

RECREATIONAL LIVING LIMITED

Dave Shaw and Elizabeth M.A. Grasby revised this case (originally titled "Whitewater West Industries Limited" written by Andrew Fletcher under the supervision of Professor John Haywood-Farmer) solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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On a cold day in January, James MacPherson sat in his office in Chatham, Ontario. It was the same office that his father had used for more than 35 years until his retirement three years ago. MacPherson, chief executive officer (CEO) of Recreational Living Limited (RL), was trying to decide where he should relocate the canoe and leisure craft manufacturing operations. The move would take place in the next 12 to 24 months. After nearly 40 years at the Chatham location, the move was necessary for two reasons. First, a residential neighborhood had been developed 10 years earlier in an area close to the plant and since then, there was an ever increasing unhappy relationship between the neighbouring community and the business. Complaints had centred around a most unpleasant odour that neighbours claimed was coming from the plant. Second, the existing plant was close to capacity and there was no room for expansion.

MacPherson had narrowed his options to three new locations, only one of which was in the Chatham area. He hated the thought of leaving the existing site where RL had started operations and had grown over the past four decades. Chatham (known also as Chatham-Kent), population exceeding 100,000, was located in Southwestern Ontario, had easy access to Highway 401 (a major expressway) and proximity to three major U.S. border crossings within an hour's drive. The MacPherson roots were deep in this city. His grandfather had been mayor of Chatham and the notion of moving to another location was difficult to even think about seriously. But MacPherson had to do something. The complaints from Chatham residents were getting louder, and the potential lost business from not expanding was worrisome.

RECREATIONAL LIVING LIMITED

Recreational Living manufactured primarily fibreglass canoes, boats (powered by outboard motors) and sailboats up to eight metres in length. As a business-to-business wholesaler, the company sold its products almost entirely to retail establishments located around the Great Lakes (the Canadian province of Ontario, and the U.S. states Michigan, Wisconsin, and New York). Annual boat shows, typically in January and February, held in Toronto, Canada, and Detroit and Milwaukee in the United States, were significant sales events for RL's sales force.

The company's sales had declined by 10 per cent in the past three years as a result of the 2008-2009 global recession. Over the past four years, many of RL's direct competitors had declared bankruptcy, closed down business, or retired. MacPherson believed these companies had either been particularly hard hit by the recession or had extended their businesses financially beyond what they could support with declining sales.

During the past two years, RL had increased its sales significantly. The majority of this growth was the direct result of the closing of a major competitor whose owner had retired after 45 years in the business. The owner, a good friend of MacPherson's, had recommended RL to his customers upon his retirement and RL's sales force had actively pursued these customers with considerable success. In the past year, sales had grown 15 per cent to \$20.6 million. RL had 55 employees and enjoyed a reputation as a good employer and a reputable supplier. Business was seasonal, with the months of February to June producing the greatest sales, but production was spread over the year with inventory increasing in the fall months in anticipation of spring deliveries. RL's production operation and the sales and administrative organization were currently housed in a 6,250 square metre building.

THE PRODUCTION PROCESS

The manufacturing process primarily used fiberglass, which was plastic reinforced by fine glass fibres. Fibreglass was formed by mixing these glass fibres with a plastic monomer,¹ often a liquid, which could then be shaped to the desired mould and set to dry as a solid form. The production process began with a gel coating that was sprayed onto a mould of the product (canoe, boat or sailboat) with a spray gun. A few hours later, fibreglass was then sprayed onto the same mould, also using a spray gun. This fibreglass spray consisted of liquid polyester resin combined with glass fibres that hit the mould simultaneously for a stronger, smooth finish. After a few hours of curing, the product was separated from the mould to let the fibreglass set and dry. RL regularly used about 40 different moulds to produce its various lines of canoes, boats, and sailboats.

LOCATION OPTIONS

MacPherson had contacted a large commercial and industrial real estate broker (DCSF Inc.) to assist him in finding either suitable acreage to build a new plant or an available existing plant with sufficient capacity to house RL. MacPherson was anxious that rumours not start about the company's plan to move for fear that it would upset employees and increase the seller's price on the target property. If the seller was aware that a large, successful company like RL was interested in purchasing the site, the seller would likely increase the site's selling price presuming that RL could afford the higher price.

It was not until after DCSF Inc. had reported back about available options that MacPherson realized a move away from Chatham could be a real possibility. This posed an added problem of potentially losing existing employees if they did not move with the company to the new location. As part of an annual overall employee survey done four years ago, a question was asked:

“If because of the upset caused by local residents' complaints about the smell from our plant, Recreational Living was forced to move to a location more than 50 kilometers from Chatham, would you:

1. Move to that community with your family members
2. Commute from Chatham to the new site
3. Look for a job somewhere else.”

Of the 57 employees surveyed, only 10 employees had indicated that they would move with the company or commute. Forty-seven employees had indicated that they would look elsewhere for a job. With the economy still recovering from the global recession and the many recent plant closures announced in the

¹ A monomer is a molecule that binds chemically to other molecules to form a polymer-like plastic.

Chatham area, MacPherson wondered if employees might answer the question differently if it was posed to them now. Nevertheless, MacPherson knew that it would take at least a month to train new employees at a new location.

Option 1: Build a new plant in Chatham

DCSF Inc. identified a 10-acre site six kilometres west of Chatham on Highway 2 (a major highway) that offered a number of benefits for a new RL plant. DCSF Inc. estimated the cost of the land at \$1.75 million. The property was zoned as industrial land so RL could have a 7,500 square metre building constructed to house its production and office operations. MacPherson already had a construction cost estimate of \$4.446 million to build the new facility and to prepare it for production. The estimate included a guarantee that the new facility would be ready for production in the required 18 months from now if he advised DCSF Inc. this week to proceed with acquiring the Chatham location.

