
CHESTER'S PLACE

Kathleen Panabaker prepared this case under the supervision of Elizabeth M.A. Grasby solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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It was early April 1995. Partners Craig King and Paul Regensburg were considering opening an outdoor patio at their Chester's Place restaurant franchise, located in Fort McMurray, northern Alberta, Canada. Construction would have to start immediately to ensure that the patio was completed in time for the popular patio season, May to August. The partners knew that a decision needed to be made quickly.

FORT MCMURRAY

Fort McMurray was located 431 kilometres north of Edmonton, Alberta. Fort McMurray's primary industry was oil. It was the site of the world's single, largest known oil deposit. By the year 2010, it was predicted that the Fort McMurray oil sands would be providing Canada with more than half of its oil.

The population of Fort McMurray was 35,000. The average age of its citizens was 27.5 years. At the time the partners conducted their market research, they discovered that Fort McMurray had the highest average male income in Canada, \$58,000. In comparison, the two largest metropolitan cities in Alberta, Calgary and Edmonton, had an average male income of \$27,000 and \$26,000 respectively.

Fast food outlets such as McDonald's, Wendy's, A&W, and KFC dominated the market. The casual dining market, however, barely existed. There were a few local, independent restaurants offering inconsistent, mediocre quality food and service. Chester's Place's closest competitor was Boston Pizza which had opened six months earlier than Chester's Place and was a block down the street from the Chester's Place location.

THE PARTNERS

Partners Craig King and Paul Regensburg were life-long friends who grew up in Fort McMurray. After Paul graduated from the University of Toronto, and while Craig was studying at The University of Western Ontario, the two of them decided to open a small sandwich shop to capitalize on Fort McMurray's

booming economy. Paul operated the day-to-day operations while Craig finished his degree. The sandwich shop was very successful and two years later the partners sold it, generating a handsome profit for themselves.

CHESTER'S PLACE, FORT MCMURRAY

Chester's Place was a restaurant chain in western Canada. The first Chester's Place was opened in 1982 by none other than the namesake entrepreneur himself, Chester. Since then, Chester's Place had expanded to include 35 franchises.

Chester's Place developed an excellent reputation for its food and atmosphere. "Great food. Great people" was more than just a slogan. All of the items from the menu were prepared fresh daily and each site was decorated to create a relaxed, sociable atmosphere. Chester's Place's employees were trained to provide excellent, friendly service to the customer whether that customer was celebrating a special occasion or dining casually.

Although Chester's Place, Fort McMurray had been operating for only three months, the partners felt positive about the results to date. Exhibit 1 summarizes the weekly statistics reports for the previous eight weeks of operation. This information was recorded weekly, in a more detailed format, and posted for all employees to see. Craig and Paul agreed that disclosing weekly results was important. They believed it instilled a sense of responsibility and ownership to the employees and promoted teamwork. Their employees responded with enthusiasm and eagerly awaited the weekly results.

The Patio Opportunity

Chester's Place franchise data showed that other Chester's Place restaurants with patios experienced a significant jump in sales during the patio season. Based on the popularity of patios in other western Canadian cities, the partners thought the idea was worth investigating. The cold Fort McMurray winters worked in their favour. The residents were keen to be outside, once the colder weather disappeared, to overcome the effects of "cabin fever." Due to Fort McMurray's northerly location, daylight hours were limited in the winter (9:00 a.m. to 5:00 p.m. on average), whereas the summer daylight hours were longer (5:00 a.m. to 10:00 p.m. on average). As well, the only patio competition currently in Fort McMurray consisted of two local, independently run restaurants utilizing old wooden decks, old patio furniture and a few faded patio umbrellas.

Craig and Paul envisioned a patio like no other the Fort McMurray population had ever seen. There would be 100 seats furnished with classy patio furniture, umbrellas, and flowers. Heaters would be installed to allow them to stay open up to an hour and a half later at night. Heaters would also extend the patio season by a month: two weeks in the spring and two weeks in the fall.

There was, however, one belief that Chester's Place customers would have to overcome — their perception that mosquitoes were intolerable at night. The partners had a number of defenses to ensure a bug-free environment. First of all, their location was downtown which meant that it was surrounded by a lot of cement, and was several kilometres away from open water, which was mosquito-breeding territory. Second, the patio would be surrounded with glass walls. Third, a number of the flowers would be citronella plants, a natural mosquito deterrent. Finally, the grass would occasionally be sprayed with a mosquito-deterrent chemical. This process was referred to as fogging the grass. The city had formerly fogged all city-

owned land but had stopped because of its potential environmental harm; however, fogging was not illegal for private businesses and citizens.

This unique patio would be expensive (see Exhibit 2); however, no additional supplies, such as cutlery and dinnerware, would be necessary. The contractor estimated that construction time would take a month which included lead time for materials.

It would be difficult to determine accurately the incremental revenue that would be earned by the patio and, thus, the return it would generate. Currently, the restaurant had 225 seats; however, Chester's Place popularity on Friday and Saturday nights was resulting in long line-ups. Increasing Chester's Place capacity by 100 seats would bring these people into the restaurant and increase sales.

