

## **Around the Way Dog**

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*Around the Way Dog was a gourmet hot dog and hamburger restaurant created in a suburban college town. This teaching case on the venture opens by tracking the difficulties in financing and structuring this startup. After startup, the case presents typical growing pains of a restaurant: labor cost management, production management, promotion of an unfamiliar brand name, and destructive partner conflict. Despite a lack of comparable competitors and a seemingly small town environment, the case concludes with a business on the brink of failure. A teaching note follows to guide discussion regarding issues such as partner relationship management and undercapitalization.*

Rebecca Jackson sat cross-legged on the black canvas futon in the quiet second floor office of her restaurant, looking around at the cheery yellow walls as if an easy decision would somehow come to light if she sat there long enough. “Easy” had not been a word in her vocabulary since opening Around the Way Dog, a restaurant centered around gourmet hot dogs and hamburgers, a year earlier. Partner conflict, a cash crunch, and her inability to maintain a business alongside a career had all made successfully owning and nurturing a small restaurant seem impossible, and she just wanted out.

But how could they get out? The restaurant had liabilities, employees, extremely loyal customers, and vendors that were relying upon her and her husband, Scott, to keep trudging on. She and Scott had decided that a sale was eminent, but the decision was still an emotionally charged one. The decision to sell just didn’t “feel” right. They felt fear, betrayal to their employees, customers, and vendors, betrayal from their partner, and uncertainty. How much could they ask for a brand new business in this recession? What type of buyer should they look for, or would anyone even be interested? How could they get the cooperation of their estranged partner? Her thoughts were interrupted as the cashier, Mel, called up the stairs, reminding Rebecca of the roll of quarters she had gone up there to get in the first place.

### **APRIL 2009**

It was starting to get warmer outside as Spring began to bloom, and so Juan Turner’s trainees at his new business, FitFolks Sports Training, were jogging outside. While jogging with them, his mind was contemplating an exciting venture idea one of his clients and he had discussed the night before. Having spent a few years in Chicago, the mecca of hot dogs, Juan had always thought it would be a great idea to bring the concept of the hot dog stand to a Southern town. His client, Scott, had mentioned that there were a few hot dog stands and a couple of hot dog restaurants in Memphis, where he worked, and that during lunch time, people would actually stand in lines 20 long to get a hot dog! The entrepreneurial desire in Juan started to tingle when he considered the idea more and more, and he wondered what his client would

come back and say this evening after talking with his wife about the matter. More importantly, he wondered what his own wife, Alaina, would have to say about him starting yet another venture.

The night before, as Scott recovered from his workout, he talked about the conversation he and Juan had. His wife, Rebecca, a professor of strategy and entrepreneurship, winced at the idea of another business. “A hot dog stand? Are you kidding?” she said. It seemed so menial, so...silly. He said, “We wouldn’t be running it – just investing in it. The start-up budget would be so little. I’ve already researched online and found that you can get a vendor cart to start with for \$5000.”

They had just closed their first business two years prior, a construction company, and it had consumed their lives while it was open. She had almost ruined her chances for tenure at her university, trying to balance a rapidly growing business and a career, and he was asking the family to do it again? She said, “Please don’t do this to me,” but inside, she understood that he wanted to give it a try. She also knew that there was certainly a market out there in their college town for junk food and little to no competition, so maybe this could work.

Scott dove in. He called City Hall to ask about the possibility of a hot dog stand in town, and there he encountered his first barrier. To be a vendor in the town would require going before the city planning department, and would only allow them 70 days of operation each year at a single location. Rebecca said, “Well, we do have some money saved and we could sell a few things to gather the rest of the money. I would bet that Juan could come up with half. Why don’t we try for an all-out restaurant? The return from a restaurant would be greater than the return off of a stand, anyways.” Scott and Rebecca met with Juan and Alaina, and the idea took off. As May rolled in, the venture began to take form. A menu was developed, a startup budget was created, and the group began to interview people in town to determine whether anyone even wanted a hot dog badly enough to try the new business. Rebecca and Scott constructed some projections that showed that, given a customer base of just 10% of the customers an established restaurant in the area was attracting each day, the idea could be viable, as shown in Table 1. All that was left now was to incorporate the business, get their pool of startup money together, and get this show on the road. According to their early estimates, about \$30,000 to \$35,000 was needed to get their restaurant idea open.

