

A CASE STUDY OF ALLEY ESTATES LTD.

by

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Fulfillment of the Requirements of
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of

Arts

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ABSTRACT

This research project is an analysis of a small, Canadian real estate firm. It is presented in the form of a case study composed of three parts.

The main text of the case is a carefully developed history of the firm. This is intended to present to future students of organization policy courses the opportunity to isolate the factors which have contributed to this firm's success, to gain experience in analysis and decision making at the entrepreneurial level, and to recognize and confront problems relating to a firm's growth.

The second component is an analysis of the case, including identification of significant variables and a recommended strategy for the firm. This section is intended for use by course instructors.

The third component is a report to the principal of the firm, outlining the various roles he might occupy, his options as they relate to the business, ramifications of each alternative, and a recommended strategy for him and his firm.

A variety of methods and materials were used in the compilation of this report. They are:

- (i) interviews with the principal of the firm
- (ii) questionnaires completed by employees
- (iii) compilation and analysis of financial data
- (iv) survey and analysis of industry practices
- (v) development and evaluation of alternative strategies.

The project has provided a case for use by future students of organization policy courses and a report to the principal of the firm. The strategy

recommended to the principal and included in the instructor's manual for the case may be summarized as follows:

- (i) increase the efficiency of the present operation by focusing more attention on cost control
- (ii) increase revenues by hiring additional, highly qualified salesmen and by more active solicitation of notary business
- (iii) hire a manager within 3-5 years so that the principal may retire from active management.

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TABLE OF CONTENTS

<u>SECTION</u>		<u>PAGE</u>
I	Approval	ii
II	Abstract	iii
III	Acknowledgment	v
IV	Table of Contents	vi
V	List of Tables	vii
VI	Text	
	- introduction	1
	- case	4
	- tables	12
	- instructor's guide	27
	- tables	34
	- report to principal	41
	- tables	54
VII	Selected Bibliography	63

List of Tables

<u>CASE</u>		<u>Page</u>
I	Statements of Income and Retained Earnings (1967-1975)	12
II	Annual Balance Sheets (1967-1975)	13
III	Statements of Changes in Financial Position (1969-1975)	14
IV	Auditor's Notes to the Financial Statements	15
V	Casewriter's Notes to the Financial Statements	18
VI	Monthly Receipts and Disbursements Statements (June, 1974 - June, 1975)	19
VII	Industry Median Cost Percentages	20
VIII	Commissions Earned by Salesmen	21
IX	Commission Rates	22
X	Industry Organization	23
XI	Single Family Dwellings Started and Completed (1969 - 1974)	24
XII	Population Trends (1966-1971)	25
XIII	Notary Revenue By Source (1970-1975)	26
 <u>INSTRUCTOR'S GUIDE</u>		
XIV	Notary Income Statement (Contribution Margin - 1975)	34
XV	Real Estate Income Statement (Contribution Margin - 1975)	35
XVI	Pro Forma of Real Estate Income - Present Cost Pattern	36
XVII	Pro Forma of Real Estate Income - Revised Cost Pattern	37
XVIII	Pro Forma of Notary Income	38
XIX	Pro Forma of Notary Revenue and Real Estate Commissions	39
XX	Alternatives to Existing Commission Split	40

List of Tables

<u>REPORT</u>		<u>Page</u>
XXI	Statements of Income and Retained Earnings (1967-1975)	54
XXII	Alternatives to Existing Commission Split	55
XXIII	Notary Income Statement (Contribution Margin - 1975)	56
XXIV	Real Estate Income Statement (Contribution Margin - 1975)	57
XXV	Pro Forma of Real Estate Income - Present Cost Pattern	58
XXVI	Pro Forma of Real Estate Income - Revised Cost Pattern	59
XXVII	Pro Forma of Notary Income	60
XXVIII	Pro Forma of Notary Revenue and Real Estate Commissions	61
XXIX	Industry Median Cost Percentages	62

INTRODUCTION

Purpose

This study has two primary objectives:

1. To provide a case history and analysis of a local small firm for possible incorporation in a case book that can be included in the curriculum of organization policy courses for undergraduate and graduate students. It is hoped that this case will enable students to isolate the factors which have contributed to this firm's success, to gain experience in analysis and decision making at the entrepreneurial level and to recognize and confront problems relating to a firm's growth. An instructor's guide is also included.
2. To outline, for the principal, Jerome Alley, the various roles he might occupy in future, his options as they relate to the business, and the ramifications of choosing any given alternative. We also hope to assist the principal by documenting and thereby clarifying existing problems in the firm and by projecting future critical decision areas for which he may have to prepare himself and his firm. This requires delineation of Alley's personal characteristics, his skills, objectives, needs, and risk preferences. The end product is a recommendation based on well defined alternatives.

Methods of Research

A variety of methods and materials were used in the compilation of this report. They are:

- (i) interviews with the principal of the firm
- (ii) questionnaires completed by employees
- (iii) compilation and analysis of financial data
- (iv) survey and analysis of industry practices
- (v) development and evaluation of alternative strategies.

Related Literature

The techniques for writing cases, instructor's guides and reports is a matter of style. On a more substantive level, however, it was necessary to draw on many general reference books on real estate and management of businesses. Those which were found to be most useful are listed in the Selected Bibliography.

As the firm operates only in the lower mainland of B.C., many of the specialized publications prepared by the Vancouver Real Estate Board are used, specifically for extraction of statistical data used in reviewing the performance of this firm in comparison with the industry. Texts describing the real estate brokerage business provide standards for the evaluation of the firm's operating policies and procedures.

Reference is also made to legislative changes in Ontario which may be adopted in B.C. and political trends which could lead to legal restrictions on, and changes in the nature and manner of services rendered by real estate agents, and the fee structure applied.

M.B.A. program text material was used to provide the theoretical background for analysis of:

- organization structure and change
- management control systems
- market strategies
- economic analysis
- business policy

ALLEY ESTATES LTD. CASEPRINCIPAL'S GOAL

In June, 1975, Jerry Alley was reflecting on the progress his firm had made in the eight years since inception, and contemplating its future direction.

"I'm approaching that point in my life when I should be able to soon start taking life easier. How can I do this? As the business grows, demands on my time increase. To retire or semi-retire will probably require an increase in my level of income, especially with inflation being so rapid. I don't want to retire completely, but 5 years from now, I'd like to be in a position where I could if I wanted to."

HISTORY

Jerome F. Alley is the president and beneficial owner of Alley Estates Limited, (A.E.L.) a small realty company engaged primarily in residential sales in the Coquitlam area of British Columbia. Coquitlam is an urban area with a population of 101,000, located east of Burnaby Mountain on the perimeter of greater Vancouver.

The firm earned \$19,323 on revenues of \$448,979 for fiscal 1975 and employs 6 salesmen and 2 secretaries, one of whom works on a part-time basis.

At 52, Jerry Alley is married and has a 10 year old son. He takes an active interest in local politics and has a reputation for speaking his mind when dealing with the municipal council. He is a life member of the provincial Social Credit party and supports the Conservative party federally. He is a past president of the Coquitlam Chamber of Commerce, a life member of the Coquitlam and District Hospital Society and is a social member of the Vancouver Golf and Country Club. He also maintains memberships in the Notary Society and the Real Estate Institute.

He estimates his net worth outside of his investment in Alley Estates Limited and its related company at \$235,000, of which 50% is accounted for by his home and personal possessions. His only recreational pursuit is salt-water fishing.

After receiving an honorable discharge from the Canadian army at the end of W.W.II, Alley spent a brief period upgrading his Grade 8 education but stopped before writing his Grade 12 exams. He decided that he would take on a variety of jobs for at least 1 year each, "work like hell", and learn as much as he could, and that this would be his education. He was employed as a cowboy, a gas station attendant, and later formed and operated a janitorial supply concern in partnership with an associate. He dissolved the partnership to pursue other interests.

Immediately prior to his career in real estate, Alley operated a contract logging firm which failed due to an absence of available timber. In 1960 he found himself in the position of being unable to obtain a job within the forest industry due to his age and inadequate formal education. On the suggestion of a friend he completed the Real Estate Council's pre-licensing course and began selling on a one year trial basis. The year proved to be a successful one and so he continued in the industry. In January, 1962, he changed employers and moved to Coquitlam, on the basis that it was a developing area that he perceived to afford greater opportunity than the stable Vancouver market.

With further study, he qualified as both an agent and a Notary Public, making it possible for him to open his own combined realty firm and notary practice. In November, 1966, with \$1,500 of personal savings, Alley and an older associate, who was also a Notary, opened Alley Estates Limited as a joint venture in a small shopping centre. Six months later the associate's health failed and Alley purchased his partner's share of the business.

In 1968 Alley expanded his premises by purchasing the flower shop adjacent to his office, liquidating its assets and taking on the lease for the additional space.

In May, 1974, Alley reached an agreement with a nearby branch of the Bank of Nova Scotia which resulted in all the branch's mortgage conveyancing being directed to Alley.

SCOPE OF OPERATIONS

Although A.E.L. was a participant in the first land development project in Pitt Meadows, and the firm has periodically purchased properties, for development and/or resale, the thrust of the business has remained in the area of residential sales since inception. Developments have been kept small because Alley didn't want to "stick his neck out".

FINANCING

With the exception of the initial funding from his personal savings, all financing has been through bank debt and retained earnings. Only once has Alley been refused financing. After the firm's first year of operations, he requested a \$20,000 line of credit which was turned down by his bank, a problem which Alley promptly solved by switching banks.

MANAGEMENT PHILOSOPHY

Alley explained his management philosophy as follows: "Good management is simply a matter of having the right people in the right jobs. I don't have to motivate these people. They are motivated. I treat these fellows as independent businessmen, which is what they are. They don't work for me; they just hire my services. The law requires that they do so."

ADVERTISING AND PROMOTION

A.E.L.'s most successful promotion tool, according to Alley, has been a detailed map covering Coquitlam and the adjacent residential communities of Port Coquitlam and Port Moody. The reverse side contains information on a variety of community services available to residents. The maps are used by students, schools, churches and even the municipal government. The unit cost to A.E.L. is approximately 50¢. The firm also uses classified advertising in Vancouver's daily newspapers, the local newspaper and on-premises signs. Alley writes a syndicated general interest column in the local paper and the company makes donations of approximately \$5,000 annually to a variety of local causes. Many of these donations are categorized as Advertising or Sales Promotion in the company's accounts. (e.g. - community centre scoreboards). Jerry Alley's entertainment costs on behalf of the firm are also included in Sales Promotion.

COMMISSION ARRANGEMENTS

Residential customers are charged 5% of the gross selling price on exclusive listings and 7% on multiple listings (of which approximately 1/2% covers the cost of the Multiple Listing Service). Approximately 40% of the commissions earned (see Table I) accrues to A.E.L. with the remainder going to the salesmen. A.E.L. absorbs the costs of advertising, clerical services, utilities and rent. The remainder goes towards the principal's salary and the profit to the firm. Competing firms use a host of commission-sharing arrangements. Those firms offering higher commission-splits to sales staff offset the reduced revenue by making employees responsible for a greater number of operating costs.