The partners were uncertain how patio sales might affect indoor sales. For example, some of the customers on the patio would be customers who would have been inside had there been no patio. In this situation, overall sales would not be increasing directly with patio usage. Based on Chester's Place's franchise historical data and some intuitive speculation about the effects of cannibalization¹ on indoor sales, the partners estimated there would be approximately \$1,000 of extra sales each day during operating hours, Monday to Sunday. In addition to these sales, the partners thought they could expect the patio to bring in an extra \$1,500 in sales each Friday and Saturday night.

The partners believed the product mix, i.e., the percentage of food sales compared to the percentage of beer or liquor sales, would be essentially the same as the product mix of current sales. As well, the average cost of sales over the last eight weeks would be used to represent the cost of sales in their projections. The kitchen and floor labour costs for the patio would be similarly calculated.

The partners did not expect the controllable costs to change significantly if the patio were opened but did estimate an extra \$100 per week would be incurred. None of the Other Fixed Costs would change if a patio was added, leaving Other Fixed Costs at \$240,000 annually.²

The partners knew they would be unable to secure any further financing at the bank with their current debt load; however, each partner would be able to borrow \$25,000 from family members at an annual interest rate charge of 10.5 per cent. Any additional cash would have to be generated from operations.

Additional Concerns

It was possible that the sales growth recorded by the other Chester's Place restaurants was not achievable in Fort McMurray. A cool, dismal summer would certainly have an effect on the projections. What if sales turned out to be only 50 per cent of what they projected? On the other hand, what if the patio was a hit and sales were 50 per cent higher than projected? Although Craig and Paul were confident that they would be able to meet their projected sales, in light of these concerns they wanted to assess the proposal's risk.

¹*Cannibalization occurs when a company introduces a new product or service and customers switch from the old product to the new product. Sales of the new product increase while cutting into the sales of the old product which subsequently decline.*

²*Each four-week period was allocated \$18,460, one-thirteenth of the other fixed costs.*

Exhibit 1
WEEKLY STATISTICS¹

Week	Period 2				Period 3				Average
	One	Two	Three	Four	One	Two	Three	Four	
SALES:									
Lunch	\$18,939	\$18,536	\$17,539	\$16,826	\$15,203	\$17,839	\$14,933	\$17,095	\$17,114
Dinner	37,520	37,429	37,438	34,329	34,194	40,047	39,014	40,060	37,504
Food	<u>38,096</u>	<u>40,786</u>	<u>39,115</u>	<u>36,825</u>	<u>35,177</u>	<u>41,249</u>	<u>37,855</u>	<u>41,761</u>	<u>38,858</u>
Total Sales	\$56,459	\$55,965	\$54,977	\$51,155	\$49,397	\$57,886	\$53,947	\$57,155	\$54,618
Total Cost of Sales (Note 1)	34.50%	28.63%	34.13%	29.46%	32.41%	29.22%	31.69%	29.88%	31.24%
Total Labour (Note 2)	33.20%	32.30%	31.70%	31.86%	31.90%	29.10%	30.70%	31.00%	31.47%
Controllable (Note 3)	3.05%	13.44%	10.36%	7.26%	5.50%	9.69%	2.78%	14.18%	8.28%
Marketing (Note 4)	8.17%	6.17%	7.06%	6.79%	7.10%	7.16%	8.05%	8.42%	7.37%
Profit Before Other Fixed	<u>21.08%</u>	<u>19.46%</u>	<u>16.75%</u>	<u>24.63%</u>	<u>23.09%</u>	<u>24.83%</u>	<u>26.78%</u>	<u>16.52%</u>	<u>21.64%</u>

¹See following page for explanatory notes.

Exhibit 1 (continued)**WEEKLY STATISTICS — EXPLANATORY NOTES**

- Note 1.** Cost of Sales — comprised of the costs of food, liquor, wine, beer and retail (Chester's Place caps, t-shirts, etc.).
- Note 2.** Labour — consists of a variable portion (kitchen and floor labour) and a fixed portion (management salaries and accounting administration). The fixed portion had averaged approximately 6 per cent of total sales.
- Note 3.** Controllable Costs — are not directly traceable to sales (e.g., utilities, linen, cleaning products, glassware, etc.).
- Note 4.** Marketing — comprised of royalty fees of 4.5 per cent, advertising fees of 0.5 per cent, and director fees of one per cent. In addition to these fees charged by the franchise, Craig and Paul also did some minimal local advertising.

Note: Chester's Place franchises separated the year into 13, four-week periods for reporting purposes. The information in the weekly statistics reports was disclosed as a percentage of sales and described components of the business that were considered manageable. Other fixed costs included items that were not considered manageable on a daily basis (e.g., property taxes, liquor license, business license, rent, etc.). Managers were able to assess weekly performance and compare it to prior weeks' performance. The underlying goal was to decrease the percentages as much as possible to increase the Profit Before Other Fixed percentage.

Exhibit 2
PATIO COSTS¹

Trellis:	
Steel Support Beams	\$ 4,000
Wooden Overhead Trellis	5,000
Heaters	7,800
Labour Installation (includes electrical and gas filter for heater)	9,000
Glass Wall:	
Steel Support Beams	\$ 7,000
Glass	14,500
Gates	2,500
Lettering	650
Miscellaneous:	
Tables and Chairs	\$ 8,900
Umbrellas	2,050
Flowers and Fogging ²	3,500
Total	\$64,900

¹The completed patio with fixtures would be depreciated using a 20 per cent declining balance method.

²Would be required annually.