

YORK'S BEST ICE CREAM COMPANY[†]: FINANCING GROWTH

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ABSTRACT

York's Best Ice Cream Company: Financing Growth is a case about Devon, a young entrepreneur, whose dream is to build a regional ice cream empire. However, the poor economic climate made it challenging for small businesses. Students are armed with information about both ice cream and street vendor industries as well as the company's financial data. They are asked to (1) evaluate how the business is performing, (2) whether Devon should continue to pursue his dream, and (3) if students conclude that the business is worth growing, they are asked to help Devon decide the next steps in financing the growth of his business.

EXECUTIVE SUMMARY

Devon, a young ice cream entrepreneur, started York's Best Ice Cream Company with one truck and a dream; to create a regional brand that was comparable to what the Good Humor Ice Cream Company accomplished in the last century. The case opens at the end of Devon's fifth full year of business as he calculates York's Best financial position. While the company's sales increased by 67 percent, Devon is frustrated by his lagging profits and the lack of capital to grow his young company to what he knows is its full potential.

Students are furnished with detailed industry information and the young firm's business environment. This provides a glimpse of the complexity of interrelated issues and challenges likely to be confronted when deciding the best way to grow a young entrepreneurial venture, especially when the founder is in his early 20s and has limited business experience. In particular, the case demonstrates the importance of using the right frame of reference for decision making and the need to pay attention to detail, critical skills for both managers and entrepreneurs. The case also gives students an opportunity to examine whether building York's Best brand name using a franchise growth model is appropriate. Thus, the case provides students with an opportunity to bolster their understanding of the trade-offs between equity and debt financing, as well as advantages and disadvantages of franchising one's business. Specifically, it forces

[†] York's Best Ice Cream Company is a fictitious name created to protect the identity of the company. All of the facts in the case are real to best to the authors' knowledge.

students to take a strong look at the potential for developing a sustainable competitive advantage through the growth model that an entrepreneur decides. Too often the focus is how to fuel a new company's growth. In Devon's case, perhaps the young entrepreneur needs to step back and ensure that York's Best has a solid foundation, not only financially, but also operationally.

INTRODUCTION

Devon sat at his parent's kitchen table going over the season's earning. He smiled as he checked over his figures for a second time. He could hardly believe that his revenue had increased almost 67 percent over his company's 2008 sales despite the tough economic times. His hard work, careful planning, and creative ideas were responsible at least in part for this growth. His smile widened as he thought about his entrepreneurship courses and professors that had also played a role in his success. He had certainly come a long way from that night where he was stranded on the side of the highway with little cash, a dead cell phone battery, and an ice cream truck that he had sunk all \$5,000 of his savings to buy.

He looked up from the numbers and thought about what he should do next. He knew growing his business by another 67 percent next year would not be easy. He had maxed out his line of credit with the only bank in town that would loan his business money, so it would be a stretch to put even one additional truck on the road. He was glad that he resisted the temptation to pay back his loan early and instead conserved his cash for investing in the growth of his business. However, his cash balance fell short of financing his business' growth plan. While Devon had already booked several after season sales at area companies, these would not generate enough profit to internally fund his expansion plan for the 2011 season. He knew that putting three additional trucks on the road would extend his reach beyond the Pennsylvania border into some of the Maryland's wealthier suburbs that had been overlooked by the few ice cream truck operators still in business. He hoped that he would not have to seriously consider his father's suggestion of inviting a partner into his business. He had heard too many stories of failed partnerships while attending Temple University's entrepreneurship program. However, what choices did he really have?

Devon thought hard about what his next steps should be. He knew that his business was at one of those important cross roads his professors mentioned. The business he was building was more than just a fleet of ice cream trucks. He wanted to bring back something big like the Good Humor man. His family broke his concentration as they piled into the kitchen to get ready for dinner. He shoved his paperwork aside to join his family.

Devon's Dream

Devon had always been entrepreneurial. He got his first taste of the world of high finance at the age of nine. His first venture was a paper route that he ran for five years. While his \$2,500 annual earnings were good for a kid of his age, Devon always dreamed of something bigger. After his paper route, he established a lawn mowing business and in high school started a concert promotion company. While Devon learned a great deal from these businesses, "it was always a dream of mine to start an ice cream business." When he was a senior in high school, Devon began plans to start his dream business to help pay for college. His plan was to scoop ice cream

from a truck. However, this plan was short lived. “After researching this I realized that novelty ice cream is easier and more profitable.”

