

# **Recovery Prior to Succession: A Case Study of a Family Business Facing Unexpected Turmoil**

*A. A. Tavakoli, Fayetteville State University  
Ray L. Benedicktus, Fayetteville State University*

## **Introduction**

Jonathan Parker, 62, is the owner of Soak & Swim, Inc., a local pool and spa retail company located in North Florida. He bought the company from its founder in the early 70's and has taken great pains to build the stores revenues in order to pass on the company to his son, Joe. Since the beginning of Jonathan's tenure, there has not been a year in which same store sales did not exceed the previous years. However, last summer the company began a critical sales slump, in which revenues have dropped nearly 19% from the annual \$3 million dollar sales goals set by the father-son management duo. In addition, increasing operating costs have been forcing the company's profits closer and closer to the break-even point. Furthermore, the aptitude for this summer's sales seems less and less promising, with weather forecasts of constant showers and tropical storms, couples with a still struggling national economy.

Jonathan wants to be able to pass on the business to his son in a more stable position. Joe, 28, has been a sales manager in the company for just over two years now. After completing an MIS degree, he worked a corporate job for a few years before returning to Jacksonville to help his father after the loss of a key sales person. Joe has caught on to both the technical and sales aspects of the business when it comes to performing front-line duties, but is unfamiliar with many of the critical tasks that allow the company to operate daily, such as dealings with vendors and Soak & Swim's warehouse procedures.

Soak & Swim currently has three stores in Jacksonville Florida. The location in West

Jacksonville has the company's largest sales floor and serves as the company's headquarters. Soak & Swim also stores its excess inventory at this location. An average of 48% of total sales come from the West Jacksonville location, 31% from the Southeast Jacksonville store, and 21% from the three year old outlet in the northern part of the city.

Soak & Swim employs about 51 employees, varying somewhat with regular turnover of younger staff either leaving for or graduating from college each year. The employees include two bookkeepers, sales and general front-line staff, store managers, and installation teams. During peak sales periods, sub-contractors are also used for installing Soak & Swim's core pool and spa products. Communication with employees is superficial at best. Management says they encourage interaction, but employees note that no such efforts have been made. Salesmen have hardly any negotiation power; they are not allowed to adjust prices and often times have to contact the "big boss" to seek approval on minor issues. This has particularly had an adverse effect on the morale of sales force, since they lose business to their competitors with more flexibility to cut deals within a reason. They are also paid an hourly wage with steady weekly hours even during the off-season! Furthermore, there are no employee performance incentives or systematic sales and service evaluation procedures.

Soak & Swim currently has a database of over 4,900 customers living within 10 miles from at least one of its stores. They average about 200 pool or spa sales each year, 93% being from new customers. Other customers either return for accessories, parts, water quality

testing services, or are reeled away by Soak & Swim's overly aggressive competitors. The company neither surveys customers on how they heard of Soak & Swim, nor does it follow up with post-sale advertising or customer appreciation materials. Soak & Swim did, however, release a full color catalog recently, mailing it to its entire database. The company's website is posted for information purposes only, not supporting online product sales to either the North Florida region or outside markets.

Soak & Swim does not have a strategic plan and although its mission statement is prominently displayed on the website, not even Jonathan can remember that it exists. Management is very involved in day-to-day operations, often performing the duties of sales and general staff. This micromanagement style is not only a source of continuous complaints by the majority of employees, it has left little time for the Parkers to critically evaluate their business, formulate a strategic plan, or visit their website to recall the company's mission!

The core products that the company sells enjoy a national reputation for quality, but are also sold by the large majority of pool and spa retailers. Thus, the market is highly competitive and pool and spa retailers are working feverishly to differentiate themselves by cutthroat pricing, value added services, and customer relationship building activities. Soak & Swim, however, has a clear niche in water purification chemicals, which exceeds the quality levels of mass merchandisers, home improvement stores, and direct mail discount retailers. It is worth noting that the company has added one new product during the last few years. It is the only pool and spa retailer that is selling the trendy decorative concrete used by customers to enhance the aesthetics of their pool. However, competitive pressure has forced most players to diversify their product lines by adding additional products such as saunas, misting systems, and gas fireplaces.

Until the recent sales slump, Jonathan was seriously thinking of retiring next year,

leaving the business to his son. In fact Mr. and Mrs. Parker have put a down payment on a condo in Vero Beach and have been spending a lot of time visiting furniture stores and planning for a retirement gala. Joe Parker is equally delighted that after so many years of waiting he will be in charge of the business and will have the opportunity to run the business his way. However, the unexpected and precipitous decline in sales over the past several months has brought several operational and strategic problems into light. Jonathan, an ambitious entrepreneur, who worked so hard to build a successful business, cannot comprehend the magnitude of the problems he faces and does not want to leave this business to Joe before identifying the underlying causes of those problems.

