

# Financial Strategy and Governance

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**Abstract:** In this article we introduce Burberry and analyse the stage of maturity Burberry's company is currently in; and use plc, while critically assessing the company's current financial strategy and proposing a new financial strategy of unbundling the business and mergers and acquisitions. This was additionally combined with corporate social responsibility and actions to ensure compliance with corporate governance.

**Keywords:** Burberry, Financial strategy, Corporate governance.

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## 1. Introduction

The company I have chosen is Burberry PLC, which is part of the luxury sector of personal products and is a luxury clothing brand with a very British heritage. The main products are clothing, clothing accessories, handbags and footwear, beauty, fragrances, home furnishings and gifts. The paper begins with an analysis of the company's development background, core products, company culture and leading technology, etc. Then using investor risk, earnings per share (eps) and net cash flow, sources of funding, dividends, Shareholders' returns, price/earnings (P/E) ratio and the share price, and the CAPM model to analyse the stage of development of the company. This was followed by a critical analysis of the current financial strategy and key figures through the Product life cycle, five years of annual reports, in particular the strategic report and financial statements, as well as relevant data. Following this analysis, a PLC approach is applied and a new financial strategy is proposed and finally a series of conclusions are drawn in relation to corporate governance.

## 2. Company Introduction

Burberry PLC, a brand founded by Thomas Burberry in 1856, is a global luxury brand with a distinctly British character. Over the decades, the brand has built its reputation on traditional craftsmanship and innovative design, and since Thomas Burberry invented the gabardine fabric over 150 years ago, the coat has been a core product of the business, and remains so today - best represented by Burberry's iconic Trench coat. Burberry's signature tartan, a crosshatched pattern of light camel, black, red and white, is a symbol of the Burberry brand. A large proportion of Burberry's products are made in Europe, with production sites and third parties primarily in the UK. It also has a centre of excellence for leather goods in Italy and works with a global network of suppliers.

Burberry Group plc is listed on the London Stock Exchange and is a member of the FTSE 100 index. In April 2020 it was ranked 17th on the list of the '50 Most Valuable Clothing Brands in the World 2020' (Burberry - Wikipedia, 2021).

Burberry's mission is to 'open spaces with creativity' and from the invention of the gabardine to the exploration of augmented reality retail, creativity thrives as a key part of Burberry's operations, setting the company apart from its

peers. In early 2020, Burberry launched an augmented reality shopping tool through Google search technology. The use of augmented reality in commerce transforms the product discovery and search phases of the retail journey by reducing the friction between online shopping and the in-store experience. Incorporating augmented reality into the online retail space provides customers with additional knowledge, offering an experience they could previously only get in-store. Burberry is one of the first luxury retailers to take advantage of this new tool from Google to introduce AR technology into the online retail space (Strategy, 2021).

Burberry is part of the personal products industry, and personal products have always been an integral part of our daily lives. With the development of the economy and the improvement of the general public's standard of living, the personal products industry has become increasingly mature, with an ever-increasing range of products and more intense competition in the market.

## 3. Financial Position Analysis

Burberry has a history of over 100 years and has a proven business strategy and growth objectives. This paper presents a financial and stock market analysis of Burberry based on five years of information collected to determine the company's stage of development.

### (1) Investor Risk

Every business is exposed to systematic and unsystematic risk. Systematic risk (or market risk), which is dependent on market conditions, is the total risk prevalent across all stocks and shares and cannot be diversified. Unsystematic risk (or non-market risk) is a risk factor specific to a company's own type of business or the industry in which it operates, and can be eliminated through diversification. Systematic risk consists of business risk and financial risk.

**Business Risk:** Business risk refers to situations where profits decline or result in losses due to uncertainty. The degree of business risk varies from industry to industry and also relates to the profits generated by the company (Davies and Crawford, 2014). The business risk is moderate during the maturity period, as the company is still struggling to maintain a sufficiently high market demand for its products once it has a certain base. Burberry has seen a steady increase in Operating Profit over the four-year period from 2016 to 2019, with a decline due to the impact of Covid-19 in 2020. But overall, it still maintains a high level of market demand, exactly as in Table 1.

