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BetterLiving Patio Rooms

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John Esler thrived on recruiting good people to implement calculated business risks. Although he enjoyed the daily challenges involved in owning a business, some days were more satisfying than others. The first day of April, for example, was a bad day. He had a territory disagreement with Craft-Bilt that required immediate resolution, he had perplexing HR troubles, and production was half of what he had forecast, so his cash was flowing red.

John's company, Patio Rooms of America, Inc. (PRA), was the exclusive Craft-Bilt dealer of BetterLiving Patio Rooms for most of the state of Massachusetts. Craft-Bilt manufactured components for building BetterLiving Patio Rooms (see **Figure 1**). The key benefit of this product was that homeowners could spend time outside without being bothered by bugs or the weather – big problems for people in New England. John founded PRA as a BetterLiving Patio Rooms marketing and installation company in November, 1997.

Sales were vigorous, so a back-log of orders (and impatient customers) was growing. In the first four months of business, PRA sold 41 rooms worth $509,006 and had a six-week installation back-log – and this for a "summer" business. John's comment was, "We had phenomenal sales in January and February. We proved that this business is not strictly seasonal."

John wanted to grow PRA – had to grow the company to support the infrastructure he was creating – but Craft-Bilt resisted selling him the adjacent Connecticut and New Hampshire territories, while up-state New York, Rhode Island, and Maine already had BetterLiving Patio Rooms dealers. Unfortunately, John was not rich enough or successful enough yet in Massachusetts, to convince Craft-Bilt that he could manage another BetterLiving Patio Rooms territory.

Since Craft-Bilt was reluctant to commit immediately, John was trying to persuade Craft-Bilt to leave Connecticut and New Hampshire open until PRA was ready to expand, but Ross Lederer did not want to concede even that. Ross Lederer, the Craft-Bilt Director of Development, was not as receptive to PRA's growth plans as John would have liked. Ross was concerned that PRA could not properly service the additional territory soon enough, so he wanted to be unhindered when approached by qualified buyers. In fact, Ross began negotiating with a couple

Dan D'Heilly prepared this case under the supervision of Professor William Bygrave, Babson College, as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. Funding provided by the Ewing Marion Kauffman Foundation.

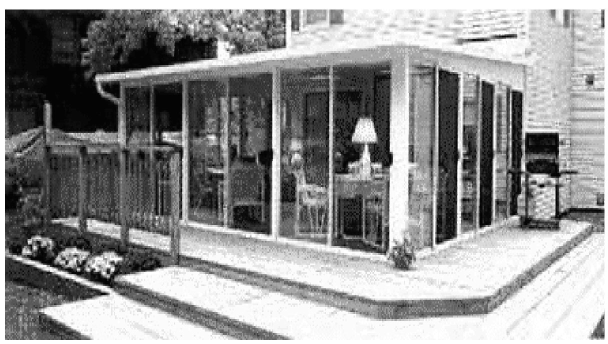
of Wharton Business School graduates for the Connecticut territory shortly after John asked for a right of first refusal.

On the human resource front, John also had serious challenges. PRA already had over a dozen employees, most building patio rooms. These employees were better paid than those in his previous businesses, but the operation was not building rooms fast enough. Craft-Bilt had told him that a two-man crew would build two rooms a week, but PRA crews were only producing one room each week.

How would he persuade Craft-Bilt to give him a right of first refusal on the Connecticut and New Hampshire territories when PRA was not performing as projected? Were his goals unreasonable? Perhaps it was just that the company learning curve was steeper than he had hoped and he needed to be patient a little while longer. But maybe the problem was deeper: John had no background in construction, yet he was running a construction company… PRA had a sales back-log, now it had to construct rooms well enough to survive.

Figure 1

A BetterLiving Patio Room



John Esler

Born and raised in Albany, NY, John first caught an entrepreneurial fever as a teenager. He had worked at the Sarasota racetrack selling tee shirts for a couple of summers and was promoted to supervisor after his junior year in high school. That summer, John found himself in charge when the owner of the business suddenly disappeared. John managed the operation for the next four years and paid his way through college with the profits. Upon graduating from SUNY Albany, John passed the business along to his brothers.

After college, John moved to New York City and worked for the Macy's department store as an associate buyer for two years. He found the work uninspiring so he returned home to Albany. While looking for a job, John noticed that there was no valet service at an upscale restaurant that certainly would have offered it in New York City. He thought a valet service would make good money at this restaurant, so he approached the owner with a business proposition, and started Valet Parking, Inc. John turned one contract into a business, and managed the company for five years. It grew to $200,000 in annual revenue, and employed 30 people (almost all part-time), but he grew bored and sold it to a senior employee in 1990.

Then came Subway Sandwiches. John purchased an Albany Subway store franchise in 1990, and over the next five years, he opened four more stores. The businesses were successful, with two of his stores ranked in the top five Subway stores for the region. However, it wasn't what he wanted long-term.

> I set five-year goals, and when I grossed $1.5 million between the five stores, I definitely met my goals. But when it came time to set new goals, I didn't want to stay in that business. I didn't like the employee equation, I didn't really like the restaurant business, I didn't particularly like the franchisor, and on top of all that, the margins were not very good. I decided to sell my stores and look for something better.

The sale left him with a wider set of options. It was around this time that he met and married Jeannie Lawton, a doctoral psychology student. John became enthused with the idea of gaining more knowledge about his chosen profession. He wanted to develop more sophisticated business skills, to meet other entrepreneurs, and to pursue bigger business challenges with confidence.

John decided to get an MBA and selected the F.W. Olin Graduate School of Business at Babson College. Babson College was a business school on the outskirts of Boston with a one year MBA degree, and a renowned entrepreneurship program.

