Case Study
James Jewelers

INTRODUCTION

Bob James of James Jewelers returned to his store in the spring of 2003 angry and depressed. “We just lost our lease; I don’t see how we can make it now.” It had been seven years since Bob and his wife, Bonnie, moved their business to Spartanburg, South Carolina. They had struggled, and sometimes excelled. But primarily, through sheer determination, they just survived in the jewelry business to this point. The loss of their lease and prime location could be the final blow that would destroy their business. Bob needed to decide, and quickly, either to fold the tent or give it one more shot.

YORK OPERATIONS

James Jewelers originally started in 1972 as Able Jewelry and Music, a pawnshop in York, South Carolina, purchased by Bob’s parents from other family members. Bob helped his mom in the business after his graduation from the University of South Carolina with a major in business in 1983. Wanting to gain more business experience, Bob earned his MBA from Regent University in 1987 and, with Bonnie, assumed ownership of the store on July 1, 1987.

Bob and Bonnie met at the University of South Carolina. She graduated in three years with a major in foreign politics and a minor in Spanish. After college she was also able to get a para-legal degree in business and real estate law and bankruptcy. Her legal training made it easy for her to find work with a law firm while Bob completed his MBA.

Even though the store was a well-recognized landmark in York, it initially had trouble earning a reasonable profit. After about three years, Bob saw the 80-20 rule in action. The pawn shop generated 80 percent of the headaches and 20 percent of the revenue. Bob wanted the store to be more upscale; he eliminated the electronics and musical
equipment inventory associated with the pawnshop and changed the name of the store to James Jewelers. Over the next four years, sales and profits grew.

Bob and Bonnie lived in Spartanburg where Bonnie grew up, about 30 miles west of York on I-85. Through their associations and church activities, they established a loyal clientele in their hometown who would travel to York to shop at James Jewelers. Many of these customers often encouraged Bob and Bonnie to open a store in Spartanburg.

In York, however, Bob had the only jewelry store that catered to a middle-class market. Unlike in Spartanburg, where there were several similar jewelry stores already established, he did not have to worry about competition. The store’s roots were in York with a long history and a devoted following. Even though the drive to work sometimes seemed long, the York site was doing well.

This situation changed in the mid-1990s. Video poker was the new craze, and numerous people in York seemed addicted to it. While illegal in South Carolina, it was legal in North Carolina. Many York citizens frequently drove north a mere 10 miles to the next state to spend their discretionary income on these games. Bob saw a change in his customer spending habits as they bought less jewelry, and some even said they or their spouse used the money instead to gamble and “hit it big.”

At the same time, York’s Main Street was going the way of many small towns without a strong economic base. Downtown businesses were shutting their doors as shoppers drove to new malls or superstores like Wal-Mart. The only stores that seemed to be opening on Main Street were loan companies, which offered high interest rate loans to consumers and businesses. Within two years, this combination of events took Bob’s operation from being profitable to barely surviving.

**SPARTANBURG OPERATIONS**

Bob secured a lease for almost 3,000 square feet in a prime location in west Spartanburg on a busy main street across from a large shopping center. This section of Spartanburg was experiencing sustained consumer consumption since it had easy access to I-85, and new upper-income home developments were opening on a regular basis. The rent for the store was $3,000 per month. The strip shopping center included some other fine stores, including an upscale women’s fashion store and a quality shoe store.

Unexpectedly, Bob learned that the landlord charged him an additional $40,000 to “up fit” the store before the first sale was even made. In some of the other lease contracts they considered, “up fitting” was already provided, and he wrongly assumed those lease stipulations were included in this current lease. Bob learned the importance of “buyer beware.” He regretted not getting professional guidance before signing the lease, but he was trying to save money and time. On top of that, Bob later learned that his share of the property tax for the facility was also charged to him at the end of the year as an additional expense versus being part of the monthly rent. Already cash poor, Bob used his remaining $40,000 in funds to acquire inventory.

With limited working capital, a discretionary income type product with low turnover, and a seasonal business, Bob continually had cash flow problems. Jewelry was expensive, and the store needed significant inventory to display in showcases in order to attract customers. He bought lots of silver, which was relatively inexpensive, to supplement gold and diamonds.

To his surprise, local banks were not as supportive as Bob thought they would be. James Jewelers’ current financial condition did not help to qualify for a loan; it seemed too risky. The financial institutions denied funding.

