



BERDYTCH CLOTHING LIMITED

Elizabeth M. A. Grasby and Dave Shaw wrote this case (originally P.W. Limited written by Dana G. Hyde, under the supervision of Richard Mimick) solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

Version: 2014-07-03

When Cristina Berdytch graduated with her HBA (honors degree in business) from the Ivey School of Business in May 2014, she did not have to spend any time looking for a job. The family business, Berdytch Clothing Limited (Berdytch), required her immediate attention and she was ready to devote her time, energy and knowledge to the business. Christina's grandmother, Josie Berdytch, was running the business and wanted to retire. In addition to some general management issues, Cristina knew there were operating and marketing problems that also needed attention. Cristina's family members looked upon her as their possible "saviour" of the family business, with her education representing the key to a successful outcome.

BERDYTCH CLOTHING

Berdytch Clothing was founded by Jiri and Marie Berdytch in 1967. The couple had escaped earlier that same year from Czechoslovakia (now the Czech Republic) and had immigrated to Canada, settling in Montreal. Just outside the city of Prague in Czechoslovakia, the couple had run a business making children's clothing, so in the North American market, they immediately established themselves as a supplier of children's clothing, sizes 2 to 6 and in a mid to higher price retail range.

Josie Berdytch, the only daughter of Jiri and Marie Berdytch, took over the business after her father died in 2000 and her mother no longer wanted to be involved in the operations. Since that time, Berdytch had been Josie's life work. In addition to designing all the clothing sold by Berdytch, Josie communicated with the customers, managed the employees, co-ordinated with the outside seamstresses and handled quality control. Josie also looked after the finances, although an accountant came in to maintain the company's books and prepare financial reports and financial statements.

Berdytch's product line included dresses, playsuits, blouses, shirts, pants and ensembles, all constructed mainly in polyester and cotton blended fabrics. Each item sold to retailers at an average price of \$18 per piece, and the products were in turn marked up a further 100 per cent by retail owners for sale to customers.

In 1967, Montreal was a thriving textile centre. By 2014, however, most of the textile manufacturers had disappeared, unable to compete with the low labour costs of their foreign competitors. However, Berdytch survived because it had a unique production system wherein it outsourced the sewing to a group of women who made the garments in their own homes on their own machines and because it enjoyed a reputation for

quality products among its customers, most of whom were large retail chains that had dealt with Berdytch for many years. A representative from one of Berdytch's major buyers, a large North American retail clothing chain that purchased over 50 per cent of the company's output, had indicated that if Berdytch could produce more, the chain would buy more. This customer also commented:

[Berdytch's] quality is flawless, and their prices are very competitive; we get exactly what we ask for. Their flexibility is also an advantage. We'll send a design over, and they will produce it for us. Sometimes, I'll simply phone over and ask them to send over a dozen of their best styles, and we're always pleased with the results. We wish their delivery was more reliable, but their prices can't be beaten.

This large chain preferred dealing with domestic suppliers and chose to limit its buying from foreign producers for several reasons: there were severe restrictions on returning orders (due to the distance), increased lead times were required, and the supplier had little flexibility due to the distance between the supplier and the buyer.

Berdytch did very little formal marketing of its products. Josie relied on the orders from her long-standing customers and on word-of-mouth, and she did most of the selling herself. Another employee processed most of the orders and kept the sales records. Berdytch spent most of its advertising budget on visiting major retail chains with product samples three to four times a year and on its business-to-business website, which was regularly updated with the latest product listings (with pictures) and prices.

THE PRODUCTION PROCESS

Berdytch bought the fabric and various supplies required for the manufacture of its clothing from several major suppliers; all supplies were shipped to Berdytch's factory. The required material averaged 10 metres per dozen garments. It was cut at the factory, 20 thicknesses at a time, using an industrial machine cutter.

The cut material, together with lace, thread and a sample garment, were delivered daily by truck to Berdytch's 15 sewers. The contract sewers' wages ranged from \$16 to \$30 per dozen garments, and some of the sewers could produce 20 dozen garments a week. Most of the sewers worked part time because they had families and other responsibilities.

When completed, the assembled garments were picked up by the truck and returned to the factory where buttons, labels and finishing touches were added by the 13 factory employees. The garments were then pressed and hung in plastic, awaiting shipment. Berdytch's variable costs (i.e., material and trim, buttons, thread and other supplies, factory labour and home labour) averaged \$10 per garment.

The company increased its production from April through to July in order to prepare for its busiest sales months in September and October, which was when retailers purchased their stock for the upcoming winter season and, in particular, for Christmas.

RECENT CONCERNS

The issue of unreliable delivery mentioned (above) by Berdytch's major retail customer had lately become a huge headache, and the firm was becoming known for its late deliveries. In July 2013, Berdytch's chief supervisor, Alva Hudak, retired after 18 years with Berdytch, and it was at this time when the problems

associated with delivery, invoicing, work scheduling and various other matters (all previously handled by Alva Hudak) surfaced. Josie had been unable to find a suitable replacement for the chief supervisor position, and she had taken on much of the work herself. As a result, the production process was a little out of control. Josie commented: “My factory workers have been with me for many years and they know their jobs, but they are too busy in the factory to help with any of the problems.”

Until recently, Josie had designed all of Berdytch’s clothing; however, since the departure of her chief supervisor, she had been too busy to design clothes. She had had to learn how to prepare invoices again and deal with office problems, after years of leaving the daily operations to the supervisor. Luckily, Josie managed to find a designer in Toronto who produced some sample designs and then sent them to Montreal for Josie’s approval.