## **The Industry**

Since 1996 the market for swimming pools has been growing at an annual rate of 11%, with only minor fluctuations in both above ground and in-ground markets. Swimming pool sales represent about \$3.95 billion of total industry revenues, while the \$1 billion national spa & sauna market makes up the remaining segment. This 'hot water' market has grown 43% in the last decade. Above ground pools are sold at over seven times the rate of in-ground pools. However, new financing incentives made possible by banks and encouraged by the declining interest rates on home equity loans are encouraging growth in the market for in-ground pools. The pool market is also correlated to the market for new homes. The cyclic sales of the industry tend to fluctuate the year after a similar fluctuation in the new home market. Single-family homes construction has increased an average of 4.2% each year since 1995, throughout the state of Florida. However, recent national events have caused mixed emotions among pool and spa retailers. The lingering deterioration of tourism has increased the time that families spend 'vacationing in their

backyards.’ Families are spending more time together and putting more emphasis on their quality of life. Some retailers have benefited from this trend and tend to be optimistic about the future. Others, like Jonathan and Joe Parker, remain skeptical, citing economic downturn, job loss, and decreased spending on luxury items. However, existing pool owners must protect their investments by spending additional monies on chemicals and water treatment, but are looking for lower cost ways to meet their needs.

Soak & Swim’s competition is composed of five local pool and spa retailers, national home improvement store chains (Lowe’s and Home Depot), the mass merchandiser Wal-Mart, and a plethora of direct mailers and Internet retailers. Other than Wal-Mart, only two competitors, Superior Design Pools & Spas, and Royal Palm Pools and Spas, have larger product lines than Soak & Swim. Royal Palm also offers pool cleaning and maintenance service to its customers, an activity in which no other retail competitor is currently engaged. Superior Designs is Soak & Swim’s greatest competitor, also having three locations, all of which are in different areas of Jacksonville. Aqua Vista Custom Pools and Royal Palm tend to be a bit pricier than Soak & Swim, but Aqua Vista does not perform water quality tests. Renaissance Pools is Soak and Swim’s most similar competitor, having similar product and service lines and charging nearly identical prices. However, Renaissance concentrates its marketing on the higher class client as well as servicing the majority of the area’s resorts/hotels. The last competitor is Workingman’s Pool and Garden Center, which primarily serves as a landscaping product company, selling and installing fishponds, birdbaths, and other materials, marketing pools as a supplementary source of income.

Brand loyalty is moderate among the customers of the specialty retailers and home improvement stores, while the customers that typically order online or from the direct mailers have been proven to migrate towards the vendor with the best perceived value for their dollars. Most customers return to the store that sold them the pool or spa when they need to order parts, but tend to be more flexible when needing accessories or chemicals. The barriers to entry are moderately high; all of the current retailers have been in business for over 20 years and have nearly saturated the market. Another entry would have to come from an established company expanding into the area in order to present any real threat to the existing businesses.

There is also a new, moderately priced product available that eliminates the need for constant chemical water treatments, saving the customer both time and money. This ionized water purification system has become popular in the southwest United States, but is only distributed through a few retailers in the southeast. In fact the closest two retailers offering this product are located in Miami and Northern Georgia. California has eight distribution centers throughout the state whereas Florida only has the one.

### **Instructions to Students**

You are expected to identify the causes of problems for Soak & Swim. In doing so, you may want evaluate the financial statements; compute critical financial ratios and compare them against the industry benchmarks; develop break-even charts; develop incentives for employees; and develop strategic recommendations for the long term survival of the firm. Some of the information that you may need to complete your analysis is included in the appendices:


