Companion Website Chapter 13

Extension of Box 13.2 – a worked through example of the WSSI

The bridge that connects the two very different business activities of product management and financial management is the WSSI (Weekly Sales, Stock, and Intake report), and its use is widespread within fashion businesses. The WSSI (pronounced "wizzy" by some) has a fearsome reputation, but is very simple in its concept and powerful as a communication tool. In short it is a weekly product budget; its role is to control the timing of product into a business. Below is a simplified WSSI (by month) with the key product budgets (sales, markdown, opening and closing stocks) that can either be derived via a top down planning approach; where the finance team set the overall budgetary requirements of the product range in line with strategic objectives, or via a bottom up approach where the product team articulate their budgetary expectations based on the strength of the market in which the business operates.

The mechanics of the WSSI means that by identifying a budgetary phasing over a defined financial period, four connections between product management and finance can be achieved:

1. Sales and markdown phasing identifies to finance when cash inflows in the form of sales are expected to be received allowing overheads to be planned in some detail. Sales phasing is predicted based on prior year history updated for current trends. The phasing of markdown in line with market trends identifies when the cash cost of marking down selling prices will occur, or in a real time fast fashion environment, as it occurs.

2. The identification of closing stock budgets to demonstrate the "ideal" amount of stock that a business should hold at any one given time. This ideal amount of stock is derived from a number of sources including:
    - The minimum value of stock required for optimal display in physical stores
    - The minimum value of "pipeline" stock required during resupply time from suppliers
    - The value of stock required in advance of a key selling period, such as an end of season sale.

    Economic Order Quantity (EOQ) concepts are at work here in the attempt to identify an ideal stockholding. A risk is taken on the amount of stock bought in advance in the hope that customers want it, offsetting the costs and risks of holding excess stock with the costs or reordering and risks of missed sales opportunities. Knowledge of the likely trading requirements from stock holding helps the planning and management of cashflow. It also allows decisions around payment terms and whether to forego early settlement discounts. There is also a hidden cost of stock ordering in terms of the administration required.

3. The calculation of open to buy (OTB, the buyers budget). OTB is the calculated value of stock intake that can be brought into a business at any one given time. Its origin lies within the sales, markdown and stock budgets of the WSSI, and in articulating the

phasing of this spend, the finance team are able to refine any cash flow projections using a realistic stock intake scenario.

Sales budget: the net selling value of all products sold within a defined period

Markdown budget: the cash cost incurred in the markdown of product

Closing stocks: The selling value of stock holding at the end of a defined period.

December closing stock	£0

Month	SALES budget	MARKDOWN budget	CLOSING STOCK budget	OPEN TO BUY budget
January	£91,955	£0	£500,008	£591,963
February	£121,649	£0	£500,008	£121,649
March	£205,942	£34,600	£498,092	£238,626
April	£119,734	£0	£490,429	£112,071
May	£121,649	£0	£475,103	£106,323
June	£297,418	£128,924	£59,021	£10,261
Total	£957,869	£163,524		£1,180,893

Opening stock: The selling value of stock holding at the beginning of the period

Open to buy: The calculated spend of buying budget for each defined period. Calculation: sales + markdown + closing stock of period – closing stock of previous period

An example of a monthly WSSI

4. The WSSI offers the business versatility. As a planning tool, it gives a detailed breakdown of overall planning assumptions for a season ahead which helps to ensure that cash is managed throughout the financial year. It also has a more dynamic use as a trading tool which can identify the impact of actual trading versus the “original” plan in a form of variance analysis. By using the WSSI as a real-time recorder of fact as a season progresses it can identify the effect of actual trading on the P&L and balance sheet as it occurs, giving finance intelligence on the pressures of trading and communicating to the product team the availability of funds to exploit new opportunities as they occur.