Juan was working hard to get his half of the startup money. He and Alaina had just purchased their first home together and were expecting their first baby in December. Money was tight. He found it all frustrating. Just a few years ago, he had been a free agent in the NFL, playing first with the Jaguars, and then moving to the Bears. Then, it wouldn’t have been an issue to come up with \$15,000. Now, with a baby on the way and a startup fitness business also in need of capital, it was a huge issue. He and Alaina were even worried about telling her parents that they were considering starting another business, so asking them for the money wasn’t an option. Asking his family wasn’t an option, either. He just didn’t feel that close to his father. In the end, they asked a friend if she would loan them the money to start the restaurant, and she agreed. Elated, they continued to plan for the startup, but as weeks passed, she never committed by actually writing the check. When they confronted her, she conceded that she just didn’t have the money to spare. Now what? After the recent purchase of their home, there was no way to get an unsecured loan for \$15,000 with their average credit.

**TABLE 1**  
**PRO-FORMA MONTHLY CASH BUDGET AFTER YEAR ONE (ESTIMATED)**

Revenue from 26 days open, 1 month:	44,000
<u>Expenses:</u>	
Fixed or Semi-Variable Costs:	
Rent	1950
Accounting fund	300
Legal fund	300
Insurance	
Workman's Compensation	180
Liability on Location	190
Benefits	
Health Insurance	3000
Vacation Time	200
Labor	7800
Management Labor	4333
Utilities	
Electricity	800
Gas	1000
Garbage Disposal	125
Cable, Phone, and Internet	225
T-Shirts	100
Cleaning Supplies	200
Office Supplies	200
Equipment Repair Fund	200
IT Fund	300
Promotion and Advertising	800
<hr/> Total Fixed Costs per Month	<hr/> 22,203
Variable Costs (based on 270 customers per day):	
Cost of Food:	13,200
<hr/> Total Variable Costs per Month	<hr/> 13,200
Total Expenses per Month	35,403
Net Profit per Month	8597

Meanwhile, Rebecca went to work on a detailed startup budget. She had heard from other restaurateurs that it would take \$100,000 to start a restaurant, but she was certain that with the purchase of used, rather than new equipment, and with the selection of a location that was already renovated, they could save a substantial amount. After researching four locations, they found a cozy, lovable house within walking distance of the large state university in town. The glory of this place was that someone else had blown their \$100,000 startup budget before opening, just a year prior, renovating the place and making it codes-compliant for a restaurant. There was still work to be done, but it was minimal. Most of the budget was going into making the location unique – a kiosk ordering system, flat screen TVs in every room for watching sports, deriving a clean but relaxed and cozy look. As was expected, the budget kept creeping

upwards, and so Rebecca designed a conservative plan to represent what would absolutely have to be purchased and completed before opening day, as shown in Table 2.

**TABLE 2**  
**DESIRED AND CONSERVATIVE STARTUP BUDGETS, AROUND THE WAY DOG**

	<u>Description</u>	<u>Desired</u>	<u>Conservative</u>
<b>Exterior</b>			
Street signage	Replacement panels, street	750.00	700.00
Exterior paint	Fix blue stripe, one coat poss.	500.00	100.00
House signage	Wooden or resin sign for house	1,000.00	200.00
Lighting	Light up wooden signs on gable end	500.00	200.00
Picnic tables	3 concrete picnic tables	900.00	250.00
Benches	2 park benches for front porch	<u>500.00</u>	<u>200.00</u>
		<b>4150.00</b>	<b>1650.00</b>
<b>Interior</b>			
Interior painting	2 coats on walls of interior	500.00	500.00
Floor renovation	Refinish floors for atmosphere	3,000.00	-
Stainless counter work	Apply stainless steel to counters	400.00	-
TVs and installation	3 flat panel TVs and brackets	1,500.00	500.00
Pictures and décor	Add nostalgic national and local art	700.00	500.00
Ceiling fans and lights	Move lights to sides of ceiling, install fans	1,000.00	350.00
Open kitchen wall	Extend wall hole leading to kitchen	600.00	-
Cleaning supplies	Supplies needed to thoroughly clean facility	150.00	150.00
Furniture	Back room furniture and kids' spot décor	<u>700.00</u>	<u>500.00</u>
		<b>8550.00</b>	<b>2500.00</b>
<b>Equipment</b>			
Freezer	Need 15 cubic ft.+ freezer	1500.00	1500.00
Cooler	Need cooler for vegetables, meats	1500.00	1500.00
Fryer	Need 1 more 2-basket or 1 4-basket fryer	800.00	800.00
Grill	Need gas grill for hot dogs and burgers	600.00	300.00
Warmers	Need 2 food warmers for chilis and dogs	<u>500.00</u>	<u>360.00</u>
		<b>4900.00</b>	<b>4460.00</b>
<b>Register/POS System</b>			
Hardware	Screens and register	3,000.00	500.00
Software	Restaurant Pro or Custom Software	600.00	200.00
Quick Books	Accounting software	<u>129.00</u>	<u>129.00</u>
		<b>3729.00</b>	<b>829.00</b>
<b>Promotions/Marketing</b>			
Cartoon graphic design	Design mascot and 2 t-shirts	400.00	400.00
Weenie costume	Construction of wearable hot dog costume	250.00	250.00
T-shirt 1 <sup>st</sup> printing	Print t-shirts for public sale	600.00	300.00
Polos-managers	Print polo shirts for management w/ logo	300.00	-
T-shirts – employees	Print t-shirts for employees upon hire	<u>450.00</u>	<u>200.00</u>
		<b>2000.00</b>	<b>1150.00</b>
<b>Purchases of Food</b>			
First food purchase	Food for one week or ½ week, conservative	5,000.00	3685.00
Paper products	Startup supply of paper products (2 weeks)	<u>2,000.00</u>	<u>800.00</u>
		<b>7,000.00</b>	<b>4485.00</b>

