

Prince Edward Island Preserve Co.

Background

Prince Edward Island Preserve Co. is a manufacturing and retail company primarily located in New Glasgow, Prince Edward Island, Canada. The private company (owned mainly by its founder, Bruce MacNaughton) is in the gift/gourmet and specialty foods market, producing and marketing specialty food products such as jam preserves, honeys, teas and coffees. The six-year-old company currently has majority of its manufacturing and retailing in Canada. Its key focus concepts at present are strategic leadership, implementation of strategies, forming international alliances, pursuing international expansion and promoting resource-based growth.

Case Problem

Should Prince Edward Island Preserve Co. pursue consumers in the Toronto and/or Tokyo market? If so, how? The choices available for achieving further growth include mail order, distributors, and company controlled stores.

Case Analysis

Industry Structure - The gift/gourmet and specialty foods industry is a market with several firms, a few of which are large players. This oligopolistic structure of the industry has led to firms competing in the quality, taste and design domains rather than in the price domain. This is clearly evident by the fact that firms emphasise more on their brand image and quality stance as their key success factors rather than the shelf price of their products. Since the goods in this industry are luxury goods, they are income-sensitive. However, they are relatively price inelastic in demand. The industry is one that has been dramatically influenced by globalisation, and now has both local and international players competing in the marketplace. Globalisation has also led to an increase of 'middlemen' such as importers and wholesalers, which has led to double (and triple) marginalisation, and has thus substantially increased the retail prices of products (or reduced profits of upstream manufacturers). It should also be noted that consumer preferences do vary from country to country, and hence it is crucial to have a clear understanding of every geographical market that a firm in the industry plans to enter and play in.

PESTEL Analysis – Considering the increased local and international competition in the gift/gourmet and specialty foods industry, it is crucial for PEI Preserve Co. to ensure that its intended strategies are coherent with the changes in its internal and external environment. Exhibit 1 lists the key external factors for PEI Preserve Co. to consider when formulating its strategy. These factors are categorised as Political, Economical, Sociocultural, Technological, Environmental and Legal.

SWOT Analysis – Exhibit 2 lists the general internal factors that PEI Preserve Co. has to keep into consideration for its future success. It lists the firm's Strengths, Weaknesses, Opportunities and Threats.

VRINE Model and Test – In the gifts/gourmet and specialty foods industry, PEI Preserve Co. has a unique position due to its location in PEI and its ability to source only the highest quality of fruits (strawberries) and other raw materials. It also has a key emphasis on brand quality and product design. But do these resources and capabilities give it a sustainable competitive edge? The VRINE model in Exhibit 3 helps us understand this. From the VRINE model analysis, it is clear that even though PEI Preserve Co. does to some extent have resources and capabilities that are VRINE-certified, they are very weakly certified and hence the firm does not gain any sustainable competitive advantage in the industry. This is a concern for the company and its future business model.

Z-Score Model – Using this model, we can assess the likelihood of PEI Preserve Co. failing. Exhibit 4 shows the workings of this model. The value of Z obtained for PEI Preserve Co. is 2.61, which is above the threshold value of $Z=1.8$. This implies that there is low likelihood of PEI Preserve Co. failing. This is good news for the company at present.

Financial Analysis – Exhibit 5 outlines some of the financial workings of PEI Preserve Co. As shown, sales had increased by 12.41% from 1990 to 1991. However, cost of sales had increased by 16.41%, meaning that gross margins increased at a slower pace. The restaurant business made a loss, which implies that its operations are questionable. The company also faces severe cash shortages due to the seasonal nature of manufacturing operations, and because it has not secured financing suitable for its needs. The growth of earnings before interest and tax was higher than the growth of sales. However, the growth of sales was lower than the growth of total assets. This implies that the growth in sales was due to the increase in price (10% increase), rather than other factors.

Operations Analysis - The company manufactures its products on a batch basis. There is ample production capacity available for the \$30,000 main kettle - preserves are made five months a year, on a single shift, on a five-days-per-week basis. Even then, the main kettle is used only 50% of the time. We do not have information about the capacities of other equipment and machinery. Since the production process is labour intensive, Bruce is considering moving to an incentive-based salary system to increase productivity and control costs. This would be a great idea. The bottling process is not completely automated due to the decorative fringe that is tied by human labour. One of the key questions is whether this fringe is really that important. Perhaps, sticking a fringe to the bottle could work. The restaurant operations – which is loss making – is a source of many headaches. Since it is an industry that is

significantly different from that of gifts and specialty foods, it worth asking whether being in this industry should be part of the corporate strategy.

