When Robert takes the proposals to the bank, the manager seems impressed but still will not give approval for the loan. Some uncertainties about the statements still bother the banker. Finally, after two weeks of collecting information—and pleading—the Normans' loan for $75,000 is approved. A major reason for the approval was their past dealings with the bank and their good credit standing. Now they can begin purchasing supplies to get started.

Before long, however, the Normans realize that they have underestimated many of their expenses. They learn, for example, that utilities, rent, and telephone all require initial deposits of $200. They also need some additional supplies, even though they had overbought some unnecessary supplies from especially persistent salespeople. The landlord requires the first and last months' rent before letting them move in. The equipment costs and inventory levels are higher than they had estimated. Finally, since the Normans had decided it would be better to incorporate their business, they face additional legal costs for which they had not planned. The result of all these additions is that The Framemakers need another $10,000—and the Normans haven't even opened the doors!

Robert and Teresa don't know what to do. They are hesitant to go back to the bank and ask for more money because of the difficulty they had obtaining the first loan. However, they know their chances of obtaining funding elsewhere are slim. On top of that, the time for the grand opening is rapidly approaching.

Questions

1. What aspects of Robert and Teresa Norman's backgrounds will contribute to their success with the picture-framing store?
2. What positive things have Robert and Teresa done in investigating the feasibility of the new store and what additional information might they have collected? From what sources could this information be obtained?
3. From the information provided, evaluate the business plan they have prepared for their new business.
4. Weigh the relevant pros and cons for the Normans of operating a U-Frame-It franchise instead of starting their business from scratch.
5. Evaluate the Normans' initial approach to obtaining financing for The Framemakers.
6. Assuming you are the banker, evaluate the financial requirements and projections Robert and Teresa prepared.

CLOVIS JEWELLERS

D. Wesley Balderson, *University of Lethbridge*

Clovis Jewellers is a small jewellery store located in Brandon, Manitoba.[1] You have been called on by the owner to prepare an analysis of the business. The owners have supplied you with a detailed description of their operation and strategy. Critically evaluate each area described in the case.

Structure

Legal Structure. Clovis Jewellers is an incorporated company under the name of Clovis Jewellers (1988) Limited. It is a privately held corporation. The only shareholders are Mr. and Mrs. Neudorf, each of whom owns 50 percent of the outstanding shares. As a corporation, Clovis Jewellers is

1 Although this case describes an actual business, the names of the business and owners, as well as the location, have been changed.

authorized to issue an unlimited number of Class A, B, and C common shares. The only outstanding shares are 100 Class A shares. In the case of Clovis Jewellers, the shareholders are the owners, directors, and managers.

Financial Structure. The capital structure of Clovis Jewellers is financed by a combination of debt and shareholder's equity. The debt constitutes roughly 75 percent of the capital and the shareholder's equity the other 25 percent. The shareholder's equity is made up of both class A share capital and retained earnings, of which the latter is by far the larger.

The debt financing is held with the Bank of Montreal and is in the form of a long-term loan. This loan is approximately $190,000. The first $150,000 is guaranteed through a provincial government small business assistance plan and carries an interest rate of 9 percent; the remaining $40,000 carries a rate of prime plus 1 percent. This long-term debt is covered by personal guarantees of Fred Meyer, a business associate of Mr. Neudorf, and by a mortgage on the Neudorfs' house.

The bank of Montreal has also authorized an operating line of credit to Clovis Jewellers with a ceiling of $20,000. This line of credit is used to assist Mr. Neudorf in managing the cash flow in the slower summer months.

Organizational Structure. There are four levels of employees in Clovis Jewellers' organizational structure (see Appendix 1 on page 464). The first level is the manager and is filled by Mr. Neudorf. The duties of this position include accounting and financial management, management of day-to-day store operations, and gemologist/diamond expert. Mr. Neudorf works together with both the assistant manager and the sales staff.

The second level in the organization is the assistant manager and is filled by Mrs. Neudorf. She works as the assistant manager approximately 50 percent of the time and as a salesperson the remaining 50 percent. The duties of the assistant manager include purchasing merchandise and controlling inventory. The inventory control function is done on a very informal basis, usually by a simple visual check.

The third level in the organization includes the sales staff and the repair service administrator. The job of overseeing the repair service is held by one of the full-time salespersons and requires approximately 20 percent of her time. The number of salespersons varies with the time of year, ranging from six to seven at Christmastime to two or three during the summer months.

