

Attaining Escape Velocity: A Strategy for Growth

by

Rob Logan
B.Sc., University of Western Ontario, 1985

PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF
THE REQUIREMENTS FOR THE DEGREE OF
Master of Business Administration
EMBA Program

in the Faculty

of

Business Administration

Rob Logan 2003
SIMON FRASER UNIVERSITY
August 2003

All rights reserved. This work may not be
reproduced in whole or in part, by photocopy
or other means, without permission of the author.

APPROVAL

Name: Rob Logan
Degree: Master of Business Administration
Title of Project: Attaining Escape Velocity: A Strategy for Growth
Supervisory Committee:

Dr. Mark Selman
Senior Supervisor, Adjunct Professor
Faculty of Business Administration

Dr. Ed Bukszar Jr.
Associate Professor
Faculty of Business Administration

Date Approved:

2-11-03

Partial Copyright License

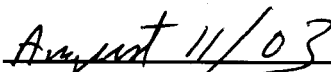
I hereby grant to Simon Fraser University the right to lend my thesis, project or extended essay (the title of which is shown below) to users of the Simon Fraser University Library, and to make partial or single copies only for such users or in response to a request from the library of any other university, or other educational institution, on its own behalf or for one of its users. I further agree that permission for multiple copying of this work for scholarly purposes may be granted by me or the Dean of Graduate Studies. It is understood that copying or publication of this work for financial gain shall not be allowed without my written permission.

Title of Thesis/Project/Extended Essay

Attaining Escape Velocity: A Strategy for Growth

Author:


Rob Logan


Date

ABSTRACT

This paper will form a strategic template for a small company currently trying to grow its business. The overview will investigate the product, the company and the market to establish whether an opportunity exists for further investment. An industry analysis will be done to understand the competitive landscape and provide clues to competitive strengths and weaknesses. An internal analysis will probe the strengths and weaknesses of the Company. The first three chapters of analysis will uncover strategic issues that are then documented in chapter four. Chapter five is the recommendation section of the paper. In this chapter concrete strategies will be developed to address the issues that have been uncovered. Finally, a financial analysis will establish whether or not the corporation has the required funds to pursue the recommendations proposed.

ACKNOWLEDGMENTS

I would like to thank my wife Kolina for her support without which I would not have been able to put in the time and effort required to accomplish this endeavour.

TABLE OF CONTENTS

Approval	ii
Abstract	iii
Acknowledgments	iv
Table of Contents	v
List of Tables	vii
List of figures	vii
1 Overview	1
1.1 Corporate Profile	1
1.2 Product Line	3
1.3 Target Market	5
1.4 Market Evolution	8
1.5 Pricing, Costs & Profitability	9
2 Industry analysis	12
2.1 Introduction	12
2.2 Intensity of Competitive Rivalry: Moderate/High.....	14
2.3 Threat of New Entrants: High	16
2.4 Threat of Potential Substitute Products: Low.....	18
2.5 Power of Buyer Is: Moderate +	19
2.6 Power of Supplier: Low.....	20
2.7 Conclusion	21
3 Internal Analysis	22
3.1 Strategic Fit.....	22
3.1.1 Product Strategy	23
3.1.2 R & D Expenses	24
3.1.3 Structure & Decision Making	26
3.1.4 Manufacturing	26
3.1.5 Marketing	27
3.1.6 Risk Profile.....	28
3.1.7 Capital Structure	29
3.1.8 Conclusion.....	30
3.2 Value Chain	31
3.2.1 Industry Value Chain	31
3.2.2 Research & Development.....	32
3.2.3 Testing.....	32
3.2.4 Manufacturing & Packaging	33
3.2.5 Marketing	34

3.2.6	Sales & Promotion	34
3.2.7	Retail	35
3.3	Corporate Value Chain	35
3.3.1	Inbound Logistics	36
3.3.2	Operations	37
3.3.3	Outbound Logistics	37
3.3.4	Marketing and Sales	38
3.3.5	Service	39
3.3.6	Technology Development	39
3.3.7	Human Resource Management	40
3.3.8	Firm Infrastructure	40
3.3.9	Conclusion.....	41
4	Issues	42
4.1	Establishing a Competitive Advantage.....	42
4.1.1	Distribution	44
4.1.2	Target Market.....	45
4.1.3	Customer Development.....	46
4.1.4	Product Ownership.....	46
4.1.5	Product Testing	47
4.1.6	Packaging	48
4.2	Access to Capital	48
4.2.1	Human Resource Management	49
4.2.2	Sourcing Capital.....	50
4.2.3	Corporate Ownership Restructuring	51
5	Recommendations.....	53
6	Financials.....	62

LIST OF TABLES

Table 1 - Product Formats.....	3
Table 2 - Lubricant Varieties	4
Table 3 - Example of Lubricant Costs	10
Table 4 - Some Personal Lubricants Currently Available.....	11

LIST OF FIGURES

Figure 1 - Personal Lubricant Market Share	8
Figure 2 - Six Factor Competitive Forces Model.....	13
Figure 3 - Strategic Fit	23
Figure 4 - Personal Lubricants Industry Value Chain.....	31
Figure 5 - Corporate Value Chain	36
Figure 6 - Marketing Budget.....	58
Figure 7 - Balance Sheet	62
Figure 8 - Income Statement	64
Figure 9 - Cash Flow Statement	65

1 OVERVIEW

1.1 Corporate Profile

The Company profiled is a North Vancouver based company that is focused on marketing personal care products such as natural botanical lubricants, moisturizers, lotions and related romance products. The corporation was established in 1999 and was founded with two active owners. Since that time, the current president has bought out the original investors and now owns 90% of the organization. The remaining 10% is owned by his spouse. The Company has yet to formulate a board of directors.

The owner is currently employing bootstrap financing. The venture has grown through investment of personal funds. Each marketing idea must be carefully weighed and profits assured before precious funds are allocated to the venture. Lost capital at this stage of corporate development could prove disastrous. The Company has followed the fundamental rule of finance – do not run out of cash.¹

Initial revenue targets set in 1999 included the assistance of outside financing which has failed to materialize. This has slowed corporate growth. Initial projections had the Company sales reaching \$500,000 in the year 2000. Although the Company has lagged behind this initial yearly sales projection it did reach sales of \$408,000 in 2002 and is projecting sales of \$950,000

¹ Sahlman, William A. (1992). The financial Perspective: What should Entrepreneurs Know? In William A. Sahlman, Michael J. Roberts & Amar Bhidé, *The Entrepreneurial Venture* (Second Edition). (1999). (pp. 238 – 261). Harvard Business School Press.

in 2003. The Company struggled under the previous ownership structure and finally began to move forward when the current president took control.

It is important to recognize that one of the key strengths of the Company is the current president. The president has effectively managed the corporation into profitability. He has a strong vision of where the Company should be headed and has been instrumental in achieving its current success.

The legal form of the Company is a corporation. This was formed mainly to minimize legal liability for owners of the organization should the venture fail. Now that the organization has been cash flow positive for a number of years the worry is transferring from failure to thrive to the need for cash to fund growth. The result of a failure to have enough cash on hand is the inability to pursue profitable opportunities that arise. The pursuit of growth that the president has decided to try and achieve is forcing the organization to begin entertaining the idea of outside financing. This results in other problems such as a possible loss or lessening of control of the organization.

The firm currently consists of three full-time employees with most functions currently being outsourced and coordinated by the president. The supporting employees provide sales and basic finance assistance. Start-ups can attract employees through opportunities to upgrade skills and build resumes rather than offering cash or options.² That is the course that the Company is following. The two employees supporting the president consist of a vice president of sales and an administrative assistant who has a financial background from China. The administrative assistant prepares reports that form the basis of financial statements prepared by an independent accountant. A marketing manager is employed on a contract basis and she supplies required

² Bhide, Amar. (1992). Bootstrap Finance: The Art of Star-ups. In William A. Sahlman, Michael J. Roberts & Amar Bhide, *The Entrepreneurial Venture* (Second Edition). (1999). (pp. 223 – 237). Harvard Business School Press.

product support as campaign opportunities develop. The corporate structure results in an extremely lean operation that requires very little capital to maintain.

The stated goal of the Company is to reach \$9 million in sales by 2008. This paper will investigate the ability of the organization to reach this goal. The focus of the paper will explore the personal lubricant market and its ability to support the expansion of the organization.

1.2 Product Line

There are currently 10 products that the Company is actively selling. Personal lubricants make up 64.3% of the sales and account for 9 of the products. The lubricants are further broken down into original and eight different flavoured varieties. The Company offers the lubricants in numerous formats (see Table 1). The only product that is not a lubricant is a clitoral stimulating gel which comprises 35.7% of total corporate sales. Although the majority of sales are generated by personal lubricants, the success of the stimulating gel may point the organization towards new product opportunities.

Table 1 - Product Formats

Size	Format	% of Sales
8 ounce	Jar	2.1%
4 ounce	Bottles	43%
2 ounce	Bottles	5%
single dose	Pillow Pack	13%
15 ml	Stimulating Gel	36%
“One touch”	Dispensing Pump	0.2%

The 8 ounce jar is a recent product offering. The jar contains a large amount of lubricant and to facilitate use the Company separately sells a “one touch” pump to dispense the lubricant out of the jar. The 4 ounce bottles provide the largest share of corporate lubricant sales. The 4 ounce bottles come in the original lubricant and also eight different flavours (see Table 2). The 2 ounce bottles are available in original format only and serve as testers for buyers that are not sure

they want a full 4 ounce bottle. The single dose pillow packs come either in packages of 6 pre-packaged fruit lube gel party packs or in large plastic jars that hold 200 pillow packs per jar. These large jars are placed on the shelf and allow retailers to sell individual samplers. The jars can be ordered by flavour or in a mixed flavour format that encourages customers to try a variety of flavours.

The stimulating gel is sold in a 15 millilitre tubes and is mostly sold in adult oriented stores along with the flavoured lubes. The original lube is available in more mainstream stores such as Pharmasave and Save On Foods. The corporation has been unsuccessful penetrating mainstream stores with either the stimulating gel or the flavoured lubricants. Pharmacies stock high volume items and lubricants are left to compete with the full line of personal care products. This limits these stores to placing two or three brands of lubricants and a minimal variety of formats.

Table 2 - Lubricant Varieties

Lubricant	% of Sales
Original	20.2%
Cherry	3.0%
Kiwi/Strawberry	3.8%
Cappuccino	1.2%
Melon	2.4%
Blueberry Cheesecake	2.5%
Strawberry Cheesecake	6.2%
Passion Fruit	2.6%
Pina Colada	2.7%
Flavoured Mix	6.8%

The product line is successfully marketed as “all-natural” products. This allows the Company to charge a premium for the products that consumers appear willing to pay. This has become one of corporation’s main competitive advantages. All new product development is focused on natural ingredients and preserving the ability to call products “all-natural”. The current strategy of the Company is to be an innovative supplier of romance products in the global marketplace. Currently, over half of the Company’s sales are in the United States with the rest

coming from Canada, Asia and Europe. The Company is hampered from aggressively entering markets by a lack of cash. This paper will focus on establishing a geographic market that the Company can successfully penetrate. By focusing the market, the paper will give the organization something that it can implement in the short term to increase cash flows. The goal is to be able to roll that money back into the organization and begin expanding to markets in other countries.

1.3 Target Market

The Company's original success came from the gay community. The Company introduced the original lubricant into the west end of Vancouver. However sales growth was slow and the market limited. The current president decided to begin establishing a market for women, convinced that the Company could be successful in this area. By visiting the corporate website it is quite evident that the Company has focused on this market effectively. The website discusses women's health, uses soft imagery and projects a feminine focus. There is ample evidence to support the decision to target women.

There are over 107 million women in the United States over the age of 18.³ 18 will be used as the minimum age for sexually active women when evaluating potential target markets. At some time during their lives, 43% of women between the ages of 18 and 59 experience sexual dysfunction.⁴ There are both physical and psychological causes of sexual dysfunction; however

³ Population Estimates Program, Population Division U.S. Census Bureau, Washington. Retrieved June 4, 2003, from <http://eire.census.gov/popest/archives/national/nation2/intfile2-1.txt>

⁴ JAMA Patient Page: Sexual Dysfunction – Silence About Sexual Problems Can Hurt Relationships, *The Journal of the American Medical Association*, 281 (6). 584.

vaginal dryness is the primary cause of painful sex (dyspareunia).⁵ The Company is convinced that this creates a need amongst the population for some form of product that can restore a woman's sense of sexuality.