Devon chose to attend Temple University to study business. It seemed only natural that entrepreneurship was the major for him. During the fall of his freshman year, Devon investigated the ice cream industry for one of his courses and recognized an opportunity for starting such a venture in his home town. While the ice cream truck vendor industry is fairly fragmented, mostly run by operators who owned only one or two trucks, Devon was able to get a lot of information and advice from on-line forums for ice cream owner/operators. He learned, for example, what to look for in an ice cream truck. During winter break in his freshman year of college, he began to seriously investigate purchasing his first ice cream truck.

Devon scoured a number of websites and found a truck on e-bay that he thought might be good. The truck he set his sight on was a 1970 original Good Humor truck. Devon traveled most of a day on several trains to a small community on Long Island, New York to take a look the truck. Excited that he was actually starting his business, he quickly handed over almost all of his savings, \$5,000, for the GMC P30 Step Van without carefully checking it out. The truck broke-down about two hours from home and he had to have it towed the rest of the way. His mechanic gave him the bad news and Devon learned the first of many lessons.

Devon did not let this serious setback extinguish his dream of becoming his town’s KING of ice cream. Almost immediately, he began looking for another truck. Before long he found a likely candidate, a 1971 Ford Good Humor truck. Armed with more information than last time, he carefully checked out the truck. However, he did not have the \$15,000 asking price. “After losing everything, I was forced to ask for money from the bank.” Devon secured a \$20,000 loan, which was enough to pay for the truck and an additional \$5,000 for start-up costs including his initial inventory.

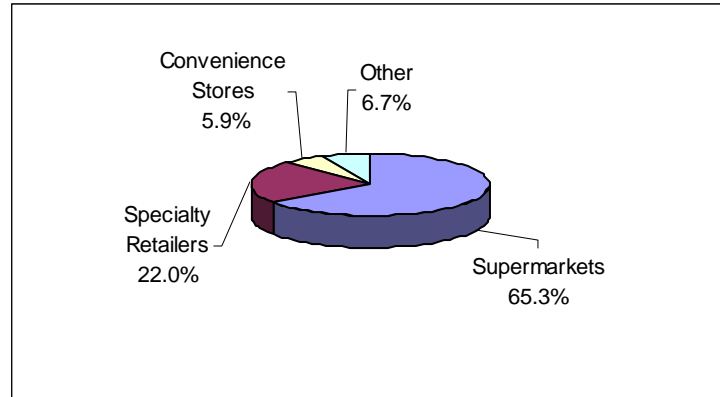
Ice Cream Industry

Americans love their ice cream. The average American consumed about 21 pounds of ice cream in 2007 (USDA, 2009). Ice cream was a \$9.7 billion industry and was forecasted to increase about 1.7 percent annually to \$10.7 billion by 2013 (Data Monitor, 2008). Those gallons of creamy products were produced at 353 plants located around the US (Schultz, 2009). However, ice cream production in 2008 compared to 2007 was down by 1.4 percent to 943 million gallons of regular ice cream (USDA, 2009).

Ice cream is distributed to eager consumers mainly through supermarkets (see Chart 1 below), with only 6.7 percent sold through other sources such as ice cream truck vendors (Data Monitor, 2008). Ice cream’s popularity and profitability is reflected by the amount of room supermarkets and other stores give to frozen dairy products. However, the business is extremely competitive, as producers fight for freezer space at retail outlets. When one looks through the freezer cases at their local supermarket they are likely to see a constant stream of new flavors and options. Many brands partner with other companies to create themed flavors, such as the Girl Scout’s Thin Mint ice cream. Slow churned ice cream gained popularity with consumers watching their weight,

(Perot, 2008) as it is a method used to turn lower fat milk into high quality creamy ice cream with fewer calories.

Chart 1 US Ice Cream Distribution Outlets



Source: Datamonitor, 2008

Frozen Novelties

The frozen novelties segment of the market has grown at a faster rate than general ice cream products. While old fashioned scoop ice cream products still account for the majority of consumer purchases, sales had declined 3.9 percent compared between 2007 and 2002 (Perot, 2008). However, frozen novelties grew 7.2 percent for the same period (Perot, 2008). The most popular novelties sold through supermarkets (2001 data was the latest available) were ice cream bars (25%) followed by yogurt novelties (20%), according to the International Ice Cream Association (Pupillo, 2009).