The fourth level in the organization is the goldsmith and repairperson. This position is filled by Mr. Neudorf and requires a great deal of his time. Mr. Neudorf works together with the repair service administrator when acting as goldsmith.

There are two positions outside of the four-level organization. One is an accountant, and the other is a lawyer. Mr. Neudorf hires these two professionals on a part-time basis as demand calls for them. Both the accountant and the lawyer interact only with Mr. Neudorf.

Personnel

Clovis Jewellers experiences very little employee turnover (one staff member every two or three years) and therefore does not engage in recruiting procedures on a regular basis. When a new staff member is needed, a small advertisement is placed in the classified section of Brandon's daily newspaper. Although an advertisement is always placed, most hiring results through word of mouth and other contacts with neighbouring businesspeople.

When selecting a new employee, Mr. and Mrs. Neudorf look for individuals with an outgoing, friendly personality. Usually the person is middle-aged and has sales experience. Application forms are screened based on these qualifications, and the applicant who best meets the qualifications is asked to come in for a personal interview. Unless there is more than one "ideal" applicant, the new employee is hired after only one interview.

The training supplied to new employees comes in two forms: product training and operations training. The product training requires the employee to learn a great deal about jewellery—a very complex area. The individual must gain knowledge about watches, diamonds, gemstones, and qualities of gold. This product training occurs as the person works in the showroom selling jewellery and takes approximately one month.

The operations training is less involved than the product training and is completed in the first week or two of employment. This training involves learning the daily routine carried out at Clovis Jewellers, as well as cash register and receipt-writing operations.

The method of employee remuneration is a straight hourly wage; no commissions are paid. Employees' hours are recorded in a payroll register, and employees are paid every two weeks based on the number of hours worked. Mr. Neudorf tried to introduce a commission pay plan in the past, but employee resistance forced him to shelve the plan.

Employee morale appears relatively high compared with other retail stores. Mr. Neudorf believes this is because he and his wife treat the sales staff with respect and as friends. The employees know the importance of selling to the company's well-being, and Mr. Neudorf continually reinforces this by verbally acknowledging an individual for his or her sales efforts. A further indication of high morale is the fact that Clovis Jewellers experiences an extremely low rate of absenteeism and lateness.

Marketing

Product. A majority of Clovis Jewellers' yearly sales consists of ring and precious stone jewellery; for this reason, its product mix heavily favours these two items. Ring sales are responsible for the single highest sales total; therefore, great emphasis is placed on the ring inventory when the product mix is evaluated. Clovis Jewellers is known for carrying good-quality merchandise; this is reflected in the purchasing habits and quality control employed at Clovis. However, Clovis has shifted to a lower-quality selection of rings and jewellery to compete with the competition. This shift appears to be temporary, as the better-quality lines remain.

Mr. Neudorf believes seasonal fluctuations in sales do not seriously affect the product mix. Relative sales of most items remain constant throughout the year.

Distribution. Clovis Jewellers is in the middle of a transition from using a traditional manufacturer-retailer distribution channel to a more direct channel. Jewellery and ring manufacturers are actually intermediaries in the supply of diamonds and precious gems (the manufacturers buy the gemstones from large diamond and gemstone suppliers). This method of purchasing was more convenient for Mr. Neudorf but inevitably meant higher-priced merchandise. Mr. Neudorf has now made arrangements to buy diamonds directly from the source of supply and therefore has greatly reduced merchandise costs. This shift also gives Mr. Neudorf much greater control over diamond and gemstone quality.

Pricing. Mr. Neudorf uses several different methods in calculating the retail prices of the merchandise. Brand-name items such as watches are priced according to the manufacturer's suggested retail price, because Mr. Neudorf thinks customers will base their purchase decisions solely on price when shopping for brand names.

Merchandise whose quality the customer cannot differentiate easily, such as gold chains, are priced very competitively. Comparisons are often made with other jewellery stores to ensure that these items are priced competitively. Jewellery items such as earrings and pendants are priced according to a standard markup of keystone (50 percent), plus an additional 10 percent to make up for markdowns, which are often needed to sell the jewellery.

Mr. Neudorf finds rings the hardest items to price, as they carry no brand names or identifying trademarks. Each ring is priced individually, based on special features (or lack of them). A general markup formula is still used, but individual factors dictate the final selling price of the ring. For example, everyday solitaire engagement rings are priced below the standard markup, whereas individual modern engagement rings are priced above that markup.

