ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.

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INTRODUCTION

The gourmet chocolate segment is the fastest growing segment in the chocolate industry and accounts for over 10% of all chocolate sales. Gourmet chocolate sales were $1.3 billion in 2005 and are expected to reach $1.8 billion in 2010 which reflects a 6.4% growth rate. Two main reasons contribute to this growth: the health benefits derived from the antioxidants in chocolate and the placement of products in mass market channels. Don Mountori, publisher of *Packaged Facts* states, AGourmet chocolates have come out of the closet and are showing some muscle in the mass market arena with exceptional branding that is making gourmet indulgence a household phenomenon. Higher cocoa content, the health benefits associated with chocolate, the introduction of organics, 'single origin chocolates', and exotic flavors such as grapefruit and habaneros are having a major impact on the industry, helping it grow more quickly than standard chocolate@.

On May 4, 2006, managers at the Rocky Mountain Chocolate Factory announced record earnings for the fiscal year ended February 28, 2006. Bryan Merryman, COO and CFO of the company, indicated, "We are very pleased to report another year of record earnings which increased 23% to approximately $4.1 million, or $0.61 per diluted share in Fiscal 2006. Our revenues rose 14% to a record $28.1 million, while total system-wide sales of our franchised and company-owned stores rose 12% to $99.4 million, compared with $88.9 million in the previous fiscal year."

Will Rocky Mountain Chocolate Factory be able to maintain this level of growth in the years to come in the highly competitive, fragmented chocolate and confections industry?

OVERVIEW OF THE CASE

The Rocky Mountain Chocolate Factory was started in 1981 by Frank Crail and is located in Durango, Colorado. The company has been publicly traded since 1982 and operates primarily by selling franchises. By March 2006, the company had 310 stores in 41 states, 6 Canadian provinces, the United Arab Emirates, and Guam. There are 301 franchised stores and 9 company-owned stores. The philosophy of the company is to use the finest, highest quality ingredients with no artificial preservatives in making its premium chocolate candy products. The company offers about 200 products and sells through stores, corporate sales, wholesaling, mail order, and the internet. Stores are located in factory outlet malls, regional malls, tourist environments, airports, and street fronts. Stores have an in-store kitchen open for customer viewing as candy makers prepare fudge and caramel apples. Other products are made at the factory located in Durango, Colorado. Approximately 40% of store sales are from products made on site. Supplies are purchased from a limited number of reliable suppliers and the company often enters into purchase contracts of 6-18 months in order to maintain a constant supply of ingredients, especially chocolate and nuts. Franchisees are carefully selected based on net worth and liquidity, work ethic, and personality. Rocky Mountain Chocolate Factory provides a 7-day training program for franchisees, operating manuals, and company field consultants. Financially the company is doing very well with a 14.5% increase in revenues from 2005 to fiscal 2006. The chocolate and confections industry is highly fragmented and competitive. Retail chocolate sales reached

$15.7 billion for year ended December 2005 and the gourmet chocolate market had sales of $1.3 billion. The candy market is expected to grow about 4% annually but the gourmet chocolate segment is expected to grow about 6%. Major companies with gourmet chocolate products include: See's Candies, Russell Stovers, MasterFoods USA, Hershey's, Nestle's, Campbell Soup Co., and Kraft. Trends in the industry include new products, new artisan chocolate companies, consumer desire for organic and natural products, health concerns, demographic changes, and concerns about obesity. The industry is highly regulated with 2006 legislation relating to candy tax, vending machine restrictions, food safety, and sugar reform. Cacao and other ingredients (nuts) are commodities and prices may vary as a result of monetary fluctuations, country political and economic conditions, and weather conditions.

SUGGESTIONS FOR USING THE CASE

This case is ideally suited for a Strategic Management course, but may also be used in a Principles of Management course to introduce students to the concept of strategic analysis. Because information is provided about the industry and the company, students can engage in an analysis of the industry using a macro-environmental driving forces analysis and the Five Forces competitive analysis model. Students may also be able to determine key success factors for the industry and overall industry attractiveness. With the company information available, students can prepare and SWOT analysis, financial analysis, and discuss the elements of the company's strategy. The Rocky Mountain Chocolate Factory primarily uses a franchise strategy to enter markets so there is an opportunity to discuss the pros and cons of franchising. The case can be used for in-class discussions of course topics, oral presentations, or written assignments.

Teaching Objectives and Suggested Assignment Questions

Teaching Objectives:

1. Apply industry analysis tools such as driving forces analysis and the Five Forces Competitive analysis model.
2. Assess the company's internal operations through a SWOT analysis and financial analysis
3. Evaluate the company's strategy and competitive advantage
4. Assess the use of Franchising as a market entry method

Suggested Assignment Questions:

1. What are the market and economic factors of the chocolate and confectionery industry?
2. What macro-environmental factors or driving forces affect this industry?
3. Complete a competitive environmental analysis using the Five Forces model. Is this an attractive industry? Why or Why not?
4. Prepare a SWOT analysis for Rocky Mountain Chocolate Factory. What information is gained about the internal operations of the company?
5. What is your assessment of the company's financial condition?
6. What are the elements of Rocky Mountain Chocolate Factory's competitive strategy? Does the company have a competitive advantage?
7. Is franchising an appropriate market entry strategy for this company? What are the pros and cons of franchising?