One reason for the surge in ice cream novelty sales was due to changes in the U.S.'s demographics and several social/cultural trends, such as healthy eating. Novelty products developed with specific demographic groups in mind, such as Hispanic customers and consumers watching their weight, had increased the demand for ice cream novelties. For example, new products like Hola Fruta! bars aimed at Hispanic consumers were expected to grow 12.9 percent between 2008 and 2013 (Faron & Berry, 2009). '100-calorie packs' that regulate portions and other branded low calorie novelties like Skinny Cow have also been a driving force in sales for those who embrace a healthier lifestyle without giving up the decadent pleasure that ice cream offers. David Morris, a Senior Analyst at Mintel[‡], stated that "Convenience and healthy eating trends drive more people to frozen novelties to satisfy cravings" (Perot, 2008).

Street Vendor Industry

Ice cream trucks belong to the Department of Commerce's Street Vendors category under the NACIS code 72233. The majority of street vendor revenues (55%) were generated from

[‡] Mintel is a leading global supplier of consumer, product, and media intelligence.

stationary locations such as street locations and corners, where pedestrians take their purchases with them (IBISWorld, 2009). Most street vendors (98 %) operate only in a single location (US Census Bureau, 2002); however some street vendor operators who have been successful have opened multiple locations. Still, 68 percent of these larger operators had four or fewer employees (US Census Bureau, 2005), making the majority of these enterprises very small.

Industry Economics

Overall, the industry experienced an 11 percent decline in the number of establishments. This may be due in part to the 2002 recession that hit large cities particularly hard where street vendors are most prevalent. Historically, the Street Vendor industry has not experienced tremendous ‘real’ growth over the past 20 years. In fact, while revenues had been positive for several years, the recessions of 2001 and 2008 had reversed those positive years. Thus, real revenue growth declined by approximately 13 percent over the past 20 years due to the industry’s health being so closely connected to the general US economy.

Interestingly, the 2008-2009 economic recession spurred an increased interest in entering the street vendor industry due to low start-up cost. In addition, increased competition from limited service restaurants, cafes, and caterers also put pressure on the vendor industry (IBISWorld, 2008). This followed a general surge in business starts, as people have been laid off, were under employed, or wanted to supplement their current income fearing that they would become part of the nation’s increasing unemployed population.

Ice Cream Truck Operators

In the ice cream vendor segment of the industry, a used truck can be outfitted to sell packaged ice cream novelties for as little as \$5,000, while outfitting a truck to sell fancier products like soft-serve can cost five to seven times more (Zwahlen, 2009). While low start-up costs may be tempting, providing inexpensive treats to children and adults alike proved to be challenging for many owner operators in the U.S. In 2009, ice cream truck sales declined by as much as 25 percent (Johnston, 2009). Devon’s per truck ice cream route business suffered a similar rate of decline. He was able to earn additional income by putting additional trucks on the road and building his B2B segment.

Ice cream truck operators often move from neighborhood to neighborhood selling their merchandise on a daily basis. Some lucky vendors find high pedestrian traffic areas like parks and beaches that have been overlooked. Often vendors need special permits to operate in these areas, which cuts down on competition as licenses are sometimes limited. In some towns, moving vendors are banned from the downtown area core to cut down on traffic problems.

Devon’s employees develop their own neighborhood routes that they follow on a weekly cycle. Thus, parents are not bombarded by York’s Best trucks on a daily basis, which Devon believed created a loyal following. In addition to weekly trips through neighborhoods, York’s Best trucks visit parks and popular recreational areas on a daily basis. Many of these locations have ice cream hungry campers who look forward to cooling off with a cold treat.

York's Best Catering Sales

Devon recognized another outlet for his products which would provide him with revenues beyond September while working on his business plan. He created a plan to market York's Best products to local companies looking for a convenient, inexpensive way of recognizing their employees. Devon's plan was to offer companies a couple of packages that would be affordable for them, but profitable for his business.

Standard Package - \$3.00 per Person

Premium Package - \$4.00 per Person

Both packages included dozens of delicious choices including sugar free and all natural treats! He also charged each customer a small delivery fee based on the mileage his truck had to travel due to the high cost of fuel.

