

House of Fraser PLC

Introduction

3.1. A description of House of Fraser's history and business was included in the Commission's two reports referred to in paragraphs 4.1 and 4.2. We set out in Appendix 5 the more important developments and changes since our 1981 report. House of Fraser now operates 122 department stores and shops; the location of those in the United Kingdom and the Republic of Ireland is shown in the map in Appendix 6. It employs about 27,000 people of whom about 8,000 are part-time, and its turnover, inclusive of VAT, was £956 million in the year to January 1984. Harrods of Knightsbridge is the best known and most important of its stores, accounting for about 23 per cent of the group's turnover and 42.5 per cent of the group's profit in the year to January 1984.

Board, management and organisation

3.2. There have been several Board changes since 1981. Sir Hugh Fraser resigned in February 1982 and Lord Duncan-Sandys and Mr R W Rowland resigned on 31 December 1984 following the sale by Lonrho of its 29.9 per cent holding to the Al-Fayed family interests.¹ New appointments include Mr C J Benson, Vice-Chairman and Managing Director of MEPC PLC and Chairman of the London Dockland Development Corporation, who was appointed as a non-executive director in April 1982, and Mr Mohamed Al-Fayed and Mr Ali Al-Fayed who were appointed in January 1985, following the resignations of Lord Duncan-Sandys and Mr Rowland referred to above. The present Board consists of:

Professor Roland Smith, *Chairman*
Mr W G Crossan, *Deputy Chairman and Managing Director*
Mr D C Mair
Mr G Willoughby
Mr D K Milligan
Mr C F L Head
Mr M M McMaster
Mr E H Sharp
Mr W A Craddock
Mr C J Benson
Mr P K Brimacombe
Mr M Al-Fayed
Mr A Al-Fayed

3.3 The Executive Committee referred to in paragraph 3.7 of our 1981 report now consists of Professor Smith, Mr Crossan, Mr Mair, Mr Willoughby, Mr McMaster, Mr Sharp, Mr Craddock and Mr Brimacombe.

3.4. The principal organisational changes in the divisions have been the amalgamations, first, of the Army & Navy and Chiesmans divisions and,

¹ Lord Duncan-Sandys and Mr Rowland were normally represented at House of Fraser Board meetings by their alternates, Mr P G B Spicer and Mr T J Robinson.

secondly, of the Northern and Binns divisions. The present organisational structure is shown in Appendix 7. House of Fraser told us that there had also been a significant strengthening of senior executives below main Board level (especially on the divisional Boards) with particular emphasis on younger management, greater involvement on the divisional Boards of main Board executive directors and a substantial reorganisation of the executive functions in order to emphasise control of the affairs of the group from the centre. The appointment of three executive directors, Mr Mair, Mr McMaster and Mr Brimacombe as operations, stores, and merchandise and marketing directors respectively for the purpose of co-ordinating the major areas of responsibility, was designed to emphasise this change of management philosophy, particularly the centralising of the buying function to be implemented by the merchandise director.

3.5 House of Fraser also drew our attention to further improvements since 1981 in the management information submitted monthly to the group Board and to executive management. At group level the management committee receives a monthly financial package, consisting mainly of trading information, which includes, for example, a group profit statement, a divisional sales and profit statement and data on the number of employees, sales per employee, expenses, stocks and debtors. Financial comparison analysis is being developed: a new report form to monitor the sales performance of each division against both the average for the group and the Department of Trade Value of Retail Sales Index is now submitted monthly to the management committee. The management committee also receives monthly the trading results of individual stores in a pocket-sized book. At the divisional level the arrangements remain substantially as described in Appendix 5 to our 1981 report.

3.6. The group Board receives a monthly financial package including returns of group profits and divisional sales and profits, data on stocks, cash positions, capital expenditure and debtors. It also receives monthly a statement showing stores with significant net profit variances, but not the full trading results of each individual store, which are circulated only to those directors who are members of the Executive Committee (see also paragraph 3.8 and footnote 2 to that paragraph). Each quarter a group balance sheet is prepared for the Board. In addition, the presentation of capital expenditure appraisals to the group Board has been developed and improved. They are now in a standard format, the content of which varies according to whether the proposal is for the development or refurbishment of part of a store or of an entire store.