The options available for managing currency exchange risk (Currency Calamities Section)

Transaction currency risk and options for its management

In March 2014 ($1.68 = £1) a UK based retailer placed an order for 5,000 shirts from a factory in China at $10 per shirt. The shirts were delivered in August 2014 ($1.62 = £1) and paid for in October 2014 ($1.60 = £1)

$\frac{5{,}000 \times \$10}{\$1.68}$ = £29,762 was the expected cost of the buy when the order was placed

$\frac{5{,}000 \times \$10}{\$1.60}$ = £31,250 was the actual cost of the buy when the order was paid

So, there was a £31,250 – 29,762= exchange **loss** of £1,488 on one small contract in 6 months. The margin impact can be computed if the foreign exchange loss per shirt is 90p on a cost of £17.86 per shirt. If the selling price is assumed at £39.99, how much is the margin impact?

The UK retailer placed this shirt order in March and calculated it would cost £29,762. Assuming here the company has negotiated credit payment terms and will not need to pay the $50,000 to the supplier until October, despite receiving the shirts in August and knowing they would have to pay this amount. The retailer has three options and referring to the application the most appropriate option depends on the size of the impact of the potential loss on the business:

OPTION 1: WAIT

The business will simply place the order, take delivery and pay for it according to the credit terms. When payment is due they will buy $50,000 on the "spot" foreign exchange market. This is risky if rates are fluctuating and margins are low as a small movement in exchange rate could change the profit. This does allow the possibility of receiving upside benefit should that exchange rate movement be favourable. This also allows free cash movement in the intervening time. But remember this is risky as there is uncertainty and the rational investor avoids uncertainty. This is an example of 'Accept' as a risk management strategy; the business is aware of the risk of the exchange rate moving. This is appropriate if the business impact were small as there were few contracts in foreign currency and where there is only a small finance team.

OPTION 2: BUY US DOLLARS IN ADVANCE

The retailer could seek complete certainty and remove all exchange rate risk by buying the US Dollars needed as soon as the order is placed. This comes at the price of having to tie up the money for 6 months in a US Dollar bank account and the loss of free cashflow could be an issue for a small company. This is an example of a 'Reduce' risk strategy as the uncertainty is removed.

The deposit would earn interest over the period, so a reduced amount would be deposited initially. Assuming US Interest Rates were 0.5% (0.25% for 6 months) to have $50,000 in 6 months the firm will deposit:

$\frac{\$50{,}000 \times 100}{100.25}$ = $49,875

To buy $49,875 @ 1.68 on the spot market when the order was placed would have cost them £29,687

OPTION 3: USE A FORWARD CONTRACT

The retailer's best option may be to use a forward contract to buy the US Dollar requirement at a forward rate for delivery in 6 months. This contract means that the rate is fixed in advance but the money does not actually move until the forward delivery date. Meanwhile the retailer is free to use that cash in its business until the contract date when it must have enough GBP to settle the contract.

The bank takes the risk on the currency movement on behalf of the retailer and so will reflect this in the price of the contract. This is an example of a 'Control' risk strategy and is appropriate where the retailer has many foreign exchange denominated contracts and margins are tight.

If for example GBP is expected to strengthen (USD to weaken) the forward rate will be calculated by adding a premium to the spot rate of around 0.05 - 0.03. Conversely if GBP were expected to weaken the spot rate would be discounted. The forward rate would be calculated as:

$\frac{\$50{,}000}{1.68 + 0.03}$ = £30,120 would then be the cost of the currency

Once the contract is entered into this price is guaranteed and must be honoured by the bank and the retailer regardless of what actually happens to exchange rates in the intervening period. Clearly the retailer may be missing out on the rate moving in their favour but they have attained certainty and removed this potential risk to profit.

Calculating the Net Present Value of Capital Investment Projects

Capital Investment Appraisal in action

A UK hosiery manufacturer is considering investing in one of two new machines, with Machine B requiring a greater initial cash outflow than Machine A. The company's financial team calculate the net cash inflow for each machine over the five years of its useful life (T1-5). Net cash inflow represents revenues less the running cost of the machine.