The traditional channel of the lubricant market has been the sex industry, which has created success for the organization and a number of other lubricant manufacturers. However this approach to marketing still misses the potential of mass market appeal. The transition to mass market by targeting women may increase the potential target market. By bringing lubricants and the issues that are relieved through lubricant use to the forefront, the Company is trying to initiate a societal shift in attitudes towards a more open and healthy population. As the population ages, discussions are beginning to take place surrounding sexual dysfunction and its causes. Sexual dysfunction is becoming increasingly recognized as a medical issue that can be treated. Results from a national survey in the US of people 18 to 59 years old reported that sexual dysfunction in women approached 43%.⁶ Shows such as Oprah and the Sunday Night Sex Show have been successful in broaching topics that were previously not discussed in public. The Company hopes to ride this wave of open expression and profit by it.

There are over 63 million women in the United States over the age of 40.⁷ This age is important because this is the age that many women begin to enter their menopausal years.⁸ Menopause, hysterectomies (removal of uterus or both ovaries), birth control methods such as the pill and even breast feeding a child can result in low levels of estrogen. A decrease in

⁵ MayoClinic.com. *Dealing with vaginal dryness*. Retrieved June 4, 2003, from www.mayoclinic.com/invoke.cfm?id=WO00034

⁶JAMA Patient Page: Sexual Dysfunction – Silence About Sexual Problems Can Hurt Relationships, *The Journal of the American Medical Association*, 281 (6). 584.

⁷ Population Estimates Program, Population Division U.S. Census Bureau, Washington. Retrieved June 4, 2003, from <http://eire.census.gov/popest/archives/national/nation2/intfile2-1.txt>

⁸ Greer, William. (2003). Preprocessing histograms of age at menopause using the fast Fourier transform, *Maturitas*, 44 (4), 267-277.

estrogen levels is the main cause of vaginal dryness.⁹ A study of 60 year old women showed that one third suffered from vaginal dryness.¹⁰ Many women now take hormone replacement therapy (HRT) to combat low levels of estrogen and minimize the effects of menopause. Unfortunately the Women's Health Initiative randomized controlled trial of risks and benefits of hormone therapy recently concluded that overall health risks from HRT exceeded benefits.¹¹ This has discouraged women from minimizing menopausal side effects such as vaginal dryness with pharmacotherapy.

Vaginal dryness is also implicated in urinary tract infections (UTI's). Almost half of the women in America experience a UTI each year. One of the causes is lack of natural lubrication during sexual intimacy. The lack of lubrication can cause skin abrasions in the vagina that can facilitate infection.¹²

Therefore, despite an industry that spends most of its promotional dollars on the sex industry and advertises prominently in gay publications such as the commercial closet, the overwhelming evidence suggests that there is a broader need for personal lubricants. Competitors' marketing campaigns suggests that women have received poor attention from current competitors. The Company will target the women who have a need for lubricants yet maintain a relatively young outlook on life. That target market will be the 40 plus women.

⁹ MayoClinic.com. *Dealing with vaginal dryness*. Retrieved June 4, 2003, from www.mayoclinic.com/invoke.cfm?id=WO00034

¹⁰ Eplov, L.F. (2002). Naked on the lawn. The sexual life of 60-year-old Danish women, *Ugeskr Laeger*, 164(41), 4815-9.

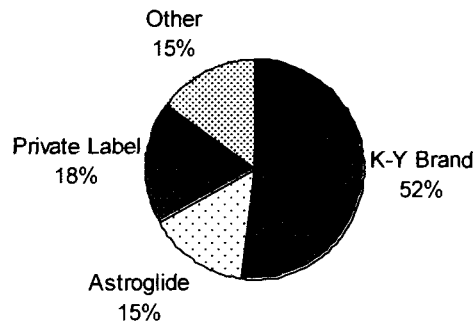
¹¹ Rossouw, Jacques E. (2002). Risks and Benefits of Estrogen Plus Progestin in Healthy Postmenopausal Women, *The Journal of the American Medical Association*, 288 (3), 321-333.

¹² Womens Health News. (2001, February). *Personal Lubricants Help Prevent Urinary Tract Infections*. Retrieved May 18, 2003, from http://www.womanshealthnews.com/past_issues/2001Feb.asp

1.4 Market Evolution

The personal care market in the U.S. exceeds \$52.9 billion in sales.¹³ Personal lubricants are a smaller niche market that account for \$80 million in sales in the U.S with the market growing at 8 percent in 2002¹⁴. The market is highly fragmented and has numerous competitors that sell in local markets. The advent of the internet has facilitated the expansion of local market lubricants onto the national stage. However few lubricants have evolved past displays in adult oriented stores. National pharmacy chains tend to carry K-Y Brand lubricant, Astroglide, possibly a third smaller brand and a private label. This is reflected in the market shares (see Figure 1). Johnson & Johnson's K-Y Brand lubricant dominates the market with a 52% market share. Private label lubricants comprise a further 18% of the market. Astroglide makes up 15% of the market. The rest of the market is divided up amongst all of the other manufacturers with well over thirty five lubricant brands actively promoting product.¹⁵

Figure 1-Personal Lubricant Market Share



¹³ Durocher, Bryan. (2003) Opportunity Knocks, *Global Cosmetic Industry*, 171 (1), 47-49.

¹⁴ Kapner, Suzanne. (2003, April 22). K-Y Jelly: Not just for sex anymore. *New York Post Online Edition*. Retrieved May 18, 2003, from <http://www.nypost.com/business/73968.htm>

The population is aging.¹⁶ By 2008 the number of people over 45 will increase from 33% to 45%.¹⁷ The increase in people over 45 will result in an increase in the number of women who have reached menopause and are experiencing the symptoms of menopause. This should result in an increase in the demand for products that help women combat the effects of menopause, vaginal dryness being one of those symptoms. However the personal lubricant manufacturers do not appear to be evolving in this direction. Many manufacturers are content to continue advertising and focusing on the sex industry and the gay community. Demographics suggest that the mass market will move towards an increasing need for lubricants that should create a major push for mainstream acceptance. Currently Johnson & Johnson is one of the few manufacturers with the resources to initiate movement into the mainstream market. A manufacturer that can take advantage of the evolving market that an aging population presents will capture a significant share of the personal lubricant market.

1.5 Pricing, Costs & Profitability

Personal lubricants can be manufactured and packaged extremely inexpensively (see Table 3). The mark up on prices to distributors can exceed 300%.¹⁸ The 2 ounce size of a lubricant can sell in the retail outlet from \$4.99 to \$14.99 U.S. (see Table 4).

¹⁵ Harris, Lynn. (2003). K-Y Jelly, we hardly knew ye. *Contemporary Culture*. Retrieved May 21, 2003, from <http://www.powell's.com/portal/ContemporaryCulture.html>

¹⁶Heumann, Leonard. (2003). Planning for an aging society, *Journal of the American Planning Association*, 69 (1), 85-86.

¹⁷Paton, Nic. (2002). An age-old problem, *Occupational Health*, 54 (12), 18-20.

¹⁸ Proprietary Information – The Company.

Table 3 - Example of Lubricant Costs

Product	Size	Production Cost*	Distributor Price	Suggested Retail
Original	2 oz.	\$ 1.10	\$ 3.09	\$ 9.95
	4 oz.	\$ 1.40	\$ 3.98	\$ 11.95
	8 oz.	\$ 2.90	\$ 8.84	\$ 24.95
Flavoured	4 oz.	\$ 1.45	\$ 4.21	\$ 12.95
Pillow Packs	Unit Dose	\$ 0.17	\$ 0.33	\$ 1.00
Stimulating Gel	.5 oz.	\$ 1.40	\$ 4.99	\$ 19.95

*An example of outsourced cost including packaging

To understand market pricing the two top lubricants on the market will be highlighted. K-Y Brand, with 52% market share, is priced at \$5.99 U.S. for 2.5 oz. and \$9.99 U.S. for 5 oz. sizes. Astroglide, with 15% market share, is priced at \$9.99 U.S. for a 2.5 oz. bottle and \$12.99 U.S. for a 5 oz. bottle. Therefore consumers appear willing to support \$5.99 - \$12.99 U.S. retail pricing for personal lubricants. The Company's products fall within this retail price range.

Establishing a brand name is important in this market. A brand name can be a competitive advantage and provide price stability. This would allow the organization to continue to charge a premium price in a more competitive environment. As sales volumes at the organization increase, manufacturing could be analysed with the goal of bringing manufacturing in house to further reduce costs. This would help preserve profitability but requires a very extensive set of new competencies.

Table 4 - Some Personal Lubricants Currently Available

Product	Size	Price	Author's Comment of USP
Aqua Lube	2 oz. / 4 oz.	4.99 / 7.99	
Astroglide	2.5 oz. / 5 oz.	9.99 / 12.95	It is rocket science
Dewdrops	2 oz. / 4 oz.	8.95 / 12.95	Field tested
Divine No. 9	2 oz. / 4 oz.	7.49 / 12.79	Liquid ambrosia
Emerita	2 oz.	8.99	Vitamin E / Oil free
Eros	1.2 oz. / 3.4 oz.	13.99 / 18.99	European
ForPlay	9 oz.	12.99	Advanced pH balance for sensitive skin
Frixion	2 oz. / 4oz.	8.95 / 12.95	New millennium superior lubricant
HR	5 oz.	2.99	Intensify lovemaking
ID Glide	5.5 oz. / 9.5 oz.	7.35 / 10.95	Condom compatible
Jason Women			
Wise	4 oz.	6.99	Aloe Vera/Chamomile in a seaweed base
Joe Lube	8.8 oz.	17.95	Aimed at men
Kuma Sutra	4 oz.	12.00	Love liquid
K-Y Brand	2.5 oz / 5 oz.	5.99 / 9.99	
K-Y Jelly	4 oz.	6.99	Obstetrician recommended
Leatherstock	2 oz. / 4 oz.	12.99 / 19.99	Aimed at men
Life Styles	2.44 oz.	5.99	Like nature intended
Liquid Silk	8.45 oz.	13.99	
Lube It	8 oz.	17.95	Between you and yourself
O'My	4 oz.	12.95	All natural
Pleasure Glide	8 oz.	9.00	
PreSeed	6 applications	19.99	Sperm friendly
Probe	2.5 oz. / 8 oz.	4.00 / 9.00	Antifungal, antibacterial & possibly spermicidal
Rain	8 oz.	7.99	
Sensual Power	2.5 oz.	12.95	Cream - moisturizes skin
Sensura	6 oz.	14.95	Sensitive, delicate skin
Sex Grease	8 oz.	7.95	Vitamin herb supplements
Shunga	4.4 oz.	12.99	Enhances bodily sensations
Silken Secret	6 applications	7.29	Vaginal moisturizer
Slippery Stuff	4 oz. / 8 oz.	8.99 / 10.95	
Sylk	40 ml	10.50	Stimulates natural human secretion
Trojan	2.1 oz.	4.99	
Very Private	2 oz.	14.99	Gynecologist recommended for tissue problems
Wet Original	2 oz. / 4 oz.	7.50 / 9.00	Water based
Zebra Glide	2 oz. / 8 oz.	7.49 / 11.69	Slipperiest

2 INDUSTRY ANALYSIS

2.1 Introduction

The Company currently sells personal lubricants primarily in North American markets. The Company enjoyed \$481,000 in sales in 2002 and is poised to exceed \$950,000 in sales in 2003. The personal lubricant market is currently a niche market in the larger global personal care market. The North American personal care market is estimated to be in excess of \$52.9 billion in sales and grew 3.7% in 2002. Worldwide the personal care market exceeds 120.4 billion U.S.¹⁹ The worldwide market grew 4.8% in 2002.²⁰ As the personal lubricant market grows it will lose its niche status and become part of the larger personal care market. This places the Company in a very large market with some dominant players. An analysis of the current industry may suggest a strategic direction for the Company to effectively compete in this marketplace.

