The CFO Program

CFO Perspectives

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CFO Speaks

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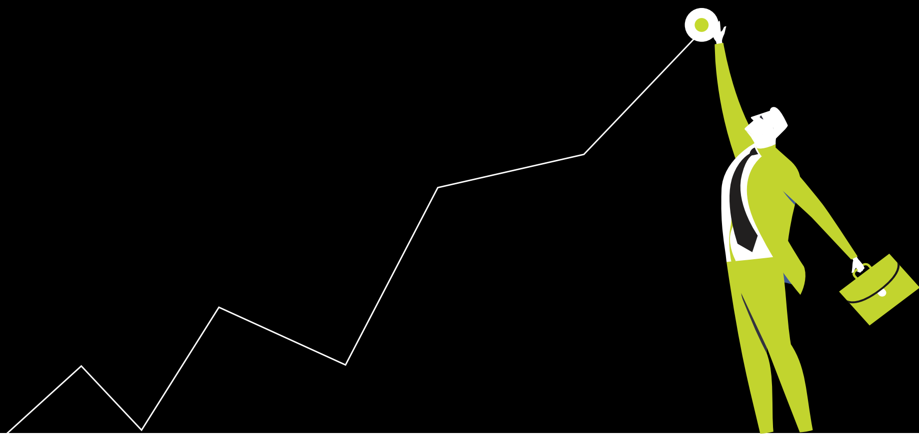


1. **What is your outlook on the economy in the next 1-2 years? As a CFO, do you think that ease of doing business has improved in India and how could this be further improved?**

   Outlook for Indian economy remains strong, although we have seen a brief period of slowdown in the recent past. The economy is picking up gradually since the last quarter and we expect strong growth of 7 to 7.5% in the next 3-4 years, which makes us as one of the fastest growing economies, on par with China. Further, I foresee continuity of government in 2019 elections, which will continue the overall positive growth trajectory of existing policies and focus areas.

   In terms of 'Ease of Doing Business', we have scaled up 30 ranks as per World Bank's latest report and India ranks at 100 now in the list. Moreover, our personal experience in dealing with the government departments have really improved and we find them more supportive in terms of approvals and understanding the business concerns. Surely we are witnessing an improvement, but there is a room for further improvement. I feel insolvency laws need to be further enhanced, but at the same time it is good to see that the work is being done in that area and we are creating a legislation framework.

   Further, recapitalization of banks is certainly a good move by the government and is required to get economy back on the track towards achieving the desired growth. However, as we move forward a lot will depend on its successful implementation.

2. **There has been a huge increase in taxes for sports shoes and equipment post GST which has increased from 4-6% to 18%. What are the challenges your business is facing in terms of logistics and operations with GST?**

   Our transition to GST regime has been fairly good from the migration perspective. We have done a decent transition in terms of logistics, manufacturing, pricing to the consumer, and enabling invoicing from the system from day-one. We have not seen many challenges in our operations so far, apart from the minor stresses which came from few vendors in initial 2-3 months. Although we have seen increase in taxes for many of our products, but as a company we have absorbed those taxes and have not passed on much to the consumers.

   Further, I believe with the implementation of GST, spurious manufacturers will be out of business, because the economics of their business will not work in the current scenario.

3. **Adidas has incurred losses in Reebok and sales growth is under pressure. As a CFO, what are your key focus areas and how do you partner with business to improve margins and grow the business?**

   As of March 31, 2017, Adidas operating entity topline grew by 22%, whereas the Reebok topline grew by

16%. The growth had slowed down for a while, but we are now back to the growth trajectory and doing well as compared to our competitors which are below 10% growth.

We did make losses in Reebok in the recent past. However, as a CFO my focus in last 4 to 5 years has been more on improving operating results through improving operating leverage. We worked in many areas like store footprint, optimizing fixed costs, cash flows, product portfolio, manufacturing efficiencies, return on marketing investments, etc. As a company we have a slogan – **"be better, before you grow bigger",** which we follow to get through a model where business is profitable and more importantly sustainable. The Reebok business has turned profitable and I believe, with our recent focus on operating business, the profitability story will continue.