During the first year, Devon rented a mailing list with 700 company names and sent out a post card with a classic picture of his truck. Soon he received 40 leads, which was nearly a six percent response rate. This was higher than the average expected rate of one to two percent. Those leads resulted in 20 sales.

In 2009, Devon rented three 1,200 name mailing lists, which he sent out three times during the season. Each mailing resulted in only 20 phone calls (1.6% response rate), but an average of 15 sales per mailing. His business to business catering sales were beginning to grow and he was getting repeat customers. Catering business customers just loved having the York's Best trucks come to their place of business.

"York's Best Ice Cream was able to accommodate all of our 1200+ employees on multiple shifts. What a tremendous experience it was for everybody!"

In addition, to increase the catering business' revenues, Devon started catering private parties such as BBQs, church picnics, and weddings. In addition to his two corporate packages, Devon added a third option for these customers: \$2.00 for cones and slushies. He made sure he covered his costs and have a profit by requiring customers to pay for a minimum of 50 people.

2008 Business Expansion

In May 2008, Devon graduated with his degree in entrepreneurship. Devon was able to turn his attention from school and focus full time on building and expanding his business year round. He purchased three used trucks for \$6,500 each. He financed his expansion with a \$25,000 bank loan, which he obtained at a local bank for prime plus two percent, for an interest rate of six and half percent. However, while he looked over the trucks more closely this time "The trucks turned out to be all lemons." "Each needed about \$10,000 in repairs."

York's Best Ice Cream's 2009 Season

In 2009, York's Best had grown to a total of eight employees in addition to Devon. The company had six trucks on the road (See Table 2 in the appendix for a historical account). The trucks, with one exception, cost less to operate as fuel prices dropped nearly in half and the trucks needed fewer repairs than the previous season. "We cut our expense due to lower truck repair and maintenance," said Devon, "We are making more of our own ice cream novelties, which really helps the bottom line."

Before the season, Devon purchased two trucks that served soft serve ice cream products, including coffee shakes, which were popular with adults. The first truck he purchased for \$36,500 fully outfitted. "This truck is on the road seven days per week and makes the driver the most money. This truck really helped to increase revenues, since there was a great deal more profits selling soft serve products.

His second truck purchase, however, "has proved to be very costly and somewhat of a nightmare" Devon stated. He flew to Oregon to look at the truck and it seemed OK. Devon spent an additional \$10,000 in equipping the truck including \$2,500 to ship the truck to York. However, it ended up in the shop quite a bit needing extensive repairs. "This truck would have helped increase my bottom line if it had been on the road more."

Devon's hard work on developing relationships with local companies had also paid off. Despite route sales being down, his overall sales were up, due to new and just as important repeat business from corporate customers. "My website is paying off, as I am getting more leads from there than from the mailing lists." However, Devon was facing a tougher sell due to the recession. "A number of customers who gave me firm bookings cancelled at the last minute trying to cut costs." Devon added, "I was quite surprised by this, as we have a package to fit every budget and this just did not happen last year after someone made a commitment."

Devon had grown the business to the point where each truck averages \$30,000 in revenue per year by the end of the 2009 season. While each truck required additional money beyond the purchase price to get it to usable condition, Devon believed that having made that investment, he would spend between four and five thousand dollars a year on each truck, since "we are now keeping up rather than catching up" with maintenance costs. Devon recognized that he needed to focus on improving the company's profit, thus he began to focus on "eliminating those products in the product line that do not have a purchase price of less than 25 percent of the selling price"

Growing the York's Best Ice Cream Brand

Devon's success was due in part to creating York's Best into a brand name around York County. Parents and kids alike were excited when one of his trucks rolled through their neighborhood. Parents liked to see the York's Best trucks, because they did not travel through the same neighborhoods every day. The York's Best man offered a variety of products at different price points. The coffee flavored drinks and soft serve also proved to be a hit with parents.

Future Growth

One issue that has been on Devon's mind is how to fund the growth of his business. He had grown his business from a single truck to six trucks in less than five years. However, Devon's dream was to create a multi-state brand that spanned both South Central Pennsylvania and Northern Maryland. Devon wanted to open a second warehouse, so that his trucks would not have to travel an extra 90 minutes each day. In order to do this, Devon needed to figure out the best way to proceed. However, he knew from his business courses that he would have to carefully plan his expansion plans. He could only manage so many employees on his own and he was hesitant to increase his overhead and risk by hiring managers.