The industry analysis will be done using a six factor model.²¹ A summary of the analysis is seen below (Figure 2). The analysis focuses on the lubricant market, although a thorough discussion must include the personal care product market. The six forces identified and described are:

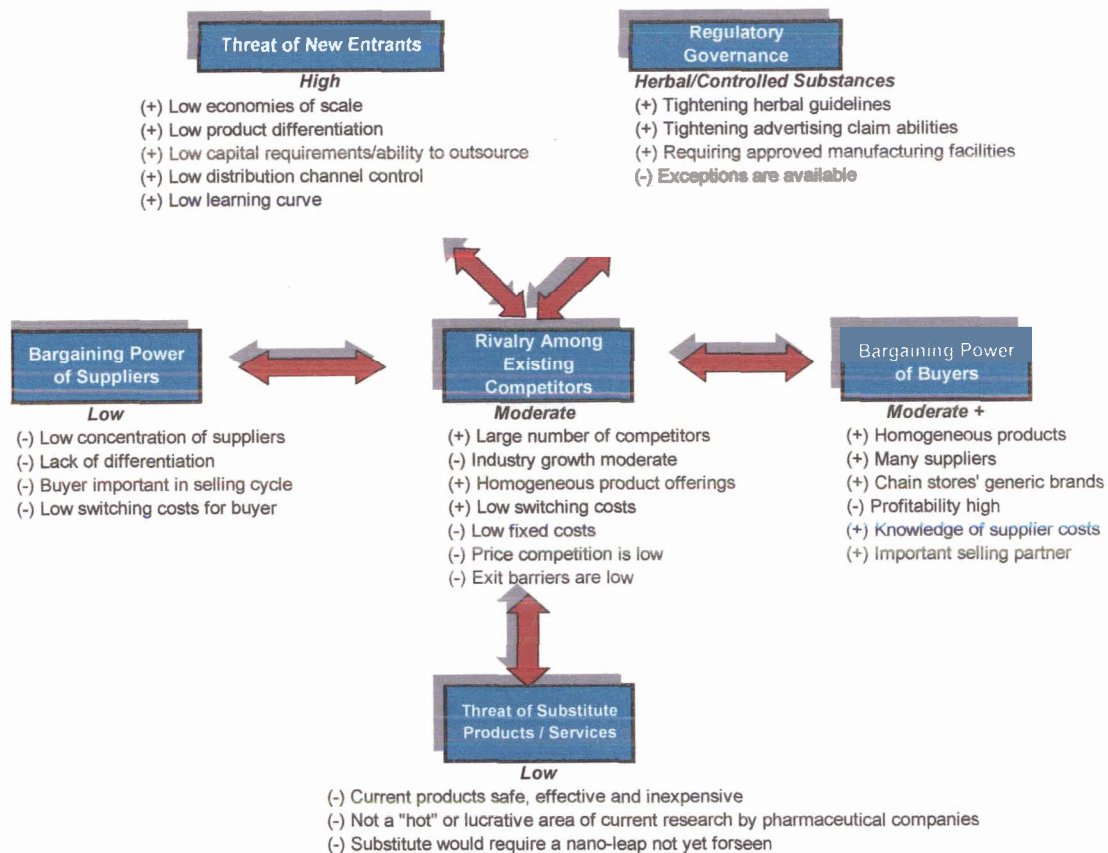
1. Rivalry Among Existing Competitors

¹⁹ Durocher, Bryan. (2003) Opportunity Knocks, *Global Cosmetic Industry*, 171 (1), 47-49.

²⁰ Seaton, Tanya. (2002), State of the industry 2002: A year in review, *Global Cosmetic Industry*, 170 (12), 40-48.

2. Threat of New Entrants
3. Regulatory Governance
4. Threat of Potential Substitutes
5. Bargaining Power of Buyer
6. Bargaining Power of Supplier

Figure 2 – Six Factor Competitive Forces Model²²



'+' = Tightening impact on competitive environment

'-' = Loosening impact on competitive environment

²¹ Adapted from: 1. Bukszar, Ed. (2003) EMBA class notes. 2. Porter, Michael E. (1979) How Competitive Forces Shape Strategy, *Harvard Business Review*, 57 (2), 137-145.

²² Adapted from: 1. Bukszar, Ed. (2003) EMBA class notes. 2. Porter, Michael E. (1979) How Competitive Forces Shape Strategy, *Harvard Business Review*, 57 (2), 137-145.

2.2 Intensity of Competitive Rivalry: Moderate/High

The competitive rivalry seen in the personal care market is high. The industry is dominated by a number of huge companies that span the globe. L'Oreal, Proctor & Gamble and Johnson & Johnson are just a few of the names that compete in this market. The companies have a strong ability to move into market segments that they currently do not occupy should profitable conditions exist. The personal care market is price sensitive, contains a large number of competitors and is growing relatively modestly. The industry struggles to establish strong brand names as product differentiation is difficult and consumer switching costs low. This creates a market that would be extremely difficult to penetrate. However the Company currently competes in a niche of the personal care market and that niche can be separated out. One must keep in mind that when the niche market reaches critical mass, the larger market will take notice and the larger competitors will enter in search of profits. The industry analysis for the organization should be updated regularly to ensure the Company is aware of the extreme competitive actions that could result from its strategic decisions and resultant success.

The intensity of competition in the personal lubricant niche category is currently low/moderate. The personal lubricant market is highly fragmented with many competitors that hold small regional markets. The dominant player in the market is K-Y Brand lubricant from Johnson & Johnson with a 52% share.²³ There are a few companies such as Wet and Astroglide that have managed to form a national presence. However they have focused on trying to differentiate their products in the sex industry. This leaves the door open for a new competitor to J&J to enter the more lucrative mass market.

²³ Harris, Lynn. (2003). K-Y Jelly, we hardly knew ye. *Contemporary Culture*. Retrieved May 21, 2003, from <http://www.powell's.com/portal/ContemporaryCulture.html>

The basic premise of the products is similar, to reduce friction and enhance sexual pleasure. This has led to many similar products with slight variations. All-natural, water versus silicon and different flavours are all attempts to differentiate the products. However, these differentiating attempts have not been successful in creating a true separation in the market. Users of the products have very low switching costs. Unless differentiation can be established, a user may try several different lubricants before settling on a favourite. This could lead to large marketing costs as firms try to establish not only product differentiation but basic product awareness. At current levels of profitability more competitors can be expected to enter the market.

The personal lubricant market does not presently compete on price. Most lubricants are priced in the same general area of 2-4 ounces per \$10 (see Table 4). This mark up provides the industry with a high margin. Even generics are priced only slightly below this range. The lubricant market is still under developed. This leaves time for an entrant to form a solid market position and align its costs. The evolution of the market suggests that consolidation will occur once the mass market begins to purchase lubricants and force costs down. At that point only low cost producers or strongly branded products will survive the intense competitive rivalry.

The personal lubricant segment of the personal care industry is experiencing very healthy market growth with rates exceeding 8% in 2002. This kind of growth rate allows competitors to focus on their own sales growth and deflects away from the need to steal market share from each other. This decreases the competitive rivalry amongst the current companies and keeps the industry focused on attracting and retaining new customers.

Fixed costs in this industry are relatively low. The lubricant market does not involve complex chemical formulation or specialized equipment. Obviously companies that decide to integrate their value chain will have much higher investment costs than companies that diversify their suppliers and outsource their production. However when the industry begins to tighten and

lower costs become essential, those companies who have invested may be in a better position to capitalize on the smaller margins. More investigation into the value chain will establish the correct strategic direction for a lubricant organization to pursue.

Exit barriers to the industry remain relatively low. A chemical formula can be developed at extremely low cost and production, packaging and transportation can all be arranged through suppliers. This could leave a company in the industry with virtually no exit costs; it merely shuts its doors and ceases supplying its distributors.

This leads to a complex assessment of competitive rivalry that is evolving over time. In the short term, that being the next five years, the industry will continue to grow as baby boomers age and personal lubricants become more socially acceptable. Within the natural lubricant market, the Company should be able to compete effectively as the market growth continues under the radar of the personal care market. As the personal care market becomes more aware of the natural lubricant market, large established competitors will enter the marketplace. This will force industry consolidation and the rivalry will increase. The organization will need to be aware of the signs of this occurring and be able to put together strategies to effectively compete in the changing market place.

2.3 Threat of New Entrants: High

The threat of entry into the personal lubricant market is very high. Economies of scale are currently low. Personal lubricants are relatively easy to manufacture with low raw material costs and numerous manufacturing facilities available that can handle large production runs. The margins the products realize negate the necessity to cut manufacturing down to the cent. A bottle in the pharmacy that currently retails for \$14.95 U.S. has a unit cost under \$1.50 U.S. Even generic lubricants sell for over \$7.00. This type of margin makes the market attractive. With a growth rate of over 8% in 2002 new entrants can be anticipated in the future.

As already discussed, product differentiation, capital requirements and switching costs are all low. This will invite other manufacturers into the market with the hopes that they can easily establish a market presence and make profits. Participants currently using lubricants show high demand for the product and the perceived ease of switching all work synergistically to make the market look attractive to new entrants.

Johnson & Johnson is the only company currently showing a high degree of distribution channel control. J&J has an extensive product line that it can leverage to bundle distribution of K-Y Brand Lubricant. No other competitor has any significant distribution channel advantage. This allows new entrants to create new or access existing channels easily and large new entrants would actually enter the market with distribution channel advantages. The advantages may extend beyond distribution channels as large personal care companies move into the market with the ability to bundle a number of products together to make a new product attractive to retailers.

As with any business, there is a learning curve associated with the market. However, large capital investments in marketing can quickly establish a brand presence and negate much of the learning curve advantages gained by the regional manufacturers. Many regional manufacturers are currently selling to niche markets and have been unable to move into the mainstream mass market.

Overall, the lubricant industry should see a number of new competitors entering the market. Current market competitors have been unable to challenge the market dominance of J&J. If this is to occur, a different market entrance approach will need to be attempted to facilitate the move from the sex industry to the mass market. If a competitor enters with significant resources, the entire market could shift as J&J flexes its market muscle and begins executing strategies to combat the new entrant. This would mark the beginning of market consolidation.

2.4 Threat of Potential Substitute Products: Low

The threat of substitutes in this market is relatively low. Personal lubricants and related personal products enhance the quality of activity for participants. While only 1 in 8 men over the age of 40 may suffer from low levels of testosterone, older women go through menopause.²⁴ This creates a large market for personal lubricants as a major effect of menopause is vaginal dryness.²⁵ There is a low probability that the pharmaceutical industry will develop a drug for this specific symptom. A more plausible effort would be to delay or minimize the entire effects of menopause similar to what has been attempted with HRT therapy. There is nothing currently in the literature to support any revolutionary new products in this area for at least five years.

Nanotechnology promises to revolutionize materials processing. Using nanotechnology industry may be able to synthesize a non-moisturizing lubricant. This would create a market segment that many people may prefer. However nanotechnology is also a number of years away from a foreseeable market impact in this area. Currently, focus is in nano-biology and nano-electronics as the large pay-off areas.

The most common substitute currently available is using nothing. Most people do not use personal lubricants. The focus of current manufacturers on the sex industry has left the mass market virtually unaware that these products can become a part of a natural and healthy lifestyle. As awareness of these products grows, the number of people using lubricants should increase. This should reduce the number of people using nothing and over time marginalize this potential threat.

²⁴ Harman, SM et al. (2001). Longitudinal effects of aging on serum total and free testosterone levels in health men. *Journal of Clinical Endocrinology & Metabolism*, 86(7), 24-31.

²⁵ MayoClinic.com. *Dealing with vaginal dryness*. Retrieved June 4, 2003, from www.mayoclinic.com/invoke.cfm?id=WO00034

At this point in time, personal lubricants are relatively inexpensive, effective and safe. These attributes make the threat of potential substitutes low. However the large amounts of money that the personal care market competitors can invest in research and development make it imperative that the Company continually scan the environment for changes in the marketplace.

2.5 Power of Buyer Is: Moderate +

Currently, most lubricant companies are selling to distributors who have retail stores or in turn sell to retail outlets. The product is then purchased by the end user who makes the decision about whether or not he/she will purchase the product again. Differentiation plays a key role in this decision process. The buyers (distributors) currently have a significant amount of power in the process. Suppliers are selling product at relatively low prices to allow buyer mark up. This gives the buyer an incentive to aggressively sell the product to their customers. If a company was successful in differentiating its product and creating a retail demand, buyer strength could be reduced. This would bring competition to the supply chain as buyers competed to carry top brands. This would force the margins of buyers down and allow the manufacturer to retain a higher wholesale cost and potentially capture the money currently lost in the distribution system.

The threat of backward migration by buyers in the sex industry is outside the area of the typical buyer's core competency, distribution. However large retail chains such as London Drugs and Shoppers Drug Mart do provide a generic lubricant supplied to them by lubricant manufacturers who contract bulk orders. This adds some power to the buyer and requires the ability of the lubricant company to differentiate the product for the consumer and create a sense of value that will keep the customer loyal to its brand. Until the product becomes a big mover, generic brand pricing of lubricants does not make this a large threat as the low volume and extra costs of outsourcing manufacturing limits the buyer's ability to cut prices much further.

Buyers' knowledge about suppliers' cost structures is well understood. Although most buyers are not in the manufacturing sector, they know the wholesale price of the product and their mark up potential. They subtract their mark up off of wholesale pricing and use this as a guess on how much the product costs to make. It is pretty close. Buyers therefore know that the lubricant market has high margins and that suppliers have room to move on the price. However, buyers currently enjoy a healthy mark up on the product and are happy to carry the product. The motivation to try and squeeze extra profits from an area outside their core competence has not been demonstrated to date but remains a threat with an undifferentiated product.

