

PROMOSHOP (A)¹

An Opportunity

It was a warm day in Jamaica in 2001. Memo Kahan was there with his family and his parents for vacation. Memo was the CEO and Founder of PromoShop, a Los Angeles-based promotional merchandise company with the marketing talent and creative culture of an advertising agency. The 20-person, privately-held, Mexican-American owned company had grown rapidly since its founding three years earlier in 1998. It was now doing around \$5 million in annual sales, producing promotional materials such as clothing, brochures, and other materials branded with clients' logos or information about their products and services. Memo had founded PromoShop after 8 years in the promotional merchandise industry working at a variety of companies. It had been a ride. Memo was excited for the company's future and had been awaiting some time off.

But today, Memo was not on the beach as planned. He was finding himself largely confined to a small set of stairs where he had found cell phone reception. He was not even on his cell phone. He was on his mother's – the only phone in the family that seemed to get reception.

Motivating all of this time on the phone was an opportunity that had arisen that could rapidly grow PromoShop. The largest company in the promotional merchandise industry, HALO, had suddenly announced they were filing for bankruptcy. HALO was publicly traded and produced promotional merchandise for some of the largest companies in the U.S..

Since the bankruptcy was announced, the Los Angeles sales team at HALO had reached out to Memo about the possibility of collectively joining PromoShop. And then Memo got a similar call indicating interest from HALO's sales team in San Diego. And then from the team in Santa Barbara. And then from the team in Boise, Idaho.

Memo knew many members of these teams from his years in the industry and thought highly of these teams. The structure of the industry meant accounts would likely come with them. These were desirable, well-known customers, and accounts bigger than many of PromoShop's current accounts. Overall, about 10 different salespeople from HALO were interested in joining PromoShop and they would bring about \$5 million in annual business with them.

If Memo went through with bringing on these teams, it would double PromoShop's revenue overnight. But was the firm ready for such rapid growth? What would he need to change to support such scaling? What tradeoffs and risks would this create, both for the business and himself? Time was of the essence, but there was a lot of complexity to consider.

¹ Case prepared by Ben Hallen and Memo Kahan. The case was developed solely as a basis for class discussion. Cases such as these are not intended as endorsements, sources of primary data, or illustrations of effective or ineffective management. Some details have been changed for confidentiality and instructional purposes.

Memo's Career Journey

Early Life and Education

Memo was born in Mexico City, into a family with two siblings. He was always big on sports and big on events. He had fallen in love with American sports. He dreamed that if ever moved to the U.S., that he wanted to have season tickets to every team and every event possible. That was his passion, both playing and watching. At the age of 15, Memo's family moved to Los Angeles. His father was a CPA by trade and an entrepreneur. In Los Angeles, Memo continued to excel in sports.

After graduating from high school, he was recruited to play varsity soccer at UC Berkeley. He had a great time and learned a lot. His first year he took a class on bureaucratic organizations that was part of the legal studies department at the school. At the end of the year he needed to declare a major to preserve his athletic eligibility for soccer. Having enjoyed the bureaucratic organizations class, he declared legal studies as his major. While he learned a lot over the subsequent years about the U.S. judicial system, he also decided he did not wish to become a lawyer.

Following graduation from UC Berkeley in 1991, he moved back home to Los Angeles. But he was unsure what to for a living. Many acquaintances and mentors pointed to his personable nature and encouraged him to try sales.

Entry into the Promotional Merchandise Industry

Memo worked with a headhunter who helped him explore a number of entry-level sales positions. Many of his interviews were with large, bureaucratic organizations. Opportunities with copy machine companies and drink companies. In these interviews he kept thinking back to the bureaucratic organizations class. He wanted to work at a place where he could make a direct impact and not be a number – and he wasn't sure these big companies were the right fit.

One day the headhunter asked him to meet with “this guy that sold buttons and badges.” Memo was not sure exactly what she meant by buttons and badges, or why he would want to talk to this individual. But the headhunter asked that he take the meeting as a personal favor to her.

It turned out the meeting was with an entrepreneur in the promotional merchandise space. This entrepreneur's company, *PromoManufacturing* (a pseudonym), had a factory in downtown Los Angeles and specialized in producing pin-on buttons, badges, and awards with company logos and other promotional branding. The entrepreneur met with Memo for four hours, telling him that he would teach him how to sell and how to make money. The entrepreneur wanted to hire Memo to sell custom promotional materials directly to businesses in the Los Angeles area. The entrepreneur would then do the custom manufacturing inhouse in the factory.

Memo was intrigued. He called back to express interest and was hired. Coming on board, there was no training. He worked out of the factory. The desk was a piece of propped-up wood.