FranNet

While in school, John's studies included franchising, dealerships, and distributorships, and he wanted the advantages of business affiliation in his next venture. John started researching specific business opportunities, but had not found a compelling opportunity by the time he graduated in May 1997. (See resume, **Exhibit 1**).

> I was looking for growth potential – multiple units or a large territory. I told people, 'I need a business that will be at least $5 million in five years. I already had the million dollar thrill.' One of the things I got from Babson was "What is your threshold?" How high can you set the bar? How much will you be satisfied with?

That summer, John took a three-week safari with his wife before getting to work identifying his next venture. Back from Africa, John decided to engage the services of business brokers. Eventually he found FranNet, a national network of franchise brokers who shared information about business affiliation opportunities. There were FranNet consultants selling franchises and dealerships nation-wide, and they operated much like realtors representing the sellers in a real estate transaction. The Boston branch was owned by Jack Kelt. Jack interviewed John then presented him with opportunities in the automotive, education, and food industries. John did not want to get back into the food business, and was not excited about the education industry; however, he thought the automotive industry had potential. After some research, John decided to meet with people at Cottman Transmission and Amoco, both headquartered in Pennsylvania. Jack first heard of Craft-Bilt at this time, and suggested John visit while he was in Pennsylvania.

Meanwhile, John had also begun interviewing to get a job. What if finding a new venture took longer than expected? He and Jeanie were not independently wealthy. The negotiations for a position as a business development agent with Cedent, the largest franchisor in the world, went as far as getting an offer. John agonized over the decision, then accepted Cedent's offer.

> FranNet had told me about Cottman Transmissions and AMCO, but I accepted a position at Cedent because they were pressuring me to make a decision. When I told them yes, they turned around and said it would take a week to get me an offer letter. Then they said there were still two other candidates they had to consider.

The week Cedent flip-flopped, John went to Philadelphia, as he recalled.

> I was angry and booked a flight to Philadelphia to meet with Cottman and Amoco. Craft-Bilt was also in Philly, I hadn't done any homework on them yet, so I only gave them three hours. I went out to dinner with the president and vice president for business development. First and foremost, I told myself, 'I trust these people.' I liked their openness and the look in their eyes.
>
> I left Philadelphia knowing that I didn't like Amoco or Cottman Transmission. With the auto shops, I didn't like the fact that everyone walked though the door upset. With patio rooms, you improve customers' lives. I liked that.

Ironically, Cedent called three days after John met with Craft-Bilt and made a firm offer for the job he had accepted the prior week. John turned them down without hesitation. After meeting with the people at Craft-Bilt, John was excited about building his own business. If his due diligence checked out, he would move forward. John returned to Boston and researched the BetterLiving Patio Rooms opportunity.

> I proceeded to visit existing dealers. I traveled to Maine, Albany, Vermont, and Providence. These were older dealerships doing 20 to 50 rooms a year as a part of home remodeling businesses, and the dealers had nothing but praise for Craft-Bilt. I looked into the industry – no dominant player. I decided to negotiate an agreement. I thought, "If they can do this focusing on patios part-time, I should be able to focus full-time and really blow the doors off."

When John first discovered BetterLiving Patio Rooms, he was impressed by the people and the opportunity. Later the challenge came into sharper focus.

> It hit me one day after I was well into the deal that BetterLiving Patio Rooms was, first and foremost, a construction play. I had thought of it more in terms of the

opportunity: a great product with a great marketing concept supported by a great manufacturer in a fragmented market. It had growth, margins, almost everything I was looking for in a business.

Of course I had also wanted to know something about the business, but with my background, I didn't think this would be likely so I was not deterred by my inexperience in the construction trade (See **Exhibit 1** for John Esler's Resume). However, it has become clear to me that this is a monster challenge.

Patio Room Industry

More Americans own their own homes in 1997 than at any time in history, both by the percentage of households occupied by owners (about 65%), and in absolute terms[1]. The American home remodeling industry was $118.4 billion in 1997, an increase of 5% from 1996. Over 500,000 American households remodeled their homes each year to add sun space[2]. Analysts placed the size of the sun space market in the $6 billion range, putting sunrooms[3] at a little over 5% of the remodeling industry. The scale of market demand was confirmed in a 1991 home owner survey where 31% reported that a sunroom was the single most desirable element in a new home, yet only 10% of the builders surveyed included this as a standard feature in their new construction developments[4].

Other data on remodeling market demand was collected using the toll-free "Homeowner Remodeling Hotline" by NARI, the National Association for the Remodeling Industry. The public called this number to ask questions about remodeling. The statistics in **Figure 2** demonstrate the extent of consumer interest in sunrooms. This is supported by **Figure 3**, a survey which shows sunroom projects were a more common project than either kitchens or bathrooms.

Figure 2
Information Requests

Project Areas	Inquirers
Kitchens	47%
Bathrooms	46%
Other Interior	41%
Windows	39%
Room Additions	35%
Sunrooms	32%

Source: NARI Homeowner Remodeling Hotline, 10/97

[1] US Department of Census, telephone interview 8/98
[2] Qualified Remodeler Magazine, 9/97
[3] The term "sunrooms" is used to for both 3-season and 4-season glass rooms. Patio rooms are 3-season rooms
[4] Professional Builder & Remodeler Magazine, 1991

Figure 3
Project Frequency

Project	Rank
Windows/Doors	1
Siding	2
Whole-house	3
Other	4
Room Additions	5
Sunrooms	6
Kitchens	7
Roofing	8
Bathrooms	9
Outdoor Spaces	10

Source: Qualified Remodeler
September, 1997

The sunroom industry could be thought of as being comprised of four niches based on framing materials and usage: aluminum or wood, and three-season or four-season use. Patio room enclosures were defined as three-season rooms. An industry trade group, the National Sunroom Association, estimated the patio room segment at about $1 billion in 1997. Consumers selected between styles based on budget, needs, and aesthetic considerations. Contractors using wood-framed construction accounted for the majority of patio room construction. Wood-frame enclosures took longer to construct and cost more than aluminum-frame rooms (the average selling price for a PRA room, $13,000, was about 70% less than an average wood frame room). In addition, aluminum required less maintenance and lasted longer.

