

Iya Y. Churakova, Yulia S. Leevik

THE END OF THE PRINT RUN FOR BRANKO: THE DOWNFALL OF A BOOK PUBLISHING BUSINESS IN ST. PETERSBURG

This case was written by Iya Y. Churakova (Associate Professor, Department of Finance, Graduate School of Business of Higher School of Economics) and Yulia S. Leevik (Associate Professor, Department of Financial Management, Graduate School of Business of Higher School of Economics).

For questions about access to materials from the collection of educational cases of the Higher School of Business of the National Research University Higher School of Economics, please contact us by email (cases@hse.ru).

© National Research University "Higher School of Economics", 2023

WE CANNOT DO THIS!

That is it, I can take this no longer. You just do not get it, but you soon will. I wonder what you are going to tell the freelancer who did such a great job with the book on Russian horn music when he calls round for his money. I have had to put him off for three months. We owe him 182, 000 roubles, but we have no cash!

I quit!

Alina was the Chief Business Executive for Branko, a publishing house in the center of St. Petersburg. Her job title suggested a large organization, but the reality was that she was the company's only direct employee. The company had been in operation for 20 years, during which time Alina had built up an enviable network of freelancing authors who had been more than happy to accept commissions to write a range of specialist books, rather than work for larger publishing houses like Mann, Ivanov, and Ferber. Without the efforts and commitment of Alina the business of Branko would have folded several years earlier. Annabelle, the owner, ignored the warnings about the deteriorating cashflow position at Branko, but Annabelle did not have a business brain and could see no further than the profit figure reported in the annual accounts. If Alina had a ten thousand roubles for every time, she had told Annabelle "Cash is King" she would have been able to set up her own business years ago!

This was now the reality for Alina. Unbeknown to Annabelle, Alina had been having talks with a business consultant, Ekaterina, a friend of hers, who had helped many people to set up their own business. Ekaterina had been encouraging Alina to set up on her own for quite a while. Alina was nervous but was confident that most people in her network would be willing to support her in her new venture. They, like Alina, had grown tired of having to wait for payment from Branko for the work they had done in good faith. The latest confrontation with Annabelle was the final straw. This was the time for Alina to realize her dreams.

THE RECENT CONFRONTATION

Alina was aware that Mann, Ivanov, and Ferber had expressed interest in purchasing Branko. A figure of 150,000 roubles had been mentioned. Without an equity stake in the business Alina would receive nothing from the proceeds of sale for the business that she had effectively established. Annabelle had a hands-off approach to running the business. Alina did all the frantic running around to keep the business afloat. Annabelle would receive the cash, but if the network followed Alina, she, and Mann, Ivanov, and Ferber, would have no business to run.

The incident that pushed Alina into quitting concerned a demand from Alina to secure a prepayment for an order to produce a book of poems. The book request came from a relative of Annabelle. It was to be a gift for her sister's husband. Annabelle refused, point-blank, to request a down payment from a close relative. Without cash to pay an illustrator, who had offered to make the book particularly appealing, the project would not get off the ground.

Alina was aware that Annabelle had taken cash out of the business on a regular basis. She did not understand that you cannot spend reported profits until they are realized in cash. Delayed payments to printing houses and for settlements with freelancers eroded goodwill. The situation had deteriorated over the past 18 months and several loyal

freelancers had severed their long-standing relationship with Branko. Annabelle did not realize the seriousness of the position of the business that Alina had repeatedly tried to explain to her.

Annabelle thought that Alina would have no alternative but to stay with Mann, Ivanov and Ferber if she accepted their offer to purchase her business. She could not imagine Alina moving on. She thought she held the trump card.

Time would tell who had taken the right decision.

ALARM! NEED SOME HELP!

Around seven in the evening, Alina received a call from a friend who she not seen for a long time. She picked up the phone but had little time to talk.

- I cannot talk. I am running to a client's meeting. I need to pick up some important documents.

- Alina, it is seven o'clock. The working day finished hours ago.

- Yes, I know. But unless I collect these documents this evening, in time for a print run in the morning, the consequences will be very serious. The documents and some sketches are needed so the print run can take place before 11.00am. This is the time the printed booklets need to be handed to the courier.

- OK, but can we meet tomorrow?

- No, sorry, tomorrow is out of the question too. I need to find some freelancers to take on a large project. It is an interesting piece of work, an album showing some wonderful, historical buildings in the suburbs. It is also very profitable for us. We need to find people willing and able to take on the project and there are very few of these people around.

- So, how about the day after tomorrow? We must sit down to discuss your situation and to think through how I can help you. Please say you will see me the day after tomorrow!

Alina knew she needed time to meet her friend, Ekaterina. The need to do so was never so urgent. She agreed to meet Ekaterina at 9.00am.

