SHOULD THEY STAY OR SHOULD THEY GO?

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The owner of The Beanery Coffee Roasters, Kurt, had an opportunity to move his small wholesale/retail coffee roasting operation to a new location nearby. By moving to this location with improved retail visibility, he would increase retail sales and expand community engagement opportunities, but would also increase overhead costs and incur the fixed costs of moving. The roasting operation would be subject to uncertain new ordinances in the new location and he would give up the freedom of operating in a neighborhood with few restrictions and no neighborhood complaints about smoke discharge from the roasting process.

On the face of it, moving to a better retail location seemed to be a no-brainer. Were there hidden risks or overhead costs that had not occurred to him? The new location seemed to be a good one; would it be good enough? Students evaluate the choices using Small Business Management principles or Entrepreneurial Skills principles, and quantify the choices using Management Accounting principles.

INTRODUCTION

Kurt Peterson finished roasting and bagging the last of the wholesale coffee orders for the day. "Liam, little man, I need your help loading up these big bags of coffee for delivery. Then you can help me count the money in the cash register." Kurt was pleased that his young children were interested in learning about the business that he had purchased a year ago.

Several years ago, Kurt had embraced the hip "specialty coffee" culture, with its community engagement, coffee tasting events, daring tales of mountainous coffee sourcing excursions, and competitive barista competitions. He was elated when the opportunity arose to purchase an ongoing specialty coffee roasting business and combine it with his existing snack vending business. He had immediately thought of several potential synergies between the two operations.

Over the following year, he had successfully integrated the two operations and had snagged several new wholesale coffee accounts. During that time, The Beanery had increased total sales by 20%: a 25% increase in wholesale and a 10% increase in retail sales. Retail sales growth had lagged significantly behind his expectations, which was frustrating to Kurt because gross profit margins were much larger for retail than wholesale sales. Despite having his eyes and ears open for opportunities to grow retail sales, they had not materialized as he had hoped.

COMMUNITY ENGAGEMENT

Community engagement had always been an important part of The Beanery's corporate mission and Kurt wasted no time in filling the calendar with charity fun-runs, local military support events, and many other community events. By the end of Kurt's first year, the Beanery had joined in on 50% more community engagements compared to the year earlier. He credited the increase in sales, both wholesale and retail, in part to this greater level of community engagement.

SALES AND MARKETING

When Kurt took over The Beanery, the sales mix of the business was a combination of wholesale sales of roasted coffee beans (in five-pound packages) and retail sales of roasted coffee (in one-pound, whole-bean, and 2.5-ounce ground sizes). Coffee could also be purchased by the cup since there was always a freshly-brewed pot of The Beanery's coffee available. Retail sales were primarily walk-in customers who were waited on by one of the previous owners.

The previous owners of The Beanery had used social media, web marketing, and community involvement, but Kurt had identified several marketing channels that had not yet been tapped. Accordingly, he had improved The Beanery website store so that customers were able to place retail orders online and have the product shipped directly to their homes. He had also increased social media marketing, and had begun regional radio advertising and print advertising at the nearby Air Force Base.

Despite these efforts, Kurt was disappointed by small increase in retail sales at the facility. He attributed this to the fact that the location of The Beanery was in an untraveled part of town and customers had to make an effort to find it. Kurt began to suspect that a more visible and convenient location would produce greater retail results than any marketing strategy.

STANDARDS OF QUALITY

The "specialty coffee" that The Beaneary sold was more than a description of good coffee: it was a defined grade of green (unroasted) coffee. Members of The Specialty Coffee Association of America (SCAA) had all agreed to abide by a defined coffee grading scale, where "specialty grade" was defined as having achieved a regulated cupping score of 80-90. The integrity of The Beanery brand was highly dependent upon the quality of the roasted coffee sold. High quality coffee was achieved by first buying excellent specialty grade coffee, then roasting it skillfully and maintaining its freshness.

