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9B21N009

Cafézia coffee: Financing Entrepreneurial Success

Martin Eidenberg 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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In January 2021, Joanne Gunther, commercial banking associate at Northern Lights Credit Union (NLCU), was reviewing a loan request from Cafézia Coffee Inc. (Cafézia). The company was owned by Natalie White, who had been managing the growth of the new venture for the previous two years. While the business had grown significantly in this initial period, White knew that additional financing would be required to ensure the business could achieve the growth and scale it needed to reach a point of sustainable profitability.

Amid a struggling economy, largely a result of the COVID-19 pandemic, Gunther was under pressure to find new business for NLCU. However, it was also critical that any loan she recommend for approval meet NLCU’s requirements, which included the applicant being able to demonstrate viable and sustainable operations, capacity for loan repayment, and strong character. Gunther had to make an appropriate recommendation to her manager about Cafézia’s application for a CA$12,000[[1]](#footnote-1) four-year loan.[[2]](#footnote-2) Additionally, White had applied to NLCU for a working capital loan with a $7,500 limit.

BACKGROUND[[3]](#footnote-3)

Cafézia Coffee

In 2019, following a chance meeting with the product’s inventor⎯a neuroscience researcher⎯while on a trail run, White began managing Cafézia. Cafézia’s coffee provided the desired caffeine energy boost that drinkers of coffee expected but without the usual adverse side effects of jitters, caffeine crashes, and sleeping trouble. To achieve these outcomes, premium, organic, Fairtrade coffee beans were combined with three key herbs: cleavers, hyssop, and yerba mate. Cafézia offered dark, medium, and light roasts and was sold in both ground and whole bean form.

Prior to becoming an entrepreneur, White graduated from the Honours Business Administration program at the Ivey Business School and worked in the marketing department at a large consumer packaged goods firm. She had also been a lecturer for the Ivey Business School’s popular first-year Business Administration 1220E course for a two-year period.

Following her jump into entrepreneurship with Cafézia, White began to rapidly expand the product’s distribution. Cafézia was now sold across Southwestern Ontario by over 50 retailers. Like many entrepreneurs, White often found herself working late into the evenings and through many weekends. Nevertheless, she truly enjoyed her work growing Cafézia.

London, Ontario

Cafézia was in London, Ontario, where White also resided. London was the largest city in Southwestern Ontario and was situated approximately in the middle of the industrial corridor between Toronto and Windsor. Over the previous five years, the city’s population had grown by 4.8 per cent to 383,822.[[4]](#footnote-4) Located close to smaller towns and cities such as St. Thomas, Tillsonburg, Stratford, Woodstock, and Sarnia, London was the central hub of the Southwestern Ontario region. Larger urban centres such as Windsor, Hamilton, and Kitchener-Waterloo were all just over a one-hour drive away.

The Coffee Industry[[5]](#footnote-5)

Cafézia was a very small player in the Canadian coffee and tea production industry, which had total annual revenues of $2.9 billion. Industry growth was projected to slow to one per cent per year in the coming five years, after having grown at an annualized rate of 8.5 per cent over the past five years.

Coffee had historically been a volatile commodity because it was often grown in geographies associated with a high degree of political and environmental risk. This meant that revenues in the industry were volatile because they were strongly correlated to the world price of coffee.

Many Canadian consumers viewed coffee as a staple product they could not do without. However, consumers adapted their preferences, tending to purchase more expensive, premium coffee brands during times of increasing per capita disposable income and cheaper, mass-market coffees in the case of declining disposable income. To be successful in the Canadian coffee and tea production industry, strong contracts and connections with retailers, especially larger supermarkets and grocery stores, were key to success.

COVID-19 Pandemic

COVID-19, the disease caused by the SARS-CoV-2 virus, was declared a global pandemic by the World Health Organization on March 11, 2020.[[6]](#footnote-6) By the end of the year, there were over 82 million confirmed cases worldwide, 571,000 of which were in Canada.[[7]](#footnote-7) In response to the pandemic, all levels of government in Canada instituted a multitude of restrictions to limit the spread of the virus.