Current Strategy Diamond - Exhibit 6 shows Prince Edward Island Preserve Co.'s current strategy diamond.

Key Question

The key question that Prince Edward Island Preserve Co. is currently seeking to find an answer to is whether it should pursue consumers in the Toronto and/or Tokyo market, and if so, how. We have been provided with sufficient information regarding these two markets, and several reasons why PEI Preserve Co. should/should not pursue each of them. Below is a summary of the advantages and disadvantages of each market.

Tokyo Market - The magnitude of the Japanese market for PEI Preserve Co. is evident by the large number of Japanese visitors who come to Prince Edward Island annually, and the fact that PEI Preserve Co.'s largest export shipment was to Japan. Research shows that Japanese tourists in Canada are expected to rise to 1 million by 1995. Most of these Japanese tourists enter through the airports of Vancouver and Toronto. With these tourists having the highest per capita amount spent in Canada, luxury products produced by PEI Preserve Co. are likely to sell well if marketed properly in Japan. Besides word-of-mouth, passive marketing through 'Anne of the Green Gables' in Japan makes it easier for PEI Preserve products to sell to 10 million people in Tokyo. The gift-giving tradition is quite dominant in Japan. There, gift-giving and entertainment expenses are enormous at a corporate level too; and they are not seasonal. Since PEI Preserve's gifts fall below the Yen2000 common price point, they could be successful in the Japanese gifts market. Theme parks are a notable market for PEI Preserve Co. – 20 theme parks have opened in Japan, and another 16 are expected to open in 1991-1992. It is said that tailoring products to the Japanese market could mean expanding sales by 10% annually.

However, there are a handful of risks and disadvantages of tapping into the Tokyo market. Firstly, Bruce MacNaughton has never visited Japan, and is currently debating whether he should visit the country in the coming year. Most information collected about Japan was from a friend, and hence the credibility of this information is debatable. Understanding the Japanese consumer market is extremely important before making any decisions – product flavour, size, packaging and design matter. Secondly, several dozen firms already import jam with a mix of distribution channels. There are extremely high import duties for jams – averaging 28%. This would make it significantly difficult for international manufacturers like PEI Preserve Co. to compete in the local Japanese market. Another hurdle is the cost of renting a location - retail space in one of Tokyo's major shopping districts would cost \$75 to \$160 per square metre (\$1600 to \$3400 per month for a shop equivalent in size to that in CP Prince Edward Hotel). Furthermore, a deposit of at least \$25000 would be required. Half of the locations also charge an administrative/maintenance fee of 5 to 12% of rent and one third of the locations have tenants paying a reward to the owner at the time of contract (\$10,000 to \$15,000). The retail staff salaries in Tokyo are also higher than in PEI.

Toronto Market – With 3 million people, Toronto is Canada's largest city and economic centre. The city has Canada's busiest airport through which 15 million people enter and leave the country annually. 20 million people visit Toronto for business or vacation annually. PEI benefits in marketing and brand awareness due to its local awareness. Specialty domestic producers tended to have limited distribution areas, meaning that PEI Preserve had a significant opportunity to expand its network of distribution. Because other specialty imports were from France or England, there would be a tariff of 15% on their imports. This would give PEI Preserve Co. a significant advantage. Compared to Tokyo, the cost of renting 22 sq. metres would be approximately \$2530 per month in a major suburban shopping mall.

However, rents could be higher in the downtown core of Toronto. These higher rents may have to be accepted if a higher footfall is required by PEI Preserve Co. Furthermore, there is no sales agent for PEI Preserve Co. in Toronto at present. This means that the company will have to begin its marketing campaign afresh, and hope that its consumers' current awareness through its exposure in other cities of Canada will give it a boost in Toronto. Competition will also be a concern, as the market is well-served by mass market and specialty jam producers at all price points, both local and imported. Retail staff salaries in Toronto are also higher than in PEI, but perhaps lower than in Tokyo.

Possible Options

One of the options for PEI Preserve Co. at this stage is to rethink its corporate strategy and decide whether it wishes to discontinue its restaurant business. The restaurant market is an industry that is very different to the gifts and specialty foods market with very little synergies. Though the restaurant industry brings about consistent revenues throughout the year for PEI Preserve Co., its management is proving to be troublesome for the company, and it is a loss-making area of the business. However, we do not have sufficient accounting information about the restaurants. Since the income statement combines the performance of both restaurants into one, we are unable to assess whether the poor performance is attributable to both of the locations or just one of them. With more accurate information on costs and revenues, we may be able to assess this option better. If only one location is contributing to the loss, then it may make sense to terminate only one branch, and transfer some of the resources (such as chefs) to the other.