Devon was also looking into new high margin products that would provide his business with some additional capital. He found that his customers were willing to purchase high margin soft serve products, but outfitting a truck required a higher investment. Devon purchased his first soft serve truck at a good price, because the owner wanted to get out of the ice cream business. Such deals could be difficult to find, especially if you had a short time line for purchasing additional equipment.

Thus, financing the company's growth was the critical issue for the young company. Devon was able to borrow to finance his company's start-up. However, he had maxed out his credit with the only bank in town that would give him a loan. The economic conditions were such that banks were unwilling to extend small businesses loans without significant collateral even with a Small Business Administration loan guarantee. He wanted to avoid asking his parents to co-sign another loan for him. Thus, he needed to look for other sources to fund York's Best growth.

Loans from Friends, Family, and Strangers. Devon could approach friends and other family members for some additional capital. The availability of funds lies in the liquidity of his family and friends and the level of risk they are willing to take. Private investors were another potential market he may be able to tap for growth capital. However, the interest rate may be higher or an angel investor may be more interested in owning a piece of his business. However, these investors may be a smarter move despite the potential cost, as they may provide smart money: investors who may be willing to mentor Devon. He could also attempt to apply for additional credit through a credit card company; however, the interest rates may be too high with rates depending on his credit worthiness could exceed 20 percent.

Peer-to-peer lending was another realistic option for small businesses that need between \$8,000 and \$25,000. Peer-to-peer companies act as intermediaries much like e-Bay. They take a small fee and provide investors with financial information, such as credit scores, as well as, collecting and distributing payments. Lenders are able to loan a fraction of what the borrower needs and even spread their risk over any number of loans to different borrowers. For example, it is not uncommon for an individual lender to provide between \$50 and \$100 on a \$5,000 loan that someone wants to build a deck on the back of their house. Rates for these loans tend to be less than credit cards and some bank loans depending on the individual's credit worthiness. According to a recent study, peer-to-peer lending is likely to account for \$5 billion of outstanding loans in the US (Petty & Stevens, 2010). Peer-to-peer companies, such as Prosper and Lending Club, match potential investors with people who seek personal and business loans.

Generally speaking, these borrowers have problems obtaining from traditional sources, like commercial banks, due to their credit history, debt to equity ratio, or a lack of collateral. Lenders seek a higher return than their banks are offering. Prosper reported that business loans accounted for only 11 percent of the company's business (BusinessWire, 2010).

Equity Investors or Partners. A second option for financing York's Best growth that Devon's dad spoke with him about was trying to attract either equity investors or business partners. Devon had given a great deal of thought to finding a partner. However, he did not know anyone with whom he would be willing to share his business. Devon knew that entering into a partnership was like getting married. His professor and several guest speakers in his entrepreneurship courses told him many stories of partnerships that went sour. Thus, Devon was very hesitant about taking a partner.

Create a Franchise Organization. Another option that Devon thought about was expanding his business through franchising. He thought about how franchising may be a good vehicle to expand York's Best without having to invest a great deal of capital into employees and new equipment. In addition, Devon could expect to charge an upfront franchise fee of between \$25,000 to \$30,000 (Clarking, 2010) as well as monthly or quarterly royalties from each franchisee, between four and five percent of gross revenues. Devon could also charge franchisees a percent of their gross revenues for marketing and advertising.

Devon would not have to worry about ensuring that his managers' goals were aligned with his. This "agency" problem would not be as much as an issue for franchisees, since they would make a considerable investment in their business. Thus, Devon could develop the market presence he sought through having a number of locations outside of his home area without having to keep a close eye on each location.

However, franchising had serious drawbacks that Devon heard about. First, setting up the franchise organization costs on average between \$30,000 and \$80,000 (Clarkin, 2010). The bare bones legal expenses alone could cost around \$20,000 (Clarkin, 2010). Second, the skill set needed for being a successful franchisor is somewhat different than skills needed for running one's own business. Entrepreneurs find that they are less involved in their original business and more involved managing the franchising organization. Devon would have to be able to switch gears to meet the extensive staffing, managing, and sales demands necessary to support a franchise system (Henricks, 2005). Selling his franchise to would-be ice cream entrepreneurs would not be the same as hiring drivers or selling frozen treats to eager children (Henricks, 2005). However, there are franchise sales organizations like FRANNET that help entrepreneurs sell their franchise.