2.6 Power of Supplier: Low

As mentioned earlier, there are numerous suppliers for personal lubricants. The low concentration of suppliers allows buyers to select products that will maximize their profitability. Therefore suppliers are limited in their ability to increase the wholesale prices for their products. The lack of differentiation in products further shifts power away from the supplier. If the supplier does not offer enough incentives to the vendor, the vendor merely switches lubricants that are carried and continues to sell to their customers. This creates a situation where supplier investment in creating consumer demand would be required to significantly increase supplier power. Many small suppliers are caught in the trap of not being well capitalized and are dependent on their vendors for distribution and sales. New products and line extensions are given to the vendors to promote, making the reliance of the suppliers on the vendors even more pronounced. Product differentiation and the resulting need for increased investment or selling bulk lubricant (generic) to differentiators are two opposite ends of the strategic spectrum that is available to the organization to combat the low supplier power that is currently occurring.

2.7 Conclusion

The personal lubricant market is currently an attractive market to compete in. Low/moderate competitive rivalry and a market growth of 8% provide the room required for a small company to grow. The threat of substitutes in this market is low giving companies time to establish product brand names. This is tempered by moderate buyer power. The profitability and ease of entry into the market mean that more competition can be expected to enter the market over the next few years. A company that executes an excellent entry strategy could become very successful and begin the process of market consolidation.

Establishing a competitive advantage in this market would decrease buyer power, and make it more difficult for competitors to enter the market. The Company will need to establish a strong competitive advantage if it wants to grow its market share. This can be done by establishing a strong brand name. A strong brand name would insulate the Company from increased competitive rivalry as the market grows. This would require a large investment in market development by the Company.

3 INTERNAL ANALYSIS

With the marketplace identified, the Company will now be looked at through two internal analysis methods. The corporation will be looked at in terms of strategic fit and a value chain analysis.

3.1 Strategic Fit

The major product of the organization is a personal lubricant that supplies the bulk of its sales. The main differentiating factor that the Company has successfully employed to date is the “all-natural” designation for its products. This allows the Company to charge a premium for the product that consumers appear willing to pay. The current strategy of the Company is to be an innovative supplier of romance products in the global marketplace. The organization has a stated goal of being a differentiated company. The following analysis will look at the Company’s strategic fit using the seven parameters shown in the summary seen in Figure 3. This will allow an assessment of the success of the Company in executing its stated goal of being a differentiated organization providing innovative products to the marketplace.

Figure 3 - Strategic Fit²⁶

	Cost Based			Differentiation	
	Low Cost/Adequate Quality			High Quality/Adequate Cost	
Product Strategy		2			
R & D Expense					
Structure & Decision Making			3		
Manufacturing					6
Marketing		2			
Risk Profile		2			
Capital Structure				5	

1 – 2 Excellent/Good Cost Based Strategy

3 – 4 Poor Cost/Differentiation Strategy

5 – 6 Good/Excellent Differentiation Strategy

3.1.1 Product Strategy

Score: 2 out of 6

The product strategy at the organization has traditionally been as a follower. The personal lubricant market was pioneered by Wet and copied by AstroGlide. Wet pioneered the market through introduction to the gay community. Similarly, the company that is the focus of this paper began sales through the West End in Vancouver and used that as an initial customer base. The Company began to develop a more extended following by attending trade shows and conferences that led to meetings with suppliers and wholesalers. The organization has not developed any ‘novel’ products to date, although its strategic focus is to continue to expand past the personal lubricant market into creams and gels. These products will probably be followers in their categories; however the categories for these products in the current market are not well defined.

The Company hopes to move the products from sex industry use into mainstream use. This would make the organization a pioneer in the consumers’ eyes, as the Company would be

²⁶ Adapted from Bukszar, Ed. (2003) EMBA class notes.

one of the first to try and break away from the “bad” image of personal products and make it acceptable to mainstream society. The organization has aggressively pursued the all-natural market niche. This has resulted in success and support from some influential consumers such as physicians and planned-parenthood organizations. The natural/organic feature tends to confer a premium on the products and has allowed a premium pricing strategy. The Company has been successful with a premium price for all-natural strategy.

The organization’s packaging is currently inferior to competitors. Packaging is inexpensive and this may affect the ability of the Company to continue charging a premium price to the consumer. If the Company wishes to convey a premium brand, investments may need to be made in improving the lubricant delivery bottle. Future products will also need premium product packaging if the organization is to be successful maintaining differentiation in the market.

The Company currently finds itself in the low cost end of the differentiation model. This is due to a number of factors, the largest being availability of resources. The Company is using the follower model as innovation is both expensive and comes with a higher risk. The organization has been successful to this point in time but will need a significant increase in investment to maintain the premium priced differentiation strategy if it wishes to continue growing.

3.1.2 R & D Expenses

Score: 1 out of 6

The Company has kept research and development costs very low. Most of the work is contracted out through external sources. A lab is responsible for production of the lubricant and has chemists that are qualified to formulate new products. This leaves the organization spending

very little in the R & D area and the Company falls in line as a low cost producer with this strategy.

Currently, new product development is accomplished without any formal market assessment. This leaves the Company vulnerable to market failures as research and development is conducted in areas where there is a “feeling” of financial returns. As the Company grows, a more formal structure of research and development will need to be instituted to ensure that monies invested in this area are maximized in relation to market potential.

The organization has deviated from its original product formula and allowed its current supplier to develop the formula, at no cost to the Company. The result is that the organization does not own the current formulation and is now required to buy it through the laboratory. This is very concerning. The Company must regain full ownership of the formula before the product becomes too successful. If this is not possible with the existing manufacturing facility the Company will be forced to invest significantly in R & D to reformulate an original product. This must be a priority

There are also regulatory issues to deal with. Each change in product formulation requires a resubmission through the government for an approval to sell. The government is becoming more active in the herbal market and natural ingredients are being continually added to or deleted from the controlled substance list. The organization recently had one of its products removed from the market at the insistence of the government after an ingredient was added to the controlled list after product approval. This type of ongoing change will require the organization to monitor government legislation concerning natural and herbal substances. This type of change will also require an ability to change ingredients within products should legislation change.

Corporate growth increases the Company profile. Research and development will play a pivotal role as the Company moves forward. To become a differentiator the Company will need to increase its spending in the research and development area.

3.1.3 Structure & Decision Making

Score: 2 out of 6

The size of the Company allows the collapse of these two concepts. The structure is very centralized because the Company consists of the president and support staff. Support staff is not encouraged to make decisions because of the importance of every decision at this stage of development. The president does display an attitude of autonomy and wishes to grow the Company in that direction. That will require hiring top quality personnel and giving them the authority to make decisions. Therefore corporate expansion will need to focus on top quality, qualified personnel if the organization wishes to be successful over a long term horizon line.

The Company's growth is currently supplied by the cash flow generated by product sales. The high margins that are realized with personal lubricants facilitates Company growth however important infrastructure improvements in processing orders and shipping will require significant investments. This is likely to exceed the funds available from operations and may require outside financing.

3.1.4 Manufacturing

Score: 5 out of 6

The Company has been very successful in securing quality manufacturing facilities that allow maximal flexibility. The Company has negotiated a very low manufacturing fee and a low minimum run. The contracted production runs allow the organization to operate without having to carry expensive production facilities or enter the business of machine maintenance. This allows the Company the flexibility of using an FDA approved manufacturing site that is a requirement for its products.

The organization has made 9 different variations of its original personal lubricant product. The addition of flavoured ingredients has expanded its sales base with a simple manufacturing process. This type of flexibility allows them to increase the scope of their product line with minimal or lesser costs. The strategy of expanding into gels and creams holds similar advantages.

However the Company risks losing control of its product with an external manufacturer. The manufacturer has the potential of entering the market as a low cost supplier with a similar product. This would be a severe setback for the Company as it struggles to establish brand recognition.

3.1.5 Marketing

Score: 2 out of 6

Marketing for the organization has been mostly through the push model. The Company is currently dependent on distributors to market its products to retail outlets. This does not give the organization a very strong market position. The launch of a new product is basically an information sheet to distributors with an incentive to sell the product through mark ups. Smaller distributors that are willing to invest the time in selling the lubricant are the main source of business. If the Company truly wants to leave the low cost area it will need to create consumer demand for the product. Although this is an expensive proposition, the organization will be able to sell its products at a higher price and take some of the margin lost to the current system.

The product is an all-natural water based lubricant and is the only national brand currently occupying this area. There is an opportunity to create a trusted brand name in this area and continue to expand it into other areas of personal care products. This would help the Company develop a competitive advantage that would serve as a barrier to entry for other niche players and protect its price premium over time.

The Company has moved away from the gay market and is targeting the much larger baby boom generation. The analysis in the initial portion of this document uncovered that population growth and personal health issues appear to support this move. However the Company is still fighting to shed its dependence on the sex market. The flavoured lubricants and the O clitoral stimulating gel are products that are firmly planted in the sex industry and continue to provide most of the Company revenues. The organization recently unveiled a lime green, billboard on wheels, mini-van. This type of activity needs to be assessed within an overall marketing plan before implementation. The organization is going to have to modify its 'marketing from the gut approach' and begin using instruments such as statistics and surveys to help make major marketing decisions.

The statistics support that the timing is right to challenge societal attitudes concerning personal care products. By targeting women and bringing lubricants into the mainstream the Company may become a first mover. However this would require a significant pull strategy to be implemented by the Company. The barriers that need to be overcome are daunting and require extensive market research to establish societal attitudes and the proper course of this action. A major campaign that executed a pull strategy would require extensive use of expensive marketing vehicles such as radio, print and television to create awareness. However a major company like Johnson & Johnson with K-Y Brand lubricant may react to the efforts of the Company creating a critical mass that could help a small organization.

3.1.6 Risk Profile

Score: 2 out of 6

Currently the corporation is risk averse. The start-up has been progressing well and there is a tendency to keep the current growth trend going through low risk activities. The Company

does not have any major financial backing and market fluctuations could prove to be serious risks. Therefore, the risk profile probably suits the current position of the Company.

The Company is not afraid to enter new areas or create new products, assuming a model of success exists. This places the organization firmly in the low cost based strategy. The near future of the organization does not see this strategy altering. The Company has been successful to date developing solid but low risk product lines. As long as the growth rate remains sustainable, the organization will remain relatively low risk.

If the organization truly wishes to become a differentiator, this profile will require modification. Success of the organization will lead to new opportunities and an increasing need of financial resources. At that time, the Company will need to re-assess its risk profile. As organizations become successful a clear strategy must be decided upon. There will be forces pulling the organization towards the middle of the model, an area that can result in superior competition from those companies who are successfully competing in the more differentiated or low cost areas. Therefore the Company must continually revisit the risk profile in this period of extensive growth.

3.1.7 Capital Structure

Score: 4 out of 6

The capital structure of the organization is conservative. The Company does not hold a lot of debt. Current investments in the business come from existing revenues. This places a strain on the organization as displayed by its research & development and marketing constraints. However the Company has been successful to date and continued 50+% growth appears sustainable over the next couple of years.

The Company is heading for a challenging year with demands for heavy investments on several fronts. The need for improved marketing, better packaging, new personnel and new

product requirements are all going to seriously jeopardize the ability of current revenues to finance. If the organization is to reach the next level of growth the Company will have to consider incurring more debt. Further analysis will be required to assess if this is the best use of capital.

3.1.8 Conclusion

Although the Company sees itself as an innovator, the organization is currently more aligned with a low cost strategy. The Company could further capitalize on this strategy by bringing manufacturing in house to achieve greater control of production costs. This is not an area of expertise for the organization and comes with significant risk. This would require a significant investment in equipment, machinery, and personnel creating a more leveraged capital structure. However these two moves would bring the organization into better strategic alignment as a low cost organization.