Property management

3.7. House of Fraser said that it recognised the importance of strong property management to the success of its business and the presence of Mr Sharp and Mr Benson on the Board was evidence of this. The property management function was now undertaken by a central property department, which had been given full authority on property matters within the group, and which had undertaken detailed reviews of all the group's properties. There had been several property sales (which realised sums above the 1981 revaluation figures), property purchases and new developments since 1981, including new stores at Perth and Epsom, a new warehouse at Avonmouth, and a hotel development in Edinburgh.

Monitoring the performance of individual stores

3.8. A statement showing the profit for each store, after charging a notional market rental¹ based on the 1981 property valuation (see note 1 to Table 3.3), is prepared both monthly and annually. It is used by group executive directors and divisional directors for management purposes but is not submitted to the main Board.² At the year end the return on capital for each store is reviewed by management and by the executive directors in two ways. First, the store profit after charging a notional economic store rental is expressed as a percentage of the store's capital employed, excluding the value of the property. Secondly, the store profit, after charging the actual rents payable, is expressed as a percentage of the capital employed including the net book value of the property.

The new trading strategy

3.9. House of Fraser told us that its policy was to remain the leading department store group and to increase its market share and profits. During recent years it had extensively reviewed the conduct of its business and had formulated a programme the aim of which was to improve its net profits by increasing its market share in particular categories of goods by better presentation and styling and by more attractive prices, so as to appeal to a new class of younger customers while at the same time retaining the loyalty of its existing customers. The objectives for each store continued to be to:

- (a) increase sales per square foot of store space;
- (b) maintain or improve gross margins so as to increase gross profit per square foot of floor space;
- (c) increase the rate of stockturn and thus increase the return on capital invested in stocks;
- (d) control operating costs; and
- (e) increase net profits after charging each store an economic market rental.

3.10. This new strategy involved the major refurbishment of stores, the reallocation of selling space between different categories of goods, more selective and competitive pricing and a number of new merchandising programmes designed to broaden the appeal of the group's stores and goods. One such programme, entitled 'Lifestyle', was aimed particularly at younger and more progressive, style-conscious customers.

3.11. The overall strategy had been determined in 1983. Following initial evaluations of every store, detailed market and financial evaluations had so far been carried out by House of Fraser executives, with the assistance of external consultants, for 25 stores, with a further seven now in progress. Two new sites had been the subject of similar in-depth evaluations, a third was now under way and others were under consideration. The less detailed evaluations of every store were from time to time updated.

¹ The practice of charging notional market rentals was started two years ago, initially using a figure of 60 per cent of the assessed market rental. This has since been increased in stages to 80 per cent. House of Fraser's intention is to increase it to 100 per cent in due course.

² The statement for 1983, calculated on the basis of charging 60 per cent of market rentals (see note 1 above) was, however, provided to Mr Robinson (Mr Rowland's alternate) at Mr Robinson's request.

3.12. In 1983 House of Fraser had estimated that capital expenditure of about £100 million on refurbishment was likely to be required over a period of about four years, of which about £69 million would be in addition to capital expenditure already envisaged under its pre-existing policies. House of Fraser intended to finance this expenditure by increased borrowing and by the increased cash flow in its business, including such part of Harrods' cash flow as may be surplus to Harrods' own capital expenditure requirements.

3.13. In view of the importance of maintaining the profit contribution from stores which are being refurbished, the work had been planned so as to cause the least possible disruption to current trading. This naturally affected the rate at which the new strategy could be implemented. Priority was given to refurbishing those stores which the detailed evaluations showed to have the greatest potential for marketing and financial gains. The minimum target return on the new investment had been set at 15 per cent. Capital appraisals of refurbishment proposals approved by the Executive Committee and the group Board since May 1983 involved expenditure of about £20 million, in addition to normal ongoing capital expenditure.

3.14. Several of the proposals for individual stores had already been implemented (for example, at Frasers, Glasgow, and Rackhams, Birmingham, phase 1). Others were in the course of implementation and more were planned. In addition, new ranges of merchandise were being sold throughout the group as a result of the new merchandising, marketing and central buying policies.

Financial information

3.15. House of Fraser makes up its accounts to the last Saturday in January each year on both historical cost and current cost bases. For most years these accounts cover 52 weeks but periodically, as in the year to January 1981, they cover 53 weeks. Table 3.1 sets out House of Fraser's trading results for the five years to January 1984 according to its consolidated profit and loss accounts prepared under the historical cost convention, restated where necessary to reflect changes in accounting policies. It also shows House of Fraser's unaudited results for the half years to July 1983 and 1984.