## Appendix A

<b>INCOME STATEMENT</b>	Year 1		Year 2		Year 3	
<b>Common Sized</b>	\$	%	\$	%	\$	%
Sales-W. Jacksonville	1,678,912	57.2%	1,877,349	55.3%	1,318,788	48.0%
Sales-S. Jacksonville	935,891	31.9%	948,005	27.9%	851,399	31.0%
Sales-N. Jacksonville	320,774	10.9%	567,649	16.7%	579,164	21.1%
<b>Total Sales</b>	<b>2,935,577</b>	<b>100.0%</b>	<b>3,393,003</b>	<b>100.0%</b>	<b>2,749,351</b>	<b>100.0%</b>
CGS - W. Jacksonville	1,057,715	36.0%	1,167,365	34.4%	693,949	25.2%
CGS - S. Jacksonville	589,704	20.1%	597,243	17.6%	451,241	16.4%
CGS - N. Jacksonville	202,592	6.9%	357,618	10.5%	306,931	11.2%
<b>Gross Profit</b>	<b>1,085,566</b>	<b>37.0%</b>	<b>1,270,777</b>	<b>37.5%</b>	<b>1,297,230</b>	<b>47.2%</b>
Selling, General & Admin. Exp.	902,543	30.7%	1,004,908	29.6%	1,041,481	37.9%
Lease/Rent Expense	64,450	2.2%	133,145	3.9%	164,717	6.0%
Depreciation	54,781	1.9%	51,595	1.5%	47,615	1.7%
Bad Debt Expense	3,777	0.1%	28	0.0%	39,547	1.4%
Total Operating Expenses	1,025,551	34.9%	1,189,676	35.1%	1,293,360	47.0%
<b>Operating Profit</b>	<b>60,015</b>	<b>2.0%</b>	<b>81,101</b>	<b>2.4%</b>	<b>3,870</b>	<b>0.1%</b>
Interest Income	14,678	0.5%	5,579	0.2%	18,752	0.7%
Gain on Sale of Assets	10,128	0.3%	0	0.0%	0	0.0%
Other Income	33,655	1.1%	24,079	0.7%	26,533	1.0%
Total Other Income	58,461	2.0%	29,658	0.9%	45,285	1.6%
<b>Profit Before Tax</b>	<b>118,476</b>	<b>4.0%</b>	<b>110,759</b>	<b>3.3%</b>	<b>49,155</b>	<b>1.8%</b>
Current Taxes (-)	(20,627)	-0.7%	(17,197)	-0.5%	(4,568)	-0.2%
<b>Profit Before Extraordinary Items</b>	<b>97,849</b>	<b>3.3%</b>	<b>93,562</b>	<b>2.8%</b>	<b>44,587</b>	<b>1.6%</b>
NET INCOME	97,849	3.3%	93,562	2.8%	44,587	1.6%
<b>RECON. OF NET WORTH</b>						
<b>Common Sized</b>						
Beginning Net Worth	(5,041)	-5.4%	92,809	56.7%	163,550	85.6%
Changes in Retained Earnings:						
Net Income (Loss)	97,849	105.4%	93,562	57.2%	44,587	23.3%
Stock Dividends	0	0.0%	35,625	21.8%	17,122	9.0%
Changes in Other NW						
Common Stock	0	0.0%	12,804	7.8%	0	0.0%
Ending Total Net Worth	92,809	100.0%	163,550	100.0%	191,015	100.0%

