

Introduction

Scott Wilson opened his first bike store several years ago in downtown Columbus, Ohio. When Scott opened his business five years ago, he was 42 years old. Like most entrepreneurs trying to start a business, Scott was not able to get a loan from a bank. Instead, he used all of his personal savings to start the business. In addition, Scott's brother Mark loaned him \$80,000 to start help start the business.

The first few years were not easy. The store struggled financially and had net losses while Scott tried to attract customers. Now his store is profitable with a net income of over \$90,000. In the last three years, Sales have increased by an average of almost \$270,000. Scott sees a very bright future for his business.

Now that his first store is profitable, Scott wants to open a second store. His Net Income at his current store is approaching \$100,000. If Scott opens a second store, he believes his profits of his business will double to \$200,000.

Regarding the location of the new store, Scott is considering Pickerington, Reynoldsburg, or Canal Winchester. All are suburbs east or southeast of downtown Columbus. The size of his current store is 5,000 square feet. Since he essentially plans to duplicate the operations of his first store, Scott wants the size of his second store to be 5,000 square feet too.

A major hurdle to opening a second store is where Scott will get the capital to pay the startup expenses necessary. Scott believes he will need \$500,000. Scott thought of some possible sources:

1. The store's business credit card.
2. A bank loan.
3. An SBA Loan.
4. Cash – currently in the Store's bank account.
5. Scott's personal investments – the S&P 500 annual return over the last 20 years has been roughly 9%. Scott believes his investments will provide the same return.
6. A mortgage loan. Scott could get a second mortgage, using his house as collateral.
7. His brother Mark.
8. His Mother – Scott's mother is retired and has retirement investments earning only a 2% return. Scott could offer her 5% on a loan to him, thereby increasing his mother's investment return.

If Scott uses debt financing, he plans to pay any loan back in 8 years.

Scott decided to get a second opinion from his niece Karla. After Karla earned her four-year business degree five years ago, she took a job in industry. Now Karla is a full-time MBA student at a large university.

Wilson's Bike Store – can the success of a business' first store be duplicated?

Scott provided Karla with:

1. Income Statement of first store (Exhibit 1)
2. Possible sources of funds for expansion (Exhibit 2).
3. Major Products and Services sold at Bike Stores, including typical profit margins (Exhibit 3).
4. His estimate of revenues and expenses for the new store (Exhibit 4).

Scott asks his niece

- A. Would it be a sound business decision to open a second store?
- B. Where should he obtain the \$500,000 needed to open the new store?
- C. What will be the net profits of the second store in the first five years?
- D. How long will it be before the net profits of the second store pays for the start-up expenses?
- E. Have I overlooked anything?

At the end of one of her Marketing classes, Karla mentions her informal consulting project to her Professor. Her Marketing Professor recommends Karla do some basic marketing research. He suggests looking for any negative news about the bicycle industry's future that would be warning signs, the number of competitors in the city where the new store might be located, and the median household income of the city.

Karla realizes the profitability of the second store, may not be the same as the first store. Furthermore, she knows many small businesses fail. Karla does not want that to happen to her uncle.

Case Requirements:

Assume Karla's role.

- A. Perform an in-depth analysis.
- B. Make a recommendation(s) to Uncle Scott.

Exhibits:

Exhibit 1 - Income Statement of the first store

Exhibit 2 - Possible Sources of Funds for Expansion

Exhibit 3 - Bike Store Products and Margins

Exhibit 4 – Estimated Revenues and Expenses for New Store

Exhibit 1 - Income Statement for First Store

**Wilson's Bicycle Store
Income Statement
For the Years ended**

	2016	2017	2018	2019	2020
Revenue	254,205	437,285	771,366	981,801	1,246,271
Cost of Goods Sold	147,693	257,561	455,106	581,226	736,546
Gross Margin	\$ 106,512	\$ 179,724	\$ 316,260	\$ 400,575	\$ 509,725
Gross Wages	43,117	89,037	160,160	201,618	259,279
Payroll Taxes	4,827	7,920	14,763	18,429	22,998
Merchant Card Fees	3,644	6,689	12,018	15,700	19,571
Depreciation Expense	8,571	9,849	11,989	14,903	18,475
Marketing and Advertising	9,382	6,082	16,906	19,718	17,122
Rent	33,000	33,000	33,000	33,000	33,000
Insurance	2,832	2,832	3,397	3,397	3,397
Utilities	1,932	2,146	2,098	2,107	2,159
Shop Supplies	2,466	3,892	7,097	9,229	12,837
Other Operating Expenses	937	822	793	854	562
Total Operating Expense	\$ 110,708	\$ 162,269	\$ 262,221	\$ 318,955	\$ 389,400
Operating Income	\$ (4,196)	\$ 17,455	\$ 54,039	\$ 81,630	\$ 120,325
Interest Expense	(3,811)	(3,384)	(2,935)	(2,463)	(1,968)
Estimated Local Income Tax, 2.5%	-	(352)	(1,278)	(1,979)	(2,959)
Estimate Federal Income Tax, 19%	-	(2,674)	(9,710)	(15,040)	(22,488)
Net Income	\$ (8,007)	\$ 11,046	\$ 40,117	\$ 62,138	\$ 92,911

Exhibit 2 – Possible Sources of Funds to open the second location.

Possible Sources for \$500,000 needed to open second location.

	Source	Interest rate on debt	Variable/Fixed	Maximum
1	Credit Card	15.00%	Variable	\$75,000
2	Bank Loan	10.00%	Fixed	400,000
3	SBA Loan	6.00%	Variable	400,000
4	Cash in store's bank account	0.00%	Fixed	100,000
5	Wilson's Personal Investments	None	Fixed	250,000
6	Mortgage	3.50%	Fixed	250,000
7	Brother	5.00%	Fixed	100,000
8	Mother	5.00%	Fixed	600,000
	TOTAL			\$2,050,000

Notes

- a. Sources #1 to #3 (loan from Financial Institution)
If Wilson obtains financing through a business credit card, Bank Loan, or SBA Loan, all will require Wilson to sign a personal guarantee. If the business cannot repay a loan, personal guarantee stipulates that the owner is personally responsible to repay the loan, regardless of whether the business has the legal status of corporation.
- b. Sources #1 - #3 and #6 - #8 (all loans and debt financing)
If Scott uses debt financing, he plans to pay any loan back in 8 years.
- c. Source #5 – Personal Investments
From 2001 to 2020, the average annual return for the S&P 500 was roughly 9%. Scott thinks he will also have a 9% return on his investments.

Exhibit 3 – Bike Store Products and Margins

Typical Bike Store Products and Gross Margins

Product	% of total \$ sales	Gross Margin %
Accessories	11%	41%
Bikes	54	35%
Service/Repair	10	75%
Parts	16	38%
Racks Automobile	4	40%
Tires and Tubes	5	51%
Total	100%	