Promotion. Clovis Jewellers uses a wide range of media in its advertising program, including a daily newspaper, a local television station, AM and FM radio stations, and flyers. Advertising is used to convey both a specific promotional method and corporate image advertising. Mr. Neudorf prepares much of his own advertising, especially radio and newspaper ads. He also gives the ads a personal touch by recording many of the radio ads himself and including his picture in several newspaper advertisements. Mr. Neudorf claims that Clovis Jewellers targets its selling toward middle-aged women, but this target is not evident in the advertising; rather, the advertising appears to be general, with no real objectives or target market in mind. The advertising budget is prepared by taking a percentage of projected sales. This target percentage is between 4 percent and 5 percent.

Mr. Neudorf uses many different forms of sales promotion throughout the year. These include diamond remount plans, jewellery repair sales, graduation promotions, Mother's Day promotions, and other general markdown sales. The number of sales promotions has increased over the past few years due to an increase in competition. The trend in promotions has switched from using them to enhance slow selling periods toward bettering higher selling periods. That is, they are now timed in conjunction with a month of already higher-than-average sales.

Personal selling is heavily used at Clovis Jewellers. Mr. Neudorf believes jewellery requires a substantial selling push and therefore uses in-store personal selling as a major marketing tool. Emphasis is on making every sale count, large or small. Monthly sales totals are updated every day and then compared with the projected sales for the month. This information is then passed on to the salespeople to keep them aware of the importance of selling.

Public relations can also be an effective marketing tool, especially in a close-knit community such as Brandon. Mr. Neudorf is involved with many community clubs and events, which give him a fair amount of low-cost public relations. Clovis Jewellers sponsors sporting events for persons with disabilities and is a member of both the Rotary Club of Brandon and the Brandon Chamber of Commerce (of which Mr. Neudorf has been president and is currently a director). Mr. Neudorf gives talks to local women's groups and at high school career days. He has also had much interaction with the Brandon City Council and has served on committees such as the Brandon Parking Commission.

Location and Layout

Location. Clovis Jewellers' trading area consists of the city of Brandon, surrounding towns and farmlands, and small communities that extend to the Ontario and Saskatchewan borders. The population of the area is slightly greater than 200,000, of which 55,000 live in the city of Brandon. The primary trading area (approximately 70 percent of the business) includes the entire city of Brandon and the surrounding towns of Virden, Souris, Minnedosa, and Neepawa.

The economy of Clovis Jewellers' trading area relies heavily on its two industries, farming and oil. Clovis Jewellers' sales experience large fluctuations due to the characteristics of each of these industries. The downturn in the oil industry has had a significant impact on the firm's profitability; sales have dropped significantly in the past three years.

Clovis Jewellers leases its site from a management firm located in Winnipeg. The basic rent is approximately $2,400 per month. On top of this expense, Clovis pays a yearly management, property tax, and insurance fee for the building. The building is a single-storey structure located on Brandon's main downtown artery. The physical characteristics of the site follow the image Clovis is trying to portray; the storefront is pleasant and modern looking.

The buildings surrounding Clovis Jewellers host mostly banks and other independent retail stores. Several retail stores on the same city block appeal to Clovis's target market, including the

Roset by Reid jewellery store located across the street. There is one vacant space on the street, located right next to Clovis Jewellers. The vacancy was caused by a fire over a year ago, and the building remains boarded up.

Clovis Jewellers is located on Ross Street, which is the centre downtown street. Ross Street has angle parking on both sides and is busy every weekday from 9:00 a.m. until around 6:00 p.m. This heavy vehicle traffic is due to the large number of banks in the area that deal with a high volume of customers every day. Ross Street also experiences a high volume of pedestrian traffic during the day, as it is situated in the heart of Brandon's retail and office sector.

Layout. Clovis Jewellers' present location is 1,000 square feet. Eight hundred square feet are used as selling space and the remaining 200 for office and storage space. The showroom is divided among rings, gold chains, watches, gift items, diamond jewellery, and regular jewellery. Although space is allocated to each section according to proportion of total sales, the allocation is based on rough estimates of both percentage of sales and space used.

The layout of the store is designed to make efficient use of high-traffic areas. The engagement rings, which are classified as specialty goods, are located at the back of the store, a spot that would normally see low-traffic volume. The shopping goods such as watches and gold chains are located in high-traffic areas around the cash register and front entrance.

Merchandise is displayed in either a locked showcase or behind a showcase out of the customer's reach. This method of displaying is necessary due to the high value and small size of individual pieces of merchandise. Each display case is lighted by two spotlights dropped from the ceiling. Florescent lights illuminate the general-purpose areas of the store; other lamps are suspended from the ceiling as part of the decor. The lighting appears adequate, as the store gives a "bright" first impression.

