

Arrow Printing and Publishing

Written Analysis and Communication I

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Section A

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Letter of Transmittal

March 31, 2003

To

Sam Dunnett
Owner of Arrow Printing and Publishing
Burk's Falls, Northern Ontario

From

Mohit Garg and Rahul Regulapati
IIM Ahmedabad

Subject: Report on the next course of action for Arrow Printing and Publishing

Dear Mr. Sam Dunnett:

Please find enclosed our recommendation report on the most appropriate future course of action for Arrow Printing and Publishing. After analyzing the current environment and the future growth prospects, it is recommended that Arrow expands into the four-color speciality services market by seeking a partnership with an experienced salesperson. If you should have any questions concerning this report and the analysis please feel free to contact Mohit Garg or Rahul Regulapati at xxx-xxx-xxx.

Enclosure: Final Report

Sincerely,
Mohit Garg
Rahul Regulapati

Executive Summary

Management is confronted with a tough decision on the future course of action for Arrow Printing and Publishing. Owner seeks to balance his personal and professional interests with the long term growth prospects of the company. Various options are being considered including selling Arrow to an external buyer, selling it to Peter Dunnett and expanding into high margin speciality services market by partnering with an experienced salesperson.

Considering that the management has a personal and financial interest in the company, these options were evaluated based on their impact on: Arrow's reputation and growth, Sam Dunnett's personal and professional interests, and financial returns. It is recommended that it is in the best interests of both the management and Arrow to seek a partnership and expand into the speciality services market.

(129 words)

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Situation Analysis

Management has been successfully running Arrow Printing and Publishing (Arrow) with healthy margins since the last 24 years despite being located in the economically depressed region of Burk's Falls, Northern Ontario. Management is re-evaluating its current stake in the company. Various options are being considered regarding Arrow's future including a stake sell off and securing government incentives in the form of capital infusion as a means of funding expansion plans. Apart from financial analysis, several other factors would need to be considered to determine the most suitable course of action. In order to understand the different options better, an analysis of the business and its environment is needed.

A major portion (80%) of the company's revenues is derived from repeated clientele which represents a profitable customer segment. New customers may not be as profitable. However, the growth of the company is dependent on conversion of first-time customers to repeated clientele. Arrow's aversion to price competition may be hampering new customer retention given new customers' sensitivity to prices.

In addition, new customers may not be from nearby areas, and may also be interested in associated products and speciality services such as personal stationery and four-color printing. However, at the moment, Arrow's business is primarily focussed in the Burk's Falls region. New customers may also be sceptical about using speciality services such as four-color printing at Arrow. Four-color printing has relatively high margins (~25%) and hence any strategic decision that improves Arrow's brand in the speciality services market may contribute to its long term growth.

Although there are no direct competitors, large franchises such as Kwik Kopy and FedEx Kinko pose challenges through their national marketing campaigns and through printing services such as “Do-it-yourselfers” and internet based product delivery. There also exists competition from in-home printing which primarily affects black and white print sales since four-color printing cannot be conducted from homes. Any step that expands Arrow’s business into four-color printing market may address threat from this competition. Technology improvements in the internet domain appear unlikely in the short term (3-5 years); internet-based printing thereby may not appeal to local customers and any regional company with local operations would find it difficult to provide such services.

Existing management policies have been such that Arrow has avoided any direct advertising and promotions that would impact business of other area printers. In addition, paid advertising has been closely linked with community development. These values could be adhered to mainly due to philosophy of the current management and their long term association with Arrow. Any decision that could bring about a change in management could potentially undermine some of these values.

The current management is also actively involved in politics, implying that the opportunity cost of forgoing this involvement, because of time devoted to Arrow, need to be considered in any future decision about Arrow.

As Arrow is a completely family run business, any change in management control could cause intangible concerns and problems. Management could consider selling to

a member of the family which may not give rise to any such issues. However, this may not contribute to envisioned growth and expansion plans of the company.

Problem Statement

What strategic decision should Arrow's current management take regarding the future of Arrow that would not only align with their personal and professional interests but also ensure Arrow's continued growth?

