

BAILEY'S FUDGE: PRODUCT ENTRY INTO REGIONAL WAL-MART

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Abstract

Bailey's Fudge and Fine Gifts is a small entrepreneurial firm located in Quincy, Illinois and has been in operation since 2003. Ruth and her daughters Melissa and Rebecca, who are the owners of Bailey's, have recently entered into a contract to offer four flavors of fudge in eleven Wal-Mart stores located within a 150 mile region within Central Illinois. Some of the major challenges facing the owners are limited production capacity, the lack of an efficient means to distribute the product on a broader geographic scale, and other personal obligations and challenges of family owned businesses, which are having a limiting effect on their ability to devote more time to the business. As a result, they are considering a number of different strategic options for the business.

Key Words: family firm, Wal-Mart, supplier, distribution channels.

Introduction

Bailey's Fudge and Fine Gifts, Inc. opened on October 25, 2003. Fifty-seven year old Ruth and her two middle aged daughters, Melissa and Rebecca had experienced success with previous entrepreneurial ventures and wanted to diversify and to try something new. The original idea of this small family owned business was to serve as a hobby and creative outlet for owner, Ruth. She wanted to open a specialty store with homemade foods for working families. The family members debated on various homemade options

including carry out dinner dishes and casseroles or soups. But in the end, due to county health department licenses, facility requirements and overall vision of the entrepreneurs, they decided to open a fudge shop. Ruth had always been known among friends and family as an outstanding cook overall, but her specialty was desserts and fudge was one of her areas of expertise. As a compliment to the homemade fudge outlet, the entrepreneurs built a floor space for specialty gift items creating a venue for high quality and exclusive specialty gifts for special occasions. In an effort to divide responsibilities within the family owned business, Ruth would be in charge of producing the fudge, Rebecca would be in charge of ordering specialty items and store design, and Melissa would be in charge of the financial aspects of the new venture. The store was named Bailey's after Ruth's Grandmother, Bertha Bailey who had been an inspiration to Ruth in the kitchen.

While the core business of Bailey's Fudge has remained the same over the years, the owners have attempted to meet the need of various customers by adding various products. The store began with only a fudge counter and a few specialty gift items. Over time, the store has added candles, coffee beans, specialty food items, homemade desserts, freshly roasted nuts and a full service coffee and smoothie bar. During the Christmas season, Bailey's Fudge makes gift baskets for various commercial clients such as banks and real estate companies. The store specializes in home-made goodness.

Over the years, Bailey's Fudge Has been able to build a solid following in Quincy, Illinois, where the store is located. Ruth has consistently provided the community with a large variety of homemade fudge flavors. Most days she has twenty-three different flavors of fudge available in the store with four different sucrose-free flavors for diabetic customers. Customers often visit the store to talk to Ruth and watch her make the fudge. Ruth lives approximately one hour from the store and has a regular routine of traveling to Quincy to make fudge on Monday, Wednesday and Friday mornings. The retail store is located in a high traffic area in a strip mall with busy stores nearby. While the client base has grown significantly each year, it became evident to the owner early on that fudge was a highly seasonal product with a busy season during the fall and into the Christmas and New Year holidays. Valentine's Day has also proven popular for

fudge sales. Due to the seasonal sales, difficulty comes in the summer months when the warm humid Midwest weather seems to deplete the local appetite for sweet tasting fudge. In an effort to supplement fudge sales over summer months, the owner increased specialty gift items but has often struggled with cash flow and large inventory costs.

As a result of unusual circumstances, what started out as a specialty store has morphed into a distributor of fudge to local Wal-Mart stores. The owner of the store is faced with questions and challenges concerning production, cash flow, image, pricing and distribution.

Background

During the spring of 2007, a local Wal-Mart store manager, James Litz, visited Bailey's and sampled some of the fudge. He immediately fell in love with the product and told Ruth that he was interested in carrying the fudge in his store. He encouraged her to contact Wal-Mart headquarters in Arkansas to begin the approval process for carrying fudge in his Wal-Mart store.

As a store manager, Mr. Litz had helped various micro-entrepreneurs gain approval to distribute their products in Wal-Mart over the years. In the past, store managers had been able to approve local distributor's placement of product in individual stores. But now, it took corporate approval from Arkansas. Mr. Litz had envisioned this process taking a "couple months" and was completely surprised when he ultimately learned that the new process for approval took in excess of two years.

