

Strong tie ltd financial and strategic issues case study examples

[Business](#), [Company](#)



1. Introduction

Strong Tie Ltd. is a Canadian family-owned company that specializes in manufacturing of standardized and customized structural connectors located in Winnipeg, Manitoba. It is run by the son of the founder together with his three daughters. Unlike its competitors, the company keeps its production in China, which is possible partly due to high level of automation of the production of standardized details. The production of customized details is labour-intensive, but high costs are supposedly being offset by high premium the customers are ready to pay.

Or are they? While Universal Connector – the main competitor who currently holds 30% market share and is growing – showed in the last financial year 10% net profit margin, 17% ROA and 28% ROE, as compared to Strong Tie Ltd., who, in fact, broke even in 2008 with reported net profit amounting to just \$7, 000, which, given the necessity to pay \$500, 000 a year dividends to the owner's sister, is equivalent to a loss.

There is no doubt that the company is going through the hard times at the moment. Financial crisis means that people are likely to build fewer houses, so the whole market is in stagnation, while the competitors – Universal Connector and several smaller companies – are gradually taking away the once-70% market share from Strong Tie Ltd. Despite superior perceived quality and possibility to charge higher prices, the company fails to show profits as expensive Canadian labour ' eats' the whole margin, while the market conditions make it difficult to implement JIT practices. The purpose of this paper is to conduct detailed analysis of the problems the company is facing and to offer the solutions.

2. Problem identification

Strong Tie Ltd. is now the only company in the market who still has the whole production at home - Universal Connector have been opening new facilities in China while closing the American ones, while the remaining competitors are the Chinese companies. The company rely on automation of the process and was recently heavily investing in fixed assets, which however, did not decrease operating costs: they rose significantly between 2006 and 2007, and stayed constant between 2007 and 2008. Depreciation costs considered, automation process so far failed to reduce costs significantly.

Apparently the great believers in domestic labour market, Johnstone family maintain perfect relationship with unions paying high salaries and providing all possible kinds of benefits. They have never had a strike, and one may wonder whether it is a good thing. As the economist Steven Landsburg puts it, ' If you never missed an airplane, you spend too much time in airports' - this may well apply to labour market: if employees are very happy, it is by no means a sign of efficiency - they can accept lower wages.

The increasing metal prices contribute to Strong Tie Ltd. costs struggle, and lack of profit in 2008 is a sign that compensating increasing costs with high premium may not work anymore. As the main competitor demonstrated very strong financial results for the same period, it is same to assume that crisis in the market is not an excuse for the downturn in Strong Tie Ltd. results. It also needs to be mentioned that fixed \$1, 5m that is being distributed every year to sister and daughters of the owner is a quiet heavy burden on the company (in fact, it is almost 10% of sales). Out of the whole range of

income statement ratios, Gross profit margin is one, which is at least comparable to that of Universal Connectors (27% against 32%), but then profits get hammered by high selling and administration costs (which include \$1m for the ladies), and the difference in operating profit margin is already huge (2, 5% in Strong Tie LTD against 16% in Universal Connectors). Selling and administration costs plus depreciation amount to almost 25% of sales, while in Universal Connectors this number is at 16%. Salaries of the daughters are responsible for two thirds of the difference - since they are closely related to the owner (though are not formally the owners themselves), one may argue that there is nothing wrong with that, as these fairly inflated salaries might be the form of dividend (probably, with favourable taxation). However, paying out the whole profit (this million would have constituted company's profit, had it not been paid to the daughters) as dividends does not appear very reasonable, especially given internal and external environment the company is faced with at the moment.

Apparently, the efficiency of operations might be an issue, too. While raw materials turnover period is almost equal to that of Universal Connectors, the company seems to keep too much of finished goods and WIP: for the former turnover period is equal to 32 days, as compared to 51 days in Universal Connectors, and for the latter it is equal to 2 days (3 days in UC). On the other hand, the company is slightly more efficient than the main competitor at collection of debt - 69 days against 63 days at Universal Connectors. The comparison, however, should be drawn very cautiously, as only one company and only for one year has been taken as a benchmark (they might have had particularly good year, while for Strong Ties Ltd. the year was horrible).

Finally, what should worry Mr. Johnstone is negative net cash flow for two consecutive years. Again, paying out tenth of revenue in cash for unproductive for the company purposes play the crucial role. Such privilege may be forgivable if the position of the company is dominant and profits are excessive, which, unfortunately, is not the case anymore - the competition is tougher, the market share is shrinking and the market itself is not developing. 2006 was the last year when the company made enough profit to not be hit hard by annual \$1, 5m payments to the family members - in 2007 less than \$0, 5m were retained, while the last year meant the losses for the company.

3. Solutions

While the company had been looking like a dream family business until recently, it does not appear to be that rosy anymore. For that reason, in my opinion, it should cease behaving like a dream family business - i. e. to pay very generous salaries, to distribute substantial part of income among family members and to support community heavily. Because of its consistent success, the owner has not been thinking about binding the daughters' remuneration to the performance of firm - high constant salary was more or less the same. Now the policy must be reviewed. In my opinion, their salary should be decreased at least two times, with the remaining depending on profit. Not only will it be beneficial for the company's cash flows, but it also must provide additional motivation for ladies - my suggestion is \$150, 000 per year for each plus quarter of profits is divided equally among them. If there is any possibility to retract from fixed bonus to the sister, it should be done - the best way is to bind it to the profit, for instance, \$200, 000 per

year + 10% of profit. With such system the company will payout only \$650,000 as the fixed amount, and 65% of profit will remain for the company's disposition.

The company also cannot afford to appease its employees anymore. I do not think that at this stage the company should necessarily move to a cheap-labor country, as it may undermine reputation of Strong Ties Ltd. as the leader in terms of quality, but such possibility should be used to negotiate a salary cut with the unions. Union's bargaining power should be weak after closure of Universal Connector's facilities in the U. S., so they have no option but to accept the deal that would cut wage bill by a tenth. If the unions resist, the company can contemplate moving to China.

In terms of operations, the company keeps too much finished goods and, correspondingly, work in process comparing to the main competitor. More effort needs to be invested in predicting demand - otherwise the operations of the company are as efficient as those of competitors.

4. Conclusion

The case presents the example of a family business with established policies that need to be revised due to increased pressure from competition. The challenge for Strong Tie Ltd. now is to adapt quickly, to get tougher in relationship with employees and possibly contractors and to be ready to give up short-term benefits for strategic development of the company.