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FIRST MATES' WHOLESALE BOATING SUPPLY COMPANY: DO OR DON'T?

Nick Pittman, president of the First Mates' Wholesale Boating Supply Company (FMWBS) was concerned that the company was not going to meet its current-year financial targets. In particular, and based on the report that had just been brought to him by Jane Warner, FMWBS's controller, it looked as if the company's current fiscal year-end earnings per share (EPS) figure was going to fall about $0.30 short of its projected $3.60. This was terrible. Everyone had predicted a challenging year but not one of such magnitude. In fact, financial belt-tightening steps had been taken, and from the year's outset, Pittman had remained fairly confident throughout about the company's ability to achieve the projected $3.60 EPS target. But now, as the year was winding down, not only was yearly EPS on a trajectory to fall substantially short of the year's target, so were total revenues, operating earnings, and sales volume. It was not pretty.

There were two months left in the fiscal year, and as he drank that morning's fifth cup of strong coffee, Pittman crafted the following e-mail for immediate distribution:

To: All Business Unit Leaders and Department Heads
From: N. Pittman
Subject: Financial Imperatives for Year End

As you all know by now, or will shortly learn, FMWBS's financial results for the current year are on track to disappoint owners, analysts, the board, and all of us. It is not clear to me that everyone has been as resourceful and as determined as they can be in order to preempt our first decline in annual EPS in 30 years. We have limited time left to salvage the year's financial results. I expect everyone to double their efforts to find costs to reduce and revenues to book. By Wednesday next week, and after having met with your direct reports, it will be time for plans and ideas to translate into actions. In the meantime, salary increases are rescinded, and a hiring freeze is now in effect.

We have overcome adversity and tough times in the past, and I know we will succeed this time. FMWBS has a proud history of attractive earnings' growth, over many years. My door is open should you want to stop by. I expect reports no later than a week from today.

Company Background

FMWBS was founded in the late 1970s in the booming Gulf Coast region of the southern United States. Three former charter fishing boat first mates, each in their midtwenties at the time, had pooled their savings and founded the company. They spent the first two years of their venture operating the company out of a small dilapidated warehouse. In the beginning, FMWBS focused on selling deep sea fishing equipment and supplies to the numerous charter companies that operated out of the large and small wharfs within a 150-mile range. The company provided quality gear at affordable prices. In addition, the company provided prompt delivery and repair service and had a no-questions-asked return policy. Based on their first-mate days, the founders knew many charter captains, and their business grew from the outset.

By their midthirties, the owners had successfully grown the company to four small warehouse/office sites covering the coastal regions of two southern states. Ten years later, the company had 12 locations, serving the coastal areas of five states.

By the time the owners had each celebrated his fiftieth birthday, the company had made the plunge to serve the lake recreational and fishing market, and the company's product line had expanded accordingly. In fact, the company established its lake boating business as a separate unit from the deep sea fishing/boating business. The lake business unit specialized in products such as water skis, towable tubes, swim-related attire, wake boards, mooring and dock-related products, bass and other small sport-fishing equipment, and ski boat products. These products were sold through a small but growing network of marinas that FMWBS had recently established, independent tackle shops and marinas, a number of specialty online stores, and one national sporting goods retail chain.

The original deep sea fishing business unit remained a relationship-oriented business with product sales via personal sales calls and follow-up contacts. This business unit provided products for heavy-duty deep sea sport fishing, big boat maintenance and outfitting, and scuba-related gear.

By age 55, the original owners declared success, ascertained it was time to enjoy life to the fullest, and cashed out—selling the company, at a generally acknowledged premium price, to a large investor group that retained the company name. It was this large investor group that had placed Pittman in the president position and who had established high expectations for the company's financial performance.