Approval Process with the Wal-Mart Corporation

At the time that the process started, potential Wal-Mart suppliers could contact the Arkansas corporate office to receive a packet of materials necessary for the approval process to become a local distributor. The packet was brief and contained only minimal information about becoming a distributor within Wal-Mart. Completion of the "Vendor Agreement" included both broad information about the business and its officers

and detailed requirements such as the insurance guarantee requirements of \$2,000,000 per occurrence for commercial general liability and \$1,000,000 of employers' liability for workers' compensation coverage.

The packet had no information concerning labeling. It was up to the small business owner to contact the FDA to get a labeling requirements brochure and to interpret the information which applied to their individual product. Labeling requirements differed based on the size of the business. For example, caloric and nutritional information was exempt for businesses with sales less than 100,000 units per 12-month period and fewer than 100 employees. Another type of exemptions applied to retailers with annual gross sales of not more than \$500,000. Surprisingly, Wal-Mart did not require verification of the labeling exemptions.

The application for approval to Wal-Mart made it clear to the potential distributor that once the packet was submitted, the distributor could not make any changes to the product, labeling or packaging for six months. After six months, distributors were allowed to send a request for changes.

Bailey's Fudge submitted a request for approval three times before being approved to distribute fudge within the local district of Wal-Mart. Each time the owner sent four pounds of sample fudge to Wal-Mart along with the required paperwork and documentation. The first time the application was denied because of an inadequate Dun and Bradstreet Distributor supplier number. This number is assigned by Dun and Bradstreet based on a formula that is unavailable to the business applying for the number. The owner contacted Dun and Bradstreet to inquire as to why their supplier number was too high for Wal-Mart and were told repeatedly it was because the business had not been open for more than five years. The Dun and Bradstreet representative explained repeatedly that it was very common for a small business to have to wait at least five to ten years before their supplier number would reach the required level for Wal-Mart distribution. However, the Dun and Bradstreet Company offers a service which will help businesses "manage" their supplier number. Upon agreement to pay \$600 for management services, the supplier rank number increased to the required Wal-Mart level. According to one of the supervisors on staff, there had been a "mistake" in the original number given to Bailey's Fudge. Although frustrated by this occurrence, the

entrepreneurs were thankful that their Dun and Bradstreet supplier number had been corrected to the level acceptable by Wal-Mart because without this supplier number, Wal-Mart would not consider the entrepreneur as a possible local distributor.

The next obstacle involved getting Wal-Mart approved bar codes and packaging. Wal-Mart had an agreement with a company named GS1 who provided all bar codes for Wal-Mart products. If a potential supplier wanted to continue in the approval process, they were required to purchase bar codes from the GS1 company and have labels made with barcodes on them. This had to be done prior to Wal-Mart consideration for approval and did not guarantee approval. GS1 required an initial set up fee of \$600 to purchase a maximum of 12 bar codes. Each subsequent year after, businesses renewed their subscription to the GS1 barcodes for \$180. Once the approved barcodes were purchased, the owners had to have the barcodes printed onto labels made for Wal-Mart. Each label cost \$0.26. To get started with this initiative, the owners ordered 500 of each of four different labels (2000 labels total) so that each flavor of fudge being submitted for approval to Wal-Mart would have its own original label containing ingredients and its own unique barcode. In addition to unique label requirements, 2000 specialty boxes were ordered at \$.20 each. The owners also had to purchase equipment to shrink wrap boxes individually to secure the sanitation of the product. The shrink wrap equipment and supplies cost \$311.

The business owner was also surprised by the Biohazard and Hazard Analysis Critical Control Point Analysis Report requirements made by Wal-Mart. Prior to the Wal-Mart approval, chemical, physical and microbiological hazards had been prevented but a policy had not been written by the entrepreneur. Wal-Mart required a detailed plan on file.

A final set back was that the state required a food wholesaler approval. This was not listed as a requirement by Wal-Mart and when the owner of the business contacted Wal-Mart to inquire about the state wholesale approval process, Wal-Mart was unaware that this was required in the state of Illinois. A Wal-Mart representative suggested to the owner of Bailey's that she contact her local health department and that they could help guide her. The local health department put the owner in contact with the State of

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Illinois Health Department. They visited the store site and approved the facility for wholesale distribution after a few minor changes were implemented. For example, since the facility manufactured fudge for both retail and wholesale purchases the state required that these processes be separate and that any fudge manufactured for wholesale distribution be stored separately from fudge manufactured for retail distribution. Bailey's purchased a new cabinet for wholesale storage for \$300.

It was also required that all supplies used in the manufacturing process be easily traced back to the individual one pound boxes of fudge that would be distributed to Wal-Mart using detailed production records. For example, the lot number on a jar of JIF Peanut Butter used to make thirty six pounds of fudge in a batch must be traceable back to each individual one pound box of fudge. The same holds true for all input items including butter, syrups, candies, etc. This tracking system has increased the paper work for Ruth, but she clearly understands the importance due to possible recalls on input items.

