THE DISTRIBUTION MODEL IN THE HEARTH INDUSTRY:
STRATEGIC ANALYSIS TO GAIN COMPETITIVE ADVANTAGE FOR
REGENCY FIREPLACE PRODUCTS

by

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ii
Abstract

This paper presents a strategic analysis of the distribution model in the hearth industry for Regency Fireplace Products (Regency). The paper researches the business environment for Regency in North America, determines its competitive position in the industry and develops strategies for competitive advantage and steady growth.

An industry analysis is conducted to determine the key success factors for incumbents that compete in the industry. Competitors are compared to explore the opportunities and threats for Regency’s distribution model within the highly competitive hearth industry. The strengths and weaknesses of Regency are analyzed, and the strategic position of Regency is presented to identify the strategic alternatives.

Several criteria are established to evaluate the strategic alternatives based on the environment; management preferences, organization and resources. An alternative assessment and internal analysis are conducted to determine the strategy for Regency. In closing, a final recommendation and action plan is outlined for Regency taking into consideration the organizations change management culture.

The final recommendation for Regency is for them to develop a franchise of retail hearth stores across North America. This strategic alternative will exploit the core competencies of Regency and allow them to maintain their differentiation strategy and gain competitive advantage in the hearth industry.

Keywords: Hearth Industry; Distribution; Forward Integration
Dedication

This project is dedicated to all my family, friends and colleagues who supported me throughout my EMBA studies. Most importantly, a special dedication goes to my wife and two boys for their patience, love and encouragement.
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1: INTRODUCTION

This introductory chapter outlines the purpose and scope of this project and provides an overview of the hearth industry. The focus firm, Regency Fireplace Products (Regency) will be introduced along with its current business strategies in North America.

1.1 Purpose and Scope

The purpose of this paper is to analyze the distribution systems within the hearth industry. Regency will be studied to develop strategic alternatives to current strategy problems at the distribution and retail level of their value chain.

The problem stems from Regency having insufficient control over the complete selling process of their products in the North American market. This analysis will outline an understanding of the current distribution systems and explain how they currently portray a high level of imitation in the industry. Moreover, the following analysis will develop an understanding of the necessities, complexities and limitations with these systems. The analysis continues to explore further opportunities as a need for change to gain competitive advantage within the hearth industry.

These opportunities in the form of strategic alternatives will look at “vertical integration” models in the retail sector. It is important to note that Regency’s performance at the distribution and retail level remains steady; however market indications show that their strategy is strained and due for change of an anticipatory nature (Crossan et al., 2009).
This strategic analysis will look into existing and future cost models and identify where improvements and unnecessary infrastructure and support can be removed from the value chain. In making these vertical integration opportunities reality, the organizational structure of Regency will be analyzed in terms of feasibility of achieving the strategic alternative(s) outlined. The analysis will be conducted to include the high end hearth product segment including wood, gas and pellet products. These primary products complement each other at the retail level and bring a component of product line for consumer choice. Although differing consumer motivations to purchase these products exist, the majority of retail stores offer a variety of these product segments on their showroom floors.

1.2 The Hearth Industry

The Hearth Industry generates U.S. $1.6 billion per year in revenue. Combine these sales with installations and this industry represents a U.S. $5 billion annual value. In the U.S., nearly 1 million wood, gas and pellet hearth appliances were shipped in 2010; of those, over 650,000 were gas-fueled models. In Canada, nearly 150,000 hearth products were shipped in 2010. (HPBA, 2011)

Figure 1.0 below shows the U.S. hearth industry appliance shipments from 1998 through 2011 (HPBA, 2011). Figure 1.1 below shows the Canadian hearth industry appliance shipments from 1999 through 2011 (HPBA, 2011).
Figure 1.0: U.S. Hearth Industry Appliance Shipments

![U.S. Hearth Industry Appliance Shipments 1998--2011](image1)

Figure 1.1: Canadian Hearth Industry Appliance Shipments

![Canadian Hearth Industry Appliance Shipments 1999--2011](image2)
The hearth industry has matured over two decades of healthy growth. Over this time, the industry has experienced cyclical ups and downs. However in 2006, the industry in North America suffered a substantial downturn. Concurrently, a market saturated with inventory, a heat wave that swept across the nation (Wikipedia, 2012) and a slowdown in job growth, economic opportunity and residential housing starts (Weller, 2006) all contributed to this downturn. Recovery within the hearth industry was delayed with the onset of The Great Recession of 2008-2009. During this period, the industry experienced mergers and acquisitions, company re-structuring and bankruptcies. The majority of the key players in the industry continued with R&D and product development so as to position themselves for the economic recovery. Now, heading into 2012, the industry has stabilized and strategies are aimed at lower inventories and “close to market” responsiveness.

The hearth industry as a whole is heavily dependent on energy prices, consumer confidence and seasonal weather trends. When energy prices are high, the weather is cold and consumers feel they have expendable money to spend on their homes, the industry and its incumbents prosper. **Figure 1.2** shows the effects of the industry and economic downturns on Regency’s production output.
Most North American homeowners have some understanding of what a fireplace is and typically associate it with heat, comfort and enjoyment of the flame. But, there are many other attributes related to a fireplace product. In fact the fireplace industry or the hearth industry as it is called is complex and loaded with consumer choice. There still exists a lack of knowledge amongst consumers regarding the application and benefits of a hearth product. Fireplaces, as they are most commonly called, come in many flavors of design, function, application, fuel type, use and price.

The most notable beginnings of the hearth industry date back to the 1950’s through the 1960’s with the introduction of zero clearance open masonry wood fireplaces. After the 1967 Oil Embargo and the subsequent 1973 Oil Crisis (Horton, n.d), wood burning heating products became a viable product for residential homeowners and hence a market was opened. In the 1970’s, the introduction of wood stoves took hold and without government and environmental regulations to contend with, many entrants came
into the market. By 1988, the Environmental Protection Agency (EPA) had implemented regulations that govern the manufacture and sale of wood burning stoves and wood burning fireplace inserts. The stringent regulations and high costs of testing and compliance forced many manufacturers to exit. These existing incumbents were not structured, prepared or possessed the sufficient resources to stay in this newly regulated, yet evolving market.

About the same time, gas fireplace products were gaining growth in a market where the homeowner preferred a cleaner and convenient method of heating their space without the mess and work of a wood stove. In the 1970s and 1980s, a number of gas shortages and price irregularities indicated that a regulated market was not best for consumers or the natural gas industry. Into the 1980s and early 1990s, the natural gas industry gradually moved toward less regulation, allowing for healthy competition and market-based prices. These moves led to a strengthening of the natural gas market, lowering prices for consumers and allowing for a great deal more natural gas to be discovered (Natural Gas, 2010).

As natural gas and propane gas became more available and cost effective for residential use, the gas fireplace market started to show substantial growth. Again, regulations regarding safety (gas connections, temperatures, clearances) and efficiencies made entry costs high for new manufacturers. Most of the firms that withstood the EPA regulations and developed certified wood burning products were now developing gas burning heating products. Through the 1990’s, gas fireplaces, stoves and inserts started to become a larger percentage of revenue for hearth product manufacturers with the typical trends of 70-80% of the industry shipments being gas products.
The hearth industry has grown over the last 30 years and has become heavily fragmented and competitive. There are standard high volume, “spec” home manufacturers, low volume specialty manufacturers and niche application manufacturers. However, a large percentage of the incumbents in the industry are diverse and have the expertise to be a threat, if they are not already, in any of these segments. The industry incumbents manufacture and sell products throughout North America and other specific regions of the world. Regional areas within North America offer differing product categories and hence competition among incumbents tends to be regional. Product offerings are vast and structured around product lines and branding. Products compete with each other on a basis of esthetics, design, function, size, application, price and geographic area. Some products compete across their own product lines while others are developed to complement a line.

Although firms within the industry may operate with different business strategies, their supply chain models have evolved to share many similarities at the industry level. In looking at the front end of the supply chain, the majority of the major players within the industry operate with common raw material suppliers and sources. However, at the back end of the supply chain, incumbents distribute and sell their products through varying channels. Some smaller firms choose to sell their “low end” products through large nationwide stores such as Home Depot or Lowes to take advantage of scale, but at a cost of margin. Some firms develop contracts with local home builders and supply into the new housing market resulting in potentially higher volume business but yielding low margins. Other firms, one of such being Regency Fireplace Products, design, manufacture, market and distribute their products into specialty dealers such as hearth,
patio, barbeque and spa stores. Consumers coming into these stores are looking to upgrade, renovate, custom build a home or increase the number fireplaces in their home. The products going into specialty dealers and sold through to the consumer generate a greater willingness to pay over big box store products due to the additional value obtained from choice, functionality and superior design.

The largest players in the industry have a developed a wide range of diversification and manufacture products for more than one segment. These firms can benefit from scale and scope economies but are also exposed to specific downturns in economic conditions, specifically if a greater percentage of their business lies in any one affected segment (for example; supplying into the new home market and the 2008 housing crisis in the U.S.). The high end segment of the hearth industry is built on high quality and reliable products, progressive product development, efficient and focused distribution and substantial spend in marketing and customer support to obtain and retain the dealer networks. As a successful firm in this high end segment of the hearth industry, Regency competes with many incumbents at varying degrees with respect to product offering, install application, regional consumer preferences and distribution strategies.

1.3 Regency Fireplace Products Overview

Regency Fireplace Products (Regency) began in 1979 in Richmond, B.C., Canada, with the founder, one employee and $10,000 in capital. Then, the company was called Triumph Manufacturing and manufactured wood stoves under the Triumph name, which were sold in Western Canada and the Western United States. Although the founder was a late entrant into the industry, he came in at the right time. The wood stove
industry boomed in the early 1980's and the company prospered. In 1984, the founder changed the company name to Regency Industries and started the process of developing the Regency® product line. In 1988 the wood stove industry changed dramatically with the United States EPA legislation of smoke emission limits for wood stoves. An estimated 90% of manufacturers closed their doors, but Regency’s technical expertise enabled the company to exceed the EPA standards and remain profitable.

In the late 1980's Regency was also quick to recognize the shift in consumer attitudes and the growing demand for gas fireplaces. In the 1990’s the company embarked on a number of strategic changes to deal with the growing demand. First, the company diversified into the manufacturing of gas fireplaces. Second, the company began to hire professional managers from larger organizations outside the hearth products industry. By 1993, new managers were running Operations, Sales, Marketing, Research & Development and Finance. These managers came from a variety of fields such as the aircraft industry, office products, and advertising and brought a diversity of knowledge and talent.

Recognizing that lack of dedicated distribution focus with Regency’s growing product lines the company made a strategic change to own and operate a regional based distribution center network. Prior to that strategic decision, third party distribution was being used through-out the industry and the needed focus and technical training required to maximize product distribution into the retail sector was lacking. In 1995, Regency started this expansion and created their first regional branch of sales, service and warehouse in London, Ontario. The year of 1996 was the start of a high growth period and many changes. The company changed its name from Regency to FPI Fireplace
Products International Ltd. (FPI) to signal a growing international presence. The second big change in 1996 was FPI’s move into its present head office building in Delta, BC. This state of the art 140,000 square foot building was custom built to house our manufacturing plant and research facility. This facility has grown to where it is presently at 200,000 square feet. In March 1996 the first US regional facility in Edgewood, Maryland was opened. Following this, a second regional facility was opened in June 1996 in Sacramento, California. In March 1998, a third branch outside Chicago was opened. In January 1999, a long time sales agent in the state of Oregon became a full branch of FPI, covering the Pacific Northwest out of Portland. In 2004, a facility in Newington, New Hampshire was opened and in January 2006, Regency opened its first branch outside of North America in Melbourne, Australia. All of these facilities provide customers in each region with product distribution and technical, marketing and sales support.

Also in 2006, Regency developed a joint venture in Shanghai, China for R&D and production of wood stove products for the Australian market. Wood stove products in Australia are approved under the Environmental Protection Agency (EPA) as exempt, as opposed to the stricter North America regulations. These products serve a different market in Australia and sell at lower price points. The resulting simplicity of design allowed Regency to off-shore these products to yield lower costs in R&D, manufacture and freight.

In addition to the North American and Eastern Australian markets, Regency also exports products to Asia, New Zealand, West Australia, Latin America and Europe. Today, again known as Regency Fireplace Products (to re-gain brand awareness), the
largest market is in the USA, where products are sold through a strong network of distribution channels and specialty retailers. Out of Regency’s fifteen hundred specialty retailers in North America, 90% are multi-competitor (MC) and 10% are Regency only product by choice. It is important to note that Regency does not wholly own any part of its dealer network.

Regency has grown as a key player in the high end hearth market with sales revenue of between CDN $55 million and $70 million over the last four years. Market share in Canada and the U.S. is maintaining a marginal, yet steady growth *(see Table 1.0)*. Regency manufactured, distributed and sold approximately 40,000 units in 2011.

Regency’s employees comprise of 90 staff at head office and 70 throughout our distribution/sales branches and the company employs, on average, 200 unionized factory workers in a seasonal and cyclical environment. Because of seasonality, Regency manufacturing does experience regular layoffs. The unionized workforce typically ranges from 240 employees at peak to 160 employees at slow periods.

Regency’s success is based on a blend of technical expertise, design aesthetics, outstanding product quality, well established distribution channels and excellent customer service. They actively seek customers’ input into their product design and their quality products depend on the crucial role that customers and suppliers play in new product development process.
Table 1.0: Market Share for Regency Fireplace Products (as of Q3, 2011)

<table>
<thead>
<tr>
<th></th>
<th>USA Units</th>
<th>CDN Units</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Market Share</td>
<td>Market Share</td>
</tr>
<tr>
<td><strong>GAS PRODUCT</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stoves (B Vent &amp; DV) - Steel</td>
<td>20.7%</td>
<td>18.0%</td>
</tr>
<tr>
<td>Stoves (DV) - Cast</td>
<td>7.2%</td>
<td>6.6%</td>
</tr>
<tr>
<td>Inserts (B Vent &amp; DV)</td>
<td>10.6%</td>
<td>10.0%</td>
</tr>
<tr>
<td>Fireplaces - DV</td>
<td>2.4%</td>
<td>2.3%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>3.9%</td>
<td>3.6%</td>
</tr>
<tr>
<td><strong>WOOD PRODUCT</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Freestanding Stoves - Steel</td>
<td>4.1%</td>
<td>3.7%</td>
</tr>
<tr>
<td>Freestanding Stoves - Cast</td>
<td>2.6%</td>
<td>1.9%</td>
</tr>
<tr>
<td>Inserts (Non Cat)</td>
<td>14.1%</td>
<td>13.8%</td>
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<tr>
<td>EPA Phase II</td>
<td>2.3%</td>
<td>2.8%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>6.5%</td>
<td>5.7%</td>
</tr>
<tr>
<td><strong>PELLET PRODUCT</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stoves</td>
<td>1.1%</td>
<td>0.9%</td>
</tr>
<tr>
<td>Inserts</td>
<td>3.1%</td>
<td>1.3%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1.5%</td>
<td>1.0%</td>
</tr>
<tr>
<td><strong>OVERALL TOTAL</strong></td>
<td>4.3%</td>
<td>4.0%</td>
</tr>
</tbody>
</table>

(Source: HPBA: Hearth, Patio, Barbeque Association 2011 3rd Quarter Industry Results. Results tabulated from sales data participation from 24 hearth industry manufacturers)

1.3.1 The Regency Strategy

Regency’s current differentiation strategy has been long standing and consistent over their 32 years in business. As an industry leader, Regency has held a respected position as a high end hearth supplier that focuses primarily on the custom renovation market. Regency’s competitive advantage with its MC dealer network is the capability and attention given to superior customer service. Regency’s service in terms of dealer
support, through their specialized sales force, is recognized as the best in the industry and allows them to enhance their exposure at the dealer level.

