Kootenay bicycle company essay sample

Kootenay Bicycle Company (Kootenay) has been captured customers' interest over the past years for its high quality custom-built bicycle; however, a clear strategic direction must be identified in order to ensure continued growth and lead to profitability.

The following report identifies and assesses:

1. Internal and external environment
2. Strategic and business issues currently facing Kooteany
3. Strategic alternatives available to the organization

In addition, this report provides recommendations that:

1. Offer clear direction for growth
2. Support the proposed growth strategy
3. Provide solutions to operational issues

Kooteany's commitment to Product Leadership and quality products support the target customer needs. Kootenay is known for high quality products, and the recommendations of this report support the continued commitment to quality that is the foundation of the company's success. A detailed implementation plan follows that outlines how to execute the recommended strategy and addresses key operational issues pivotal to its success on through to fiscal year ended 2009.

SITUATIONAL ANALYSIS

A situational analysis of Kootenay is researched in order to recommend the strategic direction of the company. Exhibit1 provides a complete list of the company's internal strengths and weaknesses, and its external opportunities and threats. The following are identified as the key factors or issues associating with Kootenay today: Internal Environment

Kootenay's key strengths are the passions of building custom bike frame in its employee – Shacketlon and Cullen. It has been translated to quality process, clearly defined products and customer satisfaction. Inventory levels are minimized as a result of order-to-make sales. Although growth is one of its objectives for Kootenay, operational efficiencies, capacity expandability, financing and management are limiting it. External Environment

Multiple alternatives have surfaced for Kootenay including facility expansion, financing and channel distribution. These opportunities can assist Kootenay to address the growing demand in Canada and North American for high-quality customized frame bicycle market. Externally, Kootenay must compete with the low cost mass-manufacturer, custom bike makers at all levels and unexpected demands in the market. Financial Analysis

As shown in Exhibit, profitability has been a concern to Kootenay – gross margins are below industry average of 28-50% for its complete bike products (Entrée; -0. 83%, Dlux; 7. 76%, and Ultra;-6. 73%) where materials have represented a high percentage of the costs (58 – 74%). Selling frame alone has shown stronger profitability (23. 33%) but overall returns needs to be improved (ROA/ROE are -14%/-22%). Activity ratio has shown the benefit of order-to-make or no overstocking of selling products (inventory turnover is 13. 07 days) but Kootenay has an extended collection period (18. 96 days). Its shortage of cash ($780) discourages any short-tem obligations. As for its coverage ratios, a large part of the equity is financed through owner's investment. Also, the allocation of 100% salary to direct labour cost has masked any labour that should be regarded as manufacturing overhead.

Mission Statement & Owners' Preference

Currently, Kootenay does not have a mission statement but its owner's preference is to make name for the successful bike manufacturers. In order to communicate the strategic direction of the company to its employees and customers, Kootenay, at this time, should create one as: " Kootenay is a custom frame maker who strives to provide the best in class quality and workmanship to customer's demand " IDENTIFICATION AND EVALUATION OF STRATEGIC OPTIONS

From the previous analysis, it is evident that Kootenay's is at a crossroads and must decide how best to address its immediate survival and future growth issues. While Kootenay's should focus on its long-term strategic direction, it should also be concerned with its short-term cash flow problem and other important internal issues. Four strategic alternatives are identified as follows, which should be evaluated in terms of feasibility, abilities of addressing current issues and compatibility with Kootenay's core competencies and owner's preferences:

1. Independent growth
2. Angel investor
3. Retail chain stores
4. Mountain High Bike (MHB)

Strategy Option 1: Independent growth

Pros:

– Core competence in unique designs and production processes – Product reputation as high quality, customized bicycle – Owner will have full control of the business

– North American market demand is shifting from low-cost standardized bicycles towards high-end customized bicycles Cons:

– Company is experiencing losses

– Lack of financing for current expansion and future growth – Poor operational efficiencies in delivery and production – Lack of accounting system to keep track of cost and labor – The company is lack of management expertise

– Maximized production capacity in space, frame-making staffs

Although the market prospece is good and there is high potential that Kootenay’s will address productivity issue in turn to improve its profitability, the strongest argument against this option is that Kootenay’s would not be able to find reliable financing to fund its operations and fuel its growth. As relocation and expansion entail significant inflow of capital, this cash flow problem would bring uncertainties to its growth and greatly undermine the feasibility of this option.

