

Centre for the Development of Enterprise

Integral Diagnostic Review Final Report Mokgabo Dec Interiors (Pty)Ltd



20-21 May, 2014, Mmadinare-Botswana

Summary

- Background
- Diagnosis process
- Preliminary results
- Recommendations

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The Company's Diagnostic Proces

- Company's background review
- Interview with the management and staff to understand the different elements of the company (20 May 2014)
- Co-construction (management validation of preliminary findings (21 May 2014)
- Final reporting (24 May 2014)

Background

- The Mokgabo Dec Interiors is wholly 100% citizen propriety limited company located in Mmadinare approximately 25km from the Selibe Phikwe mining town. Business idea originated from the owner in 1998 in Molepolole and operations started in 2005.
- The Mokgabo Dec Interiors, operates in the furniture and upholstery industry specialising in manufacturing of lounge suits, chests of drawers, ottomans, settees, couches, bean bags and cushions.
- The company's main target markets are middle income individuals from Mmadinare, Selibe Phikwe, Bobonong and Gaborone.
- The mission of the business is to supply the best quality of furniture to customers.
- The company was winner of several awards in trade expos it participated around the country from 2004-2005 The company has employed 3 people including the Managing Director.
- In 2012 the company secured a loan of P695,000 from the National Development Bank (NDB) to inject into business
- Annual turnover was around P318,544 in 2012 and P235,314 in 2013.
- Currently, the company is not producing any items due to the absence of key production personnel. The owner is embarking on recruiting expatriates as she has not been able to attract local expertise
- Main challenges: competition from South Africa, low market penetration, limited local technical skills.

Preliminary Findings

Preliminary Findings

Subareas Needing Improvement (refer to attached co-construction report)

Strategic Management

- Mission and Vision
- Strategic Objective

Finance

- Cost Analysis

Quality Management

- Procedures
- Quality control

Production and Operations

- Inventory Handling
- Planning
- Machinery Maintenance
- Plant Layout

Business Environment Analysis

- Alliance

Human Resources

- Staff Performance
- Personnel Policy
- Personnel Benefit and Incentives

Marketing and Sales

- Communications

Information Management

- Information

Results

The Company Strengths and Areas of Intervention

Strengths	Areas for Improvement
1. Business Environment Analysis – Regulation and Institutionality	1. Strategic Management – Strategic Objectives
2. Marketing & Sales – Client Relationship	2. Marketing & Sales –Communications
3. Marketing and Sales-Product	3. Finance - Cost Analysis
4. Technological Innovation-Information Technologies	4. Human Resources - Personnel Policy
	5. Human Resources - Personnel Benefits and Incentives
	6. Quality Management - Quality Control
	7. Quality Management - Procedures

Best Practices

Strategic Management – Strategic Objectives

Having strategic objectives and specific projects and action plans will enable the company to:

- Have a clear roadmap
- Develop and prioritize functions and activities
- Better planning (short and long term)
- Better allocation of resources
- Track operational performance
- Improve decision making across the company

The Strategic Process of Value Creation



Marketing and Sales - Communications

Implementing an appropriate will enable the company to:

- Develop a communication plan targeting each market segment using the appropriate channels and message
- to improve its visibility by its target market segments and increase its market share.
- developing a communication plan that clearly indicates what to communicate, how to communicate, who communicates.
- Develop a budget for communication and promotional elements.

Finance - Cost Analysis

Accurate costing of products:

- Ensures positive cash flows and non tying up of capital on products that are not profitable.
- Makes it easier to estimate the company's break even point (level of sales where all fixed costs are covered by revenue)
- Encourages good procurement methods
- Enables the company to appropriately price its products to secure the profit margin
- Therefore contributes to reduce costs and improve profit margin

Human Resources-Personnel Benefits and Incentives

Continuous engagement with staff on matters of concern to them and putting in place suitable performance criteria, incentives and benefits will help Mokgabo Dec Interiors to motivate, retain its staff and improve their performance.

Human Resources - Personnel Policy

Personnel policy will help the company to:

- Attract, recruit and retain human capital that is in line with company strategy.
- Systematically track employee performance
- Have a transparent incentive, reward and progression guidelines
- Have motivated staff

Quality Management – Quality Control

There is need for the company to have set documented quality control measures, with specific criteria used in maintaining quality.