The approval process is the first step in becoming a distributor of product to Wal-Mart stores but it does not guarantee sales in any individual Wal-Mart store. Once approved by the Wal-Mart corporate office in Arkansas, the entrepreneur had to go store-to-store within the approved district and sell their product to the store manager. Each store has its own approval process. Some stores allowed department managers to make the decision while others required the store manager's approval. There was also variation in which department each store manager wanted to display the product. For example, some stores considered fudge a food item, some considered it a seasonal item and others considered it a bakery item. Store requirements for the product varied depending on which department individual stores placed the product in. Shelf space and location were determined by each individual Wal-Mart store and had to be continuously monitored and negotiated by the entrepreneur.

Present Strategy

Final approval to distribute fudge as a local distributor to Wal-Mart took over two years. Approval was granted in one district of Wal-Mart which included eleven Wal-Mart stores. This approval was granted three weeks before Christmas of 2009. While the entrepreneur was happy to finally have the approval for fudge distribution, she was concerned about the timing due to the rapidly approaching Christmas holiday. During the three weeks prior to Christmas, Melissa was able to convince four Wal-Mart managers to allow her to place fudge in their stores. Sales at three of the Wal-Mart stores exceeded expectations. These three stores allowed Bailey's to hire samplers to provide free fudge samples to potential customers. When the product was being sampled, the store often sold out of the fudge on hand. Sampling was at the discretion of each store manager and came at the expense of the distributor, not the Wal-Mart. The various expenses associated with sampling included the product itself, employee wages and employee travel time and expenses. While fudge sales exceeded expectations during sampling, there were considerable down turns in sales when customers could not taste the product. Ultimately, Ruth did not feel that she had been given good shelf space. It appeared to her that one needs to spend significant time negotiating to obtain and keep prime shelf space, but the process seemed both ambiguous and unclear.

After the holiday season, Ruth continued to place fudge in the three more popular stores. Sales declined considerably but she felt this was to be expected due to the season. In addition to seasonal fluctuations, the recession of 2009-2010 put pressure on all luxury items including specialty foods. In her own retail shop, sales quadrupled during the holiday season but had dropped significantly following the holiday season of 2009. Sales in the Wal-Mart stores seem to follow this same cycle.

Fudge has an eight week shelf life. Wal-Mart required that the individual distributor stock the shelves and take back any outdated product at their own expense. While Bailey's had been approved for eleven stores only one of the eleven stores was in Quincy. The remaining ten stores were within a two and a half hour drive. Three of the four stores initially selling the fudge were two hours away. Ruth and Melissa found it trying to drive two hours to get information pertaining to how much product had sold and how

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much each store needed to keep their shelves looking fresh and well stocked. At times the owners would arrive at a store and have a difficult time finding the fudge because it had been moved to a different shelf location within the store. Each department manager seemed to have their own individual process for assigning shelf space and would often move products to different shelves or areas of the store without any notification to the supplier.

A major frustration was associated with the delivery process to Wal-Mart stores. Delivery often required suppliers to wait in a line outside the back entrance for check in. Again, each individual store handled this process differently. To date, the longest wait for delivery was four hours to deliver \$50 worth of fudge. This frustration often leaves the owner wondering if distribution to Wal-Mart is worthwhile. As a micro-entrepreneurial business, Melissa has often considered the option of using a food distributor for delivery of the product, but has waited to incorporate this option in hopes that sales would warrant the associated costs, both in time and money.

During the two year approval process with Wal-Mart, Ruth approached a local grocery store (Hy-Vee Foods) and was successful in placing her fudge in the floral department of that store. Sales have been mediocre at the store. The Christmas holiday season and Valentine's Day are busy times, but summer months are very slow. The grocery store is a part of a large grocery retailer in the Midwest and one consideration would be to attempt to increase the number of stores carrying the fudge in this grocery chain across the Midwest. Their order, delivery and approval processes are much easier to work with than Wal-Mart's but distribution would most likely continue to be an issue.

Ruth continues to struggle with capacity issues. The Bailey's manufacturing site has only one fudge kettle which can be used to produce 36 pounds of fudge at a time. Ruth is the only person currently trained to make the fudge and she is reluctant to give up the quality control she maintains. If Bailey's were to supply fudge to the additional eight Wal-Mart stores or to add more Hy-Vee food stores, there is concern whether or not Ruth (or the fudge kettle) could handle the capacity. Without wholesale distribution into Wal-Mart or Hy-Vee, the Bailey's retail location averages sales of 500 pounds of fudge each week during

the three weeks prior to Christmas. Adding additional outlets would require purchase of additional equipment and hiring of at least one more cook. But with the seasonal nature of demand for the product, Ruth questions if it would be worthwhile to purchase the equipment and hire additional help.