## Appendix B

<b>CONSOLIDATED BALANCE SHEET</b>	Dec. 31		Dec. 31		Dec. 31	
<b>Statement in Actual \$</b>	Year 1		Year 2		Year 3	
	\$	%	\$	%	\$	%
Cash on hand	162,386	36.9%	128,000	20.8%	43,486	6.6%
Trade Accounts Receivable	4,200	1.0%	29,727	4.8%	16,698	2.5%
Other Accounts Receivable	16,923	3.8%	5,867	1.0%	53,756	8.1%
Net Accounts Receivable	21,123	4.8%	35,594	5.8%	70,454	10.6%
Total Inventory	55,292	12.5%	172,326	28.0%	273,148	41.2%
Prepaid Expenses	7,039	1.6%	22,479	3.7%	5,169	0.8%
<b>Total Current Assets</b>	<b>245,840</b>	<b>55.8%</b>	<b>358,399</b>	<b>58.3%</b>	<b>392,257</b>	<b>59.2%</b>
Land	0	0.0%	3,116	0.5%	3,116	0.5%
Buildings	92,388	21.0%	121,884	19.8%	123,884	18.7%
Machinery & Equipment		0.0%		0.0%		0.0%
Other Equipment	146,698	33.3%	163,352	26.6%	153,583	23.2%
Furniture & Fixtures	53,080	12.0%	62,940	10.2%	62,938	9.5%
Leasehold Improvements	108,433	24.6%	142,329	23.2%	144,813	21.9%
<b>Gross Fixed Assets</b>	<b>400,599</b>	<b>90.9%</b>	<b>493,621</b>	<b>80.3%</b>	<b>488,334</b>	<b>73.7%</b>
Accumulated Depreciation	(205,837)	-46.7%	(237,322)	-38.6%	(218,189)	-32.9%
<b>Net Fixed Assets</b>	<b>194,762</b>	<b>44.2%</b>	<b>256,299</b>	<b>41.7%</b>	<b>270,145</b>	<b>40.8%</b>
<b>TOTAL ASSETS</b>	<b>440,602</b>	<b>100.0%</b>	<b>614,698</b>	<b>100.0%</b>	<b>662,402</b>	<b>100.0%</b>
Notes Payable	42,723	9.7%	113,967	18.5%	100,351	15.1%
Trade Accounts Payable	113,037	25.7%	205,209	33.4%	205,180	31.0%
Fed. Income Taxes Payable	6,348	1.4%	1,063	0.2%	0	0.0%
Other Current Liabilities	18,200	4.1%	0	0.0%	0	0.0%
<b>Total Current Liabilities</b>	<b>180,308</b>	<b>40.9%</b>	<b>320,239</b>	<b>52.1%</b>	<b>305,531</b>	<b>46.1%</b>
Long Term Debt	167,485	38.0%	130,909	21.3%	165,858	25.0%
<b>Total Liabilities</b>	<b>347,793</b>	<b>78.9%</b>	<b>451,148</b>	<b>73.4%</b>	<b>471,389</b>	<b>71.2%</b>
Common Stock	431	0.1%	431	0.1%	431	0.1%
Retained Earnings	105,182	23.9%	163,119	26.5%	190,584	28.8%
Treasury Stock	(12,804)	-2.9%	0	0.0%	0	0.0%
<b>Total Net Worth</b>	<b>92,809</b>	<b>21.1%</b>	<b>163,550</b>	<b>26.6%</b>	<b>191,015</b>	<b>28.8%</b>
<b>TOTAL LIABILITIES &amp; NET WORTH</b>	<b>440,602</b>	<b>100.0%</b>	<b>614,698</b>	<b>100.0%</b>	<b>662,404</b>	<b>100.0%</b>

## Appendix C

RMA Ratio Calculation Guide	
Ratio	Calculation
<b>Operating Ratios:</b>	
Sales Growth	Total sales - Total Sales (Next Year)/ Total Sales Next Year
Pre-Tax Profit Margin	Profit Before Tax/ Total Sales
Profit Margin	Net Income/Total Sales
Return on Assets (ROA)	Net Income/Total Assets
Return on Equity (ROE)	Net Income/Total Net Worth
Asset Turnover	Total Sales/Total Assets
<b>Current Position:</b>	
Current Ratio	Total Current Assets/Total Current Liabilities
Quick Ratio	(Cash + Accounts Receivables) / Total Current Liabilities
Working Capital	Total Current Assets - Total Current Liabilities
Working Capital/Assets	Total Current Assets - Total Current Liabilities / Total Assets
Working Capital Turnover	Total Sales / (Total Current Assets - Total Current Liabilities)
Receivable Turnover	Total Sales / Trade Accounts Receivable
Age of Receivables	Trade Accounts Receivable / (Total Sales / 365)
Inventory Turnover	Total Costs of Goods Sold/ Trade Accounts Receivable
Days Supply in Inventory	Total Inventory / (Total Costs of Goods Sold * 365)
Payable Turnover	Total Costs of Goods Sold/ Trade Accounts Payable
Age of Payables	Trade Accounts Payable / (Total Costs of Goods Sold * 365)
<b>Equity Position:</b>	
Owner Equity/Assets	Total Net Worth/ Total Assets
Creditor Equity/Assets	Total Liabilities/ Total Assets
Debt/Tangible Net Worth	Total Liabilities/ (Total Net Worth - Intangibles)
Fixed Assets/Long Term Debt	Net Fixed Assets/ (Total Liabilities - Current Liabilities)
Fixed Assets/Tangible Net Worth	Net Fixed Assets/ (Total Net Worth - Intangibles)
Plant Turnover	Total Sales/ Net Fixed Assets

## Appendix D

Price & Quality Comparison	Price of 15' Above Ground Pool	Price of 10 lb. of Chlorine Tablets	Public's Perception of Quality
Soak & Swim	\$1,700	\$32	High
Aqua Vista Custom	\$2,000	\$36	Medium
Direct Mailers	\$860	\$24	Low
Home Improvement Stores	n/a	\$19	Medium
Internet Retailers	\$1,150	\$24	Low
Renaissance	\$1,800	\$33	High
Royal Palm	\$1,900	\$34	High
Superior Design	\$1,700	\$32	High
Wal-Mart	n/a	\$26	Low
Workingman's Garden Center	\$1,400	\$28	Medium