

C&C Sports, Managerial Accounting Context

FOCUS

LEARNING OBJECTIVE

Topic Focus 1

LO 1: Describe the business environment of C&C Sports.

Guided Unit Preparation

Answering the following questions while you read this unit will guide your understanding of the key concepts found in the unit. The questions are linked to the learning objective presented above.

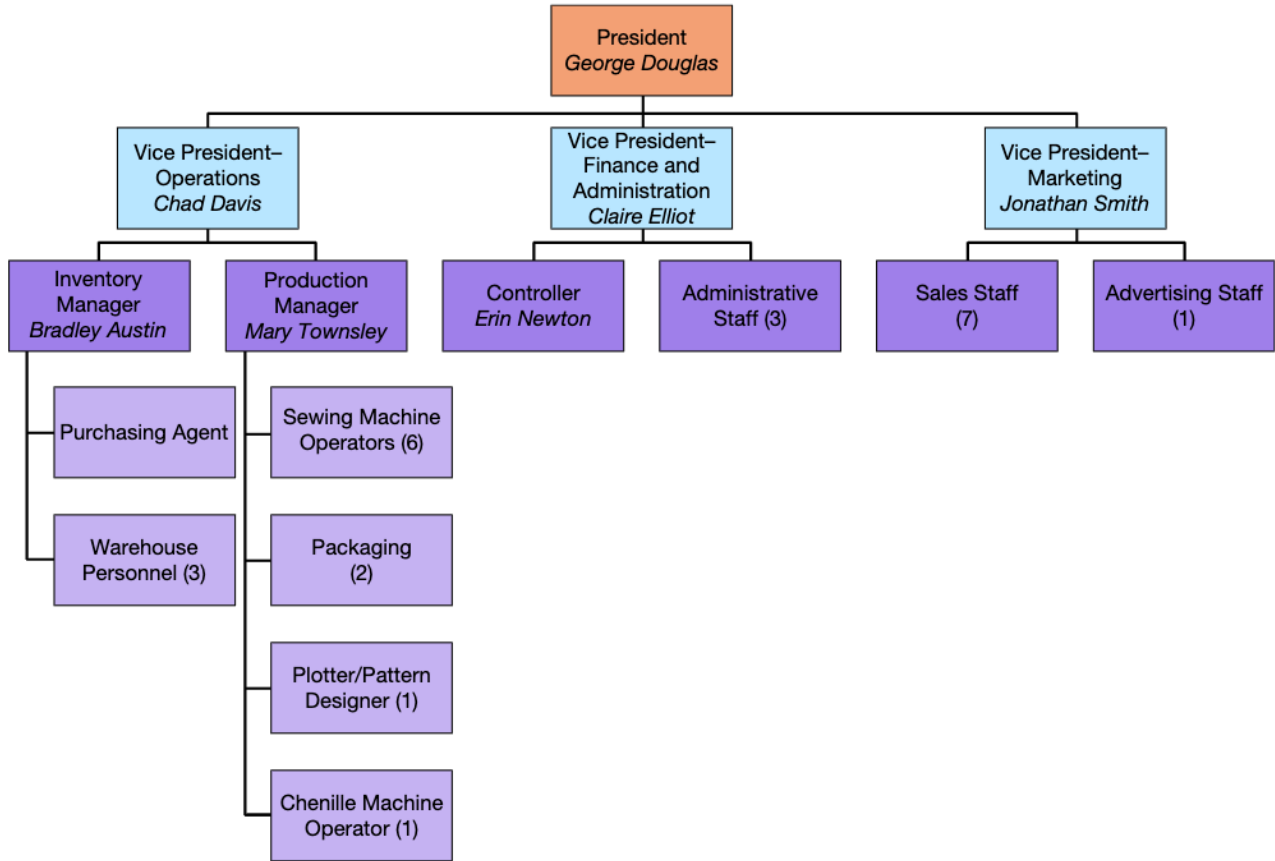
- LO 1**
1. What is C&C Sports' strategy?
 2. What are C&C Sports' greatest financial challenges?
 3. How might C&C Sports' managers generate additional cash flow?
 4. What are the potential threats to C&C Sports' future success?
 5. If you wanted to purchase baseball jerseys, baseball pants, or letter award jackets, what would you look for in a supplier?