Bob liked the idea of being his own boss, enjoyed the jewelry business, and felt he had some expertise in the area. So he kept looking for financial assistance. Eventually, he returned to his old bank in York. Even though he was leaving town, based on the relationship he had established with the bank and with their assistance, he qualified for a Small Business Administration loan of $60,000. Bob and Bonnie sold their house in Spartanburg and used the equity to add another $20,000 to start over in Spartanburg. Upon the sale of their house in Spartanburg, Bob and Bonnie and their two children, Hannah and Jonathan, moved from a 3,200-square-foot home into a 1,200-square-foot apartment.

**RELOCATING TO SPARTANBURG**

Bob and Bonnie had to decide if it was worthwhile to continue their jewelry business. They had two young children, 5 and 9, and roots in Spartanburg. With Bob’s MBA and business experience, the possibility of a job at a company in Spartanburg was attractive. Bonnie could stay home and raise the kids, and they would be free of the pressure of ownership and the worry over cash flow.

It was evident that James Jewelry in York would not survive. Persuaded by friends and motivated by his entrepreneurial spirit, Bob developed a business plan and sought financial assistance to move his operation to Spartanburg.
Bob maintained a credit purchasing relationship with many of his suppliers, but when sales did not achieve anticipated levels, Bob quickly found himself past due on many accounts. It was not long before some of these suppliers wanted cash up front for purchases. Conditions seemed to go from bad to worse as debt mounted. In 1996, the business lost over $108,000.

Bonnie and Bob both needed to work in the store because at least two people had to be around to prevent theft. With their responsibilities as parents, family activities, commitments at church, working six days a week at the store was demanding and there was little down time. They even had to give up attending or watching the games of their beloved University of South Carolina football team-an activity that in the past often gave them much-needed relaxation from the stress of running their own business.

Fortunately, the clientele from Spartanburg remained loyal and frequented the store even more now that the business was more conveniently located in Spartanburg. Store hours were 10:00 a.m. to 5:30 p.m., Monday through Saturday. Bob believed that the customers he was trying to reach, primarily non-working women who enjoyed shopping and socializing would shop during the day. These women generally entertained, wanted quality family time, and had other obligations in the evening. Also, this was more of a destination location as opposed to a mall location where there would be more walk by traffic in the evening.

Bob and Bonnie practiced a high moral and ethical standard and understood the importance of trust and honesty. They were fair in valuing stones for both buying and selling purposes, which was often a concern by less knowledgeable customers. They were also friendly and got to know their customers on a first-name basis. Customer service was highly regarded in all of their business dealings. As it turned out, many customers bought jewelry exclusively from James Jewelers. With more than 10 years of experience, plus his educational training, Bob felt he knew the jewelry business and how to make it successful.

Additionally, Bonnie, who was completely self-taught in the jewelry business, had a knack for picking the right products. She had always had an interest in colors and texture and was good at determining what looked good on fashion conscious women. As a teenager, Bonnie was paid for her commercial artwork done for the Governor of New Jersey. Since their market was primarily women in a middle- to upper-middle income bracket, it was important for Bonnie to recognize trends and styles when purchasing inventory. She believed in her products and her enthusiasm translated into sales to satisfied customers. Bonnie also learned to make jewelry. She bought older jewelry from estate sales and other secondary sources at a discounted price and used the materials to make new and more appealing jewelry items. Customers adored these unique items.

Even though competition from other jewelry stores in the immediate vicinity was fierce, James Jewelers effectively used good marketing strategy with ads in popular publications, radio, store specials, and especially word of mouth primarily catered to middle-income earners. They became active in the community and supported charitable events, which helped to give the business credibility. Also their products were more fashion forward and seemed to have a unique appeal to their customers. Their target customers were women who looked for something better than a run-of-the-mill Kmart or Wal-Mart type of product, but not the exorbitantly priced products found at the really upscale jewelry stores. Of course, many of the other individually owned stores were trying to capture the same market.

As with many owner-run businesses, Bob and Bonnie focused on little, but significant, services. They did engraving, cleaning, and elaborate gift-wrapping at no extra charge. Their best promotion was word of mouth and personal friendly service.

With all the positive factors that Bob and Bonnie had going for them, maintaining the financial viability of the business was still a struggle in a very competitive market. There were any number of factors that seemed to impact their potential for success, including the seasonal nature of sales, high carrying cost of inventory, high overhead costs, low sales volume, and even sometimes surprisingly low margins on items sold.

