**BUTTERCUP FARMS: IS SHE CRAFTING A HOBBY OR A BUSINESS?**

Audrey Smith had a problem that was never far from her mind. She thought about the problem frequently but didn’t know what to do. Audrey was middle aged and employed by the U.S. Postal Service. She had a husband, a house, and a full-time job, all of which kept her very busy. Thinking ahead a few years to retirement, Audrey was concerned she would not have enough income to live in the manner she chose. She thought perhaps she should create a small business that would supplement her income in later years. Two years ago, Audrey started a small soap making business which she named *Buttercup Farm*. At first she made the soaps to use herself and then began giving them as gifts to friends and family who raved about the soap and encouraged Audrey to commercialize and sell her products. Over the past two years, Audrey began to make the soap in batches of 20 bars, three or four times a month. She sold the bars to two outlets in the Northern Michigan area near her home, one being an Amish operated grocery store, and the other an antique store that also sold home spun wool products. She sold each bar to the outlet for $3.00 and realized a profit of about $1.86 per bar. The retailers marked up the products by 100% for a retail price of $6.00 for the average bar (see Table 1).

Audrey’s workspace was approximately 200 square feet in her attic. There she stored and made her products. Some ingredients she ordered on-line and others she purchased locally. Her biggest problem was inventory storage as she would purchase 50 pound containers of various oils needed and would then have to store these. Another problem was time. Audrey worked full time, was on her feet all day, and ran a household. She estimated that in a month, her time spent on the business including making the soap, labeling and packaging it, and ordering ingredients was only ten hours. But these ten hours came from her dwindling leisure time.

Audrey faced a decision: At present, her business was just a hobby. Should she expand her product line to include liquid soap and lotions, or should she continue on as in the past producing a few batches of bar soap each month?

**The Down Side to Expansion**

A down side of expansion into liquid soap/lotions was she did not know what types of liquid soaps and lotions would sell in her market area. Introduction of a new product required experimentation and testing of the new product, which meant lots of time and money that she feared risking. Audrey viewed the launching of a new product line as a difficult and complicated undertaking. For instance, by experimenting she had learned to her surprise that bug repellent bar soap had gone over very well. Also, she would have to do a great deal of research to arrive at a sale price for the new products. She was not sure at what price she would have to sell the new products in order to realize a profit. This demanded a further investment in both time and money.

A major down side to expansion into liquid soap/lotions required an additional outlay of about $300 (see Table 2). Audrey realized that liquid soap and lotions, unlike the bar soaps she made, would have to be cooked. Using the gas stove in her kitchen was not permitted by local zoning laws due to the alcohol content of the liquid. She needed to purchase an electric heating element and do the cooking in her attic which was her regular workspace. This was a heavy demand on her space, time, and money. In addition, the expansion would probably mean she needed to establish a webpage or eBay site, which led to more complications and money outlays, but potentially better profit margins. Expansion also might mean hiring a lawyer and acquiring trademark protection.

**The Upside to Expansion**

Audrey viewed the upside of expansion to be the lack of saturation of homemade soap products in the local area. Another advantage was that many of the same ingredients were used in making both the bar and liquid soap or lotions. She had about $700 - $800 tied up in inventory. Of course, the biggest lure of expansion was increased profits from the business. If she didn’t expand, an increase in profit was not likely to occur. Retirement and her financial condition were always on her mind.

Another upside to expansion was the fact that Audrey liked helping people. Her products did not burn sensitive skin as did some commercial soap products. She also enjoyed the socialization and camaraderie she felt with her clients and customers. The type of customers who were buying her soap were middle aged women from small communities who wanted to treat themselves by using a high quality natural soap that did not have all of the dyes and chemicals that the “store bought” brands contained. In addition to the two stores, Audrey sold bar soap to associates at her workplace and even occasionally prepared special orders of her bars. Finally, Audrey’s husband was supportive of her efforts as were her friends and family.

Audrey first instinct was to try making liquid soap, believing that if the test product did not sell well she could give the remaining products away as Christmas gifts. If the liquid soap failed, she could back out and return to her original plan of creating a few batches of bar soap monthly. This, however, would not provide her with the funds she felt were necessary to supplement her retirement.

**The Decision**

If Audrey desired to embark on expansion of her product line, she would have to make a move soon. The idea was to have the business in place in a few years to provide supplemental income when she did retire. She could either focus on expanding her customer base in the bar market, or she could broaden her market by offering a broader product line. To make it a business and not just a hobby, Audrey would need the next few years to grow her sales to the next level. To Audrey this was a critical decision and she wanted to get it right. Her future depended upon it. The question was, what should Audrey do, expand into a business or maintain her hobby?