Option 2: Build a new plant in Sarnia

MacPherson had asked DCSF Inc. to also look for a Sarnia location. Sarnia (also known as Sarnia-Lambton) was located next to the Michigan, U.S. border and was well known for the greatest concentration of petrochemical plants in Canada. Imperial Oil relocated its operations in Sarnia in the early 20th century, followed by synthetic rubber manufacturing operations by Polymer Corporation (later called Polysar, now Bayer Rubber) during the Second World War. Sarnia was rated as one of the five best Canadian cities in which to establish an export-based business. Sarnia's current population was more than 72,000 and it was 74 kilometres from Chatham. Much of the raw material used in the fibreglass process came from a refinery in Sarnia. The cost of moving the liquid needed to meet present sales levels from Sarnia to Chatham was estimated at \$725,000 annually. The cost of transporting this raw material for the fibreglass operation would be eliminated if a Sarnia location was selected.

DCSF Inc. found an 11-acre site in Sarnia with an old, abandoned factory just south of the refineries, close to the St. Croix River with industrial zoning. The property would cost \$2.975 million and removal of the existing building would cost a further \$350,000. The contractor who quoted on the Chatham location said that the cost of construction and preparation for the Sarnia plant would be the same as for the Chatham location, despite the task of removing the old building and cleaning up the site. Again, production would begin at this facility in 18 months.

Option 3: Buy an existing plant in Windsor

DCSF Inc. was acting agent for the seller of an auto parts plant in Windsor (that had been shut down two years ago), and the agent believed this plant would meet RL plant's requirements. Windsor (also known as Windsor-Essex) was the largest border city to the United States in Canada and was directly across from the U.S. city of Detroit. The city was desirable for commercial access to Canadian and North America markets with its exposure and proximity to major air, rail, and highway links on both sides of the Canada-U.S. border. Windsor had a population of more than 210,000 and was 77 kilometres from Chatham. The plant was 8,000 square metres, in good shape, and was just south of the bridge to the United States. The asking price for the plant was \$3.95 million. An additional \$2.2 million would transform the building into what RL could use as an ideal facility and could also be ready to start production in 18 months.

OTHER COSTS

In addition to the cost of the land and the building, there were other costs to consider. The following costs would be common to all three options:

New equipment including installation	\$1,350,000
Legal fees	<u>90,000</u>
	<u>\$1,440,000</u>

The cost of moving the plant equipment, the office furniture, computers and other office supplies to the new location was projected as follows:

Chatham location	\$235,000
Sarnia location	\$350,000
Windsor location	\$350,000

The decision to move to either Sarnia or Windsor posed additional employee costs as follows:

Severance package for those employees who would opt to retire rather than move	\$360,000
Recruitment and training of new employees	\$220,000

THE BENEFITS

With the additional space and new equipment, plant capacity could increase by as much as 50 per cent with the relocation. MacPherson calculated that he could increase existing orders over the next year by 25 per cent and maintain that sales level for the next five years. The contribution margin on these incremental sales would be 30 per cent.

The sale of the existing property in Chatham would generate about \$1.5 million over and above the cost to tear down the building and clean up the rest of the area.

THE DECISION

Regardless of the location chosen, MacPherson anticipated a hectic construction time ahead. The move would disrupt current production for at least two months as equipment was moved from one site to another. The good news was that with the new equipment and space, lost production could be recovered at a reasonable cost. The decision had to be made soon and it was not going to be an easy one to make. MacPherson had spent some time looking at the past two years of financial statements (see Exhibits 1 and 2) and wanted to assess the impact of this decision on RL's financial results. In addition to everything else, MacPherson knew that he had to raise some financing to pay for this move. He would start with a phone call to RL's banker and make an appointment. This was a once-in-a-lifetime decision and he wanted to make sure he had it right.

Exhibit 1

RECREATIONAL LIVING INC.
INCOME STATEMENT AND RETAINED EARNINGS
For the year ended December 31
(000s)

	Current Year	Previous Year
	\$	\$
Sales	20,600	17,620
Cost of goods sold	<u>17,302</u>	<u>14,880</u>
Gross profit on sales	3,298	2,740
Selling and administrative expenses	<u>2,080</u>	<u>1,962</u>
Profit before interest and taxes	1,218	778
Interest expense	678	439
Provision for income taxes	<u>165</u>	<u>102</u>
Net income after tax	<u><u>375</u></u>	<u><u>237</u></u>
Retained Earnings, beginning of year	2,401	2,278
Add: Net income after tax	375	237
Less: Dividends	<u>174</u>	<u>114</u>
Retained Earnings, end of year	<u><u>2,602</u></u>	<u><u>2,401</u></u>

Exhibit 2

**RECREATIONAL LIVING INC.
BALANCE SHEET
As at December 31
(000s)**

	Current Year	Previous Year
Assets		
Current Assets		
Cash	\$ 65	\$ 123
Accounts Receivable	3,167	2,578
Inventory	<u>2,432</u>	<u>1,987</u>
Total Current Assets	\$5,664	\$4,688
Property and Equipment (net)	<u>1,976</u>	<u>2,091</u>
Total Assets	<u>7,640</u>	<u>6,779</u>
Liabilities		
Current Liabilities		
Accounts Payable	2,134	1,766
Income Tax Payable	167	123
Bank Line of Credit	<u>1,737</u>	<u>1,489</u>
Total Liabilities	4,038	3,378
Equity		
Common Stock	1,000	1,000
Retained Earnings	<u>2,602</u>	<u>2,401</u>
Total Shareholder Equity	<u>3,602</u>	<u>3,401</u>
Total Liabilities and Shareholder Equity	<u>\$7,640</u>	<u>\$6,779</u>