On March 23rd, the province of Ontario required the closure of all non-essential stores and services.[[8]](#footnote-8) Cafézia’s sales declined dramatically as a result, since many of Cafézia’s retail partners were deemed non-essential. To counteract this, White expeditiously developed an online sales portal on Cafézia’s website and began to deliver customers’ orders herself.

While online sales did not offset all Cafézia’s lost revenue, they were instrumental in maintaining Cafézia’s growth and momentum. The online sales channel also had a small additional benefit: by eliminating retailers from the trade chain, Cafézia achieved improved margins from each online sale compared to sales made wholesale to retailers. White planned to continue and further improve the online sales platform post-pandemic.

COMPETITION

Competition in the coffee industry was strong and included companies ranging in size from global conglomerates to small start-up ventures like Cafézia. Some of these competitors offered comparable products that, like Cafézia, also claimed to remove the negative side effects of coffee. However, none were local to the Canadian market and all were more expensive than Cafézia. Perhaps the most well-known of these comparables was Four Sigmatic, a company started in Finland, who combined “the magic of mushrooms” with coffee.[[9]](#footnote-9)

More locally in Ontario, a variety of small-batch craft coffee companies’ products were often sold side-by-side in store with Cafézia’s products. These products were typically slightly less expensive than Cafézia’s; however, these local competitors often still maintained a sustainable brand image and produced high-quality coffee. Small-batch craft coffee companies did not produce a product that mitigated the negative side effects of coffee, a hallmark of Cafézia. Detour Coffee, Patrick’s Beans, and Fire Roasted Coffee were notable local brands in this segment.

White also considered mass manufactured premium coffees as competition. These coffees were not produced in small batches like Cafézia’s coffee or some of its local craft competitors. These brands were sold at large grocery and supermarket chains nationally and internationally. Many coffees in this category were labelled as organic and Fairtrade, but they did not negate coffee’s negative side effects with added ingredients. These mass manufactured products were sold at lower prices than Cafézia’s. Prominent coffee brands in this category included Kicking Horse, Ethical Bean, and Starbucks.

CONSUMERS

Cafézia primarily sold its coffee to a variety of retailers at wholesale prices. These ranged from smaller retailers such as Angelo’s Italian Market and Grocery Checkout to various locations of larger grocery chains such as Valu-Mart and Sobeys. However, the end customer also needed to be considered.

Information on end customers had been difficult for White to obtain, but the implementation of an online sales platform during the COVID-19 pandemic had improved Cafézia’s data on who was purchasing the company’s products. Specifically, White found that 77 per cent of Cafézia’s online customers were female and 23 per cent were male. While the online sales platform did not collect data on the age of customers, White recognized many of the names on Cafézia’s list of online customers because they were family members, friends, and other connections whom she knew were generally young or middle-aged working professionals or families.

FINANCIAL AND OPERATIONAL BACKGROUND

Cafézia began operations in 2019 with a $10,000 shareholder loan providing most of the necessary financing. While the company incurred losses in both of its first two years of operations, White managed to achieve year-over-year sales growth of over 100 per cent despite the ongoing global health pandemic (see Exhibits 1−5).

In the fall of 2020, White purchased the business outright from her co-owners.[[10]](#footnote-10) At that time, she also made a $10,000 equity infusion into Cafézia to finance the company’s continued growth and operations. White was now Cafézia’s sole shareholder and employee. She performed all aspects of the company’s operations herself, including sales, marketing, operations, and administration.

The coffee itself was produced locally at Forest City Roastery (FCR) on an outsourced basis. Currently, FCR also packaged the coffee for Cafézia. Alongside revamping all Cafézia’s branding, White had recently replaced the old plastic packaging with a new, modern design on a paper bag with a plastic liner that was specifically designed for coffee. She wondered if now was also the time to reduce Cafézia’s reliance on FCR, who also sold its own brand of small-batch craft coffee that competed with Cafézia on store shelves across Southwestern Ontario.