3.16. As noted in paragraph 3.1, the Harrods store in Knightsbridge is an important part of House of Fraser. The book value of its property in January 1984 represented about 35 per cent of the book value of all House of Fraser's department store properties. The contribution which it has made to the group's turnover and profits during the five years to January 1984 is shown in Table 3.2. House of Fraser explained that the contribution of the Harrods store to the overall profits of the group varied from year to year because Harrods catered to a large extent for an international market and was influenced by factors, such as currency fluctuations, which had little direct effect on other House of Fraser stores.

Capital employed

3.17. House of Fraser's capital employed, according to its consolidated balance sheets as at the last Saturday in January in each of the years 1980 to 1984, also prepared under the historical cost convention and restated where necessary to reflect changes in its accounting policies, is shown in Table 3.3.

TABLE 3.1 House of Fraser: trading results

	<i>Year to January</i>				<i>Half year to July</i>		
	1980	1981	1982	1983	1984	1983	1984
Gross turnover	700	777	827	877	956	395.9	439.1
VAT	(73)	(93)	(99)	(106)	(115)	(49.2)	(54.3)
Net turnover	627	684	728	771	841	346.7	384.8
Profit on ordinary activities before interest and tax	44	45	34	40	47	8.8	12.4
Interest receivable	2	2	2	1	1		
Interest payable	46 (10)	47 (14)	36 (9)	41 (10)	48 (9)	(4.5)*	(5.0)*
Profit before tax	36	33	27	31	39	4.3	7.4
Taxation	(15)	(10)	(3)	(9)	(10)	(2.2)	(3.4)
Profit (before extraordinary items) attributable to shareholders	21	23	24	22	29	2.1	4.0
Extraordinary items	1	19	2	1	(1)		
Dividends payable	22 (9)	42 (10)	26 (11)	23 (12)	28 (13)	2.1	4.0
Profit retained	13	32	15	11	15	2.1	4.0
Earnings per ordinary share before extraordinary items (pence)	14.3	15.4	15.8	14.3	18.9	1.3	2.6

Source: House of Fraser

* Net interest payable for the half year.

Note: Extraordinary items in 1981-82 included the net gain on the sale and lease-back of D H Evans, Oxford Street (£18 million) less the cost of the extraordinary general meeting to consider the transaction.

TABLE 3.2 House of Fraser: contribution of Harrods to group turnover and profits

	<i>Year to January</i>				
	1980	1981	1982	1983	1984
Gross turnover					
Harrods	145.1	157.2	172.8	183.3	222.0
Rest of House of Fraser	554.7	620.2	653.8	693.4	734.0
	699.8	777.4	826.6	876.7	956.0
Profits					
Harrods	15.6	13.6	13.6	16.2	19.9
Rest of House of Fraser	27.8	31.7	20.2	22.8	27.4
	43.4	45.3	33.8	39.0	47.3
Profit as a percentage of gross turnover					
Harrods	10.8	8.7	7.9	8.8	9.0
Rest of House of Fraser	5.0	5.1	3.1	3.3	3.7

Source: House of Fraser

Notes:

1. Profit is stated before interest, other operating income, results of related companies and allocations to the profit linked share plan.

2. A proportion of central costs has been charged to Harrods and for the first four years the basis of allocation was in proportion to stock and debtors. In the year to January 1984 the basis of allocation was changed to market rental and in view of the size and value of the Harrods property this may have resulted in a different proportion of central costs being charged to Harrods.

TABLE 3.3 House of Fraser: capital employed

	<i>£ million</i>				
	<i>January</i>				
	1980	1981	1982	1983	1984
<i>Assets</i>					
Fixed assets (including fixed asset investments)	192	374	375	399	416
Stocks, debtors and current asset investments, less creditors	109	128	156	172	190
Cash and bank balances	23	36	23	16	16
	<u>324</u>	<u>538</u>	<u>554</u>	<u>587</u>	<u>622</u>
<i>Financed by</i>					
Share capital	38	38	39	39	39
Reserves	205	423	443	458	441
Equity	243	461	482	497	480
Deferred tax	—	—	—	—	30
Equity and deferred tax	243	461	482	497	510
Long-term loans	69	48	41	58	80
Other loans and overdrafts	12	29	31	32	32
Capital employed	<u>324</u>	<u>538</u>	<u>554</u>	<u>587</u>	<u>622</u>

Source: House of Fraser

Notes:

1. The increases in fixed assets and reserves between January 1980 and January 1981 were due mainly to a £188 million property revaluation surplus.