<b>Legal Services</b>			
Lease review	Review of lease and negotiation	1500.00	1500.00
Inspection services	Permits and inspections to open	<u>550.00</u>	<u>500.00</u>
		<b>2050.00</b>	<b>2000.00</b>
<b>Employee Training</b>			
Pre-open training	10 hours training, 5 employees	<u>500.00</u>	<u>500.00</u>
		<b>500.00</b>	<b>500.00</b>
<b>Rent/Deposits</b>			
First Month's Rent	Rent for August 2009	1950.00	1950.00
Grease Trap Deposit	Deposit for Grease Trap	<u>600.00</u>	<u>600.00</u>
		<b>2550.00</b>	<b>2550.00</b>
<b>Grand Opening</b>			
Grand opening party	Party for vendors, professionals, creditors	<u>1000.00</u>	<u>500.00</u>
		<b>1000.00</b>	<b>500.00</b>
<b>Reserve Fund</b>			
Reserve fund	Fund for future orders, maintenance	<u>5000.00</u>	<u>5000.00</u>
		<b>5000.00</b>	<b>5000.00</b>
<b>GRAND TOTAL</b>		<b>41,429.00</b>	<b>25,354.00</b>

One night in mid-May, Scott read a text on his phone, and his face went pale. “They can’t come up with the money,” he explained to Rebecca. “What now?” Scott and Rebecca had already planned on other ways to get the capital, including postponing the preparation of the business until they were awarded regularly scheduled bonuses at work, selling the family’s Jeep, motorcycles and boat, or digging into their 401k. The couple developed a plan whereby Juan’s share of the business, currently planned at 51% due to his future operational management role in the venture, would start instead at 10%, and grow to 49% as he contributed small injections of capital over the first year and as he could buy back ownership share with future profit. Scott and Rebecca would fund the business upfront, with an understanding that Juan and Alaina would contribute as they could during the first year.

When the group met to discuss the plan over dinner, the tone of the relationship had already changed. Conversations that had once been jovial and easy became strained and fractious. Juan and Alaina felt insulted and lowballed by Rebecca and Scott’s offer. Juan felt that he had a celebrity status as a football player among locals that would attract diners to the restaurant. Once opened, that should count for a great deal. After all, he was the one who had the idea to start the hot dog stand in the first place. Scott and Rebecca felt uncertain and let down that the other couple had fallen through with their commitment to get funding. They also felt as if they didn’t want to anger their partners or make them feel devalued. On both sides, the level of trust had diminished. At the end of the dinner, they negotiated to the point where Juan would retain 30% ownership of the business, and he would work hard to infuse the business with \$15,000 the first year. Juan asserted that his image in the community, and the future revenue that would be made through the patrons that would come to see him was worth this share.

Over the next two months, the couples drafted an operating agreement, formed an LLC, signed a lease, and literally ate their way through hours of meetings to decide upon a menu. Juan proposed that the business use the name he had always wanted his hot dog stand to use: Around the Way Dog. Rebecca really couldn’t understand the name, was concerned as to the copyright issues it would have with LL Cool J’s “Around the Way Girl,” and didn’t think that it was memorable, but since Scott and Alaina liked it as well, it stuck. They bought used equipment from the masses of restaurants going out of business in the area, many due to the recession. It often felt like they were vultures, lighting onto those restaurants and picking around through what was left. They interviewed several people for hire who walked in while the restaurant was being renovated, and were able to retain their entire initial crew with these few and their friends. Despite their lack of experience, the only areas wherein the partners diverted from their budget

were in paying relatively massive utilities deposits and completing unforeseen electrical work, which ate up the funds they had set aside for a grand opening party.