Business decisions are always made within the context of a specific organization. To help you understand how to use managerial accounting information in making business decisions, we will focus throughout this book on a hypothetical company called C&C Sports, a manufacturer of athletic uniforms. By focusing on a single company, we hope to help you understand how managerial decisions unfold within the organization. Although C&C Sports is fictitious, its story is based on that of a similar real-world company.

C&C's History

C&C Sports is located in Brownsville, Texas, where it has been run by the Douglas family since 1928. The company began as a small sewing operation that supplied clothing to workers on the Gateway International Bridge. As Brownsville grew and workers came and went, the Douglases began to look for a market niche to guide the company's future growth. Recognizing the increasing number of youth participating in organized sports, the family decided to manufacture baseball uniforms. Today, President George Douglas heads the third generation of leadership at the company, and several other relatives hold key management positions. [Exhibit T1.1](#) shows C&C Sports' current organization chart.

EXHIBIT T1.1 C&C Sports' organization chart.



The family has made a conscious decision not to follow the textile industry's trend of transferring manufacturing operations to China and other foreign countries that offer cheap labor. They have chosen to remain a domestic producer and to focus instead on quick delivery and fast customer response within a local market—the state of Texas. The company manufactures three products: baseball jerseys, baseball pants, and letter award jackets.

Exhibit T1.2 illustrates C&C Sports' supply chain. Notice that it begins with Paladin Polymers, Inc., which makes polyester pellets. Neff Fiber Manufacturing melts the polyester pellets and pushes them through an extruder to create the raw fiber, called partially oriented yarn. Centex Yarns converts the raw fiber into finished yarn by covering, twisting, texturizing, and coloring it. Bradley Textile Mills then uses the finished yarn to weave the fabric that C&C Sports buys. C&C Sports manufactures the uniforms and sells them to retailers such as Universal Sports Exchange, which resell them to the end customer.

While Exhibit T1.2 shows the major links in the supply chain, a number of other firms play a role as well. For instance, transportation companies provide shipping services between C&C Sports and Universal Sports Exchange. And providers of other items, such as buttons and thread, supply C&C's need for production materials.

EXHIBIT T1.2 C&C Sports' supply chain.



EXHIBIT T1.3

C&C Sports' income statement.

	A	B	C	D
1	C&C SPORTS			
2	Income Statements			
3	for the Years Ended December 31			
4				
5		2020	2019	2018
6	Sales	\$ 7,855,000	\$ 7,015,000	\$ 7,065,000
7	Cost of goods sold	5,817,590	5,215,000	5,304,600
8	Gross profit	2,037,410	1,800,000	1,760,400
9	Selling and administrative expenses	1,735,539	1,570,689	1,555,778
10	Operating income	301,871	229,311	204,622
11	Interest expense	41,711	43,210	45,698
12	Income before taxes	260,160	186,101	158,924
13	Tax expense (30%)	78,048	55,830	47,677
14	Net income	\$ 182,112	\$ 130,271	\$ 111,247

A Brief Look at C&C's Resources

If C&C is to remain successful, it must generate sufficient resources to continue operating. To date, the company has enjoyed moderate financial success. Its latest financial statements are presented in [Exhibits T1.3, T1.4, and T1.5](#).

Although details of conducting an analysis of C&C's financial statements are presented in Chapter 12, a brief look at some important trends and indicators will help you understand the company's resource position. The availability of resources such as cash and inventory will determine how C&C is able to respond to changes in the business environment to take advantage of opportunities that arise.

Let's first take a look at the Statement of Cash Flows (see page TF1-5) because the ability to generate cash can make or break a small business. The first section of the statement shows that over the last three years, C&C has seen a decline in cash from operations. In fact, in 2020, cash from operations was negative. Income has been increasing, but accounts receivable and inventories have been increasing, too. In fact, the changes in all of the working capital accounts (current assets and current liabilities) have created a drain on cash.

