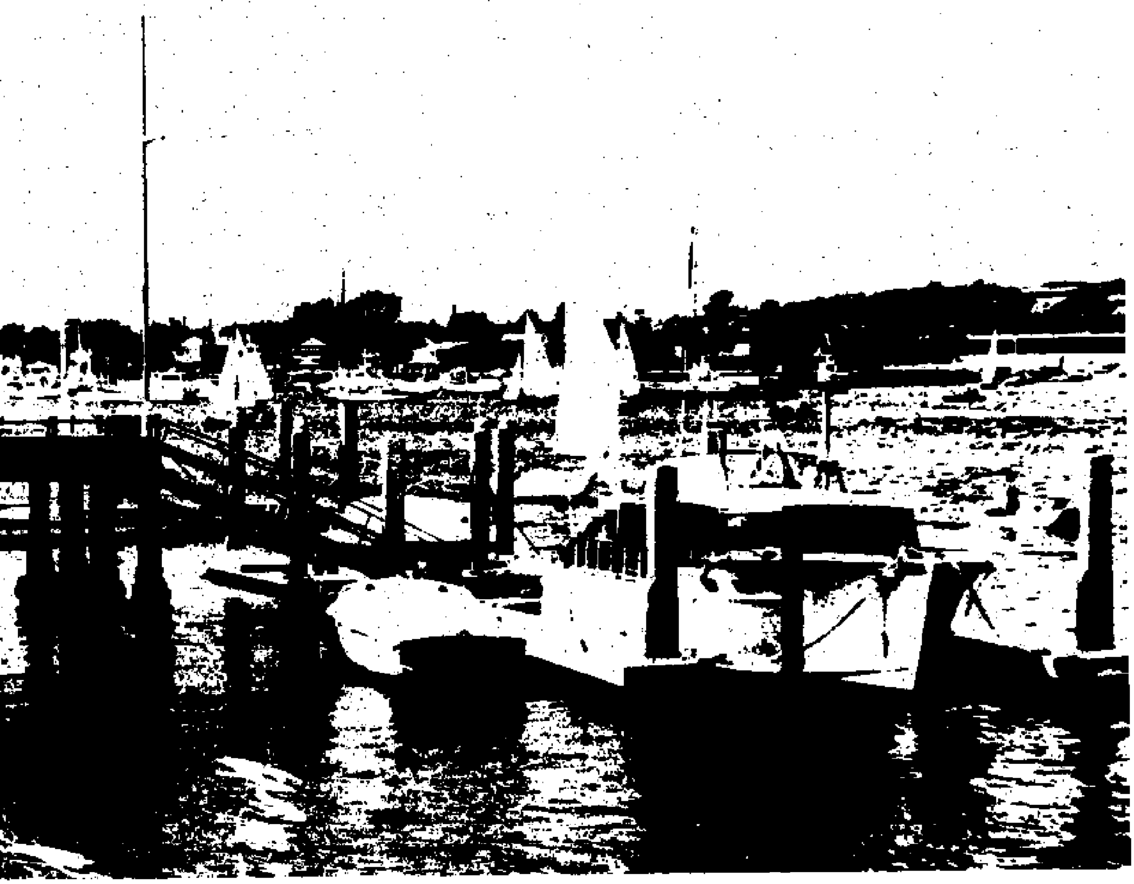
Boating Industry Management

Insights From a Seminar Held on February 24, 1977 at Newport Beach, California

Sea Grant Marine Advisory Services
Institute for Marine and Coastal Studies
University of Southern California



Contents

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Introduction

The marine environment has become increasingly popular for recreation, both along the shore and in offshore waters. In southern California particularly, with diverse coastal resources, year-round good weather, and a dense urban population, marine recreation is a booming industry. Because recreational boating is highly equipment-oriented, a sizeable portion of the marine recreation industry in this area caters to its estimated one million boaters.

In working with members of the boating industry, the USC Sea Grant Marine Advisory Services had become increasingly aware of management questions in areas of financing and capital acquisition, accounting, insurance, marketing, liabilities, and personnel. Many boating industry managers had expressed concern in knowing where to turn for resolution of certain kinds of management problems.