As a major player in the hearth industry, Regency continues to be financially successful with a low to mid range production volume and a high margin business model in comparison to its key competitors. Some competitors in the same market and dealer network have more of a cost-based strategy based on attractive product discounts and payment terms to the dealer because they don’t have the same capability to provide the service levels of Regency. This competitor strategy lends itself to a higher volume yet a lower margin business model. This is not how Regency wants to compete.

The Regency strategy is based on the lowest volume, highest quality product with the best customer service for the highest margin. As the industry incumbents operate between a differentiation and cost based strategy, Regency remains loyal to their differentiation strategy through their exceptional product quality and customer service. This customer service consists of sales training and support, technical training and support and technical after-sale service. As well, Regency’s consistent presence at fairs and home shows facilitates bringing consumers to dealers through customer education. However, once the consumer is in the MC dealer showroom, the dealer may sell them a competitive product.

The following Table 1.1, Ed Bukszár’s Strategic Grid Fit, works to look for the consistency between capabilities and strategy and to identify potential problems related to implementing a strategy.
As is seen from the strategic fit grid, Regency favors a differentiation strategy. However, a low risk profile and lack of innovation with product development has hampered Regency’s ability to fully exploit this differentiation strategy. By the nature of the industry, innovation equals higher risk. Regency has not wanted to risk the cost of innovation and has held steady, specifically over the last several years of economic uncertainty, with a lower risk profile in order to protect the financial position and profitability of the company.
The position of being a close follower in new product development is arguably a potential weakness for Regency from the point of view of overall product sell through. Moreover, when an incumbent is a first mover in launching a new product to market, they become price setters within what the market will bear. As a close follower, Regency now has to face the challenge of keeping within a reasonable reach of this market price and/or justifying its higher price model. However, selling the high quality benefits of a Regency product for this higher price is sometimes not the first priority of the MC dealer. The question is; does Regency develop products for the dealer or the homeowner? The answer is the homeowner, and Regency relies on the MC dealer to justify the benefits of its products to the homeowner.

As competitors continue to develop a diverse scope of trendy and innovative products, the question remains; do these competitors capture their return on investment or are these trendy products just a means to sell their mainstream products? In fact, hearth industry dealers are partial to innovative product in their showrooms for this very reason.

Regency’s strengths exist in economies of scope with their production process and service. Regency’s production process consistently produces industry leading product quality and their customer service is the benchmark of the industry. The unique mix of being a privately held, conservative and equity based organization with a low risk profile has allowed Regency to remain in a financially healthy position through the last decade of industry and economic ups and downs.

These strengths are the reason Regency has remained a presence in the high end hearth market. Regency’s founder and executive continue to hold true to this long standing strategy and reputation in the hearth market. However, competitors are focusing
on higher volume sell through the dealer network by means of cost-based strategies yielding lower margins. These cost-based strategies are undermining what Regency is all about and without the superior sales and marketing presence at the dealer level, Regency would lose market share.

As the market and its incumbents have evolved, Regency, recognizing the changing environment, needs to look at their own strategy from an anticipatory change (Crossan et al, 2009) point of view. Regency’s financial performance and profitability remains stable; however growth targets, although higher than inflation, have been slowing in comparison to previous years. This slowing trend should be a red flag of concern for Regency to look at going forward.

1.3.2 The Regency Structure

Regency has a hybrid structure of a professional bureaucracy in a divisionalized form (Wexler, 2011). This is shown in how their sales and distribution branches are structured and positioned amongst their corporate office and manufacturing operations. Regency is a highly specialized organization with a fairly high level of autonomy in a decentralized environment.

As most corporate decisions are made at head office, the sales and distribution branches maintain independent operations with autonomy to manage their branches as required to meet corporate objectives. Each sales and distribution location maintains its own resources of technical service/training and sales force. These regional resources service and support their respective dealer networks with marketing, training, events, home shows, sales incentives and industry leading product availability.
1.3.3 Problems with the Current Regency Strategy

Regency’s success over their 32 years in business has been through a differentiation strategy. The company is structured around and is committed to this strategy going forward. However, the primary problem existing with Regency’s current strategy is in not having a focused and controlling share of the complete selling process from the source of supply, whether it be Regency’s distribution branches and/or manufacturing facility. Regency does not control the selling process or the final sale influence of their products; the dealer does. Within Regency’s network of fifteen hundred specialty dealers, 90% of them have a multi-competitor showroom. The other 10% are “Regency only dealers”, meaning these dealers own/lease their own store and choose to sell only Regency products. Regency does not wholly own any part of the current dealer network.

A multi-competitor showroom consists of 3 or more competitive product lines. This multi-competitor environment is hampering Regency’s ability to sell its products based on a differentiation strategy because of the lack of cost-benefit knowledge given to the consumer from the dealer. The consumer at this point looks at hearth products as commodities and the dealer sells on price if the consumer doesn’t understand value.

This is where Regency’s differentiation strategy does not work so well. The problem is the lack of [MC] dealer commitment specifically with Regency product; the MC dealer wins if they sell any product. Moreover, Regency does not have a dedicated presence on the showroom floor and therefore the customer lacks necessary information. The MC dealer has the edge over Regency.
As Regency’s product is priced at the higher end, MC dealers may in fact play the Regency product off against a competitor’s lower cost product. The MC dealer environment tends to function on a cost-based strategy as a whole and this in itself creates problems due to the high fixed costs associated with a differentiation strategy. Some competitors will conform to this environment opting for higher volume product sales at lower quality levels, deeper price discounts, larger spiffs and looser payment terms. As the industry operates with similar high fixed costs, this structure yields lower margins.

Regency makes great efforts to avoid this low margin structure through its differentiation of high quality products, superior customer service and a strong presence at dealer fairs and home shows. Moreover, this cost-based industry strategy at the MC dealer level hand-cuffs Regency’s growth and margin targets in order for them to remain profitable.

With an understanding of the dangers of a cost-based strategy, Regency strives to differentiate other components of their business model, whether through lean manufacturing systems, continuous product development, aggressive marketing programs and superior before and after sale service. This is all in their objective to maintain a competitive advantage and build the Regency brand, protect reputation capital and gain market share.

Most competitors search for differentiation within product design and strive to build brand awareness and exposure. However, this is a limited objective due to the consumer’s conservative preference on design esthetics and a below average knowledge base regarding hearth products. Most consumers have minimal experience with hearth
products and the complexities of applications and installations. A consumer generally can be influenced to purchase what the retail dealer suggests.

Retail pricing is generally comparable across all competitors’ products. However, Regency positions itself at the mid to upper range. When an incumbent acts as a first mover of differentiation in product design or functionality, competitors are quick to follow and imitate as close followers, including Regency. The result is many similar products on the market.

The main rivalry is on the dealer’s showroom floor due to the multi-competitor environment. Showroom space is limited and the dealers’ influence on the consumer is substantial. Dealers apply a lot of pressure on manufacturers for attractive price structures, discounts and marketing promotions. MC dealers in the hearth industry will leverage or withhold relevant consumer information as a competitive edge in dealing with manufacturers. These dynamics put strain on the differentiation strategy of Regency and allows substantial control of the selling process in the hands of the dealer.

MC dealers will sell the product that creates the most profit for them. The competitive battle and high cost to obtain a space in a dealer’s showroom does not mean that the dealer will sell your product. Moreover, dealers may use the cost of the high end product to sell the lower end choices when a customer is unsure or a needed sale is required. In the MC dealer environment, Regency only experiences, on average, 30% of a typical dealer’s sell through. Yet, Regency outlays 100% of support, product training and market materials to these respective dealers. This is a typical scenario across the industry and creates a vicious cycle of competition among the incumbents.
Regency’s current strategy suffers from a cost-benefit problem. The high end hearth industry has currently reached a level where Regency is being pressured to operate in the direction of a cost-based strategy. Moreover, Regency’s differentiation factors are not being effectively passed on from the dealers to the homeowner. This is only offset by the extensive effort of Regency’s sales force obtaining and retaining new accounts and maintaining a high presence at regional fairs, home shows and events to ensure a Regency product will be sold. These efforts are the driving factor behind dealers selling Regency product. The competition takes another approach through substantial product discounts and less sales force presence, support and training.

Regency understands in order to position itself for continued growth in the high end hearth industry a change is required to address the current problems with its MC dealer model. This change is that of an anticipatory nature, as Regency’s performance has not seen a significant decline but yet their growth is seeing signs of slowing.

Over the last several years, in light of the 2008 U.S. recession, the hearth industry has seen an overall decline in product shipments. However, understanding this current environment and having the ability to adjust business structure and take advantage of associated opportunities will allow Regency to better position itself so as to gain a competitive advantage over its rivals.

1.4 Chapter Summary

This paper consists of four main chapters: an introduction in chapter one; the industry analysis in chapter two; an implementation/internal analysis in chapter three; and the recommendations in chapter four.
The introduction in chapter one provided an outline of the scope and purpose of the project, an overview of the hearth industry, the focus firm, Regency Fireplace Products, and their current strategy and structure. As well, the problems with Regency’s current strategy were presented.

Chapter Two will address the external environmental factors that Regency does business in and identify the key success factors (KSFs) required to be competitive in the hearth industry. A competitive analysis is provided to compare Regency against key competitors based on the KSFs to determine where the threats and opportunities arise. From this, strategic alternatives are developed for Regency to successfully compete in the hearth industry.

Chapter Three will examine Regency’s internal capabilities, and identifies gaps in resources and capabilities for implementation of the proposed strategic alternatives. The “Diamond-E Framework” is used to evaluate the strategic alternatives based on the environment, resource requirements, management preferences and organizational capabilities (Crossan et al, 2009).

Chapter Four will outline the final recommendations based on the evaluations of the strategic alternatives to determine the strategic choice that best fits Regency and satisfies management decision criteria. In closing, these final recommendations will also be used for conducting a timeline for implementation.
2:  INDUSTRY ANALYSIS

The following chapter will bring a thorough understanding to the external environment that Regency does business in. In any industry, an incumbent’s success is determined by their sources of competitive advantage. To further this analysis, these sources of advantage or key success factors (KSFs) will be identified through an industry assessment using Porter’s 5 Forces analysis (Crossan et al, 2009). In looking at Regency’s direct competitors, a competitive analysis will be used to determine opportunities and threats to the KSFs identified. By understanding these opportunities and threats, we can develop competitive strategic alternatives in order to improve the performance of Regency.

2.1  Porter’s 5 Forces Analysis of the Industry

Porter's 5 Forces analysis is a tool used in industry analysis that deals with factors outside an industry (macro environment) that influence the nature of competition within it and the forces inside the industry (micro environment) that influence the way in which firms compete. A business has to understand the dynamics of its industry and markets in order to compete effectively in the marketplace. This analysis tool comprises the forces driving competition and the resulting interaction of these forces acting on a business.

In addition to rivalry among existing firms and the threat of new entrants into the market, there are also the forces of supplier power, buyer power, and the threat of substitute products or services. Rivalry is often influenced by the competitive elements
from the other forces which explain the arrows from those elements to rivalry (see Figure 2.0). Porter’s 5 Forces analysis suggests that the intensity of competition is determined by the relative strengths of these forces. These “forces” contribute to a firm’s profitability and success within the industry they do business.

In applying Porter’s 5 Forces to the hearth industry, Figure 2.0 shows the relevant variables within the industry that can increase or decrease (threats or opportunities) these forces. For each variable, the notation (+) is used if the force increases because of this variable, and (-) is used if the force decreases because of this variable.

**Figure 2.0: Porter’s 5 Forces with the Relevant Variables in the Hearth Industry**

**Barriers to Entry = HIGH**
- Current styling/trend setting designs (+)
- (brand awareness)
- Dealer loyalty (+)
- Government regulations (+)
- Scale and scope of dealer network (+)
- Sales training/support (+)
- Technical training/support (+)
- Benchmarking capabilities (+)
- High fixed costs (+)

**Rivalry Among Competitors = HIGH**
- Large number of competitors (+)
- Industry growth slowing (+)
- High fixed costs (+)
- High exit barriers (+)
- Product and service differentiation (-)
- Brand awareness (-)
- Fragmented (+)

**Suppliers = HIGH**
- Concentrated key inputs (+)
- Increased input costs (+)
- Custom components (+)
- Reliability and quality of supply (+)
- Switching cost for incumbents (+)
- Substitute inputs (-)
- Sourcing off-shore (-)
- Volume driven (+)

**Power of Suppliers = HIGH**
- Concentrated key inputs (+)
- Increased input costs (+)
- Custom components (+)
- Reliability and quality of supply (+)
- Switching cost for incumbents (+)
- Substitute inputs (-)
- Sourcing off-shore (-)
- Volume driven (+)

**Power of Suppliers (Dealer) = HIGH**
- Fragmented (-)
- High switching costs (-)
- Low consumer information (+)
- Multi-competitor dealers (+)
- Price sensitivity (+)
- Incumbent presence at dealer (-)
- Incumbents exploring forward integration (-)

**Availability of Substitutes = LOW**
- Green technologies (+)
- High energy prices (-)

**Power of Buyers (Homeowner) = LOW**
- High switching costs (-)
- High consumer information (-)
- Price sensitivity (+)
- Low substitutes (-)
- Consumer education (-)
2.2 Threat of Entry (LOW)

Threat of new entrants refers to the threat new competitors pose to existing competitors in an industry. A profitable industry will attract more competitors looking to achieve profits. When it is easy for these new entrants to enter the market (low entry barriers), this poses a threat to the firms already competing in that market.

Progressive and high investment in R&D and product development is a KSF in keeping the threat of entry low. In order to keep with changing consumer tastes, new product development is at the heart of the industry and firms will invest heavily into R&D and new product launch initiatives. If any incumbent slows down in this process, they will quickly lose dealer support, sales and market share.

Increasing technology, government/environmental regulations and stiffer testing and approval requirements can lengthen the time and add additional challenges and cost getting a new product to market. Successful incumbents, such as Regency, have the necessary [engineering and R&D] resources and expertise to overcome these hurdles. Moreover, the learning curve with testing and approval requirements is steep and requires a long standing commitment among incumbents. As a major step in the R&D process, a new entrant will find these hearth industry regulations and product testing approvals challenging and possibly discouraging barriers, thus creating a low threat for potential entry into the hearth industry.

As consumer tastes and trends change, incumbents must stay abreast of these changes and quickly respond to market needs. Environmental scanning is a KSF in understanding industry and consumer trends so as to reduce the power of new entrants.
Without it incumbents will slowly lose contact with the changing market and leave themselves vulnerable. Regency continues to invest progressively in product development through a unique mix of competitive analysis, benchmarking and voice of the customer. However, Regency’s low risk profile keeps them as a close follower in product design as opposed to the uncertainty of innovation acceptance in the market.

The hearth industry is built on loyalty with a large scale dealer network, relying on the reputational capital of manufacturers. A well established dealer network structured on scale and scope is a KSF in reducing the power of new entrants. New incumbents can take years to develop and/or penetrate this network. Moreover, the demands and requirements needed by manufacturers to secure and sustain dealers are high and require a vast scope of sales coverage across North America. The more dealers in a manufacturer’s network, the more potential for sales.

Other barriers of entry within the industry exist with large, high efficient manufacturing facilities that achieve economies of scale. Regency experiences these scale economies by sharing resources and lowering average costs by producing a larger depth and breadth of product under one roof.

Any new incumbent into the hearth industry will discover that developing brand identity is a barrier to entry. Among the dealer network, brand carries reputational capital, and reputational capital can take years and high investment to obtain. Over its 32 years in business the Regency name is well established in the hearth industry.

Through R&D and product development, manufacturers will submit patents for technology and design. These patents can be a hurdle for existing competitors and pose as a barrier for new entrants.
2.3 Threat of Substitutes (LOW)

A substitute is the availability of a product that the consumer can purchase instead of the industry’s product. A substitute product is a product from another industry that offers similar benefits to the consumer as the product produced by the firms within the industry.