C&C doesn't have any investing activities, which is not unusual for a small business. The other source of cash flow is financing activities, and you can see that each year, C&C has paid off more debt than it has borrowed. It appears that C&C may be trading long-term debt for short-term debt, as evidenced by the repaying of long-term debt and the increase in short-term debt. This is a good strategy only if the terms of the short-term debt are better than what the company can currently get on long-term debt. Since cash from operations and cash from financing activities are decreasing, the cash balance is decreasing. This trend can't continue into the future, so management needs to find a way to increase cash, preferably from operating activities.

Now let's consider some key relationships on the income statement ([Exhibit T1.3, p. TF1-3](#)). You can see that sales decreased from 2018 to 2019 and increased from 2019 to 2020, yet net income increased every year. C&C was able to generate increasing income, even when sales declined, because expenses as a percentage of sales were reduced. The following table shows various income statement accounts as a percentage of sales. Cost of goods sold as a percentage of sales decreased each year, resulting in a higher gross profit percentage. Selling and administrative expense increased as a percentage of sales from 2018 to 2019 and decreased from 2019 to 2020.

The operating income percentage is low when compared to other apparel manufacturers. IBISWorld, a company that provides market analyses by industry, estimates that companies in this industry have an average 4.7% profit margin, as shown in [Exhibit T1.6](#).¹ In the industry, smaller firms tend to lack economies of scale in production, have a higher cost of capital, and have higher administrative costs than larger firms. This is true of C&C Sports and is the primary reason that C&C's costs runs higher as a percentage of sales than that of other apparel manufacturers.

EXHIBIT T1.4 C&C Sports' balance sheets.

	A	B	C	D	E	F
1	C&C SPORTS					
2	Balance Sheets					
3	As of December 31					
4						
5		2020			2019	
6	Cash		\$ 7,752			\$ 36,773
7	Accounts receivable, net		578,639			540,462
8	Raw materials	\$ 682,000			\$ 566,000	
9	Work in process	14,660			14,630	
10	Finished goods	227,270			211,512	
11	Total inventories		923,930			792,142
12	Prepaid expenses		24,388			8,165
13	Total current assets		1,534,709			1,377,542
14	Machinery and equipment, net		365,335			491,607
15	Other assets		29,937			33,707
16	Total assets		<u>\$1,929,981</u>			<u>\$1,902,856</u>
17						
18	Accounts payable		\$ 441,602			\$ 487,912
19	Accrued liabilities		84,642			168,319
20	Short-term debt		125,000			110,000
21	Current maturities of long-term debt		40,000			40,000
22	Total current liabilities		691,244			806,231
23	Long-term debt		410,000			450,000
24	Total liabilities		<u>1,101,244</u>			<u>1,256,231</u>
25						
26	Common stock		250,000			250,000
27	Retained earnings		578,737			396,625
28	Total stockholders' equity		828,737			646,625
29	Total liabilities and stockholders' equity		<u>\$1,929,981</u>			<u>\$1,902,856</u>

Analyzing the composition of the balance sheet will help you understand the funding sources of assets and what kinds of assets C&C holds. The table below shows selected balance sheet accounts as a percentage of total assets. First look at the liabilities and stockholders' equity section. Notice that in 2019, stockholders' equity funded about 34% of assets, and liabilities funded the other 66%. By 2020, stockholders' equity funded 43% and liabilities funded the remaining 57%. C&C Sports is decreasing its reliance on debt as a source of funding assets.

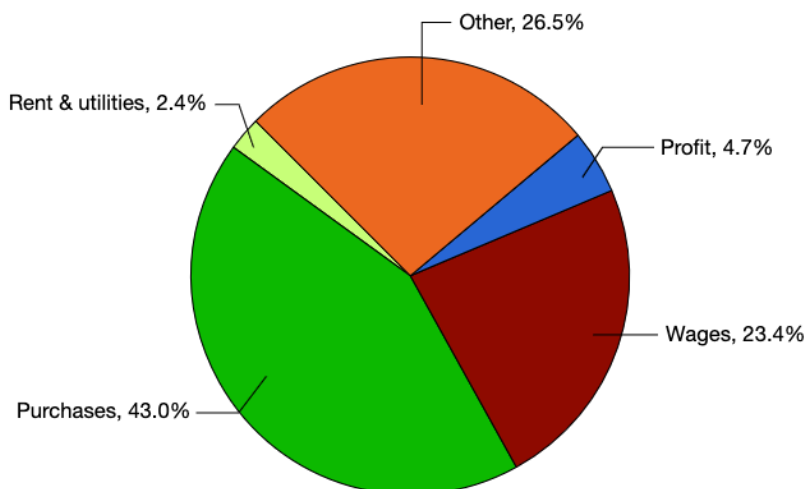
	<u>December 31, 2020</u>	<u>December 31, 2019</u>	<u>December 31, 2018</u>
Sales	100.00%	100.00%	100.00%
Cost of goods sold	74.06%	74.34%	75.08%
Gross profit	25.94%	25.66%	24.92%
Selling & administrative expense	22.09%	22.39%	22.02%
Operating income	3.84%	3.27%	2.90%
Net income	2.32%	1.86%	1.57%

