Case Study
James Jewelers

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ABSTRACT: *James Jewelers is a critical decision case involving Bob and Bonnie James, owners of James Jewelers in Spartanburg, South Carolina. This case accurately reflects dilemmas frequently faced by entrepreneurs in the highly competitive retail markets. The very survival of James Jewelers and the financial stability of Bob and Bonnie are dependent on a correct decision regarding the future of James Jewelers. Bob and Bonnie have been working in the jewelry business for 20 years and are in the midst of experiencing their second failure. With debt concerns, shrinking inventory, and a lost lease, Bob has to decide whether to throw in the towel and look for other forms of employment, or try to start over. Bob's values and beliefs enter into the decision as he feels a strong obligation to repay his debt and continue to provide a quality product and service to devoted customers. Some suppliers and many customers have stuck with James Jewelers for a number of years, and Bob feels that quitting would be a disservice to those who had faith in him. However, the financial condition of his operation continues to deteriorate. Sometimes staying in business could change a condition from bad to worse and even more people could be negatively impacted by an unsuccessful operation. Then again, if he can turn the business around, there is a greater probability that Bob can make good on his obligations. Bob and Bonnie need to decide quickly if they want to try to save or discontinue the operation of James Jewelry.*

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 pawnshop 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.

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. 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.

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.

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 not live up to their expectations. It had been seven years. What did Bob and Bonnie have to show for their effort? They had already worked nine years in York with limited success and now another seven years in Spartanburg. There were good days, but then there were also days when Bob wished just to sell a watch battery. With a $3,000-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 fortunate 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 morally 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 his loyal customers. Many had stuck with him since his early days back in York. He had spent years developing this relationship 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 entrepreneur, 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 location. 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 paralegal 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 relationships 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

	2000	2001	2002
Sales	$419,779	$419,667	$432,206
Cost of Goods Sold	232,869	297,161	228,743
Gross Margin	186,910	122,506	203,463
Operating Expenses			
Salaries and Wages	50,374	31,909	44,891
Rent	36,284	38,639	40,523
Taxes and Licenses	19,772	18,804	26,391
Advertising	13,895	15,515	11,599
Insurance	7,829	7,683	7,658
Utilities	6,506	7,412	6,504
Depreciation	19,047	16,672	16,738
Other General and Administration	3,087	11,767	19,762
Total Operating Expenses	156,794	148,401	174,066
Interest Expense	7,670	3,812	11,696
Total Expenses	164,464	152,213	185,762
Net Income Before Tax*	**$22,446**	**$-29,707**	**$17,701**

* *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.

James Jewelers Balance Sheet For the Years Ending June 30, 1999, 2000, 2001, and 2002				
	1999	**2000**	**2001**	**2002**
Current Assets				
Cash	$-4,824	$413	$-4,150	$7,637
Accounts Receivable	7,886	6,100	5,000	4,368
Inventory	186,450	188,237	111,455	99,351
Total Current Assets	189,512	194,750	112,305	111,356
Long-Term Assets				
Equipment	139,497	150,790	149,332	152,942
Less Accumulated Depreciation	-63,592	-82,639	-99,311	-116,049
Equipment (net)	75,905	68,151	50,021	36,893
Other Assets			1,458	1,458
Total Long-Term Assets	75,905	68,151	51,479	38,351
Total Assets	$265,417	$262,901	$163,784	$149,707
Current Liabilities				
Accounts Payable	$151,743	$140,000	$140,000	$141,328
Long-Term Liabilities				
Loans from Shareholders	19,471	17,200	16,200	44,177
Notes Payable	206,377	201,846	133,436	70,684
Total Long-Term Liabilities	225,848	219,046	149,636	114,861
Total Liabilities	377,591	359,046	289,636	256,189
Common Equity				
Common Stock	1,000	1,000	1,000	1,000
Retained Earnings*	-113,174	-97,145	-126,852	-107,482
Total Equity	-112,174	-96,145	-125,852	-106,482
Total Liabilities and Equity	$265,417	$262,901	$163,784	$149,707
*Prior period adjustments made to balance in retained earnings		-6,417		1,669

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 perceny) 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?