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Which Way to Grow?

You can expand a business by opening new stores. You can do it quicker with franchises. Making the choice isn't easy

The company: EvelineCharles is a chain of salons and day spas that operates in Alberta and British Columbia. Founded in the 1980s by Edmonton-based businesswoman Eveline Charles, the company has been an pioneer in combining beauty parlour and day spa services. It now has nine stores, which produced revenue of \$17 million in 2007.

The situation: Charles is developing a plan for the next phase of her firm's growth. She has several options. With a lineup of branded beauty products and salon equipment, she could start being a supplier to other high-end salons. But Charles also wants to open more stores and she is torn between organic growth and franchising.

EVELINE CHARLES looked pleased as she walked through her beauty salon and spa in Edmonton's Southgate Mall. It was late in the day, most of her staff had gone home, and the shop – one of nine outlets in her eponymous chain – was spic and span, just as she liked it.

Looking out through her storefront window, Charles watched as the last of the day's shoppers wandered towards the exits, bags in hand. Charles, however, wouldn't be heading out like the rest of them. On this mid-December evening, she was staying behind with her chief operating officer, Lina Heath, for a meeting. The subject: where to take the company next.

Turning her attention to that task, Charles sank down into one of the large black chairs in the reception lounge and looked up at Heath. "We've come a long way since we first added spa services

to our salon business in 1995," she said. "Most of our stores are doing well. We've improved our decor, introduced new items and special services. And we've stayed true to our formula of offering a luxurious and fashion-forward salon where our clients can be pampered for a few hours."

Heath nodded. Both of the women knew that EvelineCharles was in good shape. Revenue and

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profit had grown steadily with the business. The company had launched a successful line of beauty products, it had created a training school in partnership with the Northern Alberta Institute of Technology and it had established EvelineCharles as premium brand in western Canada, with annual sales of \$17 million.

Still, Charles was puzzled over where her next phase of growth would come from. At least she had options. For starters, she had a large line of branded products – upwards of 1,800 stock-keeping units (SKUs), including beauty products and salon equipment – which meant

good business model for EvelineCharles? They just didn't know and they were wary of pitfalls. Still, the idea was tempting. Growing by opening corporate stores would be time-consuming and expensive. Both women knew that well. But they also had a track record for getting it right. What was their best way forward – franchising or organic growth? Charles and Heath hoped this evening's meeting would shed some light on that question.

IF CHARLES AND HEATH knew one thing as they pondered their options, it was that they were

and, in 1995, launched her first combined salon-spa. She opened a second location in 1998, and set her sights on developing even more.

Part of Charles's strategy centred on developing signature services, such as hot-stone massages and mango body washes. To further differentiate her company, she also began developing branded lines of beauty products, like shampoos, lotions and cosmetics, a job she and Heath (who had joined the company by this time) attacked with relish. "Lina and I have spent months in all corners of the world sourcing our products," Charles says. "We have our skin-care

Developing signature services and custom products has always been a cornerstone of the growth strategy at EvelineCharles. Such offerings have made franchising an intriguing game plan for the company

she had the potential to become a supplier to other high-end salons. Heath liked this idea. The company had \$2 million worth of stock in its inventory, and she reminded Charles that becoming a supplier would increase turnover and generate cash. Charles agreed. But she had bigger ideas on her mind. "What about our thoughts on franchising our concept?" she asked Heath. "How should we assess that option? This is a unique industry where every operator wants to be an owner. We can give them the tools to build a business. With our school, we can even provide them with business training."

Both Charles and Heath were intrigued by the potential that franchising offered. But neither had experience as franchisors. Was it a

in a strong business category. The professional beauty-service market in North America was worth more than \$60 billion in 2007, encompassing services that ranged from hair cuts and facials to massage and body scrubs. It was also extremely fragmented, with single, owner-operated stores accounting for most of the business.