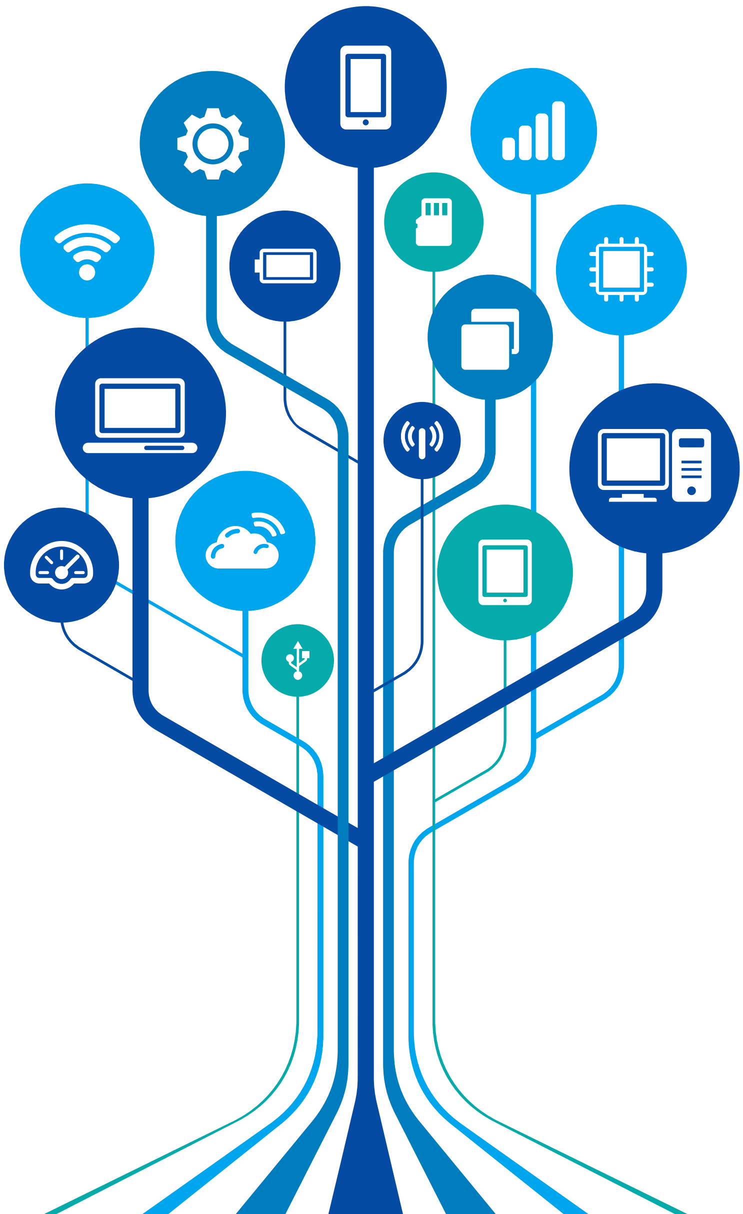
4. How do you leverage technology and harness the power of analytics in your business to project trends and analyse customer behaviour?

Essentially 50% of our business is through mono-branded stores, wherein we have our own point-of-sale (POS) system. This helps us to look at our product movement and sales very closely. We have a product line of over 20,000 and the system enables us to see the product movement from warehouse to store to final sales, and lets us know the details on what is selling and what isn't. We capture all these data and based on the information we run algorithms to analyse data and use it in our sales planning, merchandising and retail operations. On daily basis we record these details and make decisions whether to transfer a product from one store to another, or not to sell a product beyond ware house to franchise partners, or we should look at discounting to clear the stocks. These decisions are based on the analytics and I don't think anyone else in this business has such a sophisticated system of mapping data at large number of POS in the country.

We also have our CRM process in place, which gives us access to huge database of our customers. We leverage this data to communicate with our customers in terms of launches, products, offers, etc. based on the behaviour demonstrated in their previous purchase from us. We are also looking at chat-bots in the near future, with lot of work being done at our end in areas of technology and analytics.

5. You do significant contract manufacturing in India. How do you manage the risks associated with contract manufacturing, whether it be maintaining product quality or restricting spillage of the products manufactured under your brand?

We do a lot of contract manufacturing and it is almost 80% of what we sell in India; whereas the remaining 20% is imported from countries like Taiwan, Vietnam, China, etc. However, in terms of quality, the risk is well spread across the number of manufacturers. Further, we have a separate sourcing arm, which keeps a check on production quality and manages all the risks for contract manufacturing. The entire process is designed very carefully and the product quality assessment is done in close contact with these manufacturers to see that the set benchmark exists in all our products.



Leakage or manufacturing spill-out by our contract manufacturers for sale at lower prices is a risk, but we have checks and balances in place to make sure that it does not happen. As a policy, we are very strict on matters of non-compliance and the consequences are huge if someone breaches the contract terms. Thus, it deters the people with wrong intent to do any such thing which can lead to their contract termination.

