

442 MCADAM

Jessica Welsh 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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It was March 2015, and 442 McAdam (McAdam), a women's designer handbag company that offered a bohemian and equestrian style of design, had moved its operations from Calgary, Alberta, to Toronto, Ontario. Due to increasing demand for the handbags, owner and operator Sarah Shell had decided that she would no longer make the handbags herself. Instead, 442 McAdam would outsource the production of its handbags using either a local manufacturer in the Toronto area or an international manufacturer from overseas. Shell hoped that moving her company to Toronto and outsourcing the manufacturing process would allow her to focus her time on increasing sales while decreasing material costs. The move to Toronto would expose Shell's handbags to a larger market, thereby creating potential for the brand to grow in popularity and overall visibility with the company's target market.

442 MCADAM

Sarah Shell

Sarah Shell's journey in the fashion industry started in 2002, when she began studying fashion design in Florence, Italy. After completing her studies at the prestigious Parsons School of Design in New York City, Shell worked with popular brands, such as Gucci and Club Monaco, and eventually accepted a purchase analyst position at the Foranzi Group in Calgary, Alberta. During her time with the Foranzi Group, Shell designed her first handbag as a present for her mother.

Inception

After successfully handcrafting her first leather handbag, Shell continued designing handbags in her spare time as a hobby. Early on, she took approximately one week to create each handbag. While Shell was shopping in a boutique in Calgary, a local shop owner admired the handbag Shell was carrying. After learning that Shell had designed it herself, the boutique owner immediately wanted to carry Shell's handbags in the store. At this point, it became clear to Shell that she could no longer continue hand-making the bags, so she purchased a 250-pound industrial sewing machine to reduce the time it took her to create each piece to between two and five hours.

Growth

By 2008, Shell was spending all her time making handbags. In the same year, she decided to leave her position with the Foranzy Group to launch her handbag business — 442 McAdam — on a full-time basis. At this time, Shell's chief concern was the cost of the materials used to produce the handbags, something she had never had to consider in her work with the Foranzy Group.

In 2014, Shell decided to move McAdam's headquarters to Toronto, Ontario, where she knew there would be a larger market for the handbags and a greater opportunity to showcase the brand. Although the handbags were sold throughout North America, sales came primarily from Canada. The handbags were available for purchase both online and in eight retail stores, and the online prices were the same as those at any of the retail locations. It was also clear to Shell that with the anticipated growing demand for her handbags, she could no longer produce them on her own; instead, she would need to have her designs produced by an independent manufacturer, either locally or internationally.

OUTSOURCING

Both local and international manufacturers priced their work based on the number of seams needed for each design. Shell's initial designs were very intricate and unique, but replicating this number of seams would not be affordable through a manufacturer. Therefore, to keep the price of the handbags affordable for both McAdam and its customers, the number of seams would have to be reduced for each bag. Shell worried that by reducing the number of seams, the bags might lose some of their unique appeal.

Manufacturers required a minimum order quantity for each design. If the same handbag were ordered in three different colours, this would constitute three different designs. To manage inventory effectively with these minimum order quantities, Shell would have to limit the number of designs and colours available — something that had not previously been a concern.

Canadian manufacturers were more expensive than international manufacturers, charging an average of \$120¹ per handbag and requiring a minimum order of 10 handbags of each design and colour. International manufacturers charged, on average, \$80 per handbag but required a minimum order of 50 handbags of each design and colour. Handbags would be shipped to the McAdam FOB (free on board) destination with payment terms of net 60.

Regardless of the manufacturer selected, McAdam would be financing the initial purchase of inventory with the business's cash; however, this payment approach would be possible only if the majority of the inventory could be sold within six months. Due to the industry's seasonality, if the handbags were not sold within six months, it was highly unlikely that they would be sold at all, and selling them at a later date would require severely discounted prices below or near McAdam's manufacturing cost.

Shell was confident that the quality of the handbags produced would be the same, regardless of whether she selected a local or international manufacturer. By having the manufacturing portion of her business handled by a third party, Shell hoped she would have more time available to create additional designs for new handbags in the future.

¹ All currency amounts are in Canadian dollars unless otherwise specified.

THE CONSUMER

The target market for McAdam's handbags included women between the ages of 20 and 45. The handbags were priced at and marketed to the lower end of the luxury handbag market for these women, who were typically at the early stage of their careers and looking for their first real luxury fashion handbag.

McAdam's bohemian and equestrian handbag designs were of interest to women who wanted a unique style (see Exhibit 1). These women did not want a handbag that looked similar to other popular luxury handbag brands, such as Coach, Kate Spade, MARC by Marc Jacobs, Tory Burch, and Rebecca Minkoff. These well-known brands were readily available in department stores, as well as in the brands' own stand-alone stores, online, and in smaller boutiques, but rarely did their designs compare to McAdam's unique bohemian and equestrian appeal.

Shell wanted to continue satisfying her loyal customers with each one of her new handbag designs. While shopping, consumers often conversed with boutique owners about their specific requirements in a handbag. Unlike other designers, Shell made a point of speaking with these boutique owners to learn more about the end consumers' specific desires for their ideal handbag. Whenever possible, Shell designed her handbags with these ideas in mind.

PROJECTIONS

Shell decided that McAdam would need to offer five handbag designs per style season, each available in four colours. (A style season was the length of time a handbag could expect to be sold at its regular price.) There were two style seasons in each fiscal year, and Shell was concerned about whether she would be able to offer this many different styles and colours, now that the production of the handbags would need to be outsourced and minimum order quantities were set by the manufacturers. Shell estimated that each of the 12 boutiques she had enlisted to sell her handbags would purchase eight handbags per style season during fiscal 2016. Sales would increase by 50 per cent in fiscal 2017 with the addition of more retail outlets. In addition to these sales, and based on past performance, Shell predicted that sales from McAdam's online retail store would average 24 handbags a year.

The average retail price for a handbag would be \$440, regardless of the manufacturer selected. To ensure that she would not lose any customers to competing brands, Shell decided that McAdam would absorb any additional cost of manufacturing if a local manufacturer was selected instead of an international one. McAdam sold her handbags to retailers for 45 per cent of the retail price.

CONCLUSION

Shell was excited to see where outsourcing the manufacturing process could take McAdam, but she wanted to make the most financially feasible decision. In Toronto's larger market, Shell hoped to exceed the success she had achieved in Calgary. She would need to make her decision quickly in order to meet all upcoming orders.

EXHIBIT 1: 442 MCADAM SAMPLE HANDBAG STYLES



Chappy — Glitz

This beautiful little purse is perfectly ornate to enhance casual attire, or remove the strap and wear it on your shoulder for the evening. Chain handle, removable long strap, magnetic flap. Top grain Italian leather. Gold-plated steel hardware. 10.5"× 7"



Pencil Skirt — Black

A great briefcase alternative. Features removable leather sling, tote straps, zippered closure, inner compartments. A classic 442 McAdam silhouette. Genuine leather. Black top grain cowhide. Gold hardware. 15"×15.5"



Hobo — Heart Collection

Durable and practical, comfortably sits cross-body and rests at the hips. You'll forget you're wearing a bag! Removable leather sling with tote straps, zippered closure, inner compartments. Top grain Italian leather. Gold hardware. 17"×11"

Source: Company files.