Charles was such an owner when she opened her first business, a beauty salon in Edmonton, in 1984 – but she wasn't content to stay that way. By the early 1990s, she had opened two more salons and, more importantly, had a plan for future growth. Charles had detected an early-stage trend in the industry of adding spa services to the menu of haircuts and manicures offered at traditional salons. She saw promise

products and aromatherapy products sourced in France. Our nail colours come from Italy. We source from the best manufacturers and those with the strongest traditions in beauty care. And every single component is 100% customized for us. Everything we offer is unique and very difficult to replicate."

That focus on customization didn't stop at the EvelineCharles product lines. As the chain grew, Charles and Heath paid careful attention to the details of opening each new store. They oversaw construction at each location, designed the layouts, and picked the colours and the lights to create a feel consistent with the company's high-end positioning. Customers certainly noticed. Many asked if the new stores were part of a U.S. chain making its way into

INNOVATIVE IDEAS.
RELEVANT EXPERTISE.

Canada. Industry peers were paying attention, too, and Charles started to win industry awards, including Entrepreneur of the Year for Canada in the Global Salon Business Awards, in both 2004 and 2006. By the middle of this decade, it had become a major player in the salon and spa business, with stores in Edmonton, Calgary, Vancouver and Kelowna, B.C.

BACK IN THE SALON, Charles and Heath continued to discuss their options. Their existing growth strategy had taken them a long way. But opening stores themselves was a slow process. Real estate had to be found, leases negotiated and construction managed. Bringing stores to maturity in terms of sales also tied up working capital. And even though EvelineCharles had a source of recruits thanks to its beauty academy, hiring was still a major task.

For these reasons, among others, Charles and Heath were intrigued by the prospect of franchising the EvelineCharles brand. For starters, franchising would help the brand grow quickly, as EvelineCharles would be able to leverage the financial resources of its franchise partners. On the revenue side, the company would earn a percentage from each franchise and create a whole new market for its inventory of branded products.

Of course, franchisees would have to be selected carefully to maintain the quality of the EvelineCharles brand. And they'd have to be committed to growing their locations, keeping a close watch on local trends and ensuring that costs were controlled. Still, the prospects looked very tempting. "One day, EvelineCharles could become a nationwide brand," Heath mused.

But their inexperience as franchisors left Charles and Heath with nagging doubts, no matter how much they liked the idea. Turning to Heath, Charles had only one question: "What do you think we should do?"

The Expert View

By Mac Voisin

Chairman, M&M Meat Shops Ltd.



WELL, EVELINE, YOU certainly have come a long way in the past 10 years. You should be proud of your accomplishments, and the fact that you've identified your growth options well.

Looking forward, I think you need to understand the market potential for your business. There appear to be three segments to your business: education, products and service. It's definitely hard to be all things to all people. I suggest you take some time to clarify in your own mind the market size and customer demographics for each segment. Once you have this information, you need to define specifically how you are going to stand out from the competition.

In my opinion, the salon-spa business appears brand-oriented. Your reputation and image is critical. If you continue to grow – whether corporately or by franchising – please consider concentrating on the following: specific training of the service staff; standardization of the service offering; and maintenance of service standards in the salons-spas.

Franchising as a business model can work well for you in your growth plans, although

it will require a change in mindset. As a franchisor, your primary focus is on building brand awareness through marketing initiatives and market-penetration strategies. You must be diligent with franchisee relations and seek to bring franchisees into the system. After all, they will be disciples of the brand.

Franchising will allow you to grow more quickly than opening corporate-owned stores, since the capital for growth will come from franchisees instead of your own company resources. You have a source of potential franchisees and trained personnel coming out of your school now. I would also suggest you consider approaching some independent salons with the intention of converting them quickly to the EvelineCharles banner to initiate a name-recognition strategy in a new market.

Choose your partners carefully, though. Franchisees bring owner/operator enthusiasm to the business. Your role is to ensure brand integrity is maintained and service delivery and decor is standardized. These goals are achieved by finding franchisees who are willing to follow a proven system, and providing them with solid training and support. Think of your school as a launch point for developing the training that you are going to need.

I also suggest you pay attention to financial issues at the individual spa level in order to give you and the franchisee a win-win combination. Establish a royalty rate that allows the franchisees to run a profitable operation while giving your corporation sufficient funds to hire the staff necessary to service the franchisees and operate a successful company.