ENVIRONMENT

While commission rates of 5% and 7% are fairly standard throughout the industry, one firm is experimenting with a rate of 3½% on exclusive listings, combined with a strong advertising campaign, presumably on the assumption that demand for realty services is price elastic. Another change in the way commissions are set is being experimented with in Ontario. This involves the negotiation of a sales fee by the vendor and the agent prior to listing. (The adoption of such a practice in B.C. may depend at least in part on whether the government deems that the present standardized rates unduly restrict price competition.) It is uncertain whether negotiated fees would increase or decrease the agent's commission and at present there is no substantive evidence on which to base a prediction of commission rate changes.

The political climate in the province is uncertain. The N.D.P. government enacted a "land freeze" in December, 1972, which in part, is intended to curb development of agricultural land for non-agricultural uses (i.e. housing subdivisions). This legislation limited the supply of land available to residential developers, thereby restricting the supply of new housing, and increasing the prices of existing housing units. The government also proposed to undertake a study of the real estate industry in the province, which has been viewed in some circles as a thinly-veiled threat to reduce the profitability of the industry. By purchasing Dunhill Developments Ltd., the government began to compete directly with private firms in the real estate industry. Collectively, these actions indicate that pressures against realty firms are building. However the government's popularity is presently at an all-time low and many (Alley included) believe that after the next provincial election, to be held within 12 months, the party in power will have been ousted and the Social Credit Party elected in its place. The Social Credit platform is not seen as "threatening" by the industry.

Also contributing to the present mood of pessimistic uncertainty, is a world-wide economic slowdown, keenly felt in B.C. with its militant unions and high degree of dependency on primary industry. High royalties, high wage demands and slumping commodity prices have intensified inflation and unemployment in the province, to which is added the fact that recent consumer-price indexes have shown Vancouver to be the most expensive city in Canada in which to live. (Increases in the cost of serviced lots and housing construction have made a major contribution, outstripping Toronto in recent months). The supply of mortgage funds has also been uncertain and mortgage interest rates have remained near historical highs. The result has been a shortage of low cost housing while simultaneously some more expensive new homes have remained on the market for long periods of time.

EMPLOYEES' PERCEPTIONS AND GOALS

Interviews with employees indicate that Alley is generally well regarded by the staff. One salesman feels that the firm is too large, and that 3-4 salesmen would be ideal. Two feel that A.E.L. should become more involved in land assembly and development. Two salesmen also indicate an interest in becoming involved in management. At the present time, none of the salesmen has qualified as an agent, and so cannot be considered as potential purchasers of the firm. The senior salesmen feel that a greater percentage of the commission over \$15,000 should go to the salesmen with a corresponding decrease to A.E.L. They also feel that a further incentive should be related to advertising with each individual given a flexible budget for advertising equal to 10% of revenue produced. At the year end, any amount spent in excess of 10% would be paid to A.E.L. with any deficiency paid to the salesman as an efficiency bonus. The junior salesmen on the other hand indicate that the existing commission split is competitive and acceptable.

PRINCIPAL'S ROLE

By intent, Alley has employed salesmen who do not require constant supervision. The majority of the notary work is delegated to the full time secretary, who prepares the notary documentation for his signature. Alley, who does not sell real estate as he does not want the salesmen to feel he is in competition with them, is thus left relatively free.

INDUSTRY ORGANIZATION

The purpose of the Real Estate Act is to protect the public by ensuring that agents and salesmen are reasonably competent. The act provides that "No person shall act...as an agent (salesman) unless he is the holder of a valid and subsisting agent's (salesman's) licence issued to him under this Act by the Superintendent." The administration of the Real Estate Act is the responsibility of the Superintendent of Insurance. This individual has the power to issue, renew, suspend or revoke licenses. The actual administration of the regulations found in the Act is undertaken by the Real Estate Council, reporting to the Superintendent. (See Table X)

THE REAL ESTATE MARKET

Sales in County 1 (City of Vancouver) through the Multiple Listing Service (M.L.S.) in 1974 equalled \$321.3 million. The average sale in 1974 was \$57,861 and the average transaction price for the first half of 1975 was \$63,169. Use of the M.L.S. in 1975 has increased over 1974, and the market has become more competitive as indicated by an industry-wide decreasing sales-to-listing ratio. (Source: Real Estate Board)

Home prices increased steadily from 1965 to 1974, and have remained relatively level since that time. New construction starts are presently decreasing although there appears to be a shortage in all sectors, with the exception of condominiums and high priced single family dwellings.

B.C. has a growing population with the majority of citizens choosing to reside in the Lower Mainland. Coquitlam is located in this region and significant population increases are expected. While the population of Vancouver increased 16.8% between 1966 and 1971, the Coquitlam area experienced a growth rate of 41.1% over the same period. Forecasted population for the Coquitlam area is 152,500 for 1986. Satisfaction of the resulting demand for housing can only be met through additional construction.

Owners of existing homes may be expected to change their dwellings as their families and thus their needs change. Real Estate Board statistics indicate that owners change homes about every 8 or 9 years. As the supply of new homes in the lower mainland adds only 2-3% annually to the existing housing stock, (in Coquitlam, which is a faster growing area, the increase may be somewhat greater) the majority of sales will involve homes already in existence.

THE REAL ESTATE INDUSTRY

The real estate industry in B.C. consists of both large and small firms. As of May 1975, there were 1,634 persons holding agent's licences and 5,385 persons holding salesmen's licences. 52.5% of all licencees operate in the Lower Mainland. A.E.L. is located in County 4 (there are seven in the province). Within this county, 27.9% of all licencees are found of whom 362 are agents and 1,595 are salesmen. This compares with 18.2% of total licencees in 1971. County 4 contains 199 head offices and 44 branch offices. While revenues for each company are not available, it appears that no one firm unduly influences the market and that the opportunity does exist for any firm to increase its market share, or for new firms to enter the market.

ALLEY ESTATES LTD.
STATEMENTS OF INCOME AND RETAINED EARNINGS
FOR THE YEARS ENDED APRIL 30, 1967 - 1975

Table I

	1975	1974	1973	1972	1971	1970	1969	1968	1967
REVENUE									
Real Estate Commission and notarial revenue	\$408,934	\$376,257	\$342,513	\$271,869	\$192,729	\$177,226	\$151,519	\$100,713	\$ 73,998
Insurance commissions								637	637
Property sales	35,512	166,452	93,580	227,164	72,000			36,627	
Interest	2,573	13,027	10,947	1,935	2,958	80			
Rentals	1,960		493	770		525	975		
Total Revenue	\$448,979	\$555,736	\$447,533	\$501,738	\$267,687	\$177,831	\$152,494	\$137,977	\$ 74,635
DIRECT EXPENSES									
Multiple listing service fees & other agents' commissions	44,673	47,456	49,273	44,650	24,324	22,106	23,176		
Salesmen's commission	198,006	190,213	164,658	124,089	87,170	73,092	58,653	47,302	22,251
Cost of property sales	34,898	132,832	77,576	184,248	58,794			32,636	
Total Direct Expenses	\$277,577	\$370,501	\$291,507	\$352,987	\$170,288	\$ 95,198	\$ 81,829	\$ 79,938	\$ 22,251
Operating Income	171,402	185,235	156,026	148,751	97,399	82,633	70,665	58,039	52,384
GENERAL AND ADMINISTRATIVE EXPENSES									
Advertising	51,219	36,978	28,973	24,203	21,086	13,364	11,055	5,324	3,486
Automotive	2,519	1,904	1,744	1,602	1,557	2,099	1,842	1,510	
Bad debts								1,824	
Depreciation and amortization	3,967	3,009	2,826	3,263	2,058	2,597	2,117	2,187	233
Convention expenses							67	268	268
Employee benefits	11,683	12,454	1,589	1,420	587	862	731	613	457
Insurance	1,672	1,993	1,872	1,674	1,370	1,523	797	206	131
Interest and bank charges	8,475	3,280	8,144	4,299	2,508	2,517	1,197	420	73
Licences, dues, and taxes	1,676	1,162	959	865	1,150	1,194	565	756	324
Light and heat	1,048	1,079	1,035	1,067	1,014	913	566	493	233
Legal and accounting	2,695	2,495	7,485	2,985	3,463	2,230	1,580	1,120	670
Office and sundry	6,108	5,377	3,949	2,565	2,708	2,706	2,965	1,942	396
Rent	6,930	5,932	5,954	5,774	6,165	6,645	5,541	3,012	2,008
Repairs and maintenance	1,911	1,245	866	1,072	1,386	1,100	493	304	214
Salaries - management	15,000	55,000	29,541	26,500	22,800	24,500	16,000	10,000	15,661
- office	16,790	12,915	8,511	7,734	6,860	6,233	7,404	7,356	4,505
Sales promotion	6,802	5,315	4,977	6,914	4,431	3,745	1,155	610	986
Telephone	6,799	6,256	4,515	3,543	3,074	3,975	2,006	1,550	850
TOTAL GENERAL AND ADMINISTRATIVE EXPENSE	145,294	156,394	112,943	95,671	82,217	76,203	56,081	39,495	30,495
Income before income taxes	26,108	28,841	43,083	53,080	15,182	6,430	14,584	18,544	21,889
Gain on sale of fixed assets				104					
Provisions for income taxes	6,785	8,031	10,518	12,671	3,270	1,389	3,143	3,583	4,254
Net income for the year	\$ 19,323	\$ 20,810	\$ 32,565	\$ 40,513	\$ 11,912	\$ 5,041	\$ 11,441	\$ 14,961	\$ 17,635
Retained earnings beginning of year	\$135,615	\$114,805	\$ 82,240	\$ 41,727	\$ 29,815	\$ 24,774	\$ 13,333	\$ 16,004	NIL
Retained earnings end of year	154,923 *	135,615	114,805	82,240	41,727	29,815	24,774	13,333	16,004

