

KREATIVE KASUALS INC.

Kevin Dean wrote 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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In July 2010, Gary Masters started his monthly review of government tenders to determine whether there were any that he would like to bid on. Masters was the owner and president of Kreative Kasuals Inc., a textiles manufacturer based in Scarborough, Ontario. The company primarily supplied the Ministry of Community Safety and Correctional Services (the Ministry) with coveralls, shirts and boxers, as well as fabric used for internal production. There were two tenders that were of interest to Masters. One involved supplying washable trousers to the Royal Canadian Mounted Police (RCMP), and the other was a tender for uniform dress shirts and cargo pants for the Ministry.

KREATIVE KASUALS INC.

Kreative Kasuals Inc. (Kreative) was established in 1995, when Masters was in his early 40s. Kreative began its operations by offering contract sewing for running-shoe companies, retail stores and children's wear manufacturers as a result of a business contact that offered an immediate and profitable opportunity. Kreative operated out of a 2,000-square-foot facility, with only a handful of mainly part-time employees. Initial jobs were small and were mainly one-off contracts, resulting in highly irregular work schedules and unstable revenues. Kreative's first contract with the Ministry involved the supply of fabric for internal production, which meant Kreative acted essentially as a distributor of fabrics. This relationship eventually led to other contracts for providing finished garments, which allowed for increased margins. Contracts were typically issued from the Ministry to Kreative on an annual basis. To remain competitive and to ensure it continued with successful bids, Kreative performed all functions in-house, using strictly domestic labour.

Using local labour had been a practice in which Masters believed very strongly: "Using domestic labour not only keeps the jobs in Canada, but it is also the only thing that keeps our head above water. Our quality, service and turnaround time is what is keeping our product in demand over offshore imports." Offshore textiles manufacturers would typically offer a 90-day turnaround time to fulfil an order, whereas, Kreative could drastically lower that turnaround time by increasing its labour force and subcontracting

sewing to increase its production capacity in periods of high demand. Kreative also purchased its own yarn to knit jersey fabric¹ and did its own cutting and sewing. Only the dying operation was outsourced to Ontario's sole remaining dye house. With the increased volume and higher predictable revenues that resulted from the larger and higher number of contracts, Kreative had to move into a facility three times larger and make sizable investments in both equipment and labour. Kreative's main source of work continued to come from the Ministry, with excess capacity being utilized by short-term sewing contracts. An example of a short-term contract involved a fast-growing Canadian golf-apparel company that was looking for a flexible, domestic, high-quality sewer to meet the increased demand for its newest product line. Masters was happy with Kreative's recent financial performance (see Exhibit 1), but he was always looking for new opportunities in case Kreative lost any of its current contracts.

GOVERNMENT TENDERS

Government tenders represented business opportunities that were open to the public. These tenders typically had a time frame of one to three months (after being published), during which interested parties could submit a bid to win the tender and provide the required product or service. The tenders ranged from providing a stated volume of product by a predetermined date to multi-year contracts for open-ended volumes. Typically, the bids were sealed; the organization that submitted the bid was known, but the bid price was not. The successful bid was not always the lowest price, since other factors were taken into account, such as the ability to meet delivery times, quality, reputation, and meeting ethical business practice standards. The most widely used source for government tenders was MERX, an online electronic tendering service. MERX was the official posting site for the Government of Canada, and it specialized in the posting of tenders from the broader provincial and MASH (municipal, academic, social services and hospitals) sectors, as well as crown corporations and the private sector.² MERX posted over 60,000 public and private sector opportunities each year from across Canada. Once logged on to the MERX website, users could narrow their search to specific product categories of interest in order to find opportunities that matched their business capabilities.