The hearth industry for the most part deems substitutes as a low threat. The industry is still considered to be of high growth potential and there are still many North Americans heating their homes with electricity or oil. In the U.S., 8.1 million households are still heating their homes with heating oil (Green 3D Home, 2012). These homes are slowly being converted over to wood or gas heat as oil has become a costly solution for home heating.

Of course, new technologies in such areas as solar power/heating are emerging and something to keep an eye on. The industry is wise to stay abreast with emerging energy technologies and applications. Although it is true that green technologies may pose a threat in years to come, there still remains a large market for hearth products, not just as home heating products, but as focal areas for upgrading home comfort and décor. The closer incumbents can be to the consumer the better idea they will have of changing lifestyles, home design and personal needs.
2.4 Bargaining Power of Suppliers (HIGH)

Supplier power refers to the pressure suppliers can exert on businesses by raising prices, lowering quality, or reducing availability of their products or service. Suppliers can be defined as vendors, labor force or manufacturer supplying to retail.

Suppliers of the key inputs in the hearth industry are for the most part concentrated and the majority of the hearth industry incumbents share these inputs. This creates consolidated volume for the suppliers and keeps pricing on a relatively level playing field for all incumbents. Overall, competitors in the hearth industry experience similar price increases from key input suppliers. These higher input prices squeeze the manufacturers in their goal to maintain competitive selling prices.

In an effort to be competitive in the hearth market and stay within the willingness to pay range, effective pricing structures at the retail level are crucial. Off-shoring has become a KSF to reduce the bargaining power of suppliers while removing costs from the manufacturer’s product. First movers into the market with new innovative product have the ability to set their retail price to what the market will bear. Close followers in launching similar products are pressured to keep within this range. As input costs can have a substantial impact to the retail price of a hearth product, incumbents will look to off-shore supply and/or build proactive supplier partnerships.

However, off-shoring comes with its own dangers of inconsistent quality, high stocking inventories and delivery/lead time uncertainties. Proactive supplier relationships and price negotiation expertise with these off-shore suppliers are KSFs for manufacturers.
to be successful in the hearth industry and for keeping the bargaining power of on-shore suppliers low.

Incumbents with unionized labor forces may experience higher power labor. The hearth industry contains incumbents with both unionized labor and non-unionized labor. Being unionized and experiencing higher input costs than some competitors is one of the reasons Regency maintains its high margin business model and structures its product offering and pricing the way it does.

2.5 Bargaining Power of Buyers

Buyer bargaining power refers to the pressure consumers can exert on businesses to get them to provide higher quality products, better customer service, and lower prices. When analyzing the bargaining power of buyers, the industry analysis is being conducted from the perspective of the seller (the dealer) and the consumer (the homeowner).

2.5.1 Bargaining Power of Dealers (HIGH)

The MC dealer’s showroom floor will present several competitors’ products. Each product covers a specific design, segment, application, need and size. The more diverse a manufacturer’s product lines are, the more there is an opportunity to “take” dealer showroom space. Showroom space is a KSF in the hearth industry and the competition to achieve it can be fierce. The more showroom space a manufacturer has the less power the dealer has against them. Showroom space is obtained by finding an opportunity to improve a dealer’s business, whether it is a new dealer or an existing MC dealer. Moreover, obtaining showroom space from a MC dealer increases the ability of
the incumbent to push out competition, gain exposure and maintain better control of pricing, thus reducing the force of the dealer.

The power of the dealers is high and in order to obtain greater showroom space and capture greater dealer commitment, superior marketing support and customer service including sales and technical training and support are required. These are all KSFs in reducing the effects of the dealer’s power.

Proactive and innovative R&D is a high rated KSF in reducing the bargaining power of the dealer. While some incumbents, including Regency, have ventured into single brand partnerships with dealers, most still distribute the majority of their products through-out North America via multi-competitor dealerships. Dealers within the industry pose influence on the manufacturers in new product design, functionality, esthetics and price. Moreover, if dealers are disgruntled for any reason with the manufacturer, they may choose not to sell that product. As such, poor product quality and/or availability can have a negative effect on a dealer deciding to sell a certain product or brand.

Product quality/reliability is also a high rated KSF in lowering the power of dealers. If a certain manufacturer’s products, in the eye of the dealer, are quality built and reliable (keeping warranty and service costs low), allow for a quick and easy install, and are priced within the consumer’s willingness to pay, the dealer will sell that product. However, if a dealer does not explain or “sell” the benefits of a certain product for a given higher price, and only allows the consumer to focus on price, the higher priced, higher quality products will be overlooked.

Dealers prefer not to stock inventory and the peak sales of products are experienced in a short seasonal window. If a manufacturer struggles keeping up with
demand and/or has longer than dealer expected lead times, the dealer will sell a competitor’s product which is in stock. The dealer needs to make the sale, yet they do not want to stock the inventory. Just in Time (JIT) delivery from the manufacturer is what is required. This dynamic creates product availability as a KSF in reducing the bargaining power of the dealer.

Effective pricing structure set by the manufacturers is a KSF in lowering the power of the dealer. The profit the dealer makes is not just built into the final sale of the product, but rather the complete transaction; selling, freight, install, service and warranty. Some manufacturers submit a tiered retail pricing structure to the dealer and various marketing programs will supplement this. Other manufacturers will heavily discount their products to the dealer at the expense of service and support.

Multi-competitor hearth dealers can have a substantial influence on the final purchase decision of the un-informed consumer. The KSFs of environmental scanning and marketing support can help a manufacturer reduce this power. The more the manufacturer can get close to the consumer and understand their needs the greater the chance of the consumer asking for a specific brand. This can be done through developing a presence at the dealer level (fairs, home shows, etc.) and driving consumers into showrooms. As well, it is important for manufacturers to drive consumers to their respective website(s) to facilitate education and brand awareness before they enter a MC dealer showroom.

Another KSF in lowering the power of the MC dealer is forward integration. As manufacturers move further up the supply chain and take a controlling interest in the distribution and sale of their products, the power imposed by the 3rd party dealer
diminishes and or is eliminated. Forward integration can allow manufacturers to expand their own retail network, exploit their core competencies and increase profit margins.

2.5.2 Bargaining Power of Homeowners (LOW)

There are significant opportunities for the incumbent to lower the high buyer power of the MC dealer by looking at more direct consumer contact. Dealer power is too high. Empowering the homeowner doesn’t mean making him/her strong, but rather to undermine the power of the dealer. From an industry perspective, the customer is the dealer. From Regency’s perspective, the customer is the homeowner.

Fireplaces rank second among the top features desired by buyers of new homes; they are only second to outdoor patios, porches and decks. Just over half of U.S. households have at least one fireplace or freestanding stove. There were approximately 1.2 fireplaces per American home in 2010, with 80 percent of the homes having at least one fireplace or stove, and 21 percent having two or more (HPBA, 2011).

Hearth products have a limited lifespan due to firebox, efficiency and performance deterioration. Moreover, homeowner tastes and desires to upgrade/renovate typically take place in 10 year cycles. The average age of a wood fireplace is 22 years. The average age of a wood freestanding stove is 11 years and gas fireplaces are at an average age of 11 years (HPBA, 2011). This creates a large market for renovation, retro-fit and custom designed products.

The primary motivation of 42 percent of consumers that installed a hearth product in their home was to save on heating costs, while 19 percent wanted to make
a cold room warmer or to use the product as a backup source of heat. Thirty-four percent of wood or pellet stove owners view their stove as a major heat source and 50 percent consider it to be a secondary source of heat. Forty-four percent of gas fireplace owners use their appliance as a supplemental heat source. Fifty-eight percent of hearth owners consider their fireplace, wood or pellet stove or insert to be a major design feature in their home. Fireplaces have a strong, positive effect on the value of a home and 46 percent of home buyers are willing to pay more for this feature (HPBA, 2011).

Typical cost of a product including installation ($U.S.):

- **Fireplaces**: Open, EPA-certified wood fireplace $3,000-$5,000, gas fireplace $3,000-$5,000.
- **Stoves**: Freestanding wood stove with new chimney $3,000-$4,200, pellet stove $3,500-$4,000.
- **Inserts**: Pellet, gas or EPA-certified wood insert into existing fireplace with new liner $3,000-$4,000.


Generally, consumers walking into a hearth retail store fit into one customer segment. The majority of homeowners have limited knowledge, if any, about fireplaces or what these products cost. They compare products when they get into a showroom. If they want a certain product for a certain application they will pay the retail price. The price difference between competitors’ products is usually within a few hundred dollars.
When two different brands are, for example, $200 apart from each other and the customer does not understand or is not told the reasons for this price difference, they will most likely buy the cheaper product. This price difference, for the consumer who has limited knowledge of hearth products, is a big factor in their decision. Therefore, it is a big factor for the dealer.

The majority of homeowners who have conducted some product brand research and/or who have been well informed will have a higher willingness to pay for a quality product that fits their needs. The internet is becoming a more important KSF for manufacturers as consumers are spending more time researching their future purchases on the web.

Those consumers who walk into a dealer’s store with minimal knowledge of hearth products will typically be swayed to the dealer’s choice with the biggest dealer spiffs or best chance of closing a sale with the less knowledgeable customer. On the other hand, if a consumer walks into a dealer’s showroom and asks, for example, for Regency, the dealer will typically sell them Regency. There is a whole new level of opportunity for incumbents to use the power of the internet, direct consumer contact and lead generation control to direct knowledge, brand awareness and the buying decision.

2.6 **Rivalry Intensity Among Existing Competitors (HIGH)**

The intensity of rivalry among competitors in an industry refers to the extent to which firms within an industry put pressure on one another and limit each other’s profit potential. If rivalry is fierce, competitors are trying to steal profit and market share from one another. This reduces profit potential for all firms within the industry.
The level of rivalry in the hearth industry is high. R&D and product development are KSFs in reducing this power. And customer knowledge plays to this because it identifies the consumers who are willing to pay more for added utility and quality. From trend setting styling and vast scope of product to the commitment of large investment into R&D, manufacturers must be proactive in these initiatives in order to maintain and increase an edge over the competition.

Competitors in the industry all want the customer who walks into a showroom to buy their product. Direct comparisons between brands will take place and without proper product benefit information given to customer, price can become the deciding factor. Competitors strive to provide relevant information to the consumer through media such as web-sites, social media sites and U-tube. The incumbent who can get this information across to more homeowners in a more effective way should increase their chances of out-performing their competitors on the showroom floor.

Product quality in the high end hearth industry is critical and is a KSF in generating greater willingness to pay. Reliable, high performing product with well finished esthetics and good warranties is the benchmark for manufacturers to increase their reputational capital and consumer sell through.

As the hearth industry is a seasonal and sometimes cyclical business where there is a short window of opportunity to maximize sales, a KSF for manufacturers is having acceptable product availability to the market during these times. Dealers do not like to hold inventory, so the manufacturers who have the product in stock within their distribution channels when it is needed, get the sale. If a specific manufacturer’s product availability is not good, a competitor will take the sale.
The competition in obtaining and maintaining showroom space and product exposure in a MC dealer environment is fierce and is a KSF for manufacturers. Those incumbents who can capture more showroom space reap rewards by potentially driving out competitors and gaining better price control. Moreover, the pricing structure of a manufacturer’s product is a KSF in securing a competitive presence on the showroom floor.

Capturing showroom space and driving out the competition are obtained through incumbents efforts in the KSF of customer service. By finding and targeting opportunities to improve a dealer’s business, incumbents can use their specialization and knowledge in sales and technical training and support. Incumbents in the hearth industry carry varying abilities in this area and the key is using customer service as a value added feature to the dealer in order to replace the competition.

In competing in the high end hearth industry, manufacturers must have a well established dealer network across many North American regions in order to take advantage of scope and scale economies. This dealer penetration and effectiveness is a KSF for manufacturers.

Competitors need a thorough understanding of each other, and of customer trends and needs, to be successful in the hearth industry. Several KSFs such as environmental scanning, web-based customer information/analytics and marketing support through attending and supporting consumer fairs and home shows are important to lower the force imposed by rivals. Without taking part in these initiatives, incumbents will lose sight of the market opportunities and competitors will potentially take market share.
2.7 Industry Attractiveness

Industry attractiveness is the magnitude and ease of a business making profit in comparison with the risks involved within the industry itself. It is based on the overall effect of the powers of the 5 forces. Table 2.0 below shows a summary of the forces and corresponding power associated with that force.

Table 2.0: Summary of the Hearth Industry 5 Forces Intensity

<table>
<thead>
<tr>
<th>Force</th>
<th>Power</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barriers to Entry</td>
<td>HIGH</td>
</tr>
<tr>
<td>Substitutes Availability</td>
<td>LOW</td>
</tr>
<tr>
<td>Supplier Power</td>
<td>HIGH</td>
</tr>
<tr>
<td>Buyer Power</td>
<td></td>
</tr>
<tr>
<td>Multi-competitor Dealer</td>
<td>HIGH</td>
</tr>
<tr>
<td>Homeowner</td>
<td>LOW</td>
</tr>
<tr>
<td>Rivalry</td>
<td>HIGH</td>
</tr>
<tr>
<td>Industry Attractiveness</td>
<td>Attractive, yet slowing</td>
</tr>
</tbody>
</table>

In summary, the hearth industry is a competitive mature landscape with several well established incumbents and brands. The industry is still attractive but is getting less so primarily due to the high powers associated with buyers and rivals.

The industry attractiveness has been declining due to the increasing power from the dealers. All manufacturers are competing within this dealer environment and this makes for the high power of rivalry. Bypassing the dealer through forward integration strategies, thus differentiating against rivals (creating a niche), will increase the profitability and attractiveness of the industry.
The barriers to new entry are high due to the specialization in R&D, customer information, sales and technical training and well established distribution systems. The threat of substitute products remains low, yet emerging technologies progress such as “green” solutions should be watched. Supplier power is high and off-shoring is a key factor in bringing product costs down. Buyer power in the hearth industry contains two segments; the MC dealer and the homeowner. The power of the MC dealer is high as opposed to the homeowner whose power is relatively lower.

There is still a substantial market share available in North American with regards to residential heating and home décor upgrades. As existing and new consumers look to build or upgrade their homes into the future, high end hearth products remain an increasing choice for home décor and heating comfort. As such, there remains opportunity for direct consumer sales by bypassing the MC dealer and developing products that create direct customer value, utility and willingness to pay.

Rivalry in the hearth industry among competitors remains high. The rivalry over the years has shifted from product differentiation to cost competition and loyalty at the dealer level. New entrants are scare and many smaller incumbents have been merged into larger firms to develop economies of scope and scale.

The market is product segmented and incumbents maintain advantage and compete at differing levels within specific geographic regions and product segments. As well, many growth opportunities exist in other global geographic regions. Over the past 2 years, coming off the major effects if the U.S. economic crisis, the industry has maintained investment in product development, re-structured strategies and is positioning for an expected slow growth into the future.
2.8 Key Success Factors

As a result of the 5 Force Analysis above, several Key Success Factors (KSFs) have been identified as prevalent in the hearth industry. Table 2.1 lists these KSFs, a summary of what each KSF consist of, the force in which the KSF exists and the relevant importance of each KSF within the industry. These ratings are determined from the perspective of the dealer network.

2.8.1 R&D – Product Innovation (High Importance)

Product innovation and development is of prime importance in the hearth industry. Without progressive investment in R&D, incumbents will very quickly fall short in the marketplace. Competitors take different strategies with product innovation; some choose to be industry leaders and risk the uncertainty of trendy products, while others take less risk with a close follower approach. Competitors use these strategies to achieve differentiation.