**Table 1. Business Risk**

Year	2016	2017	2018	2019	2020
Operating Profit (£m)	403	394	410	437	189

Financial risk is the risk arising from the impact of interest on the earnings measured by a company's financial position, with the risk rising as debt increases. Financial risk therefore has an impact on both a company's profit and its ability to pay dividends (Davies and Crawford, 2014). The financial risk at the maturity stage moves to a medium level as more debt can be taken on. Burberry's debt surges in 2020 due to Covid-19, but remains affordable, exactly as in Table 2.

**Table 2. Financial Risk**

Year	2016	2017	2018	2019	2020
Total liabilities (£m)	749.3	720.9	802.5	877.2	2078

**(2) Earnings per share (eps) and net cash flow**

At the maturity stage of the business, eps are high and cash flow is positive as cash inflows from sales increase and cash outflows decrease (the product is mature and does not require significant investment in research and marketing). Burberry has positive cash flow and steady growth, and high eps, exactly as in Table 3.

**Table 3. Eps and Net Cash Flow**

Year	2016	2017	2018	2019	2020
Earnings per share (eps)	69.4p	64.9p	68.4p	81.7p	29.8p
Net cash (£m)	660	809	892	837	887

**(3) Sources of funding**

In the maturity phase, the company continues to be funded by equity and retained earnings. Burberry's Total equity and Retained earnings remain high despite a decline in 2020, exactly as in Table 4.

**Table 4. Total equity and Retained earnings**

Year	2016	2017	2018	2019	2020
Total equity (£m)	1620.9	1697.8	1425.4	1,460	1218.8
Retained earnings (£m)	1140.9	1,169	946.1	965.6	702.2

**(4) Dividends**

At a mature stage, the company is likely to generate profits and should have sufficient cash flow to pay dividends. Burberry does have sufficient cash flow to pay dividends to shareholders, exactly as in Table 5. Cash flows from financing activities:

**Table 5. Dividends**

Year	2016	2017	2018	2019	2020
Dividends Paid in the year (£m)	(157.7)	(164.4)	(169.4)	(171.1)	(175.2)

**(5) Shareholders' returns**

Shareholders are able to receive returns in two ways:

a) Returns in the form of dividends received. b) Through the return generated by an increase in the share price (capital

appreciation or capital growth).

Burberry has paid a high dividend in its mature stage, but has little prospect of future growth.

**(6) Price/earnings (P/E) ratio and the share price**

In a mature stage, the P/E ratio will develop to a moderate level due to high earnings but low future growth expectations. At the same time, because a major part of shareholder returns now comes from dividends, share prices should be less volatile. Burberry's P/E ratio and share prices have developed moderately and with less volatility, except for the impact of Covid-19 in 2020 which has led to greater variability, exactly as in Table 6.

**Table 6. P/E ratio and Share Price**

Year	2016	2017	2018	2019	2020
P/E Ratio (£m)	19.5	26.40	24.62	23.75	46.78
Average share price (£m)	1308.9	1738.2	1878.5	2014.1	1544.8

**(7) CAPM Model**

In the CAPM, the beta for the whole market is 1. If a company's beta is less than 1, its returns are less volatile than the market and it is generally a company in a mature stage, while if a company's beta is greater than 1, its returns are more volatile than the market (Davies and Crawford, 2014), more volatile than the market and it is generally a company in a growth stage. In Burberry's CAPM model, the value of  $\beta$  is 0.9280, exactly as in Table 7.

**Table 7. CAPM Model**

SUMMARY OUTPUT						
Regression statistics						
Multiple R	0.44352827					
R Square	0.19671732					
Adjusted R Square	0.18286762					
Standard error	0.08870775					
Observations	60					
Variance analysis						
	df	SS	MS	F	Significance F	
Regression	1	0.11177002	0.11177002	14.2037231	0.00038621	
Residual	58	0.45640576	0.00786906			
Total	59	0.56817578				
	Coefficients	Standard error	t Stat	P-value	Lower 95%	Upper 95%
Intercept	0.00044961	0.0118832	0.03783559	0.9699487	-0.0233372	0.02423641
Mkt-RF	0.82804333	0.24624465	3.376878271	0.00038621	0.43513071	1.42095595

From the above research it can be concluded that Burberry's current life cycle is a mature one.