EXHIBIT T1.5

C&C Sports' statement of cash flows.

	A	B	C	D	E	F	G
1	C&C SPORTS						
2	Statements of Cash Flows						
3	for the Years Ended December 31						
4							
5					2020	2019	2018
6	Cash flows from operating activities						
7				Net income	\$182,112	\$ 130,271	\$ 111,247
8				Adjustments to reconcile net income to cash provided by operating activities			
9				Depreciation	126,272	120,163	124,731
10				Changes in operating assets and liabilities			
11				Accounts receivable	(38,177)	(31,466)	(38,663)
12				Inventories	(131,788)	(98,510)	(105,411)
13				Prepaid expenses/other assets	(12,453)	(14,507)	(22,116)
14				Accounts payable	(46,310)	(28,438)	8,197
15				Accrued liabilities	(83,677)	(55,267)	(38,575)
16	Net cash provided (used) by operating activities				<u>(4,021)</u>	<u>22,246</u>	<u>39,410</u>
17	Net cash provided (used) by investing activities				<u>0</u>	<u>0</u>	<u>0</u>
18	Cash flows from financing activities						
19				Short-term borrowing	15,000	0	0
20				Repayment of long-term debt	(40,000)	(40,000)	(40,000)
21	Net cash provided (used) by financing activities				<u>(25,000)</u>	<u>(40,000)</u>	<u>(40,000)</u>
22	Increase/(Decrease) in cash				(29,021)	(17,754)	(590)
23	Cash at beginning of period				36,773	54,527	55,117
24	Cash at end of period				<u>\$ 7,752</u>	<u>\$ 36,773</u>	<u>\$ 54,527</u>

Notice that most of C&C's assets are current assets and that the relative percentage increased from 2019 to 2020. Accounts receivable represents sales not yet collected and is much higher than that of other apparel manufacturers. For example, in 2017 **Under Armour, Inc.** had accounts receivable that were approximately 15.2% of total assets. C&C's inventory balance increased not only in absolute size (dollars) but also in relative size. This increase could indicate that C&C is experiencing a buildup in inventory that could be caused by overproduction or obsolete inventory. Or it could indicate that the company is building up an inventory buffer in anticipation of sales growth. C&C's inventory as a percentage of assets is not out of line with others in the industry.

**EXHIBIT T1.6**

Average cost structure for costume and team uniform manufacturing in the United States, 2018.

	<u>December 31, 2020</u>	<u>December 31, 2019</u>
Accounts receivable, net	29.98%	28.40%
Total inventories	47.87%	41.63%
Total current assets	79.52%	72.39%
Machinery and equipment, net	18.93%	25.84%
Total assets	100.00%	100.00%
Total current liabilities	35.82%	42.37%
Long-term debt	21.24%	23.65%
Total stockholders' equity	42.94%	33.98%
Total liabilities and stockholders' equity	100.00%	100.00%