At times Bob had trouble making the monthly lease payment on the store. This last year he was four months behind. Like many businesses, the jewelry business was seasonal. The majority of sales were made during the Christmas season with other peaks in February, May, and June. Months like July and August were extremely slow. In the past, Bob caught up on the rent payments in December when he had a better cash flow.

Over the years, Bob and Bonnie had no choice but to rely on credit card debt, which had amounted to over $50,000. Once they were unable to make even the minimum payment, their credit scores tumbled-and they no longer qualified for any personal loans or other credit cards. Nevertheless, they worked hard to repay suppliers and establish a better relationship with those companies to hopefully get more favorable terms for future purchases.

Even with their best efforts, the Spartanburg store did
become available. It was just three blocks away, but it was
he had become established? he even find a suitable location for his store close to where
business, and he would lose control. Furthermore, could
would probably want 51 percent ownership or more of the
given his history. If he brought in a partner, that partner
It was doubtful that he could arrange for debt financing,
that his lease was terminated by his landlord? Seven years
fulfill these obligations.
Suppliers and others had placed faith in them and given
had created such a bad debt situation, and they felt moral
values and integrity, Bob and Bonnie felt badly that they
to make good on this debt? Because of their high ethical
interest expenses increased as his credit rating went down
few years. While the total company debt had decreased, his
income decreased, plus monthly rent, it was easy for Bob to determine that
he needed over $200 in sales (assuming a 100% markup)
every day just to pay the rent. Sometimes Bob felt he was
working for his landlord.

However, Bob and Bonnie both gained much joy
selling a quality product, like an engagement ring to a
satisfied customer, knowing they played a role in a special
event. Bob and Bonnie enjoyed working the store together
and had complementary skills and a strong marriage even
though they were together almost 24-7.

Bob surveyed what he had. His $100,000 of inventory
could neatly fit into a couple of shoeboxes! There was the
large safe, showcases, fixtures and some office furniture.
Of course, there also was the $250,000 debt. He felt for-
tunate that some of the debt was still interest-free and that
his average cost of debt was around 11 percent. He had
worked very hard to reduce the level of debt over the past
few years. While the total company debt had decreased, his
interest expenses increased as his credit rating went down
and his perceived riskiness by creditors went up.

If he left the store he asked himself: how was he going
to make good on this debt? Because of their high ethical
values and integrity, Bob and Bonnie felt badly that they
had created such a bad debt situation, and they felt moral-
ly obligated to make good on all of the outstanding debt.
Suppliers and others had placed faith in them and given
the store favorable credit terms and assumed they would
fulfill these obligations.

FUTURE OPERATIONS

If Bob wanted to begin again, could he, especially now
that his lease was terminated by his landlord? Seven years
ago, he had a house with some equity that he sold to raise
capital for the business. Now, he did not even have that.
It was doubtful that he could arrange for debt financing,
given his history. If he brought in a partner, that partner
would probably want 51 percent ownership or more of the
business, and he would lose control. Furthermore, could
he even find a suitable location for his store close to where
he had become established?

He was aware of another location that had recently
become available. It was just three blocks away, but it was
only 1,250 square feet, 40 percent of the size of his current
store. Bob surmised that the monthly lease rate would be
about half of his current rate. What kind of other lease
terms would he face with a new landlord? Bob did not
want to be surprised again with hidden charges in another
lease agreement. Also, could he afford the cost of a move,
especially transporting the large and very heavy safe?

There was also the issue of employees. Because of the
need to always have at least two employees on site, Bob
had often hired extra help at various times during the year.
Currently, two additional employees had come to depend
on Bob and the job for their source of income. They too,
would have to seek other employment. And there were their
loyal customers. Many had stuck with him since his early
days back in York. He had spent years developing this rela-
tionship and market. Did he want to give up this valuable
but intangible resource?

If he folded the business, what would he do? For 20
years he had been in the jewelry business. Working for
another company in jewelry, like a competitor, seemed like
such a step down. He wanted to stay in Spartanburg, and
he had plenty of connections. But after being an entre-
preneur, could he work for someone else? What would
Bonnie do? Their children were now 12 and 16. How
would they react to this situation? They had already been
through a lot.

