To Expand or Not: Strategic and Cultural Concerns in a Family Business

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Introduction

Robert sat at his desk and pondered. Should Road Warrior Parts (RWP), an automotive recycling business he co-owned with his four closely-knit brothers, start a separate location and divide its customer base? Robert had even stated to one of his mentors, “It makes sense to locate the retail facility in a larger city and let our existing facility serve the more profitable wholesale business, but doing that will likely tick off our friends and neighbors whom we have done business with since the beginning.” Further, Robert figured that at least one, if not two, of his brothers would need to work full-time at the new facility. This would mean leaving their old duties behind, relocating their families, and possibly creating tension among the five closely-knit brothers who owned the business equally and worked out decisions in regular, informal, and very friendly meetings.

While expansion had its risks, RWP was growing, its customer base was changing and, if the company did not expand, it might need to stop serving its long-time, pick-and-pull retail customers in favor of its new, high-margin, wholesale customers. Instead of opening up another retail business in a larger town, Robert considered closing down the retail side of the business and shifting the focus entirely on higher-end, wholesale customers. However, he also realized that turning away the firm’s current longtime retail customers could lead to tremendous bad blood in their 5,000 person town. They and the company had grown up in this town, and ignoring their loyal customers (many of whom also happened to be personal friends and relatives) could have negative ramifications for their business, as well as for their social and family ties.

Another option was to keep serving both customer bases by dividing RWP’s existing lot into two separate facilities. While this option seemed the simplest on paper, Robert felt it might be the worst option to actually execute.

RWP Business Model

RWP was in the business of recycling or “salvaging” wrecked or older vehicles. The business consisted of three main sources of revenue, which were vehicle crushing, pick-and-pull customers, and wholesale customers.
Vehicle crushing involved the utilization of a very large vehicle crusher that would crush a vehicle to a fraction of its size for ease of shipment to a customer who would melt the vehicle down to base metal. The crushing process provided 30% of their overall revenue and 30% of their profit.

Pick-and-pull retail customers were those individuals who would visit RWP for the sole purpose of purchasing one or more parts for their own vehicle repair. These customers were considered important to the business, as they were the base customers at the onset of RWP’s existence and yet “high maintenance”, as they required significant one-on-one attention. These customers would either have someone at the counter retrieve a part from the shelf, or pull the part themselves from the salvage vehicles. This pick-and-pull process made up 25% of RWP’s revenue and 20% of its profit.

Wholesale customers would buy parts from RWP in volume at a wholesale price, either to resell them, or to repair their own customers’ vehicles. These customers were local, regional, national, and even, to some extent, global. The use of an Enterprise Resource Planning system (ERP) made it possible for RWP to sell and ship parts to wholesale customers, via phone orders or internet sales, as well as from the existing brick and mortar facility. This process provided RWP with 45% of its revenue and 50% of its profit, and offered continual growth opportunity (see Figures 1 and 2 for a graphical representation of the breakdown of the revenue and profit distribution by customer base).

**Figure 1: % Revenue by Customer Base**
All three processes operated out of the same facility. The original customers were pick-and-pull locals. The crushing operation had provided a portion of the income early-on as well, although its contribution to overall profitability had diminished over time. Wholesale operations came along later and were substantially enhanced by the use of the ERP.

**History of a Family Business**

Robert’s reflections took him back in time to the ambition his father Josh had had years ago, with few resources. Overcoming significant financial hardship, Josh purchased the business in 1992. A few years later, while the business was struggling, a man named Joe Timberland offered to work for a year to help fix the business. The agreement was that their salaries would be due at the end of the year, if the business succeeded, but no money would be due if the business failed. Joe worked at the business for a number of years, and together Joe and Josh helped the business to grow.

Josh went on to have a large family, including six sons. Josh’s sons grew up extremely close and loyal to one another, always doing things together. The family had a strong culture of inclusiveness and loyalty. Not surprisingly, by 2008 the five oldest sons, including Robert, had joined the business. By 2012, Josh had retired and at this point each of the brothers became co-owners of the business.
A Transitioning Firm

Many factors led Robert to consider expanding the family business to a second facility. Primarily, Robert was worried that, in its current form, the business could not maintain needed efficiencies and adequately serve all of its varied customers. Robert realized RWP was trying to offer multiple service levels to two different customer bases (individual pick-and-pull customers and larger wholesale customers). He also realized that RWP had five regional competitors, who primarily served the pick-and-pull market. As such, Robert wondered if there was a way the firm could expand the business to better serve older, individual customers, along with the firm’s growing base of wholesale customers, and do so in a manner that could provide a solid living for the firm’s owners and their families. Robert also wondered if the firm should just focus on wholesale customers.