6. What are the top 3 challenges you face as a CFO in the current environment?

i. **Regulatory uncertainty** is one of the biggest challenges we face as a CFO. The regulations keep changing and we are never sure that what regulation exists today, will be there tomorrow. I feel we should have continuity of regulations and policies for next 5-10 years.

ii. **Growth** is another challenge which we face. It is important to identify the channels and partners, from where the growth will come. Also, we need to determine if there are any adjacent products and categories where we can get into for sustainable growth. Further, it is important to have correct pricing for continued growth.

iii. Lastly, **profitability and cash** are important factors for any business to sustain. It is important for CFOs to see how we grow profitably and to identify the channels and brands which would give us incremental profitability as opposed to the legacy business.

Expert Views

Budget 2018: An Overview

In a modern electoral democracy such as India, the last Budget of any government before an election typically has little elbow room for structural reforms. This was clearly demonstrated by the Finance Minister when he presented his Union Budget for the fiscal year 2018-19 on February 1, 2018.

The budget estimate of fiscal deficit for financial year 2017-18 was 3.2% of the gross domestic product (GDP); the revised estimate is now 3.5%, the same as for financial year 2016-17. The Finance Minister noted that this is because the government will receive goods and services tax (GST) revenue for 11 months in 2017-18 and face shortfall in non-tax revenue due to lower accrual through spectrum auction. The revised fiscal deficit target for 2018-19 is 3.3% of the GDP against the earlier target of 3%. However, rising global crude prices, increase in minimum support price and a slew of social schemes announced in the Budget including Modicare raise a question as to whether this target can be adhered to.

On the tax front, the composition of direct and indirect tax in total tax collection remains skewed in favour of indirect taxes. Apart from China, India has the lowest share of direct taxes in total taxes. The economic survey notes that commensurate to the stage of development, India is not an outlier and its direct tax share is similar to other countries at a comparable stage of development. However, unlike in other countries, India's reliance on direct taxes seems to be declining, a trend that will be intensified if the GST proves to be a buoyant source of revenue.

This incongruity is primarily because successive Indian governments have succumbed to the low hanging fruit of increasing indirect tax scope and collections rather than implementing tough measures for increasing the direct tax collections leading to an unequitable tax regime. Implementation of the recommendations made by Tax Administration Reform Committee (TARC) would certainly be helpful.

At the same time, the government seems to be keeping up with its promise of moving to a 25% tax rate over a period of time The tax rate for domestic companies with a turnover below INR 250 crores in financial year 2016-17 has been reduced from 30% to 25% (rate of cess has been increased from 3% to 4%). This reduction in corporate tax rate is in line with the global trend of increasing the tax base and lowering of tax rates. Recently, the US government slashed its corporate tax rate from 35% to 21%; UK, which has already reduced the corporate tax rate to 19%, plans to cut corporation tax to 17% by the end of the decade.