The patio room lifestyle cut across several socioeconomic classes. Purchasers of this product tended to come from the middle class, the upper portions of the lower socioeconomic class, and the lower portions of the upper socioeconomic class. In Pennsylvania, the BetterLiving Patio Rooms customer base had also been segmented by age, with baby boomers (ages 45-60) buying 60% of the patio rooms, younger couples (ages 30-45) buying 25%, and seniors the remaining 15% of the rooms. The prime patio room customer age was the largest part of the population (35-54) in Massachusetts.

John's experience was that customers purchase BetterLiving Patio Rooms for a variety of reasons: lifestyle improvement, increased living space, value vs. the four-season and wood alternatives, extended use of an existing deck, custom design vs. pre-fabricated alternatives, and protection from insects. John put it succinctly, "Our hottest markets are bug-infested! People need enclosures because of the mosquitoes."

Favorite patio room activities included private phone conversations, dinner "outside," bird-watching, and enjoying the evening sky. As an investment, the return on patio room additions was about the same as other home remodeling projects as shown in **Figure 4**.

Figure 4
Remodeling ROI

Project	ROI
Minor Kitchen Remodel	102%
Bathroom	77%
Deck	73%
Siding	71%
Patio Room	70%
Home Office	69%
Windows	68%

Source: Today's Homeowner, 2/98

There was no nationally dominant manufacturer in the aluminum patio room industry, and most manufacturers and dealers were privately held, so the industry size and growth rate were difficult to estimate. However, there were about a dozen aluminum frame manufacturers and the largest, Patio Enclosures, had revenue of $58 million in 1997. Patio Enclosures had had a compound annual growth rate over 10% since 1991.

Craft-Bilt

Founded in 1946, Craft-Bilt was located in Pennsylvania, an hour west of Philadelphia. This privately held family firm experienced a management succession in the late 1980s, when the founder Bud Stone died, and his son Andy rose from vice president to chairman and CEO. Andy recruited Ross Ledderer, making him vice president and director of business development. Ross joined the team with carte blanc for growing the company.

Ross Ledderer had experience in merchant banking and franchising. He had helped grow a restaurant chain to 300 units, and then tried to buy it back from the franchisors. Unsuccessful in gaining control of the organization, Ross went looking for an opportunity to create a Fortune 1,000 company, and found Andy Stone with a similar vision. Together with Ross, Andy established a retail sales goal of $200 million for 2002. Privately held, Craft-Bilt declined to divulge annual sales numbers, however an online company reporting service listed Craft-Bilt's 1992 wholesale revenues at $5 million. To achieve their goal, Craft-Bilt needed a revolutionary improvement in its dealership performance.

Historically, Craft-Bilt sold its patio rooms through small, established home remodeling contractor/dealers. Craft-Bilt paid for five-day training seminars for all dealership sales and installation personnel at corporate headquarters. The ten best BetterLiving Patio Rooms dealers usually sold over 100 rooms a year, but many sold less than a dozen. Meanwhile, the market leader, Patio Enclosures, had branches in Chicago, Cleveland, Philadelphia, Baltimore, and Washington DC which consistently installed 700 to 1,000 rooms a year. Patio Enclosures' offices were either owned and operated by the manufacturer (24 branches) or by franchisees (11 franchisees). These operations focused exclusively on selling patio rooms and two complementary products (casual furniture and window treatments).

In mid-1997, Craft-Bilt implemented a program offering world-class support for a new class of dealers known as Craft-Bilt Super Dealerships (CSD). CSDs were created to focus on and dominate a patio room marketplace. Craft-Bilt developed new products and services to support the CSDs (e.g., "best in class" marketing, training, and dealer recruitment programs), and set a course for unprecedented growth.

Patio Rooms of America

John completed his due diligence and began negotiations. Andy and Ross were enthusiastic about John opening up the Boston territory, but John wanted a larger sphere, and made an offer for the Worcester and Springfield territories immediately. Ross was skeptical about John's request due to his lack of experience and financial depth. After discussions back and forth, John entered into exclusive dealership agreements with Craft-Bilt Manufacturing for three territories: Boston, Worcester, and Springfield, Massachusetts. John paid a $35,000 fee for the exclusive rights to the Boston territory. The Worcester and Springfield markets cost $10,000 each. John signed all three contracts in October 1997.

As someone who had financed five Subway stores, he had a good idea what was involved. John was not too worried about raising $125,000 in bank debt because he had $75,000 in mutual funds for collateral, he was investing his own equity capital in the company, and he had a successful track record. His first stop was the bank that he worked with in Albany, as John recalled.