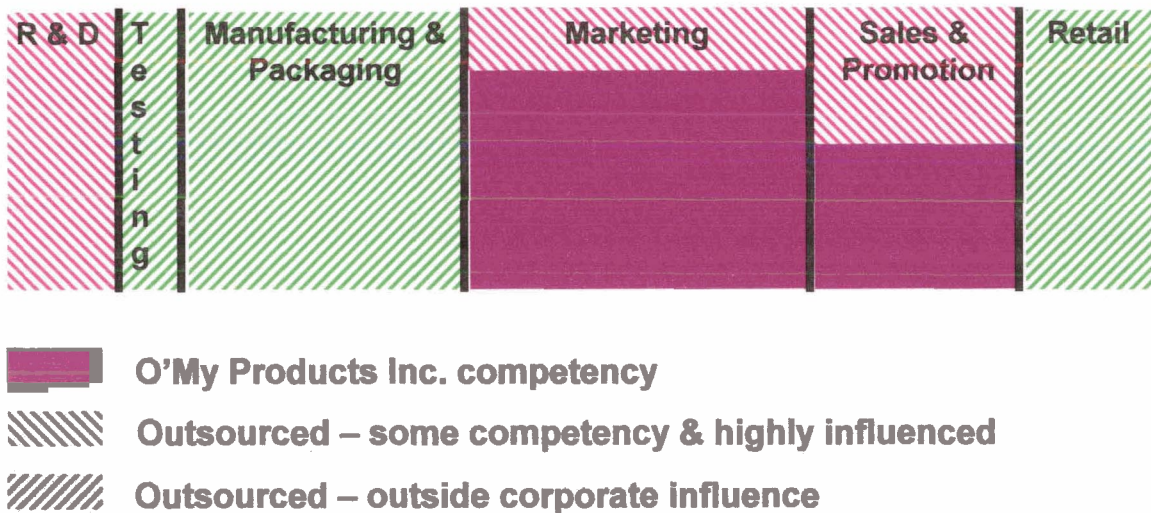
However the stated goal of the president is as a differentiator. This will require significant investments to build the organization. Research & development expenses will need to be increased to allow the Company to pursue innovative products. More marketing spending will be required to create higher brand awareness. The Company will need to develop a decentralized structure that has the autonomy to make decisions affecting local markets. The owner of the Company will also need to come to grips with an increased risk profile as the Company begins significant investments in new and unproven markets. The organization will need to select a dominant strategy and streamline the organization to fit the way it wants to do business.

3.2 Value Chain

3.2.1 Industry Value Chain

The personal lubricant market industry value chain is shown visually in Figure 4. The width of the segment suggests its importance and the color indicates the organization's competency level versus the overall industry in the different parameters shown in the chain. Manufacturing, marketing and sales & promotion dominate this value chain. The highly fragmented personal lubricant market is still developing R & D, testing and retail support. The personal care industry value chain differs from the lubricant industry value chain. The personal care industry is dominated by large organizations that vertically integrate larger R & D and retail segments. As the lubricant industry grows, personal care competitors will enter this market altering the value chain. For now, this paper will look specifically at the lubricant market and discuss each area to understand where value is created in the industry.

Figure 4 - Personal Lubricants Industry Value Chain²⁷



²⁷ Adapted from Bukszar, Ed. (2003) EMBA class notes.

3.2.2 Research & Development

Personal lubricants are relatively simple products. They are traditionally petroleum, silicon or water-based with a variety of additives to differentiate the products. Once a company has developed a lubricant it is ready to go to market. The only companies that appear to be spending significant amounts in research and development are the market leaders, companies such as Johnson & Johnson and BioFilm Inc. This is a disadvantage for those companies that cannot afford to invest in research and development. By reinvesting resources into their products, companies should be able to differentiate and grow their product lines. Therefore this segment of the chain is a significant opportunity to create long term value.

The Company uses outside chemists to develop new products. Much of the new product development is spurred by the Company president. The president approaches chemists who develop the appropriate formulas for each idea. The organization currently has access to a top level chemist who has spent years developing lubricants, creams and oils. If this chemist were to leave the business, the Company would find itself at a disadvantage. This is an area that the organization will need to strengthen if it wishes to increase its product portfolio.

3.2.3 Testing

Although this is a subset of development, it is important to note that many lubricants on the market are untested. There is no requirement from the FDA or Health Canada for tests on products whose ingredients are not restricted. This reduces barriers of entry to the market and helps to explain the fragmentation seen in the industry.

Testing can add significant value to the product through consumer confidence. Endorsement by physicians is seen as an important differentiator in a market that is overshadowed by the sex industry. Endorsements move the product from a niche market into the

more acceptable mass market. This could result in significant value being added to the chain (i.e. widening of the current link as depicted in Figure 4) and should be pursued by the Company.

3.2.4 Manufacturing & Packaging

Manufacturing personal lubricants is a simple mechanical mixing process. Most companies manufacture at FDA approved facilities to ensure quality. The lubricant itself can be manufactured for under \$1.00 a gallon. The same product can retail for up to \$19.99 for a 4 ounce bottle. The value comes in the branding. Johnson & Johnson and BioFilm Inc both manufacture lubricants in-house. The investment required to manufacture in-house is not justified for many of the smaller lubricant providers who cannot reach the minimum efficient scale. Currently the organization fits into this category. The relatively low cost of outsourced lubricant production makes it senseless for the Company to invest resources at this time that are better utilized in other areas of the Company.

This makes it imperative that the organization forge excellent partner relations with the up-stream value chain. Currently the Company is able to buy packaged product from a supplier in California. This arrangement has existed for a couple of years and appears to be quite stable. Timelines for receiving product are satisfactory and there is minimal hold up potential at this time. However success by the Company could result in competitors moving to block lubricant supply or bounded rationality may come into play as the producer searches for ways to increase profits. Whether through business negotiations or a takeover, the single source of supply for the Company's products could be a target for competitors looking to gain an edge in the market.

Once the organizations sales reach a critical point, in-house manufacturing and packaging can be explored. However this is a move into an area that is not a core competency and must be studied thoroughly before the Company is launched in the direction of manufacturer.

3.2.5 Marketing

Marketing is the most important link in the personal lubricant value chain. Those companies that are able to create differentiation for their products add the most value. We saw under manufacturing how inexpensive the product is but how much a differentiated brand can demand from the consumer. This is also the most expensive area of the value chain. Most companies focus on marketing to the sex industry and on the internet, both low cost, highly specific market segments. The Company has been successful to date differentiating its product within this arena but has yet to expand beyond these boundaries. If the Company is to reach the next level of success, expansion beyond these markets is essential.

Consumer research needs to be conducted. The organization is trying to create a consumer wave and catch it. Is a sexy and fun campaign with bright colours and flavoured lubricants going to increase the organizations market share? Is current packaging enticing? Do we know that the population is ready to talk about this issue?

From the value chain it is obvious that marketing is where the Company should place most of its resources. Creating a trusted brand name will allow the organization to launch related products and continue to grow the Company. As the Company increases its revenues, other areas of the value chain can be explored for further investment. Other organizations carrying lubricants do not seem to be spending large resources in this segment of the value chain. Therefore this can become a competitive advantage for the Company.

3.2.6 Sales & Promotion

The industry currently does not pursue traditional models of sales and promotion. Only Johnson & Johnson with K-Y Brand lubricant is capable of fielding a sales force that can actively sell to individual retailers. Other manufacturers rely on distributors, the internet, and

conventions to increase awareness of their products. Promotions are usually limited to the gay market or the sex industry, leaving the mass market untouched.

Distributors add value by performing this function for the smaller companies in this market. Distributors receive a significant mark up on products due to the high fragmentation in the market. Mass market appeal would drive consolidation and create mass brand awareness. That would force distributors to be more competitive on prices and allow brands to capture a larger portion of the value chain.

3.2.7 Retail

The industry is dependent on retail outlets to provide the product to the public, but no manufacturer actually owns any retail outlets. Retailers are much like distributors and excessively up-charge lubricants. This highlights the focus on marketing to create brand awareness and lower buyer power in an attempt to give lubricant manufacturers the opportunity to extract more value from the chain.

3.3 Corporate Value Chain

The corporate value chain is illustrated in Figure 5. The organization is relatively small and currently the value chain is relatively simple. The different parameters seen across the bottom of the chain are discussed in more detail on the following pages.

Figure 5 - Corporate Value Chain²⁸

Firm Infrastructure	• Accounting					M A R G I N
Human Resources Management	• Temporary Help					
Technology Development	• Contract Research • Quality Control	• Testing Services				
Primary Activities	<ul style="list-style-type: none"> • Transport Services • Warehousing Services • Inbound Materials Handling 	<ul style="list-style-type: none"> • Inventory Management • Internal Materials Handling 	<ul style="list-style-type: none"> • Order Processing • Shipping • Order Fulfillment • Distribution Channels 	<ul style="list-style-type: none"> • Advertising & Promotion • Customer Website • Conferences & Conventions • Distributor Relations 	<ul style="list-style-type: none"> • Money back Guarantee 	
	INBOUND LOGISTICS	OPERATIONS	OUTBOUND LOGISTICS	MARKETING AND SALES	SERVICE	

3.3.1 Inbound Logistics

The organization out sources the manufacturing and packaging of finished goods and has them delivered to a warehouse in North Vancouver. Goods are delivered ready for shipment to the final customers. From the North Vancouver location, goods are then shipped by UPS to distributors who in turn deliver to retailers. The actual cost of this service is minimal as the current rent that is being paid for the warehouse is relatively inexpensive. There is also a forklift and a part-time labourer that contribute to the inbound logistics operation of the Company.

This function serves to provide little value and could easily be outsourced to a company that handles warehousing and shipping. The Company could then divest itself of the overhead costs of rent and labour. The building is currently for sale and a new lease will cost the

²⁸ Porter, Michael E. (1979) How Competitive Forces Shape Strategy, *Harvard Business Review*, 57 (2), 137-145.

Company significantly more than it is currently paying. If the cost of contracting a company to warehouse and ship product is less expensive than vertically integrating it into the Company, then the Company should investigate that option. This would leave the organization with a need for only office space, and an appropriate lease could be signed based on sales projections. The projections could determine when the cost of outsourcing the service will outweigh the cost of setting up an inbound logistics department. At that time the Company could then lease more space and set up a warehouse.

3.3.2 Operations

Operations within the organization are minimal. Inventory management is linked through the accounting program to register when certain SKU's reach a minimum level and need to be reordered. This prevents the organization from reaching an out of stock situation. This function within the organization adds little value to the final product and if it could be accurately executed by a third party would allow the organization to focus on the two key value added areas; marketing and sales & promotions.

3.3.3 Outbound Logistics

Outbound logistics are an area that can be easily outsourced at this time. Order processing and fulfillment are manually done, actually decreasing value in the chain. Everyone in the organization at some point in time finds themselves in the warehouse filling orders, especially if a big order comes through. This is time spent away from value added activities. Inbound logistics, operations and outbound logistics could easily be outsourced and will actually add value to the organization by allowing the staff to concentrate on higher value added functions.

3.3.4 Marketing and Sales

This area of the Company adds the most value to the organization. The Company has been successful differentiating its product through innovative marketing. The company has developed bright and distinctive advertisements, novel in store display cases and strategic alignments with important customers such as drugstore.com. Marketing is currently carried out both internally and through contracts. If the organization focused more energy on this area they could extract more value from the chain as product differentiation and customer awareness continued to increase. This would result in less customer buying power and shift more power back into the organization in the form of increased profits.

Conferences and conventions have been the major vehicle for meeting with interested distributors and extending distributor relations. Increasing the availability of the Company's natural lubricant should be the focus of the organization. This can be done by investing more resources in market research and consumer buying patterns. The organization is currently only using one vehicle to increase awareness of the product. By understanding consumer behaviour, a more thorough marketing plan could be constructed. The goal is to create a societal shift. This would require a fundamental knowledge of customers and their likes and dislikes surrounding lubricants. A marketing campaign that created a ground swell of public acceptance could easily double or triple the market. If every sexually active woman in the U.S. purchased one bottle of lubricant a year the market would be over \$800 million U.S.²⁹ To actively promote in a market that has that kind of growth potential could be very lucrative.

Unfortunately, investing the required resources to change societal attitudes and cause a consumer shift in buying patterns can be very expensive. By selecting a target market to test the success of a major consumer campaign, the Company could gauge public sentiment and fine tune

the probability for success on a small scale. This would also give the organization some insight to the feasibility of growing the organization to \$9 million in sales on existing products.

3.3.5 Service

Currently, the organization guarantees the product and refunds money immediately. The organization is dealing mainly with distributors who are required to place a minimum \$3,000 order. The service that is provided is acceptable to these companies. If the Company is to enter major distributors such as London Drugs and Shoppers Drug Mart then service will need to be dramatically improved. These accounts tend to be “high maintenance” accounts that are constantly demanding the best service and sophisticated electronic delivery capabilities. At that point service could well add a lot of value to the chain. Shoppers Drug Mart will not allow suppliers that cannot electronically link with their matrix distribution system to be placed into the system. This effectively locks such suppliers out of over 700 drug stores (approx. 14%) across the country.