Ekaterina worked as a business consultant. She had great experience of helping people start-up their own business. She could not help Alina until she understood the nature of the Branko business and work out the problems that would need to be overcome to allow it to thrive.

THE LIFE AND AMAZING ADVENTURES OF BRANKO

Two days later in Branko's office.

The consultant (Alina's friend):

- Tell me a little about Branko. I know it is a publishing house, but I don't really understand what goes on and what makes it special. It is a small business, in terms of people employed, isn't it?

Alina:

- Our company is not only a small business; it is a microenterprise. Effectively there is the company's founder and CEO, Anabelle, and me. Annabelle is responsible for strategic decisions and external communications. I am the Chief Business Executive. It is a grand title. In practice it is me who is responsible for all operational activities.

- We develop unique, personalized, non-recurring publications: gift and anniversary books, albums of a wide range of topics for a specific date. The publishing house helps collect and structure information, write text, select and prepare illustrations, conduct all prepress preparation, and control the printing process. There are very few small firms who do this.

- We pride ourselves in the high quality of the end product. We have fewer competitors in this regard.

- 80-90% of all the company's products are products for business (for corporate clients), and 10-20% - products for authors.

C: Tell me how is the process is organized if it is so dependent upon you.

A: The company's business model is built entirely on outsourcing and flexible office ideas; the main production processes are transferred to third-party organizations (outsourcers) and publishing specialists (freelancers). Each of the "part-timers" performs its function and part of the entire business process. However, Branko takes full responsibility for the completed order to the client and is responsible for all processes related to the order's execution, which is always limited in terms of execution time and allocated budget. That is why I spend so much time running around trying to make things happen.

C: Now give me a bit more detail about the business processes in which you get involved.

A: The company's business process is simple. There are six basic stages in the business process of the company:

Stage 1- Identifying potential customers. Customers are attracted in various ways: the client himself applies to the publishing house or is attracted by an employee of the company. We use cold calls, emails, and networking for this purpose. Sometimes we carry out an Internet surfing to identify large research institutes, organizations and companies celebrating the anniversary of the foundation, or memorable dates of leading specialists.

Stage 2 - Development of a commercial offer. At this stage, the technical specification is developed. It includes the content of the product, the requirements and restrictions for its production, the time plan for the implementation of the order, the budget within which the product should be developed.

Stage 3 - Conclusion of the contract. The company's representative makes the final decision on which order will be most appropriate, whether there are resources and opportunities for its implementation. There is a meeting with the customer, and all the details of the order are discussed, an advance payment is made depending on the total cost of the order.

Stage 4 - Order implementation. The order is transferred to the head of publishing

projects, who in turn distributes the powers between freelance performers: organizations (outsourcers) or specialists (freelancers). At the stage of the implementation process, the product layout is developed and approved, proofreading and constant monitoring of the order execution are used.

Stage 5 - Production. Printing of products, considering all the adjustments and wishes of the customer.

Stage 6 - Transferring the completed order to the client. If there is a 100% payment the customer receives his order, executed strictly according to the contract. If prepayment included just 50% of the project cost, we send the books after the final payment.

C: OK. So if you were to identify the main problem that is bothering you, what would it be? situation?

A: The company's success and customer satisfaction depend on the quality of outsourcers and freelancers performing their business processes. And I am responsible for both functions, clients' search, and production. Figuratively speaking, with one hand I must collect vegetables in the garden for soup, and with the other hand to cook this soup, which is unrealistic, since one side always suffers from a lack of attention. I am afraid I lose control of the situation. It is clear from our phone conversation, you see!

C: Why do you use an advance payment for one project to cover the final payment for another?

A: Outsourcers and freelancers can work on several orders at the same time; that fact leads us to the fact that the cash flows of different orders intersect and mix. Under these conditions, it is almost impossible to determine an individual's financial condition in the middle of the reporting period. Moreover, sometimes we took orders without a prepayment from influencers or close friends. They often pay late, and we must cover our expenses using prepayments from other orders. It is a serious problem, as we do not manage projects' budgets separately.

C: You seem to have a good grasp of the cashflow problem and have clearly been thinking about it for a long time.

- I am sure I can help you to bring about the changes in policies and operations to improve the effectiveness of management. Before we agree an action plan, let us take a closer look at the numbers. Show me the latest management accounts.

30 minutes later:

- Wow!, I did not realize the scale of the problem. There are some figures here that really disturb me.

- First of all, I see that turnover has fallen by almost 50% in 2020. What is going on?

- I see that the company took out a large loan in 2019. Who provided the loan? What are the terms and conditions attached to it?

- The figure for accounts receivable is a matter of real concern to me. Are you sure all those debtors are good? Who are they? Do you have an ageing analysis of them?

- Who are your major creditors? What are their terms of trade? Has anybody

been pressing you for payment??

