
THE STITCH HOUSE: A CASE OF ENTREPRENEURIAL FAILURE

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CASE DESCRIPTION

This case concerns why entrepreneurs fail. Issues related to the case include how entrepreneurs make decisions, the marketing, financial, and accounting issues that should be considered when starting a new business. A secondary issue illustrated by the case is the risks involved in mixing business and personal finances in a start-up business. This case has a difficulty level of three. However, it may be used, with time allowed to develop alternate scenarios of the business owner's choices, in both senior and first-year graduate courses. The case is designed to be taught in one 75 – 90 minute class session and is expected to require one to two hours of outside preparation. Alternatively, an instructor may elect to use this case to challenge advanced students to create a business plan that would have a greater likelihood of success. For such use, the case may require up to 5-6 hours of outside preparation. Additionally, a shortened version of this case has been used effectively as an examination case in a senior-level Entrepreneurship course.

CASE SYNOPSIS

Why did The Stitch House fail so quickly? Louise had business experience, adequate start-up capital, and people with experience in marketing her product. But, in less than six months time what seemed like a certain success consumed her capital, was abandoned by her erstwhile partners, and left her with substantial personal debt. This case gives students the opportunity to learn from one of the majority of new small business startups – those which fail in less than two years. Based on an actual entrepreneurial situation, the case illustrates the impact that each decision an entrepreneur makes may have on the ultimate survival of the business and how easily a new business can fail. It presents students with the opportunity to analyze the basic decisions that an entrepreneur must make in creating a new business. Alternatively, advanced students may be challenged to re-construct the business concept and create a business plan for The Stitch House.

INSTRUCTORS' NOTES

Recommendations for Teaching Approaches

The authors recommend two possible approaches to using this case in a course. The first focuses on analyzing the decisions that the entrepreneur made during the process of forming and starting up the business. The second approach focuses on analyzing the market and formulating a business plan using the information provided.

A Decision-making Approach to the Case

For use in a single 75 – 90 minute class session, use of the case may focus on exploring and analyzing the decisions that may have contributed to the ultimate failure of the business. We suggest the following structure for management of the discussion:

- 10-15 minutes – free-form student discussion of what went right and what went wrong in the business;
- 15 minutes – list each decision that Louise made;
- 30-45 minutes – go through the list of decisions Louise made and critically evaluate each one; analyze her presumed motive for deciding as she did and the effect this decision had on the conduct of the business;
- 15 minutes – wrap-up.

If this approach is followed, students should be expected to list the following specific decisions the entrepreneur made in the course of establishing and operating her business:

1. She decided to start a new business, in a field in which she had no experience, based on personal contacts and weak information. She also did not do adequate research on the business background of her partners.
2. The initial market (thread bobbin supplies) targeted was changed with little examination of the risks inherent in the new market (embroidered goods).
3. The business was established as a sole proprietorship, thereby making Louise personally liable for any debts of the business.

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4. She made two other people “partners” using a self-written contract. However, although they were partners, Louise seemed to most of the work and kept total control of the decision-making process when setting up the business. While one might wonder what the partners were doing, it appears that they were standing by – waiting for Louise to give them direction.
 5. Production equipment was selected without considering how its capacity might limit sales volume and, it appears, without consulting either partner, both of whom had experience in the industry.
 6. Funds were spent on advertising and setting up a website, although Robert seemed to base his expectations for success on personal selling.
 7. She spent funds to “do things the right way” without considering the impact on the cost structure of the business.

DISCUSSION AND ANALYSIS

Students should be encouraged to discuss and critically analyze each of the above decisions and its effect on the business. Three specific questions can then be used to guide further discussion.

1. Using Michael Porter’s model of the five forces that shape an industry, describe the structure of the embroidered products industry, specifically the portion of the industry that The Stitch House (TSH) sought to compete in.

TSH faces intense rivalry with 60 local competitors of all sizes currently listed in the San Antonio Yellow Pages directory (2005 edition). There are few suppliers so there is little opportunity to bargain for lower prices on inputs but there are also many small buyers. Inter-firm rivalry enables even small buyers to bargain with competing firms to drive down prices. It also appears that there are very low barriers to entry into the business. At the same time, consumers may elect, in many applications, to substitute lower-cost screen printed apparel for embroidered apparel.

2. Is there one decision that Louise made which, more than the others, contributed to the current failure of the business?

It appears to the authors that the most critical decision Louise made – once she decided to start the business – was in the selection of production equipment. The equipment selection

severely limited production capacity and, therefore, the types of business The Stitch House could pursue and its ability to compete. Some argument can be made to the effect that the lackadaisical manner in which she selected her business partners contributed to the failure of the business.

3. Do you think this business can be salvaged or not?

Making some crude assumptions, we could say that TSH's contribution margin is \$5.00 per blanket (selling price minus \$4.00 raw material + assumed \$1.00 variable labor cost). With fixed expenses of \$1635/month (rent has been eliminated by moving operations to Louise's house), the business needs to sell 327 pieces per month, or 82 pieces per week just to break even. This is within their production capacity, but profits will be likely to be very low. The real question may well be whether or not they can get orders for this much product without Robert. Reduction of expenses such as advertising and general office expenses, and stretching out the Visa payments will further reduce the breakeven quantity. It is, however, optimistic to expect the business to generate much profit given the production constraint.

A MARKET ANALYSIS/BUSINESS PLAN APPROACH

This approach is most appropriate for use with senior or first-year graduate students and may be used in conjunction with the questions in the previous section. Using the approach, instructors will find it most convenient to introduce the case in one class session and assign the analysis or business plan as a written assignment or presentation for a subsequent class session.

First, instruct students to analyze the market the business proposes to serve, based on the planned main product: embroidered baby blankets. Students should develop a definition of the target market and an estimate of the market size. Census data at <http://www.census.gov> for San Antonio (Bexar County, Texas) should be used to estimate the number of babies in the market area. Geodemographic lifestyle data based on PRIZM segmentation profiles, which may be found on the Claritas Corporation website, <http://www.claritas.com>, may also be useful. Instructors should note, however, that the PRIZM data is compiled by zip code; so students should survey a number of zip codes to gain understanding of the San Antonio market. In the analysis, students should be encouraged to be creative in assessing the market and the behavior of buyers. While the financial aspects of the business are important, in this phase of the assignment, students should be encouraged to focus on the potential buyers of the product and potential demand. A good analysis will include: 1) a profile of potential buyers and the buying occasion, 2) an estimate of the potential market demand, 3) a description of how the product may be marketed and the marketing channels used, and 4) a pro-forma breakeven analysis.

Second, students should attempt to develop a business plan for the next twelve months of operations. Using the data given in the case, and the information developed in the market analysis, the business plan should map the operations, marketing, and projected financial of the business. Depending on the organization of the course, instructors may specify different levels of detail in the plan. At a minimum, the plan should describe the production process, state the plans' assumption about production quantities, and project production costs. It should then describe the marketing channels for the product and estimate unit volume and marketing expenses. Finally, the business plan should project the financial results from the planed operations and marketing activities. While the plan itself is important, of equal importance in teaching entrepreneurship is the process of developing the business plan for The Stitch House. The process should be used to illustrate the problems – many unforeseen by Louise – of creating a successful small entrepreneurial business.