3.3.6 Technology Development

Quality control, research and product testing are all performed by outside providers. These areas do add value to the organization through new product development but are outside the capabilities of the current organization. The organization has a corporate goal of moving beyond lubricants into gels, creams and oils. When the organization begins generating enough revenue to support in-house research this area should be looked at again. The current flexibility the organization has in sourcing expertise to develop products has added value to the

²⁹ 107 million women (18+) x 1 bottle at an average price of 7.50 U.S.

organization. Overhead costs have been kept low and product formulation consistently achieves FDA standards.

3.3.7 Human Resource Management

This area of the Company has not been well developed. With only three full-time employees the organization has not had to implement a formal human resources department. The organization will need to be very careful in this area. The president has a vision of the organization and will need to hire people who share that vision. The president also has a strong sense of the corporate culture that he wishes to develop; a corporate culture that could become a competitive advantage. The current president believes in empowerment, employee equity and a strong sense of team. These traits could create a strong positive atmosphere within the organization that would attract outside talent looking for increased responsibility. Vancouver suffers from the problem of having relatively few corporate head offices compared to major cities such as Toronto. Therefore executives with business ambitions are frequently required to choose between increasing business responsibilities or increasing quality of life. With such a small organization the immediate concern is that each person that is added to the organization will have a huge impact on corporate culture. Formal interview processes need to be established that capture upwardly mobile, talented individuals that can add to a positive business atmosphere. This area deserves attention in the value chain; the strength of any organization is the people who agree to work there.

3.3.8 Firm Infrastructure

The Company has been built very carefully with the focus on keeping costs to a minimum. The organization has managed to sustain its growth to this point through outsourcing

most non-essential services. Within the firm infrastructure, accounting and legal services are outsourced. There is an attempt to develop partnerships in these areas so that an understanding of the Company and its goals is held by the service providers. This has left the organization with little debt and contributes significantly to its appeal as a small, growing company.

3.3.9 Conclusion

The organization is structured extremely efficiently. The organization is not large enough to take advantage of many segments in the value chain. Minimum efficient scale, flexibility with suppliers and costs all affect different segments in the chain. Marketing and sales & promotions are two areas that the Company should be concentrating on to maximize the value that is added to their products. The organization should make the extra step of outsourcing logistics and operations to help them focus on maximizing value. A formal human resource management program with specific criteria for screening potential candidates to join the organization must be implemented to ensure that new individuals bring the required skills and attitude into the organization to create a competitive advantage.

4 ISSUES

The preceding analysis has uncovered a number of issues that will now be ranked in terms of importance. It must be kept in mind that the central issue of the paper is to develop strategies that support the firm's stated goal of growing to \$9 million in sales in 2008. The fundamental question is whether or not this organization can continue growing at its current pace and establish itself as a success in the international business community.

The most immediate strategic issues concern the establishment of a sustained competitive advantage that will foster growth and access to enough capital to support the resultant growth. Currently the balance sheet (see Figure 7) shows that the organization has enough cash flow to support itself and some investment in ongoing market development. Therefore the issues discussed below will be followed in chapter five by recommendations on how the organization can move forward and realize its full potential.

4.1 Establishing a Competitive Advantage

The organization is currently well on its way to securing a competitive advantage. The Company has tried to differentiate its product through all-natural ingredients. This is an example of using product features to help the consumer develop a set of criteria with which they can make an informed decision on brand support. Other sources of competitive advantage include product quality. The owner of the Company has considerable expertise in the lubricant area and has also worked hard to develop a product that has superior performance; it does not break down under vigorous conditions. This helps to establish the quality of the product and helps create a competitive advantage with the consumer if marketed appropriately. Within the lubricant

industry, companies are also using unique design specifications (Astroglide currently does this by linking its design to the aerospace industry) or unique packaging as differential characteristics.

One of the most powerful ways to establish a competitive advantage is to establish a strong brand. A brand is a seller's promise to deliver a specific set of features, benefits and services consistently to the buyers. A brand can convey some or all of the attributes, benefits, values, culture, personality, and type of user and uses these attributes to try and produce positive associations for the brand.³⁰ These positive associations influence the consumer to support a specific brand of product. In this way the consumer can be cultivated to become a loyal brand supporter.

Although the development of brand equity can be expensive, the rewards can be enormous. Distributor and retailer power is diminished as the public begins to demand that a specific product be carried. The perceived quality that a brand conveys usually results in a consumer tolerance for higher prices. Brand loyalty can help minimize competitive pressures to switch to another brand by increasing perceived switching costs with the consumer. Line extensions can also be easier to launch because the consumer already has an association with the brand. By establishing a strong competitive advantage through brand development, the Company can expand its consumer base and protect its differentiated pricing strategy. This is the most important area for the organization to address, establishing a sustained competitive advantage.

³⁰ Kotler, Philip, Cunningham, Peggy H., & Turner, Ronald E. (2001). *Marketing Management* (10th Ed.), Toronto, Ontario, Canada: Prentice Hall of Canada.

4.1.1 Distribution

Distribution is a major weakness in the current value chain. The industry analysis uncovered that the Company is dealing with distributors who have high buying power. This causes a significant portion of value to be lost in the value chain. This also creates a competitive disadvantage. Competitors, especially K-Y Brand that have the ability to leverage other Johnson & Johnson products and create a competitive advantage in the distribution area, hold a significant advantage. The inability of any small producers to exercise any channel control puts them at the mercy of the distributor.

The organization must decide what type of distribution it is looking for. The organization may be looking to maximize price and therefore select exclusive distribution, where the product is only available in certain stores. This strategy is currently seen in the health and beauty area where Estee Lauder has resisted allowing its products into pharmacies to maintain its exclusive brand image. Selective distribution would see the product more widely available but not everywhere. This increases the accessibility of the product but still tries to protect the price point. Finally, the organization can decide that intensive distribution is the target. This would involve getting the product everywhere. This strategy maximizes consumer exposure but may also create a downward pressure on price as the product becomes more of a commodity.

Distribution has currently stayed away from direct sales of any kind, including the internet. The Company's products are available through a number of websites and retailers, however they all purchase through a distributor. This is a sound strategy. A small company like this organization would be overwhelmed with accounts receivables if it opened its doors to large scale direct sales. Stores tend to rank accounts by priority and pay the most important suppliers first. This would leave a small company at the mercy of late paying accounts. The lack of direct internet sales can be directly attributed to channel conflict. Close working agreements with distributors and retailers such as drugstore.com have precluded direct sales to date. The

organization needs to develop a distribution strategy to significantly reduce buyer power and give the Company some flexibility in choosing a distribution strategy, rather than having one chosen for it due to financial necessity.

4.1.2 Target Market

The Company currently has a hybrid marketing strategy that is aimed at women and at the sex industry. Flavoured lubricants and the O Clitoral Stimulating Gel, which sell predominantly in sex shops, account for much of corporate sales. Therefore a fundamental strategic decision needs to be made whether the organization should pursue a strategy of increasing awareness in the sex industry or increasing awareness with women. The two strategies appear to be a bifurcation. Many women are uncomfortable shopping at sex shops. That would negate an advertising campaign focused on women for a product that was available only in sex shops. Many retailers are uncomfortable supporting a product that is linked with the sex industry. This would limit the distribution possibilities should the Company decide to focus on the sex industry. Therefore the organization has two choices. The Company could decide to focus on one market and establish its brand for that market or the Company could develop two brands and market each separately. Increased resources would be required to establish brands in both markets.

The sex industry is where the Company started building its marketing and driving its sales. The Company was moderately successful but the highly competitive market was difficult to penetrate. Sales did not begin to increase dramatically until the current president took the Company in the direction of marketing to women. This seemed to strike a chord with the public and support is growing steadily. The target market overview showed that the overwhelming users of lubricants should be women. Much of the customer information that the Company has gathered supports the view that most of their clientele are women. However this is an area that

has not been developed by any other personal lubricant company. Therefore significant risk comes with investing in this market and trying to create awareness for a new category.

4.1.3 Customer Development

A better understanding of the target market is required before investing in further customer development. Once a target market has been chosen between the sex industry and women, a thorough exploration of the intended target audience should be undertaken. Focus groups and customer surveys can give the organization a sense of the needs of the customers. By aligning the product most closely with those needs, the Company can help increase the chances of success with their chosen strategy. Solid market and consumer information can increase corporate confidence by legitimizing assumptions and providing information to develop a sound business strategy. A well developed, well executed strategy secures employee enthusiasm and motivation increasing the likelihood of success. It can also increase investor confidence that the organization is exploring all options before moving forward.

4.1.4 Product Ownership

The organization is currently outsourcing the manufacturing of its personal lubricant. Although the Company owned the original formula, enhancements have been made and the resultant formula on the market is not proprietary. This could seriously jeopardize the ability of the organization to exercise control over the production of its main product. As previously discussed, a solid working relationship has developed between the Company and the manufacturer. However acquisitions, mergers or new alliances could all affect the access of the Company to the formula and to production. A contract has been signed that gives the organization exclusive rights to market the lubricant. However hold-up must be discussed as a

possible concern as the product increases in success. Bounded rationality concerning contracts leaves one to believe that a problem with supply could occur if unforeseen external market factors came into play.

4.1.5 Product Testing

Current testing of lubricants is not a requirement to market the products. However physicians and health groups continue to be extremely influential in endorsing certain types of societal behaviours. The organization has already developed a solid business relationship with some obstetricians in Canada and the United States. This has come directly from the all-natural product stance. Further investigation into this field with physicians has uncovered a need for more product testing if these professionals are going to support the product. Some of the requests from health professionals are studies that investigate a number of concerns a health worker may have. Questions such as the product's propensity for skin irritation, the effect on sperm motility or stability, and the compatibility with condoms are all important issues that would require statistical proof before receiving professional endorsement. A study or studies that investigated these issues would create a great deal of comfort with medical practitioners.

The ability to align with strategic partners is a way that small companies can leverage influence and increase appeal. A product that is aimed at a broad market would need to receive some form of endorsement from the medical community. Pharmacies are the logical retailer to carry this kind of a product. Although not directly medical in design, this category offers itself as a logical extension of the health and beauty aid line. Testing will legitimize the product and encourage health professional endorsement.

4.1.6 Packaging

Although customer research studies would include a discussion on packaging, this area needs to be investigated separately. Packaging and graphic design must define, support and communicate brand positioning.³¹ Current packaging has supported current product success and it must be kept in mind that drastic changes in packaging can result in loss of market share.³² As the success of the brand grows the brand recognition for existing packaging becomes engrained with the customer. This makes the switch to superior packaging more expensive as time moves forward. Customer surveys would indicate the appropriateness of current packaging and whether different packaging would influence the perceived quality of the product. Customers may appreciate the simple design of the current packaging but the Company must realize that the packaging must enhance the overall perception of the product. Further considerations could include package protection and environmental issues that support the all natural product stance.

4.2 Access to Capital

The financial strength of the Company is adequate for its current business. The organization currently has cash reserves fluctuating around \$100,000 and is growing total assets monthly. However increased sales bring increased costs to almost all areas of the Company. This requires an increase in the capital base to ensure that any unforeseen market anomalies do not have serious consequences on the viability of the Company. In chapter 6 of this thesis financials are discussed and cash flow calculations show a shortfall of \$588,414. That is the number that will need to be bridged for the organization to reach escape velocity. Therefore

³¹ Opatow, Lorna. (1984). Packaging is Most Effective When It Works in Harmony with the Positioning of a Brand, *Marketing News*, 18 (3), 3-4.

access to capital will become an issue for the organization as it grows. The most pressing issues that the Company should attempt to address over the next year to facilitate its access to capital are discussed below.

4.2.1 Human Resource Management

To attract outside investment, the Company will have to build a management team. Outside investors will be looking for the ability of the organization to deliver on its promised top and bottom line milestones. This requires talent in marketing, sales, finance and strategic management. Attracting talent to the organization becomes a major concern.

There are a number of ways to attract talent to a corporation. Unfortunately one of the best ways to attract talent is to be successful. This can produce 'the chicken or the egg' thinking. Success requires talent and usually the talent arrives to provide the success. A relatively new and growing organization is usually unable to pay high salaries to incoming talent. Therefore equity incentives can help to attract the attention of skilled workers. Allowing the employees to hold equity in the organization encourages volunteerism, that extra effort that employees put into their careers that comes from internal motivation. This can be a very powerful incentive to attract individuals to an organization.

The sheer array of positions and responsibilities that are shared through the organization allow a candidate to build resume qualifications that cannot be obtained from larger institutions. This allows skilled people that are looking for a change the opportunity to expand their skill sets while contributing to corporate performance. By providing a varied work environment and

³² Margulies, Walter P. (1979). Don't Shock Buyers-Subtle Package Updates are Best, *Advertising Age*, 50 (8), 53-59.

encouraging cross functional development, attractive recruits may join the organization with the intention of growing with the organization. ' 1

Corporate culture can become a significant enticement to get talent into an organization. Culture can be thought of as shared beliefs and values. Shared beliefs and values represent important common assumptions that guide organization thinking and action.³³ Experienced employees may be looking to join an organization that aligns with their beliefs and values. Progressive management practices that encourage empowerment and decentralized decision making could provide the basis for a strong corporate culture that can be used to attract current or future top level employees.

