

CARIBBEAN INTERNET CAFÉ

Michelle Theobalds prepared this case under the supervision of Professor Murray Bryant 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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In June 1996, David Grant was visiting his home in Kingston, Jamaica, while on summer vacation from the MBA program at the Richard Ivey School of Business in London, Ontario. He was gathering information on the feasibility of opening an Internet café in Kingston upon his graduation from the MBA program in 1997. David had always wanted to be his own “boss,” and he felt that the timing was right to pursue this business opportunity in Jamaica.

Prior to entering the MBA program, David had worked as a computer systems engineer at the local telephone company, Jamaica Telecommunications Limited (JTL). JTL, 80 per cent owned by a British telecommunications company, was one of seven Internet service providers on the island. If this venture turned out to be feasible, David intended to lease the telephone lines from JTL. He had also worked as a part-time teacher at the University of Technology and as a computer programmer in Jamaica.

THE CONCEPT

A “typical” Internet café offered computer services (including access to the Internet), a small menu of light snack foods and an assortment of beverages. While he was studying in London, David visited a number of Internet cafés and became intrigued by the concept. A café seemed to be the perfect vehicle for people to use the Internet and other computer services without making an expensive investment in computer hardware. In addition, a cybercafé provided a social outlet: customers could “surf the net” together, listen to music or simply relax and socialize.

COMPETITIVE ENVIRONMENT

In Jamaica, although there was high awareness of the Internet, there was very low accessibility and usage. Mainly corporations and universities used the Internet. However, even at these institutions, individuals had to reserve time to access the Internet and they were limited to short time periods. Private usage was still low and David expected that it would remain that way at least for the next three years. The main reasons

for the low penetration rates were: a) the high cost of computers as a percentage of average salary, b) the lack of telephone lines in some areas in Kingston, and, c) the high rates currently being charged by the existing Internet service providers. Most providers charged a flat rate for a fixed number of hours per month, and then hourly rates for any extra usage. This pricing scheme tended to penalize those users who only checked e-mail and used the Internet for a few hours per month. The average hourly rate charged by the service providers was \$90.¹

There were a large number of restaurants and “cafés” in Kingston, however, none of these establishments provided Internet services. Most of the cafés provided outdoor seating, music, games or other entertainment, and traditional drinks and restaurant fare. Most cafés did not serve coffee as, traditionally, the beverage was not very popular in Jamaica.

CARIBBEAN INTERNET CAFÉ

David planned to introduce the European café concept to Jamaica, offering brewed coffee (e.g. local and imported premium coffee beans, espresso, cappuccino and café latte), imported wines, fresh tropical juices, and baked products such as croissants, bagels, donuts and other pastries. He envisioned three areas in his café: a computer area with booths, a wine lounge with some comfortable sofas, and a general café area with tables and chairs. Initially, he would purchase five “Pentium” processor computers and connect to the Internet via a 56 kbps² telephone line leased from JTL. The café would also provide printing services, a scanner and the latest office software (spreadsheet, word processing and presentations). Caribbean Internet Café (CIC) would not have a kitchen. All the baked products would be sourced from local bakeries as needed.

The target market would be computer literate 18 to 35 year old university students and professionals with a relatively high disposable income. Most of these persons would have limited access to the Internet at work or school, but might wish additional access for leisure or research. This group would also be busy and trendy, and would appreciate a venue where they could relax and unwind, but where they would also have access to the facilities to work if necessary. David estimated the total size of his target segment in Kingston to be about 20,000. CIC would initially accommodate 50 seats: 15 at the computer terminals (three per booth), 15 in the wine lounge, and 20 in the general area.

David thought that New Kingston, the city’s business district, would be a good location. Most banks, insurance companies, other financial institutions and corporations had head offices or branches in this area. There were also two major hotels and a shopping centre. Most workers in New Kingston were in white-collar jobs such as banking, insurance, programming and consulting. In addition, New Kingston was close to several affluent suburbs from which CIC could attract patrons.

PRELIMINARY INVESTIGATIONS

While visiting Kingston, David began to gather data on the investments and costs that would be necessary to start his venture. He first made a list of the equipment that he would need. He intended to purchase most of these items in the United States and ship them to the island himself. In this manner, he could save the

¹All dollar amounts in the case are in Jamaican currency, unless otherwise stated. The exchange rate was approximately JA\$25 = Cdn\$1 and JA\$35 = US\$1.

²kbps = kilobytes per second

exorbitant mark-ups that many stores charged in Jamaica. The list of equipment and costs is shown in Exhibit 1.