**Table 1: Bar vs liquid costs per unit**

Bar Liquid

Retail price $6.00 $6.00 -$12.00\*

Wholesale price $3.00 $3.00 - $6.00\*

Cost of materials $1.07 $.62

Cost of packaging? $.07 $.93

Profit per unit $1.86 $1.45 - $4.45

Time to process 2 hr/batch 4 hr/batch

Curing time 4 weeks 2 weeks

Shelf life 1 year 2 years

Trade-offs 20 bars (3.5 oz) 36 bottles (8 oz)

(more storage space required)

$22.80 cost per batch $55.80 Cost per batch

simple process more complicated process

(more ingredients, steps, equipment)

bar form only shampoos, bath gels,

bubble bath, hand soaps/lotions

variety of molded shapes, variety of bottles,

fragrances, & colors fragrances, & colors

Volume limitations 10 batches per month 7 batches per month

Many of the fragrances and other raw materials can be used in either product.

\*Best guess on possible range of prices she could charge.

**Table 2: $300 investment for liquid soaps or lotions**

Electric heating element ($50 estimated)

Bottles, pumps, dispenser tops

Exotic oils (hempseed or emu oil)

Colorants

Fragrances

**SENSEMAKING: IS SHE CRAFTING A HOBBY OR A BUSINESS?**

**TEACHING NOTE**

**Abstract:**

This critical incident concerns a middle aged woman in a small community who is considering how to grow her soap-making hobby into a business capable of supplementing her future retirement income. She has experience making and selling all natural bar soaps through two retail outlets, but she is considering developing the expertise needed to make and sell soap in liquid form (hand soap, shampoo, bath gels, and lotions).

This critical incident could be used in any Introduction to Business, Entrepreneurship, Communication, or Marketing Principles class.

**Learning objectives (Students should be able to:)**

**1. Analyze the trade-offs required for bar soaps versus liquids.**

**2. Evaluate the decision-making process of an entrepreneur faced with less than adequate information.**

**3. Assess whether a hobby could be converted into a suitable business model.**

**Questions**

1. **Examine the choice Audrey is facing concerning expansion from bar soap to liquid soap.**
2. **Using Weick’s Theory of Organizing, evaluate the amount of information Audrey currently possesses. Is this information adequate to make the decision to expand into liquid soap? What additional information is needed before a decision should be made?**
3. **Using Gamble/Thompson’s Theory of a Successful Business Model, assess whether Audrey has found a suitable business model to expand beyond her soapmaking hobby.**

**Answers**

1. **Examine the choice Audrey is facing concerning expansion from bar soap to liquid soap.**

Bar Soap

Positives: cheaper to make, simpler process, more experienced at making bar soap, lower risk per batch, less time needed to mix a batch, understands the local market for bar soaps

Negatives: longer curing times, shorter shelf life, lower price, limited distribution

Liquid Soap

Positives: could charge more, could have better profit margins, less curing time, if she fails, she could give them to friends as gifts

Negatives: inexperienced, more complicated process, no market yet and no certainty that a market exists, greater time/effort to sell, unknown price, no distribution, unfamiliar with local market for liquid soap

On the face of it, since liquid soap will probably have better profit margins, it seems appealing, but this is not considering the higher risks due to the additional costs, time/effort spent selling it, and unknown public reactions. Because it is still very early in the evaluation process, it might be worth it to try a batch to verify proof of concept. If it fails Audrey could still hand out bottles of liquid soap as gifts.

1. **Using Weick’s Theory of Organizing, evaluate the amount of information Audrey currently possesses. Is this information adequate to make the decision to expand into liquid soap? What additional information is needed before a decision should be made?**

Classified as a systems theory, Weick’s Theory of Organizing provides a method of removing ambiguity from a decision making process. Weick defines his process of organizing as “the resolving of equivocality in an enacted environment by means of interlocked behaviors embedded in conditionally related processes” (Weick, 1969, p. 91).

Weick suggests that when faced with making an ambiguous decision, an individual first must determine if rules exist; Weick terms these ‘assembly rules’ (Miller, 2012). If this decision is one the individual has never faced in the past, there is no rule to use. If a rule does not exist, the individual must enter what Weick refers to as a communication cycle. He must seek additional information concerning the decision and then again assess if the decision may be made. If not, he again seeks additional information (another communication cycle) and then once again stops to assess the situation. If he still does not possess enough information to make the decision, he then enters a third communication cycle seeking more data on which he might possibly base his decision. This process continues until the individual is able to make his decision based on all the information available.

Weick suggests that any information gained from this process leading up to the decision be stored in a ‘retention’ area for future use. This information and the subsequent decision are now considered to be an ‘assembly rule’ that may be called up in the future when a similar decision must be made.