* \$15 tax paid on undistributed income

Table II
ALLEY ESTATES LTD.
UNDER THE COMPANIES ACT, BRITISH COLUMBIA
BALANCE SHEETS AS AT APRIL 30, 1967 - 1975

	1975	1974	1973	1972	1971	1970	1969	1968	1967
Assets									
Current Assets									
Cash	\$ 760	\$ 10,803	\$ 1,780	\$	\$	\$ 4,644	\$ 3,805	\$ 4,065	\$ 7,247
Term deposits		97,000						400	
Accounts receivable	43,415	26,141	3,925	843	927	6,551	2,182	8,747	5,611
Shareholders' advances		19,760						866	
Mortgages and notes receivable			59,900	169,382	43,598	37,527	933	12,000	
Prepaid expenses	1,102	992	10,963	992	929	400	400		400
Property held for resale - at cost	164,272	8,311	63,922	61,231	19,324		6,999		6,519
Investment in Joint Venture	34,800		42,328		16,566	5,050			
Advances to affiliated company					111				
Corporation taxes refundable									
Total Current Assets	244,349	163,007	182,818	232,448	81,344	54,283	14,319	26,078	19,777
Investment in and advances to subsidiary company									
Shares	85,774								
Advances	3,510								
Investment (in joint venture) at cost		9,777			15,985	225	225		225
Investment in property for development						14,396	44,931		
Long term investment	28,000								
Total	117,284	9,777			15,985	14,621	45,156		225
Fixed Assets									
Automotive	6,631	5,212	5,212	5,212	5,076	5,076	5,872	5,872	
Furniture and fixtures	11,661	11,413	8,701	8,386	8,976	8,852	4,621	3,859	3,761
Leasehold improvements	8,387	8,387	8,387	7,672	4,532	4,532	4,531		
Total cost	26,679	25,012	22,300	21,270	18,584	18,460	15,024	9,731	3,761
Less accumulated depreciation and amortization	13,776	13,321	10,904	8,078	9,216	7,158	4,560	2,443	489
Net Fixed Costs	12,903	11,691	11,396	13,192	9,368	11,302	10,464	7,288	3,272
Incorporation Costs	337	337	337	337	337	337	337	337	337
Total Assets	\$374,873	\$184,812	\$194,551	\$245,977	\$107,034	\$80,543	\$70,276	\$33,928	\$23,386
Trust Funds	\$14,652	\$122,516	\$60,420	\$65,520	\$112,087	\$62,800	\$20,886	\$11,750	\$8,367

Table III

ALLEY ESTATES LTD.
STATEMENTS OF CHANGES IN FINANCIAL POSITION
FOR THE YEARS ENDED APRIL 30, 1969 - 1975

	1975	1974	1973	1972	1971	1970	1969
Sources of Working Capital:							
From operations	\$ 23,290	\$ 23,819	\$ 35,392	\$ 43,762	\$ 13,970	\$ 7,639	\$ 13,559
Proceeds from sale of fixed assets	1,700	400		1,575			
Advances from affiliated company			9,693	13,415	(11,516)		
Advances from shareholder			481	1,597	121		384
Sale of real estate held for development				15,985	(1,589)	6,567	
Sale of investments					225		
Investment in joint venture transferred to current assets							
TOTAL WORKING CAPITAL PROVIDED	<u>3,777</u>	<u>24,219</u>	<u>45,566</u>	<u>76,334</u>	<u>969</u>	<u>14,206</u>	<u>13,943</u>
Application of Working Capital:							
Fixed asset additions	5,879	3,704	1,031	8,647	124	3,435	5,293
Investment in joint venture		9,777					
Advance to affiliated company	850	3,423				5,050	
Advance to shareholder		2,126					
Investment in and advance to subsidiary company	89,284			11,704	(671)		
Payment of agreement for sale	28,000						
Long Term investment	15					215	
Reduction of Shareholders loan							
Tax paid on undistributed income							
Property purchased							
TOTAL WORKING CAPITAL APPLIED	<u>125,028</u>	<u>19,030</u>	<u>1,031</u>	<u>20,351</u>	<u>(547)</u>	<u>8,700</u>	<u>9,930</u>
(Decrease) Increase in working capital for the year	<u>(90,261)</u>	<u>5,189</u>	<u>44,535</u>	<u>55,983</u>	<u>1,516</u>	<u>5,506</u>	<u>1,280</u>
Working capital at beginning of year	117,932	112,743	68,208	12,225	10,709	5,203	6,483
Working Capital at end of year	<u>\$ 27,671</u>	<u>\$ 117,932</u>	<u>\$ 112,743</u>	<u>\$ 68,208</u>	<u>\$ 12,225</u>	<u>\$ 10,709</u>	<u>\$ 5,203</u>

ALLEY ESTATES LTD.NOTES TO THE FINANCIAL STATEMENTSAPRIL 30, 1975

1. SIGNIFICANT ACCOUNTING POLICIES:

(a) Property Held for Resale:

The Property held for resale is valued on a specific item basis at the lower of cost or net realizable value. Carrying charges such as property taxes, interest and legal fees are added to the cost of property held for resale.

(b) Investment in Joint Venture:

Investment in the real estate joint venture is recorded under the equity method of accounting which, at the company's year-end, approximates cost.

(c) Investment in Wholly-Owned Subsidiary Company:

The company accounts for its investment in Port Moody Developments Ltd. under the equity method. Accordingly, the value of the investment is increased by the subsidiary company's earnings for the year and is reduced by the amount of any dividends received. As the earnings of the subsidiary since the date of acquisition, July 12, 1974, are minimal, the value under the equity method approximates cost.

(d) Depreciation:

Automobiles and office fixtures are being depreciated at the C.C.A. rates of 30% and 20% per annum respectively. Leasehold improvements are being amortized on a straight line basis over the terms of the lease.

2. INVESTMENT IN JOINT VENTURE:

The company holds a 50% interest in a joint venture to develop residential property for resale in Port Moody, B.C. As at April 30, 1975 the assets and partners' equity were as follows:

ALLEY ESTATES LTD.NOTES TO THE FINANCIAL STATEMENTSAPRIL 30, 1975

2. INVESTMENT IN JOINT VENTURE (Continued):

ASSETS:

Land - at cost	\$ 64,067
Development expenses and carrying charges	5,533
	<hr/>
Total assets	\$ 69,600
	<hr/> <hr/>

PARTNERS' EQUITY:

Richelle Homes Ltd.	\$ 34,800
Alley Estates Ltd.	34,800
	<hr/>
Total partners' equity	\$ 69,600
	<hr/> <hr/>

It is the partners' policy to account for property held for development and resale in accordance with the policy described in Note 1(b).

3. INVESTMENT IN WHOLLY-OWNED SUBSIDIARY COMPANY:

On July 12, 1974 the company acquired all of the issued and outstanding shares of Port Moody Developments Ltd. for a cash purchase price of \$ 85,774. The purchase price is representative of the fair market value of land situated on Clarke Road, Coquitlam, B.C. held by the company.

The assets, liabilities, and the detailed revenues and expenses of the subsidiary have not been included in these financial statements as they would not materially affect the financial position and results of operations of the company.

4. LONG TERM INVESTMENT:

During the year the company acquired shares to hold as a long-term investment.

ALLEY ESTATES LTD.NOTES TO THE FINANCIAL STATEMENTSAPRIL 30, 1975

5. BANK LOAN:

The Bank of Nova Scotia demand loans totalling \$ 90,000 are secured by a lodgement of certificates of title of the properties held and the guarantees of the shareholders and an associated company, J-Dor Holdings Ltd. Subsequent to the year-end, the bank postponed payment of \$ 75,000 of this amount for eighteen months.

6. CONTRACTUAL ARRANGEMENTS:

Deferred Profit Sharing Plan:

The company has entered into a deferred profit sharing plan requiring yearly contributions totalling not less than 1% of the salaries of each of the plan's member employees. During the current year the company contributed \$ 8,737 to the plan, the amount of which is included in "employee benefits".

7. STATUTORY INFORMATION:

Remuneration of directors and senior officers, as defined in the Companies Act, British Columbia, for the year totalled \$ 31, 790 (1974 - \$ 67,915).

8. CONTINGENT LIABILITY:

As a participant under the joint venture agreement described in Note 2, the company is contingently liable for all obligations of the joint venture.

ALLEY ESTATES LIMITED

Table V

CASE WRITERS' NOTES TO FINANCIAL STATEMENTS

(1) Expenses, including management salaries, may reasonably be allocated 2/3 to real estate operations and 1/3 to notary with the exception of:

- | | |
|--|---|
| - clerical | - 50% notary |
| - advertising and sales promotion | - 100% real estate |
| - interest and bank charges | - 100% real estate |
| - multiple listing service fees and other agents' commission | - 100% real estate |
| - licences, dues, and taxes | - \$100.00 for notary; balance to real estate |
| - insurance | - 85% real estate; 15% notary |

(2) Cost behavior pattern

<u>Expenses</u>	<u>Variable Portion</u>	<u>Fixed Portion</u>
Advertising	86%	14%
Employee benefits	75	25
Licences, dues, taxes	20	80
Sales promotion	62	38
Telephone	56	44

(3) Revenue from interest, rentals, and property sales all accrue to real estate.

(4) Other expenses can be classified as either all fixed or all variable based upon normal expectations for these particular expenses.

ALLEY ESTATES LTD.
Monthly Receipts and Disbursements Statements*
For the period June 1, 1974 to June 30, 1975