	Machine A	**Machine B**
T0 - initial cash outflow	(£4m)	(£5m)
T1 – net cash inflow	£2.0m	£1.2m
T2 – net cash inflow	£1.6m	£1.6m
T3 – net cash inflow	£1.2m	£2.0m
T4 – net cash inflow	£0.8m	£2.8m
T5 – net cash inflow	£0.4m	£2.4m
Total Inflow	£6.0m	£10.0m
Net Cashflow (Total Inflow – Initial Outflow)	£2.0m	£5.0m

You can see from this pattern of net cashflows that machine B is not only more expensive initially but it takes longer to payback the initial investment. If you made your decision purely on payback you would choose Machine A as you have repaid your investment early in year 3 as opposed to early in year 4 for Machine B. You can then invest that money in your next project. But is that short-term view the right decision? Look at the total cashflows. Machine B brings in more net cashflow over its whole lifetime; so, if you are willing to take a longer term risk you can make more money.

But that is the decision made by looking at absolute cashflows. If we take into account the time value of money and apply discounting techniques we can bring back those later year cashflows to today's value. This is done by multiplying the cashflow by a discount factor, which is calculated with reference to the company's cost of money (its Cost of Capital - remember this is not the bank base rate but dependent on the relative weighting of different sources of funding on the company's balance sheet). Note that the discount factor at time zero (today) is 1 as we don't need to discount and the reducing effect of the decimal gets bigger the further away the cashflow is from Time Zero (today) reflecting the risk associated with those cashflows being harder to predict.

Time	DF @ 16%	Net Cashflow A	DCF A	Net Cashflow B	DCF B
0	1	(£4m)	(£4m)	(£5m)	(£5m)
1	0.862	£2.0m	£1.724m	£1.2m	£1.034m
2	0.743	£1.6m	£1.189m	£1.6m	£1.189m
3	0.641	£1.2m	£0.769m	£2.0m	£1.282m
4	0.552	£0.8m	£0.441m	£2.8m	£1.546m
5	0.476	£0.4m	£0.190m	£2.4m	£1.142m
Net Present Value			**£0.313m**		**£1.193m**

So, what is the decision based on NPV? The bigger NPV should always win so you would choose Machine B. An investment yielding a negative NPV should be avoided at all costs as it is destroying value for the business. Often the NPV decision is a close call which is where soft benefits become important in swaying the decision.

This example assumes the company's cost of capital is 16% and calculates the discount factor using the equation $1/(1+r^n)$ where r = Cost of Capital expressed as a decimal and n = number of years.

The NPV technique can be further developed into calculating the Internal Rate of Return (IRR) of an investment project. Further reading on this topic is recommended along with other capital investment appraisal techniques such as the Accounting Rate of Return.

Longer Version of Case Study Shanghai Tang: Growing an international brand with a strong Chinese Identity.

Natascha Radclyffe-Thomas

Introduction

The Chinese luxury brand Shanghai Tang is an interesting example of a non-Western fashion label seeking to build a global presence. Reviewing the launch, growth and subsequent rebranding of the brand shows how it strategically grew its business by establishing an iconic brand identity enabling it to expand its product offer and target a new domestic market. But the brand's recent history demonstrates the difficulties faced establishing a consistent customer base whilst competing in a luxury market dominated by European heritage brands. In common with other luxury brands Shanghai Tang sought to exploit design heritage and historical connotations associated with country of origin, but distinctively in Shanghai Tang's case the cultural associations were not European but Chinese, at a time when 'Made in China' had distinctly negative connotations. Nearly twenty-five years later the financial press report that Shanghai Tang's lack of success is evidence that the modern luxury consumer still prefers to spend their money with those established European luxury houses.