The Options

The following options are available for the management

- 1) Sell Arrow to Peter Dunnett
- 2) Seek an external buyer for Arrow, possibly one with a national brand and who is looking to expand geographically
- 3) Expand into the speciality services market i.e., four-color speciality web work by seeking partnership from an experienced salesperson. Current management would be interested in retaining a controlling stake of 51% in this case

Criteria for Evaluation

Considering that management has a very personal interest and a long term association with Arrow, criteria such as long term health of Arrow (as measured by its reputation and growth), and its impact on the personal and professional life of Sam Dunnett need to be considered along with financial returns. The following criteria were considered for evaluation of options:

- 1) Impact on Arrow's reputation and growth
- 2) Impact on Sam Dunnett's personal and professional life
- 3) Financial returns

Evaluation of Options

All options are being evaluated assuming that a decision to this effect will come into force at the beginning of 2004.

Sell Arrow to Peter Dunnett

Arrow's growth will be stalled at 2003 levels, as Peter will not be able to devote full time to Arrow because of his other professional interests. So while this decision may not impact Arrow's recognition because customers may perceive the company as still in the hands of Sam Dunnett, it may negatively impact its growth prospects. Considering that Dunnett family may have close emotional ties with Arrow, this decision will allow the Dunnetts to keep control of the company. Because this option also allows Sam Dunnett to actively pursue his political career, this has a positive impact on the personal and professional life of Sam Dunnett. Financial returns are the

weakest among the three options (Exhibit 1) as production output would drop because of Peter Dunnett's other commitments and because there is no additional source of revenue from other services like four-color speciality works.

Seek an external buyer for Arrow

Arrow may not experience growth, as its overall sales are unlikely to be affected. Assuming that the buyer has a national brand, the reputation of Arrow may actually improve in regions outside Burk's Falls. Reputation of Arrow within Burk's Falls would remain contingent on the active role played by current management. Overall, this option would have a slight positive impact on Arrow's reputation and growth. On the other hand, this option may have a neutral impact on the personal and professional life of Sam Dunnett. While Sam Dunnett can actively pursue his political interests, his exit from Arrow may have a negative emotional impact. Financial returns would be good (Exhibit 1), as cost synergies resulting through this acquisition would negate any additional expenses due to increased bad debts. Net Income can thereby be expected to increase significantly in the next five years.

Expand into the speciality services market by seeking partnership from an experienced salesperson

This option would create excellent growth options as it would allow Arrow to enter the high margin four-color specialities services market creating an additional revenue stream. In addition, Arrow's brand would reach new customer segments. Overall, this would have a positive impact on Arrow's reputation and growth. Because Sam would now have a challenging job, it would negate the opportunity cost of not full time pursuing his political career. While the Dunnetts would still retain majority control,

there could be disagreements on the values currently followed by Arrow, because of a new partner. Overall, this option may have a neutral impact on Sam Dunnett's personal and professional life. Financial returns are estimated to be the highest among all the three options (Exhibit 1) even after considering interest expenses on new liabilities, because of increased growth rate and additional revenue from speciality services.