**4. Current financial strategy****(1) Product life cycle (PLC)**

PLC analyses the level of sales over the product life cycle and it can be used to forecast trends in sales, profits and cash flow. At each stage of the PLC there are varying degrees of business risk. In PLC, maturity is a period of equal demand and supply. The demand for a product decrease with time, product replacement or the availability of alternatives, so the maturity period is not always constant. Once a company enters the decline phase, they are faced with the need to develop new products or go out of business (Davies and Crawford, 2014).

**(2) Critically evaluate company's current financial strategy**

Over the past 100 years, Burberry has become one of the world's most valuable luxury goods. Since its initial public offering in 2002, the company has enjoyed strong growth in a number of categories. But today's luxury industry has changed, with new consumers coming in demanding that brands bring creativity, personality and appeal. They are moving away from traditional ideas of luxury and elegance

and are looking for casual and fun fashion pieces to make a statement. At the same time, an increasing number of customers are more willing to mix luxury and mass market products. To win over consumers, Burberry has had to strengthen its brand positioning, and getting more bang for the buck in the market is the only way to achieve sustainable long-term value. As a result, Burberry launched a new transformation strategy in November 2017, focusing with positioning luxury fashion. By reinvigorating Burberry's products and customer experience, it will drive sustainable growth and meaningful operating margin growth, while continuing to deliver attractive returns for shareholders.

Burberry's transformation will take place in two phases: first, a two-year investment in rationalising the company's distribution to strengthen the brand positioning and position Burberry firmly in the luxury segment; in the second phase, growth is expected to accelerate, driven by a new creative vision and a re-energised brand positioning, combined with appropriate distribution support, exactly as in Table 8.

**Table 8.** Stock Return, Operating Profit and Average Share Price

Year	2016	2017	2018	2019	2020
Stock return	28.21 %	11.19 %	11.49 %	24.60 %	- 8.37%
Operating Profit (£m)	403	394	410	437	189
Average share price (£m)	1308.9	1738. 2	1878. 5	2014. 1	1544. 8

As can be seen from the table, stock return, operating profit, and average share price increased in the two years following 2017 with the launch of the newly positioned luxury fashion strategy, the new strategy increased the reach of the brand and consumers responded very positively to the products. Therefore, the strategy is effective and appropriate for Burberry. However, due to the significant impact of the Covid-19 epidemic, there was a significant decline in 2020. This is due to the closure or reduction of shops around the world, a significant reduction in customer traffic and disruptions on the supply side. The strategy is therefore not designed to be comprehensive enough to face unexpected risks.

Therefore, health emergencies, restrictions on public life and economic recessions are likely to persist in the coming months and they will have a greater impact on the demand for luxury goods. How to stabilise the market value of the brand and protect shareholders' rights is an urgent consideration for the company's strategy.

## 5. Propose New Financial Strategy

PLC analyses although companies that persevere through market turmoil will enjoy high levels of sales and stability. But the maturity stage does not last forever, because as the economy develops and the market renews, it is inevitable that it will move from the maturity stage to the decline stage, where the demand for the product will decrease over time (Davies and Crawford, 2014). So how to stabilise Burberry's maturity phase, re-energise the brand and slow down the move into the decline stage is the aim of the proposed new financial strategy.

(1) Splitting up the business. This strategy can be used to split up a large group and thus operate as a separate business. As the timing of the return to economic growth following the

COVID-19 pandemic is uncertain, there is a risk that the spread will continue and/or the recovery will take longer. There could also be further significant impacts on the future operations, cash flow and viability of the company. It is therefore possible to split Burberry into separate businesses. For example, in mainland China, where the outbreak has been effectively contained and the economy, which economists predict will be the only country in the world to grow. Burberry could set up a separate business to operate in China, drawing on the operational experience of Chinese companies, which could design items more relevant to the preferences of Chinese consumers, and establish strategic partnerships with Chinese companies as well as third party partnerships.