Strategy Option 2: Angel investor

Pros:

– Will directly address the cash flow problem

– Capital can be obtained with no direct obligation to repay the funds

– Clear terms of the offer which mean less uncertainty about the option

Cons:

– Difficulty in valuing the company because of variety of methods and complex factors involved

– The 50% ownership interest offer will give up equal control to the investor group

– The 100% ownership interest offer is against owner’s preference, which is to have control over his business

– Owner would lose his job or even other opportunities in the industry

This option addresses the cash flow problem, but at the cost of 50% or entire ownership of the company, which is not in line with owner’s preferences of maintaining control. Further more, this option does not address any operational issue, such as supply chain, distribution, logistics and accounting. This option does not appear to bring adequate benefits.

Strategy Option 3: Retail chain stores

Pros:

– Guaranteed purchase from reliable distributors

– Diversify channel distribution for products for future sales

– Potential cost reduction through outsourcing to China manufacturer

Cons:

– Not in line with company mission of providing quality, customized products

– Purchasing price substantially lower than current cost of production

– Must reduce costs and expand production facilities

– Potential loss of intangible assets in product design through outsourcing

– Loss of existing customers and increased dependencies to chain stores retailers

This option would not appeal to Kootenay's who targets high end customized bicycle market. Kootenay's is not competitive in terms of cost against mass bicycle manufacturers. This option would erode Kootenay's competitive advantage in the long run, straying far from its core competence. Strategy Option 4: Mountain High Bike

Pros:

– Will provide the interim financing

– Production facilities will be available rent-free for five years; all indirect costs will be covered

– Access to state-of-the-art painting facilities

– Purchasing, logistics, accounting and distribution support available

– Expansion of production up to 500 bikes per year

– Possible reductions in direct labor hours of 35% to 40%

Cons:

– Financial data of MHB not available

– Potential conflict of management style and practice

– In five years, MHB will have equal control of the business

– Shotgun clause in favor of stronger partner

This option not only solves the cash flow problem but also addresses operational issues such as supply chain, distribution and accounting. It is also compatible with Kootenay's mission and core competencies. This option appears to be the viable option. STRATEGIC RECOMMENDATION

Based on the above analysis, it is recommended that Kootenay's 1) enter into alliance with Mountain High Bike, 2) decline the offer by the angel investor and the retail chain stores and abandon the option of independent growth. Among the four options, only the MHB option addresses cash flow problem, various operating issues and provides a viable strategic direction for the company. The lack of resources, high level of competition and tight profit margin make it viable for an early-stage company like Kootenay's to work together with a partner that possesses complementary expertise to explore broader market opportunities.

Through the partnership, a leveraged growth would be realized by engaging in activities and accessing resources outside Kootenay's own boundaries. In the long run, when the partners prove to work well together, a merger would be feasible that would enable the two partners to joint efforts and explore the profitable recreational bicycle market. The risk associated with this recommended alternative should be addressed hrough the negotiation period. MHB's recent financial statements should be requested for detailed analysis of its performance and potential for growth. Furthermore, milestone for each stage and an exit strategy should be in place in case the desired result cannot be attained. Instead of transferring ownership according to time frame, Kootenay's should negotiate with MHB for result-oriented transfer terms. Revisiting Mission Statement

By implementing the recommended change, Kootenay is destined to operate in a niche market whose competition is against custom bike builder in the mountain bike market. A revised mission statement is recommended: " Kootenay strives to be become a profitable custom frame maker where every bike or frame is produced with the best quality and process"

OPERATION ISSUES

Product Mix

We recommend Kootenay's to keep all three product lines as they appeal to different customer groups: The Ultra for bicycle crazies who simply want the best, the Dlux for customers who want the balance between quality and price, and the Entrée for budget minds who want a quality customized bicycle for minimum price. In order to maintain its market position, Kootenay's should pay attention to the industry technology and now materials. Kootenay's should consider adopting new materials such as carbon fiber or titanium[1] as the market demand shifts. Productivity

To inline with the mission and owner's preference, Kootenay's should strive to improve its productivity without sacrificing quality. We recommend Kootenay's not to reduce the inspection standards as inspection is a key step in quality control. By allying with MHB, Kootenay's should be able to improve productivity significantly through MHB's modern facility. Detailed production projection can be found in exhibit 3. Production Capacity