Packaging Equipment Purchase

White had recently been offered high-quality, used packaging equipment at a reduced price from a close contact in the industry. Purchasing the equipment would allow White to reduce Cafézia’s reliance on FCR, in addition to giving her more control over operations and production timing. The equipment consisted of a mixing drum, which would mix Cafézia’s side-effect-reducing herb combination with the premium coffee; a bagging machine; and a sealer, to ensure the coffee would remain fresh in each bag (see Exhibit 6).[[11]](#footnote-11) With the purchase arrangement already in place, Cafézia would acquire the new equipment immediately if NLCU were to grant the $12,000 four-year loan.

As the pandemic created significant uncertainty about the level of growth Cafézia would achieve in fiscal 2021, Gunther wanted to project the company’s financial performance for the next year under two scenarios. In the lower, more conservative projection, White had estimated that sales would grow by 30 per cent. In the more optimistic scenario, she estimated that sales would grow by 80 per cent. White predicted that the wholesale versus online sales breakdown in the coming year would remain the same as what Cafézia had experienced in fiscal 2020.

White also projected that Cafézia’s cost of goods sold would remain at the same overall percentage of sales as in fiscal 2020. Additionally, she believed it was reasonable to assume that the average time Cafézia held its inventory would remain the same as in the previous year. However, White believed that she would be able to achieve a reduction in the business’s age of accounts receivable back to fiscal 2019 levels. She also planned to continue the declining trend with the time it took Cafézia to pay its suppliers and further reduce this to 32 days.

White anticipated that fiscal 2021[[12]](#footnote-12) would bring increases to a variety of Cafézia’s expenses due to growing sales and the costs of bringing the coffee packaging in-house. Cafézia’s insurance broker informed White that doing the packaging in-house would result in an increase of $400 per year in insurance costs. To somewhat reduce the load on her own time, White planned to hire a part-time packaging assistant to help with this new task. The new assistant would be paid an hourly wage of $16 per hour.[[13]](#footnote-13) Professional service expenses were budgeted at $1,000 for fiscal 2021. All other expenses were expected to remain at either the same dollar amount or the same proportion of sales.

DECISION

When the COVID-19 pandemic began, Gunther and her colleagues at NLCU were forced to work from home. Now sitting at her kitchen table, Gunther leafed through the various papers related to Cafézia’s loan application. She was not sure whether other financial institutions had reviewed Cafézia’s financing request, but in her virtual Zoom meetings with White, Gunther had been impressed by White’s entrepreneurial drive and business acumen.

Gunther’s meeting with her manager, when she would have to provide her recommendation about Cafézia’s loan application, was scheduled for first thing the next morning. She had to consider both the $12,000 long-term loan request and the $7,500 working capital loan application. While there were two separate decisions to be made, Gunther knew that one could also potentially necessitate the other. Gunther knew she would need to provide a well-reasoned case to her demanding manager, whether she chose to grant the loan(s) or not.

EXHIBIT 1: CAFÉZIA COFFEE INCOME STATEMENTS AND FINANCIAL RATIOS (UNAUDITED)

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **for the years ending December 31** | **2020** | | | **2019** | | | |
| **CA$** | **%** | | **CA$** | **%** | | |
| **Revenue** |  | |  |  | |  |
| Wholesale Sales | 29,860 | | 70.8 | 19,930 | | 100.0 |
| Online Sales | 12,467 | | 29.2 | - | | 0.0 |
| **Total Revenue** | **42,327** | | 100.0 | **19,930** | | 100.0 |
|  |  | |  |  | |  |
| **Cost of Goods Sold** |  | |  |  | |  |
| Wholesale Sales | 10,332 | | 24.4 | 7,105 | | 35.6 |
| Online Sales | 2,867 | | 6.8 | - | | 0.0 |
| **Total Cost of Goods Sold** | 13,199 | | 31.2 | 7,105 | | 35.6 |
|  |  | |  |  | |  |
| **Gross Profit** | **29,128** | | 68.8 | **12,825** | | 64.4 |
|  |  | |  |  | |  |
| **Expenses** |  | |  |  | |  |
| Advertising | 3,809 | | 9.0 | 2,218 | | 11.1 |
| Bank Charges | 64 | | 0.2 | 44 | | 0.2 |
| Depreciation | 250 | | 0.6 | 250 | | 1.3 |
| Insurance | 996 | | 2.4 | 166 | | 0.8 |
| Miscellaneous | 1,296 | | 3.1 | 1,495 | | 7.5 |
| Office Expenses | 648 | | 1.5 | 459 | | 2.3 |
| Professional Services | 698 | | 1.6 | 153 | | 0.8 |
| Salaries | 30,000 | | 70.9 | 15,000 | | 75.3 |
| **Total Expenses** | **37,761** | | 89.2 | **19,785** | | 99.3 |
|  |  | |  |  | |  |
| **Net Income** | **(8,633)** | | −20.4 | **(6,960)** | | −34.9 |