2.8.2 Product Quality (High Importance)

The high end hearth industry is built on high quality products. Product quality is a differentiator in the industry. A greater willingness to pay and loyalty is achieved through the strong reputational capital of manufacturer’s ability to consistently design and produce reliable, esthetically pleasing and user friendly products. As knowledge of hearth products with homeowners is limited, they are partial to knowing they will be purchasing a high quality and safe product. As quality level drops, so does reputational capital across the industry.
<table>
<thead>
<tr>
<th>KSF</th>
<th>KSF Description</th>
<th>Industry Force</th>
<th>Importance Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>R&amp;D - Product Innovation</strong></td>
<td>Current styling/Trend setting Dealer loyalty High investment Diverse scope</td>
<td>New Entrants Rivalry Buyer Power (dealer)</td>
<td>3</td>
</tr>
<tr>
<td><strong>Product Quality</strong></td>
<td>Esthetics/Workmanship Reliability/Performance Warranty Reputational capital</td>
<td>Rivalry Buyer Power (dealer)</td>
<td>3</td>
</tr>
<tr>
<td><strong>Product Availability</strong></td>
<td>In-Stock On-demand/ lead time Reputational capital</td>
<td>Buyer Power (dealer) Rivalry</td>
<td>3</td>
</tr>
<tr>
<td><strong>Dealer Network</strong></td>
<td>Scale and scope Geographic coverage</td>
<td>New Entrants Rivalry</td>
<td>3</td>
</tr>
<tr>
<td><strong>Dealer Showroom Space</strong></td>
<td>Brand exposure Price control Drive out competitors</td>
<td>Rivalry Buyer Power (dealer)</td>
<td>3</td>
</tr>
<tr>
<td><strong>Forward Integration</strong></td>
<td>Control distribution Control retail sales Product exclusivity</td>
<td>Buyer Power (dealer) Rivalry</td>
<td>3</td>
</tr>
<tr>
<td><strong>Customer Service</strong></td>
<td>Sales training/support Technical training/support Specialization/Knowledge Reputational capital</td>
<td>New Entrants Rivalry Buyer Power (dealer)</td>
<td>2</td>
</tr>
<tr>
<td><strong>Environmental Scanning</strong></td>
<td>Benchmarking competition Home décor trends Customer tastes/needs</td>
<td>New Entrants Rivalry Buyer Power</td>
<td>2</td>
</tr>
<tr>
<td><strong>Price Structure (low cost)</strong></td>
<td>MSRP Discounts/Promotions</td>
<td>Rivalry Buyer Power (dealer)</td>
<td>2</td>
</tr>
<tr>
<td><strong>Web-Based Customer Info</strong></td>
<td>Consumer education Brand awareness Analytics</td>
<td>Rivalry Buyer Power (homeowner)</td>
<td>2</td>
</tr>
<tr>
<td><strong>Marketing Support</strong></td>
<td>Dealer support Events, Fairs, Trade Shows Website/Programs</td>
<td>Rivalry Buyer Power (dealer)</td>
<td>2</td>
</tr>
<tr>
<td><strong>Off-Shoring Supply</strong></td>
<td>Lower input prices Custom components</td>
<td>Supplier Power</td>
<td>2</td>
</tr>
<tr>
<td><strong>Supplier Partnerships</strong></td>
<td>Lower Input Price Reliability Product Design Process</td>
<td>Supplier Power</td>
<td>1</td>
</tr>
</tbody>
</table>
2.8.3 Product Availability (High Importance)

As the hearth industry is a seasonal business and consumers generally do not consider home heating solutions until the weather gets cold, there is a relatively short window to sell and install products into a home. Moreover, hearth dealers recognize this and rely on the manufacturers to supply products in a quick and efficient manner. Hence, product availability is crucial to securing and finalizing a sale. If a dealer cannot rely on the manufacturer having sufficient stock and/or lead time is too long, the dealer, in their goal to make a sale, will sell a competitor’s product.

2.8.4 Dealer Network (High Importance)

For hearth industry incumbents to be successful, they need to develop and maintain a dealer network. The effectiveness of this network depends on scope and scale economies across many regional areas. A typical manufacturer will manage anywhere from 800 – 2000 specialty dealers across North America. The majority of these dealers, and in Regency’s case up to 80%, are MC dealers. Without the expertise, knowledge of a vast dealer network to promote, sell and install hearth products to the homeowner, manufacturers would lose market share.

2.8.5 Dealer Showroom Space (High Importance)

One of the main success factors in bringing on new dealers and maintaining existing dealers is the amount of showroom space a manufacturer can obtain. Showroom space is all about brand awareness and product breadth and exposure. Without sufficient
space captured for a certain manufacturer’s products, there is a threat of the consumer being drawn to a competitor’s product line. In the multi-competitor environment, there continues to be a fierce battle in competitors trying to push each other out and grab more space. This is done through product innovation, pricing structures, full product line offerings and value added support to the dealer.

2.8.6 Forward Integration (High Importance)

Forward integration strategies would allow manufacturers to gain more control over the distribution and sale of their end products. Manufacturers can achieve more control downstream in the supply chain through owning their distribution centers to bypassing the traditional dealer network and creating their own retail network. These strategies will reduce the power of the dealer and put increased customer information, profit making potential and market share gain in the hands of the manufacturer.

Some manufacturers own a small portion of their distribution centers, while a select few own up to 100% of their distribution centers. Others still make full use of wholesalers and 3rd party distributors. Currently, no manufacturer in the hearth industry has forwardly integrated into the retail sector.

2.8.7 Customer Service (Medium Importance)

In looking at value added support to the dealer, delivering superior customer service is a key success factor for manufacturers. This level of service includes sales training and support and technical training, information, and resources. The way in which a manufacturer responds to a dealers needs, can have a large bearing on the dealers
influence to sell that manufacturers products. Some manufacturers, such as Regency, use customer service as a differentiation. Regency puts great effort into a high level of customer service in order to ensure the benefits of their products are being promoted and supported in the field. Moreover, a manufacturers reputational capital rests on the level to which they support and stand behind their products.

2.8.8 Environmental Scanning (Medium Importance)

The ability for manufacturers to stay abreast with a changing market and consumer needs, it is important that some level of environmental scanning take place. Understanding consumer utility, home décor styling trends and competitor products, a manufacturer will be more effective with product innovation initiatives. However, some manufacturers take a more passive approach and allow a competitor’s innovation efforts to direct their product development.

2.8.9 Price Structure (Medium Importance)

Retail pricing on high end hearth products tends to range on criteria of quality, features, performance and functionality. Some competitor’s strategy is lower quality for lower prices, while others maintain higher range pricing for high quality benefits. Low price is a KSF in battling against using differentiation. There is however a higher willingness to pay if the consumer gains knowledge through research and/or a dealer takes the time to explain the higher quality products to the consumer. Pricing structures are a competitive tool for manufacturers that consist of discounts, promotions, dealer incentives, and payment terms.
2.8.10 Web-based Customer Information (Medium Importance)

The internet has become an increasing competency for manufacturers in the hearth industry. In North America, most homeowners have access to web services and have shown increasing use of the internet for researching future purchases. Manufacturers can use web-analytic tools to track specific website traffic as consumer tastes and preferences. Incumbents in the hearth industry can leverage these trends through delivering customer valued information. A manufacturer’s website is becoming an increasingly effective means to educate the consumer directly with a brand of hearth product so as to influence their buying decision.

2.8.11 Marketing Support (Medium Importance)

Marketing support in the hearth industry is seen in varying degrees of intensity. This support consists of dealer marketing materials, promotions and dealer incentives and presence and assistance with industry fairs, events and trade shows. Some incumbents in the hearth industry spend a high level of effort in the presence of the dealer at fairs and events to ensure that the manufacturers brand is being promoted effectively. Other incumbents will only push incentives to the dealers so as to influence the dealer’s decision.
2.8.12 Off-shoring Supply (Medium Importance)

In an effort to battle increasing costs and remain competitive on retail price, manufacturers look to reduce raw material input costs by using off-shoring alternatives. Developing an off-shore supplier base that will deliver sufficient quality and reliability at low unit cost is an ongoing initiative for hearth manufacturers. Off-shoring is an effective measure in competing against a low price retail strategy.

2.8.13 Supplier Partnerships (Low Importance)

Whether off-shore or more local, supplier partnerships are important within the hearth industry. Effective partnerships between suppliers and manufacturers that are built on a win-win platform create an understanding of business cycles, trends and constraints. Communications from effective partnerships allow for trust, accountability and reliability. As stated earlier, with the hearth industry being seasonal and cyclical, these benefits are in the best interest for both supplier and manufacturer. However, effective partnerships still do not guard against increasing input costs.


2.9 Competitive Analysis

For the purposes of this paper we will look at two key competitors of Regency to gain an understanding of where these incumbents are situated with each other in terms of size, established presence in the hearth industry and product offering. Travis Industries and Napoleon Fireplaces are the closest to Regency in terms of years in the industry, product segments, sales revenue, employee headcount, shared dealer network and specialized capabilities. The following section will give a brief description of these two key competitors and then summarize a relative competitive analysis, rating these competitors with Regency against the industry key success factors.

2.9.1 Main Competitors

The main competitors of Regency that serve the hearth industry operate with differing strategies. Travis Industries, like Regency, runs its business with a differentiation strategy with high quality products and a loyal dealer network. Napoleon Fireplaces, unlike Regency, runs a more cost-based strategy, based on a large breadth of lower quality product and a fragmented distribution model.

2.9.1.1 Travis Industries

Travis Industries (Travis), founded in 1979, is a privately owned wood, pellet and gas stove, insert and fireplace company in Mukilteo, Washington. They design, manufacture and distribute four high-quality brands: Fireplace Xtrordinair,
Avalon, Lopi and Tempest Torch. These brands make up a multitude of product lines that all available exclusively from a network of more than 1,200 authorized retailers throughout the United States, Canada, Australia and China. Travis’ products are manufactured within an 11-acre facility called the House of Fire employing up to 600 employees (Travis, 2012).

Travis employs approximately one half of the sales force as Regency. Travis focuses on a loyalty program with a smaller number of dealers. These dealers are treated as “family” relations with Travis, and these relations are built on mainstream state of art product innovation. This is Travis’ differentiation in the market and they hold this loyalty in place by using recognition programs with their dealers through annual events and trips.

2.9.1.2 Napoleon Fireplaces

Napoleon Fireplaces (Napoleon) was founded in 1976 from a steel railings start-up called Wolf Steel in Barrie, Ontario, Canada. With a primary focus in the Ontario hearth market until the mid 1980s, Napoleon has since expanded their fireplace products throughout Canada and into the United States. Their products range from wood and gas fireplaces (inserts and stoves), gourmet gas and charcoal grills, outdoor living products and waterfalls. Napoleon operates with 500,000+ square feet of manufacturing space and over 400 employees (Napoleon, 2012).

Napoleon has created a distribution system focusing on a smaller number of sales force then Regency’s, that work to a tiered wholesale structure to the dealer. Napoleon
sales force, in this structure, virtually has zero control over the dealers’ purchase decisions. Dealers essentially can choose and dictate price from the multiple Napoleon wholesalers. The Napoleon strategy is built around developing vast product lines of low quality and low cost hearth products.

2.9.2 Relative Competitive Analysis

When comparing hearth industry competitors to industry KSF’s it should be noted that the KSF’s identified are the same for the various product segments (wood, gas and pellet) offered to consumers. Table 2.2 shows the relative competitive analysis with the above main competitors based on the importance of the industry KSFs.

This competitive analysis will rate each competitor against the KSF in terms of importance to the industry. The higher the score at each KSF the stronger the manufacturer is in that KSF. It is important to note, that traditionally, manufacturers in the hearth industry have structured their entire business models to the MC dealer environment.
Table 2.2: Relative Competitive Analysis

<table>
<thead>
<tr>
<th>Key Success Factors (KSFs)</th>
<th>Industry Importance Rating</th>
<th>Competitor Rankings to KSFs</th>
<th>Travis Industries</th>
<th>Napoleon Fireplaces</th>
<th>Regency Fireplace Products</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>3=very key 2= key 1=less key</td>
<td>5=strong 3=average 1=weak</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R&amp;D - Product Innovation</td>
<td>3</td>
<td>5</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Product Quality</td>
<td>3</td>
<td>5</td>
<td>2</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Product Availability</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Dealer Network</td>
<td>3</td>
<td>4</td>
<td>2</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Dealer Showroom Space</td>
<td>3</td>
<td>5</td>
<td>3</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Forward Integration</td>
<td>3</td>
<td>3</td>
<td>0</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Customer Service</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Environmental Scanning</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Price Structure (low cost)</td>
<td>2</td>
<td>3</td>
<td>5</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Web-Based Customer Info</td>
<td>2</td>
<td>3</td>
<td>5</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Marketing Support</td>
<td>2</td>
<td>1</td>
<td>3</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Off-Shoring Supply</td>
<td>2</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Supplier Partnerships</td>
<td>1</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td><strong>Overall Scores</strong></td>
<td></td>
<td><strong>113</strong></td>
<td><strong>90</strong></td>
<td><strong>128</strong></td>
<td></td>
</tr>
</tbody>
</table>

Note: The individual competitor scores against KSFs have been derived and from the 2011 Dealer Survey Results, conducted on an annual basis by Regency Fireplace Products in conjunction with Regency sales and marketing representatives; sample size of 500 survey respondents included Regency dealers and non-Regency dealers.
2.9.3 Opportunities

As shown in the above Table 2.3, Regency outscores competitors in product availability, equals Travis with high scores in product quality and outscores all competitors in customer service. These are all opportunities Regency can leverage so as to capture consumer interest, build brand awareness and develop better control over the selling process.

The hearth industry is a seasonal business with a short window when homeowners are looking to upgrade their home heating solutions. There is an opportunity in this period to maximize sales in the winter months and superior product availability is critical to an incumbent’s success. Regency leads the industry with excellent product availability which has added to their reputation of superior customer service. Well structured, wholly owned and controlled distribution centers continue to have a substantial bearing for this excellence.

Regency scores high with product quality, as does their competitor, Travis. Exceptional product quality and workmanship have always been the pride of Regency. In the hearth industry, product quality refers to the esthetics, reliability, performance, ease of use and materials used in the construction and warranty aspects of the product. Charged at a higher price, excellent quality in hearth products does increase a customer’s willingness to pay and this generates a huge opportunity for Regency.

Consumers are willing to pay more for a hearth product that is safe and reliable, easy to use and satisfies their styling. However, at the MC retail level, the dealer does
not always articulate or convince these benefits to the consumer. If a consumer does not understand product quality differences, they will lean toward the lower priced products.

On a less important industry success factor, Regency outscores competitors in marketing support as well. Marketing support in the industry refers to the effort and involvement in fairs, events, home shows and dealer support around North America. Although less important to the industry overall by means of competitors not putting much effort in this area, Regency feels their efforts and investment is much needed in order to take more control at the consumer level.

Regency has recently developed a dynamic leads generation and control system whereby they capture and own the sales lead generated from these fairs and home shows. From there, Regency can educate their products benefits and influence the consumer to ask for a Regency product when they visit a dealer’s showroom. Moreover, Regency’s market presence alongside a dealer(s) at fairs and home shows can ensure the dealer is promoting Regency product proactively to the consumer.

2.9.4 Threats

In looking at Table 2.3 above, the areas of key success factors where competitors outscore Regency is with product innovation and pricing structures. Regency is well known as a close follower with product development in the hearth industry. Regency’s competitors have come to respect this and Regency dealers have come to reluctantly accept it. Regency’s view is that innovation is costly and unpredictable. As a low risk, conservative company Regency has been able to stay fairly abreast of consumer tastes and styling. Regency has experienced falling behind in product development in its
history. This has proven damaging to Regency in terms of dealer loyalty and sustainment. However, over the last five to six years, Regency has re-gained focus, commitment, and investment back into positioning themselves as a quick decision making and responder to competitor innovation and market trends. Survival in the hearth industry heavily depends on progressive and continuous new product development and/or existing product upgrades. Regency competitors currently have an upper hand in a more innovative approach to new product launch. As such, this key success factor remains a threat for Regency.