To address some of the problems identified, the USC Sea Grant Marine Advisory Services, in cooperation with the Marine Division of the Newport Harbor Area Chamber of Commerce, sponsored a one-day seminar in boating industry management. The goal of the seminar was to provide analysis and opportunity for discussion of typical current boating industry management problems. The seminar was held on February 24, 1977, and was attended by boat builders and dealers, boatyard owners, marine electronics and hardware suppliers, and others involved in serving recreational boaters.

The following is a report of the seminar, which summarizes some of the important points made by each speaker. For this first management seminar for members of the boating industry we tried to touch on each of the seven identified areas of concern: financing, capital acquisition, accounting, insurance, marketing, legal liabilities, and personnel. These summary statements are by no means definitive assessments of the problems that they address and subsequent seminars may be designed to provide more in-depth analysis of fewer issues.

We hope the report will not only be a useful summary for those who attended, but also will contribute some insights to others involved in the boating industry who were not able to attend the program.

Susan H. Anderson
Marine Recreation Specialist
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How to Get Money Out of Banks

Banks are a primary source for yacht financing, Yacht brokers particularly should be aware of some of the hurdles that their prospective customers must clear before they can close the deal. Thus, bank loan procedures were reviewed by Michael Knoche, Loan Office for the Bank of America in Long Beach, California.

In General

The prospective boat buyer should follow these basic principles:

— Reserve borrowing for items you truly need
— Shop for the lowest interest
— Limit your request to the least amount possible
— Repay the loan quickly

If you wish to buy a new vessel, the bank may lend up to 80 percent of the selling price as established by a purchase agreement. For used vessels, the figure is up to 80 percent of the market value based on a marine survey, or 80 percent of the cash selling price, whichever is the lower figure.

When you apply for a loan to purchase a vessel, banks usually request information concerning the following:

— *The borrower*—age, marital status, place and length of employment, income, and outstanding indebtedness. For self-employed persons, two previous income tax returns may be requested to verify stated income. The bank will also wish to know your previous experience with boat ownership.
— *The vessel*—type, age, size, location, purpose, and use of the craft.
— *The sale*—is it being handled by a broker or privately?
— *The loan*—the amount requested and the duration preferred.

Evaluation Criteria

Because of the high purchase and maintenance costs of yachts, banks perform in-depth credit analyses and check documents thoroughly. Their primary considerations in evaluating a request for financing are:

— The ability of the buyer to continue generating income to service the loan;
— The amount and nature of the borrower's total capital, or what is referred to as "second source payment;" and

— Whether the loan request is reasonable, as established either by a purchase agreement on a new yacht or a marine survey on a used vessel.

Proper insurance coverage is required for the protection of both the bank and the borrower.

Alternative Financing For Capital Acquisition

Suppose you are starting a new business, such as a boat-building business, and you need a long-term loan or equity capital. What kind of institution can provide it? Dr. Stephen Slingsby, President of Statewide Calbidco (California Business and Industrial Development Corporation), had an answer.

Banks are the last place to look for such a loan. They are interested in financing a business with a cash flow and sufficient collateral. They must protect their position because they receive only interest in return for their risk.

Insurance companies are also unlikely sources, due to minimum size requirements. At one time pension funds were potential sources, but a law passed in 1974 states that portfolio managers of pension funds can suffer personal liability if they incur losses on individual investments. This marked the end of speculative investments with pension funds.

State Development Companies

A viable alternative is the state development company or state development bank such as Calbidco. These nongovernmental agencies can provide long-term loans at rates that will not lead to a heavy demand on a company's cash flow.

They are able to do so by taking an ownership position in the company through a convertible debenture or an equity "kicker." A debenture is a subordinated or unsecured debt instrument; "convertible" means it starts as a debt on which the lender receives interest, but at his (the lender's) election or by a pre-set formula, the debt is converted to equity and ends up as ownership in the company. A "kicker" is an amount of equity in addition to the debt: that is, the debt obligation is not converted to equity but is paid off and the kicker is a form of additional compensation.

Role of Government

The long-term schedules of state development company loans are made possible by government guarantees. In fact, usually 90 percent of a long-term loan is made with government backing. If a lender makes a 15-year term loan to a company for a million dollars, it can still take the guaranteed part of it—usually 90 percent—and sell it to a pension fund or insurance company at competitive rates.