In addition to the concerns surrounding production and capacity with wholesale distribution, the family has felt a strain on relationships as a result of this new venture. With the origination of Bailey's Fudge, the responsibilities associated with the specialty shop had been divided equally among the three family members. With the addition of wholesale distribution, Ruth has been handed a much larger amount of responsibility with the manufacturing and packaging of all the fudge. Melissa was involved in the approval process for Wal-Mart and continues to be involved with taking orders and delivery of the fudge but some of this responsibility has also fallen on Ruth due to Melissa's full time employment elsewhere. Rebecca has not been involved in the Wal-Mart aspect of the business largely due to her fulltime employment elsewhere and the fact that she lives one hour from the store. Overall, the wholesale distribution venture has left Ruth with a vast increase in work load.

Industry Structure/Competition

Bailey's Fudge is located in Quincy, Illinois. Quincy is a small Midwestern city with approximately 40,000 people. The city of Quincy serves as a shopping hub for several smaller communities in the area thereby increasing the shopping population to approximately 80,000 individuals. Bailey's Fudge has established a strong reputation for high quality homemade fudge. There are no other fudge manufacturers in the area. There exists one retail competitor, but this store does not carry homemade fudge; rather they ship the fudge in to their store from an outside manufacturer. One option that has been put under consideration by Bailey's owners is to approach this store and inquire about it becoming a supplier of fudge to the competitor so they could have the Bailey's homemade brand in their store.

Marketing

As a micro-enterprise dealing with a seasonal product, Bailey's Fudge has struggled to develop and maintain a marketing budget. Over the years the owner has tried various medium including radio, billboard, newspaper, yellow pages, a social media site, and direct mail. Repeatedly, social media and direct mail have prevailed as the most effective means of reaching past and potential future customers. While the business owners believe word-of-mouth is also a strong marketing tool they have often been surprised by the number of customers who seem to stumble upon the store front and say they had no idea the store was in Quincy. While this is a concern, the owners have been unable to figure out how to broaden the customer base without spending a great deal of money on marketing efforts. As a family owned business, none of the three owners have really taken an active role in the marketing aspect of the business.

Putting coupons in the Quincy's only local newspaper has resulted in little or no response. Placing coupons on the backside of local grocery store receipts has resulted in mediocre response but typically only by long-time customers, not new customers. Due to the high expense associated with each of these marketing options, Ruth has ceased to use them.

Point of purchase opportunities are limited or void at the Wal-Mart locations. Three out of four stores allowed sampling of the fudge during the holiday season and this was very effective in increasing sales. The problem however, was finding quality staff to do the sampling and absorbing the cost associated with handing out free fudge. It seems as though a business owner needed to be present for the samplings, but this put further strain on family relationships as the owners tried to determine who should take time out of their personal lives to do sampling for the business.

Pricing

There seems to be consensus in the general public that Wal-Mart sets the prices for its suppliers. However, during the process of approval and placement in the individual stores, pricing was never negotiated with Wal-Mart. The owner set her own price at the beginning of the process and there was no pressure whatsoever to drop the price. As a matter of fact, she priced the product higher than needed in anticipation of negotiation, but the negotiation did not happen.

The profit for Bailey's on each one pound box of fudge sold to Wal-Mart is currently \$5.00 per box. Manufacturing and packaging costs \$2.80 and Wal-Mart purchases the fudge for \$7.80 per pound. Wal-Mart sells the fudge for approximately \$10.00 per one pound box. Wal-Mart has the discretion to set its own retail prices but to date has kept prices at the recommended retail price of \$10.00 per pound. This is \$1.50 cheaper than the Bailey's Fudge store price. The owners of Bailey's Fudge had to sign an agreement with Wal-Mart that their store would not sell the product cheaper than Wal-Mart at any time.

Bailey's Fudge gained approval on four flavors of fudge in the Wal-Mart system: chocolate, chocolate walnut, maple walnut and peanut butter fudge in one pound approved boxes only. To make any additional flavors of fudge available at the Wal-Mart locations, the owner would need to go through an approval process at the corporate headquarters of Wal-Mart in Arkansas.