Bob pulled out his last three years of financial data to
try to determine if they even had resources or the financial
viability available to make the store viable at a new loca-
tion. From Bob’s understanding of the jewelry business,
successful operations have a gross margin of around 50
percent and a profit margin of at least five to ten percent.

Maybe it was time to consider another direction.
He had an MBA and years of retail experience, surely he
could find a job in the Spartanburg area in the $50,000
to $60,000 range. Plus Bonnie, with her talents and skills
in the jewelry business, could easily find a part-time or
maybe full-time job and earn up to $30,000. Also, with
some catching up on the latest laws in the legal field, she
could probably get a much higher paying job as a para-
legal with a law firm in the area. The thought of using
her legal bankruptcy training on their own store was not
amusing. But was it or should it be just about the money?
They really enjoyed the jewelry business and the rela-
tionships established with their clientele. Their faith had
remained strong, but this was going to be a test. Or was it
an opportunity?
### James Jewelers Income Statement
For the Years Ending June 30, 2000, 2001, and 2002

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<thead>
<tr>
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<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
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<tr>
<td>Sales</td>
<td>$419,779</td>
<td>$419,667</td>
<td>$432,206</td>
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<td>Cost of Goods Sold</td>
<td>232,869</td>
<td>297,161</td>
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<td>Gross Margin</td>
<td>186,910</td>
<td>122,506</td>
<td>203,463</td>
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<td><strong>Operating Expenses</strong></td>
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<tr>
<td>Salaries and Wages</td>
<td>50,374</td>
<td>31,909</td>
<td>44,891</td>
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<tr>
<td>Rent</td>
<td>36,284</td>
<td>38,639</td>
<td>40,523</td>
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<tr>
<td>Taxes and Licenses</td>
<td>19,772</td>
<td>18,804</td>
<td>26,391</td>
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<td>Advertising</td>
<td>13,895</td>
<td>15,515</td>
<td>11,599</td>
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<td>Insurance</td>
<td>7,829</td>
<td>7,683</td>
<td>7,658</td>
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<tr>
<td>Utilities</td>
<td>6,506</td>
<td>7,412</td>
<td>6,504</td>
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<td>Depreciation</td>
<td>19,047</td>
<td>16,672</td>
<td>16,738</td>
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<td>Other General and Administration</td>
<td>3,087</td>
<td>11,767</td>
<td>19,762</td>
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<td><strong>Total Operating Expenses</strong></td>
<td>156,794</td>
<td>148,401</td>
<td>174,066</td>
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<td>Interest Expense</td>
<td>7,670</td>
<td>3,812</td>
<td>11,696</td>
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<tr>
<td><strong>Total Expenses</strong></td>
<td>164,464</td>
<td>152,213</td>
<td>185,762</td>
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<tr>
<td><strong>Net Income Before Tax</strong>*</td>
<td><strong>$22,446</strong></td>
<td><strong>-$29,707</strong></td>
<td><strong>$17,701</strong></td>
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</table>