The Small Business Administration provides about 20 percent of all government guarantees. These are limited to $500,000 per loan except for pollution control abatement programs. For these programs companies can receive up to several million dollars.

The lender can get out of his equity position by mandating that an ESOP (Employee Stock Ownership Plan) be created. This is a secondary income plan and may be set up as a substitute for a pension plan. For instance, through regular salary withholdings, employees gradually buy stock in the company from the lender. The dividends eventually return to the employees as secondary income rather than to the state development company lender.

Does Your Business Qualify?

State development companies seek to invest in industries that are innovative and expanding at a rapid rate, i.e., book value increase of two to five times in the same number of years accompanied by significant increases of employment with a capital/employee ratio of $10,000 per job or less.

Those in the marine industry seeking long-term loans must help state development companies recognize the industry's innovations.

Two publications that will assist you in identifying the various sources of long-term debt and equity capital are Bank of America's Vol. 13 No. 7 issue of the "Small Business Reporter" covering financing a small business, which is available at your local branch; and "Doing Business in California 1977," which is available for $10.60 from the Business Development Institute, 717 Lido Park Drive, Newport Beach, California 92663.

Accounting As a Management Tool

Accounting is more than record-keeping. It is a system of recording, classifying, and interpreting information about a business in financial terms. How can this information be used in management? Dr. Leslie Loschen of USC's School of Business Administration had these suggestions.

Accounting is an information system, a chart of accounts. The data may be:

— accumulated in enough detail to make cash projections or cash flow analyses to be used for decision-making, such as budgeting;

— used for historical record-keeping and financial reports to the Internal Revenue Service and to creditors; and

— the key to cost saving, for the way to trim costs is to have highly reliable accounting data.

Accounting is more than auditing. If you hire an auditor to come in and audit your books, he or she will do just that: attest to the reliability of your statements. Do not expect management consulting or advice; they can provide this but will charge an additional fee.

Your employees can be trained in the management aspects of accounting through a new Certified Management Accountant Program which involves two years of management accounting experience instead of the two years of audit experience required for the Certified Public Accountant exam. The examination subjects are much broader—economics, management, and finance, in addition to accounting, modeling, and information systems.

Your accounting system should be tailormade for your business. Data must be useful. It is not information until it is communicated.

Budgeting

A budget is a plan of your operation in financial terms. You should formalize it—not to limit yourself, but to give yourself a guide.

To devise a budget you should establish several smaller budgets and then fit them together into a larger one. You usually start with the sales budget because this is the ultimate restraint in most businesses. If you expect a certain volume of sales, you should have sufficient inventory to ensure adequate color, style, size, and selection for one full period plus inventory to finish the current period. Then subtract what you have in stock from the required inventory to determine what you need to produce (or buy).

The production budget looks at how much material and how many hours of labor are needed to produce items to complete the required inventory. Some of these items must be obtained by a cash expenditure and will have an impact on the cash budget. Others will have to be obtained through a short-term credit and will appear on the balance sheet as a short-term liability. Others will involve long-term financing and therefore appear as a long-term financial debt. Putting together these various sub-budgets—sales, production, cash, debts—will give you an operating budget.

Know your costs and their behavior. Know whether they are variable or fixed, and whether they will vary with volume in the future. Knowing where your costs can be reduced is the best way to increase your profit.

Incidentally, remember that for tax purposes, businesses with installment sales can record income as they receive it, even though financial profit was made at the time of the sale.

Inventory Control

An accounting system can also help you with inventory control. The basic principle involved here is to determine your minimum required inventory to meet deliveries and customer needs. To do this, consider the costs of ordering. What are the risks of having no inventory? At what point will back orders cause you to lose sales? What will be the additional clerical costs to handle all sales on an 'order as requested' basis? Compare these costs with those of carrying (i.e., storage, investment in warehouses, risk of obsolescence or deterioration). To carry inventory will involve a capital investment. Even if you are not financing this investment, your capital is still tied up in slow-moving inventory and in effect, you are paying interest on the money.