One month after the university started classes in the fall, the business had its first day, a soft opening scheduled on a Sunday just for friends to come by, try the food, and suggest improvements. Unfortunately, too many were invited. In the final five minutes before opening, Rebecca strained to figure out the subtleties of the cash register and Scott and Juan tried to fan the flames of the grill in the back. One hundred fifty customers waited outside in the heat in a parking lot made for about 18 cars. As 1:00pm struck, the doors were opened, and people flooded the building. Some customers waited 45 minutes to be served a hot dog and fries, but everyone remarked about how exceptional the food was. Three hours later, the last customers left, and cleaning began. The group identified several operational bottlenecks that were keeping them from serving as many customers as they would like, and Rebecca sighed. She was three weeks into the semester, and the workweek would begin early for Scott and her the next morning. The partners' parents, who had proudly showed for the opening, patted them on their backs and gave them encouragement, and they locked the doors.

## **NOVEMBER 2009**

Two months after the official opening, life was good for the restaurant. The brand image they had wanted to portray, that of an irreverent challenge to the status quo, cookie-cutter nature of the average fast food restaurant, had worked. Early adopters: transplants from the northern U.S. and foodies who were constantly on the lookout for the newest offering in town, were already regulars. Thanks to Juan's previous stint at a Heisman-potential running back at the university in town, the local newspapers and football fans were very interested in the young start-up. After two articles appeared in the local paper, lunches at the small restaurant were standing-room only. Sales had just reached projected levels required for profitability, and this happened months before the partners had even imagined. They hired more help just to clean tables and direct walk-through traffic in the shop.

Still, all was not perfect. The rush of customers was greater than the capacity of the restaurant. Scott created a helpful new production and cooking procedure in the back kitchen; however, still, only around 8 to 10 orders could be cooked simultaneously. Through most of the midday, 30 to 40 people were there, causing some to wait 30 minutes for lunch. The word getting around was that the food was super, but only if you could afford to wait for it. Scott felt like he couldn't avoid driving from his workplace in Memphis every day to spur lunch production. The boom from the initial press lasted about four weeks, and, just as quickly, sales began to drop. Payroll from the busy days was also becoming a burden to cover with the dwindling revenue, and with the effects of the newspaper coverage waning, advertising and promotion were becoming a priority. Free-flowing cash was needed, but nowhere to be found. Juan had been working several months in the restaurant without a paycheck from another job, and took a \$1000 draw from the business to help cover his family's mounting expenses at home. As December came, he felt himself growing impatient, and stagnant sales were eroding his hope. His son was due any day, and the restaurant wasn't providing the financial support he had expected from the initial crowds. There were too many things on his plate, and he felt his partners could not empathize, since they had careers that supported their household.

## **JANUARY 2010**

But the Jacksons weren't set at home. Their paychecks were steady, it was true, but now the business wasn't supporting itself. They had initially used most of their savings, their summer bonuses, and even sold some of their recreational equipment to fund the start-up, and had little left to use for important promotional campaigns. The business still needed \$2000 to \$3000 in addition to its revenue, just to operate monthly, and it was coming from their pockets. While Juan was growing impatient with the business, Rebecca was growing impatient with Juan. There had been no mention of his locating the share of capital he had committed to before startup, and he regularly needed someone to replace him during the

day, which drove up labor costs. Some days, Juan would bring his newborn son with him and place him in an infant carrier on a front table so that he could cover his shift and watch his son. Other days, he would leave his son in the upstairs office and listen for him on the baby monitor. Occasionally, he would leave his son with employees to run errands or meet for job interviews while Alaina was at work. Clearly, he was doing the best he could, as was Rebecca, but was it enough? At a particularly incendiary officers' meeting, as he argued for a pay cut to the employees, his frustration boiled over, and he exclaimed, "Screw the employees, my family's going broke!"

Christmas break had been dreadful. With college students comprising 50% of their customers, the restaurant had become a ghost town for a month. Sales dropped 50% over the break, and Rebecca had to dip into her retirement fund and take the resultant penalty to cover payroll. Bills were seriously starting to pile up, both in the business and in the Jackson's household. What was worse, Rebecca frequently had to leave her work at the university to do routine checks on the restaurant during the mornings and afternoons, then work the restaurant at night. Her daughter had to stay at the restaurant with them and watch TV, paint, draw, or visit with the customers every night. Three days each week, before Rebecca started work, she drove an hour into Memphis and an hour back to pick up fresh buns from their artisan baker, as well as any fresh produce that was needed. She started to become depressed as she resigned herself to the fact that this cycle might not end anytime soon.