Table VI

	June/74	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan./75	Feb.	March	April	May	June
Income													
Real Estate Commissions & Notarial Revenue	\$27,214.40	\$14,145.70	\$12,568.00	\$17,714.50	\$25,488.57	\$29,100.93	\$27,536.55	\$34,102.97	\$31,653.66	\$27,427.46	\$47,285.39	\$50,744.79	\$49,254.54
Interest Revenue	160.27	272.46	827.00	712.87									
Rental Revenue				580.00	175.00	315.00	315.00	315.00	320.00	45.00	145.00	270.00	270.00
Other Revenue					1,025.00				13,966.00				
Total Revenue	27,374.67	14,418.16	13,395.00	18,807.37	26,688.57	29,415.93	27,851.55	34,417.97	45,939.66	27,472.46	47,430.39	51,014.79	49,524.54
Direct Expenses													
Multiple Listing Service fees and other commissions	2,379.00	3,198.20	180.00	1,830.00	4,344.00	6,277.00	2,717.00	7,406.00	1,063.75	4,597.25	6,220.75	10,431.25	5,293.58
Salesmen's Commissions	11,554.40	6,669.93	6,728.00	8,217.00	9,234.35	10,542.00	11,541.59	14,019.30	22,628.02	11,281.53	20,395.35	20,465.70	22,044.43
Total	13,933.40	9,868.13	6,908.00	10,047.00	13,578.35	16,819.00	14,258.59	21,425.30	23,691.77	15,878.78	26,616.10	30,896.95	27,338.01
General Expenses													
Advertising	2,959.38	3,850.67	3,870.67	4,451.07	3,369.95	2,196.73	3,050.94	2,212.35	2,045.09	2,991.82	6,252.87	3,874.02	2,421.56
Auto	218.18	189.62	319.47	50.15	93.17	339.62	369.56	314.97	93.25	78.00	84.90	249.50	152.24
Boat	36.20	24.34	645.51					85.07	1,378.30	422.27	788.75		
Corporation Tax	1,200.00	1,200.00	1,200.00	1,200.00									
Legal Disbursements	681.90	996.35	94.50	1,024.60	1,272.75	1,469.60	1,154.30	1,741.31	1,759.70	1,665.57	2,006.15	1,825.20	2,294.08
Donations	540.00				10.00	55.00		8.00	20.00	757.00	10.00		
Employee Benefits	38.59	40.89	40.89	31.53	31.53	31.53	31.53	31.53	3,742.76	186.76	353.90	367.36	53.24
Hydro	98.97			165.70	106.85		171.20	85.00	106.00	304.34	100.00	86.00	86.00
Insurance	344.67	262.06	563.50	351.23	507.23	351.23	351.23	351.23	351.23	351.23	351.23	351.23	351.23
Interest & Bank Charges	313.76	686.97	1,097.63	856.49	879.74	923.64	858.75	590.99	484.46	28.84	28.65	32.25	12.16
J. Alley - Draw	2,436.04	2,000.00	2,465.02	2,071.55	1,980.00	1,800.00	1,900.00	2,769.95	1,700.00	1,500.00	2,320.61	2,176.10	2,561.59
- Income Taxes	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00				1,000.00		1,000.00		
Legal & Accounting	88.30		83.33	83.33	90.62	90.62	90.62	117.25	117.25	117.25	117.25	127.00	100.00
Licences & Fees	20.00	165.50	12.00			40.00	15.00	211.00		176.50	41.00	14.16	50.91
Miscellaneous & Office Expense	9.10	125.15	63.00	28.00	22.33	69.46	63.28	5.96	61.80	31.80	38.00	28.00	37.10
Sales Promotion	151.35	241.25	209.88	189.02	143.57	142.80	155.39	281.81	160.05	139.55	159.70	148.65	229.31
Rent	458.00	526.78	526.78	526.78	526.73	526.78	528.95	529.95	528.95	528.95	458.00	1,045.00	1,045.00
Repairs & maintenance	80.00	129.50	80.00	80.00	97.85	95.00	80.00	135.72	80.00	80.00	134.12	80.00	209.24
Salaries	1,150.00	1,370.00	1,370.00	1,330.00	1,330.00	1,330.00	1,530.00	1,380.00	1,380.00	1,500.00	1,550.00	1,550.00	1,688.00
Stationery	58.90	275.52	277.47	476.43	476.43	507.22	268.98	207.18	125.27	149.53	517.90	211.35	330.96
Telephone	451.40	541.07	506.77	577.03	513.73	516.86	552.79	568.26	530.37	554.47	569.90	559.80	693.78
Rental Property Expenses											623.40		
Total	12,334.74	13,625.67	14,426.42	14,016.48	12,468.63	10,486.09	11,172.52	11,626.53	15,664.48	11,563.88	17,506.33	12,725.62	12,316.40
Total Expenses	26,268.14	23,493.80	21,334.42	24,063.48	26,046.98	27,305.09	25,431.11	33,051.83	39,356.25	27,442.66	44,122.43	43,622.57	39,654.41
Net Income	\$ 1,106.53	\$(9,075.64)	\$(7,939.42)	\$(5,256.11)	\$ 641.59	\$ 2,110.84	\$ 2,420.44	\$ 1,366.14	\$ 6,583.41	\$ 29.80	\$ 3,307.96	\$ 7,392.22	\$ 9,870.13

* Prepared for Manager by Bookkeeper, monthly

B.C. REAL ESTATE INDUSTRY
 MEDIAN COST PERCENTAGES*

Table VII

Gross Revenue		100.0%
Expenses:		
Accounting	.6%	
Advertising	6.0%	
Automotive	1.5%	
Clerical	5.3%	
Commissions	55.5%	
Depreciation	1.1%	
Entertainment	1.0%	
Insurance	.5%	
Licences	.6%	
Miscellaneous	5.8%	
Rent	3.1%	
Stationery	1.1%	
Telephone	1.8%	
Unemployment Insurance and Canada Pension Plan	<u>1.0%</u>	
TOTAL EXPENSES		<u>84.9%</u>
Net Income Before Owners Drawings		<u>15.1%</u>

*Source

B.G. Boaden, Report on Expense Allocations as Percentages of Commissions Earned. (Vancouver: Faculty of Commerce and Business Administration, University of British Columbia, 1969), p.19.

COMMISSIONS EARNED
BY SALESMEN OF
ALLEY ESTATES LIMITED
APRIL 30 YEAR END

Table VIII

<u>Fiscal Year</u>	Salesperson Number					
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>
1973	\$59,398	\$51,282	\$37,482	-----	\$16,496	-----
1974	39,334	57,384	49,485	18,402	26,608	-----
1975	41,811	60,648	48,150	25,587	19,778	2,032

ALLEY ESTATES LIMITED
SALESMEN'S COMMISSION RATES

Table IX

JUNE, 1975

<u>GROSS COMMISSIONS EARNED</u>	<u>SALESMEN'S SHARE</u>
(a) Up to \$15,000 Per Annum	60.0%
(b) \$15,001 - \$18,000	63.6%
(c) \$18,001 - \$28,000	67.2%
(d) \$28,001 - \$43,000	70.8%
(e) \$43,001 +	74.4%

REAL ESTATE INDUSTRY ORGANIZATION*
FOR BRITISH COLUMBIA

Table X

*(Effective : July, 1972)

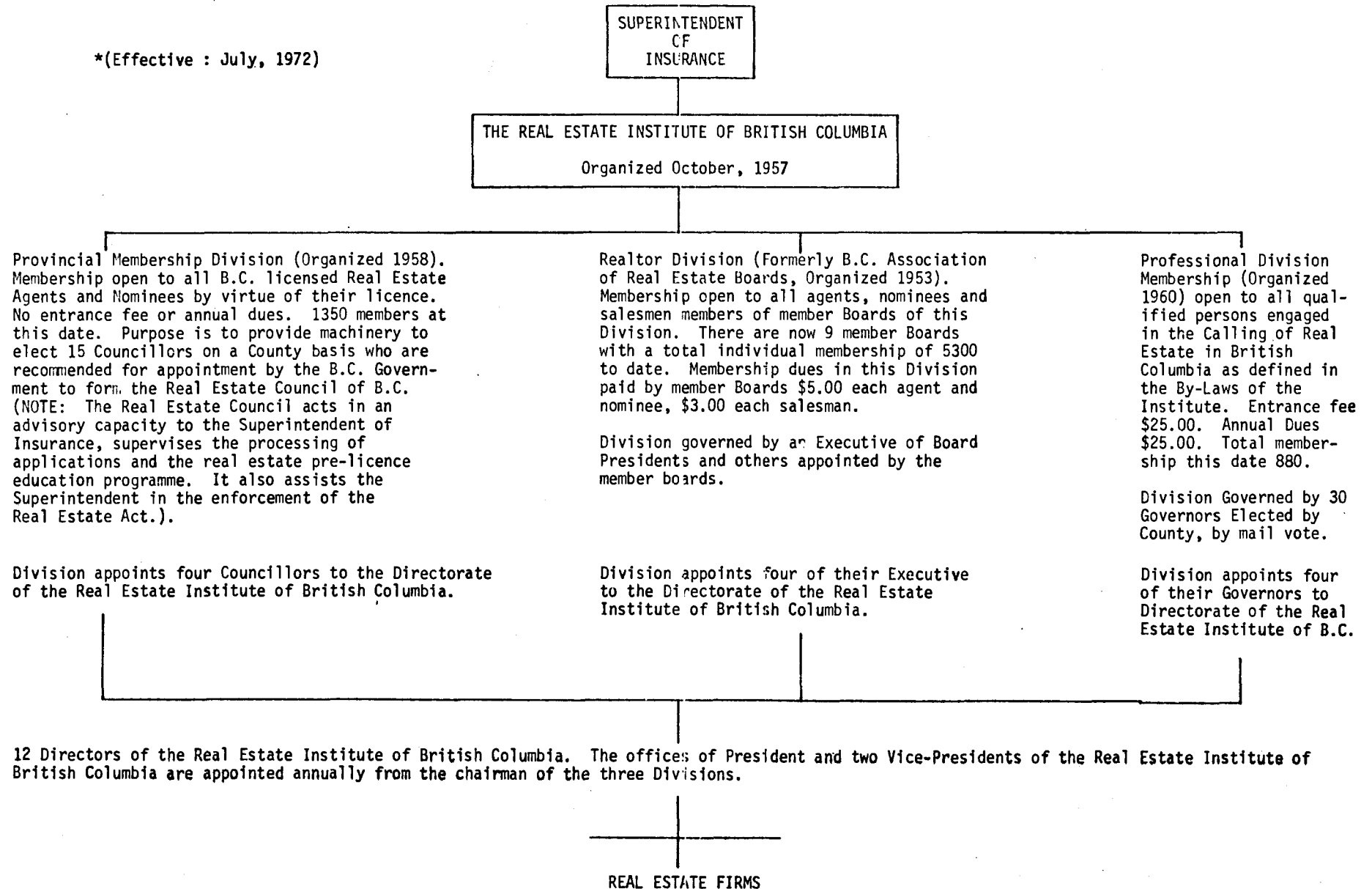


Table XI

SINGLE FAMILY DWELLINGS STARTED

	1969	1970	1971	1972	1973	1974
Coquitlam	231	206	247	350	524	628
Port Coquitlam	413	310	299	289	282	291
Port Moody	63	42	46	23	38	87
TOTAL	707	558	592	662	844	1,006

SINGLE FAMILY DWELLINGS COMPLETED

	1969	1970	1971	1972	1973	1974
Coquitlam	293	189	199	299	460	479
Port Coquitlam	439	325	277	317	255	327
Port Moody	66	54	56	22	33	81
TOTAL	798	568	532	638	748	887

Table XII

POPULATION TRENDS

	<u>Area In Sq. Miles</u>	<u>Census</u>		<u>Increase 1966 - 1971</u>
		<u>1966</u>	<u>1971</u>	
Coquitlam	46.1	40,916	53,073	29.7%
Port Coquitlam	10.4	11,121	19,560	75.9%
Port Moody	4.9	7,021	10,778	53.5%
Fraser Mills	0.6	164	157	-4.3%
TOTALS	62.0	59,222	83,568	41.1%

Metropolitan Vancouver

	1,073.9	933,091	1,082,352	16%
--	---------	---------	-----------	-----

Table XIII

ALLEY ESTATES LIMITED
 STATEMENT OF NOTARY REVENUE BY SOURCE
 TO
 APRIL 30, YEAR END

<u>Year</u>	<u>Total Notary Revenue</u>	<u>Notary Revenue Associated with Real Estate</u>	<u>"Walk-In" or Other Notary Revenue</u>
1970	\$17,780	\$ 9,877	\$ 7,903
1971	21,207	12,079	9,128
1972	24,317	15,663	8,654
1973	24,054	13,740	10,314
1974	26,959	12,739	14,220
1975	36,097	14,739	21,358

ALLEY ESTATES LTD.INSTRUCTOR'S GUIDE

Alley Estates Ltd. is illustrative of the first step in the growth of a firm. The entrepreneur has begun with a concept and created a small, profitable operation which has enabled him to enjoy a good standard of living and to create the asset base and acquired skills necessary for the next step in the growth of the firm.