Source: Company files. (Financial information has been adapted for case purposes).

EXHIBIT 2: CAFÉZIA COFFEE STATEMENT OF RETAINED EARNINGS (UNAUDITED)

|  |  |  |
| --- | --- | --- |
| **for the years ending December 31 (in CA$)** | **2020** | **2019** |
| Beginning Retained Earnings | (6,960) | 0 |
| Add: Net Income | (8.633) | (6,960) |
| Less: Dividends | 0 | 0 |
| **Ending Retained Earnings** | **(15,593)** | **(6,960)** |

Source: Company files. (Financial information has been adapted for case purposes).

EXHIBIT 3: CAFÉZIA COFFEE BALANCE SHEETS (UNAUDITED)

|  |  |  |
| --- | --- | --- |
| **as at the years ending December 31 (in CA$)** | **2020** | **2019** |
| **ASSETS** |  |  |
| Current Assets |  |  |
| Cash | 1,160 | 574 |
| Accounts Receivable | 1,398 | 551 |
| Inventory | 1,152 | 940 |
| Prepaid Expenses | 83 | 83 |
| **Total Current Assets** | **3,793** | **2,148** |
|  |  |  |
| Fixed Assets |  |  |
| Computer Equipment | 2,000 | 2,000 |
| Less: Accumulated Depreciation | (500) | (250) |
| **Total Fixed Assets (Net)** | **1,500** | **1,750** |
|  |  |  |
| **TOTAL ASSETS** | **5,293** | **3,898** |
|  |  |  |
| **LIABILITIES** |  |  |
| Current Liabilities |  |  |
| Accounts Payable | 1,286 | 758 |
| Current Portion⎯Shareholder Loan\* | 500 | 500 |
| **Total Current Liabilities** | **1,786** | **1,258** |
|  |  |  |
| Long-Term⎯Shareholder Loan | 9,000 | 9,500 |
|  |  |  |
| **TOTAL LIABILITIES** | **10,786** | **10,758** |
|  |  |  |
| **EQUITY** |  |  |
| Common Stock | 10,100 | 100 |
| Retained Earnings | (15,593) | (6,960) |
|  |  |  |
| **TOTAL EQUITY** | **(5,493)** | **(6,860)** |
|  |  |  |
| **TOTAL LIABILITIES & EQUITY** | **5,293** | **3,898** |

Note: \*The shareholder loan was to be paid back in equal annual instalments over a 20-year period. It was not interest-bearing.

Source: Company files. (Financial information has been adapted for case purposes).

EXHIBIT 4: CAFÉZIA COFFEE SELECTED FINANCIAL RATIOS

|  |  |  |
| --- | --- | --- |
|  | **2020** | **2019** |
| **Profitability** |  |  |
| Return on Equity | N/A | N/A |
|  |  |  |
| **Liquidity** |  |  |
| Current Ratio | 2.12 : 1 | 1.71 : 1 |
| Acid Test | 1.43 : 1 | 0.89 : 1 |
|  |  |  |
| **Efficiency** |  |  |
| Days of Accounts Receivable | 12 days | 10 days |
| Days of Inventory | 32 days | 48 days |
| Days of Accounts Payable | 36 days | 39 days |
|  |  |  |
| **Stability** |  |  |
| Net Worth to Total Assets | −104% | −176% |
| Interest Coverage | N/A | N/A |
|  |  |  |
| **Growth** |  |  |
| Sales | 112.4% |  |
| Net Income | −24.0% |  |
| Total Assets | 19.9% |  |
| Equity | 35.8% |  |

Note: N/A = not applicable.