Weick’s theory as described here is simplified but serves well in explaining how decisions are made when faced with ambiguity. Audrey must pass through a variety of communication cycles gaining more information to help her make the decision whether or not to expand her small business into liquid soap. After her decision is made, Audrey should store the information in a retention area (a file on her computer) so that in the future the information gained and process followed is available to aid with future decisions.

Although less than perfect information is available and a decision-maker might prefer higher levels of certainty with the information, we live in an imperfect world and this appears to be all of the information Audrey has available at this point. She has gone through communication cycles to gather more data to remove as much ambiguity as possible before making her decision. Given the data she has, she has enough to proceed at least to the “trial run” phase of her plan. With product in hand, she might then explore market acceptance and verify the wholesale price she would expect to receive

As an inexperienced business operator, Audrey lacks some basic understanding of the necessary numbers needed to successfully operate a profit-making company. Audrey needs better information on the details of her potential costs of bottling, storage, and distribution. In addition, she needs a more accurate measurement of the time it will take her to produce each type of soap so that she can pay herself for her time. We would assume she would at least want to make the equivalent of minimum wage for her time. Using this information she could run a break-even analysis to estimate the amount of soap she would need to sell to reach profitability.

1. **Using Gamble/Thompson’s Theory of a Successful Business Model, assess whether Audrey has found a suitable business model to expand beyond her soap making hobby.**

According to Gamble and Thompson (2011), there are three elements of a company’s business model: 1) the customer value proposition, 2) the profit formula, and 3) the identification of key resources and processes to create and deliver value to customers.

*Customer Value Proposition:*

Audrey believes that there is a market for reasonably priced, homemade soaps. These soaps do not have the amount of chemicals present in “store bought soaps” and will not dry skin like “store bought” soaps.

*Profit Formula (based on existing assumptions):*

Given space and time constraints for bar soaps, Audrey feels that she can run 10 batches/month X 12 months/year X 20 bars/batch X $1.86 profit/bar = $4,464 profit/year.

Given space and time constraints for liquid soaps, the best case scenario would be that she can run 10 batches/month X 12 months/year X 36 bottles/batch X $4.45 profit/bottle = $19,224 profit/year.

Potential annual profit could run from $4,464 to $19,224 annually. This might be enough to supplement her retirement income, but it would be difficult for Audrey to solely rely on it as a primary source of income.

*Identification of Key Resources*

Audrey’s key limitations are time, space, and money. For bar soaps the key limitation would likely be space due to the longer curing time. For liquid soaps the key limitation would likely be the time required due to the extended processing. Lack of money would act as a limitation for either product, but liquid would have a higher risk associated with production (if somehow a batch is destroyed more money is lost).

In addition, from the business perspective, Audrey lacks a good distribution system and a good marketing plan. Using only two outlets for her bar soaps is very limiting and would be unlikely to sell the volume of product needed to net a good profit. It might be a better business move to focus on expanding distribution before expanding her product line. Her products also lack a strong brand image due to her limited exposure in the marketplace.

Three Tests of a Winning Strategy (Gamble and Thompson (2011)

1. Does the strategy fit the company’s situation?

Assuming nothing negative happens (Audrey always receives the full price, she never burns a batch, etc.), Audrey could make as much as $19,224 a year, wholesale, with relatively low out of pocket expenses. However she is currently dealing with only two retail outlets. Could she support more retail outlets and cover the associated costs? That might be hard to say given the information found in the critical incident, but one can easily envision an expansion of distribution overwhelming her ability to cover inventory expenses.

1. Has the strategy yielded a sustainable competitive advantage?

There appears to be no special skill set involved in soap-making beyond the willingness to do it. It would seem easy to replicate it if one were willing. However, building a brand name and creating a terrific soap recipe might offer opportunities to develop a competitive advantage.

1. Has the strategy produced good financial performance?

$4,000-$19,000 dollars in supplemental income while working on something Audrey loves doing might be “worth” it. However, if she tried to pursue soap making full-time, this might not be a sustainable income stream. This is not counting the profit potential if she sold her soaps directly (eBay/on-line) and captured the retail markups.

At her current production scale, this does NOT appear to be a successful business model (beyond a hobby). However, if she developed a better distribution system while commercializing her operations (larger scales production and purchasing) this might lead to a viable business.

**General discussion**

Students might volunteer other opportunities for expansion such as developing a better distribution network, finding a new customer base such as a Bed and Breakfast, or finding new trendier products such as lotions or creams. Audrey had not, as yet, considered these options. Here is where her lack of business experience is a drawback.

**Epilogue**

Audrey continues to struggle with the decision and has yet to decide her course of action. Although Audrey has tried to make a batch of moisturizing lotion, she has not, as yet, created a test batch of liquid soap.

References:

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