> Two days after I talked to him, my banker said, 'You are approved. No problem.' I was going to get $50,000 as a letter of credit for Craft-Bilt and $75,000 in cash. They said it would take two weeks to do the paperwork.
>
> Two months later, I finally got a letter of commitment from the bank – after I had opened the business – and the deal fell through the same day I received the letter. Someone at the bank reviewed the deal and realized that some of my collateral was non-assignable! My folks could not use their retirement account for collateral. I should have looked into it, but I thought the banker would have known. So here I was in December, I owed Craft-Bilt $30,000 for inventory already in my warehouse, and I had material worth another $20,000 on the way. I had to liquidate my mutual funds to pay the first bills.
>
> The next day I called one of my contacts at Babson College, Professor Joel Shulman, and he connected me with Tim Fahey of Middlesex Bank. They provided $125,000, collateralized by the assets of the company, and $35,000 of my cash. The $125,000 only yielded $40,000 in working capital, because Craft-Bilt demanded a $50,000 letter of credit (LC) in order to get 30-day terms on inventory. Without the LC, no terms. Bankers hate LCs, that's why Tim kept $35,000 against the $125,000. I wrote checks for all $40,000 the day I got the money.

John opened an office serving the Boston and Worcester territories on November 1, 1997. This territory included the entire state, north to New Hampshire and south to Rhode Island, beginning with Worcester county and moving east to the ocean. PRA established a 6,800 sq. ft. warehouse and office space in Northboro to serve as corporate headquarters.

John expected to install at least 850 rooms annually in these three territories within five years (**Figure 5**). There were over 1.3 million owner-occupied homes in this area, and the 35-54 age group was the largest segment of the population (see **Figure 6**). When John Esler opened the Boston territory, PRA became one of the first CSDs. With PRA's mid-winter sales performance, it rapidly became a model CSD operation.

> We did some installations during the winter because most go on existing decks. The problem was doing the footings[5] in winter. We did not know what we were doing. It took a week with everyone pitching in to put up one room with new footings.

Figure 5
Patio Room Sales by Territory

Territory	1998	1999	2000	2001	2002	2003
Boston	135	175	225	275	350	425
Worcester	31	50	100	150	175	200
Springfield		50	100	150	200	225
Rooms Sold	166	275	425	575	725	850

Figure 6
Territory Demographics

(000s)	Pop	Personal Income	Home-owners	Homeowners Ages 35-54
Boston	4,011	$112,249,701	988	407
Springfield	666	13,664,970	164	68
Worcester	717	15,544,172	186	76

Sources: Markets in 1994 with Population by County - Regional Economic Information System CD (REIS); Household Size - Population Estimates Program, Population Division, U.S. Bureau of the Census, 8/21/97; Homeownership rates - U.S. Dept of Commerce, Economics and Statistics, HTTP://www.census.gov/hhes/www/homeown/source.html

[5] Footings are the concrete foundation posts in the ground for supporting structural weight. Producing new footings is difficult when the ground is frozen as it usually is in New England from December through February.

According to Craft-Bilt, this business should operate at about 37% COGS, 50% gross margins, and 15% net margins (see **Exhibit 2** for Income Statement). Overall, John expected that material costs would remain stable over time because prices for aluminum products were historically stable and Craft-Bilt had a track record of resisting price increases. The production labor costs should be controllable because of the modular process for installing rooms. Finally, the in-home sales transaction should continue to generate undiscounted sales. Start-up inefficiencies had kept PRA's margins below these levels.

Team Building

John began putting his team together by networking, as he put it, "My most important function is selling the company to the people we need on-board." He found that two friends who lived in Albany were interested in helping to launch PRA. Ed Jackowski had known John at Subway where Ed was involved in selling franchises. Andy Constable was educated as an architect, skilled at carpentry, and had been in John's wedding party. Andy recommended another friend in Albany who was willing to move to Boston, also named Andy, Andy Malone, who was an architect by training, but a master carpenter by profession. With a nucleus in sales and production, John set up the warehouse in Northboro and began recruiting.

> We're trying to build a company here. I am a good employer who treats employees like members of my family. That's why we provide medical and dental insurance, earlier than we can really afford it. I want everyone who works here to want PRA to be the last company they ever work for. It may sound corny, but I look for people with a good heart who can see that vision.
>
> The results have been great so far. Low turn-over and in each BetterLiving Patio Rooms training class, one of our people has finished number one. We have consistently attracted top quality people.

Turn-over was less than many firms in construction, and John believed that having founding principles was an important part of his success formula (see **Figure 7**). John explained how the third principle found a practical application.

> These principles have to translate into little and big things. I bought a plunger after a toilet got clogged, and brought it to a sales meeting to illustrate the point. I said, 'If the toilet gets clogged, I'll be the first one to grab the plunger. We shouldn't need to hire a janitor to clean up after us because if it is to be, it is up to me – and you.'

Figure 7
PRA's Founding Principles

1. Practice integrity in everything that we do.
2. Value is always defined by the customer
3. The Rule of the Tens Twos (10 words with 2 letters):
   "If it is to be, it is up to me."

By April, PRA had three people in sales (five including John and the sales manager), four in the media department (all but the manager were part-time), and four crews for a total eight installers and the production manager.

An important part of John's team was his independent board of advisors. The board included world-class experts in several fields: manufacturer relationships, franchising, entrepreneurship, construction, and one of John's classmates from Babson. These people met bi-monthly to review progress on the business.

Marketing

Compared to other firms selling patio rooms, John had a larger, more highly trained marketing team, and a more aggressive media program. PRA expected to spend 9% of projected gross sales on this program (an estimated $185,589) in year one of operations.[6]

Developed in part by Craft-Bilt, PRA's marketing mix relied heavily on television infomercial advertising (usually placed on cable stations). The 30-minute television infomercials were not run continuously due to the large number of leads produced by these programs. Media buys were made by Direct Results Marketing (DRM) as directed by PRA. Craft-Bilt hired Direct Results Marketing in Ohio to produce the infomercials, and the contract allowed DRM to place the ads and earn a 15% commission. To monitor variation from goal, PRA produced tracking sheets called Daily Marketing Reports (see **Figure 8**). The average cost for placement on a local cable station was $175 for a 30-minute spot, which produced an average of 12 names for $14.64 cost per name. PRA was the only market competitor using TV.