THE TEXTILE MANUFACTURING INDUSTRY

In 2008, the Canadian textile manufacturing industry employed approximately 24,300 people, down from 44,700 in 2004, for a compounded annual growth decline of 9.9 per cent.³ Canadian textile exports dropped 17.7 per cent in 2008, mainly due to a decrease in exports to the United States (see Exhibit 2).⁴ The U.S. economic recession that followed this period served to further decrease exports levels to the United States. Along with the weak economic situation in North America, intensifying competition from offshore companies – located primarily in China, India and Pakistan – substantially contributed to the poor performance and decline in the industry.

When economic times were difficult, competition for government tenders increased because government contracts had essentially zero payment-default risk. Businesses willingly slashed their bid prices in order to fill idle production capacity due to the lack of private sector business. In Masters' own words, "You

¹ Jersey is a plain-knit, machine-made fabric of wool, silk, nylon, rayon, etc., characteristically soft and elastic, used for garments.

² <http://marketing.merx.com/support/MERXOverview.pdf>, November 18, 2010.

³ Statistics Canada, www.ic.gc.ca/eic/site/textiles-textiles.nsf/eng/tx03224.html, November 18, 2010.

⁴ Ibid.

can't sell anything to customers you don't have." This type of price slashing was viewed as necessary in order to compete against lower-cost imports coming from the offshore textiles industry.

On any given textiles tender, there were at least 30 companies bidding, ranging from multinational corporations to small importers and textile mills. Depending on the number, size and location of the bidding companies, Masters would assess whether he needed to "sharpen his pencil" on Kreative's bid. If there were domestic companies bidding, Masters looked at their relative size, gauged their overhead costs, and then estimated the profit margin Kreative needed. He then bid strategically, based on these calculations.

OPERATIONS

The manufacturing process for garments was a straightforward process that involved five steps: (1) knitting, (2) dying, (3) cutting, (4) sewing and (5) quality control/packaging. T-shirts were the only garments that involved all five steps. The fabric for boxers and coveralls was bought pre-dyed, and therefore entered the manufacturing process at the cutting stage. Kreative purchased yarn to knit its own jersey fabric for use in the manufacture of T-shirts, then sent the knitted jersey fabric to the dye house, and when it was returned, entered the cutting stage. The packagers were responsible for quality control and thread clipping of the finished garments before they were packaged and shipped.

Kreative operated out of a 6,000 square-foot plant in Scarborough, Ontario, which was split 80:20 into production and office space, respectively. In terms of total units produced, Kreative manufactured 20 per cent coveralls, 50 per cent boxers and 30 per cent T-shirts for its current contracts. Currently, Kreative was producing 10,000 units a month, but the company had the ability to produce 100,000 units a month by increasing its labour force and using subcontractors.

Kreative used its knitting machines for internal production only; therefore, when knitted jersey fabric was not needed, the machines remained idle. One knitter and one cutter could produce 4,000 metres and 4,500 metres of fabric per eight-hour shift, respectively.

For the manufacture of T-shirts, at a cost of \$3.75 per kilogram, yarn was used to knit the jersey fabric at a ratio of 3.85 metres per kilogram. The jersey fabric was then sent to the dye house at a cost of \$1.15 per metre. Each T-shirt used a total of 1.1 metres⁵ of jersey, and one sewer could sew 140 T-shirts in an eight-hour day. After the T-shirts were sewn, packagers reviewed each garment for quality and clipped any loose threads before final packaging into plastic sleeves of ten shirts each and cardboard boxes of six sleeves each. Packagers worked at roughly the same pace as sewers.

Fabric used in the manufacture of boxers and coveralls cost \$0.95 and \$2.70 per metre, respectively, with boxers using 1.12 metres of fabric and coveralls using 3.00 metres. Boxers required elastic at a cost of \$0.09 per garment, and coveralls used \$0.25 worth of Velcro. Sewers were able to complete 96 boxers and 21 coveralls per eight-hour shift.

Unlike its competitors, Kreative paid its employees on an hourly basis as opposed to a piecework basis, because Masters believed that doing so helped to ensure a quality product. Sewers working on a piecework basis might be inclined to reduce the number of stitches per inch⁶ to produce a higher volume of

⁵ Includes wastage.