One unique service that The Beanery was able to offer its clients was the ability to create taste-tailored blends of beans. Coffee beans grown in different countries and regions had different flavor profiles, much like the grapes grown in different regions created different flavor profiles for wines. For example, Central American grown coffee beans had some subtle differences in their flavor profile from that of coffee beans grown in South America, and beans grown in Colombia had some differences from those grown in Brazil. During his time of ownership, Kurt had developed the ability to blend these beans in differing proportions to create unique flavor profiles. The Beanery marketed roasted beans from 14 different countries, and had created 10 of their own blends that they sold on an on-going basis.

OPERATIONS

The operation of The Beanery included the coffee roasting operation itself and the retail store. Retail customers parked on the street and walked into a storefront where they purchased coffee by the cup or by the bag. Store hours were M-F 9-2. Snacks from Kurt's vending business were also offered for sale. Customers were able to view the coffee roasting operation from the retail area. The small overall size of the facility limited the amount of space that was allocated to retail sales, so seating for retail customers was limited to a small table and a couple of chairs.

The facility was located about ½ mile from the local university, on a quiet side street on which several other unrelated commercial businesses were located. Although smoke was emitted from the vent during the roasting process and tractor-trailer trucks parked on the street while delivering green coffee, the neighbors had been tolerant and had never lodged any complaints.

Most of the space was utilized for the roasting operation, which included a receiving area for 60-kilo bags of green coffee, a storage area for those bags, the coffee roasting machine, the grinding and bagging area with grinders and bagging tools, and the cleanup area. The roasting machine used LP gas fuel and discharged smoke into ductwork connected to a short smoke stack. As a 1-person operation, it had a maximum capacity of 1,377 lbs. of roasted coffee per week (one shift). Due to moisture loss of approximately 15% during the roasting process, about 1,620 lbs. of green coffee was required in order to produce 1,377 lbs. of roasted coffee (1,377/(1-.15)=1,620). In order to produce this much, the roasting machine had to be in nearly continuous operation while the store was open. Each batch of roasted coffee started with about 18 lbs. of green coffee beans and each cycle of the process took 20 minutes, requiring almost constant attention from the person performing the operation. The maximum capacity took into account time needed for necessary maintenance and cleaning of the machine.

TABLE I
CAPACITY BREAKDOWN

Lbs/batch	Batches/hr	Hours/day	Days/wk	Moisture loss	Lbs of roasted coffee/wk
18	3	6	5	15%	1,377

One of the skills that Kurt had especially enjoyed learning was the art of the roasting process. By roasting beans for different lengths of time and to different temperatures, Kurt had learned to tailor the flavor profile of the coffee beans that he was roasting. It took him several months to master the basics, but even a year later he often felt that he was still learning the intricacies of the roasting process.

Whole (not ground) coffee beans were bagged in 1-lb or 5-lb bags, depending on the customer order. Ground coffee was bagged in 2.5-oz. bags. Using the bagging equipment included with the purchase of the Beanery, one person working alone was capable of the following production per hour:

TABLE 2
COFFEE BAGGING PRODUCTION

Bag Size	2.5 oz. (includes grinding)	1-lb	5-lb
Number of bags per hour	50	30	20

Alternatively, Kurt had identified automatic bagging equipment suitable for an operation of their size, priced at $9,000. This machine could bag and seal 12 bags/minute. Label application was not included. Kurt estimated that they could manually apply 4 labels per minute. Although labeling machines did exist, they required more space than was available.

The Beanery's labeling process, while not sophisticated, allowed for a good bit of customization. Kurt had even had a number of customers ask if the Beanery would be willing to create a private-labelled product which they then planned to resell to their customers. Some non-restaurant client companies had even made sizable retail purchases with custom labels for leaving "thank you" gifts for some of their loyal customers.

EXPLANATION OF COST OF GOODS SOLD

The "cost of goods sold" included the cost of green beans plus other costs such as the bag and label. The cost of green beans, the major component, was based on the world price for coffee. This baseline price was dictated by world supply and demand. The price paid by The Beanery was the baseline price plus a premium depending on the geographical origin and regulated quality level.