Recommendation

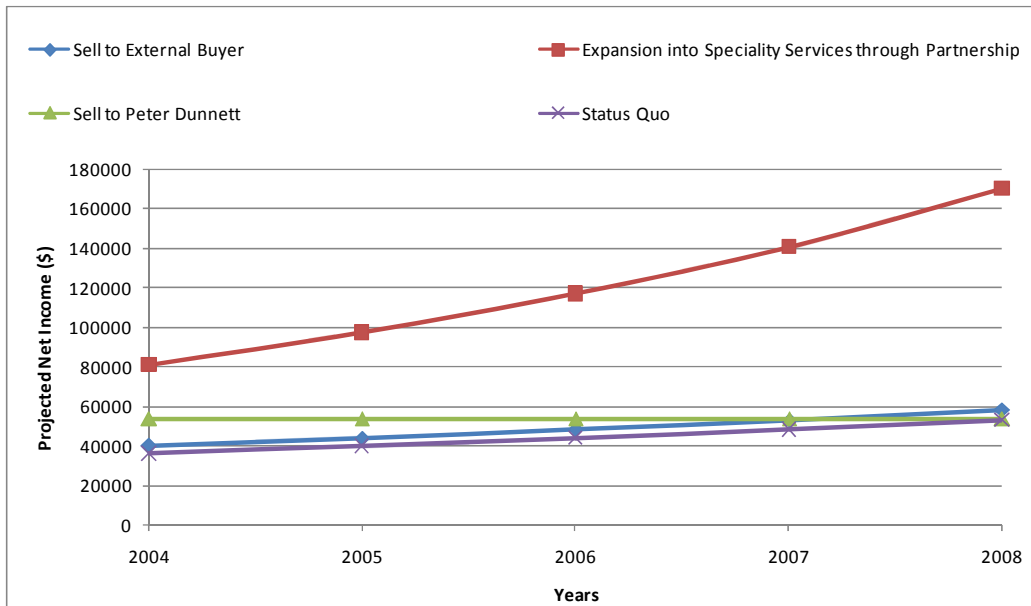
It is recommended that Arrow expand into four-color speciality services by seeking partnership from an experienced sales person to capitalize on the excellent growth opportunities and financial returns offered by this market.

Action Plan

- 1) Apply for funding through the Government of Ontario's Community Futures program to secure funding of \$500,000
- 2) Reach out to existing contacts in the printing industry to meet potential partners who could handle sales for speciality services
- 3) Negotiate the desired partnership agreement with interested parties (51% management control with the current management)
- 4) Purchase equipment and upgrade buildings for producing four-color works
- 5) Put in a place a road map for expanding sales into this market

(1296 words)

Exhibit 1 Financial Returns Comparison



This graph depicts the projected net incomes for the next 5 years for the three options that are being considered. The projections for the status quo have also been shown for reference.

Notes and Assumptions:

The analysis period is five years. The profit margin of 25% for the specialty web work is assumed to be the net profit margin. Net Present Value (NPV) analysis is redundant since each of the three options will be discounted in an identical way and the qualitative nature of the graph will not change.

A) Selling Arrow to Peter Dunnnett

- Assuming 2003 net income will be 10% higher than 2002 net income.
- Assuming the net margins of approx. 21.30% + 25.2% (salary expenses will be now profits) to be sustained for the next five years.

- Assuming that Peter Dunnett takes control at start of 2004 and will be able to run the company at 75% of its 2003 output with no growth.

Year	Net Income (\$)
2004	53,708
2005	53,708
2006	53,708
2007	53,708
2008	53,708

B) Selling Arrow to an external buyer

- Assuming 2003 net income will be 10% higher than 2002 net income.
- Assuming the net margins of approx. 23.5% to be sustained for the next five years (after taking into consideration the projected reduction in cost of production, increase in irrecoverable debts and advertisement expenses).
- Assuming that the new buyer will take control at start of 2004 and will be able to run the company at with the same annual growth rate of 10% for the next five years.

Year	Net Income (\$)
2004	39,809
2005	43,790
2006	48,169
2007	52,986
2008	58,284

C) Expanding into the speciality services market through partnership

- Assuming that the partnership will take control at start of 2004.
- Assuming 2003 net income will be 10% higher than 2002 net income.
- Assuming the net margins of approx. 21.30% to be sustained for the next five years.
- Assuming new activities to generate revenues worth \$200,000 in the first year followed by an annual growth rate of 25% (with net margins of 25%).

- Assuming that the old operations continue at a rate of 10% annual growth rate for the next five years including and beyond 2004.
- The principal repayment on debt of \$125,000 is not taken into account. The interest has been deducted at a rate of 4% per annum.

Year	Net Income (\$)
2004	81,082
2005	97,190
2006	116,784
2007	140,682
2008	169,898

D) Status Quo

- Assuming 2003 net income will be 10% higher than 2002 net income.
- Assuming the net margins of approx. 21.30% to be sustained for the next five years.

Year	Net Income (\$)
2004	36,082
2005	39,690
2006	43,659
2007	48,025
2008	52,828