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BLACK FLY BEVERAGES: A SHOT AT SUCCESS

Mano Majumdar wrote this case under the supervision of Julie Gosse 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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The husband-and-wife team of Rob Kelly and Catherine Siskind-Kelly, co-founders of Black Fly Beverage Company Inc. (Black Fly), had cause for celebration. They had founded Black Fly in 2005 as brave outsiders to a complex and demanding industry. In the 11 years since, the company had sold over nine million bottles of their ready-to-drink (RTD) alcoholic beverages. Small but persistent like its namesake, Black Fly had made its mark in an ecosystem dominated by multinational behemoths.

Success brought rewards, but also challenges. By 2016, the demand for Black Fly’s products was growing rapidly, and the company’s plant in London, Ontario, was nearing its limits. The founders knew that more shifts and more overtime were temporary measures at best, and serious interventions were required to keep up with the needs of the future. Martin Kamil, Black Fly’s vice-president of finance and operations, had provided the co-founders with a set of proposals, from which the co-founders would have to choose.

LIQUOR SALES IN ONTARIO

The alcohol industry in Ontario was distinguished by the central role played by the Liquor Control Board of Ontario (LCBO), a Crown corporation[[1]](#footnote-1) that was the sole licensed retailer of alcoholic beverages in the province.[[2]](#footnote-2) The LCBO was the largest independent buyer of beer, wine, and spirits in the world, with over 650 outlets and over 200 agency stores selling nearly 24,000 products from 80 countries. There was no domestic content requirement at the LCBO, and Canadian companies had to compete on an even basis with foreign producers. The LCBO maintained a minimum price to fulfill its mandate to promote responsible consumption. Its near-monopoly status nevertheless kept shelf space in high demand, and in 2015–16, it returned nearly CA$2 billion[[3]](#footnote-3) to the province in the form of an annual dividend.[[4]](#footnote-4)

The LCBO had strict quality requirements for products sold in its stores. Every detail, from product quality to package design, was reviewed by the LCBO before it carried a product, and the products continued to be evaluated after being listed. LCBO classified its products into categories of wine, beer and cider, spirits, and coolers. Sales targets were set by the LCBO for each category and were not adjusted to account for the size of the supplier. Products that failed to constantly meet the LCBO’s strict performance benchmarks were discontinued; strong performers hoped to qualify for a coveted “general listing,” allowing them to be listed year-round at the best stores province-wide.

Black Fly accounted for four per cent of the LCBO’s $240 million RTD business. For a spirits business such as Black Fly, being delisted from the LCBO would mean they would no longer be able to be sell in Ontario, so quality benchmarks were extremely important.

BLACK FLY BEVERAGES

Kelly had initially planned to start a craft brewery. He noticed, however, that beer sales in Ontario were losing market share to coolers, which had doubled their sales each year for two years. Kelly and his wife decided to start a craft distillery instead. After many setbacks and surprises, they were finally able to secure the necessary provincial and federal permits and were granted the first distillery licence in Ontario in nearly a century.

In its early days, Black Fly had occupied a former bank building in downtown London, hoping the space would bring visibility. As the company grew, it eventually had to shift to a larger and more traditional manufacturing plant on the outskirts of London.

Black Fly differentiated its products in a variety of ways to stand out in a crowded market. Its recipes prioritized local and identifiably Canadian ingredients and did not use artificial sweeteners, which resulted in a dry drink that the company advertised as “not too sweet.” The drinks retailed in $12 packs of four 400 ml bottles, larger than the 330 ml bottles that were typical in the industry. The price included a 40-per-cent margin for the LCBO and a 60-per-cent markup for Black Fly.

At 7 per cent alcohol by volume compared to most brands at 5 per cent, Black Fly delivered more standard drinks per four-pack than its competitors. The bottles were wide-mouthed to allow users to directly add ice cubes to their drinks, and they were re-sealable because each bottle represented more than one serving. The bottles were strong yet flexible, so that the drink could also be frozen to a slush and safely squeezed out of the bottle. Uniquely, Black Fly manufactured its own bottles on-site.

Black Fly was popular right from the start. It was eventually granted general listing on the LCBO, and by 2016, its beverages could be purchased in all Canadian provinces and territories, and in eight American states.

THE CURRENT PRODUCTION PROCESS

In the broadest terms, Black Fly mixed ingredients in a hot batch to melt the cane sugar, cooled the mix down, carbonated it, and bottled it (see Exhibit 1). Those bottles were then capped, labelled, and packaged in sets of four bottles, which were further organized into cases of six four-packs. Finally, 60 of these cases were shrink-wrapped on a pallet for further shipping. A variety of pallet configurations were used depending on customer requirements.