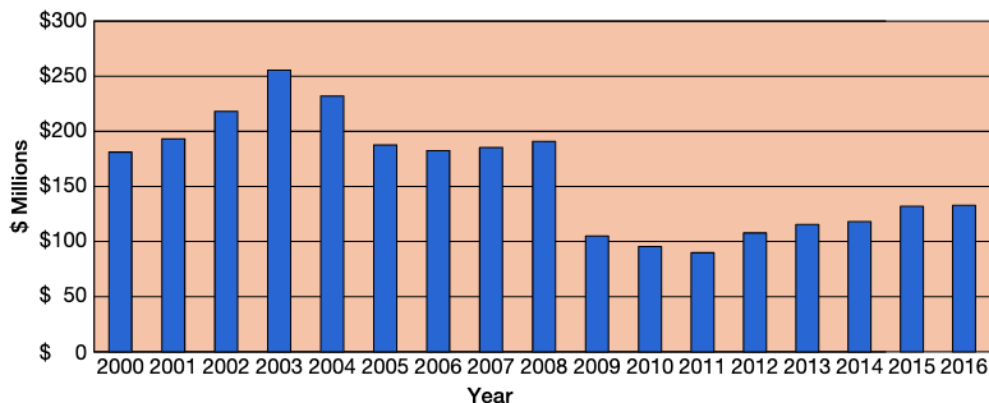
Industry Statistics

Numerous sources, ranging from government agencies to industry trade associations, provide industry statistics that help managers assess the future of the industry. To help them determine the size of the baseball uniform industry, C&C managers start by looking at the U.S. Census Bureau's *Annual Survey of Manufactures*. Since this survey does not show baseball uniforms as a separate category, the managers must look at the market for men's and boys' team sports uniforms as a whole. As shown in [Exhibit T1.7](#), shipments of these uniforms have been somewhat cyclical—increasing to 2003 and then falling to 2006, increasing to 2008 and then falling to 2011, and finally increasing to 2016. The decrease in shipments in 2009 was particularly dramatic, possibly a result of the general declining economic conditions in the United States and the resulting lower consumer disposable incomes.

IBISWorld, a leading provider of industry research and analysis reports, estimates that team sports uniforms account for 22.6% of the \$1.2 billion costume and team uniform manufacturing industry (NAICS 31529). The market for team uniforms has been steady for the past five years, and there is little projected growth in the coming years. IBISWorld reports that manufacturers of these uniforms have largely moved manufacturing from the United States to countries that offer lower wage rates. Imports satisfied 69.5% of total U.S. demand in 2017, although this level is expected to decrease in the next few years as U.S. manufacturers increase

EXHIBIT T1.7

Value of U.S. men's and boys' team sports uniform shipments.



Sources: U.S. Census Bureau, Annual Survey of Manufactures Value of Product Shipments: 2001; U.S. Census Bureau, Annual Survey of Manufactures Value of Product Shipments: 2004; U.S. Census Bureau, Annual Survey of Manufactures Value of Product Shipments: 2006; U.S. Census Bureau, Annual Survey of Manufactures Value of Product Shipments: 2008; U.S. Census Bureau, Annual Survey of Manufactures Value of Product Shipments: 2010; U.S. Census Bureau, Annual Survey of Manufactures Value of Shipments: 2011; U.S. Census Bureau, Annual Survey of Manufactures Value of Shipments: 2014; U.S. Census Bureau, *Annual Survey of Manufactures Value of Shipments: 2016*.

domestic production levels. A bright spot for the team uniform industry is that many of the new high-tech specialty fabrics used in uniforms are produced primarily in the United States, which supports a healthy niche of domestic manufacturers that produce custom team uniforms using these materials.²

Consumers are willing to pay a higher price for a uniform that is durable and of high quality. Firms that provide a high level of customer service by producing special orders and making timely deliveries can establish a competitive advantage. While the majority of uniforms are sold through retail outlets, Internet sales are growing and becoming a more important sales channel.

While we have been examining the overall market for athletic uniforms, C&C managers need to understand the size of the potential market for baseball uniforms to evaluate the company's future prospects. Perhaps the most important factor in assessing the market for baseball uniforms is the number of people playing baseball, and trade associations such as the Sports and Fitness Industry Association (SFIA) are a good source for this type of specific information. SFIA reports that in 2017, baseball was the second most popular team sport in the United States, based on total number of participants.³

According to statistics reported by the Sports Business Research Network (SBRnet) and shown in **Exhibit T1.8**, the number of people playing baseball has been in gradual decline since 2004.⁴ However, SFIA reported increases in casual baseball participation of greater than 10% in both 2016 and 2017.⁵ This increase is likely a result of Major League Baseball's "PLAY BALL" initiative launched in 2015.⁶ SBRnet also reports that 46.3% of baseball players in 2017 were between the ages of 7 and 17, and 62.3% of the players lived in a household with income of at least \$75,000. The vast majority of players (78.8%) are male, and there has been recent growth in the number of people who are playing baseball 50 or more days each year.