Another KSF that continues to challenge the Regency strategy is pricing structure of hearth products. Regency scores low against Napoleon in pricing structure, yet is competitive with Travis. Regency’s position is with retail pricing is the mid to high level structure. Based on Regency’s strategy of high quality, high margin products, they have made a conscious decision not to allow their products to market at low price yielding low margin. However, the threat comes from the dealer not explaining the benefits of the higher priced Regency product and hence the consumer settles to focus on price.

Consumers, having limited knowledge of hearth products or brand, can be very much influenced by the dealer’s direction and opinion. In the hearth industry, high quality products that are safe and reliable do lend themselves a higher willingness to pay with the homeowner. However, the benefits and customer value need to be explained to the consumer for this to take place.

The customer value aspects of hearth products are not usually visible to the eye alone and without the dealer and/or manufacturer properly educating the consumer as to
the benefits for cost; price will be the primary focus. At that point, hearth products could be seen as commodities. This is in essence the threat to Regency.

2.10 Strategic Alternatives

Looking back at the problems with Regency’s current strategy and understanding their opportunities and threats derived from the industry and competitive analysis, there are strategic alternatives that would favorably alter Regency’s performance in the hearth industry.

As Regency discovered in the early nineteen nineties, venturing into wholly owned distribution centers created an effective level of control and focus in getting their products to market. Wholly owned distribution centers, a differentiator in the industry at that time, allowed Regency to develop their products into a growing dealer network to take advantage of scale and scope economies. Now in 2012, as competitors have caught up to this distribution model, the MC dealer network is the source of hampering Regency’s differentiation in the market. This again is where more forward integration thinking may pose advantage to Regency into the future.

For Regency to stay status quo and make no changes to their strategy would pose many risks to growth potential, market share and maintaining their high margin model. As earlier stated, MC dealers comprise of 90% of Regency’s complete dealer network and the other 10% are Regency only dealers (but not wholly owned). It can be seen that the control of the complete selling process is not in Regency’s hands and this makes the risks prevalent.
Regency’s management preference is to maintain their high quality, high margin renovation market model and therefore competing on cost-based strategies is not an option. However, management preference does see benefits in more control through forward integration. Regency’s advantage in customer service and presence at the dealer level shows this commitment to controlling more of the selling process for their products.

2.10.1 The Concept of Economic Surplus

It is important to note that the main reason to consider forward integration strategies is not entirely “value added” advantages or “closer to the customer” reasoning, but rather economic surplus (Stuckey & White, 1993). Economic surplus comprises of consumer surplus and producer surplus and Figure 2.1 shows the relationship between the two on the supply and demand curves.

Figure 2.1: Economic Surplus Graph

(Source: http://en.wikipedia.org/wiki/Economic_surplus)
**Consumer surplus** is the difference between the total amount that consumers are willing to pay for a good or service (indicated by the demand curve) and the total amount that they actually pay (the market price). **Producer surplus** is the difference between what producers are willing to supply a good for and the price they actually receive. The level of producer surplus is shown by the area above the supply curve and below the market price. (Riley, 2006)

By exploring forward integration strategies, Regency can obtain better control over sales and prices and capture upstream profit margin, through the economic surplus concept. It is important to note that economic surplus is more likely to arise the closer you are to the customer because at this stage you can obtain any available consumer surplus (Stuckey & White, 1993). By having more direct influence on the consumer, with no middleman (MC dealer), Regency has better access to this consumer surplus through selling the benefits of Regency products and capturing a greater willingness to pay. As strategic alternatives are looked at, the concept of economic surplus needs to be a factor in achieving Regency’s goal of having better control over the complete selling process.

The remaining of this chapter will outline strategic alternatives and what these alternatives would entail. Again, these strategic alternatives are to develop a more controlling factor in the complete selling process of Regency products and mitigate the risks stated above. The two strategic alternatives that will be proposed are Corporate Retail Ownership and The Regency Franchise.
2.10.2 Corporate Retail Ownership (Strategic Alternative #1)

When looking at forward integration strategies, the question is what extent of control would be right for Regency to seek at the retail level. Corporate owned retail, or full integration, would involve an infrastructure which Regency currently does not have. However, 100% control over the selling process would be achieved with this strategic alternative.

Although a consistently profitable company, Regency is a low risk profile, private company with limited shareholders. As such, resources to gain financial backing into wholly owned retail ventures would need close analysis and the costs would be high.

The initial impact of undercutting existing dealers would need to taken into consideration as geographic locations are being assessed. Brand exposure and relevance to the homeowner are crucial in determining locations. It is important to realize that bringing in wholly owned stores would be a slow, phased process with careful attention given to regional locations with normal seasonal weather patterns and higher targeted population. Proximity to Regency’s distribution centers is of importance to minimize inventory at the retail level, create just in time (JIT) delivery and ensure profitability at each store.

Pilot project stores operating in key areas over a complete business would test the viability of such a venture. Viability can also be tested with respect to the relative demographic and age of housing infrastructure. For example, locating a store in the proximity of a cluster of just new home construction will not see much consumer traffic because there is no need to upgrade or renovate these homes for several years.
High consumer traffic areas surrounded by complimenting products and services, such as home décor and furnishing stores would be most effective. Mutual working relationships with these complimenting businesses would help drive consumers into Regency stores.

Human resource and change management factors will be prevalent in sourcing the right people to deliver a unique customer experience that can ensure Regency’s differentiation strategy remains. More than just a fireplace store, Regency would need to create a complete fireplace “solutions” store, delivering consumer friendly information and entire room décor ideas centering on the hearth product. The value proposition would be to make the fireplace solution purchase easy for the consumer.

Wholly owned retail means having Regency employees and therefore compensation and commission structure will need to weigh against revenue per store projections. Above average dealers in the hearth industry sell and install approximately 300 units per year. This volume is typically constrained by install resource capacity. Moreover, other seasonal products (to offset hearth seasonality) will in fact need to be offered to generate additional revenue streams.

2.10.3 The Regency Franchise (Strategic Alternative #2)

As wholly owned retail stores (full forward integration) gives 100% control to Regency with a more defined and narrow location criteria, the franchise model decreases some control but potentially adds more store exposure across a wider scope of geographic areas, while reducing financial risk.
Developing a franchise model in the United States entails meeting several requirements under individual state legislation. As well, Regency will be required to prepare a standard disclosure document for a franchise operation. This document, called the Uniform Franchise Offering Circular (UFOC) is required of all companies, by the Federal Trade Commission, if they want to offer franchises for sale anywhere in the United States. To facilitate the franchise process, Regency will need the services of an experienced franchise development consultant.

As part of the legal aspects of setting up a franchise, Regency will need to prepare audited financial statements for the franchise company. Other considerations are whether Regency should set up another company to franchise their concept or if they want to use the existing business entity they are operating in as the franchise company.

Regency is an evolved culture of over 32 years of being a performance driven company. Effective and efficient business and operational systems have contributed to this. Going forward with a franchise model, Regency will need to develop and document the systems that a franchisee will use to run their respective business successfully. These systems would comprise of sales training, product and technical training, marketing plans and financial/accounting services and structure.

To ensure a successful franchise model, finding the right people to run these businesses is crucial. It is important to note for Regency that franchisees are not employees and they need to be treated as such. Moreover, for Regency to follow its goal of more control of the complete selling process, they will have to ensure the franchisees do what Regency wants and needs, on a consistent basis, with regards to their products and service. Again, Regency would need to supply the ‘system’ and then monitor
closely the quality of execution. Having a flagship franchise store where franchisees can come and learn these systems would be critical for Regency’s success.

2.11 Strategic Alternatives Summary

Corporate Retail Ownership and Regency Franchise, respectively, would facilitate control of the selling process, lower the threat of rivalry and generate economic surplus. The elimination of competitor’s product from entering showroom space and a fully focused store on marketing, promoting and selling Regency product would take full advantage of Regency’s core competencies.

The following Chapter 3 will discuss implementation through understanding Regency’s internal capabilities and whether those capabilities are sufficient or could be made sufficient to implement one or more of the above strategic alternatives.
3: IMPLEMENTATION ANALYSIS

An implementation analysis determines whether the internal capabilities of Regency are, or could be, made capable of achieving the strategic alternatives proposed in Chapter 2. The “Diamond-E Framework” is used to evaluate the strategic alternatives based on the environment, resource requirements, management’s preferences and the organization’s capabilities (Crossan et al, 2009).

3.1 Diamond-E Framework (Crossan et al, 2009)

As the environment analysis was conducted in Chapter 2 with Porter’s 5 Forces, the remaining Diamond-E Framework tests the strategic alternatives in Chapter 2 against three analyses:

- Management Preference Analysis;
- Organization Analysis; and
- Resources Analysis.

The Management Preference Analysis determines how well the proposed strategic alternative fits with management’s preference. This includes preferences which may reflect personal and/or professional values, personality traits, experience level and leadership styles. It also includes standard decision criteria like the expected sales and profitability growth and maintaining to the budget. Management, for the purposes of this paper, will consist of the key contributors to decision making within Regency. The
management team will consist of the Founder and CEO, President, and Vice Presidents (Operations/R&D, Sales & Marketing, Finance/IT).

The Organizational Analysis determines how well the proposed strategic alternative fits with the organizational structure. This analysis will also take into consideration Regency’s systems and organization culture.

The Resource Analysis determines how well the proposed strategic alternative fits with the organizational resources available. This analysis will take into consideration the operational, human and financial resources available within Regency.

It is important to note that if the internal capabilities of Regency cannot be made to satisfy the strategic requirements of an option, then it is dropped from the analysis as unworkable (Crossan et al., 2009).

3.2 Assessment of Strategic Alternative #1

Strategic Alternative #1 is proposed as Corporate Retail Ownership. In this alternative, Regency would wholly own the retail stores for which to market and sell its products.

3.2.1 Management Preference Analysis

Management preference analysis will consider management objectives, management experience, management team and leadership. Each of these preferences will be assessed below.
3.2.1.1 Management Objectives

In adopting Corporate Retail Ownership, 100% of the complete selling process would be under the sole control of Regency. This brings a new dynamic of understanding and commitment to the retail business in the hearth industry.

Table 3.0 below summarizes the required preferences of the alternative and compares them to the preferences that are observed amongst the key decision-makers for Regency. The resulting gaps and gap-closing recommendations are also summarized for each preference.

The management team, under this strategic alternative, will need to change the overall long standing business model of lower volume-high margin. To get around the seasonal and cyclical nature of the hearth business, Regency will have to commit to a significant amount of investment in innovative product development, financial support, and sourcing and/or developing other seasonal products to off-set slow periods of hearth sales. These products would comprise of low margin patio, garden and barbeque products.

The entire investment for the start-up would be the responsibility of Regency and while assuming all profits, they would be the bearer of all losses as well. There must be an understanding that opening company owned stores will take a lot of capital and time and yield high risk. Opening each store can be a slow proposition in location selection, capital funding, hiring and training.
Table 3.0: Management Objectives Under Strategic Alternative #1

Corporate Retail Ownership

<table>
<thead>
<tr>
<th>Management Subject</th>
<th>Required Preferences</th>
<th>Observed Preferences</th>
<th>Major Gaps</th>
<th>Gap-Closing Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Founder and CEO</td>
<td>Interest in a high level of commitment to seasonal hearth business w/low margin products</td>
<td>Interest in doing “the least amount of effort for the most margin”</td>
<td>Need an interest in absorbing lower margin products into core high margin. Needs new vision, new core</td>
<td>Change long term mindset to allow different business model(s)</td>
</tr>
<tr>
<td>President</td>
<td>Interest in developing an effective retail chain with seasonal product offerings</td>
<td>Interest in the hearth industry and associated products only</td>
<td>Need an interest in diversifying product line into non-hearth seasonal products. Doesn’t know the new lines.</td>
<td>Increase knowledge, experience and investment across organization</td>
</tr>
<tr>
<td>VP Finance/IT</td>
<td>Interest in developing solid financial systems across retail stores</td>
<td>Interest in profitability of current company financial model structure. Keeping risk low</td>
<td>Interest to expand financial support and reach into retail businesses at a higher risk model</td>
<td>Increase financial resources to support while accepting risk</td>
</tr>
<tr>
<td>VP Operations/R&amp;D</td>
<td>Interest in voice of the consumer and market driven trends to drive innovative product development</td>
<td>Interest in being reactive to market trends and a close follower approach</td>
<td>Interest to becoming more innovative in product designs and other non-related products</td>
<td>Develop a more proactive market research, design team and investment</td>
</tr>
<tr>
<td>VP Sales &amp; Marketing</td>
<td>Interest in driving consumers into retail stores</td>
<td>Interest in supporting MC dealers to push Regency sales</td>
<td>Interest to create more control over consumer leads and potential undercutting MC dealers. No expertise with non fireplace products</td>
<td>Shift marketing and sales focus from dealer to consumer direct with varying product segments</td>
</tr>
</tbody>
</table>

3.2.1.1 Gaps in Management Objectives

Based on observations and history with Regency, as well as through interviews with the management team, there appear to be significant gaps between the preferences of management and the required preferences to make this strategic alternative move
forward. As Table 3.0 shows, the gaps that exist will actually have a substantial impact on the long standing corporate objectives of the organization.

Although the VP’s of Marketing and Finance seem confident in the gap closing factors, there was a fairly strong consensus that this strategic alternative would bring too much disruptive change to Regency. This alternative would involve taking on completely different types of products into sourcing, buying and distribution. These added challenges and risks are feared to disrupt an already complex business. Most of this management team has been with Regency between 16 to 20 years and high-risk change is not in their preference.

### 3.2.1.1.2 Suggested Gap-Bridging Solution

To close these substantial gaps will require significant changes to the long standing business model of the Founder and CEO of Regency. It will also put the company into a higher risk profile than the management team prefers to be in.

The management team and specifically the Founder and CEO will most likely decline this alternative of corporate retail ownership due to the drastic change in business objectives and financial risk. Therefore, this alternative fails because it cannot satisfy management preference no matter how competitive it would be in the industry environment.

### 3.2.2 Summary of Assessment

Regency’s goal of obtaining a more controlling factor over the complete selling process at the retail level would be achieved through implementation of this strategic
alternative. However, because the management team is very unlikely to move forward with this proposal, the strategic alternative of Corporate Retail Ownership will not be considered any further.

In addition, and in interviewing the Founder and CEO, it is understood that Regency will not deviate from its long standing corporate objective of a high-margin financial model. By the high investment in wholly owned stores and in distributing various other seasonal non-hearth products, the business model will see much complication and add heavy risk to Regency’s financial structure.

3.3 Assessment of Strategic Alternative #2

Strategic Alternative #2 is proposed as the Regency Franchise. In this alternative, Regency would develop a franchised retail model across selected regional areas in which to market and sell its products.

3.3.1 Management Preference Analysis

3.3.1.1 Management Objectives

In adopting a Regency Franchise model, the management team, would need interest in creating a common, standardized approach to these retail stores. Building brand image and customer experience would be of top priority. This franchise model would be the first of its kind in the hearth industry.

The management team, under this strategic alternative, will have the added complexities of finding and maintaining the “right” people and resources to operate these
franchises. Moreover, the systems and controls required to ensure consistent experience from one store to the next would need a robust monitoring and audit system.

Table 3.1 below summarizes how this compares to the preferences that are observed amongst the key decision-makers for Regency.