In addition to having a problem replacing the chief supervisor, Josie was also having difficulty finding and retaining good home sewers. Some of the current sewers were interested in retiring or at least slowing down. As well, although there were many home sewers available for work, few of these women were skilled enough to sew the garments to the standard expected. Also, some of the existing sewers had asked to be paid more – a rate as high as \$40 per dozen pieces – to more accurately reflect the “going market rate” for this kind of work and to make it worth their time and effort. Josie stated that, although her home sewers were loyal to Berdytch (many of them had sewn for the company for 20 years), she was not sure whether their loyalty would withstand the lure of higher wages. Knowing that the company could sell more than it currently produced, the need for more good sewers was obvious.

Now 68 years old, Josie was talking daily about retirement and selling the business. In fact, she thought the time was right to sell. “We’ve got too many problems right now, and I don’t want to work much longer,” she said. “But the business is in good financial health, and I’ve got loyal customers, a dedicated work force and a group of wonderful sewers. I believe that I could sell the business for the value of the shareholder’s equity on the balance sheet.” (Financial information is provided in Exhibits 1 to 2.)

DECISION TIME

Cristina Berdytch listened to her grandmother’s thoughts and concerns, but she did not have much time to evaluate the situation and decide on a course of action. If the business was to be sold, what would be a reasonable price? And if it was not to be sold, what could be done to solve the problems? Christina started her review of the situation by examining the company’s financial statements and her own ratio analysis of the firm (see Exhibit 3).

EXHIBIT 1: INCOME STATEMENT
for the years ending March 31
(in 000's)

	2014	2013	2012	2011
Sales	\$ 1,374	\$ 1,264	\$ 1,434	\$ 1,376
Cost of goods sold:				
Inventory - beginning	102	101	210	106
Purchases - materials	446	526	552	652
Wages and contract labour	<u>338</u>	<u>320</u>	<u>452</u>	<u>398</u>
Cost of goods available for sale	886	947	1,214	1,156
Less: inventory - ending	<u>102</u>	<u>102</u>	<u>101</u>	<u>210</u>
Cost of goods sold	784	845	1,113	946
Gross profit	590	419	321	430
Operating Expenses:				
Freight and delivery	36	26	34	33
Packaging and shipping	27	24	28	27
Miscellaneous	13	12	7	6
Utilities and rent	52	50	49	49
Administration salaries	47	45	36	34
Marketing and advertising	25	24	23	20
Management salaries	<u>97</u>	<u>81</u>	<u>95</u>	<u>83</u>
Total operating expenses	297	262	272	252
Net income before taxes and interest income	293	157	49	178
Interest income	<u>16</u>	<u>8</u>	<u>3</u>	<u>0</u>
Net income before taxes	309	165	52	178
Income tax expense	<u>92</u>	<u>49</u>	<u>15</u>	<u>53</u>
Net income after taxes	<u>\$ 217</u>	<u>\$ 116</u>	<u>\$ 37</u>	<u>\$ 125</u>

Exhibit 2: BALANCE SHEET
for the years ending March 31
(in 000's)

	2014	2013	2012	2011
Assets				
Current Assets:				
Cash	\$ 94	\$ 112	\$ 75	\$ 50
Bank term deposits	240	200	75	0
Accounts receivable	194	126	156	106
Inventory	<u>102</u>	<u>102</u>	<u>101</u>	<u>210</u>
Total current assets	630	540	407	366
Fixed Assets:				
Machinery and equipment	380	380	380	380
Less: accumulated depreciation	<u>309</u>	<u>293</u>	<u>274</u>	<u>250</u>
Total fixed assets	71	87	106	130
Total assets	<u>\$ 701</u>	<u>\$ 627</u>	<u>\$ 513</u>	<u>\$ 496</u>
Liabilities and Equity				
Current liabilities:				
Accounts payable	\$ 102	\$ 160	\$ 131	\$ 89
Taxes payable	<u>28</u>	<u>1</u>	<u>8</u>	<u>2</u>
Total current liabilities	130	161	139	91
Shareholder's Equity:				
Common stock	2	2	2	2
Retained earnings, beginning of the year	464	372	403	330
Add: net income after taxes for the year	217	116	37	125
Less: dividends	<u>112</u>	<u>24</u>	<u>68</u>	<u>52</u>
Retained earnings, end of the year	<u>569</u>	<u>464</u>	<u>372</u>	<u>403</u>
Total shareholder's equity	<u>571</u>	<u>466</u>	<u>374</u>	<u>405</u>
Total liabilities and equity	<u>\$ 701</u>	<u>\$ 627</u>	<u>\$ 513</u>	<u>\$ 496</u>

**Exhibit 3: RATIO¹ ANALYSIS
for the years ending March 31**

	2014	2013	2012	2011
Profitability				
Cost of goods sold	57.1	66.9	77.6	68.8
Gross profit	42.9	33.1	22.4	31.3
Expenses	21.6	20.7	19.0	18.3
Net income after taxes	15.8	9.2	2.6	9.1
Return on equity ²	42.7	27.6	9.5	30.9
Liquidity				
Current ratio	4.8	3.4	2.9	4.0
Acid test	4.1	2.7	2.2	1.7
Efficiency				
Age of receivables (days)	51.5	36.4	39.7	28.1
Age of payables (days)	83.5	111.0	86.6	49.8
Age of inventory (days)	47.5	44.1	33.1	81.0
Stability				
Net worth: total assets	78.6	74.3	72.9	81.7
Growth				
Sales	8.7	-11.9	4.2	
Assets	11.8	22.2	3.4	
Equity	18.2	24.6	-7.7	
Profit	87.1	213.5	-70.4	

¹ 365 days used

² Calculated using average equity when possible