COMPREHENSIVE CASE DAN KIM: PART 2

Although the numbers Dan put together indicated that the Ladder Rail business might face several challenges, he decides to devote all his spare time to the venture. This is primarily because of the positive response that he has received from his co-workers, the local Home Hardware dealer, as well as numerous comments on the Internet, all agreeing that the product has potential. Dan is particularly excited about some of the positive comments on crowd-sourcing sites, as they had come from all over the world, and he is convinced the product could have global appeal. Dan was so enamored by the response that he decided to put up a few units for sale using Kijiji and some Internet sites used by inventors. He quickly had to pull the ads down, as he sold 10 units within a few short days, essentially running out of product. Feedback from customers has been positive, and this is encouraging Dan.

One of the decisions that Dan is concerned about is whether to build a manufacturing plant or purchase an existing facility. He is aware of a small plant close to his home that is for sale. It has much of the metal-bending equipment that he needs, and he could retrofit the plant to suit his purposes for $10,000. However, when he learns that the owner of the plant is asking $200,000 and that its net worth is only $180,000, Dan feels that it is just too much money and is leaning toward building his own plant. Dan's wife, Suzie, has been pressuring Dan to consider manufacturing the product in China to reduce costs, but Dan is insistent that the product be made in Canada.

Regardless of how he establishes the manufacturing facility, one thing that Dan learned in his small business management class was that he should prepare a business plan. He therefore sets to work preparing the plan. The outline of Dan Kim's business plan for the Ladder Rail is found below.

Introduction

My objective in starting this business is to become independent and develop a business that will provide an adequate living for my family and me. I anticipate that within three years, the product will experience high awareness and demand throughout Southern Ontario and Canada. At that time, I will look to expand globally. I have considerable expertise in construction and roofing, which has allowed me to be knowledgeable about the safety and convenience concerns associated with the use of ladders.

Marketing

The product is a light metal handrail that will attach to most aluminum extension ladders commonly used in the construction industry and by many homeowners. It can be made inexpensively (estimated at $10 per unit) and has great profit potential (selling price estimated at $40 per unit). I anticipate that anyone who owns a ladder would see the Ladder Rail's benefit and would be interested in purchasing it. I intend to promote the product on the Internet during the early days of the company, making use of social media sites, sites that allow for free advertisements such as Kijiji, and perhaps make use of some traditional promotion such as newspapers and perhaps television advertising. I am also hopeful that I will be able to generate some publicity for the product, as there is currently no other product like it on the market.

Physical Facilities

Although I now can manufacture the Ladder Rail in my garage, as sales increase, I will need to build or purchase a small factory to meet the demand. I estimate that an adequate production facility, including the required equipment, will cost approximately $170,000. I already own the land that the plant would be built on.

Financial

I currently have $20,000 of my own money to invest in the business and will borrow the rest from the local bank. I am certain that the business will be able to generate the required income to make the interest payments on the loan plus provide a good living for my family.

Legal

I plan to operate the business as a sole proprietorship for the first few years until incorporation looks positive. I will need a business licence to operate the manufacturing plant.

Personnel

The business will employ three people initially, including me. I will be in charge of the production process, assisted by two others. I will also handle the marketing and financial aspects of the Ladder Rail with the help of my wife, Suzie.

Questions

1. What aspects about this situation would suggest that Dan should buy the plant instead of building it from scratch?
2. If Dan decided to purchase the building and estimated that income from the plant would be $20,000, is the asking price reasonable, assuming he wanted to make a 10 percent return on the investment? (Use the capitalization of earnings formula.)
3. Evaluate the business plan that Dan has prepared. Suggest improvements.