Jerry Alley's firm has now reached a point where further long term decisions are necessary. His goal is to develop his assets in a form and quantity which will make it possible for him to relinquish daily responsibilities within a five year time horizon without a significant reduction in his income. His immediate task is to devise a strategy which will assist him in achieving this goal.

Students are provided the opportunity to observe the growth of this firm, identify some of the variables contributing to its success, and based on this analysis, make recommendations as to what Jerry Alley's strategy should be.

A thorough approach to the case will involve consideration of the following questions.

- (1) What are the present strengths and weaknesses of A.E.L.?
- (2) What opportunities and risks does the environment present to this firm?
- (3) What options does Jerry Alley have and what are the ramifications of choosing any one of them, for the firm and for Alley?

This analysis should not only enable the students to recommend an appropriate strategy but should also lead into a discussion of a number of more general questions, such as:

- (1) Do the problems faced by a small firm differ in kind or merely in size from those faced by a larger firm?
- (2) At what point in the firm's growth curve is it appropriate for the functions of ownership and management to be segregated?

ANALYSIS:

(a) Present Strengths of the Firm

- (i) 3 competent salesmen
- (ii) 1 fully trained conveyancing secretary
- (iii) asset base of \$156,000 at historical cost
- (iv) location in a rapidly growing urban community
- (v) notarial, realty and management skills of owner/manager
- (vi) complementarity of services offered.

(b) Present Weaknesses of the Firm

- (i) manager makes limited contribution to the operations
- (ii) declining working capital
- (iii) narrow base of notary revenue (essentially directed revenue from one bank)
- (iv) lack of cost control
- (v) firm has low market value
- (vi) lack of capital and skills necessary to expand the scope of real estate operations beyond residential services.

(c) Opportunities Presented by the Environment

- (i) population growth will result in increasing demand for residential and commercial real estate and notarial services
- (ii) real estate market is not dominated by a few major firms - opportunity exists for any firm to increase its market share or for new firms to enter the market.

(d) Risks Presented by the Environment

- (i) salesmen may leave firm if competitor offers more attractive compensation split
- (ii) conveyancing secretary may resign at some point
- (iii) increased competition by realty firms and lawyers as community grows may reduce revenues
- (iv) increased operating costs resulting from lack of control by manager and inflation, may erode profits
- (v) change in commission rates may reduce revenues.

(e) Options Available to Jerry Alley

- (i) Keep the business and maintain the present operations.
Examination of Table I shows that with the exception of 1974 (a year of panic buying), Alley's net wealth has been increasing at a decreasing rate (Net Income plus Management Salaries) since 1972. If this trend continues, Alley's wealth will begin decreasing absolutely within the next five years. If we assume that Alley is capable of earning \$30,000 annually as a salesman or notary, and further assume that he requires a minimum rate of return on his equity in A.E.L. of 15% (after

corporation income tax), then a minimum acceptable increase in his wealth for 1975 would be \$50,500 (\$30,000 plus 15% of \$137,000). His actual wealth increase was only \$34,300 (\$15,000 plus \$19,300) during 1975.

Clearly, continuation of the status-quo will not enable him to attain his goal.

(ii) Sell the business.

This option may be rejected out-of-hand for the following reasons.

- Alley's skills are primarily in the area of residential real estate sales and it has been in this area that he has accumulated the major portion of his present wealth.
- The market price of a real estate agency as a going concern is nominal. An agency's goodwill is its only marketable asset, and the market price of the goodwill possessed by one small competitor in a fragmented market is not great.
- Capital realized from the sale of the firm and its assets would earn a lower R.O.I. than is possible within the firm (e.g. - 10% term deposits).

(iii) Sell the business and retain a management contract:

This option may also be rejected. Alley's goal is to stop working but have his income continue. As a manager in the employ of the firm, he must continue working in order to receive an income.

(iv) Change the commission-sharing arrangement.

This possibility, although it may be extensively pursued by some of the more mathematically-inclined students, may also be readily dismissed. Increasing Alley's earnings, either by increasing his share of commissions or by allocating more expenses to the salesmen, will be rejected by the salesmen. Such a suggestion, even though not subsequently implemented, unnecessarily exposes the firm to the risk of losing one or more of the top salesmen. Decreasing Alley's share of gross commissions, or increasing his expenses will necessarily lead to decreased profits to him. Therefore, any change in the commission split favoring the salesmen will have to be perfectly offset by allocating more expenses to them. (See Table XX). The net result is that profits to Alley will remain constant regardless of the commission split, assuming the present scale of operation is continued.

(v) Change Alley's role in the firm.

Alley's most obvious option is to become re-involved with the firm in the role he must have held earlier, that of an active manager. "Contribution Margin" income statements (Tables XIV & XV) prepared from material in the case clearly indicate that both Notary and Realty services are profitable, while a comparison of projected net incomes (Tables XVI & XVII) shows the advantage to be gained from controlling costs. Cost control may be accomplished either through maintaining personal supervision of

expenditures, or giving employees a budget, or a combination of both. Generating more revenue is primarily a matter of "hustling," a skill which, as an entrepreneur, he clearly possesses. Specifically it involves soliciting more notary work from mortgage-granting institutions, and hiring productive salesmen to replace some of his present "marginal-producers".

The second way in which Alley's role may be changed, is by removing him from active management and hiring a professional manager. While this alternative might result in greater revenues and monitored expenses, it is less attractive than the first for three reasons.

- (a) Alley has stated that he doesn't want to retire yet.
- (b) The manager would be relatively less expensive if the business were larger and more profitable.
- (c) The cost of hiring a manager to maintain the business will be less than the cost of either a clean-up manager or a business-development manager. Any individual capable of both consolidating the existing operation and making it grow at this point would probably be another entrepreneur, and would want control of the firm.

If Alley "tightens" the present operations, and increases revenues, he can create a situation where he can justify a professional manager and also meet his requirements for an increased personal income.

RECOMMENDED STRATEGY:

Alley's strategy then should be:

- (1) increase the efficiency of the present operation by focusing mere attention on cost control
- (2) increase revenues by hiring additional highly qualified salesmen and by more active solicitation of notary business
- (3) hire a manager within a 3-5 year time span so that he may retire from active management.

Alley Estates Ltd.Notary Income Statement (Contribution Margin)

Table XIV

April 30, 1975

<u>Revenue:</u>	
Notarial revenue	\$36,097
<u>Less expenses:</u>	
<u>Variable:</u>	
Automotive	\$ 839
Employee benefits	2,917
Licences, dues, and taxes	20
Office and sundry	2,034
Repairs and maintenance	636
Telephone	1,268
	<hr/>
Total variable	7,714
	<hr/>
Contribution margin	\$28,383
	<hr/>
<u>Fixed:</u>	
Depreciation and amortization	\$ 1,321
Employee benefits	973
Insurance	251
Legal and accounting	897
Licences, dues and taxes	80
Light and heat	346
Office salaries	8,395
Rent	2,308
Telephone	996
	<hr/>
*Total fixed:	\$15,567
	<hr/>
Net income before income tax	\$12,816
	<hr/> <hr/>

*Management salary is excluded

Alley Estates Ltd.

Table XV

Real Estate Income Statement (Contribution Margin)April 30, 1975

<u>Revenue:</u>	
Commissions	\$372,837
Interest	2,573
Rental	1,960
Property sales	35,512
Total revenue	<u>\$412,882</u>
<u>Less Expenses</u>	
<u>Variable expenses:</u>	
<u>Selling:</u>	
Advertising	\$ 44,048
Cost of property sales	34,898
M.L.S. service fees and other agents commissions	4,673
Salesmen's commissions	198,006
Sales promotion	4,217
Telephone	2,540
Total selling	<u>\$328,382</u>
<u>Administrative:</u>	
Auto	\$ 1,680
Employee benefits	5,845
Interest and Bank charges	8,475
Licences, dues and taxes	315
Office and sundry	4,074
Repairs and maintenance	1,275
Total administrative	<u>\$ 21,664</u>
Total variable	<u>\$350,046</u>
Contribution margin	<u>\$ 62,836</u>
<u>Fixed expenses:</u>	
Advertising	\$ 7,171
Depreciation and amortization	2,646
Employee benefits	1,948
Insurance	1,421
Legal and accounting	1,798
Licences, dues and taxes	1,261
Light and heat	702
Office salaries	8,395
Rent	4,622
Sales promotion	2,585
Telephone	1,995
*Total fixed	<u>\$ 34,544</u>
Net income before income tax	<u>\$ 28,292</u>

*Management salary is excluded.

Alley Estates Ltd.

Table XVI

Pro Forma of Real Estate Income - Present Cost Pattern

<u>Sales Volume</u>	<u>Total Commission earned @ 5%</u>	<u>65% of Commission to salesmen and M.L.S.</u>	<u>Balance to A.E.L.</u>	<u>Costs</u>	<u>* Fixed</u>	<u>Income from Commission</u>
				<u>Variable</u>		
\$ 6,000,000	\$300,000	\$195,000	\$105,000	\$ 60,000	\$34,500	\$10,500
7,000,000	350,000	227,500	122,500	70,000	34,500	18,000
8,000,000	400,000	260,000	140,000	80,000	34,500	25,500
9,000,000	450,000	292,500	157,500	90,000	34,500	33,000
10,000,000	500,000	325,000	175,000	100,000	36,000	39,000
11,000,000	550,000	357,500	192,500	110,000	36,000	46,500
12,000,000	600,000	390,000	210,000	120,000	43,500	46,500
13,000,000	650,000	422,500	227,500	130,000	43,500	54,000
14,000,000	700,000	455,000	245,000	140,000	45,000	60,000
15,000,000	750,000	487,500	262,500	150,000	45,000	67,500

* Management salary is excluded.

Assumes additional secretary at volume of \$12,000,000. One half salary chargeable to real estate operations.
 Assumes increase of \$1,500 per annum for each additional salesman - effective at levels of \$10 million,
 \$12,000,000 and \$14,000,000.

Alley Estates Ltd.

Table XVII

Pro Forma of Real Estate Income - Revised Cost Pattern

Sales Volume	Total Commission earned @ 5%	65% of Commission to salesmen and M.L.S.	Balance to A.E.L.		Costs		Income from Commission
			Balance to A.E.L.	Variable	Fixed *		
\$ 6,000,000	\$300,000	\$195,000	\$105,000	\$ 46,800	\$31,250	\$ 26,950	
7,000,000	350,000	227,500	122,500	54,600	31,250	36,650	
8,000,000	400,000	260,000	140,000	62,400	31,250	46,350	
9,000,000	450,000	292,500	157,500	70,200	31,250	56,050	
10,000,000	500,000	325,000	175,000	78,000	32,750	64,250	
11,000,000	550,000	357,500	192,500	85,800	32,750	73,950	
12,000,000	600,000	390,000	210,000	93,600	40,250	76,150	
13,000,000	650,000	422,500	227,500	101,400	40,250	85,850	
14,000,000	700,000	455,000	245,000	109,200	41,750	94,050	
15,000,000	750,000	487,500	262,500	117,000	41,750	103,750	

* Management salary is excluded.