## **MARCH 2010**

Spring brought a renewal in more than just nature. Sales at Around the Way Dog started to steadily climb again as word of mouth caught on. A new promotion, Two Dog Tuesday, was designed to combat the Tuesday discounts at each of the restaurants surrounding "The Dog," as it had had come to be called, and it had caught on like wildfire to the discount-sensitive college students. Tuesdays had become a social event for hipsters, aggies, and Greeks alike. Because the food was excellent, most customers would return multiple times during the week, stating that they couldn't hold out until the next Tuesday. Still, when random townspeople were asked about the restaurant, more than 75% did not know what or where it was.

By March, the animosity between the partners had mounted to intolerable levels. Rebecca had let Juan know that he couldn't continue to bring his son to the business and maintain the atmosphere they were looking for, and Juan was aggravated by what he felt were out of control expenses. He began to instruct the employees to serve food in smaller portions or with fewer toppings. If employees hesitated to serve sloppily assembled food, he would grimace at the idea of wasting it to correct the issue, and would tell them to send the product out anyway. He grew angry at the fact that Scott and Rebecca scheduled employees to work the restaurant on slow nights so that they could go home and rest. After all, she complained about profits; that was causing an unnecessary expense. Juan also felt that Rebecca and Scott were too friendly with employees, going out with them occasionally or having them over to their house. It was getting to the point where employees would refuse his requests to reduce costs, simply out of some cultural allegiance they had to Scott and Rebecca's vision for the restaurant. After a while, he and Alaina stopped coming to the restaurant entirely, and refused to meet with Scott and Rebecca. Why bother when their ideas and minority votes, in all practicality, didn't count? Even as sales were climbing, Around the Way Dog was crumbling from the inside out.

## **SUMMER 2010**

As the summer loomed ahead, along with it came the assurance that sales would plummet again, due to students' summer moves back home. At least Rebecca's classes were done, so that she could manage all day at the restaurant. Extra cash was unheard of, as was her partner. Rebecca and Scott realized that with three months of slow sales ahead before the students returned, the only option for the business was a large cash infusion, both for the three months ahead and for a promotional campaign to push brand awareness into the mass market. Their frustration came from the glowing reviews they had, coupled with the lack of customers. One Yelp review had labeled them, "An Instant University classic." So where was

everyone? The couple began to consider selling more of their assets, taking out an unsecured loan, and lastly, selling the business to someone who could take it to the next level.

Surely among the venture community, there was someone who would want to take a business that was undercapitalized, but strategically promising. Scott and Rebecca considered that they could get \$4000 to \$15,000 together on their own quickly, but that a new owner could offer unlimited capital potential. Rebecca looked at the income statement, shown in Table 3, for the first nine months, and shook her head. Where were all of the customers they had counted on to cover their fixed costs? She looked at their pro-forma budget and compared it with their actual expenses, shown in Table 4. She cynically snickered at the idea of being able to afford health insurance or a monthly trip to the bookkeeper to do the work she currently did, as her daughter was falling asleep on the office futon behind her. How foolish she was to believe this would ever work!

**TABLE 3**  
**INCOME STATEMENT, SEPTEMBER 2009 THROUGH MAY 2010**

Income		
Food Sales		
Food Sales - Cash		70,150
<u>Food Sales - Credit Card</u>		<u>88,740</u>
Total Food Sales		158,890
Cost of Goods Sold		
Food Purchases		79,024
<u>Restaurant Supplies</u>		<u>7,440</u>
Total COGS		86,464
Gross Profit		72,426
Expense		
Advertising and Promotion		7,175
Alarm Service		249
Bank Service Charges		3,934
Business Licenses and Permits		1,176
Charitable Donations		300
Computer and Internet Expenses		557
Equipment Rental Fees		1,541
Gas Expense		392
Insurance Expense		4,231
Office Supplies		2,643
Payroll Expenses		56,501
Pest Control		542
Professional Fees		1,575
Rent Expense		16,562
Repairs and Maintenance		6,724
Restaurant Decor		1,259
Uniforms		492
<u>Utilities</u>		<u>10,816</u>
Total Expenses		<u>116,669</u>
Net Income		(44,243)

