in a business. Next Plc’s gearing ratio changed from 74. 26% in 2007 to 111. 22% in 2008 and 81. 5% in 2009, whereas Marks and Spencer’s gearing ratio was 50. 71% , 58. 9%, 59. 3% in 2007 2008 and 2009 respectively.

In 2008, gearing ratio crossed over a 100% for Next Plc because of high level of debt taken by the group in order to finance the expansion and it exceeded the level of equity present in the group.

” We continued to invest in the Next Brand, spending £39m refitting stores, maintaining advertising spend and improving the quality and design of our clothing and Home ranges” (Simon Wolfson, CEO Next Plc, Annual Report 2008)

Interest cover:

The interest coverage ratio indicates the extent of which earnings are available to meet interest payments. An interest cover ratio of more than 3 times is considered safe as even if profits are reduced to half the company will still be able to meet its financing costs.

Next Plc’s had a very high interest cover of 15. 37 in 2007. It then decreased to 12. 38 and 9. 74 in 2008 and 2009.

On the other hand, the interest cover of Marks and Spencer’s showed a varied trend. It increased to 10. 15 from 9. 14 in 2008 and then decline by 51. 6% to 5. 24 times in 2009.

Interest covere declined for both the companies in 2009. This was mailny due to the financial crisis the economy of UK is going through, but still it is much more than the safety margin i. e 3 times, therefore both the companies are in the position to settle their financial obligations.

3. 5 INVESTOR OUTLOOK

The earnings per share measures how much profit after tax is made for each individual share.

(EPS) has been quite high for the group despite of the fall in the revenue in the 2009.

The EPS of the group was 127. 4p and it increased by 15. 4% from 146. 1p in 2007 to a record high of 168. 7p in 2008. In 2009, EPS fell to 156p due to the fall in revenue.

” The continued use of surplus capital to buy back shares has again enabled us to deliver superior growth in earnings per share, our main financial objective” (John Barton, Chairman, Next Plc, Annual Report 08)

The dividend per share of Next Plc was 44p and it then increased by 12. 24% from 49p in 2007 to 55p in 2008. The group managed to maintain the same dividend per share of 55p in 2009, which is covered 2. 8 times by earnings.

Marks and Spencer’s EPS was 39. 1p in 2007 and increased to 49. 2p in 2008 before declining to 32. 3p in 2009. The dividends per share were 18. 3p, 22. 5p, 17. 8p in 2007, 2008 and 2009 respectively.

Despite having a very high EPS, the dividend payout ratio of Next Plc is much lower than Marks and Spencer’s. It was 33. 5%, 32. 6%, 35. 2% in 2007, 2008 and 2009 while the ratio of Marks and Spencer’s was 46. 8%, 45. 7%, 55. 2% in 2007, 2008 and 2009.

This shows that Next Plc retains much of its profit as compared to Marks and Spencer’s. This can turn out to