- Is Anabelle of the position? Does she realize the problems the company is facing?

At that point Annabelle walked into the room.

- Good morning. Alina, is this our new client?

- She turned to Ekaterina: Are you coordinating the layout of our new album?

Alina responded:

- Annabelle, let me introduce you to Ekaterina. She is a consultant to small businesses to help them identify issues that may hamper their development. She provides advice to help businesses like ours overcome problems they are experiencing.

Ekaterina stared at Alina when Annabelle declared:

- What are you talking about? We do not have any problems, do we?

It was Alina's turn to turn to Ekaterina and say:

- Thanks for your help this morning Ekaterina. Let us keep in touch. I will give you a call this evening, if that is OK?

Six hours later Alina was running to the printing house to make an advance payment for the latest order.

In her pocket was a letter from the bank manager. When she opened it she saw it was notification from the bank detailing the business owner's withdrawal of cash. It dawned upon Alina that she no longer had access to the funds necessary to make the advance payment.

She headed home, hoping that Ekaterina would be in to take her call.

Ironically, at much the same point in time Anabelle was at home considering an offer of 150,000 roubles to purchase Branko. The formal offer from Mann, Ivanov, and Ferber had arrived that morning.

Exhibit 1. Financial Statements

**Publishing House «Branko»
Income Statement
For the Year Ended December 31, 2020
(In Thousands RUR)**

| | 2020 | 2019 | 2018 | 2017 | 2016 |
|--|-------------|-------------|-------------|-------------|-------------|
| Net revenue | 2 885 | 5 346 | 6 188 | 5 028 | 3 518 |
| Cost of goods sold | (2 637) | (4 822) | (5 571) | (4 644) | (3 222) |
| Gross profit | 248 | 524 | 617 | 384 | 296 |
| Selling, general and administrative expenses | --- | --- | --- | --- | --- |
| Operating income | 248 | 524 | 617 | 384 | 296 |
| Interest expense | (1) | --- | --- | (16) | --- |
| Other non-operating income | --- | 159 | --- | 93 | --- |
| Other non-operating expenses | (52) | (235) | (13) | (109) | (10) |

| | 2020 | 2019 | 2018 | 2017 | 2016 |
|-----------------------------------|------------|------------|------------|------------|------------|
| Income before income taxes | 195 | 448 | 604 | 352 | 286 |
| Income taxes | (47) | (100) | (68) | (49) | (42) |
| Net income | 148 | 348 | 536 | 303 | 244 |

**Publishing House «Branko»
Balance Sheet
At December 31, 2020
(In Thousands RUR)**

| | 2020 | 2019 | 2018 | 2017 | 2016 |
|---|--------------|--------------|--------------|--------------|--------------|
| Assets | | | | | |
| <i>Current assets:</i> | | | | | |
| Cash | 15 | 20 | 10 | 8 | 18 |
| Accounts receivable | 4 201 | 4 711 | 3 771 | 2 568 | 1 197 |
| Office supplies inventory | 1 274 | 1 294 | 1 517 | 2 212 | 2 299 |
| <i>Total current assets</i> | <i>5 490</i> | <i>6 025</i> | <i>5 298</i> | <i>4 788</i> | <i>3 514</i> |
| Total assets | 5 490 | 6 025 | 5 298 | 4 788 | 3 514 |
| Liabilities | | | | | |
| <i>Current Liabilities:</i> | | | | | |
| Accounts payable | 1 666 | 2 309 | 2 913 | 2 788 | 2 002 |
| Short-term debt | 1 104 | 1 144 | 194 | 266 | 79 |
| <i>Total current liabilities</i> | <i>2 770</i> | <i>3 453</i> | <i>3 107</i> | <i>3 054</i> | <i>2 081</i> |
| Total liabilities | 2 770 | 3 453 | 3 107 | 3 054 | 2 081 |
| Stockholders' Equity | | | | | |
| Contributed capital | 10 | 10 | 10 | 10 | 10 |
| Retained earnings | 2 710 | 2 562 | 2 181 | 1 724 | 1 423 |
| Total stockholders' equity | 2 720 | 2 572 | 2 191 | 1 734 | 1 433 |
| Total liabilities and stockholders' equity | 5 490 | 6 025 | 5 298 | 4 788 | 3 514 |

Required:

- Write a letter to Alina explaining the data in balance sheet and offer your comments on the company's apparent financial condition based on this information. Suggest other information Alina might want to review before coming to a final decision on whether to stay or leave the Branko.
- What would be your recommendation to the owner?
- As a financial analyst you have been asked to write a short memo evaluating the problems facing Branko. Emphasize the problems and suggest solutions.
- What is the quality of income ratio for the most recent years? What were the major causes of difference between net income and cash flows from operations?