David intended to staff CIC with university students majoring in computer science and hospitality. They would work part-time for about 15 hours per week, and would double as Internet tutors and waiters. Wages for the students would be approximately \$40 per hour. The café would be open to the public for 84 hours, six days per week, and employees would be needed for around 90 hours per week. An average of two employees on duty would be required. Although he planned to be on hand to manage the finances and to oversee the operation, David intended to hire a manager with experience in the Jamaican restaurant industry. This person would assist with the start-up, staffing, training, menu development, quality control and customer service. He estimated that the salary for this person would be \$40,000 per month.

David found a number of suitable sites in New Kingston, and estimated that the lease costs would be \$30,000 per month. He preferred to lease rather than purchase the property, since mortgage rates were currently very high (25 per cent per annum) and he did not want to fund a down payment. He estimated that telephone bills and utilities would cost \$15,000 per month and that he would need to make an initial deposit with the utility companies of \$7,000. David spoke to a former co-worker at JTL and determined that he could lease the link to the Internet for \$10,000 per month. Internet service would be provided by JTL at a cost of \$60 per computer per hour. He also obtained a quote from an insurance company to insure the contents of the facility for a premium of \$10,000 per month.

Advertising, marketing and promotion would cost \$10,000 per month. However, he expected to spend an additional \$20,000 on advertising just prior to opening the café. Other up-front costs such as legal fees, incorporation expenses, licences and permits, and decorating expenses were estimated at a total of \$120,000. Miscellaneous monthly administrative and maintenance expenses would be \$50,000.

PRICING

After examining the rates of the local Internet service providers, David decided that he would charge a 30 per cent premium on their average hourly rates for a total of \$120 per hour. He thought that customers would accept this rate since they would not have to purchase several hours up-front. Time on the computers would be available in one-hour slots. David estimated that 40 per cent of his customers would pay for access to a computer. The other clients would probably share a computer with a friend, or simply socialize in the café or wine lounge. All customers would spend an average of one hour in the café. He expected that the average customer would spend \$140 on drinks and \$60 on food. Average costs per customer for drinks and food would be \$50 and \$30 respectively.

AN OFFER FROM JTL

As David looked over his list of expenses, he felt overwhelmed. He wondered how he would finance the venture. He had approximately \$500,000 in savings that he was willing to invest in the café. He approached friends, relatives and other potential investors with his idea, but to no avail. Finally, he contacted his former boss at JTL and showed her his business plan. Together, they prepared a proposal for the senior management. JTL expressed some interest in the proposal; management thought that the café would increase usage and awareness of the Internet in general, thereby increasing JTL's sales of Internet service.

After several rounds of meetings and negotiations, JTL made David an offer. JTL proposed to invest \$500,000 in shares in CIC (50 per cent partner) and to provide a further \$1,250,000 as a long-term loan to the company. CIC would be charged a special concessionary interest rate of 10 per cent per annum on the loan. In addition, JTL commissioned a market study conducted by an independent market research firm. The firm agreed with David's estimate of the total segment size, and then made three estimates of potential usage of the café in the first year. The market research firm projected that, optimistically, 50 per cent of the segment would visit the cafe, on average, five times per year. A realistic projection was that 40 per cent of the segment would visit the cafe an average of three times per year. Finally, a pessimistic estimate was that 30 per cent of the segment would visit twice per year.

THE DECISION

After an exhausting "vacation," David sat down to review his notes. He wondered if he should proceed with the CIC venture, and, if so, if it would be a profitable business for him and JTL.

Exhibit 1

EQUIPMENT REQUIRED FOR THE CARIBBEAN INTERNET CAFÉ

| EQUIPMENT LIST | | | |
|--|-----------------|------------------|-------------------------------|
| ITEM | NUMBER OF ITEMS | UNIT COST (US\$) | TOTAL COST (JAS) ³ |
| General Equipment | | | |
| Telephone system | 1 | \$150 | \$5,250 |
| Counter fixtures | 1 | \$10,000 | \$350,000 |
| Espresso machines | 2 | \$2,000 | \$140,000 |
| Cash register | 1 | | \$50,000 |
| Photocopier | 1 | \$800 | \$28,000 |
| Hardware | | | |
| Pentium systems, colour monitors, CD ROMs and modems | 5 | \$2,000 | \$350,000 |
| Colour ink-jet printer | 1 | \$400 | \$14,000 |
| Laser printer | 1 | \$800 | \$28,000 |
| Software | | | |
| Windows 95 | 1 | \$100 | \$3,500 |
| Microsoft Office | 1 | \$350 | \$12,250 |
| Furniture | | | |
| Tables or booths | 20 | \$150 | \$105,000 |
| Chairs or stools | 50 | \$100 | \$175,000 |
| Sofas | 2 | | \$50,000 |
| Other | | | |
| Artwork/sculptures | 4 | | \$10,000 |
| China, cutlery, glassware | | | \$100,000 |
| Flowers/plants | | | \$5,000 |
| TOTAL | | | \$1,426,000 |

³Inclusive of import duties and taxes.