[6] Note: Although expressed as percentage of sales, marketing expenditures were driven by lead requirements.

Craft-Bilt told us that the names to appointments ratio was 37%, appointment to close was 27%, so we could predict very closely what our sales would be. This was critical because we had to keep our salespeople busy and not keep our prospects waiting too long.

The key for using our capacity was to fill our day spots, because we knew that we could fill evenings and Saturdays. We were booking 18 appointments on Saturday, something like 60% of our business. There was a nice predictability to the revenue equation.

Figure 8
Marketing Conversion Ratios

	Success Rate	***Households***
Names from TV	100%	100.0
Appointments Written*	33%	32.8
Appointments Issued**	76%	24.9
Demonstrations	91%	22.7
Sales Closed	28%	6.4
Installed Rooms	72%	4.2

Source: PRA Daily Marketing Reports

* This refers to the customer contact where an appointment is set
** This refers to the confirmation call where each customer is contacted again the evening prior to the scheduled appointment.

John planned to incorporate other marketing techniques later, but many traditional BetterLiving Patio Rooms dealers excluded TV from the marketing mix, so these other mediums were also proven to generate business.

The marketing process began when a prospective customer called for product information. The 800 number was fielded in Florida and faxed the next morning. The media department mailed literature after the faxes arrived. PRA planned to move some of these functions in-house at some point, as John explained.

I would rather have developed print and television marketing expertise in-house, however the Craft-Bilt turn-key system worked and that was worth a lot. DRM knew the home remodeling direct response market, but we were as involved as we could be.

This marketing system created a sales interview virtually free from competition. Each lead was pre-qualified long before a salesperson arrived at the customer's home – the demonstration was at least the fifth contact with BetterLiving Patio Rooms (see **Exhibit 3**). The PRA sales process involved no cold calling. As a result, PRA representatives were closing sales at a rate between 25% and 40%, and averaged 28% in March; they were required to achieve a minimum closing rate of 20% to remain employed by PRA. However, John was proud of the fact that this was not a high-pressure sale,

> We explained the product and its benefits, and then offered the same price sheets to everyone. Customers actually used our price sheets to design and price the room themselves. They could change the room to lower the price, and we offered a standard discount for 'buying tonight,' but we didn't haggle.

PRA received a 25-33% down payment at the time of sale. Two weeks later, before ordering materials from Craft-Bilt, PRA would bill for another third of the total. Then when the customer was satisfied with the installation, payment-in-full became due.

> It was a long winter; I was down close to zero a couple of times. I didn't think of changing our payment terms until February. We were living on 25% down. Most customers accepted the new terms without blinking an eye. Our cash situation improved immediately.

Competition

Competition in the Massachusetts market was highly fragmented with small contractors accounting for the majority of patio room construction. These carpenters typically built fewer than ten wood-frame rooms per year. As John described it,

> Our main competition was the conventional 'stick build' addition which takes over three weeks to build. However, we were 60% of the price and our rooms went up in 2 or 3 days. It was a fantastic advantage!

There were no other marketers using TV and representing competing manufacturers in New England. Companies in the Massachusetts market with an aluminum product similar to BetterLiving Patio Rooms included Texas-Aluminum (30 installations in 1997), Oasis Sunrooms (40 installations in 1997), and Four Seasons Patio Rooms (30 installations in 1997). These dealers were mostly contractors who specialized in home remodeling and built patio rooms as a product-line extension. Patio Enclosures was the only manufacturer with a comparable patio room marketing program. They had no branches in the Boston market.

At home shows, other aluminum patio room dealers offered direct competition, however home shows were a minor part of the PRA marketing plan. An estimated 15% of PRA's sales began with a referral in 1998, and John expected this percentage to increase with the growth of the installed base. The remaining 85% began with a TV infomercial. Almost all sales transactions occurred during in-home sales demonstrations. The intimate nature of the two-hour in-home presentation significantly reduced the threat of competitive challenge, as John explained.

> People didn't usually shop around for patio rooms, unless they were at a home show. We went into the home as professional contractors – not salespeople. What we did in the home was warm and fuzzy. We talked about their dreams, about improving their quality of life, and two-thirds of our sales happened in the first meeting. You have got to love getting non-contested sales.

Production & Operations

PRA's operations were initially based on guidelines produced by Craft-Bilt. Craft-Bilt was in the process of creating a turn-key system for opening new territories. Craft-Bilt passed this system along by training owners, managers, installers, and salespeople at corporate headquarters. The training was supported afterwards by telephone consulting and regular on-site visits from key Craft-Bilt personnel.

The key position in the BetterLiving Patio Rooms system was the production manager. The production manager had to have construction experience, computer skills, and management talent. The production manager was responsible for all aspects of production. His human resource duties included hiring, training, and scheduling installers. His operations duties included coordinating the permit process, confirming sales measurements and job feasibility, ordering materials, managing inventory, and monitoring job costs. Hiring someone with this unique set of skills was a difficult challenge, as John recalled.

> We blew our first production manager out of the water in two weeks. He had a lot of experience in construction management, and had even built patio rooms, so he seemed perfect. But after two weeks, he looked at me with fear in his eyes. For him, pulling 20 permits was like building 20 homes. He said, 'I'm not your guy.' I promoted a lead installer, John Leahy, and the whole team pitched in to make things work, but it continued to be a big problem area.