The process started by combining ethanol,[[5]](#footnote-5) sugar, and juices in a 4,800-litre tank. The resulting solution was stirred in the tanks for 90 minutes and then cooled to 0°C by a chiller, at the rate of 640 litres per hour. This was then carbonated using pressurized carbon dioxide, a method that took another three hours to process the entire 4,800-litre batch. The carbonated mixture was stored in a holding tank, from which it could be bottled after being tested to ensure that it contained no more than 7 per cent ethanol by volume. The bottling line had been upgraded recently and could fill, bottle, and cap 1331/3 bottles per minute, a significant improvement over the previous rate of 30 bottles per minute. This was the upstream process, followed by packaging and palletization downstream.

Black Fly was in a highly seasonal business. In a 212-day window that lasted from February to August inclusive, demand tripled from the usual 1,200 cases per day. On average, each worker was paid for the equivalent of 50 weeks per year of 40 hours each at a rate of $17.50 per hour including benefits.

UPSTREAM ALTERNATIVES

Kamil had proposed upgrades to both the cooling and carbonation steps. The existing chiller could be replaced with a newer model that could cool 3,200 litres per hour, in theory, and would only be operated at 23.5 per cent of that capacity due to constraints in the piping network. The new chiller would cost $90,000, including installation and one-time training costs, and the old chiller was estimated to have a salvage value of $5,000. The old chiller would be sold at the same time the new chiller was bought, offsetting the new chiller’s purchase price.

The next option was the installation of an in-line carbo cooler, a machine that would continuously carbonate the fresh mix, replacing the current batch process without any change in capacity. Attempting to increase the line’s overall speed without a carbo cooler would be prohibitively expensive. The carbo cooler installation would cost $85,000, including installation and one-time training costs, and free up 6,000 hours of labour per annum.

Increasing the speed of the line using either of these methods would require additional downstream labour to support the higher speed. It was expected that the number of downstream workers would rise from six to 16 per shift if either option were implemented individually, or in tandem.

DOWNSTREAM ALTERNATIVES

Once the bottles were filled and capped, they were organized successively into four-packs, cases, and pallets.

The first step, sleeving, was a manual process with eight workers constructing the corrugated four-packs and placing the bottles into them. It took significant time to train employees to achieve the speed required to keep up with the bottling step and not everyone had the agility and endurance for the work. This step could instead be automated with a $770,000 sleever/cartoner (S/C) system created by AFA Systems Ltd., another mid-sized private company in Ontario.

The second step, case-packing, was the manual process of erecting cases, filling them with four-packs, and taping the top and bottom. This was currently done by three workers working together. AFA Systems would also be supplying the automated case packer. AFA quoted a price of $330,000 for this system.

Three operators would be required to oversee and maintain either or both automated systems. Kamil knew from experience that it might be possible to negotiate a small discount of 2–5 per cent if both systems were purchased, but the exact number was not known (and could well be zero).

The increased bottling speed had made it more strenuous for workers to keep pace for an entire 10-hour shift, resulting in frequent absences and diminishing returns. The number of workers needed had increased from 6 to 16 after the bottling-line upgrade, further crowding an already busy production floor. Black Fly had previously operated double shifts when necessary, but attempting to do so with the increased headcount had decreased output, increased waste, and introduced risks to quality assurance. Automation would reduce the shift headcount back from 16 to 6 workers, making a second shift possible without adding to the payroll.

While none of the automation options would increase Black Fly’s capacity, the reduction in labour costs could be meaningful. Additionally, having an automated system in place ensured that Black Fly could learn best practices on a small scale before expanding to meet its market demand in the future.

CONSTRAINTS AND CONSIDERATIONS

Black Fly prided itself on its record of improving job variety and providing upskilling[[6]](#footnote-6) opportunities for its employees while maintaining high standards of quality and fulfilling virtually all its LCBO orders on time. Given the cash-intensive nature of the business, the founders were comfortable committing no more than 25 per cent of the company’s $4.4 million in cash to capital projects at this point; the Kellys wondered how that money could be most efficiently allocated.

EXHIBIT 1: PROCESS FLOW DIAGRAM

Mix

Chill

Carbonate

Bottle

Package

Source: Case authors.

1. A Crown corporation was a state-owned enterprise in Canada and could be provincial or federal in origin and scope. [↑](#footnote-ref-1)
2. A privately-owned consortium known as The Beer Store had a similar monopoly on the sale of beer in certain formats, and local producers could sell small quantities of their own products under permit from the LCBO. [↑](#footnote-ref-2)
3. All dollar amounts are in CA$ unless otherwise indicated. [↑](#footnote-ref-3)
4. “Quick Facts,” LCBO, accessed July 31, 2018, www.lcbo.com/content/lcbo/en/corporate-pages/about/media-centre/quick-facts.html. [↑](#footnote-ref-4)
5. The term “alcohol” refers to a class of similar chemical compounds; ethanol, or ethyl alcohol, is the alcohol suitable for human consumption. [↑](#footnote-ref-5)
6. Upskilling refers to the retraining of existing workers to acquire new skills and perform more valuable functions. [↑](#footnote-ref-6)