Prior to jumping into franchising, understand the franchise business. Seek out specific legal expertise from a lawyer who specializes in franchise law. I also recommend contacting the Canadian Franchise Association. The CFA hosts meetings, seminars and conventions for

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franchisors, and provides a wealth of contacts and best practice information.

The financial advantage to you of rapidly expanding your base of spas is the ability to expand the distribution base of your proprietary products. I suspect these products carry a very high margin, and if the averages hold, an additional nine salons would double your inventory turns and profits from product sales. You could turn \$1 million of inventory into cash with an additional nine spas.

As you grow, be aware of customer demographics at a local level. You want to penetrate each market with enough spa-salons to provide good service levels. I also recommend you try to grow in proximity to existing markets to take advantage of "word of mouth" advertising, rather than jumping large distances towards unknown markets.

Now, I don't know the spa business like you do, but it seems that 1,800 products may be excessive. Here at M&M Meat Shops, we carry about 400 items. Try to rationalize the product lineup first. Hold off on product development for a little while, and redirect that spending to building brand awareness and developing a broader spa base.

Also, be very aware of the product-development trap. You clearly have a passion for this side of the business, but it appears to take up significant time and financial resources. I believe you need the brand awareness that can be created by the spas to give your product

potential, get the right people involved, standardize your processes, simplify your business, be fair to your franchisees, and most important of all, have fun.

By Tyler Morse
CEO, MCR Development LLC



EVELINECHARLES HAS A LOT of potential, but it needs more focus. For starters, it has too many SKUs for a company of its size. When I was president of Bliss, a U.S. spa and beauty products company with more than \$100 million in revenue, about two-thirds of that revenue was from product sales. When I had that job, we had about 275 SKUs spread across three brands. It's quite an achievement that EvelineCharles has managed to get so many products to market. Nevertheless, it needs to streamline its offerings.

In terms of next steps, I don't think the

Turning to other options, there are good margins to be had on the product side of the business. EvelineCharles should look at a website or an intra-Canada catalogue for its branded products. That way, they can test the market and get in front of people fairly inexpensively.

But EvelineCharles shouldn't try to sell all of its SKUs simultaneously – that's like trying to boil the ocean. It needs to pick a smaller number and concentrate on them. Customers don't have the bandwidth to absorb too much at once. EvelineCharles should initially pick a handful of products – maybe even just five – that are really great and put its staff and resources behind them. It can also use its own spas as the laboratory to find out which ones get the best acceptance from their clients. That's critical. You need to be in tune with what the consumer wants. It's easy to say the product is great, but if it's not what the consumer wants to buy, then it's not a great product.

Finally, EvelineCharles shouldn't try to grow its market for branded products too quickly. The company could hit speed bumps. Marketing products in the U.S., for example, may require changes to formulations to meet regulatory requirements. It's much easier to work through such issues if you're dealing with a handful of focused products, rather than your entire line. It's best to choose just five to start with and grow from there.

Overall, however, I'm impressed with

The Outcome

the company's growth and I believe that EvelineCharles is a firm with good potential. AS 2007 TURNED to 2008, Charles and Heath were still weighing their options. Both women agreed that more research had to be done to properly evaluate their alternatives and develop appropriate strategies. To do this, they are now gathering information from industry sources and soliciting feedback from employees and suppliers. The prospect of franchising remains

Note: The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The views represented here are solely those of the case authors and are based on their own professional judgment. Certain names, scenarios or identifying information may have been disguised to protect confidentiality.

“Before franchising, be sure you understand the business. Talk to lawyers and franchise associations”

line recognition. Expanding your base of spas will give you the critical mass you need to sell these products effectively. Product is a good method of maintaining proprietary products in a franchise system, but you want to be careful not to minimize the role and opportunities for your franchisees by selling these proprietary products through other channels.

To summarize – determine your market

company should franchise. The idea looks good on paper, but the reality is that most people in the spa business like to control their product, so following franchisor rules might be difficult for franchisees. As well, the legal fees in franchising will choke you, such as having to provide a uniform franchise offering circular and other documents. EvelineCharles would be better off raising capital to build spas of its own.