Another problem was the building permits which were required for every job and issued by building inspectors. Unfortunately, every town had different requirements and inspectors, some with unexpected biases. For example, one inspector refused to let PRA build on a preexisting concrete slab, in spite of the fact that he concurred that it was perfectly sound. Another wanted footings for the deck that were deeper than the footings for the house.

> We wanted to be able sell a room today, measure it tomorrow, and get a permit the next day, but we learned in March that it never happens that fast. One reason is the plot plan. Homeowners don't have a plot plan, and nobody issues permits without one, so we have to get customers' land surveyed.
>
> But the plot plan is just one of the hurdles to getting building permits. There seems to be no rhyme or reason to what gets approved. Building inspectors are prosecutor, judge, and jury all in one.

Once a permit was obtained, materials were ordered. With the BetterLiving Patio Rooms product, the most expensive parts of the room were custom-ordered by the job. In April, John speculated that PRA would never need to have more than $50,000 in inventory (see **Exhibit 4**).

After the building materials arrived, the job would be scheduled, and installers assigned. Installers picked up building materials at the warehouse between 6:30 and 7:30 AM, and returned between 4:30 and 6:30 PM. This produced more over-time than John had projected in his initial business plan. However, the larger problem was that jobs were not being done right the first time, or going up fast enough.

> The real challenge is in constructing rooms. You have to put rooms up fast and tight, or there is no profit. If a room takes too long, the profit gets killed by labor costs. If a room isn't done right, the profit gets killed by call-backs. I hate the sound of the phone ringing when it rains.

Problems on the job site were not always the fault of the installation team. PRA sold custom-built rooms. The installation guru at Craft-Bilt was on record saying, "50% of the rooms can not be built as sold." It was the production manager's job to make sure he discovered these problems and resolved them before scheduling a crew for installation. John Leahy scheduled crews to build unbuildable rooms in March.

> I wanted to put up 20 rooms in March, but we only put up five because of permitting and construction problems. However, we sold 30 rooms, so we had $350,000 in sales and something like $75,000 in cash (see **Exhibit 5**). We expect to install 20 rooms in April because we are learning to be more efficient. If we can do jobs in 2-3 days instead of 4-5 days, we can start making money.

Often, making a room buildable meant extra expense and John was displeased by how often customers were told that the price went up after the sale. Salesmen were not contractors, but on-going training was essential because they needed to know what additional costs might arise when building a room. This was critical for all concerned because PRA salesmen were paid straight commission based on job profitability, so either they sold profitable jobs, or starved.

Issues with Craft-Bilt in Early April

Although he was worried about construction and operations issues, John's biggest concerns involved Craft-Bilt. John did not accept the terms Craft-Bilt wanted to impose on the relationship, and saw potential problems awaiting down the road.

> I wrote a business plan focused on developing Boston in the two weeks after sales training, and realized that the whole nation was up for grabs. Either we got a bigger piece of the pie right away, or we would wish we had when we wanted to expand.

Craft-Bilt had never sold multiple BetterLiving Patio Rooms territories to a dealer before, but I sold them the vision of me as the Babson-educated super entrepreneur. All Craft-Bilt upper management read my business plan. I went back to the table and got Worcester and Springfield.

Of course, they didn't believe we would actually implement the plan until they saw us doing it. We became a prototype dealer for BetterLiving Patio Rooms when we sold rooms all winter.

The biggest thing I missed in the dealership agreement was the way the letter of credit (LC) would work. I thought the $50,000 LC got me 30-day terms on inventory, but all it got me was terms on inventory worth $50,000. In effect, I got no terms. We're discussing this issue too. In the past, they were dealing with "hook and ladder" guys, so withholding credit made sense. However, when you've got CSDs, it makes no sense. I have an annual quota of 375 rooms beginning in year five, and seasonality creates a steep annual ramp-up, so why no terms? They say it would put the company at risk, but I don't buy it.

What do we want in our on-going relationship with Craft-Bilt? We have a sales and marketing organization that can move home improvement products. We are developing a service delivery system. We are learning how to get our name in front of people and sell in the home. And we are learning how to deliver construction projects. Craft-Bilt offers us a quality product, but long-term, there will have to be more value in it for us.

We have a great relationship now, but will they allow us to grow? We've talked about it, and they don't seem threatened, but they don't want to give me any more ground either. I want to open Connecticut and New Hampshire next year, but Ross is dragging his feet. I also want a right of first refusal for all other New England territories if any current dealers lose their regions. So far, Ross has not budged on these issues, yet he wants me to sign a tighter non-compete. They have the power to limit the scope of this business to western Massachusetts. There is no way I am going to let that happen.

Exhibit 1
John Esler's Resume

JOHN K. ESLER

100 Otis Street * Northboro, MA 01532
Telephone/Fax: 508-393-0400, Ext. 226 * E-mail: jesler@patios.com

Background Summary

A results driven, high performance, entrepreneurial general manager and a sales/business development leader with an exceptional range of accomplishment based on key strengths in:

Leadership *- The combination of analytical, interpersonal skills and emotional resilience gained through firing line experience to create a vision, engender dedication and hard work, and maximize team's talents to achieve outstanding performance.*

Rapid Contribution *- The learning skills, obsession with excellence and excitement for the task at hand to quickly contribute in new and rapidly evolving situations.*

High Performance *- Exceptional energy level, dedication, competitive drive and commitment to thrive on pressure and multiple challenges, and infuse the organization with the same level of performance.*

Communications *- Strong written and oral communicator with superior ability to negotiate and persuade.*

General Management Perspective *- Experience in a P&L position for a large company and ownership of a small business. Developed business planning, business strategy and implementation skills focused on creating profitable relationships with customers.*

Entrepreneurial Management *- Demonstrated ability to recognize opportunity, martial the necessary resources, create entrepreneurial organizations and achieve result.*

Professional Experience

Subway Sandwiches, Albany, NY **Principal/Owner** **1990-1996**
Originated and operated 2 year-round and 3 seasonal locations that ranked as first and second volume locations in a 65 store market.

