Reed’s clothier, inc.

Reed's had been run well in the past that the company had been in existence of many years as evidence by the fact that the company was even founded by Jim Reed's father and eventually transferred to Jim upon his father's retirement. Jim had come to believe that increase in inventory was related to sales hence, he had chosen to increase his inventory consistently and necessarily increased sales with 75% of his sales on account.

An analysis of his recentfinancial statementrevealed that he had much inventory caused by overstocking and his collection period has suffered as result because of too liberal sales terms and collection policy. His bank has become recently concerned about his financial management and had suggested to Jim to decrease his inventory and reduce his accounts receivable by collecting aggressively from past due accounts. b. Answers to questions 1, 2, 3, 4, 5, 6, 7, and 8 Question 1 Reed's financial ratios compared to the industry are as follows:

The ratios indicate that Reed is less profitable and less liquid than industry averages and may be a sign of problem on the part of the company's management. Question 2. Holmes was Reed to have an inventory reduction sale for Reed to increase inventory turnover and improve terms with customers and supplier to make Reed's operation more efficient. Question 3. Tightening of working capital would normally not affect sales, however if it too tight it might affect the amount of needed inventory to increase sales. Question 4. The following is the Reeds' pro forma income statement.

Question 5. Jim Reed is advised to have an inventory system of leaner inventory. He needs not to over-purchase inventory if his purpose is to increase sales on account which will be collected in period more than double his terms at 30 days. Question 6. Jim needs to increase its receivable turnover since average collection period was already 72. 25 days. See answer to question number one. The collection period is already very much above its normal terms to customer at 30 days and this must be something not normal and therefore an inefficient practice.

To have his sales on account at 30 days, 75 % of his sales cannot justify the lengthy collection period of more than double his terms to customers. This would be tantamount to selling but not collecting in time. He needs therefore to be strict with terms to customers and by aggressively collecting the accounts on time. He needs to monitor collection as to control his accounts receivable. Question7. Yes, the increase in sales is related to the increase in inventory. There is an observed direct relationship of the two. Increasing inventory would increase sales and vice versa. Question 8.

Not taking supplier’s discounts is a sign of financial incompetence since rates of discounts given are normally higher that normal or market interest rate. Thus financial accounting even recognizes the fact that purchases should be recorded at net of discount and that inability to take discount would mean a forfeited income opportunity. His terms with suppliers is 3/10, n/60 and not to avail of this purchase discount is effectively losing about 9 percent for one month or more than 100 percent per annum. It is a big loss of income not to avail the same.

Reference: Case Study- Reed’s Clothier, Inc.