4.2.2 Sourcing Capital

Access to capital is a concern in any corporation that selects growth as its main goal. Banks are difficult to deal with and outside financing would most likely require some form of equity exchange. This would require the current ownership to relinquish partial control of the organization. Chapter 6 identifies a cash shortfall of \$588,414. Therefore these issues will need to be dealt with and a plan of action developed within the organization. The organization can slow growth rates to try and give itself more time to access cash. However this would create opportunity costs. The organization has a huge opportunity in the marketplace that should be capitalized on. The delay would diminish the effectiveness of the campaign and give competitors the ability to create offensive strategies. This would affect overall corporate performance and would jeopardize its ability to reach \$9.0 million in 2008.

³³ Sathe, Vijay. (1994). Implications of Corporate Culture: A Manager's Guide to Action. In L. Mainiero, & C. Tromely (Eds.), *Developing Managerial Skills in Organizational Behaviour*, (pp. 329-340). Prentice Hall. Upper Saddle River, NJ.

Raising capital can become a full time job for an organization. The ideal investor would be an angel investor, someone who was interested in helping the organization grow but left ownership control in the hands of current management. Venture capitalists would require a significant equity stake and tend to move aggressively to protect their investments. If there is no other choice, this route may need to be taken. The best way to begin accessing individuals is to attend networking events and begin fostering relationships within the business community. At present the Company has a couple of promising routes to access some capital, although they need to be developed. This process can take 12 to 18 months to secure; therefore there is immediacy in addressing this issue. They are now 18 to 24 months away from requiring the capital.

4.2.3 Corporate Ownership Restructuring

If the Company wants to attract both employees and outside capital the Company will have to alter its share structure. The Company is owned by two individuals: The president with 90% ownership and his wife with 10% ownership. This arrangement is not secured by shares issued by the organization. New investors are going to want to purchase significant equity positions. They are going to want shares that are redeemable for cash at some time in the future. Investors do not want shares that are worth thousands of dollars per share. The liquidity of shares that are that expensive is compromised by the large value. Therefore a new share structure will need to be investigated to encourage investment in the Company.

The timing of the ownership restructuring could also be important. Valuation of the Company could be compromised if share values are altered just before negotiations with an investor. If 5 million shares are issued and purchased for \$500 dollars the value of each share becomes valued at \$0.0001. The corporation then begins accruing share value from that point forward. If an investor is willing to pay \$0.50 per share, the values of the remaining shares have now reached that level and the organization is now valued at \$2.5 million. If the corporation

requires cash and investors know the value of the last issuance, the investors may be tempted to use the information to achieve a more favourable investment deal. However if the organization addresses the share situation now, Company valuation will be minimally affected.

Altering the shares in the organization does not affect the current ownership structure. However shares can then be set aside to attract outside management talent that may be required to help the Company move forward. Top level people will demand high salaries, an equity position in the Company or both. Setting aside 1 million shares to use as in an executive recruitment and retainment strategy gives the corporation some flexibility as the organization grows. This type of share structure could also assist when negotiating with potential investors and possibly used as leverage to secure a more favourable financing deal.

5 RECOMMENDATIONS

The market analysis has shown that the Company would require an 11.25% market share of the U.S. lubricant market. This is not an impossible task to accomplish. However the market is growing and in 5 years the share required could be as low as 7.25%.³⁴ Therefore the personal lubricant side of the organization could provide the growth needed increase sales to \$9.0 million dollars per year. The issues discussed in Chapter 4 must be addressed if the organization is going to be successful in establishing itself in the marketplace.

A competitive advantage is achieved when strategy, organizational competence and markets are in synch.³⁵ The Company is focused on women, a large and growing target market that has a demonstrated need for the product. This part of the strategy is in synch. Unfortunately the market is under developed. The awareness of the population regarding personal lubricants is relatively low. Only Johnson & Johnson with K-Y Brand has dared to venture tentatively into the mainstream market. The risk may be higher in trying to develop a new market but the rewards would equally be higher. Within the next 5 years a competitor is going to break away from the pack with a campaign based on the mass market. Recent advertisements touting Viagra have broken a societal barrier surrounding personal issues such as sexual performance. As society grows older people will be looking for enhancements for a variety of problems that aging brings. Lubrication is one of those problems and is something that affects a large number of females. Therefore it appears that the time for action and market development is now.

³⁴Lubricant Market - 8% growth of 80 million over 5 years results in a market size of \$117.54 million. The company at \$9 million would result in a 7.25% share.

³⁵ Bukszar, Ed. (2003) EMBA class notes.

Establishing a competitive advantage remains the key focus of the organization. Without a sustained competitive advantage, the organization cannot maintain its price points or retain its customer base. The all-natural ingredients in the product provides differentiation from competitors, however this can be copied. Therefore a strong brand name needs to be developed that can give the organization some protection from competitors. A small company that has less than \$1 million in sales does not have the resources required to effectively blanket the mass market. Therefore a focused approach to mass market entry seems to be appropriate for this company.

A focused approach would be to target specific geographic areas with advertising dollars and measure results. This would allow the organization to spend relatively small amounts of money developing the right formula before rolling the strategy into other geographic areas. The tight geographic element would allow a concentrated spend, producing enough market noise to judge whether individuals are responding to the marketing campaign. \$2.0 million spent on North America would not produce any impact. \$200,000 carefully targeted to certain marketing vehicles and spent only in one major city may produce an impact. Therefore a targeted geographic approach would make sense for a small company with a good idea. If the marketing campaign was successful, it could produce a chain reaction that can be fuelled with appropriate advertising and public relations. It is difficult to change societal attitudes but if the right message is found it will happen, the need is real.

Selecting the appropriate geographic area is important. The market should be progressive, represent an average North American city and yet be relatively small to allow an assessment of market impact with a smaller investment. This reduces corporate exposure to a failed campaign. Distribution remains a key issue. The product has to be available to the general population of that target market. If the product is too difficult to source the corporation will spend much of its resources trying to expand distribution instead of trying to build brand

awareness. Customers may become frustrated if they cannot source the product where they shop and end up selecting a competitor that is available. This would be the worst scenario, beginning the shift in societal attitudes but giving the business to competitors. Therefore the Company should be looking for a smaller progressive market where distribution is adequate. For the organization, Vancouver is a logical city to launch the campaign.

There are over 12.42 million women in the Canada over the age of 18, slightly more than 39% of the total population. There are over 1.66 million women over the age of 18 in British Columbia.³⁶ The percentage of people living in the Greater Vancouver area is 49.41%.³⁷ This leaves a population in Greater Vancouver of approximately 820,000 women. We know that at some time during their lives, 43% of women between the ages of 18 and 59 experiences some form of sexual dysfunction.³⁸ This creates a relatively small, geographically distinct and progressive market close at hand. The Company would need to convince 60,000 women or 7.3% of women over the age of 18 in the lower mainland to buy one bottle of lubricant to break even on the campaign. The success rate of the campaign is hoped to reach more into the 15 to 20% range. This would create a healthy profit for the organization and reduce the reliance on the sex industry to provide corporate sales.

If the Company is going to enter the mass market, it will need to focus its spend on the original lubricant. Flavoured lubricants and the clitoral stimulating gel may be fun accessories to the body discovery line in the future, but initial investments should be made into the original lubricant. The original lubricant is a product that current mass market retailers are familiar with and currently carry. Pharmasave and Save On Foods are currently only ordering the original

³⁶ Statistics Canada. Retrieved July 13, 2003, from CANSIM II, series V469829.

³⁷ Population Estimates for Greater Vancouver. Retrieved July 13, 2003, from www.cometobc.com/populationtrends.html

lubricant and this facilitates access by the mass market. The ability to focus on one product is essential to create enough noise to reach the consumer.

Distribution is currently strong in the lower mainland with popular retailers such as Save On Foods and Pharmasave both stocking the product. This would cut down on the expense of increasing distribution before beginning a campaign. However picking a third major retailer and targeting some spend against them could prove to have significant results. There is a major, Vancouver based retailer who has the presence to significantly improve the distribution of the Company. This organization is very progressive and is always exploring ideas on how to increase front store volume. The creation of a 'Body Discovery Products' category would appeal to a retailer trying to create a competitive advantage with its rivals. This specific retailer, in addition to being progressive, would entertain novel money saving ideas such as advertisement swaps. By focusing spend on one retailer and trying to create traffic for the product; the Company would have a second benefit of establishing enough volume to appear in the Nielsen ratings. This would create an awareness of the product with other retailers when they received their monthly numbers and result in a cascade of demand. By approaching a retailer and establishing an agreement before launching a marketing campaign, the Company could then maximize the marketing spend on that campaign. A close working relationship with the retailer could result in the establishment of a new category, expanded marketing coverage all without significantly increasing the Company's investment.

The Company does not have the expertise to execute a complex marketing campaign. Therefore outside assistance will be required to develop creative and assist with the execution. A major agency could handle creative development, customer development and media placement.

³⁸ JAMA Patient Page: Sexual Dysfunction – Silence About Sexual Problems Can Hurt Relationships, *The Journal of the American Medical Association*, 281 (6). 584.

Lubricants offer an advertising agency a huge opportunity. Agencies are rarely handed societal changing campaigns. A well executed lubricant campaign lends itself to awards and recognition, something an agency covets. It allows agencies to build prestige within the community and offers public relations opportunities. By asking different Vancouver agencies to pitch for the business, the Company should be able to generate some competitive interest, keeping costs low. The concern is that agency fees may constitute the bulk of campaign spending, and this does not help the organization. Therefore a significant budget will need to be allotted for executing the campaign.

A creative of this magnitude will require agency investment. An account representative, a creative developer, a media placement specialist and a strategy specialist will all be brought into the execution of the campaign. Hard costs such as production of media ideas are not included in agency costs. This would include any type of advertisement layout, photography, talent and studio time for radio advertisements or other related costs considered production costs. Negotiations with agencies must be very up front with budgets and maximums. If the business is desired, ways can be found to decrease costs on agency, production or media costs. The Company has a huge lever, further business from a successful campaign. With this campaign as a template the promise of further business in an ever expanding market is very appealing, especially for agencies that are trying to establish themselves. A proposed budget is shown in Figure 6 on the following page.

Figure 6 - Marketing Budget

	Budget	% of Budget
Agency Costs	20,000	10%
Production Costs	25,000	13%
Media Execution	140,000	70%
Distributor Activity	15,000	8%
Total	200,000	

This budget was presented to a number of agencies in Vancouver. As discussed above, all agencies were eager to participate in the campaign and many were willing to go significantly below the \$20,000 finally agreed on for the initial idea. However the Company felt that any agency would be more motivated to work within guidelines if it felt it had received a fair and equitable up front payment. A more motivated team may produce a better concept for the advertisement and this is the catalyst that will drive the campaign. If the organization reaches \$9 million in sales in 2008, the extra \$10,000 spent now will be a very good investment. The above budget fits within the projected income statement found in Figure 8 in chapter 6. This idea has already been executed and Rethink won the bid. The first meeting to brainstorm the campaign begins in August of 2003 and the campaign is scheduled to launch in October 2003.

Customer development is crucial to a successful campaign. The target market has been identified as women over 40 years old. The marketing campaign will be focused on the 45 year old women. An interesting anomaly occurs with aging. Many people see themselves as they were, not as they are. Therefore advertisements will feature 35 year old women. Enjoying adult pleasures naturally should be the focus. Advertising should not focus on the problems that women are experiencing. This would give the lubricant an antiseptic feel. The focus will be on the excitement and energy the product brings to life.

The advertising agency will be responsible for executing and sharing results from customer surveys and focus groups. This will serve a number of purposes. The target market must be consulted on development of the big creative idea that will underpin the campaign. The idea development must resonate with the potential target market and that target market must be ready to receive the message. These issues can only be resolved by asking the potential target market. Creative ideas must be passed by focus groups to get reactions to the intended message. This will allow the organization to minimize the potential of alienating prospective customers. This type of customer interaction should also be used to help drive packaging decisions. Including a section on packaging issues in initial surveys will tell the Company whether or not current packaging is sufficient to appeal to customer tastes. Any developments in packaging can then be passed by focus groups. Surveys will also help locate where the target markets can be accessed and what advertising vehicles should be used to reach the market. This could include print, radio, television or even more obscure vehicles such as the back of bathroom stalls. Finally surveys can be done post launch to ensure the correct message is being received by the customer and give suggestions for any fine tuning or campaign development ideas. Customer development will remain an ongoing activity throughout the lifetime of the product.