There are also a number of legal hurdles that Devon would have to overcome. First, he would have to develop a Franchise Disclosure Document (FDD) that would be given to potential franchisees. It would take a great deal of time away from his current business operations to create the necessary FDD.

Conclusion

Devon spoke with his family about all of his growth plans over dinner. He explained the opportunity to continue to rent space in the local indoor farmers market, which he tested for the last two months of the year. This “will not only allow me to sell my products year round, but also let me manufacture my own novelties that will lower my product costs and boost my profits.” An earnest Devon turned to his father and asked, “What should I do to grow my business?”

Table 1: Time Line for Each Summer Season

	2004	2005	2006	2007	2008	2009
Major Milestones	Started York’s Best with the purchase of first truck	First Full Season	Focused on Business Catering	First Employee	Graduated from Temple Univ. Purchased 3 Trucks & Hired New Employees	Purchased 2 Trucks Started Selling Coffee Drinks
Number of Employees	0	0	0	1	6	8
Number of Trucks	1	1	1	1	4	6

**York's Best Ice Cream
Company
Balance Sheet
December 31, 2009**

ASSETS		
Current Assets		
Total Cash	\$4,645.43	
Total Current Assets		4,645.43
Fixed Assets		
Equipment	50,614.77	
Accumulated Depreciation	(76,103.00)	
Leasehold Improvements	6,325.68	
Total Vehicles	<u>149,309.28</u>	
Total Fixed Assets		<u>130,146.73</u>
TOTAL ASSETS		<u>134,792.16</u>
LIABILITIES & EQUITY		
Liabilities		
Total Current Liabilities	3,984.22	
Total Long Term Liabilities	<u>129,025.00</u>	
Total Liabilities		133,009.22
Equity		
Member's Contribution	27,619.54	
Member's Draw	(13,595.25)	
Members Equity	20,524.22	
Net Income	<u>(32,765.57)</u>	
Total Equity		<u>1,782.94</u>
TOTAL LIABILITIES & EQUITY		<u>134,792.16</u>

York's Best Ice Cream Company
Income Statement
For the year ending December 31, 2009

Income		
Company Catering	\$35,551.00	
Event sales	15,593.95	
Market Sales	795.00	
Mileage	305.00	
Route Sales- Novelty	97,636.79	
Route Sales-Soft Serve	<u>36,057.52</u>	
Total Income		185,939.26
Cost of Goods Sold		
Cost of Goods Sold	422.63	
Ice	1,154.00	
Merchandise	2,589.26	
Novelty Ice Cream	25,538.18	
Paper Goods	4,344.37	
Shaved Ice Materials	1,944.63	
Small Tools and Equipment	507.26	
Soft Serve	<u>422.63</u>	
Total COGS		<u>49,562.38</u>
Gross Profit		136,376.88
Expense		
Selling Expenses		
Employee Wages	44,039.08	
Insurance Expense	14,227.53	
Repairs and Maintenance		
Routine	6,538.58	
Unexpected	17,516.62	
Other	<u>463.76</u>	
Total Repairs and Maintenance	24,518.96	
Rent Expense(Central Mkt)	900.00	
Shop Supplies	1,896.02	
Truck Expense	14,318.01	
Total Utilities	1,608.37	
Vehicle Registration	740.60	
Vendor Fee	<u>2,083.40</u>	
Total Selling Expenses	104,331.97	
Total General & Administrative	19,713.01	
Depreciation Expense	42,902.00	
Total Expense		<u>166,946.98</u>
Operating Income (EBIT)		(30,570.10)
Other Income/Expense		
Gain on Sale of Equipment	1,286.65	
Total Taxes	(211.82)	
Interest Expense	3,693.94	
Total Other Income/Expense		<u>(2,195.47)</u>
Net Income		<u>(32,765.57)</u>

YORK'S BEST ICE CREAM COMPANY: TEACHING NOTE

Synopsis:

This case tells the story of Devon, a young entrepreneur, who started an ice cream truck business called York's Best Ice Cream Company at the end of his first year in College. Devon is a hardworking guy in his 20's trying build his dream of creating a highly recognized brand name for York's Best. The case provides brief overviews of both the Ice Cream and Street Vendor industries and how the economic and social/cultural environments affect these industries.