**TABLE 4**  
**ACTUAL MONTHLY CASH PERFORMANCE AFTER NINE MONTHS OPEN**

Revenue from 26 days open, 1 month:	\$20,518
<u>Expenses:</u>	
Fixed or Semi-Variable Costs:	
Rent	\$2000
Legal fund	\$31
Equipment Rental	\$180
Insurance	
Workman's Compensation	\$230
Liability on Location	\$190
Labor	\$5383
Utilities	
Electricity	\$800
Gas	\$925
Garbage Disposal	\$125
Cable, Phone, and Internet	\$300
Restaurant Décor	\$150
Office Supplies	\$120
Repairs	\$662
Pest Control	\$50
Bank Charges and Credit Card Machine	\$521
Alarm Service	\$30
<u>Promotion and Advertising</u>	<u>\$690</u>
Total Fixed Costs per Month	\$12,387
Variable Costs (average 105 customers per day):	
<u>Cost of Food:</u>	<u>\$9916</u>
Total Variable Costs per Month	\$9916
Total Expenses per Month	\$22,303
Net Profit per Month	(\$1785)

Two major concerns about putting the business up for sale existed. The first of these concerns was the valuation of a business that seemed to have potential and a loyal customer base, but had negative net income and few tangible assets, as shown in Table 5. How much would be too much, in a recessionary economy? Could they be sure the price was high enough to attract someone with ample capital to grow the business? Would they allow for financing options for an interested buyer? Would they continue to stay on as minority partners? How were they to approach this with Juan and Alaina?

**TABLE 5**  
**AROUND THE WAY DOG BALANCE SHEET, MAY 31, 2010**

	May 31, 2010
<b>ASSETS</b>	
Current Assets	
Cash	2349
Cash Register	222
Utility Deposit	1910
<u>Security Deposits</u>	<u>2550</u>
Total Current Assets	7031
Fixed Assets	
Furniture and Equipment	6918
<u>Signs</u>	<u>548</u>
Total Fixed Assets	<u>7466</u>
<b>TOTAL ASSETS</b>	<u><b>14,497</b></u>
<b>LIABILITIES AND EQUITY</b>	
Liabilities	
Current Liabilities	
Accounts Payable	4280
Payroll Liabilities	7127
<u>Sales Tax Payable</u>	<u>4540</u>
Total Current Liabilities	<u>15,947</u>
Total Liabilities	15,947
Equity	
Rebecca Jackson Equity	36,229
Juan Turner Equity	0
<u>Retained Earnings</u>	<u>-37679</u>
Total Equity	<u>-1450</u>
<b>TOTAL LIABILITIES AND EQUITY</b>	<u><b>14,497</b></u>

The second concern Rebecca and Scott held was that of cultural continuity. Even with a new owner, what would happen when the customers came in and weren't welcomed by their friends, Scott and Rebecca? What would a new owner do with their current employees, and how would they be treated? Would a new owner keep the current menu, or try to cut corners to save costs?

Even as they began the post to craigslist.com for Local Restaurant for Sale, they felt traitorous and sorrowful, but at the same time, they felt the hope that someone might be able to rescue this operation and make something extraordinary out of it. The next few months would reveal whether their decisions would salvage or kill the young business.

## **QUESTIONS FOR THOUGHT**

1. What problems were inherent in creating conflict between the owners from Day 1?
2. Describe the problems with the partnership team composition that caused undercapitalization from the start.
3. What are the barriers that are hindering this small business?
4. What is the best course of action for the owners from this point onward?
5. What changes in course of action could have improved the owners' current position?
6. What should be done to address the absentee owners?
7. How would you go about valuing this ongoing business for sale?
8. Does it make sense to try to sell this business, or should the owners attempt liquidation and closure? Provide a rationale for your choice.

## **TEACHING NOTE AROUND THE WAY DOG**

### **CASE PURPOSE AND AUDIENCE**

This case is intended to serve a dual pedagogical purpose, part a financial lesson and part an interpersonal lesson. From a financial perspective, the purpose is to provide practice in the division of ownership share in a business, both before startup and through early stage growth, and to allow students a chance to provide cash flow and cost level advice for a fledgling operation. Financially, this case is designed to generate dialogue that focuses on intangible assets, such as celebrity status as a predictor of future revenue streams, as well as on cash flow management and undercapitalization of a small enterprise. Interpersonally, this case provides a look at partner choice and conflict management in a dysfunctional partner relationship and allows for students to consider what factors should go into the choice of a partner, and how conflict between partners can ruin a business.

The best audience for this case would be an undergraduate, introductory entrepreneurship class, preferably which has had exposure to both team member selection and to interpretation of accounting statements. Students with this level of training would be able to address the fact that the organization is severely undercapitalized from the start, both in terms of cash and expertise. Another audience for this case could be an undergraduate small business strategy class, who could utilize this case from the multiple functional perspectives of a business to examine the overall health of the company as it grows.