This will ensure:

- Systematic checks that will allow timely application of corrective measures
- A clearly defined procedure for handling complaints
- Less rejection of products
- Consistency in products quality
- Improved customer loyalty
- More sales

Quality Management – Procedures

There is need for the company to have set documented quality procedures, with specific criteria used in maintaining quality.

This will ensure:

- Competitiveness in the market
- Compliance to existing standards
- Regular and consistent quality checks.
- Implementation of training and benchmarking for the relevant personnel to maintain high quality products and competitiveness in the market.

Financial Analysis

Disclaimer

- *The financial analysis and indicators are based on financial statements provided by the company for the years 2011 to 2013.*
- *There may be a number of apparent discrepancies leading to some extreme ratios and variations which are the subject of outstanding queries.*
- *The inclusion by the CDE consulting team of these figures and ratios in no way implies verification of the figures and ratios by the CDE consulting team.*

Financial Analysis

Inconsistencies in financial statements

The financial statements submitted by Mokgabo Dec Interiors Pty Ltd for the years 2011 through to 2013 reflect inconsistencies in the balance sheet: no paid in capital is indicated for any of the three financial years. The calculation of reserves is inconsistent from one year to another making it impossible to track the figures on the balance sheets. Thus the equity position of the company may be uncertain.

This may further entail that the financial statements could generally be inaccurate.



Mokgabo-Dec Interiors (Pty) Ltd. : Balance Sheet 2011 - 2013

ASSETS	2013	2012	2011
Cash and cash equivalents	27,814	26,355	12,231
Accounts receivable (debtors)	0	38,652	11,346
Inventory	255,000	320,758	55,960
Prepaid expenses	0	0	0
Other Current Assets			
TOTAL CURRENT ASSETS	282,814	385,765	79,537
Physical fixed assets	71,038	143,450	8,950
Financial Fixed Assets	0	0	0
Intangible assets	0	0	0
Other Assets	0	0	0
TOTAL FIXED ASSETS	71,038	102,181	2,051
TOTAL ASSETS	353,852	487,946	81,588
LIABILITIES	2013	2012	2011
Account payable	26,822	0	3,457
Short term portion of loans payables	0	0	40,418
Taxes liabilities	0	0	321
Short term provisions			0
Other Current Liabilities			0
TOTAL CURRENT LIABILITIES	26,822	0	44,196
Long term debt to banks and fin. Inst.	439,329	472,711	26,000
Long term Provisions			
Other Long term debt			
TOTAL LONG TERM LIABILITIES	439,329	472,711	26,000
TOTAL PAYABLE LIABILITIES	466,151	472,711	70,196
Paid in Capital			
Reserves (Retained Earnings, other reserve)	-40,150	-16,150	-24,000
Current year net profit	-72,148	31,385	35,392
EQUITY	-112,298	15,235	11,392
TOTAL LIABILITIES	353,852	487,946	81,588

Mokgabo-Dec Interiors (Pty) Ltd. – Profit And Loss Statement 2011 – 2013

PROFIT/LOSS STATEMENT	2,013	2,012	2,011
Sales revenues	235,314	318,544	149,736
Cost of goods sold			
<i>Materials</i>	38,391	55,407	25,329
GROSS PROFIT	196,923	263,137	124,407
<i>Wages & salaries</i>	158,530	64,000	29,675
<i>Other costs</i>			
NET VALUE ADDED	38,393	199,137	94,732
Depreciation	33,618	34,370	1,195
Operating Expenses (G&A, selling, R&D)	39,785	55,568	51,328
OPERATING INCOME	-35,010	109,199	42,209
Financial income	2		
Financial expenses	68,524	89,207	5,790
Other non-operating income	31,384	11,392	-706
Other non-operating expenses	0	0	0
INCOME BEFORE INCOME TAX	-72,148	31,385	35,713
Income Tax Provision	0	0	321
NET INCOME	-72,148	31,385	35,392

Strategic & Financial Indicators

Strategic Indicators	2013	2012	2011
Local sales per employee	29,414	39,818	18,717
Variation of local sales	-26%	113%	-
Net value added, NVA	38,392	199,137	94,732
Productivity	4,799	24,892	11,842
Gross profit margin	83.7%	82.6%	83.1%
Net profit margin	-30.66%	9.85%	23.64%
Net worth	-112,299	15,235	11,392
Number of managers to employees	0.14	0.14	0.14
Fixed Assets turnover	3.31	3.12	73.01