Students are armed with data from the ice cream and vendor industries as well as information about Devon's company, including its 2009 income statement and balance sheet. Students are asked to analyze this data and provide Devon with a recommendation of how to grow his business. This requires the student to first evaluate the viability of Devon's dream and then identify areas where Devon should focus his entrepreneurial efforts. Next, students are asked to look ahead to determine the best source(s) of capital to help Devon grow his business. Thus, students are left with the task of unraveling the issues and possibilities in formulating a response that will help Devon turn York's Best into a well recognized brand. Three potential ways of funding growth are presented, including developing York's Best Ice Cream into a franchise. The real Devon has already given this some consideration.

The case is well suited for use in advanced undergraduate or graduate entrepreneurship courses such as new venture creation, new venture management, and entrepreneurial finance and franchising. There are a number of potential side issues to explore at the instructor's discretion. For example, what will it take to turn York's Best into a big brand name ice cream company? And, how should Devon balance his desire to grow his firm and ensure it maintains a secure financial footing given the weak economy?

SUGGESTED CASE PREPARATION AND/OR DISCUSSION QUESTIONS:

1. What are some of the trends that you have noticed in the ice cream industry?

This is a good opportunity to get students out of the classroom to explore ice cream products that supermarkets, specialty stores, restaurants, and what the local ice cream 'man' may offer. Students should especially take note that shelf space at the local market is considered very valuable, thus is extremely competitive, as companies fight for every inch of space for their products. Students should consider the following on their road trip to the supermarket: How much of the shelf space is allocated to traditional ice cream and sherbet products? How much room is dedicated to novelty products? What are the reasons behind the product mix?

At this point, students may be asked how this product mix might help Devon determine what he should be selling in order to attain his growth goals. Students should be encouraged to think about the general environment using a framework such as PEST or STEEP analyses.

2. How is Devon's company doing?

This question is usually one of the first questions one asks about a business. The pedagogical purpose is to teach entrepreneurial students to not only analyze the obvious information, but the need to both penetrate the details of the business (including the financial statements) and employ the appropriate frame of reference in order to reach an informed conclusion.

Students often focus on the obvious negative information: the business is still losing money after five years of operation, *Note: Additional detailed teaching notes could not be included due to the page restrictions.*

After some discussion, the instructor should ensure students understand that while profitability and return on equity are the measures for an established business, cash flow is the key in managing a successful startup. Using standard financial management techniques summarized in Cornwall, Vang, and Hartman, (2009) on pages 140-153, the Operating Cash Flow (OCF) can be determined from the York's Best income statement as follows:

EBIT	\$(30,570.10)
-Taxes	(211.82)
<u>+Depreciation</u>	<u>42,902.00</u>
Operating Cash Flow	12,543.72

The instructor should allow a brief discussion on the OCF and its meaning. Potential discussion items could include:

Free Cash Flow versus Operating Cash Flow: *Note: Additional detailed teaching notes could not be included due to the page restrictions.*

The frame of reference to use if the OCF were negative: *Note: Additional detailed teaching notes could not be included due to the page restrictions.*

The return on Devon's investment is calculated as:

$$\text{ROI} = \text{OCF}/\text{Members Equity} = 12,543.72/20,524.22 = 61\%$$

Note: Additional detailed teaching notes could not be included due to the page restrictions.

In conclusion, the business is generating a positive cash flow. In the short term, it yields a very good return on Devon's investment. Finally, it is financially strong enough to cover its current liabilities (assuming it can refinance its debt). Subjective considerations from the case should include that Devon feels that "At the end of this year, we will have caught up with the emergency maintenance and will only be spending our money on routine maintenance." If true, this should increase cash flow and reduce the net loss by a little over \$17,000 in future years. Additionally, the fact that Devon is returning to his 25% of revenues compensation plan for his drivers should reduce expenses from their current levels. Before proceeding, the instructor should reinforce the importance of making sure students examine the details of the case. *Note: Additional detailed teaching notes could not be included due to the page restrictions.*

If the discussion does not evolve to a more objective way of evaluating the venture, the instructor could ask “how does Devon’s business compare to others in this industry?” A simple benchmarking analysis to determine relative performance would consist of comparing the 2009 year performance versus the IBIS world averages for the category. The table 3 (below) summarizes the results of that comparison.