2. The deferred tax provision of £30 million at January 1984 was necessitated by changes in the Finance Act 1984.

3.18. £409 million of House of Fraser's fixed assets at January 1984 consisted of tangible assets, details of which are set out in Table 3.4.

Returns on capital employed and equity

3.19. The returns on House of Fraser's average capital employed, and on its equity and deferred tax, for each of the five years to January 1984, based on its balance sheet figures, are shown in Table 3.5.

3.20. For the purpose of Table 3.5 the average capital employed and equity for each year have been taken as simple averages of the opening and closing figures. These may understate the position as stocks and borrowings are likely to have been higher during the year than at the year end, due to the need to finance the main trading periods at mid-summer and Christmas. In addition, the trend shown is distorted by the effect of the property revaluation surplus of £188 million in the year to January 1981. If that surplus were treated as having arisen at the beginning of the five-year period and property depreciation for the first two years were calculated on the increased values, the position would be as shown in Table 3.6.

Borrowings and gearing

3.21. House of Fraser's borrowings have not been heavy. Its gross debt/equity ratios for each of the five years to January 1984, adjusted in the case of the first year for the effect of the £188 million property revaluation surplus, are

TABLE 3.4 House of Fraser: tangible fixed assets

	<i>Properties</i>				<i>£ million</i>
	<i>Total</i>	<i>Freeholds</i>	<i>Long leaseholds</i>	<i>Short leaseholds</i>	<i>Fixtures, fittings, vehicles & equipment</i>
Properties independently valued in 1981	318	218	96	4	—
Properties acquired since 1981 and other assets, as cost	150	31	20	1	98
	<u>468</u>	<u>249</u>	<u>116</u>	<u>5</u>	<u>98</u>
Depreciation	(59)	(8)	(5)	(1)	(45)
	<u>409</u>	<u>241</u>	<u>111</u>	<u>4</u>	<u>53</u>

Source: House of Fraser.

TABLE 3.5 House of Fraser: returns on average capital employed and on equity and deferred tax

	<i>£ million</i>				
	<i>Year to January</i>				
	<i>1980</i>	<i>1981</i>	<i>1982</i>	<i>1983</i>	<i>1984</i>
Average capital employed	313	431	546	570	605
Profit before interest payable and tax	46	47	36	41	48
Return on capital employed (%)	14.7	10.9	6.6	7.2	7.9
Average equity and deferred tax	236	352	471	490	503
Profit before tax	36	33	27	31	39
Return on equity and deferred tax (%)	15.3	9.4	5.7	6.3	7.8

Source: MMC.

TABLE 3.6 House of Fraser: returns on average capital employed and on equity and deferred tax adjusted for the effects of the property revaluation in the year to January 1981

	<i>£ million</i>				
	<i>Year to January</i>				
	<i>1980</i>	<i>1981</i>	<i>1982</i>	<i>1983</i>	<i>1984</i>
Average capital employed	501	525	546	570	605
Profit before interest payable and tax	44	45	36	41	48
Return on capital employed (%)	8.8	8.6	6.6	7.2	7.9
Average equity and deferred tax	424	446	471	490	503
Profit before tax	34	31	27	31	39
Return on equity and deferred tax (%)	8.0	7.0	5.7	6.3	7.8

Source: MMC.

set out in Table 3.7. However, as noted in paragraph 3.20, the levels of borrowing during the year may be higher than at the year-end.

Profits as a percentage of turnover

3.22. House of Fraser's profits before tax expressed as percentages of its gross and net turnover are stated in Table 3.8.

TABLE 3.7 House of Fraser: gross debt/equity ratios

	<i>£ million</i>				
	<i>Year to January</i>				
	<i>1980</i>	<i>1981</i>	<i>1982</i>	<i>1983</i>	<i>1984</i>
Gross borrowings	81	77	72	90	112
Equity	431	461	482	497	480
Gross debt/equity ratio (%)	18.8	16.7	14.9	18.1	23.3

Source: MMC.