⁶ "Stitches per inch" refers to the number of times the sewing needle pierces the garment within one inch. The lower the number of stitches, the faster the machine can run. Higher quality product would have upwards of 12 stitches per inch; whereas, low quality may have fewer than six.

garments, which resulted in a reduced level of quality. Sewers, cutters and packagers all earned a wage rate of \$15 per hour, while knitters earned \$20 per hour, since knitting was a more specialized skill. Total sewing labour hours for the typical month were 1,320. Monthly rent for the factory was \$4,700, and heat and utilities totalled \$1,300 a month. All production machinery had been completely amortized, but Masters spent \$2,000 annually in maintenance and repairs. Administrative overhead included telephone and Internet costs of \$150 a month, as well as Masters' salary of \$60,000 per year. Masters believed the number of labour hours required for each garment was the best cost driver of the company's manufacturing costs.

BID ALTERNATIVES

Washable Trousers

Public Works and Government Services Canada had issued a tender for a firm quantity of 28,450 (see Exhibit 3) pairs of washable trousers for the RCMP, with a small number of optional additional pairs in follow-on orders, intended for the RCMP. This order represented a one-time, firm-quantity tender requiring the initial 28,450 pairs be delivered by December 31, 2010. The fabric had to be purchased from the RCMP and would cost \$3.10 per metre. Zippers, buttons and Velcro would cost \$0.45 per pair. Each trouser would use 1.5 metres of fabric, and sewers could complete 35 pairs per eight-hour shift. The trousers would be packaged exactly the same as were Kreative's current products. From the number of companies that had already submitted bids, Masters noticed there was significant interest in this tender. Companies were likely hoping this business could help fill their idle capacity as a result of weak sales in the first half of 2010. If Masters wanted this work, he would have to be competitive, but he would also have to be careful to ensure Kreative was compensated fairly.

Uniform Dress Shirts, Cargo Pants and Shorts

The tender by the Ministry was unique because it was an open tender⁷ to supply any police service in Ontario with uniform dress shirts, cargo pants and shorts at its behest. There were five main product categories on which companies could bid (see Exhibit 4), and since the contracts would be awarded individually, Masters could bid on any or all of the five. Masters was primarily interested in the cargo pants and shorts because he had more expertise with the materials required for the polyester/rayon-based and the polyester/cotton-based garments. The tender was for a period of two years, with an optional two-year extension, but there was no guarantee on the volume purchased. In spite of this lack of a volume guarantee, Masters knew from working with the Ministry that a typical monthly request would likely run between 2,000 units to 3,000 units. For simple comparative purposes, Masters decided to calculate the cost of the polyester/rayon-based cargo pant only, since the polyester/cotton-based cargo short would simply cost Kreative approximately 20 per cent less (due to less fabric used resulting in a lower price equal to 80 per cent of the price per pant). The polyester/rayon-based fabric would cost \$2.90 per metre, with each pant pair using 1.7 metres of fabric. Each pant pair would use \$0.45 worth of zipper, button and Velcro, and each sewer could complete 35 pairs of pants in a shift. If Masters were to pursue this tender, he estimated that his incremental time investment would warrant an additional \$20,000 in salary. As well, production-related utilities expenses would increase by approximately 30 per cent.

⁷ A public tender with no contractual volume guarantee.

CONCLUSION

Masters wondered whether he should submit a bid on these tenders, and if so, at what price. He was thoroughly enjoying the summer, spending time with his children, but then again, the past year and half had taken a financial toll on the industry. With the bids closing within the week, Masters needed to crunch the numbers and quickly make his decision.