Table 2 Benchmarks for Vendor Industry

Item	IBIS World Benchmark (% of Revenue)	York’s Best (% of Revenue)
Profit	25	Negative
Purchases	27	26.7
Wages	18.7	23.7
Expenses(other)	26.9	64.6
Utilities	0.2	0.005
Rent	0.2	0.009

Source: IBISWorld 2009

The comparison requires the students to apply their knowledge of managerial accounting to classify the expenses properly. *Note: Additional detailed teaching notes could not be included due to the page restrictions.*

Once the comparison to the average street vendor is made, the discussion now becomes data driven with the focus on reducing operating expenses and which categories of operating expense should be targeted. *Note: Additional detailed teaching notes could not be included due to the page restrictions.*

3. What are the sources of financing that may be open to expand Devon’s business?

Good entrepreneurs and businesspeople should consider all options and students should carefully consider all of Devon’s options. Students may find it helpful to create a list of advantages and disadvantages for each financing option. If students bring their list to class and then form groups, they will benefit from learning how their classmates viewed each option.

Option One: Debt

Devon has all but exhausted his ability to borrow additional money from a bank; however, there are other avenues, such as friends, family, and other interested individuals who may be interested in lending money to the business. Another fairly new, almost hip, source of debt financing that students may consider is capital through one of the peer to-peer lending websites such as Prosper (http://www.prosper.com/welcome/how_it_works.aspx) and Lending Club (<http://www.lendingclub.com/home.action>).

Option Two: Equity

While Devon is not excited about selling an equity stake in his business to an outside investor or active partner, he must consider this option. Students should consider some of the almost emotional aspects that come into play should Devon give up a portion of ownership. Bringing a partner on board certainly should provide Devon with a number of additional resources, which may include mentoring in addition to financial capital.

Option Three: Franchising

Another option for Devon is to grow the York's Best brand through franchising. Franchising one's business may help Devon deal with several issues. First, franchising York's Best may help Devon overcome financial constraints that limit his business' growth, (Dant, 1995; Lafontaine, 1992), since franchisees provide the franchisor with a stream of revenues.

Second, creating a franchise relationship may also help deal with agency issues that arise as businesses grow (Eisenhardt, 1989). Devon would experience increasing costs for monitoring managerial activities at dispersed locations as he grows his business by opening additional stations to service his fleet of trucks. This cost may account for the relatively high incidence of franchising in the restaurant sector (Sen, 1998). Instead of an owner relying on employee managers to run additional locations, they partner with franchisees, who have an economic incentive to run their businesses efficiently and effectively, since they invest their own capital. In addition, franchisors and franchisees share the business risk, making the venture less risky for both parties (Lafontaine, 1992b).

Third, as Devon grows his business he will need to attract talented management, which may be difficult, costly, and once again suffer the agency problem. Franchisees provide human capital through their own management talent (Sen, 1998). Norton (1995) points out that franchisees provide a bundle of financial resources and the necessary human capital to the relationship, which may cement the bundling.

Fourth, Devon may be able to reach his goal of creating a highly popular brand name more quickly by becoming a franchisor due to the factors mentioned above. In fact, Sen (1998) found that franchising helps firms overcome various constraints that inhibit growth by providing a bundle of financial capital and managerial talent. Thus, in the early stage of the franchise life cycle, young firms tend to use franchising to attain growth, while older firms tend to rely less on franchising to add outlets.

4. Is the York's Best concept a franchisable business?

Students must consider the advantages and disadvantages for turning York's Best into a franchise operation. Entrepreneur.com had a nice article that provides some insight into what makes a franchisable business (Henricks, 2005). The business must appear to be a good business opportunity for others. Thus, does Devon really have a concept that people would find valuable? According to the article:

- The franchise must have pizzazz.
- Produce a superior product or service.
- The concept must be teachable.
- The business must be repeatable; thus, many people must be able to replicate it in many places.
- The franchisor must invest the necessary resources to ensure that they can get the training and support they need to be successful.

5. Assume that York's Best Ice Cream is franchisable business. Identify and discuss who Devon should target as potential franchisees. What does Devon need to have in place before he can sell franchises?

This question should stir quite a conversation. *Note: Additional detailed teaching notes could not be included due to the page restrictions.*

6. What should Devon do to achieve his business goals?

Note: Additional detailed teaching notes could not be included due to the page restrictions.

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