Brand Heritage

Shanghai Tang was founded in Hong Kong in 1994 by Sir David Tang as a tailoring atelier and developed its clothing offer into a ready-to-wear line primarily aimed at an expatriate and tourist customer who wanted to capture a piece of Hong Kong heritage by buying into a romanticised retro vision of Chinese sartorial style. The entire brand identity evoked the glamour of 1920s and 1930's Shanghai, a golden age of Chinese fashion when Shanghai was known as the Paris of the East. Shanghai Tang's marketing materials have consistently supported its brand identity, described on the website in 2017 as the 'perfect marriage of China's epic history with a modern aesthetic'. The name Shanghai Tang is the English for The Bund, the iconic 1930's riverside promenade the locale of the most fashionable Shanghainese. Key products for Shanghai Tang were the *cheongsam* or *qipao* the form-fitting dress most widely known in the West as the 'Suzie Wong' dress for women, and Mandarin collared jackets for men. Subsequent expansions of the brand offer have relied on the cultural connotations of Shanghai specifically and China more generally to inform product development and in 2017 the brand comprises 48 boutiques operating in 55 countries globally.

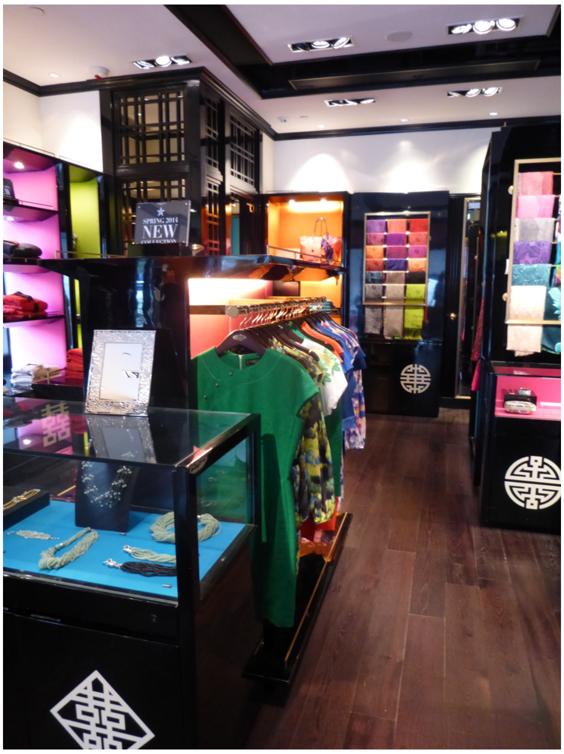
Okonkwo (2007) has referred to the importance for luxury brands of communicating their heritage, and particularly in a pre-digital age the importance of establishing an iconic physical presence has been a key strategy in creating a brand universe. Heritage architecture has become increasingly valuable in the luxury sector and Shanghai Tang's first retail presence was its flagship Pedder Street store. Nestled among the skyscrapers of Central Hong Kong, the Pedder Building at number 12 Pedder Street is a unique pre-war Beaux Art listed building on Hong Kong Island and Shanghai Tang occupied the ground floor and basement from 1994 to 2011 when it relocated due to rent increases. Launching Shanghai Tang in Hong Kong, which at the time was still under British colonial rule before its handover to Mainland China in 1997, meant the business could benefit from its locale in terms of authentic cultural heritage. Additionally Hong Kong regularly scores in the top rankings of global comparisons for ease of 'doing business' and has been a successful retail environment for brands trialling China market entry.

The Development of an international lifestyle brand

With a vision of creating an international Chinese lifestyle brand Shanghai Tang opened a flagship store on New York's Madison Avenue in late 1997, taking its collection of Chinese classics to the heart of US high fashion retail. Sensing the potential growth opportunities for a Chinese luxury brand both abroad and domestically, with the opening up of the Chinese economy, Richemont acquired a controlling stake in Shanghai Tang in 1998, and bought out the residual share in 2008 the same year the Beijing Olympics turned a spotlight on all things Chinese. However, although the stateside launch garnered much media attention for the brand, sales figures were disappointing and with high rental costs Shanghai Tang was relocated to a store with smaller square footage.