* *Due to significant losses from prior years, no taxes have been paid over the three years because of net operating loss carryforwards. The marginal federal plus state tax rate, if taxes had been paid, would be 15 percent.
<table>
<thead>
<tr>
<th></th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>Cash</td>
<td>-4,824</td>
<td>413</td>
<td>-4,150</td>
<td>7,637</td>
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<tr>
<td>Accounts Receivable</td>
<td>7,886</td>
<td>6,100</td>
<td>5,000</td>
<td>4,368</td>
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<tr>
<td>Inventory</td>
<td>186,450</td>
<td>188,237</td>
<td>111,455</td>
<td>99,351</td>
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<td>Total Current Assets</td>
<td>189,512</td>
<td>194,750</td>
<td>112,305</td>
<td>111,356</td>
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<td><strong>Long-Term Assets</strong></td>
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<td></td>
<td></td>
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<tr>
<td>Equipment</td>
<td>139,497</td>
<td>150,790</td>
<td>149,332</td>
<td>152,942</td>
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<tr>
<td>Less Accumulated Depreciation</td>
<td>-63,592</td>
<td>-82,639</td>
<td>-99,311</td>
<td>-116,049</td>
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<tr>
<td>Equipment (net)</td>
<td>75,905</td>
<td>68,151</td>
<td>50,021</td>
<td>36,893</td>
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<td>Other Assets</td>
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<td>1,458</td>
<td>1,458</td>
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<tr>
<td>Total Long-Term Assets</td>
<td>75,905</td>
<td>68,151</td>
<td>51,479</td>
<td>38,351</td>
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<tr>
<td><strong>Total Assets</strong></td>
<td>$265,417</td>
<td>$262,901</td>
<td>$163,784</td>
<td>$149,707</td>
</tr>
<tr>
<td><strong>Current Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>$151,743</td>
<td>$140,000</td>
<td>$140,000</td>
<td>$141,328</td>
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<tr>
<td><strong>Long-Term Liabilities</strong></td>
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<tr>
<td>Loans from Shareholders</td>
<td>19,471</td>
<td>17,200</td>
<td>16,200</td>
<td>44,177</td>
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<td>Notes Payable</td>
<td>206,377</td>
<td>201,846</td>
<td>133,436</td>
<td>70,684</td>
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<td>Total Long-Term Liabilities</td>
<td>225,848</td>
<td>219,046</td>
<td>149,636</td>
<td>114,861</td>
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<tr>
<td>Total Liabilities</td>
<td>377,591</td>
<td>359,046</td>
<td>289,636</td>
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<tr>
<td><strong>Common Equity</strong></td>
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<td></td>
<td></td>
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<tr>
<td>Common Stock</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
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<tr>
<td>Retained Earnings*</td>
<td>-113,174</td>
<td>-97,145</td>
<td>-126,852</td>
<td>-107,482</td>
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<tr>
<td>Total Equity</td>
<td>-112,174</td>
<td>-96,145</td>
<td>-125,852</td>
<td>-106,482</td>
</tr>
<tr>
<td><strong>Total Liabilities and Equity</strong></td>
<td>$265,417</td>
<td>$262,901</td>
<td>$163,784</td>
<td>$149,707</td>
</tr>
<tr>
<td>*Prior period adjustments made to balance in retained earnings</td>
<td>-6,417</td>
<td></td>
<td></td>
<td>1,669</td>
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</table>
SUGGESTED TEACHING APPROACHES AND QUESTIONS

The James Jewelers case can be used in a small business, finance, or managerial accounting class at the undergraduate or graduate level that covers the topic of alternative choice decision making and financial statement analysis. The information presented is relatively straightforward, and there is a clear decision point. There are sufficient extenuating circumstances to make for a good discussion of critical factors in this type of decision analysis.

This case can be presented open-ended without any specific questions or directed with several recommended questions focusing on both quantitative and non-quantitative issues. Classroom formats can be instructor-led or student-led discussions of the critical issues and decision in the case. The case may also serve as an exam case if the instructor is using a text with cases and wants to offer a case in a slightly different format and not readily available to students.

This case has been classroom-tested in a financial and managerial accounting class of 40 students at the graduate level. It served as a final exam focusing on cash flow statements and financial analysis. The computational aspects proved sufficiently challenging and the discussion questions proved to be thorough and comprehensive. The decision dilemma was especially appealing as students were about equally divided between closing the store (60 percent) and continuing (40 percent). Additionally, there were a variety of creative suggestions for Bob to proceed, especially if he remained in the business.

This case lends itself to an open-ended or directed discussion format in a classroom setting. Some or all of the suggested questions listed below can be used depending on the issues being addressed. The suggested questions also do not represent an all inclusive list, as many others can be added at the discretion of the instructor. A comprehensive set of teaching notes with suggested answers is available from the author. The students should be able to do the following:

• Complete an analysis of a decision situation (Question 1) (Bloom’s Taxonomy learning outcome level 4)
• Recall a knowledge of specific non-financial and non-quantitative facts that could be critical in a decision situation (Questions 2, 3 and 4) (Bloom’s Taxonomy learning outcome level 1)
• Demonstrate a comprehension of specific financial and non-financial facts that could be critical in a decision situation (Questions 1, 2, 3 and 4) (Bloom’s Taxonomy learning outcome level 2)
• Synthesize and apply knowledge and skills to recommend a course of action for the decision situation. (Question 5) (Bloom’s Taxonomy learning outcome levels 3 and 5)

If the case is presented in a more directed format, the following questions may help to formulate the discussion.

1. Complete a financial analysis of James Jewelers and discuss your findings.
2. Identify critical non-quantitative issues that should be considered in the decision process.
3. What risk factors should Bob be most concerned about regarding his decision?
4. Identify possible ethical or at least values-based issues that could impact any decision.
5. What should Bob and Bonnie do?