Alignment with strategic partners will be a key element of any campaign. The extension of the health and beauty aid line into body discovery products will need the assistance of health care professionals such as pharmacists. The reduction in the number of department stores is beginning to increase pressure on personal care product companies to begin importing more prestigious brands into pharmacies.³⁹ Pharmacies are the logical retailer to carry this kind of a product. Although not directly medical in design, this category offers itself as a logical extension of the health and beauty aid line. Testing will legitimize the product and encourage health

³⁹ Strauss, Marina. (2003, July 18). Drugstores undergoing cosmetic facelifts. *The Globe and Mail*, B5.

professional endorsement. Therefore small scale testing to establish basic product attributes such as lack of skin irritation, lack of interaction with latex and sperm motility and any other issues that may come up during customer development.

The whole project moving forward is to provide the product with a sustained competitive advantage. However lack of ownership of the basic formulation is troubling. The Company must move to repurchase rights to the product. There is currently nothing in this plan that investigates internal manufacturing. As discussed earlier, manufacturing comes with a number of issues such as high capital costs, quality control issues and a lack of corporate expertise. Therefore a repurchasing plan that locks the Company into a medium term manufacturing agreement (up to 5 years) should be acceptable and should be pursued with the current manufacturer. Barring success at reaching an agreement, alternate formulations that mimic the current product should be investigated so that if any hold up in supply occurs, the Company can respond by manufacturing its own product. The original producers will be able to then sell their formulation to others but the brand name will be protected and follow the new formulation. This is something that should be addressed within the next six months.

The organization faces a financial shortfall. In the next chapter on financials the cash flow statement in Figure 9 shows a shortfall of \$588,414. Therefore the organization is going to be forced to access extra capital if it wishes to grow to \$9.0 million using the numbers provided. Capital can be accessed from a number of different sources. The least attractive is venture capitalists, who will attach many demands to their offers. Angels are an attractive financial source, providing the fit between the investor and the Company requesting the money is synergistic. Irrespective of the source, the Company will need some cash. It will be difficult to attract the required cash without putting some effort in establishing a management team. This must be done within the next 6 months as the capital will be required in 2005. The management

team needs some time to establish a network of business contacts and begin the task of raising the funds.

Finally, the owner needs to restructure the ownership of the Company by issuing shares. Issuing 5.0 million shares would give the shares some liquidity when they rise above penny status. Setting aside 1.0 million shares to attract senior management would leave 4 million shares within the organization. 3.6 million shares would be owned by the president and 400,000 by his wife. This accomplishes two things. It maintains current ownership of the organization but represents a first easy step towards exit for the owner. As the organization grows, the goal is to transfer ownership of the Company to others through a lucrative exit strategy. By sharing small parts of the organization with talented business people, the current president is actually protecting his investment. The share values will continue to grow so the smaller number of shares will actually have a much greater value. This effect will be to create an incentive for everyone to work hard to achieve the final product, in this case success.

There are a number of issues that will crop up as the organization moves forward. A strategy paper cannot predict everything that may or may not occur. However this plan puts the Company on an aggressive footing for expansion and delivers a beginning blueprint. Implementing the major issues outlined above gives the organization direction on establishing a competitive advantage. The geographic roll out strategy stays under the radar of major companies in the short term. They will watch the Vancouver market closely and see if the plan is successful. By the time the success materializes, the next market launch will be initiated and this will continue until escape velocity is reached. The market for women under “Body Discovery Products” has risks however if the Vancouver experiment fails, the organization will still be going concern. A new strategy can be developed at that time.

6 FINANCIALS

A number of factors are contributing to the financial situation of the Company. Although cash flow positive and growing the organization is currently at a financial disadvantage. There are a number of reasons for this. The lack of direct consumer interactions leaves the organization vulnerable to high buyer power. The growth itself will place a large strain on the organization as accounts receivable, inventories and an increased need for more staff place strains on corporate cash flow.

Figure 7 - Balance Sheet

The Company Balance Sheet June 30, 2003			
Current Assets		Current Liabilities	
Cash	\$77,676.66	Accounts Payable	\$103,490.86
Accounts Receivable	\$91,496.71	Bank Loan Payable	\$1,448.40
Inventories	\$129,878.91	Accrued Liabilities	\$938.92
Prepaid Expenses	\$1,233.13	Estimated Tax Liabilities	\$1,065.25
Total Current Assets	\$300,285.41	Total Current Liabilities	\$106,943.43
Fixed Assets		Non-Current Liabilities	
Property, Plant & Equip	\$83,439.86	Long Term Debt	\$105,992.23
Depreciation	(\$21,627.87)	Agreement for Sale	\$72,850.00
Net PPE	\$61,811.99		
Investments	\$143,639.70	Total Liabilities	\$285,785.66
Patents & Trademarks	\$3,500.00		
Total Assets	\$509,237.10	Owners' Equity	
		Common Stock	
		Paid in Capital	(\$27,175.00)
		Retained Earnings	\$250,626.44
		Total Liab. & SE	\$509,237.10

Figure 7 shows the current balance sheet for the Company. The balance sheet shows that the organization is currently using debt and not invested capital to fund operations. Inventory is

extremely high, costing over 13% of total sales. Accounts receivable is also high, making up almost 10% of total sales. Although the organization is able to keep capital costs low out sourcing product manufacturing this is a double edged sword. It cuts down on the capital costs associated with manufacturing but minimum production runs increase inventory requirements. Inventory and accounts receivable constitute a cash investment of almost 23% of yearly sales. This figure is excessive and ties up a lot of capital. Next years sales of \$1.6 million would require over \$370,000 in working capital just to handle inventory and accounts receivable.

Another key area is the cash conversion cycle. The cash conversion cycle is 62.52 days. The cash conversion cycle is made up of the inventory conversion cycle (how often inventory turns) and the accounts receivable collection period (time to collect money from customers) minus the accounts payable deferral period (time required to pay suppliers). The inventory conversion cycle is 135 days, meaning that inventory can sit for almost 5 months before being sold. The culprit is minimum orders, something that increased sales will actually help alleviate. The accounts receivable collection period is a respectable 35.15 days. The Company gives an incentive to distributors by offering a 2% net 15 payment schedule. The accounts payable deferral period is 107 days and this is bringing the cash conversion cycle back into alignment. However an organization cannot use the accounts payable deferral period as a line of credit. Suppliers expect prompt payment and this number must be brought down. This can only be done by reducing inventory and possibly using some form of friendly collection reminder to try to reduce an already low accounts receivable collection period.

The balance sheet for the Company is healthy although the cash contingency is low. This could become a problem if accounts receivable issues arise and customers fail to pay. There is currently not enough cash to cover accounts payable, although accounts receivable are paid promptly. Any accounts receivables that move beyond 90 or 120 days should be written off to

give the organization a clear snapshot of its position. This will allow the organization to make prudent financial decisions in the face of low cash supplies.

The income statements shown below in Figure 8 shows that a considerable increase in spending over the next five years will be required if the Company wishes to reach its goal of \$9 million in sales. Expenditures will increase in all areas including large increases in marketing and sales and increases in operating costs such as administration and wages. A decision concerning in house manufacturing will not be investigated at this time. The Company will continue to operate leanly, maximizing bottom line contributions yet providing the infrastructure to produce the required results.

Figure 8 - Income Statement

	The Company Projected Income Statement 2003 - 2008							
	2001*	2002*	2003	2004	2005	2006	2007	2008
Sales	160000	408000	950000	1600000	2650000	4200000	6500000	9000000
Cost of Sales								
Direct Production Costs	35200	93300	253000	368000	609500	966000	1495000	2070000
Indirect Production Costs	16000	44472	99000	144000	238500	378000	585000	810000
Total Cost of Sales	<u>51200</u>	<u>137772</u>	<u>352000</u>	<u>512000</u>	<u>848000</u>	<u>1344000</u>	<u>2080000</u>	<u>2880000</u>
Gross Margin	108800	270228	598000	1088000	1802000	2856000	4420000	6120000
Operating Costs								
Marketing & Sales	16200	88000	272800	650000	1100000	2000000	2080000	2250000
Administration	13000	42000	157300	225000	397500	592200	845000	1080000
Total Operating Costs	<u>29200</u>	<u>130000</u>	<u>430100</u>	<u>875000</u>	<u>1497500</u>	<u>2592200</u>	<u>2925000</u>	<u>3330000</u>
Net Income before Taxes	79600	140228	167900	213000	304500	263800	1495000	2790000
Income Taxes (47%)	37412	65907	78913	100110	143115	123986	702650	1311300
Net Income	<u>42188</u>	<u>74321</u>	<u>88987</u>	<u>112890</u>	<u>161385</u>	<u>139814</u>	<u>792350</u>	<u>1478700</u>
Cumulative Net Earnings	42188	116509	205496	318386	479771	619585	1411935	2890635

* Actual

The growth required to get to \$9.0 million will need to be fuelled. The money will be channelled into marketing & sales. The marketing and sales budget will continue to grow to

almost 50% of corporate sales in 2006 before beginning to edge down. The final goal would be to contain the marketing and sales spend to below 25% of total corporate sales. Administration costs include new employees and office related expenses. These expenses will receive strong upward pressures and will require difficult decisions to be made if they are to be kept in check. Money rolling in must be channelled into market development if the goal of \$9.0 million is to be reached. By trying to control these two costs, a healthy net income of 16% is maintained. Taxes have been calculated at a very conservative 47%. Therefore much of the growth appears to be financed by net income. However cash flow must now be analyzed to see if further financing is required.

Figure 9 - Cash Flow Statement

	The Company Projected Statement of Cash Flow 2003 - 2008							
	2001*	2002*	2003	2004	2005	2006	2007	2008
Net Income	42188	74321	88987	112890	161385	139814	792350	1311300
Add/(deduct) cash flow adjustments:								
Proceeds of Financing	100000							
Inventory cash requirements	(25000)	(40000)	(90000)	(70000)	(195000)	(265000)	(385000)	(515000)
Receivables cash requirements	(23400)	(42600)	(57400)	(75400)	(144550)	(204050)	(335450)	260750
Capital expenditures	(20000)	(25000)	(38500)	(40000)	(50000)	(60000)	(75000)	(100000)
Contingency	0	0	0	(100000)	(100000)	(100000)	(100000)	(100000)
Total adjustments	31600	(33279)	(96913)	(172510)	(328165)	(489236)	(103100)	857050
Total cash flow(deficit)	73788	41042	(7926)	(59620)	(166780)	(349422)	689250	2168350
Cash on hand, beginning	0	73788	114830	106904	47284	(119496)	(468918)	220332
Cash on hand, close	73788	114830	106904	47284	(119496)	(468918)	220332	2388682

* Actual

Cash flows from 2001 through to 2008 appear above in Figure 9. The organization should be able to support growth through 2004. However the cash conversion cycle and its reliance on increasing accounts payable periods will need to be addressed before the situation results in insolvency. In 2005 and 2006 the organization is showing projected cash shortfalls of \$119,496 and \$468,918 respectively. This means that the organization will require financing of

at least \$588,414 to bridge into 2007 and reach escape velocity. After that period, the organization begins producing cash at an increasing rate.

Sourcing financial support will become a full time activity. The Company will need financial management talent when the initial management team is put in place. This person will become responsible for raising the required capital the organization will need to achieve escape velocity. The ideal candidate would have a strong connection with the Vancouver business community and access to possible investors. Initial job expectations should be centered on getting the required financial resources to allow the company to take advantage of the current market opportunity. If recruitment is not successful there are many resources that can be accessed. A presentation should be developed that serves as an introduction to the organization. This will include an introduction to the business, the corporate mission, a detailed business plan including past and future performance and milestones, an introduction to the management team, a financing plan and an exit strategy. This presentation should be no longer than 10 minutes and be delivered to interested investors. There are many vehicles for meeting investors including angel forums, Vancouver Board of Trade events and approaching local venture capitalists. This activity will need ongoing support until the company has been successful in securing the required resources.

The income statement shows that in 2007 investments in the organization remain sizable but sales are sufficient to produce a healthy cash flow. In 2008 the investment remains healthy but as a percentage of overall sales, costs are declining and flowing to the bottom line in the form of profits. This is where an exit strategy should be contemplated. Success in executing the discussed plan will leave the organization with a number of exit options. Selling to a competitor, to a personal care company not currently involved in body discovery products or issuing an initial public offering are all possibilities. The organization should concentrate on achieving the

2007 target and use current market conditions at that time to decide on the appropriate exit strategy.