(2) M&A. The company can regain market share by acquiring several small competitors in the industry at low cost, or by acquiring companies that are considered to be significantly undervalued. For example, in the spreading environment of the Covid-19 epidemic, some companies in the start-up or turbulent stages may be at risk of transformation or bankruptcy. If Burberry acquires at a low cost, it can be more advantageous in the negotiation process with suppliers and customers. The products of the acquiring company can be rationalised by eliminating surplus capacity, giving the opportunity to increase sales prices and achieve greater profitability. At the same time, acquiring companies that are considered to be significantly undervalued could increase Burberry's future market share and be more beneficial to the brand's position.

## 6. Corporate Governance

Corporate governance reflects the mechanisms by which the owners of a business manage the directors and management of the business and involves the relationship between the directors, shareholders, stakeholders and managers of the company, and corporate governance tools can deal with agency problems to some extent. There are three principles underlying the Code: Openness; Integrity; Accountability (Davies and Crawford, 2014).

### (1) Corporate social responsibility (CSR)

In a world where corporate trends and decisions are strongly influenced, the importance of corporate social responsibility is becoming increasingly important. Burberry, one of the world's leading luxury goods companies, is actively engaged in corporate social responsibility to enhance its brand image and future growth. Employees take pride in the organisation they work for and good CSR can also improve customers' attitudes towards the company. Companies can benefit from word-of-mouth marketing, which can lead to more business opportunities. During the special times of the COVID-19 epidemic, Burberry could produce some personal protection or frontline medical staff supplies, and the company could also donate amounts to the COVID-19 Community Fund. In general, the company could also promote environmental protection, reduce pollutant emissions, etc.

### (2) Actions to ensure compliance

For directors: they must ensure that they are fully informed about the affairs of the company and the contents of important meetings, that they are competent and of good character to do their jobs and that they are also responsible for the careful and timely management of the accounts. The legal side: Burberry's legal department keeps abreast of constantly changing laws and regulations. Compliance with the law is an ongoing process, particularly as legal requirements vary from

country to country around the world. It is the responsibility of the legal department to change its strategy in line with local laws and regulations to ensure that they apply to the company and to keep abreast of changes. For employees: policies are of no value if employees do not comply with company policies. Burberry could consider compliance training for employees and implement a system of rewards for compliance and participation in the development of sanctions. Schedule regular internal audits: Regular internal audits are an important tool for identifying non-compliance and its causes. Internal audits may focus on employee conduct, financial status, technical or regulatory aspects, etc. Internal auditors should be discreet and fair in their review of compliance.

## 7. Conclusion

This paper analyses the Burberry Company and concludes that its financial position is in the maturity stage. Since the maturity stage is not always constant and if proper financial strategies are not adopted it will enter the decline stage and will face the development of new products or go out of business, the current financial strategies are critically evaluated. The assessment revealed that Burberry launched a new transformation strategy in November 2017, focusing on positioning luxury fashion, but ignoring unexpected risks. This caused the company's operating profit and average share price to fall significantly after encountering the Covid-19 epidemic. A new financial strategy was therefore proposed in light of this situation, mainly by splitting up the business and making acquisitions. Finally, in the area of corporate governance, proposals are made to assume corporate social responsibility and to ensure compliance measures with the aim of facilitating the implementation of the new financial strategy and thus the further development of the company. However, the report has a number of limitations that cannot be overcome. For example, firstly, the CAPM model used in the article has a number of flaws and caution is advised. Secondly, the data analysed is for the past five years and is historical in nature and cannot be used with complete accuracy to predict future developments. Thirdly, because the Covid-19 epidemic is an unexpected risk and it is impossible to predict future changes, the new financial strategy has a number of limitations.

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