Exhibit 1

STATEMENT OF EARNINGS
for the year ending December 31

	2009	2008
Sales	\$ 1,350,000	\$ 1,285,000
Less: Cost of goods sold	<u>945,000</u>	<u>925,200</u>
Gross profit	\$ 405,000	\$ 359,800
Operating expenses:		
Rent	\$ 11,280	\$ 11,280
Utilities	3,120	3,120
Phone	1,800	1,720
Salary	60,000	60,000
Miscellaneous	<u>18,600</u>	<u>14,200</u>
Total Operating expenses	<u>94,800</u>	<u>90,320</u>
Net income before tax	<u>\$ 310,200</u>	<u>\$ 269,480</u>

Source: Company Files.

Exhibit 2

TEXTILES — MAJOR ECONOMIC INDICATORS
(in millions of Canadian dollars)

Economic Indicators	2004	2005	2006	2007	2008	% 08-07	CAAGR
Apparent domestic market	9,906.3	9,556.6	8,536.9	8,243.6	7,821.6	(5.1%)	(5.7%)
Shipments	7,129.3	6,647.2	5,585.9	5,236.8	4,621.6	(11.7%)	(10.3%)
Gross domestic product	2,731.2	2,463.8	2,156.1	2,064.2	1,814.2	(12.1%)	(9.7%)
Manufacturing intensity ratio	38.3%	37.1%	38.6%	39.4%	39.3%	(0.4%)	0.6%
Total imports	5,731.6	5,633.3	5,367.5	5,192.8	4,999.0	(3.7%)	(3.4%)
Domestic exports	2,954.6	2,724.0	2,416.4	2,185.9	1,799.1	(17.7%)	(11.7%)
Trade balance	(2,777.0)	(2,909.4)	(2,951.1)	(3,006.9)	(3,199.9)	6.4%	3.6%
Import penetration	57.9%	58.9%	62.9%	63.0%	63.9%	1.5%	2.5%
Export orientation	41.4%	41.0%	43.3%	41.7%	38.9%	(6.7%)	(1.6%)
Domestic market share	42.1%	41.1%	37.1%	37.0%	36.1%	(2.5%)	(3.8%)
Labour productivity	61.1	65.6	67.2	63.2	74.7	18.2%	5.1%
Employment (thousands)	44.7	37.5	32.1	32.7	24.3	(25.6%)	(9.9%)

Source: Statistics Canada, <http://www.ic.gc.ca/eic/site/textiles-textiles.nsf/eng/tx03224.html>, November 18, 2010.

Exhibit 3

WASHABLE TROUSERS

Details

Category	Textiles and Apparel
GSINS	N8405: OUTERWEAR, MEN'S
Region of Delivery	Ontario
Region of Opportunity	
Agreement Type	Agreement on Internal Trade (AIT)
Tender Type	Notice of Proposed Procurement (NPP)
Estimated Value	
Solicitation Method	

Notice Description

TROUSERS WASHABLE MALE/FEMALE

Trade Agreement: Agreement on Internal Trade (AIT)

Tendering Procedures: The bidder must supply Canadian goods and/or services

Attachment: YES (MERX) Electronic

Competitive Procurement Strategy: Lowest/Lower Bid

Comprehensive Land Claim Agreement: No

Nature of Requirements: Trousers, washable, male and female. To be manufactured in accordance with Specification G.S. 1045-293 dated 2010-05-19 and sealed sample.

To be delivered to the Royal Canadian Mounted Police (RCMP) in Ottawa, Ontario.

Firm quantity: 28,450 pairs (22,700 male and 5,750 female)

Government available material must be used and purchased from the RCMP.

Delivery: firm quantity is to be delivered by December 31, 2010.

In addition, there is also a requirement for a minimum option of 4,688 pairs and up to a maximum option quantity of 9,375 pairs which may be exercised within 24 months from contract award date.

Also a quantity of 5,425 pairs (combination of male/female & regular/special sizes) may be ordered on an as-and-when requested basis within 24 months from the contract award date.