The case has several potential uses as a class tool, depending on the instructor's focal lesson. Partner selection, the difficulty of valuing intangible assets, equity division at startup, partner conflict, and the sale of a young business are all possible topics that could be focal points in a class covering this case. Furthermore, the case could be used at the beginning of an entrepreneurship course to show the harsh reality of business ownership, and continually consulted throughout the semester to provide short ad hoc application lessons as students augment their knowledge base.

### **SYNOPSIS OF THE CASE**

Rebecca and Scott Jackson and Juan and Alaina Turner were two couples who decided to become partners in a gourmet hot dog and hamburger restaurant called Around the Way Dog. Early in the relationship, difficulties in financing the startup caused tension between the partners and confusion as to how to structure the ownership of the business. The partners pressed on, performed market research, and designed a startup that they believed had potential due to its uniqueness. After startup, the partners experienced typical growing pains of an independent restaurant, including labor cost management, production design and management, and promotion of an unfamiliar brand name. Additionally, the

introduction of personal financial difficulties and a new baby into the life of one of the couples seemed to be more than they could handle.

Around the Way Dog suffered from the cyclical nature of sales from their most loyal customer segment, as well as a lack of cash flow and growth capital. Despite a lack of comparable competitors and a seemingly small town environment, the restaurant found it difficult to gain familiarity with the mass market through inexpensive means. By its ninth month of operation, the business was smothering for lack of capital, and its remaining active owners Rebecca and Scott found themselves trapped in the operational management of a company they had originally only intended to finance, with careers of their own. The owners thought, "Can we sell this business, intact and running, to someone who can infuse the capital it needs, while simultaneously relieving ourselves of this entrapment? What could we sell it for, assuming continued growth?"

## **BASIC ISSUES AND TEACHING OBJECTIVES**

### **Partner Choice**

One of the first, most obvious topics illustrated in this case is that of partner choice. Entrepreneurship texts frequently focus on the selection of early employees as a critical component of entrepreneurship, but fail to examine the concept of correct partner choice and the factors that lie within. In the case, the partners had known each other for a short while, roughly six or seven months. The partners did not perform additional research to examine each other and their compatibility. Students should be urged to discuss what factors might be included in the optimal partner selection process. Concepts that appear in the discussion should include prior experience in an industry, ability to work well together, access to capital, goal congruence for the venture, strong and loose social ties within the relevant market sphere, creativity, and decision making ability. Partners who have similar access to social networks or other capital could be more desirable, not only for their direct benefit for the venture, but also for the reduction in power difference between partners that can lead to dissention. It is also beneficial for students to discuss what types of preventive measures could be placed into a partnership agreement to eliminate the risk taken on by each partner due to weaknesses in their partner choice.

### **Partner Conflict**

A second topic illustrated in this case, and one that segues naturally from the above discussion is the control and management of partner conflict in an ongoing relationship. Once partners are committed to a business, and it begins operation, how should their relationship work, and how should it be structured? How can partners better communicate to avoid dysfunctional conflict and promote constructive criticism? How can partners make the transition from creators and dreamers to effective upper management and director roles?

The best decisions in organizations are made by using a number of informed persons' perspectives, but in an organization with one majority owner and one minority owner, one person's voice can be continually drowned out, resulting in a zero sum mindset. Both sets of couples had different ideas about human resource management and cost control, for example. One of the ways that the owners could have made more progress in a compromise strategy involving human resource management and cost control was to exercise more strategic planning before opening. By creating policies and procedures, as well as a values statement, the owners could create a structure that would not change with the stress load or personal situations of the owners. Another way that the owners could avoid conflict would be to create a board of advisors who could meet with them periodically. Such a board would introduce new ideas to them and give them insight on areas of disagreement from a third party perspective.

Another personal conflict issue in this case that created conflict was that neither owner was personally or financially ready to own a business this large. Both owners experienced financial difficulty in their homes as a result of being involved in the business, and Juan's financial struggles led to his disillusionment and subsequent withdrawal from obligations that he had committed to when the business began. Both partners had young families that required attention they could not afford to give. Rebecca and

Scott were involved in careers that required their full-time attention, and relying on Juan to provide free labor when he was in no personal position to do so was delusional. Frustration on the parts of both parties for the other partner to fix problems devolved into desperation and anger. Conflict about how to run the business degenerated into personal attack and defense of each other, and the business became much like a small child standing on the sidelines during a parents' tumultuous divorce. Instead, asking questions about what outcomes would be best for the business and working backward through to a set of strategies could result in more constructive discussion.