Considerations for the Future of Bailey's

Currently, Ruth and her daughters are concerned that there is an inconsistency between the high quality, high image brand that has been created and thus far sustained for Bailey's Fudge and the discounted retail sales of the brand at Wal-Mart. Sales at Bailey's retail store in Quincy have decreased since the product has been placed in Wal-Mart stores and the longer-term prospects of maintaining Bailey's image as a high image specialty brand seems questionable at best given the fact that the product is now available through a mass merchandiser. But the owners feel they may have invested too much time and money into the Wal-Mart initiative to give up on the dream of mass distribution.

Depending on levels of sales revenue generated at Wal-Mart stores, one strategy for the business may be to close the retail shop altogether and attempt to grow sales further by attempting to place Bailey's fudge not only in the eleven approved Wal-Mart stores but also in Wal-Mart stores in other regions if she could obtain the corporate approval to do so from the Wal-Mart corporation. This strategy could be supported by an increased focus on mass media advertising of the product throughout regions where it is sold, including social media advertising. However, the entrepreneurs are hesitant to go this route as it runs counter to their original vision for the business and the high quality image that they have attempted to maintain for the brand. They also feel that their shop has an upscale, unique atmosphere that many local customers associate directly with the brand and they do not wish to alienate this segment of the market. Yet another concern with this option is capacity limitations related to the kitchen facility in their current location and the staffing associated with mass production. Currently, Ruth is the only cook in the kitchen. She makes all the fudge and takes great pride in the quality of her product. She has considered training her co-owners and daughters to make the fudge but with their limited availability, feels it may not be worth the time to train them in fudge making. She also feels their time should be spent other places within the Bailey's business. Another consideration is to share her recipes and fudge making techniques with an employee but she has concern over maintaining high quality control.

A second option under consideration is to only sell the product at Wal-Mart on a seasonal basis. Product sales peak during fall and winter months at which time the fudge could be sold in Wal-Mart stores. With this strategy, the entrepreneurs could continue to operate the specialty store, with the product being sold at the retail location throughout the entire year and through the mass merchandiser only during the holiday season. With this strategy, an element of exclusivity could be maintained for both the brand and the business itself but, at the same time, Ruth could capitalize on higher volume sales at Wal-Mart during peak demand periods. A lingering concern with this option is developing and maintaining relationships with Wal-Mart store managers who are responsible for assigning shelf space and product location. Melissa has generally negotiated shelf space and she is concerned that each holiday season she would have to start

over in terms of convincing each store manager to give her shelf space again. She is also concerned with staffing and equipment challenges of maintaining enough fudge in the retail store and at the Wal-Mart stores during the holiday season and the overall health of her Mother, Ruth, as she faces high stress during peak production demands over the holiday season.

A third option that the owners of Bailey's Fudge are considering is to adopt a dual-branding strategy in which product sold at the retail store would retain the Bailey's Fudge name. However, product sold at Wal-Mart would be sold under a different brand name. In this manner, the image of Bailey's as a high quality, exclusive product may be preserved, but Bailey's could still sell fudge at Wal-Mart. But the owners feel that there is may be somewhat of an ethical dilemma with dual-branding unless there are actually tangible differences between the two products. They feel concern that long-time Bailey's Fudge customers will be "short changed" in that they will think that they are purchasing an exclusive product when, in fact, it is identical to product being sold at Wal-Mart. Melissa is also concerned that making any changes to the name or labeling of the product could result in starting over the approval process with both Wal-Mart and the Illinois Health Department. With this option capacity and distribution continue to be of concern.

Another option for Bailey's Fudge would be to maintain the Bailey's brand name for all products produced, but only sell fudge at Wal-Mart stores outside of the local market region. This strategy would allow Ruth to more legitimately maintain the high image, exclusive distribution strategy in local markets but yet attempt to mass market the product in other regions. The biggest limitation to this strategy is that Bailey's currently does not have a contract with a distributor and is therefore limited in terms of attempting to serve more than one geographic market with their product. At the present time, Ruth and Melissa deliver product themselves to Wal-Mart stores and all Wal-Mart stores that they delivers product to are within approximately a 120 mile radius of the store in Quincy.

Finally, the entrepreneurs have considered selling the entire operation to another entrepreneur or a larger competitor. Ruth is now in her late sixties and her husband Jake is in poor health. However, this

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option may be the most difficult of all for Ruth as she, like most other entrepreneurs who have built their businesses from the ground floor up, has very strong emotional ties to the business and views it as a strong and positive expression of her personal being. This entrepreneurial venture was named after her grandmother and she uses many of her grandmother's recipes in the Bailey's store. Melissa and Rebecca have both expressed support of Ruth and want her to make the decision concerning selling because they both concur that Ruth has the greatest work burden in the daily operation of the store and the most time invested.

References

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