Robert knew that the vehicle parts industry serviced many different types of customers, and that it became more and more difficult to service all of them adequately. He also knew that RWP could not be all things to all people. The greatest difficulty in servicing these multiple customer types was maintaining efficient processes that satisfied the different types of customer needs. He knew the company made a higher percentage of their profit by selling parts to wholesale customers, such as mechanic shops, car lots, and body shops, than to its original customers, the pick-and-pull individuals who were also their neighbors and friends. Robert believed these customers had established RWP’s initial success and, therefore, the company felt a communal responsibility to this segment of the customer base, even though the wholesale customer base was more profitable. Robert and his family prided themselves on loyalty, and they and their families had deep ties in the small, local community. To walk away from the customer base who helped them get their start would be difficult, as it would feel like they were being ungrateful for what these small, local customers had done.

The owners of the business brainstormed several times, trying to come up with ideas as to how to make changes, using the existing facility to continue to service these individual customers. One major issue was that the pick-and-pull customers wanted lower dollar items, but they wanted things quickly. The “I only want to spend $50 but I want immediate order fulfillment” mentality, held by a large portion of this customer base, was causing problems with scheduling delivery and fulfillment for the higher profit margin wholesale customers. Wholesale customers had their own retail customers waiting for parts that were required from RWP on a just-in-time basis.

Strategic Options

The brothers discussed having two separate processes in the existing facility, but worried that such a plan would create too much inefficiency. They also openly discussed if there was too much duplication/confusion and not enough contribution to overall profit to continue serving individual customers. The brothers pondered if it was possible to give pick-and-pull customers full self-service access to existing physical facilities, while offering full service to the wholesale customers from the same facilities. However, they worried that pick-and-pull customers having full access to the lot would damage inventory.
For example, it was highly possible that when pick-and-pull customers rummaged through stored inventory or removed parts from cars that were not yet processed, inventory tracking would be disrupted and parts would get destroyed. This, in turn, would lead to not having any confidence in the inventory and result in a number of redundant inventory checks and quality checks, which, in turn, would damage wholesale customer relationships. A further concern was the possibility that allowing pick-and-pull customers to have lot access would increase liability insurance costs to a prohibitive level.

Given these concerns, but still wanting to serve their long time pick-and-pull customers, the team then considered splitting the facility in halves, one to serve each customer base. This plan involved creating a pick-and-pull operation in one half of the facility, with the wholesale operation in the other half, separated by a fence down the middle of the yard. That would have allowed operating under different rules and different insurance considerations on separate sides of a physical barrier. This thought process led to an even grander idea. The team pondered the idea of opening a standalone, self-serve facility for pick-and-pull customers in a larger city about 25 miles away. To make such a plan a reality, RWP would need to build a new facility from scratch, or purchase an existing operation in the neighboring town. Importantly, while competitive pressure existed in both the small town and the larger town where expansion was being considered, RWP felt it could outperform pick-and-pull competitors in both towns due to its recent inventory tracking system and other management tools it was using that were not being used by the local competition.

What to do?

So, as Robert saw it, the firm had 3 options, as follows:

Option 1: Split the existing yard – this option involved building a fence through the middle of the yard, serving retail customers on one side and wholesale customers on the other side

Option 2: Open a separate retail facility in a larger town – this option involved terminating retail service in the existing location and moving that service to a much larger town, 20 miles south.

Option 3: Termination of retail sales – this option involved terminating all retail sales and focusing the firm entirely on the more profitable wholesale customer base in the current location.

Each option had pros and cons. Option 1 would allow all five brothers to continue living and working in the same town. However, Robert worried about whether the facility was big enough to split. He also wondered if his brothers and the firm’s employees would actually split operations, if everyone was still on the same site.

Option 2 would allow the firm to actually focus on two very different customer groups at two separate facilities. Locating the second facility 20 miles south, in a much larger community, would certainly allow RWP to offer its retail service to a bigger customer base. However, this
option had the most risk, requiring the firm to either buy an existing firm or build an entirely new facility. It also could lead to tension among the brothers. Splitting the firm into two separate locations and focusing on different customer bases could ultimately lead them to making decisions separately and developing separate cultures at the respective sites. Robert wondered if this could lead to conflict and disunity among the brothers, which was something the family business had prided itself on avoiding. In addition, most of their longtime loyal customers were local retail customers, and these customers would now be required to drive 20 minutes to get their parts.

Option 3, termination of retail sales altogether, was attractive because it would allow RWP to focus its operations on a much smaller group of higher-margin wholesale customers. However, Robert felt this option could lead to tremendous “bad blood” in the local community, as the owners, as well as the company itself, had grown up in that small town and had many family and friendship ties to the area. To shut that portion of the business down completely could understandably be seen as an act of disloyalty. Further, RWP had its roots in pick-and-pull retail customers. Leaving that behind would require a huge cultural shift for the family firm. Finally, this option may not leave enough work for all the owners/brothers and their employees, which could cause a need for downsizing, buyouts, and retraining. If the elimination option did in fact not leave enough work for all, Robert felt the cultural issues would be devestating, potentially even leading to the firm’s failure.

As he continued to ponder, Robert realized that, while a decision had to be made, an easy option did not exist among the three choices.