Purchasing and Inventory Control

Purchasing. Mrs. Neudorf is responsible for purchasing the majority of the required merchandise. The salespeople often assist her, especially when the purchasing is done in Clovis Jewellers' showroom. Purchasing is done through a combination of jewellery and gift show attendance and meetings with individual supplier representatives.

The tradeshows Mr. and Mrs. Neudorf attend are held throughout Canada and the United States and include cities such as Hawaii, Vancouver, Brandon, Calgary, Winnipeg, and Toronto. Roughly 20 percent of total purchases are made at these tradeshows. Mr. and Mrs. Neudorf attend them to obtain new products and ideas as well as to make actual purchases.

Eighty percent of purchasing is done in-store and with the help of the salespeople. Mrs. Neudorf prefers in-store purchasing because it gives her the undivided attention of the company representative and allows her to compare items with Clovis's existing merchandise. Each company representative visits Clovis Jewellers two or three times a year, usually in the spring and early fall.

Mr. Neudorf has arranged special payment terms with approximately 75 percent of his suppliers. The credit terms are usually 30/60 days, 30/60/90 days, 30/60/90/120 days, or even up to six months; most companies will give these terms free of any interest charges. Mr. Neudorf finds these terms necessary for cash flow management, as the majority of purchases are made during slow sales periods.

Mr. Neudorf maintains a tight level of quality control, inspecting each piece of jewellery before it is put on sale. Each item is checked for diamond or gemstone quality, quality of stone settings, and adequate stamping of gold quality. Items that do not meet the strict quality standards are returned to the supplier for exchange.

A purchasing budget is prepared by multiplying the target gross margin percentage by the budgeted sales figure. This total purchase figure is then spread out throughout the year according to monthly sales, with the majority of purchases made in the pre-Christmas season.

Inventory Control. No formal inventory control method is used at Clovis Jewellers. Mr. and Mrs. Neudorf rely on experience when it comes to controlling inventory levels. Visual inspections determine whether inventory levels are sufficient or need replenishing. No automatic reorder procedure is used; Mr. and Mrs. Neudorf believe automatic reordering would hurt rather than enhance sales because customers expect to find unique pieces of jewellery at Clovis.

Mr. Neudorf has insurance to cover fire, loss of merchandise stored in the safe, loss of customer goods stored in the safe, and business interruption (up to six months). Insurance to protect against theft of merchandise not stored in the safe is either not available or too expensive. All of the rings and diamond jewellery are placed in the safe after business hours; therefore, most of Clovis's inventory is insured in the event of a break-in. The business interruption insurance is related to inventory; a major loss or damage of inventory would not force Clovis Jewellers out of business, as the firm would continue to have a daily cash flow.

Accounting and Financial

Recording and Classifying. The daily and weekly recording and classifying done by the staff at Clovis Jewellers basically follows a one-write system, with the addition of certain journals and a daily cash summary. The one-write system, kept by Mr. Neudorf, is used to maintain all of the sundry (non-merchandise) accounts, as well as the company payroll. The non-merchandise accounts are paid as they arise and therefore require almost daily attention; the payroll is calculated every two weeks.

Mr. Neudorf prepares a daily cash summary every weekday morning (Friday's and Saturday's are prepared on Monday). This cash summary includes a summary of the day's sales, both cash sales and charge sales; a summary of how the cash flow is distributed, including cash expenses and bank deposits; and a record of returned merchandise and cheques. The main purpose of this cash summary is to ensure that the cash transactions balance on a day-to-day basis.

Mr. Neudorf also keeps an accounts payable ledger, which he updates weekly. Proper managing of the accounts payable is important to Clovis Jewellers because it relies on trade credit to purchase all of its inventories. A journal of monthly purchases is kept to maintain control over the inventory and the merchandise purchases. Mrs. Neudorf is responsible for keeping this journal up to date; usually she adds all of the invoices to the journal at the end of the month, when a total can be calculated.

One final area in which recording is done on a day-to-day basis is the jewellery repair journal and record of ring sales. Clovis Jewellers has an extensive jewellery and watch repair department. The repair department is run by the sales staff and involves entering every repair job into a journal for easy reference. Because of the quick turnover of repair jobs (usually one to two days), they must be entered into the journal the same day they are received to prevent any bottlenecks in the system. Individual ring sales are also recorded in a book for quick reference as needed.