Financial Focus

As many investor groups do, these investors established FMWBS's predominant mission as continuing to generate attractive and consistent financial returns. On an appropriately adjusted per share basis, the company's history of EPS was one of consistently upward results (**Exhibit 1**). Such historical results and the need for similar future results were not only important but also expected. Pittman had been brought on board four years earlier to keep the track record intact. He had seen the chairman of the board in action once before, when another company in the group's portfolio had failed to deliver its targeted financial results: The president of that company had been unceremoniously deposed. Pittman's smarts, doggedness, and optimism had served him well over the years, and he was certain he would need all three to turn the current year around. He had done so with the floundering startup company he had led before coming to FMWBS, Knowhow.com, and he was sure he could do it again. Moreover, since coming on board, he had guided the company through a Sarbanes Oxley Section 404 material weakness remediation, obtained a $2 million collateralized line of credit, and divested the company of a small 10-year venture into the motorcycle equipment and apparel business (that business unit's financial results, although frequently touted internally as promising, had never been satisfactory).

Pittman's style with direct reports was to establish growth goals, garner agreement, interact in a no-nonsense fashion, and then turn the business unit leaders and department heads loose to make it happen. His managers were paid well, and they all participated in a profit-sharing plan. He was beginning to wonder, however, if he had let the "horses run between the rails on their own" too long this time without early and strong guidance.

Lake Products Business Unit Meeting

"Okay, gang," John Newel, vice president—Lake Business told the group, "we are behind budget quite a bit. The hoped-for fourth quarter economic recovery does not appear to be materializing, nor should we expect that it will." He looked around the room. "Let's hear your ideas for how to pull off the big year-end financial finish we need to make our profit targets."

No sooner had Newel, uttered those words than his team of direct reports began presenting suggestions. If any group of young managers could successfully finish the year with a flurry, this group of ambitious, dedicated water-sports-enthusiast departmental leaders could. Not wanting to stifle any creative energies flowing in the room, Newel let the near-chaotic, multivaried ideas bubble up and out.

Jeremy Tolmit, head of promotions and marketing, said:

> We'll stop the ad campaign, hold off accruing for and paying the bills we currently have from last month's media runs and wait and see if it makes sense to restart the campaign in a few months. And while I'm on a roll, I'll make sure next

quarter's automatic marina replenishment orders get shipped before the end of this quarter instead of waiting the usual 10 to 20 days into the new quarter.

Newel responded with his idea:

Jeremy, how about calling a few of our best customers to see if they are willing to increase the orders we have on hand from them under an arrangement where we invoice them now at a discounted price for the additional items, and we hold the goods till they need them?

"Will do, boss," Tolmit said.

"John, as you know, our franchised marinas are starting to sign up new boat owner members," said Sara Horner, who had spearheaded this new endeavor for FMWBS for the past year. "We should see an influx of new membership fees, at $2,800 a pop, start rolling in. Those initial fees will really help our revenue stream this year, along with the monthly operating fee of $100 we will get from the boat owners who have chosen to berth their boats at our marinas."

Not to be left out, Hank, the multitalented back-office guru looked up from his notepad and said:

Here are two things I can do. First, I'll reclassify some of the expenditures we made last month to reroof the original warehouse from the repairs expense ledger to the asset improvements category—we could have done it that way from the beginning. Second, we are getting ready to ship a fairly large quantity of diverse product items we've offered to a southwest network of marinas for their inspection in the hope that they will choose to carry some or all of our products. We have been trying to sign them as an ongoing customer for months. I'm pretty sure they'll like what they see, so I feel comfortable booking those shipments as sales. By the time we touch base with them, answer any questions they have, and reconnect to get their decisions, it'll be next quarter, and we'll worry then about any returns and/or disinterested outcome.

Deep Sea Fishing Business Unit Meeting

Miriam Arthur was in charge of the deep sea business unit and had been during its steady growth over the past decade. She had been with FMWBS almost from its founding, first working summers while in college and then joining the guys when she graduated after serving a tour with the Peace Corps in a Caribbean island nation. She loved the sea, the sand, the sun, the surf, and all things nautical. She had contemplated retiring when the three first mates had, but she figured she might as well continue getting paid for what she loved to do. It was her ocean recreation and sport expertise that made her so unique and so valuable to the business—she let others manage the financial and operations side of the business. She enjoyed calling on charter captains, testing and using the latest gear, and attending as many trade shows as she could both as a speaker/expert and as a buyer.