Table 3.1: Management Objectives Under Strategic Alternative #2

<table>
<thead>
<tr>
<th>Management Subject</th>
<th>Required Preferences</th>
<th>Observed Preferences</th>
<th>Major Gaps</th>
<th>Gap-Closing Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Founder and CEO</td>
<td>Interest in developing a respected company image though a unique customer experience</td>
<td>Generally match with required preferences, though finding the “right” store owners is a concern</td>
<td>Maintaining a consistent franchise image with multiple business owners</td>
<td>Developing a “formula” and careful selection of business owners and understanding their entrepreneurial strategies.</td>
</tr>
<tr>
<td>President</td>
<td>Interest in developing the right formula and people to effectively run these businesses</td>
<td>Interest in keeping complexities of retail business to minimum</td>
<td>Accepting the added complexity and resources to develop an effective franchise</td>
<td>Allowing cost, time, development and monitoring of people, systems and controls</td>
</tr>
<tr>
<td>VP Finance/IT</td>
<td>Interest in overcoming legal and liability barriers</td>
<td>Interest in protecting business structure against costly risks</td>
<td>Interest in reducing the risk to the company</td>
<td>Develop a phased in approach to understand legal/financial issues</td>
</tr>
<tr>
<td>VP Operations/ R&amp;D</td>
<td>Interest in developing products to enhance franchise image and sell through</td>
<td>Match with required preferences</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>VP Sales &amp; Marketing</td>
<td>Interest in building brand image and supporting multifaceted advertising campaigns</td>
<td>Interest in supporting MC dealers to push Regency sales</td>
<td>Need an interest in servicing two distinct retail models</td>
<td>Creating additional components in marketing structure and focus. Need time to develop strategies.</td>
</tr>
</tbody>
</table>
3.3.1.1 Gaps in Management Objectives

Although this strategic alternative is within preference of our Founder and CEO, the majority of the management team interviewed showed caution to pursue the franchise model at full speed. There was a common feeling that the impact of developing a franchise would conflict with the primary focus of the current business model. Moreover, there is a lack of experience and expertise with franchising among the management team. In discussion with the management team, they do not wish to facilitate the more extensive staffing demands necessary to support an entire franchise system at this time.

Regency’s Founder and CEO has stated an ongoing concern with finding the “formula” and the right people to run these franchises. Franchisees tend to be of an entrepreneurial nature and Regency, being an entrepreneurial company, would have to let go of control to some extent. This is typically not in Regency’s preference. Strict controls and monitoring would need to be facilitated in order to ensure consistency and quality of the stores. Regency’s management team feels the necessary resources are not available and already feel stretched with responsibilities and initiatives related to the current business model.

As stated above, the management team including the Founder and CEO feel that a Regency franchise concept and the required systems are not yet understood. They would prefer to somehow experiment a concept store and system first before committing resources to the franchise model.
The management team feels the increased complexities with state and provincial regulatory laws makes this strategic alternative challenging for Regency. Again, this is mostly due to the lack of available resources and knowledge currently in the company to deal with the complex process, systems, recruitment and training in developing the franchise model.

3.3.1.1.2 Suggested Gap-Bridging Solution

Regency’s Founder and CEO has expressed much passion and vision for this alternative. As a true entrepreneur, he feels the franchise model is a viable and industry changing venture. He is not ready to commit large resources (either human or financial) to this alternative, but rather look for opportunity to experiment with different concepts of what a Regency franchise may look like.

The management team agrees and feels the company does not have the required resources or expertise at this time to implement this strategic alternative. They feel this alternative, if executed too fast, would pose risk to the company in terms of financial health, undercutting the existing dealer network and complicating the business structure.

Regency prefers an incremental approach to the change process so as to gain an understanding of franchise system. With there being a clear lack of expertise with franchising, the management team would prefer to develop the concept and system through leveraging opportunities in the existing dealer network. There are two observed approaches to achieve this and with fifteen hundred dealers currently in Regency’s network, these opportunities exist.
These “experiment” opportunities could be deemed as the “Franchise Feasibility Analysis Phase” (Murphy, 2008) to really ask the question: has our franchise concept been sufficiently proven in the marketplace? These limited franchise experiments, that will facilitate proving a franchise concept while keeping risk low, will be called the “Key Dealer Plus” model and the “Targeted Dealer” model.

The **Key Dealer Plus** model is structured to identify opportunities to assist struggling retailers and/or disgruntled retailers due to problematic manufacturers. Regency would assist in securing lease-hold retail space from multi-competitor retailers. By owning the lease, Regency will have control over the retail sale process through removing competitor’s products from the showroom floor creating Regency exclusivity. **Figure 3.0** shows the financial investment details including sales plan, gross margin (G/M) and return for both the dealer business and the incremental business for Regency.

**Figure 3.0: Leasehold Opportunity Investment and Return**

<table>
<thead>
<tr>
<th>Key Dealer Plus Model</th>
<th>Potential Dealer Business (3yr)</th>
<th>Regency Incremental Business (3yr)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>($000s)</td>
<td>($000s)</td>
</tr>
<tr>
<td></td>
<td>Year 1</td>
<td>Year 2</td>
</tr>
<tr>
<td>Units</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Identify with the MC dealer network</td>
<td>200</td>
<td>250</td>
</tr>
<tr>
<td>struggling dealers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>struggling manufacturers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>disgruntled dealers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>* Assist in locating and/or securing lease of retail location in key location (2,000 sq. ft location ideal)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>* Seasonal rental assistance (if required)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>* Company formation/setup guidance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>* Assist in showroom design/layout and build out</td>
<td></td>
<td></td>
</tr>
<tr>
<td>* Provide showroom units at no cost</td>
<td></td>
<td></td>
</tr>
<tr>
<td>* Business development funds and marketing assistance</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Regency Investment of $100K**

($50K reno's/support, $50K display units)

Positive returns after one year

(Source: Data from VP Finance, CFO, Regency Fireplace Products, 2011)
The “Targeted Dealer” model is structured toward the non-Regency dealer who wants to sell his/her business but lacks the know-how and/or financial resources to do so. Regency would assist in the financing (buying/selling process) to facilitate an effective succession plan for the exiting owner and the new owner. This model would include the components of the “Key Dealer Plus” and would give Regency control over the selling process, showroom contents and product exclusivity. Figure 3.1 shows the valuation (buy-out price), 5 year term loan, interest cost, gross margin (G/M) at 300 unit sales per year, and return for Regency.

**Figure 3.1: Hearth Dealer Succession Plan Investment and Return**

<table>
<thead>
<tr>
<th>Estimated Dealer VALUATIONS (buy-out price)</th>
<th>Low Case (C Dealer)</th>
<th>Base Case (B Dealer)</th>
<th>High Case (A Dealer)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Units ($Sales)</td>
<td>200 ($900K)</td>
<td>250 ($1,100)</td>
<td>300 ($1,300)</td>
</tr>
<tr>
<td>EBITDA (Profit)</td>
<td>$30</td>
<td>$45</td>
<td>$60</td>
</tr>
<tr>
<td>Valuation (2.0x EBITDA)*</td>
<td>$60</td>
<td>$90</td>
<td>$120</td>
</tr>
<tr>
<td>Valuation (2.5x EBITDA)*</td>
<td>$70</td>
<td>$113</td>
<td>$150</td>
</tr>
</tbody>
</table>

* Assume business inventory = debt (net $nil additional cost). Value ranges from $120K to $150K

75% Regency FINANCING ($150K Loan)

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>5 Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan Balance (pay $3/mth)</td>
<td>$150</td>
<td>$122</td>
<td>$94</td>
<td>$64</td>
<td>$33</td>
<td>0% PAID</td>
</tr>
<tr>
<td>Interest cost (% i rate)</td>
<td>$7.5</td>
<td>$6.7</td>
<td>$5.6</td>
<td>$4.2</td>
<td>$2.3</td>
<td>$26</td>
</tr>
<tr>
<td>Regency G/M</td>
<td>$260</td>
<td>$260</td>
<td>$260</td>
<td>$260</td>
<td>$260</td>
<td>$1,300</td>
</tr>
</tbody>
</table>

Each new location to sell 300 units/year, $540K revenue, $260K margin

Regency Investment of $200K

Positive returns after one year (Net $1.1M to Regency after 5 years)

(Source: Data from VP Finance, CFO, Regency Fireplace Products, 2011)
Both of these opportunities would bring Regency product exclusivity, control of the complete selling process and the ability to experiment with a low-risk model to help develop the franchise concept and system. In time and when a repeatable formula is developed, these initial experiment stores would be rolled over into Regency franchises. It is important for Regency to develop a solid foundation from the beginning. A determination needs to be made whether franchising ideas should be pursued, postponed or abandoned and, assuming these experimental opportunities are showing a positive result, what would need to be fine-tuned.

Both of the pilot project opportunities above would need to be identified within the market and selected carefully. In discussion with the VP of Sales and Marketing, the identification could be facilitated by existing Sales Directors and Account Executives in their respective regions with no extra human resources required.

Regency is willing to put forward up to $100K - $200K per opportunity as they feel this experimental process is a lower financial risk than pushing too fast with an un-proven franchise model. As well, with expected product sell through, positive returns would be expected after one year. If the franchise concept were not to materialize, Regency maintains good position and returns from these retail stores while maintaining control and product exclusivity.

3.3.1.2 Management Experience

In Strategic Alternative #2, the management team’s experience will require thorough understanding of Regency, the hearth industry, the state of the existing dealer network, and potential markets where franchise opportunity exists. Regency’s Founder
and CEO and the rest of the management team will need the ability to assess certain opportunities that may put Regency in a high risk position and/or put Regency’s existing dealer network in threat.

But more importantly, the management team, or some representation of the management team, will need a full understanding of how franchises work and how they are developed. Regency must realize that planning to franchise is like entering a new business with new customers (business owners-operators). This new business will require skills, abilities and expertise in sales training, technical training, market support and financial/accounting assistance. It will be critical to have experience in developing effective evaluation, documentation, mentoring, training and consulting.

From a legal, regulation and protection perspective, experience is required with franchise documents such as the Franchise Disclosure Document (FDD), Training Program Curriculum, Franchise Operations Manual and Franchise Registration Application that are required in many states and provinces.

**Table 3.2** below summarizes the required preferences and compares to the preferences that are observed amongst the key decision-makers for Regency.
Table 3.2: Management Experience Under Strategic Alternative #2

<table>
<thead>
<tr>
<th>Management Subject</th>
<th>Required Preferences</th>
<th>Observed Preferences</th>
<th>Major Gaps</th>
<th>Gap-Closing Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Founder and CEO</td>
<td>Experience in franchising a well established business</td>
<td>Growing knowledge of franchise concept and vision, with expertise in the hearth industry and customer experience.</td>
<td>Full understanding of developing a successful franchise</td>
<td>Seek professional assistance regarding setting up and developing a franchised business</td>
</tr>
<tr>
<td>President</td>
<td>Expertise in managing a franchised business model</td>
<td>Experience in sales and marketing, with a detailed understanding of the dealer network</td>
<td>Understanding the dynamics of both businesses</td>
<td>Develop the ability to focus on the franchise business network through hiring a Director of Franchise Development</td>
</tr>
<tr>
<td>VP Finance/IT</td>
<td>Experience to facilitate legal/financial assistance</td>
<td>Match to required preferences</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>VP Operations/R&amp;D</td>
<td>Expertise to respond to customer needs quickly by effectively deploying resources</td>
<td>Match to required preferences</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>VP Sales &amp; Marketing</td>
<td>Experience to develop custom marketing Programs as per franchise needs</td>
<td>Match to required preferences</td>
<td>None</td>
<td>None</td>
</tr>
</tbody>
</table>

3.3.1.2.1 Gaps in Management Experience

As shown in Table 3.2, only the VP of Finance/IT, the VP of Sales and Marketing and the VP of Operations/R&D required preferences in management experience match those observed. The majority of the current management team has been in the hearth industry and/or working with Regency for 15-20 years. Still being very engaged with his company, Regency’s Founder and CEO has 35 years of experience in the hearth industry.
Regency has a vast cross-section of experience across all aspects of the industry, dealer network, marketing, product design and financial and legal.

However, the primary gaps in management experience are observed to be those revolving around franchise business development. Although, some research has observed to be done by the management team, specifically the Founder and CEO, a firm understanding of what makes a franchise business model successful is still in question. Without this knowledge, commitment and focus to plan, set-up, execute and develop a franchised business, Regency may have serious challenges with success.

3.3.1.2.2 Suggested Gap-Building Solution

The experience required for Strategic Alternative #2 to be successful is critical. There needs to be focus and expertise placed on strategic franchise planning to manage the current and future franchise effort. In question is the current level of experience and time resources required to make this happen. In order to bridge this gap, it is recommended the Regency needs a senior manager or director in charge of franchise business development. This senior position would oversee, facilitate and manage all aspects of franchise planning, development, audit and performance of the current and future franchise locations. Ideally, this senior manager would hold a high level of hearth industry experience and work directly with the senior management team. This position salary approximately is observed in the $130K - $160K/year base, plus bonuses and benefit package.
3.3.1.3 Management Team

The Founder and CEO of Regency is a creative entrepreneur who generates many ideas and strategic concepts toward his management team. He holds much respect for his team’s experience and delegates as such.

Strategic Alternative #2 will required a complete team effort of brainstorming and consensus building in order to assess and execute opportunities in developing the Regency franchising model.

Table 3.3 below summarizes how this compares to the preferences that are observed amongst the key decision-makers for Regency.

Table 3.3: Management Team Under Strategic Alternative #2

<table>
<thead>
<tr>
<th>Management Subject</th>
<th>Required Preferences</th>
<th>Observed Preferences</th>
<th>Major Gaps</th>
<th>Gap-Closing Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Founder and CEO</td>
<td>Ability to delegate and allow team autonomy</td>
<td>Match with required preferences</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>President</td>
<td>Ability to facilitate to consensus among team</td>
<td>Match with required preferences, However concise team decisions not always reached</td>
<td>Decisions are sometimes left on the table, with no immediate resolution</td>
<td>Deploy existing human resources for recommendations. Put in place an experienced manager in charge of franchise development decisions</td>
</tr>
<tr>
<td>VP Finance/IT</td>
<td>Ability to work productively with team</td>
<td>Match with required preferences</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>VP Operations/R&amp;D</td>
<td>Ability to work productively with team</td>
<td>Match with required preferences</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>VP Sales &amp; Marketing</td>
<td>Ability to work productively with team</td>
<td>Match to required preferences</td>
<td>None</td>
<td>None</td>
</tr>
</tbody>
</table>
3.3.1.3.1 Gaps in Management Team

For the most part all of the required preferences in management team match those observed. The management team at Regency holds a high level of experience and opinion and generally embraces change well. However, because of this dynamic, reaching a consensus is sometimes a challenge.

With the complexity and detailed requirements of planning and developing a franchised business, decision making relating to this venture could be challenging for the existing management team. When a decision is imminent and a consensus cannot be made, Regency’s President will need to make a concise decision to settle the matter and ensure opportunity does not pass itself by due to disagreement.

3.3.1.3.2 Suggested Gap-Bridging Solution

As opportunities arise in the market to execute Strategic Alternative #2 (including the two experimental franchise models described in Management Objectives section 3.3.1.1), thorough assessment followed by timely decision making will need to take place. The high level of personal opinion held by the management team may need to be managed so a final decision can be made. It is important to note that high level strategic decisions in Regency are dealt with on a consensus basis within the entire management team. However, by using Regency’s existing regional Sales Directors to make initial decisions and recommendations would be in Regency’s best interest. These Directors could be deployed to manage the front line opportunities in the existing dealer network.
for the franchise feasibility analysis phase, as stated in Management Objectives section 3.3.1.1, and bring detailed analysis and recommendation to senior management.

However, in light of the attention and understanding required to make the franchise business successful, and as stated in Management Experience section 3.4.1.2, Regency should consider adding, or promoting from within, a senior manager in charge of franchise business development. The challenge is finding a person with a balance of franchise and hearth industry experience. This manager would ultimately report into the VP of Sales and Marketing and be charged with responsibility for franchise related decisions making.