Budgeting. Five years ago, the budgeting process was almost non-existent at Clovis Jewellers. Except for some very rough, off-the-top-of-the-head figures, no budgets were prepared. This has changed in the last few years, and although the budgetary process still needs improvement, it has taken a definite shape and form.

The process starts with a sales budget. This budget is prepared by looking at last year's sales and then updating them based on any special considerations for the upcoming year. The budget is prepared monthly and used to make regular comparisons with actual sales figures.

Once the sales budget is complete, a merchandise purchases budget is prepared based on the specific level of monthly sales. The purchases budget includes all shares of merchandise purchases, including the cost of repairs.

Mr. Neudorf prepares an expense budget using previous years' expense totals. These expense totals are evaluated as being too high, too low, or correct over the past year and are then changed accordingly for the upcoming budgeted year. The budgeting of all the expense totals is very important, as it allows for better control of these expenses as they are incurred.

The final budget prepared is the cash flow project budget. This is done by combining the projected sales, merchandise payments, and expense budgets. This cash flow projection is very important for Clovis Jewellers, because the seasonal cash inflows it experiences often creates cash shortages; the cash flow analysis allows Mr. Neudorf to plan for these shortages.

Financial Statements. Clovis Jewellers has a complete set of financial statements prepared once a year by a certified general accounting firm (see Appendix 2 on pages 442–444). The statements are prepared after January 31 of each year, which Mr. Neudorf has chosen as the year-end date due to the low volume of business and low inventory count that occur at this time. All financial statements are prepared showing the previous year's figures for purposes of easy comparison.

The balance sheet is prepared in the traditional format, with assets on the left side of the statement and liabilities and equity on the right. Current assets constitute roughly 75 percent of the total assets; inventory is the largest and most important part of the current assets. Clovis Jewellers has a long-term loan payable, which makes up the largest part of the total liabilities. This loan contract is held with the Bank of Montreal and carries personal guarantees from both Mr. Neudorf and his business associate, Fred Meyer.

An income statement is prepared based on sales and expense figures supplied by Mr. Neudorf. This statement does not include a detailed list of the operating expenses. For this purpose, a detailed statement of operating expenses is prepared. This statement lists each expense totalled for the year and in alphabetical order.

A statement of changes in financial position is also prepared at year-end. This statement explains how funds were generated and used throughout the year. The purpose of this statement is to indicate any changes in the working capital of the business and explain how those changes occurred.

Planning

Long-Term Planning. Management at Clovis Jewellers appears to be typical of most small businesses in that a serious lack of any long-term planning exists. The only long-term planning that has occurred is the signing of a five-year lease. Although this means of planning is extremely informal by even a liberal definition, it indicates that some consideration has been given to the long-range plans of Clovis Jewellers.

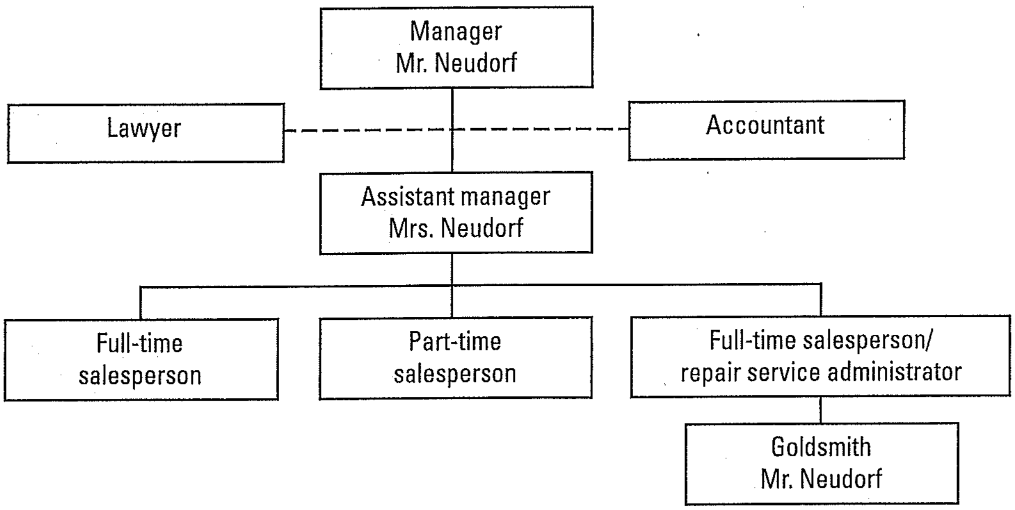
Short-Term Planning. Mr. Neudorf engages in a number of forms of short-term planning, including budgeting for the upcoming year, planning promotions, and planning cash flow. Budgets are prepared early in the fiscal year and extend to the end of the year. The budgets include a sales budget, a purchases budget, and an expense budget. The budgetary process is still in the early stages of development, but an increased awareness on the part of Mr. Neudorf ensures that it will be an effective form of short-term planning in the future.