Kootenay's must proactively increase its production capacity to meet the extra demand from its market. In order to increase productivity from 160 to 500 frames per year as facilitated by MHB, Shackelton and Cullen must offload some non-value added activities or train new frame makers. We recommend Kootenay's to bring in a trainee for assembly, packaging and inspection while being trained for making frames during his first year. In the second and third year, the trainee is expected to achieve 50% and 100% efficiency in making frames to Kootenay's current standard (57 or 113 frames/year). Also, the process of bike assembly, packaging and quality inspection should be dedicated for the trainee and hired assemblers. Exhibit 3 provides the productivity projection for the next 5 years with 3 trainees and a full time assemblers being hired at different time. The use of time card as suggested below would be a good monitoring tool of productivity improvement. Pricing

Target costing approach was used to revise current products' pricing and costing to achieve profitable margin at industry levels (28-50%) after 5 years. Please refer exhibit 3. A step approach is employed for all products to attain 15%, 20%, 28%, 35%, 45% gross margins or higher in year 1, 2, 3, 4, and 5 respectively. Not only would customer see a minimal price increase (~6. 8 to 12% on average) from previous year, a cost reduction of 10% for parts kits is factored as a result of MHB's enhanced sourcing ability. Dlux's and frame's pricing will remain unchanged in the next 2 years to maintain projected gross margins. MHB accountant to review suggested retail pricing by including actual material savings from purchasing. Accounting

The lack of proper accounting and labor activities records resulted in improper financial reporting for Kootenay's past years of operation. This also cost Kootenay's chance in obtaining financing from financial institutions. Also, products costs were poorly allocated which is why Kootenay was unable to set prices properly. To resolve these issues, we recommend Kootenay to utilize industry standard accounting system to keep proper business records and implement job card system to record labor hours for each order for reporting and review purposes. Activity-Based Costing (ABC)

Kootenay's current costing system assumes all of Shackelton and Cullen's labor hours apply to forming tube framing or complete bike. Indirect manufacturing activities such as ordering parts from suppliers, parts and complete bike inspection are charged to direct labor costs regardless of products or actual labor applied. These labor costs should be applied to Kootenay as manufacturing overhead labor while direct labor cost only represent the manufacturing of tube frame which includes cutting tube, forming triangle, mounting head tube and bottom bracket shell as well as welding. Activity-based costing (ABC) that tracks manufacturing activities in smaller pools of overhead costs and charge against product based on cost drivers is recommended by another report (source) and should be implemented after further consideration of activities at MHB facilities. In addition, consideration should be given to extra material cost for special order such as oversized frame requested by customers. Marketing

To date, Kootenay's marketing activity has been minimal. Although Kootenay hasn't had problem with orders to fill its full capacity, we believe targeted marketing activities can help Kootenay to establish the high-end image and strengthen its position in the market place. We recommend Kootenay to: Human Resource Management

Currently, Kootenay is facing two human resource issues. First, Kootenay has only two frame makers. They have to work extended hours and Saturdays to keep up production. Even then, Kootenay's capacity is severely limited. Second, Kootenay does not have a business manager who can keep proper accounting records, and manage customer accounts and suppliers. In light with the two issues, we recommend Kootenay to: 1) Expand capacity instantly, and ensure human resource for further expansion in the future. 2) Keep proper accounting record and handle customers' accounts and suppliers. Proper accounting records will assist Kootenay to control cost and set proper prices. Supply Chain Management

Kootenay hasn't changed suppliers ever since they started the business. Although the supplier never raised prices, Kootenay may be paying premium prices for part kits and material. By forming alliance with Mountain High, Kootenay will be able to access Mountain High's sourcing network and supply chain. We recommend Kootenay to use 10% target cost reduction in part kits and material for the first year, and add it into the contract with Mountain High as a condition for ownership transfer. The new business manager should conduct a supply chain performance evaluation by the end of the first year. IT System

We recommend Kootenay to improve its IT system by redesigning its website to improve appearance and functionality. On-line payment option through company website should add value to the company. IMPLEMENTATION PLAN

Exhibit 4, Gantt chart, illustrates the timelines associated with the following implementation plan. 1. Hire business development manager (BDM): Cam Shackelton should be involved to hire a BDM immediately to keep proper accounting record, supervise customers' accounts, and negotiate price with suppliers. The manager should prepare for timelines and obtain required information for the MHB alliance. 2. Aliance with MHB:

Cam Shackelton, Bill Cullen and the new BDM should visit MHB's facility as soon as possible so they can start planning for the relocation. Cam and Bill should work with MHB to develop a feasible production plan to utilize modern facilities and improve productivity. This must be done prior to signing the final contract. The BDM should start drafting the contract with MHB. The contract should specify the following terms: amount of financing MHB would provide for expansion, priority on shared facilities between Kootenay's and MHB, Supply chain, logistic, distribution and accounting support. Performance should be evaluated every year after the alliance. 3. Implement accounting software and performance measurement system: Diane Shackelton should purchase Simply Accounting Basic™ software immediately in order to keep accounting records. ($149. 99[2]) Diane will acquire the training courses for use of the program. Together, Cam and new business manager must develop performance measures using the Balanced Scorecard to ensure that the company's goals are clearly communicated to the staff and that they are aware of their contributions to the success of the company. 4. Implement ABC and Target Costing:

BDM to employ ABC with target costing in Kootenay's accounting system, review bike production activities to form proper cost pools for cost allocation. Time card to track labor hours spent on various activities to accurately determine the cost of their product. 5. Marketing strategy and Utilize the website:

BDM should hire an IT consultant for improving its website. The new website should be featured with product information including pictures and pricing, a discussion forum allowing bicycle fans to discuss cycling activities and products, and online payment option. Also, it should place pay-per-click ads in major search engines (Google, Overture) to attract targeted customers to the company website. Also, the company should join national hobbyist association, participate in trade shows and advertise in sports event. 6. Develop Supplier Relationship:

Cam and the BDM should inform its current supplier about the alliance with MHB as soon as the contract is signed. The BDM should negotiate with current suppliers and new suppliers through MHB to achieve a target cost reduction of 10% while maintain high quality. CONCLUSION

In conclusion, Kootenay's core competences are the skill, experience and emphasis on quality in making custom bike. The strategic direction recommended in this report does not trade off any of its core competence. Shackelton's preference for Kootenay is to become the name for custom bike manufacturer with growth, and the following are recommended:

• Accept MHB alliance proposal after detail review of contract and analysis; • Reject financing proposal from angel investor;

• Reject distribution proposal from retail chain stores;

By implementing the strategic and operational recommendation in this report, Kootenay should experience both short and long term growth, become operational efficient and become profitable. Kootenay is destined to become a reputable name for custom bike manufacturing in Canada.

EXIHIBIT 1: SWOT ANALYSIS

STRENGTHS:

– Owner's passion for the work, and ability to improve productivity over the years; – Experienced, skillful employee with strong emphasis on quality process, parts; – Long term debt free;

– Multi-purpose products for commuting, winter riding, racing on snow and sand; – Product mix with clear boundary in materials, designs and features; – Customized product with prolific customer feedback and loyalty; – Highly skilled process to discourage from copying design;

– Order-to-make model reduces inventory level to minimum;

WEAKNESSES

– High cost facility with insufficient space that cost un-efficiency; – Accounting – lack of experience, proper reporting on labor hours, recording and a system to measure direct manufacturing and overhead cost; – Backlogging and delayed delivery (3 weeks behind 6-week promised lead time); – Lack of a mission statement and a strategic direction of the company; – No current trainee for possible expansion of capacity;

– Lack of cash or maximized operating line of credit for expandability (facility); – Lack of marketing means in brochure, packaging logo, poorly managed website; – Operating loss, low or negative gross margins in Entrée/Ultra; – No patent for designs;

– Lack of business management at corporate level for stewardship.

OPPORTUNITIES

– Increasing demand for bike industry in North America[3], West Coast Canada[4]; – Trend to move from low-cost standardized bicycles towards high-end customized bicycles with high quality parts and frames[5]; – Alliance opportunity with MHB to expand capacity, reduce overhead costs, obtain financing, diversify supplier and distribution networks; – Moving to new facility for productivity improvement and expandable capacity; – Retail chain stores opportunity that leads to guaranteed revenue and outsourcing Entrée/Dlux to China manufacturers; – Angel investor opportunity to obtain financing;

– Change of product mix by selling frame set only or mountain bike frames;

THREATS

– Copying design ideas by small or large, offshore bicycle makers; – Custom frame competitors in pricing, design at all levels from large manufacturers to small local bike shops; – Low turnover cycle of the product;

– Seasonal demand pattern;

– Low cost foreign makers entering market;