3.3.1.4 Leadership

In Strategic Alternative #2, the leadership required will need to be one of allowing others to make the necessary changes and decisions to achieve the common goal set out. This alternative will require initiative, perseverance and commitment. The management team will need to be on the same page and show confidence and passion in their actions and how they relate to the franchise opportunities, systems and support. Effective leadership in planning and developing the franchise business will need to be consistent and focused, without being influenced by other agendas or initiatives within the company.

This strategic alternative will require leaders with the ability to balance the business between existing MC dealers and franchised stores. The leadership needs to ensure clear direction and vision are supported with both retail strategies to avoid
confusion among those supporting each. For example, a new product design, consuming R&D resources, may only be in development exclusively for the franchise business.

3.3.1.4.1 Gaps in Leadership

In discussion with the management team, they feel the Founder and CEO is a true entrepreneurial leader who trusts and gives them the autonomy required in order for them to be good leaders of change. Although, the management team holds slightly differing leadership styles, they all believe that Regency is a performance driven company and as such lead their respective teams accordingly.

Each respective member of the management team currently supplies effective leadership and decision making within their areas of responsibility. These areas of responsibility currently cater, on the most part, to the MC dealer network. The leadership to develop the franchise business is currently non-existent. This is the primary gap in achieving success with Strategic Alternative #2. Decision making and direction need to be clear among Regency employees and ensuring there is the necessary separation between the MC dealer and the franchise business.

As observed and mentioned earlier, Regency’s Founder and CEO has been researching the viability of franchising for his business. However, in the long run, he would not be the one to supply day to day leadership and decision making in this venture. Decision making with regards to the franchise business will need a dedicated leadership role.
3.3.1.4.2 Suggested Gap-Bridging Solution

Regency continues to hold strong management and leadership capabilities. However, in order to bridge the gap of not having dedicated leadership and decision making for Strategic Alternative #2, Regency would be best to hire, develop, and/or promote a manager or director responsible for this alternative as stated in section 3.3.1.3 Management Team.

In the short run, Regency’s Founder and CEO should hold a high level of involvement in the concept and vision of the franchise business. However, in the long run, once a formula is developed and proven, the franchise business will need to be the responsibility of an executive team member. This will facilitate clear direction and decision making with focus on expanding the franchised stores across North America.

3.3.1.5 Management Preference Summary

The analysis of Management Preferences indicates that there are nine gaps that need to be filled. It is to be noticed that there is one common gap that appeared in management objectives, management experience and leadership with regards to experience and leadership with franchise business development. The following is the summary of the gaps indentified:

- Maintain a consistent franchise image with multiple business owners
- Accepting added complexity to business
- Interest in reducing risk to company
- Interest in marketing to two distinct retail models
- Understanding franchise business development
- Understanding dynamics of two business models; MC dealer and franchise
- Distinct product development expertise for franchise model
- Decision making left on table
- Lacking long term leadership with franchise development

Table 3.4 below summarizes the suggested methods to fill these gaps:

**Table 3.4: Summary of Management Preference Gaps and Suggested Solutions for Strategic Alternative #2**

<table>
<thead>
<tr>
<th>Gap</th>
<th>Suggested Solution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maintain a consistent franchise image with multiple business owners</td>
<td>Develop a proven “formula” and careful selection of franchisees</td>
</tr>
<tr>
<td>Accepting added complexity to business</td>
<td>Allowing cost, time and development of people, systems and controls to control complexity</td>
</tr>
<tr>
<td>Interest in reducing risk to company</td>
<td>Develop a phase in approach to understand legal/financial issues and constraints using experimental franchise stores: “Key Dealer Plus” and/or “Targeted Dealer”</td>
</tr>
<tr>
<td>Interest in marketing to two distinct retail models</td>
<td>Create additional components in marketing structure/focus and develop strategies for both models</td>
</tr>
<tr>
<td>Understanding franchise business development</td>
<td>Initially seek professional assistance regarding franchise planning/development</td>
</tr>
<tr>
<td>Understanding dynamics of two business models; MC dealer and franchise</td>
<td>Develop ability to focus on franchise business network through hiring a senior manager in charge of franchise development</td>
</tr>
<tr>
<td>Distinct product development expertise for franchise model</td>
<td>Ensure clarity and develop or find experience in design concepts and project scope for niche (franchised) applications</td>
</tr>
<tr>
<td>Decision making left on table</td>
<td>Deploy existing human resources for opportunity recommendations. Place an experienced discipline in charge of franchise development decisions</td>
</tr>
<tr>
<td>Lacking long term leadership with franchise development</td>
<td>Short run: Founder and CEO to supply vision. Long run: senior executive team member to supply direction and decisions for the franchise business</td>
</tr>
</tbody>
</table>
It is important to note that Strategic Alternative #2, as it was explained in Chapter 2 as the Regency Franchise, has been significantly modified to reduce the risk to Regency. Again, due to Regency’s lack of franchise experience, experimental franchise stores will pose as a feasibility study in developing the “right” franchise concept and formula.

3.2.2 Organization Analysis

3.3.2.1 Systems

In order for Strategic Alternative #2 to be successful, many systems need to be developed, proven, implemented, monitored and adjusted as required. The key is having these systems well defined and understood before attempting to develop a franchise program. A successful franchise development program begins with a solid foundation (Murphy, 2008). The long-term goal is to establish balanced, integrated and successful business relationships with qualified individuals (owners) who support Regency’s goals and image. From the franchisee’s perspective, they risk their capital because of their confidence in Regency’s products and proven systems. Creating these relationships requires a comprehensive strategy that addresses all aspects of the franchise venture.

The danger here is allowing franchise consultants and/or franchise legal services to deliver “cookie cutter” systems and documents for the franchisor to use. In this case, these documents would be generated by feedback from Regency, who at this point, has minimal knowledge of franchising a business. Yet, Regency would be charged with making all the strategic decisions. Regency needs to be very aware of this and ensure they undertake well thought-out strategic planning and systems before they enter the franchise industry.
A good strategic plan for franchise systems should be approached as a team effort between the Regency’s management and any outside consultants and legal professionals.

Table 3.5 summarizes the basic elements of the strategic planning systems for a franchisable business (Canada Business, 1999).

Table 3.5: Summary of Systems Required for a Franchisable Business

<table>
<thead>
<tr>
<th>Elements of Systems</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Franchise operations</td>
<td>Defines the franchisor’s program for each step of the franchise relationship</td>
</tr>
<tr>
<td>Operational format</td>
<td>Defines the relationship between the company and its franchise distribution systems</td>
</tr>
<tr>
<td>Manuals and training</td>
<td>Determines the correct structure and language for procedural and operational manuals and training</td>
</tr>
<tr>
<td>Retailing</td>
<td>Defines the retail operating system including standards, inventory, marketing, advertising, loss prevention</td>
</tr>
<tr>
<td>Development</td>
<td>Prioritizes the goals for an effective growth program</td>
</tr>
<tr>
<td>Franchisee selection</td>
<td>Determines the franchisee recruitment and selection process. Market selection, entry, and distribution</td>
</tr>
<tr>
<td>Royalties/fees</td>
<td>Determines projected growth rate for the franchise business including financial projections and start-up costs, royalty fees, advertising contribution</td>
</tr>
<tr>
<td>Technical</td>
<td>Define technical training specifications, execution and frequency i.e.: new product introductions</td>
</tr>
</tbody>
</table>

A good franchise concept has to be teachable. To accomplish this, Regency’s franchise model should be thoroughly systemized and its operations documented so it can be copied by others. Moreover, the [franchised] business must be able to operate in a non-centralized way. An effective method to document operations is in a franchise operations manual. These manuals reflect standardized methods, processes and procedures for every facet of the franchised business. The franchise operations manual
becomes a training program for owners, managers and employees and can be used for audit purposes from the franchisor.

A major reason for solid and standardized systems is the concept of repeatability. Repeatability is the essence of a franchisable business and therefore the business must be one that can be replicated over and over in many places by many people. It is important to note for Regency, that if their “formula” and system can only work in one location or one narrow geographical region, it is not repeatable and therefore not franchisable.

Technical training systems will be critical for Alternative #2 to be successful. New owners/managers will need industry expertise knowledge transfer for design, application, install and service perspectives. These systems could range from training workshops to webinars to instructional web-based videos and must be frequent enough and stay abreast with new product development and introductions.

As much as technical service systems are important, sales and marketing training systems and advertising support will be required to ensure product utility benefits are passed to the consumer so as to generate a greater willingness to pay. This in conjunction with exceptional product development will capture the economic surplus for Regency, as described earlier.

3.3.2.1.1 Gaps in Systems

Regency has developed strong and stable business systems over their evolution. Specifically, since 2004, Regency has successfully adopted a continuous improvement mindset of identifying and removing no-valued added activity based on cross-functional problem solving and solution implementation. The basis for this mindset is through
process mapping current state activity and conducting gap analysis against a desired future state. This mindset will assist Regency in developing effective franchise systems going forward.

However, there is a known gap in Regency’s IT systems with their Enterprise Resource Planning (ERP) computer system. This system, originally implemented in 2003, is a single database for sales, operations, distribution and finance transactions and information across North America. It has been observed through 3rd party auditing and employee survey that the system has reached its lifespan because the technology and functionality are antiquated and will not allow future flexibility, visibility, integration and growth through-out Regency’s supply chain. Newer systems available are designed to deliver fully integrated information and process visibility across an organizations supply chain. These newer systems can facilitate real time information right through planning, procurement, manufacturing, distribution, retail and after sale service.

Regency continues to be an industry leader in customer service in terms of technical before and after sale service and training as well as sales and marketing support. This is currently what differentiates Regency in the industry and they need to ensure these systems stay abreast of market shifts, changing needs and opportunities. No gaps are identified here as it is observed that Regency’s customer service abilities will in fact be a driving asset to developing the franchise business.

However, Regency currently has no systems in place related to setting up or developing, selecting, servicing and monitoring the franchisees. These systems are all the procedures that become the franchise operations manual and cover everything from startup activities to marketing, office procedures and personnel management. The gap
here is in Regency having the technical writing skills to create these procedures in order to ensure they are effective, clearly understandable and repeatable. This operations (systems) manual will be the standard for which monitoring, auditing and performance measurement will be based off. Moreover, control systems such as mystery shoppers and integrated point-of-sale (POS) devices will need to be put in place to monitor the franchisees activity and commitment to Regency products.

3.3.2.1.2 Suggested Gap-Bridging Solution

In order to close this gap with the IT systems, Regency would need to implement or upgrade a better ERP solution with the focus on improving the supply chain effectiveness, specifically downstream from their manufacturing operations, through distribution and into the retail store. In discussion with Regency’s President and VP of Finance/IT, this ERP implementation is currently being planned for a 2nd quarter of 2013 go-live. This IT solution will allow Regency to achieve improved work-flow, better visibility of real time information and enable a fully integrated supply chain through its distribution and into the franchised business.

Regency, although holding depth of skills and experience in the hearth industry, will need assistance with developing proper documents and procedures that make up the franchise operations systems manual. By acquiring the skills of technical writers, in conjunction with an experienced franchise attorney and a competent franchise consultant, these procedures can be constructed so they are easy to read and satisfy all legal requirements. This experience, to render the services required in developing the franchise operations manual are estimated to cost $60K.
3.3.2.2 Structure

One of the reasons to develop a franchised business is to maintain Regency’s differentiation strategy and this is best achieved through a decentralized structure. Having regional decision making, sales and technical training and support and product availability will allow Regency to enhance their differentiation strategy at the franchise level. Because each region has differing customer needs in terms of product offering, maintaining regional focus will benefit the customer, store owner/manager and Regency.

In terms of supporting the distribution and logistics for North American franchises, Regency’s head office and manufacturing and their six sales and distribution branches, will need clarity with reporting structure. Roles and responsibilities across the organization in the areas of sales, marketing, distribution and manufacturing will need review to ensure consistency with objectives and service to all regional areas supporting the franchised business.

A more direct focus on the franchise business and network is important to mitigate any crossed-agendas between the MC dealer business and the franchise business. These two distinct retail strategies have differing systems and tactics. The franchise business as it develops and stabilizes will continue to need a well defined structure supporting it. However, it is important to note that the longer a particular franchisee is in operation, the less support it should require from the franchisor.
3.3.2.2.1 Gaps in Structure

The gaps in structure stem from having the sales and distribution branches reporting respectively into Regency’s Sales Directors. There are six decentralized structures like this existing in Regency today and these sales and distribution entities report into Regency’s VP of Sales and Marketing. **Figure 3.2** shows the current organizational chart with respect to sales and distribution structure.

**Figure 3.2: Organization Chart for Current Sales and Distribution Structure**

As can be seen from the existing organizational structure, there is gap with having no organizational focus on the franchise business. There are broken links between manufacturing (supply) and distribution and this fragmented organizational structure is
causing ineffective product allocation decision making from supply to retail. As well, in a discussion with Regency’s President, there is a concern over lack of presence and effectiveness with the Sales structure of the company. This structure will clearly be of prime importance in scanning and locating opportunities for developing and expanding the “experimental franchise” stores and the full Regency franchise.

3.3.2.2 Suggested Gap-Bridging Solution

The suggested gap-bridging solutions for improving the structure effectiveness is to develop distinct organizational structure focuses, linking manufacturing, distribution, sales and marketing to the retail showroom floor. The suggested solutions are as follows:

- Re-structure the distribution branches by removing the direct responsibilities away from the Sales Directors and putting them under Operations;
- Re-structure the Sales and Marketing structure, having the re-structured Sales Directors full focus on their sales teams, MC dealers network and initial pilot opportunities in assisting with developing the franchise business;
- Put in position a Director of Franchise Development reporting in to VP Sales and Marketing in charge of franchise business, systems, planning and development;
- Create a VP Supply Chain position, having the responsibility of all manufacturing and distribution operations across North America. This will build better focus to improve systems, efficiencies, inventory management and allocation to service entire retail network.
Expected costs to Regency would be incremental as business development grows.

In observation, the existing Director of Manufacturing position is poised to assume the VP Supply Chain responsibilities and the needed Director of Franchise Development could be potentially filled through consolidating existing Sales Director positions.

**Figure 3.3** shows the future organizational chart with respect to the Sales and Distribution structure.

**Figure 3.3: Organizational Chart for Future Sales and Distribution Structure**

![Organizational Chart for Future Sales and Distribution Structure](image-url)
3.3.2.3 Organizational Culture

For Strategic Alternative #2, the culture of Regency at the senior management level needs to be one of respectful dialogue, discussion and autonomy. The management team needs to have the ability to listen to others, brainstorm and allow ideas to live.

As many issues regarding the industry, competitors and tactical measures will come into play, these team members all need to be able to listen to middle management regarding opportunities in the market and more specifically the owners/managers of the retail stores. Regency will have to create a mechanism for the franchisees to supply input and feedback regarding product and customer information.

This environment must flow down to all functional areas and employees in order for the organization to hold an acceptable level of authenticity. Only then, will Regency be able to capitalize on strategic change through buy-in and commitment from others.

3.3.2.3.1 Gaps in Organizational Culture

As a true entrepreneurial company with decentralized decision making and autonomy, Regency is observed to fit the culture needed for franchising. Regency has a continuous improvement culture, where all employees are encouraged to challenge the status quo and identify opportunities for required change. Change is accepted freely, yet if of a strategic nature, is typically discussed among the senior management team to a decision that is best of the company as a whole. This is how strategic change is looked at from the senior management level. Respect and understanding of each other’s viewpoints is apparent and visible. With the careful selection of franchisees, and in
discussion with the Founder and CEO, Regency hopes to maintain this culture. With the right franchisees in place, Regency hopes to capture the direct customer needs and allow the franchisee a voice and give input back to head office to improve product, service and systems. This can be achieved through having a direct structure and discipline supporting the franchise business, as stated in preceding sections. There are no visible gaps currently observed with regards to organizational culture.

