

## **Nathanael E. Yellis | Writing Sample**

I prepared this analysis report as part of a case discussion at the Acton School of Business. Cash America is a national chain of pawn shops facing a common growth challenge: improving profitability as the firm expands. I argue that understanding the underlying customer needs will push the firm toward an appropriate solution.

**From:** Nathanael E. Yellis

**To:** President & Board, Cash America International

**Date:** July 1, 1994

**Re:** Increase Retail-Only Locations to Improve Profitability

### **Introduction**

Cash America's successes -- sales growth and higher profits -- disguise a troubling phenomenon. Profitability and return on assets, key measures of the asset-intensive business, fell 22% and 31%, respectively, over the past two years. While hard numbers have grown, core ratios are slumping. This memo identifies the cause of Cash America's problems and proposes a solution.

Cash America combines two businesses, retail and lending. Separating these functions into different stores will better serve the two customer bases and improve the key profitability ratios.

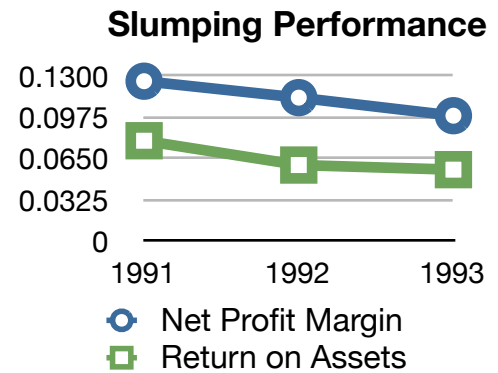
### **The Pawn Shop**

Cash America serves two types of customers. On the lending side, it serves customers who earn less than \$25,000 per year and cannot qualify for short-term credit. These people are willing to pay 16.8% in interest each month because they have no substitute source for fast cash. Each pawn transaction is worth \$35. On the retail side, Cash America serves wealthier customers who are looking for bargains on consumer products. These customers probably make closer to \$35,000 per year. Each retail transaction is worth \$145. Retail and lending are different transactions serving different customers.

## Return on Assets and Profitability Down Since 1991

Two key indicators, return on assets and net profit margin, evidence the underlying problem.

Return on assets represents the key investments we make in each store: loans and inventory. The large amount of capital required to maintain sufficient outstanding loans and inventory keeps potential competitors from entering the industry. Cash America invest over \$500,000 in each store. The balance sheet reports these investments as assets. Cash America's assets drive sales and net income, thus dividing net income over assets indicates the financial health of the company. Return on assets fell 31% the last two years.

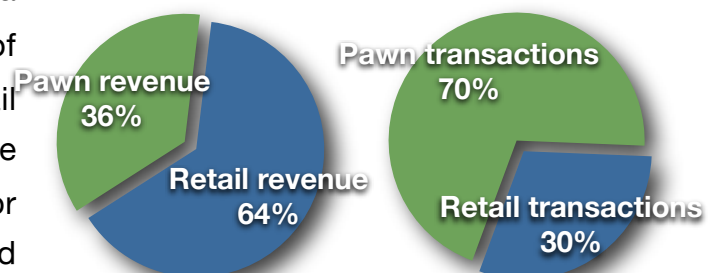


What is causing the decline? In 1992 assets grew 57% and sales grew 33%. Acquisition of stores and inventory destroyed the percentage return on assets. If Cash America recognizes the two different kinds of transactions it conducts by building two different kinds of stores, the investment per store will decrease, driving return on assets back up.

The second indicator is simpler. Net income over sales results in the profit margin. Because costs have risen as a percentage of sales over the past two years, net profit margins are down 22%. Most costs are fixed--the cost of running existing stores does not decrease. Thus the company must increase sales to increase net profit margins in the existing business. As it expand, Cash America should divide its transactions into two types of shops. Pawn shops will continue to require more expensive labor; retail stores will require less expensive clerks. Lowering operating costs in half of the new stores will also increase net profit margins.

## Cause of Slumping Return on Assets

Cash America's retail customers drive a disproportionate volume of revenue. Only 30% of loans default and result in goods available for retail sales. But retail sales are 64% of revenue. These are different customers purchasing different products or services from Cash America. The company should



separate its functions to better serve each group.

While pawn shops should continue to offer both pawn and retail, I propose two types of stores. The company has already developed small kiosks that only offer pawn loans, not retail goods. The other customer group needs expanded service. This capitalizes on the goods the company carries as inventory by building Cash America retail stores. Already, the larger stores located in more affluent areas have higher sales. Cash America needs to capitalize on its retail price advantage and serve those customers better. Instead of restricting the business to areas with average incomes above \$35,000, the company needs to recognize both groups of customers and serve them in appropriate ways.

## **Conclusion**

This plan will result in proximate service for both sets of customers: core pawn clients will continue to have Cash America pawn shops in their neighborhoods, and retail customers will find new, attractive shops in their areas. This effectively splits the sunk investment per store, enabling the company to open locations with less investment. This improves return on assets by lowering the needed assets. Fixed costs will also decrease because instead of needing skilled pawnbrokers at each location, the company will be able to staff retail branches with typical store clerks. This improves net profit margins by lowering operational costs. In addition, this plan serves customers better and thus should increase overall sales. By separating the core businesses, this expansion plan will bring more economies of scale into the company, making it stronger as it grows.