RH Macy and Company, New York, NY **Asst Buyer, Sportswear Dept** **1986-1989**
Promoted from Management Training program to Sales Manager to Assistant Buyer with responsibility for purchasing, inventory management and pricing for a $15 million product category.

Valet Services, Inc. /Saratoga Flats, Albany, NY **Principal/Owner** **1981 -1995**
Founded and established two entrepreneurial businesses. Sold both as ongoing entities.

Education

F.W. Olin Graduate School of Business, Babson College **1997**
Master of Business Administration - Entrepreneurial Studies and Marketing
Magna Cum Laude Honors, GPA: 3.7 Class Rank: 6, Class Size: 220
University of New York at Albany **1985**
Bachelor of Arts, Dual Major- Finance/ Economics

Outside Interests

National/American Hockey League - youngest ever to officiate at the professional level
Enjoys golf, skiing, tennis, SCUBA diving and travel.

Exhibit 2
PRA Income Statement **(continued on Exhibit 6)**

	Jan		Feb		Mar		Total
Rooms Installed	5		8		7		20
Recognized Sales	$ 71,571		$ 98,744		$ 81,657		$ 251,972
Average Selling Price	$ 12,599						
Cost of Construction							
Materials	28,317	40%	34,117	35%	37,444	46%	99,878
Field Installation	7,412	10%	9,854	10%	16,383	20%	33,648
Equipment & Trucks	5,650	8%	2,996	3%	6,138	8%	14,784
Permits	730	1%	550	1%	526	1%	1,806
Total CoC	42,109	59%	47,517	48%	60,491	74%	150,116
Gross Profit	29,462	41%	51,227	52%	21,166	26%	101,856
Sales & Marketing							
Sales Compensation	9,711	14%	11,656	12%	14,383	18%	35,750
Media Department	3,540	5%	3,691	4%	3,745	5%	10,976
Advertising	10,804	15%	3,992	4%	9,537	12%	24,334
Misc. Expenses	538	1%	1,712	2%	2,070	3%	4,320
Total Sales & Mkg	24,594	34%	21,051	21%	29,735	36%	75,380
Indirect Operations							
Production Mgmt	2,722	4%	4,000	4%	4,000	5%	10,722
Warehouse	244	0%	812	1%	476	1%	1,531
Awards	-		-		-		-
Indirect Oper. Exp.	2,966	4%	4,812	5%	4,476	5%	12,254
G & A							
Salaries	7,630	11%	4,167	4%	3,326	4%	15,123
Rent	3,883	5%	-	0%	3,883	5%	7,766
Telephone	2,922	4%	927	1%	2,639	3%	6,489
Insurance	3,199	4%	2,034	2%	3,191	4%	8,423
MIS	300	0%	774	1%	835	1%	1,909
Office Supplies	356	0%	250	0%	835	1%	1,440
Professional Fees	991	1%	2,138	2%	5,468	7%	8,597
Utilities	884	1%	1,502	2%	1,452	2%	3,837
Dues / Subscriptions	75	0%	85	0%	44	0%	204
Travel / Entertainment	1,602	2%	393	0%	644	1%	2,639
Bank Charges	30	0%	1,052	1%	-	0%	1,081
Total G&A	21,872	31%	13,321	13%	22,317	27%	57,509
TOTAL (non-CoC)	$ 91,540	128%	$ 86,701	88%	$ 118,130	145%	$ 296,372
EBIT	$ (19,958)	-28%	$ 12,043	12%	$ (36,473)	-45%	$ (44,388)

Exhibit 3
PRA Sales and Installation Cycle

- **Day 1:** TV ads generate calls to an 800 number answered in Orlando, Florida.
- **Day 2:** These leads are faxed to PRA the next morning and the PRA media supervisor sends out product literature to prospects.
- **Day 4-5:** The media department calls to answer questions and schedule in-home sales appointments. These calls are typically made in the morning or early evening when individuals can most often be reached at home.
- **Day 6-10:** The day before an appointment, media calls to confirm.
- **Day 7-11:** Scheduled appointments are conducted by the sales department. Initial job measurements are made as part of the sales demonstrations. PRA estimates that 65% of all sales are closed on the first visit to the home. A 33% deposit is the standard down payment.
- **Day 8-12:** John or the salesman begins work on obtaining customer financing if needed. Less than 50% of PRA customers seek financing.
- **Day 8-12:** The production manager receives work orders. He visits customers to confirm measurements, and fills out job order forms to purchase materials. Orders are placed once per week and materials are received within 10-14 days. Terms for material are net 30-days. Customers pay another 33% of the sales price prior to PRA ordering building materials.
- **Day 12-32:** Installations are scheduled to be completed 3-5 weeks from the close of the sale. During this time, the production manager obtains any building permits that may be necessary from the town. Additionally, any preparatory deck or foundation work is completed.
- **Day 33-46:** Patios are installed by PRA crews. Installation times range from 1 to 7 days, depending upon complexity and any complicating factors. The average installation time is running a little over 3 days. Upon job completion, the outstanding balance is collected.
- **Day 47- 61:** Door hangings are placed on neighbors' doors and an open house is scheduled to be held in the newly installed patio room.