In accounting for your inventory the cost may not be the important figure, but rather the quantity of items in stock. With a business involving boat sales for instance, cost data should be available for each boat, but the inventory control account need only consider the total quantity of boats available for sale. If your business is boat construction, your inventory will include materials used in building boats, boats in the process of construction, and finished boats ready for sale.

Financial Reports

Finally, remember the importance of "conventional" accounting, i.e., analysis of the data provided in financial reports. These accounting data—especially the gross profit and the net income after taxes—give you much information on your investment. These data can tell you whether the investment gave you the best return on your money, or whether you should try an investment in something else.

Practical Problems in Marine Insurance

Skyrocketing insurance costs–what are the reasons? A prime factor, according to Pat Ayres, Vice President of Lido Shipyard and President of the Newport Harbor Area Chamber of Commerce Marine Division, was a 1972 amendment to the Federal Longshoremen and Harbor Workers Act passed by Congress.

Before 1972 the marine industry was subject to two insurance laws—the Federal Longshoremen and Harbor Workers Insurance Act and the State Workman's Compensation Insurance Act. The basic difference between the two was the line of jurisdiction, drawn at the water's edge.

The Federal Act covered accidents occurring during any type of marine employment, on the navigable waters of the United States, and in any adjoining facility or drydock facility, but not inland of the water's edge. The state insurance covered accidents inland of the water's edge.

The 1972 amendment to the Federal Longshoremen and Harbor Workers Insurance Act extended the line of jurisdiction to include all navigable waters, any adjoining pier, drydock, or place of occupation; it also extended coverage to include any type of work that "adjoins" the navigable waters of the United States. In various legal cases the word "adjoin" has been interpreted on a functional, rather than geographical basis, so that no matter where you are, you *adjoin* if you build or work on boats that *travel* on navigable waters.

The insurance companies that were required to carry this insurance had no experience ratings on which to base prices for premiums. Some refused to sell insurance for these contingencies at all. Those that did sell insurance lost money until they began to raise prices. Last year insurance went up 300 percent; recent rates were $18.75 per $100 of wages.

Businesses Affected

Everyone connected with the marine industry, including the pleasure boating industry, has been affected by the new insurance rulings. For example,

- — those who operate a fish market, even though located away from the docks, must carry insurance because they must go to the docks to pick up their wares;
- — a power boat building firm in the East which employs 750 people must pay $250,000 per year to cover their workers; they recently reported that they will have to raise the price of their boats one percent just to cover the insurance cost increases.

Lobbying Efforts

Currently the Southern California Marine Association is tabulating information about the local marine recreation industry, such as the number of employees, number of accidents last year, and number of accidents during the last ten years. They hope to demonstrate that small marine recreation businesses have no need for the Longshoremen and Harbor Workers insurance. For many of these businesses the requirement to carry this expensive insurance will force them out of business.

Marketing and Advertising

"Make a better mousetrap and everyone will come and buy it." No way, says Charles Mottl, President of Charles Mottl and Company. Here he explains how in today's world, competition is so intense that four out of five products fail, and the one that succeeds does so for a reason.

The reason is: the company's marketing director has taken the time, money, and energy to find out whether the better mousetrap is something the public wants and needs, and then has made it available at a reasonable cost.

Preparing a Marketing Plan

Most manufacturing is impulsive, and marketing is a lot of work. No one *wants* to go through the pains of preparing a marketing plan, but it has to be done before you spend a dime on promotion or advertising—even before the manufacturing step.

To form a marketing plan, answer the following questions:

- — Where are you now? How much money can you invest in the new product?
- — Where do you want to go? What are your goals? For instance, do you want to get 15 percent of the market share of the particular product?
- — How fast do you want to get there? In how many years? Three? Four? Five?
- — How much is it worth to you? What do you want to spend? Five or ten percent of sales in addition to savings?

The answers to these questions should be the parameters of a marketing plan.

Steps Toward Effective Marketing

Study your customers. Some say that any given model sailboat has only a five-year life and after that time, something new should be produced.

Test the product with a prototype or control sample; prices should be tested also.

Train your salespeople in the details of the product.

Advertise your product. This takes advance planning. Start at least five months ahead, since editorial deadlines are often three or four months before publication date.