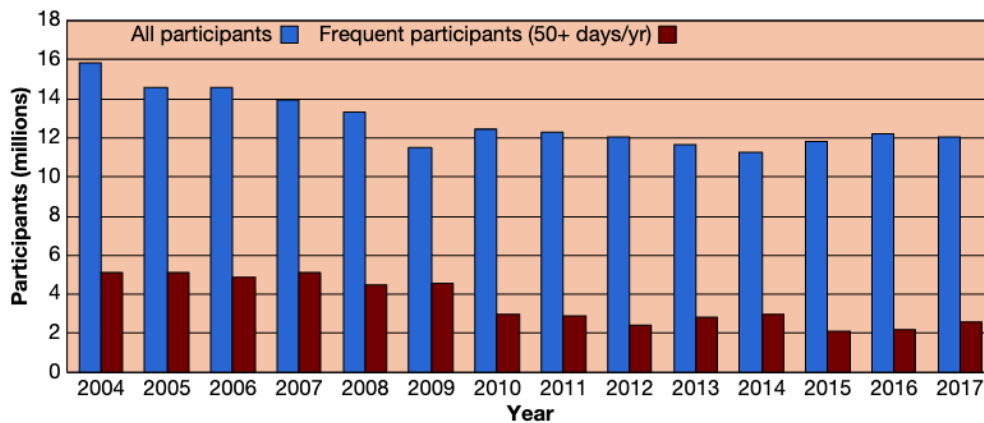


EXHIBIT T1.8

U.S. participants in team baseball 7 years of age or older, at least once per year.

Source: Sports Business Research Network, *Baseball: Participation by Total vs. Frequent*

Learning Objective Summary

Describe the business environment of C&C Sports.

C&C Sports is a manufacturer of baseball jerseys, baseball pants, and letter award jackets. Located in Brownsville, Texas, the company is a domestic manufacturer that competes in a local market (Texas). C&C Sports focuses on quick delivery and fast customer response time.

Recently, C&C Sports has experienced a decrease in available cash and an increase in inventory. Sales revenue has been increasing at a faster rate than expenses, generating a higher level of profits. Approximately half of C&C's asset base is financed through debt and half through equity.

The industry faces increasing pressure from imports, particularly from China, which creates a need to compete on price. However, customers in this market are willing to pay higher prices for goods that are durable and of high quality. The Internet is becoming an increasingly important sales channel.

Endnotes

1. Lucie Couillard, IBIS World Industry Report 31529: *Costume & Team Uniform Manufacturing in the US*, May 2018.
2. Lucie Couillard, IBIS World Industry Report 31529: *Costume & Team Uniform Manufacturing in the US*, May 2018.
3. The Sports and Fitness Industry Association, *2018 Sports, Fitness and Leisure Activities Topline Participation Report*.
4. Sports Business Research Network, *Baseball: Participation by Total vs. Frequent*, <http://www.sportsmarketanalytics.com/research.aspx?subRID=46>, (accessed June 27, 2018).
5. SFIA, "SFIA Sports, Fitness, and Leisure Activities Topline Participation Report Indicates Americans are Changing Their Activity Habits," press release, March 26, 2018, https://www.sfia.org/press/904_SFIA-Sports%2C-Fitness%2C-and-Leisure-Activities-Topline-Participation-Report-Indicates-Americans-are-Changing-Their-Activity-Habits (accessed June 28, 2018); SFIA "2018 Sports Fitness, and Leisure Activities Topline Participation Report," website, https://www.sfia.org/reports/612_2018-Sports%2C-Fitness%2C-and-Leisure-Activities-Topline-Participation-Report- (accessed June 28, 2018).
6. Major League Baseball, "Baseball, Softball Combined Most Participated Team Sport in USA," press release, May 17, 2018, <https://www.mlb.com/news/c-230969784> (accessed June 28, 2018).