Sealed sample, which is provided for guidance, may be viewed at the following DPWGS District Offices:

Quebec, PQ
 Montreal, PQ
 Mississauga, On
 Winnipeg, Man
 Edmonton, Alta
 Vancouver, BC

Delivery Date: Above mentioned

The Crown retains the right to negotiate with supplies on any procurement.

Documents may be submitted in either official language of Canada.

Exhibit 4**UNIFORM DRESS SHIRTS, CARGO PANTS AND SHORTS****Invitation to Proponents**

This Request for Proposals ("RFP") is an invitation to prospective proponents to submit proposals for the provision of Uniform Dress Shirts, Cargo Pants and Shorts, as further described in Part 2 – The Deliverables (the "Deliverables") to the Ministry of Community Safety and Correctional Services (MCSCS) and the Ministry of Children and Youth Services (MCYS). This RFP is issued by Her Majesty the Queen in right of Ontario as represented by the Minister of Community and Correctional Services (the "Ministry").

It is estimated that the terms of the Agreement(s) arising from this procurement process will be accessible by any Police Service within the Province of Ontario and First Nations Police Services ("Province of Ontario Police Service").

Type of Contract for Deliverables

From this RFP process, the Ministry intends to select a Proponent(s) for the purpose of establishing Agreement(s) for the supply and delivery of Uniform Dress Shirts, Cargo Pants and Shorts to the Ministry, MCYS and to the Province of Ontario Police Service, at various locations throughout the Province of Ontario on an as-and-when required basis.

The Selected Proponent(s) will be required to enter into an agreement with (i) the Ministry of Community Safety and Correctional Services, and (ii) the Ministry of Children and Youth Services for the provision of the Deliverables in the form attached as Appendix A to this RFP. It is the Ministry's intention to enter into the Form of Agreement attached as Appendix A to this RFP. Any rights or obligations of the Ministry of Community Safety and Correctional Services that are set out in the RFP are, in the case of the Agreement(s) with the Ministry of Community Safety and Correctional Services, also rights or obligations of the Ministry of Children and Youth Services.

The term of the Agreement(s) is to be for a period of two (2) years with an option in favour of the Ministry to extend the Agreement(s) on the same terms and conditions for two (2) additional terms of up to one (1) year each. It is anticipated that the agreement will be executed on or around August 2010.

A Proponent who submits conditions, options, variations or contingent statements to the terms set out in the Form of Agreement, either as part of its proposal or after receiving notice of selection, may be disqualified.

No Guarantee of Volume of Work or Exclusivity of Contract

The Ministry makes no guarantee of the value or volume of work to be assigned to the successful proponent. The Agreement executed with the successful proponent will not be an exclusive contract for the provision of the described Deliverables. The Ministry may contract with others for the same or similar Deliverables to those described in this RFP or may obtain the same of similar Deliverables internally.

Contractor Security Screening

The Ministry reserves the right to conduct a security check and security clearance investigation (hereafter referred to as "Security Investigation") on each partner, director, officer, and shareholder and additionally on any employee, agent or sub-contractor engaged in performance of the services.

Background

Through this RFP the Ministry is seeking a Supplier(s) to supply and deliver Uniform Dress Shirts, Cargo Pants and Shorts as specified in the five (5) categories (the "Categories") listed below:

1. Uniform Dress Shirt – Polyester/Wool; Polyester Rayon
2. Uniform Dress Shirt – Polyester Moisture Wicking
3. Uniform Dress Shirt – Polyester/Cotton; 100% Cotton
4. Cargo Pants – Polyester/Wool/Lycra; Polyester/Rayon
5. Cargo Pants – Polyester/Cotton; 100% Cotton

Proponents may submit a proposal for one, more than one, or all of the five (5) Categories. Proponents must bid on all items within a Category to be considered for an award. Proponents that submit proposals that do not include pricing on all items within a Category shall be disqualified at the sole discretion of the Ministry. Each Category will be evaluated and awarded individually.