Devise incentives. Sometimes regular sales promotions cannot sell a product and you have to have incentives. For example, if one buys a 26-foot yacht, give them $2,000 in gadgets. It does not cost you, the manufacturer, all that much, and it stimulates sales.

Follow through. Keep cards on your customers. Three to five years from now they may be interested in a bigger boat.

Potential Legal Liabilities

As with marketing, says Richard A. Higbie, a Newport Beach attorney, everyone should sit back and assess the legal aspects of his business, then make a plan and talk with his lawyer to see what can be done about future pitfalls.

Preventive Medicine

Boats, boat hardware, propellers, pumps, etc., come into the category of consumer products. Manufacturers and dealers must be aware of their obligations to the consumer. For example, if your instructions, sales literature, or invoices state nothing about warranties, according to the law they are implied for two years.

You must have a plan to prevent being sued if for any reason your product should fail. Take your sales promotion material, dealer agreements, and marketing plans that involve dealing with the consumer; read them to be sure you understand them; then ask your lawyer to make you a plan to protect you from the warranty obligations imposed on you by law.

Collections

More important than making the sale is collecting the money from the customers, and it takes the same amount of effort. One way is to urge the customers to pay for the boat when they pick it up. Have the bill ready when they arrive, or if you deliver the boat, pick up the money at that time.

Consider getting a credit application from all customers, which includes a home and business address, drivers license, and a social security number, and whatever other information you think would fit your needs.

If you render service to a vessel, legally you have a lien on that vessel, that is, a right to hold the property and have it sold should the owner default on payment. The proceeds of the sale would then be applied to payment of the claim, or foreclosure of a lien in the Admiralty Court. If this procedure became necessary, you would have to see a lawyer immediately and act within a few months.

Before you undertake repair work on a vessel, insist on knowing what the legal ownership status is. If you are a shipyard that takes possession of the boat during repairs, you do not have to return the vessel until you are paid. However, if there is a legal owner (i.e., a lending institution) you must send him a registered letter concerning the repairs before the work commences, or the registered owner can take the boat by making a $200 payment. If you have properly notified the legal owner, your lien is in first place and you can sell the boat after putting a notice in the newspaper, without permission from the legal owner.

Accidents

If you are operating a boat or even carrying passengers and there is an accident, you can be liable. See your lawyer if you cannot get insurance BEFORE you incur the liability. See if any other protection is available.

Delegating Responsibility For More Effective Management

Delegating responsibility is the key to a successful business and to enjoying a successful life outside the business, says William P. Ficker, architect and skipper of the INTREPID.

Why delegate authority and responsibility?

— to accomplish more work so the business will grow;
— to sell more;
— to improve product quality;
— to free your time to act more effectively in your business; and
— to provide opportunities for people to communicate, compare their efforts, and grow within a company.

These are just some of the many reasons. It is important to establish habits of delegating early in your business. Delegating is like putting together a ball team. You have to cut and fit. It may take several years to put together a team of the type of people who are ready and able to assume the responsibilities.

Leadership is important because you will usually be delegating to numerous people and you will have to define what their responsibilities are and state the goals you will all be trying to accomplish.

Be sure not to delegate what you do best. If you are good at selling, designing, or production, don't delegate that to others to be free to run the company. Consider delegating upward—find a President and give him or her the opportunity for making the organization function and be profitable.

Selecting People

Choose the people you assign responsibility to carefully. Make sure they are qualified and have an understanding of the limits of their authority and responsibility. They must be disciplined and aware that they are representing you or your company, and not themselves.

Do not fragment responsibilities by delegating too liberally. There must be an ultimate authority, discipline, and leadership, or the efforts of these people will lack cohesiveness.

Do not hesitate to take back a delegation of authority. You will have to monitor work very carefully and if the job is not getting done, change your course.

Evaluating

Try to keep the following question uppermost in your mind: "Does this delegation of authority really accomplish what I set out to do?" Think hard about your objectives.

What criteria should you use in evaluating those to whom you have delegated authority? First you must set up guidelines with them—discuss how their performance will be judged. Then be sure to judge that first task critically. Also you must instruct people working with them concerning what is expected of them. Be honest and prompt in your evaluation.

And finally, do not fail to evaluate yourself. This is a difficult task, but worthwhile if you establish the pattern early.

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