3.3.2.4 Organization Summary

The analysis of the Organization indicates that there are four main gaps that need to be filled:

- IT systems, specifically their Enterprise Resource Planning (ERP) computer system is hampering flexibility and growth.
- Control systems for developing, selecting and monitoring franchisee activity.
- No technical writing skills to create franchise business procedures in order to ensure they are effective, clearly understandable and repeatable.
- No organizational structure focused on the franchise business.
  - Reporting structure of distribution branches into Sales Directors
  - Concern over lack of presence and effectiveness with the Sales structure of the company

The suggested ways to fill these gaps are summarized in Table 3.6 below.
### Table 3.6: Summary of Organization Gaps and Suggested Solutions for Strategic Alternative #2

<table>
<thead>
<tr>
<th>Gap</th>
<th>Suggested Solution</th>
<th>Estimated Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT systems, specifically their Enterprise Resource Planning (ERP) computer system is hampering flexibility and growth</td>
<td>Need to implement or upgrade a better ERP solution with the focus on improving the supply chain effectiveness, specifically upstream from their manufacturing operations, through distribution and into the retail store.*</td>
<td>$800K - $1M for complete system and implementation</td>
</tr>
<tr>
<td>No technical writing skills to create franchise business procedures and control systems in order to ensure they are effective, clearly understandable, repeatable and legal</td>
<td>Acquire the skills of technical writer, in conjunction with an experienced franchise attorney and a competent franchise consultant</td>
<td>Up front, one-time cost of $60K to complete franchise operations manual, documentation and control systems</td>
</tr>
<tr>
<td>Control systems for monitoring franchisee activity</td>
<td>Integrated POS devices and use Regency’s regional employees as mystery shoppers</td>
<td>Use ERP computer system integrated functionality to see real time sales data</td>
</tr>
<tr>
<td>No organizational structure focused on franchise business</td>
<td>Re-direct the responsibilities of the distribution warehouses away from the Sales Directors and create a Supply Chain Management function.</td>
<td>Additional $50K per year in salary and bonuses</td>
</tr>
<tr>
<td></td>
<td>Consolidate Sales Directors and create a Director of Franchise Development</td>
<td>Additional $50K per year in salary and bonuses</td>
</tr>
</tbody>
</table>

### 3.3.3 Resources Analysis

#### 3.3.3.1 Operational Resources

For Strategic Alternative #2 to be successful, well established yet flexible operational resources will need to be in place. These resources include R&D capabilities
to develop and maintain a breadth and depth of product line enough to enhance and differentiate the franchise business.

Minimal inventory at the franchisee level is critical for profitability and lower risk. Therefore, the distribution system, for Strategic Alternative #2, would need focus to supply on an “on-demand” basis into the retail store with minimal lead times. Product supply (manufacturing and procurement) into finished goods distribution would need to be flexible, agile and have the ability to be responsive to consumer demands.

As opportunity arises to expand the franchise and maintain consistent customer service, a strong capability with sales and technical training and support would be required to bring store managers and staff to a high quality level of customer service. As new products enter the market the franchisees must stay abreast of the technology and functionality. Other important operational resource capabilities in order to support Strategic Alternative #2 would be infrastructure to offer financial services, business development assistance and marketing programs.

3.3.3.1 Gaps in Operational Resources

Most current capabilities in operational resources match those required to make Strategic Alternative #2 successful. In observation and discussion with the management team, Regency has strong operational resources across the company. All R&D and product development personal within Regency and supporting resources outside Regency have strong skills and experience in hearth design, prototyping, testing and approval process.
Regency has developed an efficient manufacturing plant built on the philosophy of agility, flexibility and responsiveness to changing market demands. This coupled with six wholly owned distribution centers throughout North America allows efficient movement of product to the marketplace.

Each decentralized distribution center, strategically located across North America, is fully capable of supplying sales and technical training in order to support a franchised retail network. Each distribution center has the current ability and resources to deploy the technical training internally or externally. Moreover, IT development is assisting in this ability through web-based sales assistance and technical training and instructional videos.

Regency, over the years, has maintained a healthy and strong financial position. Strong knowledge and experience along with a commitment to Regency’s business model from all the management team is the primary reason for this. Financial resources at Regency include IT and legal entities. It is agreed, from the Regency’s Founder and CEO and the VP of Finance, that this knowledge and support could be deployed to bring solid business development assistance to opportunities within Strategic Alternative #2. There are no observed gaps in Regency’s operational resources.

3.3.3.2 Human Resources

For Strategic Alternative #2 to succeed, Regency will require a strong senior management team across all functional areas. As well, industry specific skills and experience in marketing, sales and technical training would be of prime importance. In
looking for the “right” people to run these franchises, Regency should look at its employee base for future franchise owner/operators as a viable option.

For this to be possible, Regency may need to look into HR systems to develop potential franchise operators. The advantage here is having personnel that understands the Regency culture and preferably has grown with the company to understand its products and differentiation. Regency would need to develop career planning and succession planning development programs to advance skill sets and readiness for the franchise business.

3.3.3.2.1 Gaps in Human Resources

Regency has a strong senior management team with 15-20 years with the organization and/or the hearth industry. The depth of employees under the management team shares the same level of respective knowledge, specialization and tenure. Regency’s retention rate is high with 60% of their staff employees being with the company for an average of 13 years and 60% of that group have been with Regency for an average of 20 years. As observed in annual employee surveys the level of Regency employees that are committed to the organization and wanting to contribute to its success is high.

However, there are observed gaps in leveraging this experience and commitment with respect to career development and skill building for potential owner/operators for a franchised store. In observation and discussions, many of Regency employees show interest in this opportunity to become a business owner, operator or manager of a
Regency franchise. Their years of knowledge and understanding of Regency culture could be, with proper training and development, easily transferable to the retail level.

3.3.3.2 Suggested Gap-Bridging Solution

In order to bridge the gap stated above, and improve the success of Strategic Alternative #2, Regency will need to look at creating career development programs focusing on the skills in becoming a franchise owner or manager. This program would allow selected employees the opportunity to advance their prospective entrepreneurial careers, yet stay within the culture of the company they have grown with.

This program should be considered an investment to Regency and would run in parallel with franchise development. A program of this nature would yield minimal cost and would utilize existing resources in sales, technical, product knowledge and Regency’s franchise “formula”. An estimated cost of $2000 per year per employee would be expected.

3.3.3.3 Financial Resources

The financial resources required for Strategic Alternative #2 can vary depending on scale and scope of the franchise business. For this alternative to be successful, it must be recognized that significant financial resources are required for franchise development, organizational structure changes/additions and systems implementations.

**Table 3.7** outlines the estimated internal organizational and human resource costs required to support the franchise business. The organizational structure changes are estimated as a one-time adjustment to existing employee base salary and bonus structure.
Table 3.7: Organization/Human Resources Costs to Support Strategic Alternative #2

<table>
<thead>
<tr>
<th>ORGANIZATIONAL STRUCTURE CHANGES</th>
<th>$100,000</th>
<th>* one time salary adjustment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Create VP Supply Chain and Director of Franchise Development from existing human resources*</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>INTERNAL CAREER DEVELOPMENT</th>
<th>$6,000/yr</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Skills development for existing employee franchisee potentials (3/yr)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 3.8 below outlines the financial budget costs associated with developing a franchise (Murphy, 2009). These are estimated costs and can vary depending on expertise and time spent in the planning phase of setting up the franchise.

Table 3.8: Franchise Development Budget Costs

<table>
<thead>
<tr>
<th>STRATEGIC PLANNING, OPERATIONS MANUAL &amp; TRAINING PROGRAM</th>
<th>$60,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Months of critical franchise strategic planning, including helping develop a professional, customized franchise operations manual and training program that are fully integrated with the FDD (below).</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>FDD FRANCHISE DISCLOSURE DOCUMENT</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Also includes drafting the FDD Franchise Disclosure Document, a 23-chapter document with various exhibits including franchise agreement, audited financial statements</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>FRANCHISE REGISTRATION APPLICATION</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Also includes preparing and filing a franchise registration application with one franchise registration state.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ADD NEW ENTITY FORMATION COSTS</th>
<th>$2,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Forming a new entity to offer and sell the franchises (Corporation or LLC)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ADD CPA COST OF AUDITED FINANCIALS FOR FDD</th>
<th>$5,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of audited financials for FDD</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ADD REGISTRATION FILING FEE</th>
<th>$1,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registration application fee paid to a franchise registration state</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Budget to Enter Franchising [1]</th>
<th>$68,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional franchisee follow-up and training</td>
<td>$6,000</td>
</tr>
</tbody>
</table>

[1] - does not include whatever amount is used to initially capitalize the new entity at start up, or post-development expenses such as franchise advertising and marketing costs. A franchise development program normally takes about four to six months to complete and can be expedited even further on a "rush" basis. Review-registration time by governmental agencies depends on a variety of factors and will take further time to complete. The estimate includes an FDD containing a single unit franchise agreement and filing in one franchise registration state. Using a defined franchise budget gets the cost to franchise a business to an acceptable, affordable level and ensures the most efficient use of resources and talent. Paying at hourly rates can increase the cost five-fold or more.

(Source: http://www.franchisefoundations.com/franchisebudget.html)
3.3.3.3 Gaps in Financial Resources

In discussion with the Founder/CEO and President of Regency, regarding the financial budgets above, they showed acceptance to these initial estimates. Understanding that a well run franchise could yield sales revenues of $1.2M per year (300 units @ $4,000 retail) at a franchise royalty fee of 4-10% (Siebert, 2010), the investment required yields a return that is acceptable to the company.

As stated in above sections, Regency capital structure yields a strong balance sheet and the company has remained profitable over its duration in the hearth industry. Financial resources to develop Strategic Alternative #2, whether from the business and/or lending institutions, are within the capabilities of Regency. Based on the observation and opinion of senior management, no gaps in financial resources are identified at this time.

3.3.3.4 Resources Summary

The analysis of the Resources indicates that there are two gaps that need to be filled:

- Ability to supply business development and financial support and assistance to potential Regency only retail stores.
- Re-organization of people and/or departments with regards to manufacturing, distribution and sales in order to streamline focuses in the supply chain functions.

The suggested ways to fill these gaps are summarized in Table 3.9 below.
Table 3.9: Summary of Resources Gaps and Suggested Solutions for Strategic Alternative #2

<table>
<thead>
<tr>
<th>Gap</th>
<th>Suggested Solution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ability to supply business development and financial support and assistance to potential Regency only retail stores.</td>
<td>Develop the business development and financial resources model that can be deployed as needed to the would-be, less experienced store managers.</td>
</tr>
<tr>
<td>Re-organization of people and/or departments with regards to manufacturing, distribution and sales in order to streamline focuses in the supply chain functions.</td>
<td>Creating a supply chain focus within the company. New position would ideally be part of the senior management team and the individual would have the skills and experience to make decisions and influence change with respect to manufacturing operations, inventory systems and distribution and logistics.</td>
</tr>
</tbody>
</table>

3.3.4 Summary of Assessment

The primary reasoning for the strategic alternatives proposed is for Regency to obtain a majority control over the complete selling process of its products to homeowners. One of the main objectives is to remove competitors from the showroom floor where these sales take place.

The two proposed alternatives will both satisfy this objective. However, a risk adverse management preference and a long standing successful business model are putting the Corporate Owned Retail (Strategic Alternative #1) in a less desirable state. In fact, management stated they would not pursue this alternative.

Risk adverseness is also affecting the full implementation of the Regency Franchise (Strategic Alternative #2). However, with the needed skills and feasibility phase (experimental franchise stores) the Regency Franchise model would be a viable strategic alternative in pursuing forward integration. Depending on the outcome of this experimental phase with the “Key Dealer Plus” and “Targeted Dealer” models, Regency
could very well be in a position to develop their franchise business. In making the Regency Franchise alternative successful, Regency has various gaps to fill. However, filling these gaps is well within the management preference, organizational capabilities and company resources.
4: **FINAL RECOMMENDATION**

This chapter will summarize the findings, recommend the best alternatives based on previous studies, explain the gap bridging solutions, and offer a timeline for strategy implementation.

4.1 **Summary of the Strategic Alternative**

Based on the analysis of the hearth industry and Regency’s internal capabilities, it is suggested the Regency move forward with Strategic Alternative #2, The Regency Franchise. This strategic alternative, in looking back at Table 1.1 and ‘The Strategic Grid Fit’, is in keeping with Regency’s differentiation strategy.

A Regency Franchise model will allow the company to leverage its core competencies to gain competitive advantage over its competitors in the hearth industry while capturing economic surplus. Regency’s goal to obtain a more control over the complete selling process while creating a unique and consistent customer experience. This can be done, while maintaining their low risk profile, through developing a retail “formula” that can be repeatable for a franchise model.

4.2 **Summary of Phased Action Plan**

To implement the above strategic alternative, Regency has to bridge the gaps identified in the areas of management preference, organization capabilities and company resources. In reviewing the Chapter 3 analysis, these gaps can be summarized in four key...
phases of implementation. Table 4.0 below, shows the phase, area of interest, action, plan and timeframe frame.

*Table 4.0: The Regency Franchise Phased Implementation Plan*

<table>
<thead>
<tr>
<th>Phase</th>
<th>Interest</th>
<th>Action</th>
<th>Plan</th>
<th>Timeline</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Organizational Structure Phase</td>
<td>Is the organization structured to support the franchise?</td>
<td>Structure organization to support a franchise business model</td>
<td>Remove distribution branches from Sales Directors and structure a fully focused sales team</td>
<td>Q1 – Q2 2012 (March 2012 - August 2012)</td>
</tr>
<tr>
<td>2 Franchise Feasibility Phase</td>
<td>Has the concept been sufficiently proven?</td>
<td>Create a proven “formula” for franchising</td>
<td>Leverage existing dealer network with Regency Key Dealer Plus and Targeted Dealer models – creating exclusivity and control</td>
<td>Q1 – Q4 2012 (March 2012 – February 2013)</td>
</tr>
<tr>
<td>3 Franchise Strategic Planning Phase</td>
<td>Is there a solid foundation in place for franchising?</td>
<td>Maintain clear focus and decision making with franchise development</td>
<td>Hire or promote a Director of Franchise Business Development to foster the management of the franchise business</td>
<td>Q1 – Q2 2013 (March 2013 – August 2013)</td>
</tr>
<tr>
<td>4 Franchise Documentation Phase and Launch</td>
<td>Are all the required systems and legal aspects in place?</td>
<td>Understand and knowledge to develop the model and launch the franchise plan</td>
<td>Deploy external consulting expertise to assist in bringing franchise to market</td>
<td>Q3 – Q4 2013 (September 2013 – February 2014)</td>
</tr>
</tbody>
</table>
It is important to understand the timeframe above is taking into consideration Regency’s current ERP computer system implementation scheduled for a beginning of Q2 (June) 2013. This ERP system implementation is an organization wide initiative and will consume human resources into Q3 of 2013. However, Phase 1 and Phase 2 above can be executed in parallel with no disruption to the ERP project. This schedule will allow Regency thorough time for Phase 2 (Franchise Feasibility) so as to understand and experiment with differing concepts at the retail level with direct contact to customer information. Regency will also have the ability to test new product designs and concepts away from the MC dealer and in a controlled Regency exclusive environment.

Regency’s preference to change management, as mentioned in this analysis, is not one of sudden change but rather incremental through a series of learning steps and adjustments. Strategic Alternative #2, The Regency Franchise, is recommended to be implemented in the same fashion. However, once human resources, structure and systems are in place and a franchise concept and formula have been proven, Regency will be in a position to replicate and roll out their franchise model to North America.
Bibliography