Assumes additional secretary at volume of \$12,000,000. One half salary chargeable to real estate operations. Assumes increase of \$1,500 per annum for each additional salesman - effective at levels of \$10 million, \$12 million and \$14 million.

Note:

Advertising and sales promotion in 1975, was 15.6% (2.7% fixed, 12.9% variable) of real estate commission revenue. Table VII in the case indicates a median industry figure of 7%. A reduction to 10.4% is still in excess of the industry median, but is representative of the needs for this small firm. The dollars spent for advertising and sales promotion by the small firm must form a greater percentage of revenue than would be the case in the large firm.

Alley Estates Ltd.

Table XVIII

Pro Forma of Notary Income

<u>Notary Revenue</u>	<u>Variable Costs</u>	<u>Fixed* Costs</u>	<u>Profits from Notary Revenue</u>
\$36,100	\$ 7,714	\$15,567	\$12,819
41,700	8,911	15,567	17,222
48,300	10,322	15,567	22,411
56,000	11,967	21,567	22,466
64,900	13,869	21,567	29,464
75,200	16,070	21,567	37,563

* Management salary is excluded.

Assumes additional secretary at volume of \$56,000. One half salary chargeable to notary revenue.

Note:

To reach successive levels of increased Notary Revenue, a 16% growth figure has been used. To achieve these revenue and profit levels both clerical employees should be able to undertake the preparation of papers for notary signature.

Alley Estates Ltd.

Table XIX

Pro Forma of Notary Revenue and Real Estate Commissions

	<u>12 Months</u>	<u>24 Months</u>	<u>36 Months*</u>
<u>Revenue</u>			
Real Estate Commissions to A.E.L. (Table XVII)	\$ 157,500	\$ 192,500	\$ 200,000
Notary Revenue (Table XVIII)	<u>41,700</u>	<u>48,300</u>	<u>50,000</u>
Total Revenue	<u>199,200</u>	<u>240,800</u>	<u>250,000</u>
<u>Costs</u>			
<u>Variable:</u>			
Real Estate	\$ 70,200	\$ 85,800	\$ 89,150
Notary	8,911	10,322	10,870
Total variable	<u>79,111</u>	<u>96,122</u>	<u>100,020</u>
Contribution Margin	<u>120,089</u>	<u>144,678</u>	<u>149,980</u>
<u>Fixed:</u>			
Real Estate	\$ 31,250	\$ 32,750	\$ 34,250
Notary	15,567	15,567	15,567
Total Fixed **	<u>46,817</u>	<u>48,317</u>	<u>49,817</u>
Net income before income tax	<u>\$ 73,272</u>	<u>\$ 96,361</u>	<u>\$ 100,163</u>

* Revenues and costs are between the levels indicated on tables XVII and XVIII.

** Management salary is excluded.

Note:

1. The above excludes property sales, interest and rental revenue.
2. Advertising and sales promotion have been reduced by 1/3 (Table XVI).

Alley Estates Ltd.

Table XX

Alternatives to existing commission split
using 1975 as a base

Proposals

1. 70% to salesmen, all advertising and sales promotion become salesmen's responsibility.
 30% to A.E.L. for use of office facilities.
2. 95% to salesmen, salesmen accept all real estate costs.
 5% to A.E.L. primarily for use of firm's name.

<u>Revenue:</u>	<u>Proposal 1</u>	<u>Proposal 2</u>
Commissions (to A.E.L.) net	\$111,851	\$ 18,641
Costs:		Nil
M.L.S. service fee and other agents commission	\$44,048	
Variable telephone	2,540	
Variable administrative	21,664	
Fixed	<u>27,373</u>	
Net income before income tax	\$ <u>95,625</u>	<u>\$ 18,641</u>
Former net income before income tax (Table XV)	<u>18,291</u>	<u>18,291</u>
Increase (Decrease) in net income	<u><u>(\$ 2,065)</u></u>	<u><u>\$ 350</u></u>

Note:

1. Proposal 1 is illogical for the firm as salesmen are not assuming the appropriate costs for the additional commission.
2. Proposal 2. As the agent, is responsible for M.L.S. fee and other agent's commissions, this amount would have to be included as revenue to the firm and then extracted as a cost.

REPORT ON ALLEY ESTATES LTD.

April 23, 1976

Mr. Jerome Alley,
President, Alley Estates Ltd.,
570B Clarke Road,
Coquitlam, B.C.

Dear Sir:

Re: Alley Estates Ltd.

Enclosed is our report on Alley Estates Ltd., which we are submitting to you for your perusal and consideration.

We would like to thank you most sincerely for allowing us into your firm, and for the cooperation extended to us by you and the members of your staff throughout the project.

If we may be of further assistance to you in any way, please do not hesitate to contact us.

Yours very truly,

Allan D. Cobbett

Gordon H. Farrell

c.c. E.M. Scott
J.P. Herzog

ALLEY ESTATES LTD.STATEMENT OF THE PROBLEM:

Your objective is to develop your assets in a form and quantity which will allow you to retire from active participation in the business while maintaining your personal income, within a five year time horizon. Your problem is to develop a strategy which will facilitate accomplishment of this goal.

METHODOLOGY:

In order to determine whether or not Alley Estates Ltd. is the appropriate vehicle in which to maintain your investment, it is necessary to identify its current strengths and weaknesses, which must subsequently be matched to opportunities and risks in the environment. Once we have determined those opportunities on which the firm is capable of capitalizing, we may identify your options, predict the effects of selecting any one of them and as a result, select an optimal strategy for you in light of your goal.

STRENGTHS AND WEAKNESSES OF YOUR FIRM:

In the course of our analysis, we have identified the following strengths and weaknesses in your firm's operation.

(a) Present Strengths of the Firm

- (i) 3 competent salesmen
- (ii) 1 fully trained conveyancing secretary
- (iii) asset base of \$156,000 at historical cost
- (iv) location in a rapidly growing urban community
- (v) notarial, realty and management skills of owner/manager
- (vi) complementarity of services offered.

(b) Present Weaknesses of the Firm

- (i) minimum contribution of manager to operations
- (ii) declining working capital
- (iii) narrow base of notary revenue (essentially directed revenue from one bank)
- (iv) lack of cost control
- (v) firm has low market value
- (vi) lack of capital and skills necessary to expand the scope of real estate operations beyond residential services.

We have also identified the following opportunities and risks in the environment.

(a) Opportunities Presented by the Environment

- (i) population growth will result in increasing demand for residential and commercial real estate and notarial services
- (ii) real estate market is not dominated by a few major firms- opportunity exists for any firm to increase its market share or new firms to enter the market.

(b) Risks Presented by the Environment

- (i) salesmen may leave firm if competitor offers more attractive compensation split
- (ii) conveyancing secretary may resign at some point
- (iii) increased competition by realty firms and lawyers, as community grows, may reduce revenues
- (iv) increased operating costs resulting from lack of control by manager and inflation, may erode profits
- (v) change in commission rates may reduce revenues.

At this point, it becomes necessary to identify the options available to you, and to examine each of them in detail, bearing in mind the results of the analysis to this point. The options to be considered are:

- (i) maintain the present operation
- (ii) sell the business
- (iii) sell the business and retain a management contract
- (iv) modify the commission split
- (v) alter your role in the firm
 - increased involvement
 - decreased involvement.

Projecting the probable result of selecting each alternative will enable us to discern those which will assist you in achieving your goal, from those which will not.

(f) Keep the business and maintain the present operation

Examination of Table XXI shows that with the exception of 1974 (a year of panic buying), your net wealth has been increasing at a decreasing rate (Net Income plus Management Salaries) since 1972. If this trend continues, your wealth will begin decreasing absolutely within the next five years. If we assume that you are capable of earning \$30,000 annually as a salesman or notary, and further assume that you require a minimum return on investment on your equity in A.E.L. of 15%, then a minimum acceptable income for 1975 would be \$50,000 (\$30,000 plus 15% of \$137,000). Your actual income was only \$34,300 (\$15,000 plus \$19,300) during 1975.

Clearly, continuation of the status-quo will not enable you to attain your goal.

(ii) Sell the business

This option may be rejected out-of-hand for the following reasons.

- Your skills are primarily in the area of residential real estate sales and it has been in this area that you have accumulated the major portion of your present wealth.
- The market price of a real estate agency as a going concern is nominal. An agency's goodwill is its only marketable asset and the market price of the goodwill possessed by one small competitor in a highly competitive market is not great.
- Capital realized from the sale of the firm and its assets would earn a lower return on investment than is possible within the firm (e.g. - the best you could hope to earn through a standard investment vehicle, such as a term deposit, might be 10%).

(iii) Sell the business and retain a management contract

This option may also be rejected as your status becomes that of an employee in someone else's firm. In order to maintain your earnings, you must continue to work, which is not the situation that you have stated you want to be in, five years from now.

(iv) Change the Commission - Sharing arrangement

Increasing your share of the commissions, will undoubtedly be rejected by your salesmen, as will the allocation of a portion of the expenses to them. Conversely, increasing the salesmen's share of commissions will result in decreased profits to you unless you allocate a similar amount of expenses to the salesmen, perfectly offsetting your decreased revenue with

decreased expenses. The result of these conflicting forces is that the net income to you and to your salesmen will remain constant, regardless of the commission split, if neither party wishes to become worse off, assuming the present scale of operation is continued. (See Table XXII.)

(v) Change your role in the firm

Your most attractive option is to become more involved with the firm in the role of an active manager. "Contribution Margin" income statements (Tables XXIII and XXIV) clearly indicate that both Notary and Realty services are profitable, while a comparison of projected net incomes (Tables XXV and XXVI) shows the advantage to be gained from controlling costs. Cost control may be accomplished either through maintaining personal supervision of expenditures, or giving employees a budget, or a combination of both. Generating more revenue is primarily a matter of "hustling", a skill which, as an entrepreneur, you clearly possess. Specifically, it involves soliciting more Notary work from mortgage-granting institutions, and hiring productive salesmen to replace some of your present "marginal-producers". (See Table XXVIII).

The second way in which your role could be changed is by hiring a professional manager. While this alternative might result in greater revenues and better monitored expenses, it is less attractive than the first for three reasons.

(a) You have stated that you do not want to retire yet.

(b) The manager would be relatively less expensive if the business were larger and more profitable. In a larger operation, his salary would represent a smaller portion of total revenue, and the need of the firm for a manager would be greater.