Strategic & Financial Indicators

Financial Indicators	2013	2012	2011
Current Ratio	10.5	-	1.8
Acid test (Quick ratio)	1.04	-	0.53
Average collection period (day)	-	44.29	27.66
Average payment period (day)	49.72	0	22.94
Debt to equity ratio	-4.15	31.03	6.16
Inventory Conversion Period (day)	472.65	980.48	371.34
Times interest earned	-0.05	1.35	7.17
% Over (Under) Break-even point	-47.7%	121.4%	80.4%

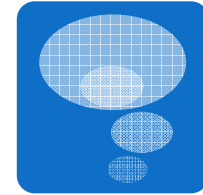
Financial Analysis

➤ Sales and profitability

- Sales increased between 2011 and 2012 by 113%. The following year, they dropped by 26% from P 318,544 in 2012 to P235,314 in 2013.
- During 2012-2013 period the company lost its key production personnel – there was less furniture made as reflected in reduced materials cost and inventory levels.
- Gross profit margin remained steady over the 3 years at an average of 83%.
- The operating income plummeted from P109,199 in 2012 to –P35,010 in 2013. This was mainly the effect of the wage increase in 2013 and the severe decline in sales.
- According to the business owner, the abnormal wage increase (P158,530 in 2013) does not reflect the rate of production. This amount accounts for a vehicle she purchased at P130,000 for a serving manager in lieu of past salaries forgone. The actual direct wages were P28,530.
- This decision plunged the company into losses with a net income of –P72,148
- Mokgabo Dec Interiors is operating in 2013 at 47.7 % below breakeven point.

Financial Analysis

- **Strategic indicators**
- Assets turnover
 - It can be concluded that the assets are generally utilized 3 times. The high turnover rate of 73 in 2011 was because assets were almost fully depreciated though functional. More machinery was acquired in 2012.
 - There is a declining net worth which stands at –P112,299 in 2013 from P15,235 in 2012. The move from an equity base of P15,235 in 2012 to –P112,299 in 2013 could not be justified as company's loss in 2013 accounts only for - P72,148. Equity balance in 2013 should have been –P56,913. This comment also applies to 2012 and points to deficiencies in the accounting system.
 - The company's equity base is completely depleted.



Financial Analysis

➤ **Solvency**

- The current ratio is at 10.54 in 2013. Though aesthetically high (standard is 1 to 2), Mokgabo Dec Interiors has just enough to cover its liabilities. This is reflected in the acid test ratio which stands as of 1 in 2013. Only 10% of its current assets are in cash with P255,000 of current assets held up in inventory.
- A significant part of the debt which stands at P 439,329 and P472,711, in 2013 and 2012 respectively, has served to finance inventory (P255,000 and P320,758 in 2013 and 2012). This could have been invested in productive assets instead.
- Mokgabo Dec Interiors is under heavy financial strain. With a time interest earned ratio of -0.05 in 2013, it is unable to pay its interest charges on the existing debt. Additionally, the company has had to commit 28% of its sales revenue in 2012 and 29% in 2013, to financing the debt alone.

Financial Analysis

➤ **Gearing / long term debt to equity**

- The company has plunged into debt with a debt to equity ratio in 2013 of -4.15. This ratio can be explained by the purchase of a vehicle for a staff member coupled with reduced revenues that led to losses in the year.
- Mokgabo Dec Interiors is at risk as financing institutions may at anytime force the company into bankruptcy for default payment. Financial institutions may not positively consider further funding requests.
- Furthermore, they are currently not producing new items to sell and relying on clearing their current stock. The inventory value of P255,000, if converted to cash at a rate of 472 days could secure only P16,000 a month. This is not sufficient to cover operations.

Conclusions of the Diagnosis

Conclusions

- The Mokgabo Dec Interiors is a wholly 100% citizen propriety limited company located in Mmadinare approximately 25km from the Selibe Phikwe mining town, started operations in 2005.
- The company is manufacturing furniture, upholstery and specializes in maturing lounge suits, couches, bean bags, cushions, etc.
- Mokgabo Dec Interiors successfully started up but was not quite ready to enter the growth stage after 8 years of operations. The business is still characterised by weak management and accounting systems. There is also no plan to run the business in a more formal way. A customer base was firmly established but no formal plans to increase sales are being implemented. Erratic sales, high levels of inventory and the inability to retain key staff are indicative of weak internal systems. Main challenges is the unavailability of specialist in upholstery and carpenter which has led the company to close down the production unit.

