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Recommended Citation

USU Jon M. Huntsman School of Business and Herrmann, David, "Dog Eat Dog World: Challenges of an Entrepreneurial Start-Up" (2012). *Jon M. Huntsman School of Business News Collection*. 160.

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Dog Eat Dog World: Challenges of an Entrepreneurial Start-up



Editor's note: "When Theory Meets Practice – Stories From The Workplace" is a feature in the Huntsman Post in which professionals share stories of challenging events that tested them with the unexpected. The names of the companies and of David Herrmann's partner in the story below have been changed.

By David Herrmann, executive-in-residence

It was my boss who got me thinking about taking a leap of faith and starting my own business. It proved to be a leap I survived even though I had a faulty parachute.

I had worked for a local pet supply company, ACME Pets, for six years when it was taken over by a large national company, GC Pet Supplies (GCPS). It was during a weekly sales meeting for the new company that the inspiration came. When my new boss announced some changes that most of us thought would be bad for our customers he offered this reassurance, "Who are the customers going to get their supplies from if they don't like it?" By acquiring our company GCPS had secured a pet supply monopoly in the region.

It was at that moment that I began to consider starting my own company. I later found out that a friend, Dwayne, also thought the time was ripe for GCPS to have some competition. Dwayne had worked for ACME Pets for nine years, starting as a warehouse laborer while he finished college. When he graduated, the owner approached him about taking over a sales route for a departing rep. The position was perfect for him. His warm genuine personality quickly won over his customers, and eventually Dwayne increased his territory's annual sales to more than \$2 million, one-third of that office's total.

I had started six years earlier as a buyer and had built a strong relationship with more than one hundred vendors from whom ACME purchased products. I worked hard and simultaneously pursued an advanced management degree. My efforts paid off, and I moved up the company ladder rapidly. At the time that GCPS bought ACME, I was the general manager of the company. As such, I had ample opportunity to build relationships with many of the customers and vendors that worked with ACME.

After seven months of research, we determined that our potential enterprise had merit. We left the company to start our new business, Qualco Pet Supply. Our challenges were far from over. We still needed to secure the required financing to get the company off the ground.

GCPS was obviously not happy about the potential competition and it attempted to flex its muscles and discourage suppliers from selling to our new company. Suppliers and customers, however, liked the idea of a new pet supply distributor in the area, and Qualco was reasonably successful at securing commitments. In fact, the number-one supplier in the industry sold and shipped product to Qualco three months before its planned opening. This provided legitimacy for Qualco that we were able to leverage. The fact that we had already procured a significant amount of product from the industry's top supplier opened doors at many other suppliers.

GCPS became increasingly distressed by the competitive threat and practiced open retribution on suppliers that sold to Qualco. The effect, however, was the opposite of what it intended. GCPS's tactics generated a wave of support among suppliers for Qualco, both overtly and covertly.

While Dwayne was shoring up support from customers for the projected launch, I worked feverishly on business plans and projections. Based on discussions with potential customers, we projected that they could capture approximately one-sixth of the \$6 million market in our first year. We determined that it would ultimately take \$300,000 to \$400,000 in inventory to offer a full line of products, which would be vital to achieving our long-term market share goals. We could not, however, justify that many dollars in inventory for the initial launch. So, I calculated the bare minimum level of inventory that we believed would be needed to get started. If Qualco could begin with \$175,000 of inventory, with a 30% margin, and minimum four turns, we would be able to generate \$1 million in sales.

In addition to the inventory costs, I anticipated that Qualco would need \$87,500 for other start-up expenses. I felt we would need at least \$300,000 in funding to cover inventory and other start-up costs, with a small cushion for operating losses and an accounts receivable balance. Monthly operational expenses were expected to be about \$22,000, including principle and interest on the \$300,000 note. We planned to push any spare monies into additional inventory. I knew that finances would be tight, but I believed that the goals were attainable.

Fortuitously, we found a mutual friend who offered to help financially with our new business. Rather than providing funding for the venture, our friend opted to help us secure a bank loan that would be personally guaranteed by each of the three of us. The loan would be collateralized with the value of our homes. We were approved for a \$300,000 loan from a branch office of a large regional bank. The pieces were falling into place, and we were well prepared for the launch of Qualco Pet Supply (or so we thought).

Always Expect the Unexpected

Armed with formal bank approval, we borrowed some short-term money from friends to pay for our first few product orders and to cover some of our start-up expenses. We leased warehouse space and hired a couple of key employees. We also used personally-guaranteed loans to purchase trucks to be used for delivery.

Finally, the big day to close on the loan arrived. The much needed money would be used to pay off the short-term loans and acquire the additional inventory we needed to finally open the doors. All three partners, and their wives, traveled to the bank to "sign their lives and homes away."

As we entered the bank, we were greeted by a nervous loan officer who informed us that a "committee" had met that morning and revised the bank's previously approved loan down from \$300,000 to \$175,000. The bank was unyielding, even with the threat of a lender liability suit.

Given the start-up expenses already incurred, that left Qualco with half the needed money for inventory and nothing for operational losses or accounts receivable. We were literally sick! We had run the numbers a dozen times and could not see how the business could survive with the amount of money that was available. We had already spent tens of thousands of dollars and had committed to tens of thousands more. There just was not enough money for inventories to get the job done.

In hindsight the bank did us a favor as they forced us into a bootstrapping scenario that formed the base of our competitive strategy. We became the most efficient operator in the industry, later opening offices in Denver and Seattle (GCPS was forced to close in two of those markets), and servicing thousands of retail accounts in 11 western states. Specifically, we looked at how we could double our turns on inventory, pre-sell orders, tighten our AR, consolidate delivery routes, and contract delivery on routes we were light on, etc. Our people were financially motivated towards efficiency, everyone from the buyer to the delivery staff. We grew substantially in a market in which growth curve had peaked. It also became the basis for what I teach in the entrepreneurship program here at the Huntsman School: "doing more with less."