Arthur was in her office, a place she tried to avoid as much as possible, when she opened Pittman's e-mail. "Better cancel my flight to Belize…this sounds important," she thought as she began to mentally run through where her business unit stood. She knew her unit was not hurting nearly as much as Newel's. In fact, she was thankful that the year before had been such a good one. If the unit had not been able then to (1) delay a few major customer shipments till this year, (2) prepay and expense the costs associated with a major trade show it had sponsored this year, and (3) substantially increase the estimated uncollectible accounts-receivable reserve that was then partially reversed last quarter, there was no doubt in her mind that she would be really scrambling to make this year's earnings target. As it was, her team would need to extend a bit more of a year-end effort, but there was no doubt in her mind that it would deliver.

When Arthur's team had finally assembled, she discovered that her intuition had been correct—members were eager to brainstorm and take the actions they agreed on for ending the year in a strong financial position. To get the ball rolling, Arthur announced she would be undertaking a much-reduced travel schedule for the rest of the year. Teleconferencing would simply have to suffice for some of the sales calls she had planned on making in person.

Immediately, Molly Jackson, who took care of all things financial for Arthur, spoke up. Jackson was young but facile with numbers, analytics, and the financial ways of the accounting world. Arthur was confident that there was not an erroneous number to be found in her business unit and not one number Jackson couldn't recall off the top of her head. "I have a host of ideas whose time has come to help," Jackson said. "These are easy to do, legitimate, and they can help us." Jackson explained:

> First, I propose we relax our credit screening for new customers to expand our customer base. We'd just have to commit to closely monitoring their subsequent payment patterns in order to justify not increasing this year's uncollectible accounts estimate again. Also, in the time it takes to make a computer keystroke, I can lengthen the period of time over which we depreciate our buildings and vehicles—twice as long an estimated life, half as much depreciation expense. Next, we normally maintain a couple million dollars of inventory on hand. We've been on LIFO for at least a decade, during which time the costs we have been paying for our inventory components has steadily increased. If we let our remaining sales this year serve to shrink our ending inventory levels, without replacement, that will have a positive bottom-line impact.

Jackson paused. "Should I keep going?" she asked, as her mind continued to race and her enthusiasm for being of such great assistance surged.

"Molly, as you know, I have always given you total control over and responsibility for the unit's financial records and reporting," Arthur said. "I have not always understood what you did or why you did it, but you have never let me down. Is all that you are now saying really legitimate? I must confess that it sounds like it is, but it seems too easy."

"Absolutely!" Jackson replied.

Jeff McCain, head of marketing, spoke up:

I was talking to a buddy of mine at the All-Things-Digital Company. He says that one of the ways his company has boosted sales and made some real inroads with new customers who were hesitant to place big orders with them was to go through the normal purchase order/shipping/invoicing/sales recording process and then issue a supplemental letter to the customer detailing some specially negotiated sales return policies. It seems in such circumstances, some new customers are much more willing to take the plunge in placing a large order, and even existing customers seem more willing to order some product lines they were previously hesitant to acquire.

"Sounds like a thoughtful response to allaying some customers' specific concerns," Arthur said. "Jeff, are there a couple of customers you believe this approach would increase our year-end sales to?"

"Yep…at least four that I can think of off the top of my head, with a potential dollar benefit of at least a hundred thousand," McCain said.

"Great, go for it," Arthur said, "and make sure the accompanying letters are precise and clear. I don't want any customers coming back to us arguing that they thought the letter's product-return terms were different from what we intended them to be."

As the meeting drew to a close, in his indomitably semiserious way, McCain said, "We could always ship bricks and call them sales. I heard some computer products company in the Mountain West region did that and got away with it for awhile."

But Arthur, wanting to erase any doubt, quickly stated, "No way, no how, not now!"

Later

Within 72 hours of sending his e-mail, Pittman had heard from all its recipients. All the managers had met with their direct reports, and they had assured him that with creativity and hard work their teams would come through for FMWBS's benefit. Pittman was thankful for such a talented group of people and for their loyalty and dedication. He encouraged them to get started, and he scheduled meetings with Arthur and Newel for Wednesday.