Source: Company files. (Financial information has been adapted for case purposes).

EXHIBIT 5: CAFÉZIA COFFEE STATEMENT OF CASH FLOW (UNAUDITED)

|  |  |  |
| --- | --- | --- |
| **for the years ending December 31 (in CA$)** | **2020** | **2019** |
| **OPERATING ACTIVITIES** |  |  |
| Net Income | (8,633) | (6,960) |
|  |  |  |
| Adjustments to Cash Basis: |  |  |
| Depreciation | 250 | 250 |
| Accounts Receivable | (847) | (511) |
| Inventory | (212) | (940) |
| Prepaid Expenses | - | (83) |
| Accounts Payable | 528 | 758 |
|  |  |  |
| **Net Cash Flow from Operations** | **8,914** | **(7,526)** |
|  |  |  |
| **FINANCING ACTIVITIES** |  |  |
| Shareholder Loan | (500) | 10,000 |
| Common Stock | 10,000 | 100 |
|  |  |  |
| **Net Cash Flow from Financing** | **9,500** | **10,100** |
|  |  |  |
| **INVESTING ACTIVITIES** |  |  |
| Fixed Assets: Computer | - | (2,000) |
|  |  |  |
| **Net Cash Flow from Investing** | **-** | **(2,000)** |
|  |  |  |
| Net Cash Flow | 586 | 574 |
| Beginning Cash | 574 | - |
| Ending Cash | 1,160 | 574 |

Source: Company files. (Financial information has been adapted for the case).

EXHIBIT 6: USED EQUIPMENT PRICES

|  |  |
| --- | --- |
| **Equipment** | **Estimated Price (CA$)** |
| Mixing Drum | 5,000 |
| Bagging Machine | 5,500 |
| Sealer | 1,500 |

Source: Company files. (Based on the owner’s personal estimates).

1. All currency amounts are in Canadian dollars unless otherwise stated. [↑](#footnote-ref-1)
2. Interest on the loan would be charged at a rate of 10 per cent per year on the loan’s outstanding balance. [↑](#footnote-ref-2)
3. The information in this section is drawn from Julie Gosse and Martin Eidenberg, *Cafézia Coffee: Brewing Entrepreneurial Success* (London, ON: Ivey Publishing, 2021). Available from Ivey Publishing, product no. 9B21M071. [↑](#footnote-ref-3)
4. “Community Profile,” City of London, October 10, 2018, https://www.london.ca/About-London/community-statistics/city-profiles/Pages/City-Profile.aspx. [↑](#footnote-ref-4)
5. IBISWorld, *Coffee & Tea Production in Canada: Market Research Report*, accessed July 15, 2020, https://www.ibisworld.com/canada/market-research-reports/coffee-tea-production-industry. [↑](#footnote-ref-5)
6. Jamie Ducharme, “World Health Organization Declares COVID-19 a ‘Pandemic.’ Here’s What That Means,” *Time*, March 11, 2020, https://time.com/5791661/who-coronavirus-pandemic-declaration. [↑](#footnote-ref-6)
7. Worldometer, “COVID-19 Coronavirus Pandemic,” December 30, 2020, https://www.worldometers.info/coronavirus. [↑](#footnote-ref-7)
8. Ryan Rocca and Nick Westoll, “Coronavirus: All Non-essential Workplaces Ordered to Close in Ontario,” Global News, March 23, 2020, https://globalnews.ca/news/6717022/ontario-doug-ford-coronavirus-covid-19-march-23. [↑](#footnote-ref-8)
9. Four Sigmatic, accessed July 20, 2020, https://us.foursigmatic.com. [↑](#footnote-ref-9)
10. This transaction had no impact on the terms of the existing shareholder loan. [↑](#footnote-ref-10)
11. White estimated that all equipment would have a useful life of five years. [↑](#footnote-ref-11)
12. Due to a variety of government initiatives targeted toward small businesses and start-ups, White estimated Cafézia would incur a corporate income tax rate of 8 per cent in fiscal 2021. [↑](#footnote-ref-12)
13. White estimated that the packaging assistant would need to work 15 hours per month. [↑](#footnote-ref-13)