Conclusions

- The depleted equity base coupled with the acquisition of a loan of P695,000 (NDB) in 2012 has resulted in an increased debt to equity ratio in 2013 at 5.32 from -3.91 (2012) and company is financially capable to honour its debt obligations.
- The company is struggling to pay its debt and is currently negotiating with the Bank to restructure its payments for the loan. This situation still reflects concerning indebtedness and risk as the business still has a great amount of liabilities in comparison to its equity or net worth.
- Our assessment of the company's management has revealed 5 broad areas needing improvement: Strategic Management, Marketing and Sales, Finance, Human Resources and Quality Management.
- More specifically, Mokgabo Dec Interiors needs urgently to close the gaps in strategic planning, communications, cost analysis, personnel policy and performance management, quality control and procedures.

Recommendations for Improvement

SUB-AREAS	RECOMMENDATIONS	
	INTERNALLY	WITH SUPPORT OF EXTERNAL RESOURCES
STRATEGIC OBJECTIVES	<ul style="list-style-type: none"> ➤ Develop strategic goals in line with company's mission and vision ➤ Cascade strategic goals to operational levels and identify activities to support these goals ➤ Put in place mechanisms to monitor progress 	<ul style="list-style-type: none"> ➤ Evaluate strategic options ➤ Establish stabilization & transition measures ➤ Facilitate business and investment plan to help in mobilizing needed resources
COMMUNICATIONS	<ul style="list-style-type: none"> ➤ Update social media presence (Face Book and LinkedIn) ➤ Create a website ➤ Dedicate resources to marketing and advertising activities ➤ Develop and utilise brand logo more extensively 	<ul style="list-style-type: none"> ➤ Development of a marketing plan ➤ Development and communication of brand

SUB-AREAS	RECOMMENDATIONS	
	INTERNALLY	WITH SUPPORT OF EXTERNAL RESOURCES
COST ANALYSIS	<ul style="list-style-type: none"> ➤ Clearly identify all fixed and variable costs ➤ Update the existing pricing to ensure all costs are captured ➤ Constantly reconcile the costing with financial records ➤ Periodically reconcile the costing and pricing with financial records 	<ul style="list-style-type: none"> ➤ Enlist the help of a cost accountant to develop an effective cost structure and implement a costing system
PERSONNEL BENEFITS AND INCENTIVES	<ul style="list-style-type: none"> ➤ Organise discussions with staff to identify suitable incentives and benefits ➤ Define performance criteria and put in place quarterly performance target and review meetings for all the staff ➤ Base the incentives and benefits allocation on the measured performance 	<ul style="list-style-type: none"> ➤ No recommendation based on external expertise

SUB-AREAS	RECOMMENDATIONS	
	INTERNALLY	WITH SUPPORT OF EXTERNAL RESOURCES
PERSONNEL POLICY	<ul style="list-style-type: none"> ➤ Develop an administrative and personnel policy manual ➤ Implement the policy and monitor progress 	<ul style="list-style-type: none"> ➤ Assistance to develop and establish a performance management system
QUALITY CONTROL	<ul style="list-style-type: none"> ➤ Develop a documented quality control policy ➤ Define documented responsibilities and train quality control personnel ➤ Develop procedures and documentation to monitor rejection and wastage. 	<ul style="list-style-type: none"> ➤ Enlist the help of an expert to develop, train and document procedures

SUB-AREAS	RECOMMENDATIONS	
	INTERNALLY	WITH SUPPORT OF EXTERNAL RESOURCES
PROCEDURES	<ul style="list-style-type: none"> ➤ Establish clientele preference ➤ Implement and document recognized standards such as BOBS ➤ Establish documented measurement criteria's ➤ Identify and document critical control points which should be adhered to ➤ Implement quality checks procedures 	<ul style="list-style-type: none"> ➤ Enlist the assistance of experts in this field of business

Priority Interventions

This company is bankrupt and requires immediate actions to get back it on feet. To improve growth and profit margin, Mokgabo Dec Interiors should develop and implement a plan to turnaround the business which implies:

a) Finance

- Clear the inventory and all receivables
- Set up stringent cash flow management system, with weekly review and update
- Put in place a product costing system taking into account all variable and fixed costs
- Restructure the long term loan
- Recapitalize the company to rebuild its equity base

b) Hire key personnel (production manager)

c) Boost sales revenues

- Further investigate the market to identify segments with growth and profit potential e.g. retail stores, wholesales
- Put a marketing and sales plan and generate more sales
- Determine product pricing based on costing in a way to secure adequate margin



Thank You