(c) The cost of hiring a manager to maintain the business will be less than the cost of either a clean-up manager or a business-development manager. Any individual capable of both consolidating the existing operation and making it grow at this point would be another entrepreneur, and would want control of the firm.

If you "tighten" the present operation, and increase revenues, you can create a situation where you can justify a professional manager and also meet your desire for an increased personal income.

RECOMMENDATIONS

Based on the foregoing analysis, we recommend the following as an optimal strategy.

- (1) Increase the efficiency of the present operation by focusing more attention on cost control.
- (2) Increase revenues by hiring additional, highly qualified salesmen and by more active solicitation of notary business.
- (3) Hire a manager within a 3-5 year time span so that you may retire from active management.

IMPLEMENTATION - RECOMMENDATION (1)

It will be easier for you to concentrate on the selection of additional personnel and expansion of your revenues if you are confident that the existing operation is functioning efficiently and profitably. Therefore, your first objective is to exercise control over the costs incurred by the present level of business. To do this, you must change your bookkeeping system. The monthly statements which you presently use reflect cash flows only. They do not allocate costs to specific products; they do not separate your personal expenses from business expenses and they do not charge costs of a particular period to that period. Therefore, you cannot use these monthly

statements to evaluate your operations meaningfully. For example, your monthly statements for fiscal 1975 indicate an approximate net loss for the year of \$20,000, when in fact net income for the year was \$19,000, a net discrepancy of \$39,000. Allocation of interest costs resulting from investments in special ventures and allocation of your personal expenses to A.E.L. has the effect of making A.E.L. realty operations appear unprofitable, when in fact this may not be the case at all.

You will be able to evaluate your operations correctly if your monthly statements are prepared on an accrual basis, as are your annual statements, and if costs are allocated to those projects which incur them. This system is referred to as a product costing system. We recommend that you discuss such a system with your accountants, Deloitte, Haskins and Sells with a view to implementing it immediately.

Once you have a system which accurately measures and allocates your costs, you can then begin to evaluate each cost to determine whether it contributes adequately to profits. Your approach might be to ask yourself one or more questions about any given cost, such as: "How would my revenues have been affected if I hadn't spent this money? Was it a necessary expenditure, or would I have done as well without it?" This will enable you to take a hard, but fair look at each expense item.

One area which we strongly recommend be reviewed is that of advertising both in terms of the media you are using and the amount being spent. You should immediately set a flexible budget for advertising equal to 10% of realty revenue (compatible with industry practice) and monitor these expenses to ensure that they do not exceed this limit. A comparison of Tables XXV and XXVI indicates that advertising and sales promotion as a percentage of revenue exceeds the industry median by 100%. While classified advertisements and your "on-premise" signs are probably very effective, it is difficult to believe

that media such as scoreboards and brochures give you a revenue return of \$10 for every \$1 spent. Although the effect of advertising expenditures on revenue is always difficult to evaluate, given your limited financial resources, you should emphasize those on which a satisfactory return is fairly certain and avoid those on which it is not.

IMPLEMENTATION - RECOMMENDATION (2)

Please refer to Table XXVIII. The annual commissions from realty operations may be increased to the levels shown on this table if the following steps are taken sequentially.

- (1) Guidance is given to the marginal producers presently on staff and one additional experienced salesman is added to your staff as quickly as possible. (Realty revenue should reach \$157,500 in the 12 months following implementation).
- (2) Another experienced salesman is added to the staff within 12 months. (Realty revenue to reach \$192,500 in the 12 months following implementation).
- (3) Another experienced salesman is added to the staff within 24 months. (Realty revenues to reach \$200,000 within the 12 months following implementation).

This will increase your sales staff from 6 to 9 salesmen. However, increases in commissions beyond an annual level of \$200,000 will be accompanied by a substantial increase in fixed costs (see Table XXVI), primarily as a result of the need for an additional, qualified secretary and additional office space. For this reason, we do not recommend the expansion of realty revenue beyond the \$200,000 level within a three-year time horizon.

Note also, that this increase in revenue will bear with it a corresponding increase in the number of transactions to be processed by your clerical staff.

It is important, therefore, that the less experienced of your two secretaries be encouraged to expand her skills to the point where she also can skillfully and confidently handle transactions arising from either realty or notary operations. If this is accomplished, your secretarial staff will be able to process realty revenue of \$200,000 and notary revenue of \$50,000, annually. Expansion of revenues beyond this level will require the addition of a third, fully-qualified secretary to your staff compliment. We do not recommend such an expansion within a three-year term on the basis that present facilities would be inadequate and that the resulting increase in fixed costs would not be justified.

In order that the projected annual notary revenue of \$50,000 per annum may be achieved, two conditions should be met.

- (1) "Walk-in" notary business to continue to increase at an annual rate of 16 percent. Assuming that population growth projections for the Coquitlam area are correct, such a linear projection is both justifiable and obtainable within the time frame given.
- (2) A second financial institution which will, over time, direct the major portion of its mortgage conveyancing to you, be secured. While achievement of the budgeted notary revenues does not depend on this increased market share, it is extremely important that you diversify your risk in this area. At present, you are highly dependent on one bank, and a cessation of referrals by them to you would cause a substantial drop in your revenue. The addition of a second, mortgage-granting institution would serve to reduce this dependence and to assure achievement of the projected goals. We recommend that you attempt to secure a second institution within 12 months.

Generating the desired revenue while simultaneously maintaining costs within the levels shown (Table XXVIII) will result in net income before management salaries and taxes of approximately \$100,000. This amount will permit you to hire a professional manager without substantially decreasing your personal income. For example:

Salary - J. Alley	\$ 50,000
Salary - Manager	30,000
Balance to Retained Earnings	20,000
	<hr/>
	\$100,000
	<hr/> <hr/>

The \$20,000 remaining after salaries would be available to pay corporate income tax, to finance operations, and to pay dividends to you, as the sole shareholder.

The recruitment and selection of additional competent personnel and an additional conveyancing secretary will increase your strengths and decrease your weaknesses. The gradual addition and assimilation into your firm of motivated, proficient people will increase your earnings and capacity, increase your firm's influence and market share, and decrease the negative effect on the firm of losing any one person. Two additional comments seem appropriate at this point. First, you will probably not lose good staff to someone else paying slightly higher commissions unless:

- (a) the competing firm has as good a reputation in the community as does A.E.L.
- (b) the salesman is confident he can take all his clients to the new firm
- (c) the salesman is confident he will like the staff and management as well at the new firm.

To summarize, switching firms is a hassle and your senior staff likely won't do so without very sound reasons. Second, you must bear in mind that

it would be naive to think that you could retain in one office, the best salespeople in the city. No sound business can stand the strain of many prima-donnas. From time to time you will lose good people but the world won't end as a result. You will simply replace them.

You have an identifiable and growing residential market, a proven record of success with that market, and a pool of talent matched to that market. Bringing into the firm additional people with similar skills is simply capitalizing on your existing strengths of location, market and talent.

IMPLEMENTATION - RECOMMENDATION (3)

As your business grows larger and more profitable, you will have greater need for, and greater ability to pay for, a professional manager. It will probably be easier to find, and retain at a reasonable price, a manager to maintain a larger, more profitable business, than it would be if you attempted to retain a "man for all seasons".

At what point you wish to retire from active management will be a personal decision which we cannot project. However it would seem reasonable that you begin your search at least two years prior to your retirement. It may take a year's diligent search to find a person with the appropriate skills and personality and another year to establish that you had made a correct choice and that the incumbent was both competent in and confident with his new position. This time period assumes a person with real estate and managerial skills. If you wish to select a less experienced individual, and train him yourself, the time lag will be that much greater.

CONCLUSION

By selecting the strategy we have outlined, and by implementing it in the sequence indicated, you should attain your five year goal. You will be in a position at that time to retire if you wish to do so, without suffering a significant decrease in your personal income.

ALLEY ESTATES LTD.
STATEMENTS OF INCOME AND RETAINED EARNINGS
FOR THE YEARS ENDED APRIL 30, 1967 - 1975

Table XXI

	1975	1974	1973	1972	1971	1970	1969	1968	1967
REVENUE									
Real Estate Commission and notarial revenue	\$408,934	\$376,257	\$342,513	\$271,869	\$192,729	\$177,226	\$151,519	\$100,713	\$ 73,998
Insurance commissions								637	637
Property sales	35,512	166,452	93,580	227,164	72,000			36,627	
Interest	2,573	13,027	10,947	1,935	2,958	80			
Rentals	1,960		493	770		525	975		
Total Revenue	\$448,979	\$555,736	\$447,533	\$501,738	\$267,687	\$177,831	\$152,494	\$137,977	\$ 74,635
DIRECT EXPENSES									
Multiple listing service fees & other agents' commissions	44,673	47,456	49,273	44,650	24,324	22,106	23,176		
Salesmen's commission	198,006	190,213	164,658	124,089	87,170	73,092	58,653	47,302	22,251
Cost of property sales	34,898	132,832	77,576	184,248	58,794			32,636	
Total Direct Expenses	\$277,577	\$370,501	\$291,507	\$352,987	\$170,288	\$ 95,198	\$ 81,829	\$ 79,938	\$ 22,251
Operating Income	171,402	185,235	156,026	148,751	97,399	82,633	70,665	58,039	52,384
GENERAL AND ADMINISTRATIVE EXPENSES									
Advertising	51,219	36,978	28,973	24,203	21,086	13,364	11,055	5,324	3,486
Automotive	2,519	1,904	1,744	1,602	1,557	2,099	1,842	1,510	
Bad debts								1,824	
Depreciation and amortization	3,967	3,009	2,826	3,263	2,058	2,597	2,117	2,187	233
Convention expenses							67	268	268
Employee benefits	11,683	12,454	1,589	1,420	587	862	731	613	457
Insurance	1,672	1,993	1,872	1,674	1,370	1,523	797	206	131
Interest and bank charges	8,475	3,280	8,144	4,299	2,508	2,517	1,197	420	73
Licences, dues, and taxes	1,676	1,162	959	865	1,150	1,194	565	756	324
Light and heat	1,048	1,079	1,035	1,067	1,014	913	566	493	233
Legal and accounting	2,695	2,495	7,485	2,985	3,463	2,230	1,580	1,120	670
Office and sundry	6,108	5,377	3,949	2,565	2,708	2,706	2,965	1,942	396
Rent	6,930	5,932	5,954	5,774	6,165	6,645	5,541	3,012	2,008
Repairs and maintenance	1,911	1,245	366	1,072	1,386	1,100	493	304	214
Salaries - management	15,000	55,000	29,541	26,500	22,800	24,500	16,000	10,000	15,661
- office	16,790	12,915	8,511	7,734	6,860	6,233	7,404	7,356	4,505
Sales promotion	6,802	5,315	4,977	6,914	4,431	3,745	1,155	610	986
Telephone	6,799	6,256	4,515	3,543	3,074	3,975	2,006	1,550	850
TOTAL GENERAL AND ADMINISTRATIVE EXPENSE	145,294	151,394	112,943	95,671	82,217	76,203	56,081	39,495	30,495
Income before income taxes	26,108	28,841	43,083	53,080	15,182	6,430	14,584	18,544	21,889
Gain on sale of fixed assets				104					
Provisions for income taxes	6,785	8,031	10,518	12,671	3,270	1,389	3,143	3,583	4,254
Net income for the year	\$ 19,323	\$ 20,810	\$ 32,565	\$ 40,513	\$ 11,912	\$ 5,041	\$ 11,441	\$ 14,961	\$ 17,635
Retained earnings beginning of year	\$135,615	\$114,805	\$ 82,240	\$ 41,727	\$ 29,815	\$ 24,774	\$ 13,333	\$ 16,004	NIL
Retained earnings end of year	154,923 *	135,615	114,805	82,240	41,727	29,815	24,774	13,333	16,004

* \$15 tax paid on undistributed income

Alley Estates Ltd.