Discontinuing the restaurant business would also help PEI Preserve Co. ease pressure on its vital resources, both financial and human. By improving its financial health, the company may then be able to pursue more rapid expansion in its gifts and specialty foods market. It could pursue its expansion to Tokyo and/or Toronto. However, such expansion could also be gained by simply approaching new banks that may be interested in providing finance to PEI Preserve Co. for favourable interest rates. Another option is also issuing preferred shares, though this may not be a tax-efficient method of raising finance.

Another option for PEI Preserve Co. is to exploit the Toronto market. The fact that Toronto is a local market gives PEI Preserve massive advantage through lower costs (of transport) and marketing synergies. With Toronto's massive market that also attracts Japanese people, the company can gain a significant share of the market. One interesting proposal is to consider opening a retail store at the Toronto airport. This would be a fantastic way of attracting 15 million tourists, all of who would be interested in buying gifts for families and friends. Accepting that PEI Preserve Co. does not have any sales agent in Toronto, it may be a good idea to start contacting various distributors in and around Toronto to form alliances that could prove beneficial for exploiting the Toronto market.

There is plentiful evidence that Tokyo is an emerging market for PEI Preserve Co. Though it may be a market unknown to PEI Preserve Co., Bruce MacNaughton can begin to learn more about Japan and its gifts and specialty foods market by visiting it as soon as possible. Though import tariffs may be high, and rent in Tokyo may be unaffordable, it may be a good market to exploit considering that with the high rent comes the high population density. There is a growing market in Tokyo, and PEI Preserve Co. has already made an opening through Canadian World. Exporting products to Japan on a larger scale would also allow PEI Preserve Co. to utilise its main kettle and equipment more efficiently, hence reducing its average cost of production and passing on the cost reductions to consumers with lower export prices for the Japanese market.

A longer term option for PEI Preserve Co. may also be to set up its manufacturing locally in Japan, or outsourcing some of the manufacturing or packaging there. This may help in reducing its import duties and middlemen margins, which will mean higher profits from the Japanese market. However, if PEI Preserve Co. is outsourcing, then the quality should be controlled by ensuring that cost-reducing outsourcing is pursued rather than quality-reducing outsourcing (perceivable attributes should be outsourced).

Recommendation and Implementation Plan

PEI Preserve Co. would benefit from organizational renewal. Considering the findings from the VRINE test that the resources and capabilities of the company are weakly certifying the test proves that the business model is weak and that the long-term competitive advantage of PEI Preserve Co. is questionable.

The first recommendation would be to rethink how the firm's core resources and capabilities could be made more 'VRINE' – add more differentiators, reduce imitation by patenting or trademarking particular features, add value by placing a quality seal or meeting a licensing standard, continue developing new products etc.

The second recommendation would be to reduce seasonality in the business by exploiting the Japanese corporate consumer market or introducing less seasonally demanded products. This reduction in seasonality will enable PEI Preserve Co. to employ quality staff on a full-time basis, which will improve the capabilities of the human capital in the firm, and reduce the load off Bruce's shoulders.

The third recommendation would be for Bruce to visit Japan as soon as possible, and begin setting up clear systems for targeting the Tokyo market through a retail store there. This retail store should be set up within 1 year's time (by end of 1992). The reason for pursuing the Tokyo project is because it would immensely benefit PEI Preserve Co. by reducing its seasonality, and also increase awareness of the company in Japan itself. By producing on a larger scale, the company may also be able to benefit from economies of scale, which could improve its position in the global marketplace. Catering to hotels and airlines would be a possibility if new machinery and equipment is bought to meet their product needs. Hiring a marketing manager would also enable PEI Preserve Co. to attend various trade shows and exhibit its products.

The Toronto plan should be delayed by 1 year, and thus be established in 1993. The reason for this is because expanding to Toronto is a relatively easier project for PEI Preserve Co., and hence it could be undertaken parallel to the Tokyo project, but at a slower pace. Crucial thing to do is to prepare a list of specialty stores throughout the Toronto and neighbouring market and to contact them to gauge interest.

A major area of needed improvement for PEI Preserve Co. is in the environmental and technological realms. Advanced machinery could be used for smaller-sized recyclable bottling, eco-friendly packaging and automated decorations on bottles.

Upon further analysis and assessment of the restaurants, a decision should be made on the continuity of this area of the company. With a combination of a strong line of products, and resources and capabilities that strongly certify the VRINE test, PEI Preserve Co. will be able to secure its longer-term competitive position in the gifts/gourmet and specialty foods market.

Recommended Strategy Diamond - Exhibit 7 shows Prince Edward Island Preserve Co.'s recommended strategy diamond.