Promotions are planned on an informal basis; no concrete goals or objectives are stated. Most of the promotions are planned based on the success of the previous year's promotions. If a promotion proved successful one year, it is automatically considered for the next year. This method produces mixed results, as some promotions are successful one year and quite unsuccessful the next.

One area of short-range planning that requires attention is the planning of future cash flows. Mr. Neudorf prepares a complete cash flow analysis for the upcoming year based on projected sales, merchandise purchases, and expenses. This cash flow analysis does not always prove accurate due to extraordinary items that arise in the course of the year, but at least it gives Mr. Neudorf a plan for goals for which to aim.

Appendix 1

Clovis Jewellers: Organizational Structure



Appendix 2

Clovis Jewellers: Financial Statements

CLOVIS JEWELLERS (1988) LTD.
Balance Sheet
(Unaudited)
January 31, 2010

	2010	**2009**
Assets		
Current		
Cash	$ 24,886.15	$ 32,834.17
Accounts receivable (trade)	4,885.34	5,725.74
(shareholders)	18,186.40	18,462.84
Inventory	190,612.90	197,318.70
Prepaid expense	8,437.01	9,150.01
	247,007.80	263,491.46
Assets		
Investments	1,045.00	—
Fixed	10,853.69	13,566.69
Other		
Goodwill less amortization	56,672.20	59,228.20
Incorporation costs	—	373.54
Due from Neudorf holdings	15,448.95	15,448.95
	$331,027.64	$352,108.84

Liabilities		
Current:		
Accounts payable and accruals	$ 70,987.17	$ 92,214.96
Employee remittance payable	1,447.75	1,539.07
Corporation taxes payable	925.40	834.85
Current portion of long-term	11,316.00	8,000.00
	84,676.32	102,588.88
Long-Term	199,961.77	214,156.14
	284,638.09	316,745.02
Shareholders' Equity		
Share Capital	$ 100.00	$ 100.00
Retained Earnings	46,289.55	35,263.82
	46,389.55	35,363.82
	$331,027.64	$352,108.84

CLOVIS JEWELLERS (1988) LTD.
Statement of Income
(Unaudited)
Year Ended January 31, 2010

	2010	2009
Sales	$420,559.99	$472,035.50
Cost of Sales	218,332.01	261,016.36
Gross Margin	202,227.98	211,019.14
Selling Expenses	192,626.33	210,073.57
Operating Income	9,601.65	945.57
Other Income:		
Interest earned	350.48	213.63
Gain from sale of assets	—	1,133.00
Income before Taxes	9,952.13	2,292.20
Income taxes	925.40	834.85
Net Income	$ 9,026.73	$ 1,457.35

CLOVIS JEWELLERS (1988) LTD.
Statement of Operating Expenses
(Unaudited)
Year Ended January 31, 2010

	2010	2009
Operating Expense:		
Accounting	$ 761.20	$ 1,039.30
Advertising	11,024.93	33,250.03
Amortization	4,556.00	4,556.00
Auto expenses	1,794.77	3,146.33
Bank charges and interest	4,318.90	4,549.10
Canada Pension Plan	1,201.94	1,296.32
Donations	350.00	350.00
Depreciation	2,713.00	3,391.00
Employment insurance	2,492.46	2,539.19
Equipment rental	4,200.00	2,700.00
Interest	28,016.38	30,747.77
Insurance	3,047.00	3,079.41
Legal expenses	448.54	80.09
Memberships and dues	510.00	587.74
Postage and stationery	1,382.82	2,388.12
Rent	28,965.29	28,175.00

CLOVIS JEWELLERS (1988) LTD.
Statement of Operating Expenses *(continued)*
(Unaudited)
Year Ended January 31, 2010

Repairs and maintenance	432.41	464.59
Salaries	82,180.91	74,505.54
Security	711.39	681.25
Supplies	2,224.87	2,308.94
Taxes	2,603.75	3,144.88
Telephone	983.67	1,104.04
Travel and promotion	3,764.89	1,621.14
Utilities	3,818.71	4,092.59
Workers' compensation	122.50	245.00
Total expenses	$ 192,626.33	$ 210,073.57