Table XXII

Alternatives to existing commission split
using 1975 as a base

Proposals

1. 70% to salesmen, all advertising and sales promotion become salesmen's responsibility.
30% to A.E.L. for use of office facilities.
2. 95% to salesmen, salesmen accept all real estate costs.
5% to A.E.L. primarily for use of firm's name.

<u>Revenue:</u>		<u>Proposal 1</u>	<u>Proposal 2</u>
Commissions (to A.E.L.) net		\$111,851	\$ 18,641
<u>Costs:</u>			Nil
M.L.S. service fee and other agents commission	\$44,048		
Variable telephone	2,540		
Variable administrative	21,664		
Fixed	<u>27,373</u>	95,625	
Net income before income tax		\$ 16,226	\$ 18,641
Former net income before income tax (Table XV)		<u>18,291</u>	<u>18,291</u>
Increase (Decrease) in net income		<u>(\$ 2,065)</u>	<u>\$ 350</u>

Note:

1. Proposal 1 is illogical for the firm as salesmen are not assuming the appropriate costs for the additional commission.
2. Proposal 2. As the agent, is responsible for M.L.S. fee and other agent's commissions, this amount would have to be included as revenue to the firm and then extracted as a cost.

Alley Estates Ltd.

Table XXIII

Notary Income Statement (Contribution Margin)April 30, 1975

<u>Revenue:</u>	
Notarial revenue	\$36,097
<u>Less expenses:</u>	
<u>Variable:</u>	
Automotive	\$ 839
Employee benefits	2,917
Licences, dues, and taxes	20
Office and sundry	2,034
Repairs and maintenance	636
Telephone	1,268
Total variable	<u>7,714</u>
Contribution margin	<u>\$28,383</u>
<u>Fixed:</u>	
Depreciation and amortization	\$ 1,321
Employee benefits	973
Insurance	251
Legal and accounting	897
Licences, dues and taxes	80
Light and heat	346
Office salaries	8,395
Rent	2,308
Telephone	996
*Total fixed:	<u>\$15,567</u>
Net income before income tax	<u>\$12,816</u>

*Management salary is excluded

Alley Estates Ltd.Real Estate Income Statement (Contribution Margin)

Table XXIV

April 30, 1975

<u>Revenue:</u>	
Commissions	\$372,837
Interest	2,573
Rental	1,960
Property sales	35,512
Total revenue	<u>\$412,882</u>
<u>Less Expenses</u>	
<u>Variable expenses:</u>	
Selling:	
Advertising	\$ 44,048
Cost of property sales	34,898
M.L.S. service fees and other agents commissions	44,673
Salesmen's commissions	198,006
Sales promotion	4,217
Telephone	2,540
Total selling	<u>\$328,382</u>
<u>Administrative:</u>	
Auto	\$ 1,680
Employee benefits	5,845
Interest and Bank charges	8,475
Licences, dues and taxes	315
Office and sundry	4,074
Repairs and maintenance	1,275
Total administrative	<u>\$ 21,664</u>
Total variable	<u>\$350,046</u>
Contribution margin	<u>\$ 62,836</u>
<u>Fixed expenses:</u>	
Advertising	\$ 7,171
Depreciation and amortization	2,646
Employee benefits	1,948
Insurance	1,421
Legal and accounting	1,798
Licences, dues and taxes	1,261
Light and heat	702
Office salaries	8,395
Rent	4,622
Sales promotion	2,585
Telephone	1,995
*Total fixed	<u>\$ 34,544</u>
Net income before income tax	<u>\$ 28,292</u>

*Management salary is excluded

Alley Estates Ltd.

Table XXV

Pro Forma of Real Estate Income - Present Cost Pattern

<u>Sales Volume</u>	<u>Total Commission earned @ 5%</u>	<u>65% of Commission to salesmen and M.L.S.</u>	<u>Balance to A.E.L.</u>	<u>Costs</u>		<u>* Fixed</u>	<u>Income from Commission</u>
				<u>Variable</u>			
\$ 6,000,000	\$300,000	\$195,000	\$105,000	\$ 60,000	\$34,500	\$10,500	
7,000,000	350,000	227,500	122,500	70,000	34,500	18,000	
8,000,000	400,000	260,000	140,000	80,000	34,500	25,500	
9,000,000	450,000	292,500	157,500	90,000	34,500	33,000	
10,000,000	500,000	325,000	175,000	100,000	36,000	39,000	
11,000,000	550,000	357,500	192,500	110,000	36,000	46,500	
12,000,000	600,000	390,000	210,000	120,000	43,500	46,500	
13,000,000	650,000	422,500	227,500	130,000	43,500	54,000	
14,000,000	700,000	455,000	245,000	140,000	45,000	60,000	
15,000,000	750,000	487,500	262,500	150,000	45,000	67,500	

* Management salary is excluded.

Assumes additional secretary at volume of \$12,000,000. One half salary chargeable to real estate operations.

Assumes increase of \$1,500 per annum for each additional salesman - effective at levels of \$10 million, \$12 million and \$14 million.

Alley Estates Ltd.

Table XXVI

Pro Forma of Real Estate Income - Revised Cost Pattern

Sales Volume	Total Commission earned @ 5%	65% of Commission to salesmen and M.L.S.	Balance to A.E.L.	Costs		* Fixed	Income from Commission
				Variable			
\$ 6,000,000	\$300,000	\$195,000	\$105,000	\$ 46,800		\$31,250	\$ 26,950
7,000,000	350,000	227,500	122,500	54,600		31,250	36,650
8,000,000	400,000	260,000	140,000	62,400		31,250	46,350
9,000,000	450,000	292,500	157,500	70,200		31,250	56,050
10,000,000	500,000	325,000	175,000	78,000		32,750	64,250
11,000,000	550,000	357,500	192,500	85,800		32,750	73,950
12,000,000	600,000	390,000	210,000	93,600		40,250	76,150
13,000,000	650,000	422,500	227,500	101,400		40,250	85,850
14,000,000	700,000	455,000	245,000	109,200		41,750	94,050
15,000,000	750,000	487,500	262,500	117,000		41,750	103,750

* Management salary is excluded.

Assumes additional secretary at volume of \$12,000,000. One half salary chargeable to real estate operations. Assumes increase of \$1,500 per annum for each additional salesman - effective at levels of \$10 million, \$12 million and \$14 million.

Note:

Advertising and sales promotion in 1975, was 15.6% (2.7% fixed, 12.9% variable) of real estate commission revenue. Table VII in the case indicates a median industry figure of 7%. A reduction to 10.4% is still in excess of the industry median, but is representative of the needs for this small firm. The dollars spent for advertising and sales promotion by the small firm must form a greater percentage of revenue than would be the case in the large firm.

Alley Estates Ltd.
Pro Forma of Notary Income

Table XXVII

<u>Notary Revenue</u>	<u>Variable Costs</u>	<u>Fixed* Costs</u>	<u>Profits from Notary Revenue</u>
\$36,100	\$ 7,714	\$15,567	\$12,819
41,700	8,911	15,567	17,222
48,300	10,322	15,567	22,411
56,000	11,967	21,567	22,466
64,900	13,869	21,567	29,464
75,200	16,070	21,567	37,563

* Management salary is excluded.

Assumes additional secretary at volume of \$56,000. One half salary chargeable to notary revenue.

Note:

To reach successive levels of increased Notary Revenue, a 16% growth figure has been used. To achieve these revenue and profit levels both clerical employees should be able to undertake the preparation of papers for notary signature.

Alley Estates Ltd.

Table XXVIII

Pro Forma of Notary Revenue and Real Estate Commissions

	<u>12 Months</u>	<u>24 Months</u>	<u>36 Months*</u>
<u>Revenue</u>			
Real Estate Commissions to A.E.L. (Table XVII)	\$ 157,500	\$ 192,500	\$ 200,000
Notary Revenue (Table XVIII)	41,700	48,300	50,000
Total Revenue	<u>199,200</u>	<u>240,800</u>	<u>250,000</u>
 <u>Costs</u>			
<u>Variable:</u>			
Real Estate Notary	\$ 70,200	\$ 85,800	\$ 89,150
Total variable	<u>8,911</u>	<u>10,322</u>	<u>10,870</u>
Contribution Margin	<u>79,111</u>	<u>96,122</u>	<u>100,020</u>
<u>Fixed:</u>			
Real Estate Notary	\$ 31,250	\$ 32,750	\$ 34,250
Total Fixed **	<u>15,567</u>	<u>15,567</u>	<u>15,567</u>
	<u>46,817</u>	<u>48,317</u>	<u>49,817</u>
Net income before income tax	<u>\$ 73,272</u>	<u>\$ 96,361</u>	<u>\$ 100,163</u>

* Revenues and costs are between the levels indicated on tables XVII and XVIII.

** Management salary is excluded.

Note:

1. The above excludes property sales, interest and rental revenue.
2. Advertising and sales promotion have been reduced by 1/3 (Table XVI).

B.C. REAL ESTATE INDUSTRY
 MEDIAN COST PERCENTAGES*

Table XXIX

Gross Revenue 100.0%

Expenses:

Accounting	.6%
Advertising	6.0%
Automotive	1.5
Clerical	5.3
Commissions	55.5
Depreciation	1.1
Entertainment	1.0
Insurance	.5
Licences	.6
Miscellaneous	5.8
Rent	3.1
Stationery	1.1
Telephone	1.8
Unemployment Insurance and Canada Pension Plan	<u>1.0</u>

TOTAL EXPENSES 84.9

Net Income Before Owners Drawings 15.1%

*Source:

B.G. Boaden, Report on Expense Allocations as Percentages of Commissions Earned. (Vancouver: Faculty of Commerce and Business Administration, University of British Columbia, 1969), p.19.

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