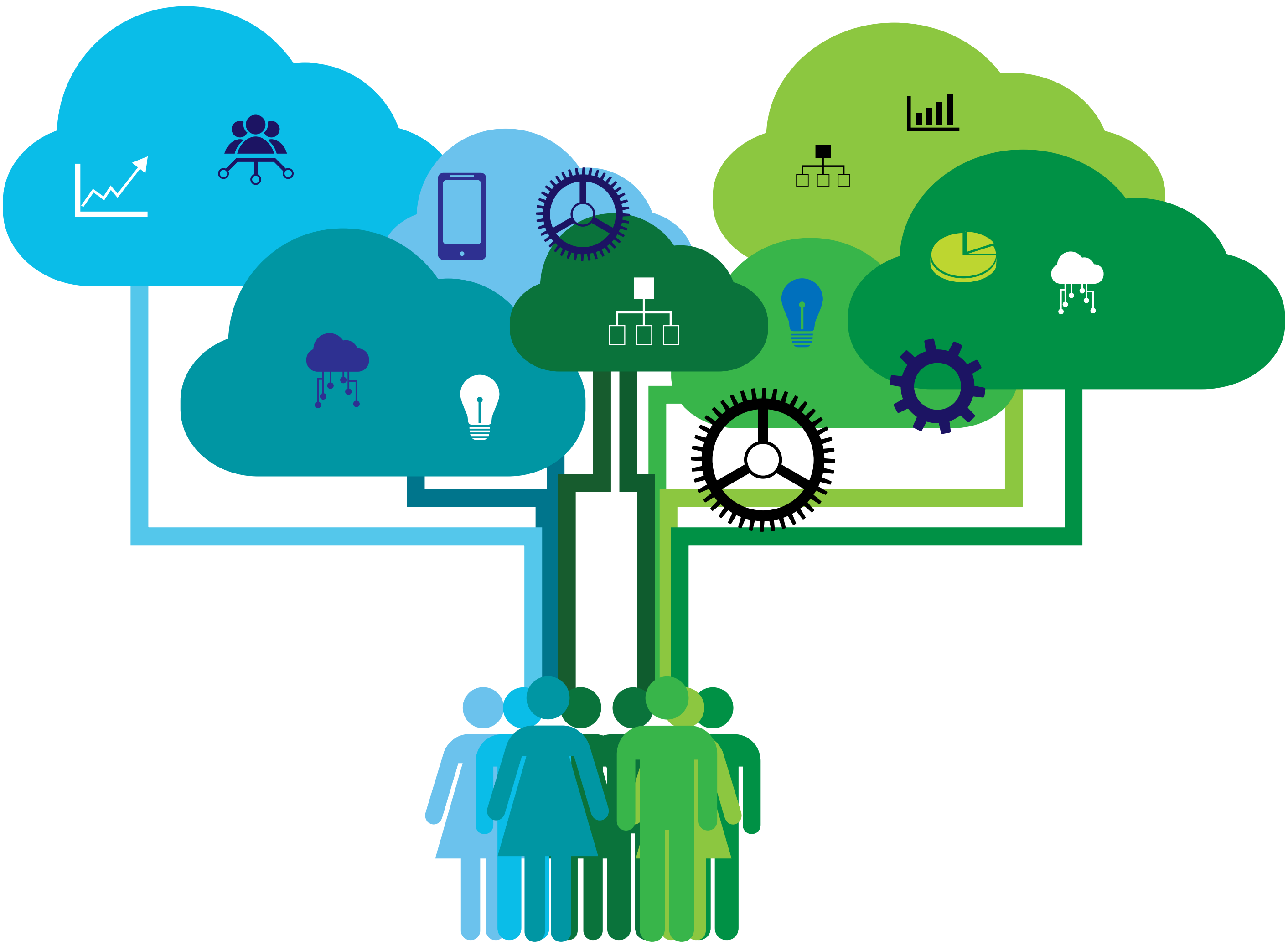
The most attention seeking proposal in the Budget is removal of the exemption on long term capital gains tax on sale of listed shares, unit of an equity-oriented fund or a unit of a business trust. Interestingly, in 2004, the then Finance Minister, P Chidambaram had abolished capital gains tax for listed securities in lieu of a small price in the form of a securities transaction tax, which one had to pay. This was done with a view to simplify the tax regime on securities transactions. Fourteen years down the road, an investor is now seeing a complicated capital gains tax regime with multiple rates and calculation mechanism depending on the type of security and the period of holding. The silver lining is the grandfathering of the gains arising on or before January 31, 2018. The jury is still out on whether the post-Budget reaction in capital markets is linked to the proposal or due to a mere broad-based global impact. Removal of capital gains tax exemption on sale of units of Infrastructure Investment Trusts and Real Estate Investment Trusts would also impact the success of these new reformative structures introduced to address issues relating to finding markets for illiquid investments.

The government has also introduced measures to facilitate insolvency resolution. These include increased ability to carry forward and set-off of losses while calculating taxes under Minimum Alternate Tax provisions and ability to carry forward losses even when there is a change in shareholding beyond 51%. These changes will give relief to companies which are restructuring and rehabilitating themselves through the statutory corporate insolvency resolution process.

To incentivise domestic value addition and to promote Make in India, the Budget proposes Social Welfare Surcharge, to be levied at the rate of 10% on import of all goods except those specifically notified. The surcharge would be applicable on aggregate customs duties (excluding IGST and Compensation Cess).

The definition of 'business connection' under the domestic tax law is proposed to be aligned with the corresponding changes suggested under the OECD-G20's Base Erosion and Profit Shifting (BEPS). The Budget also proposes to introduce the concept of 'significant economic presence'. Fortunately, the government has itself clarified that these changes would not impact the position under tax treaties. Specifically, the concept of 'significant economic presence' is not present in the multilateral convention (MLI) to implement BEPS recommendations and the Indian government would need to renegotiate the existing tax treaties individually to implement these changes.

After facing a temporary dip due to demonetization and implementation of GST, the Indian economy is inching back to 7% plus growth rate. The IMF expects India to grow at a rate of 7.4% next year. All in all, the Budget is an attempt to reduce inequality between the rich and the poor. The pudding will be sweeter if the implementation is equally effective and appropriate efforts are directed accordingly.



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