Further financial challenges for the brand were closer to home with the Asian financial crisis which negatively impacted the Hong Kong economy for two years from late 1997. This was followed by the SARS epidemic in 2003 which saw tourist numbers dwindle, although this was ameliorated later in the year when the PRC government relaxed visa restrictions for Mainland Chinese to visit Hong Kong. Sir David Tang had launched Shaghai Tang with a vision to be the first Chinese luxury brand but by the early 2000s it was struggling to communicate its fashion relevance and Joanne Ooi was appointed as Marketing and Creative Director to modernise and rebrand the label.

The Hong Kong flagship store was the perfect shop window for the Chinese heritage label's rebrand, its stone clad building and double bay windows enhanced by a quirky new product line and matching visual merchandising to further reinforce its brand DNA. The store was designed as a nostalgic multisensory experience; polished parquet floors, period furniture and features including songbirds in wicker cages provided the backdrop for retro-inspired womenswear, menswear, childrenswear and homewear. The back half of the ground floor was devoted to the Imperial Tailoring line; a functioning instore tailors' shop-within-a-shop lined with rolls of Chinese silks, with a cutting table, tailoring ephemera and mannequins complementing the atmosphere. Elsewhere in the store Chinese antique furniture, chests and wedding cabinets were used as store fittings along with period glass cabinets and vintage hat stands displaying new ranges incorporating references from classical and contemporary Chinese art. A curated soundtrack of 1930's Chinese flapper lounge music remixed with a contemporary backbeat played and the store atmosphere was further enhanced with scent branding; the house's signature scent Ginger Lily diffused throughout and seeped out into the surrounding streets. Chinese silks woven with symbols of good fortune and longevity were used for dresses and scarves and motifs such as Chinese dragons further supported the brand's cultural connotations.



Shanghai Tang store interiors

Image Credit: Natascha Radclyffe-Thomas, courtesy of Shanghai Tang

As well as adopting these classic Chinese design features, Shanghai Tang playfully referenced China's more recent Communist history, incorporating visual references e.g. the red star in its accessories line which featured pop art elements designed to appeal to an East-West customer. Shanghai Tang opened stores in Paris and Shanghai in 2003 keeping the mission of spreading Chinese essence with its store and product design, but now with a more consistent seasonal approach with collections inspired by specific Chinese cultural references moving the designs away from costume into fashion. The early 21st century was a boom time for Chinese contemporary art and Shanghai Tang has collaborated with several of the young generation artists including fine artists Yu Chen and Jacky Tsai, performance artist Li Wei and photographers Chen Man and Wing Chya. Wing Chya's 2015 retro-themed photographs exhibited instore as part of Art Basel Hong Kong displaying the blend of nostalgia and modernity that the brand itself identifies as its core differentiator.

Moving back to the Chinese Consumer

New product developments and marketing have seen the brand's customer base shift towards Chinese domestic consumers. The Beijing Olympics of 2008 not only drew attention to Chinese history and culture for an international audience but also instilled Chinese pride in its own heritage. This newfound interest in all things Chinese was seen as an opportunity for Shanghai Tang to capture its share of the growing luxury Chinese customer base. Shanghai Tang had been building its presence in hotels and department stores worldwide. It opened a Kowloon-side Hong Kong store in the repurposed former Marine Police Headquarters luxury retail development 1881 in 2009 and extended the brand experience opening a Shanghai Tang café in Xintiandi, Shanghai's exclusive heritage shopping development, in 2010.

2011 saw the Pedder Building store close; it was subsequently leased by Abercrombie and Fitch for their Hong Kong flagship. An alternate heritage building was acquired on Hong Kong Island-side; the Shanghai Tang Mansion opened on Duddell Street in 2012, a 15,000 square foot four-storey retail space incorporating a restaurant and gallery space on its top floor. The potential for targeting new generations of Chinese luxury consumers and a newfound interest in *fugu* (retro) informed the rebrand which saw a focus on new product design and store experience, starting with the brand's China-based stores. Design studio MVW created a new-look interior to showcase the most recent rebrand for Shanghai Tang designed to move the brand from costume to Chinese chic. In addition to the new Hong Kong Mansion Shanghai Tang acquired the historic Cathay Mansion, a 1932 art deco building, for its Shanghai flagship. The interior of the rebranded stores reflects each aspect of the revamped brand identity with sleek interior styling that still references Chinese culture and motifs but in contemporary materials and colourways.