### **Valuation of Ownership and Valuation of the Business**

There are two opportunities for students to consider valuation, both of intangible and tangible assets and resources. The first situation which required valuation was the division of equity at the outset of the relationship. The second situation requiring valuation was that of the sale of the business.

This case evidences a relationship in which a split of control was an issue, and in which one partner had a dream which the other partner financed. Both partners, at the beginning of the case, wondered what their contributions to the startup were worth, in terms of ownership share. When capital brought to the relationship was similar among the partners, division of ownership was simple. As Juan was to have operational management of the company, and Rebecca and Scott were to mainly invest and provide little labor, the decision was simple – to have Juan as the slight majority owner. When things became complicated was the moment Juan admitted that he could not find the capital needed. At that point, the proper division of ownership was clouded, more by emotion than anything else.

Students should list the resources that each partner brought to the relationship: Juan: an idea of starting a hot dog restaurant, local athletic celebrity status that could bring faster customer awareness; and Rebecca – strategic management knowledge, financial capital, a communication channel to collegiate customers, and any others that students detail. Students should practice estimating the future earnings that might be made from customers who would not otherwise come, were it not for Juan's image, and there should be discussion as to what that calculation might be. Students should discuss whether the resultant ownership division that actually did occur was fair for both sides, and how the students would have structured the company instead. Another discussion point that could arise include the value of an idea – should someone be compensated with ownership share simply because a business concept was their idea in the first place? Finally, an important topic to cover with students is the concept of "skin in the game." Do students believe that Juan would have decreased in his effort toward the business, if he had made a sizeable contribution of his own to equity? Would that change if he had gotten the funding from his friend, as opposed to using his own savings? Topics such as these will help students to consider the structuring of partnerships.

This case also concerns the valuation of an ongoing business for its sale. Students should consider if any value is added by selling the business in operation, versus a potential buyer starting his own, brand new business instead. Is there something of value in the fact that the owners have gone through the rigor of the setup of a new enterprise? What tangible assets are available that are gathered already in an existing business? What intangible assets are established or created in this operating business? Are those valuable enough to warrant a price above the market value of the tangible assets in the event of a liquidation and closure?

The fact that the business has not reached profitability causes difficulty in any method of "times earnings" business valuations, excepting those that use estimated future earnings. In this business's situation, the only thing that could be used to defend a valuation over the market value of the assets if liquidated would be the set of features that currently add to create a competitive advantage for the business. The worth of the loyal customer base, the strength of the brand name, the location near the college, the line of proprietary recipes and production techniques, or the business's extraordinary customer service could be considered as intangible assets to add to the market value of the tangible assets for sale.

## Undercapitalization

One of the most frequent causes of entrepreneurial failure is undercapitalization, or failing to have adequate resources for supporting the business and its growth. Undercapitalization, theoretically, is the outcome when the amount of payments, or revenue, that a firm receives is constrained, because the firm has not gathered enough capital at startup to fund its progress toward its strategic goals. The firm may be missing expertise of a partner, or a decent location, or even a great product line-up, because there are not enough resources under the firm's umbrella to procure these things. Literally, the firm's lack of revenue mirrors any shortcomings the firm may have had in assembling the resources necessary to pursue the opportunity its owners identified. Survival through the economic model assumptions the business started under absolutely requires the gathering of ample resources to fuel that model.

One of the first signs of undercapitalization is the cash flow difficulty such as that which was experienced by Around the Way Dog. A second early sign of undercapitalization is an inability to make bulk purchases that could have earned the firm discounts. This compromises the ability of the firm to move toward profitability. A third warning of sign of undercapitalization is early stagnant growth, due to a lack of sizeable marketing campaigns that could affect the business's strength of brand image and identity in its market.

The founders of the business in this case were hesitant to borrow startup money from a financial institution, due to the increased risk of such an obligation. However, their hesitation may have caused the business to flounder unnecessarily in the startup months. Students should discuss the pros and cons of debt financing in today's tight credit environment. Furthermore, the partners in this case were given information that they needed \$100,000 or more to start a business like theirs, and they ignored it, thinking that somehow they were more creative than the average entrepreneur, or that they could find better deals on startup materials than others that had gone before them. Students can discuss what they believe is the value of having industry average financial data. Also, the optimism that is considered a hallmark of the entrepreneurial personality could be discussed, for its strengths and weaknesses.

## SUGGESTED ADDITIONAL READINGS

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