So, because supply was difficult to predict—uncertain weather and political events occur, for example—the cost of goods sold was expected to fluctuate in the future. Over the last ten years, The Beanery's cost of green beans (including freight) had ranged from as high as $5.00/lb. down to a low of $2.00/lb. for the same coffee. Recent costs had been hovering at $4.00/lb. Other costs amounted to $1.53/lb., adding up to total cost of goods sold of $5.53/lb.

2015 FINANCIAL PICTURE

Kurt had upheld the standards of quality, increased community awareness of the brand, and employed an array of marketing strategies. The financial picture had improved during 2015, but their long-term survival depended upon an increase in the net profit growth rate. With that in mind, Kurt evaluated various strategies for wholesale and retail sales growth, while controlling overhead and cost of goods sold. (Refer to Appendix, EXHIBIT 1)

Increasing wholesale sales, with its narrower gross profit margin, required a great deal of time and effort and also required hiring a sales person. Increasing retail sales, with its greater gross profit margins, required relocating the operation to a more visible location.

A RELOCATION OPPORTUNITY

Recently Kurt had learned that a location suitable for both wholesale and retail operations would become available. This larger property was located on a highly-trafficked, four-lane street that connected the local university (approximately 11,000 students) to the largest retail area in town (including the local mall). The proposed location was halfway between these two centers of activity, approximately ¾ of a mile from each, and had room to expand roasting operations and retail space as well as to add a retail coffee bar. Kurt estimated that a move to this location would certainly result in at least a doubling of retail sales.

The proposed location was in an incorporated city within the city, an enclave known as much for its arbitrary enforcement of unclear ordinances as for the concentration of bars and restaurants frequented by the university students. Despite the lack of clarity around the ordinances that might affect The Beanery in the new location, Kurt did not expect any unusual difficulties, considering the wide variety of retail stores and restaurants already operating nearby

TABLE 3
FACILITY COMPARISON

	Existing Location	**Proposed Location**
Retail Store Area (sf)	250	600
Production Area (sf)	650	1,200
Overhead Cost (annual)	$65,305	$110,000
Traffic Count (per day)	3,000 vehicles	30,000 vehicles
Parking	On-street	8-vehicle parking lot
Area Use	Light commercial	Retail/Restaurant

(Traffic Count based on Georgia Dept of Transportation "Traffic Counts in Georgia")

Two things were clear: the proposed location was located in a desirable location for retail sales and the larger space was able to accommodate growth. Should Kurt move The Beanery to the proposed location and expand retail sales, or should he stay at the present location and continue with the same business strategy?

EXHIBIT 1
The Beanery
Income Statement
12/31/2015

		Ratios	Notes
Sales			
Wholesale Sales	$170,000	69%	
Retail Sales	$75,000	31%	
Total Sales	**$245,000**	100%	
Cost of Goods Sold			
Wholesale Sales	$110,600	65%	Whsle CGS/Whsle Sales
Retail Sales	$33,180	44%	Ret CGS/Ret Sales
Total Cost of Goods Sold	**$143,780**	59%	Tot CGS/Sales
Gross Profit			
Gr Profit from Wholesale	$59,400	35%	Whsle Gr Profit Margin
Gr Profit from Retail	$41,820	56%	Ret Gr Profit Margin
Total Gross Profit	**$101,220**	41%	Gr Profit Margin
Overhead & Admin	**$65,305**		
Net Profit	**$35,915**	15%	Net Profit Margin
Wholesale Volume (lbs)	20,000		
Retail Volume (lbs)	6,000		
Average Cost/lb.	$4.00		
Average Wholesale Price/lb	$8.50		
Average Retail Price/lb	$12.50		
Other CGS/lb	$1.53		

REFERENCES

Series of interviews with Kurt Peterson, March 1 – October 1, 2016

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