The Imperial Tailoring Line made-to-measure service still exists as a link to the brand's naissance but now serves more as a visual merchandising anchor. Each season a limited edition of womenswear is released inspired by the qipao but reinterpreted contemporary fabrics and using modern techniques e.g. laser cutting. Women's ready-to-wear still includes Chinese classical references but also applies modern treatments e.g. digital prints inspired by Chinese artworks. The menswear line maintains the Shanghai Tang polo shirt as a key product; since 2006 Shanghai Tang has supported the polo playing in Mongolia by sponsoring the Genghis Khan Polo Club and organising a Shanghai Tang Polo Cup.

2014 saw the twentieth anniversary of the brand celebrated with new initiatives designed to decode the brand vision and attract a younger Mainland Chinese customer. The China Fashion Chic fashion show held in Shanghai showcased the Spring/Summer 2015 see-now-buy-now[1] collection modelled by Chinese supermodels Liu Wen, Bonnie Chen and Zhao Lei. The show featured a capsule collection designed in collaboration with Chinese designers Masha Ma and Wang Pei Yi. In the same year Hong Kong's Pacific Place mall hosted a Shanghai Tang exhibition and at Hong Kong Fashion Week Shanghai Tang partnered with sustainable textile NGO Redress in the annual EcoChic Fashion Awards. Recent campaigns have followed Shanghai Tang on international adventures to Morocco (Spring/Summer 2014), New York (Autumn/Winter 2014), Capri (Spring/Summer 2015), Paris (Autumn/Winter 2015), Southern Spain (Spring/Summer 2016), and closer to home to Mongolia (Autumn/Winter 2016). The glamorous Shanghai Tang couple on their globetrotting adventures perhaps reflecting the lifestyle of the increasing numbers of Chinese international leisure travelers.

Shanghai Tang has successfully built a brand celebrating Chinese cultural heritage and sought to develop the brand in response to the changing demographic of luxury fashion

[1] Shanghai Tang first introduced shop the runway in September 2013 for its fall-winter 2013-14 collection.

consumers. Using country-of-origin as a differentiator has added value for European luxury labels where provenance has reinforced positive associations of quality, craftsmanship and style. With Richemont's announcement of the sale of Shanghai Tang in July 2017 it seems that the market has not embraced their vision of a global Chinese luxury label and sets a strategic challenge for its new owners.

Reference
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This case study was authored by Natascha Radclyffe-Thomas with reference to:
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Radclyffe-Thomas, N. (2018) Weaving fashion stories in Shanghai: Heritage, retro and vintage fashion in modern Shanghai in A. Peirson-Smith and J. Hancock III (Eds). *Transglobal Fashion Narratives*, Bristol: Intellect

Case Challenges and Conversations (Use Chapters 4, 6 10 and 13

1. Analyse the various types of risk that Shanghai Tang has faced as it has implemented an international growth strategy. To what extent do you think that the company fallen short in risk evaluation in recent times. (Chapter 13)
2. In the global luxury fashion market, analyse the differentiation strategy of Shanghai Tang, and suggest how the store environment reinforces this (Chapters 4 and 10)
3. Using Kapferer's identity prism concept (see Chapter 6) analyse the brand identity of Shanghai Tang and suggest how the identity has been central to the company's brand strategy (Chapter 6)
4. Critically discuss the reasons why the brands' cultural references and heritage of Shanghai Tang may not be as highly valued as that of European brands by the luxury consumer
    a. In China
    b. In Europe and the US.

    (Chapter 4, 6 and 13)