TABLE 3.8 House of Fraser: profits before tax as percentages of turnover

	<i>per cent</i>				
	<i>Year to January</i>				
	<i>1980</i>	<i>1981</i>	<i>1982</i>	<i>1983</i>	<i>1984</i>
Of gross turnover	5.1	4.2	3.3	3.5	4.1
Of net turnover	5.7	4.8	3.7	4.0	4.6

Source: MMC (from data in Table 3.1)

Current cost accounts

3.23. House of Fraser has supplemented its historical cost accounts with current cost accounts since the year to January 1981. During the year to January 1984 the BSO indices used previously to make the current cost adjustments were discontinued and replaced by new ones. Current cost profits for the two years to January 1984, and current cost balance sheets as at January 1983 and January 1984, are summarised in Tables 3.9 and 3.10 respectively.

TABLE 3.9 House of Fraser: current cost profits

	<i>£ million</i>	
	<i>Year to January</i>	
	<i>1983</i>	<i>1984</i>
Historical cost profit before interest and tax	39	47
Current cost operating adjustments	(12)	(13)
Current cost operating profit	27	34
Gearing adjustment	1	2
Interest payable (net)	(6)	(6)
Current cost profit before tax	22	30
Taxation	(9)	(10)
	13	20
Extraordinary items	1	—
	14	20
Dividends	(11)	(13)
Current cost profit retained	3	7

Source: House of Fraser.

3.24. It will be seen from Table 3.9 that House of Fraser earned £30 million profits before tax in the year to January 1984, which represented a return of

TABLE 3.10 House of Fraser: current cost balance sheets

	£ million	
	January	
	1983	1984
<i>Assets</i>		
Fixed assets (including fixed asset investments)	415	428
Stocks, debtors and current asset investments, less creditors	172	190
Cash and bank balances	16	16
	603	634
<i>Financed by</i>		
Share capital and reserves	513	492
Deferred tax	—	30
	513	522
Current cost equity and deferred tax	513	522
Loans and overdrafts	90	112
	603	634
Current cost capital employed	603	634

Source: House of Fraser.

5.8 per cent on the average current cost equity and deferred tax for that year, compared with 3.6 per cent and 4.3 per cent for the years to January 1982 and 1983 respectively.

Source and application of funds

3.25. Appendix 8 summarises House of Fraser's source and application of funds statements for each of the five years to January 1984.

Share capital

3.26. House of Fraser's issued ordinary share capital at 21 December 1984 consisted of 153.7 million shares of 25p each (£38.4 million). It provided us with particulars of the beneficial owners of holdings of more than 1 per cent of the ordinary share capital on 18 May, 1 November and 21 December 1984, which are set out in Table 3.11. The changes between those three dates reflect certain share transactions which we describe more particularly in paragraph 4.16.

TABLE 3.11 House of Fraser: principal ordinary shareholdings

	At 18 May 1984		At 1 November 1984		At 21 December 1984	
	Million shares	%	Million shares	%	Million shares	%
Alfayed Investment & Trust (UK) Ltd	—	—	—	—	46.1	29.9
Lonrho	45.5	29.8	46.1	29.9	9.7	6.3
Fraser trusts & family	5.9	3.8	4.1	2.7	0.6	0.4
Mr J A Hayward	2.0	1.3	2.0	1.3	—	—
Dr A Marwan	4.0	2.6	4.0	2.6	—	—
Arab Banking Corporation/Daus & Co GmbH*	2.0	1.3	2.0	1.3	2.0	1.3
Merchant Navy Officers Pension Fund	5.6	3.7	5.6	3.7	5.6	3.7
House of Fraser Profit-Linked Share Plan	4.0	2.6	4.5	2.9	4.4	2.9
Trustees of British Rail Pension Fund	2.9	1.9	2.9	1.9	2.9	1.9
British Telecom Pension Fund	1.6	1.0	1.6	1.0	1.6	1.0
Globe Investment Trust Ltd	4.2	2.7	4.2	2.7	4.2	2.7
Legal & General Assurance Society Ltd	2.9	1.9	2.9	1.9	2.9	1.9
National Coal Board Pension Fund	3.6	2.4	3.6	2.4	3.6	2.4
	84.2	55.0	83.5	54.3	83.6	54.4
Shareholdings under 1 per cent	68.8	45.0	70.2	45.7	70.1	45.6
	153.0	100.0	153.7	100.0	153.7	100.0

Source: House of Fraser.

* Subject to restrictions imposed by the Scottish courts.