Exhibit 4
PRA Balance Sheet

	Dec-97	Jan-98	Feb-98	Mar-98
Assets				
Checking/Savings	1,913	17,604	36,900	63,480
A/R	-	-	250	17,107
Inventory	3,197	37,989	16,300	34,759
Fixed Assets	-	2,874	4,666	7,802
Other Assets	37,125	37,125	37,125	37,125
Total Assets	**$ 42,235**	**$ 95,592**	**$ 95,241**	**$ 160,274**
Liabilities and Equity				
A/P	17,369	32,735	21,919	36,230
Loans From Related Parties	75,981	59,730	64,102	62,795
Notes Payable, bank	-	74,000	73,700	73,025
Customer Deposits	4,649	4,849	(801)	88,496
Equity	(55,764)	(75,722)	(63,679)	(100,272)
Total Liabilities & Equity	**$ 42,235**	**$ 95,592**	**$ 95,241**	**$ 160,274**

Exhibit 5
PRA Cash Flow Statement

	Jan-98	Feb-98	Mar-98
Sales Collected	$ 75,946	$ 98,494	$ 64,800
Expenses:			
Cost of Construction	26,743	58,332	46,180
Sales and Marketing	24,594	21,051	29,735
Indirect Operating Exp	2,966	4,812	4,476
General & Administrative	21,861	13,321	23,549
Total Expenses	**76,163**	**97,516**	**103,939**
Net Operating Cash Flow	**(217)**	**978**	**(39,139)**
(Inc)/Dec in Inventory	(14,793)	21,690	(18,459)
Inc/(Dec) in Cust deposits	200	(5,650)	89,297
Puchase of Fixed Assets	(2,874)	(1,792)	(3,137)
Loans From Related Parties	(16,251)	4,372	(1,307)
Loans From Bank	74,000	(300)	(675)
Net cash inflows/outflows	**40,065**	**19,297**	**26,579**
Beginning Cash	(22,462)	17,603	36,901
Ending Cash	**$ 17,603**	**$ 36,901**	**$ 63,480**

Exhibit 6
Pro Forma Income Statement

	4/98	5/98	6/98	7/98	8/98	9/98	10/98	11/98	12/98	Totals
Rooms Installed	**11**	**15**	**19**	**23**	**27**	**23**	**19**	**15**	**11**	**183**
Total Sales	$142,340	$194,100	$245,860	$297,620	$349,380	$297,620	$245,860	$194,100	$142,340	$2,361,192
Cost of Construction										
Materials	52,666	71,817	90,968	110,119	129,271	110,119	90,968	71,817	52,666	**$880,289**
Field Installation	19,928	27,174	34,420	41,667	48,913	41,667	34,420	27,174	19,928	**$328,939**
Equipment	4,288	5,848	7,407	8,967	10,526	8,967	7,407	5,848	4,288	**$78,330**
Permits	621	847	1,073	1,299	1,525	1,299	1,073	847	621	**$11,009**
Total CoC	77,503	105,686	133,869	162,051	190,234	162,051	133,869	105,686	77,503	**$1,298,568**
Gross Profit	64,837	88,414	111,991	135,569	159,146	135,569	111,991	88,414	64,837	**$1,062,624**
Sales & Marketing										
Sales Comp	14,234	19,410	24,586	29,762	34,938	29,762	24,586	19,410	14,234	**$246,672**
Media Dept	2,847	3,882	4,917	5,952	6,988	5,952	4,917	3,882	2,847	**$53,160**
Advertising	6,405	8,735	11,064	13,393	15,722	13,393	11,064	8,735	6,405	**$119,248**
Misc.	805	1,097	1,390	1,682	1,975	1,682	1,390	1,097	805	**$16,243**
Total Marketing	24,291	33,124	41,957	50,790	59,623	50,790	41,957	33,124	24,291	**$435,324**
Indirect Operations										
Production Mgmt	2,890	3,941	4,991	6,042	7,093	6,042	4,991	3,941	2,890	**$53,543**
Warehouse	300	409	518	627	736	627	518	409	300	**$5,977**
Total IO	3,190	4,350	5,510	6,669	7,829	6,669	5,510	4,350	3,190	**$59,520**
G & A										
Salaries	3,103	4,232	5,360	6,489	7,617	6,489	5,360	4,232	3,103	**$61,109**
Rent	2,570	3,505	4,440	5,374	6,309	5,374	4,440	3,505	2,570	**$45,854**
Telephone	1,607	2,191	2,776	3,360	3,944	3,360	2,776	2,191	1,607	**$30,300**
Insurance	2,413	3,290	4,168	5,045	5,923	5,045	4,168	3,290	2,413	**$44,179**
MIS	458	625	791	958	1,124	958	791	625	458	**$8,696**
Office Supplies	432	589	746	903	1,060	903	746	589	432	**$7,841**
Professional Fees	2,694	3,674	4,653	5,633	6,612	5,633	4,653	3,674	2,694	**$48,516**
Utilities	24	33	42	51	59	51	42	33	24	**$4,195**
Dues / Subscr	131	178	226	273	321	273	226	178	131	**$2,142**
Travel / Ent	489	666	844	1,022	1,200	1,022	844	666	489	**$9,881**
Bank Charges	45	61	77	94	110	94	77	61	45	**$1,745**
Total G&A	13,966	19,044	24,123	29,201	34,280	29,201	24,123	19,044	13,966	**$264,457**
TOTAL (non-CoC)	118,949	162,203	205,458	248,712	291,966	248,712	205,458	162,203	118,949	**$2,057,869**
EBIT	**$23,391**	**$31,897**	**$40,402**	**$48,908**	**$57,414**	**$48,908**	**$40,402**	**$31,897**	**$23,391**	**$303,323**