The entrepreneur gave Memo a list of people to start calling. Memo quickly discovered he was good at selling buttons and badges. And that promotional material was a big industry. The entrepreneur's sister had a t-shirt company, and Memo started also selling custom t-shirts with promotional branding. Similarly, the entrepreneur's brother-in-law owned a plastics company, so Memo started selling plastic cards with promotional branding.

As Memo began to learn about some of the other companies in the industry, however, he also learned that PromoManufacturing was somewhat unique in its business model. The broader industry was largely vertically separated between a set of manufacturing firms that could manufacture custom promotional materials and a set of sales firms that would typically work with a handful of manufacturing firms – often in a somewhat transactional and hands off manner. In contrast, PromoManufacturing did manufacturing, but also sold directly to clients. While there were some advantages to being vertically integrated and being involved in both manufacturing and direct sales to companies, it meant that many of the large sales firms would not work with PromoManufacturing. Memo also came to realize the sophistication of many of the sales-oriented companies, with greater training and more structured internal processes, made it hard for him to compete for some of the same clients.

Memo pitched the owner of PromoManufacturing that they should consider spinning out the sales group and letting Memo lead it. But the owner was not interested and quickly shot down these ideas. After giving it some thought, Memo gave his notice and took a job with one of the sales-oriented companies he had met, Idea Man.

Working at Idea Man & PromoCreative

From the outset Memo learned a lot at Idea Man. For example, on the first day his manager had him meet with a sales trainer to work on his handshake and personal presence with clients. The trainer had been at IBM for many years. And while Memo didn't adopt everything the trainer said, he appreciated the opportunity to learn best practices.

Idea Man also took a different approach to working with its sales team. Whereas Memo's former boss had asked him to do many things not directly related to sales or account management, Idea Man wanted Memo focused on meeting his numbers that they regularly set for him. If you met the numbers, they loved you – and you got to stick around. As before, there was a base salary, but most of the earnings were commission based. The expectations were high. Memo did well, learned a lot, and made several friends.

While at Idea Man, Memo had built up a relationship to Paramount Pictures. One of his fraternity brothers from UC Berkeley, who worked in marketing at Paramount, introduced him to someone senior that oversaw their promotional merchandise. Over time this individual gave him larger and larger contracts. One day she encouraged him to meet with Mark, head of PromoCreative (a pseudonym), a competitor in the promotional merchandise space. She thought they might hit it off and there might be mutually beneficial opportunities.

Memo and Mark played golf together. Memo learned that while PromoCreative was smaller than Idea Man, PromoCreative differentiated itself from other promotional merchandising firms by

having a creative team in house. This allowed them to do more customization for clients. It felt very Hollywood. Lots of consideration of creative trends and helping clients' promotional merchandise being on the edge of new trends. They also emphasized not just the ultimate product, a branded shirt for example, but how it was packaged and decorated. This was something unique that Memo had not seen from other promotional merchandise companies, including Idea Man.

Mark pitched Memo on joining PromoCreative to head up sales. The understanding was that Memo would participate in profit sharing and start working toward ownership. While Memo gave Idea Man the opportunity to match the offer, they were not able to and he left for PromoCreative.

When Memo joined PromoCreative in 1996, they were doing about \$3 million in sales. In 1998, two years in, they had grown to \$12 million in sales. Memo had played a big role in this growth, which occurred during a busy time in his life. He had had his first child and bought his first house.

As the sales grew, PromoCreative began to be approached by potential acquirers. At the same time, Memo and Mark were also trying to finalize the details of Memo's ownership. Mark said that Memo had vested 30% ownership in PromoCreative and could either buy or vest toward 19% more. Memo shared his excitement about this with his father. But his father responded that *"49 is as good as having nothing"* and encouraged Memo to push for 50 percent ownership.

Memo went to Mark and said *"if it's only going to be 49 percent, I am going to start my own company"*. He reiterated how much he loved working with Mark and his family. But when Memo showed up the next day for work, Mark told him he was no longer welcome at the firm. He could return that evening and get his stuff, but at the moment he needed to leave.

Founding PromoShop in 1998

Memo walked out of the PromoCreative office, and then went downstairs to exit the building. He paused. He knew he had a good book of business. He knew he could start his own firm in the industry. That was why he had brought it up, even if he had not intended to actually leave and do so. He called his father. He explained what had just happened. His father asked what he needed. Memo said a phone and a bank account.

Memo's father had recently sold his small business. He still had six months left on the lease on his former office space, which he let Memo use. A friend of his father's was an attorney who guided Memo through the early stages of getting his business setup. For instance, he helped guide Memo through the process of registering his company's name: PromoShop.

The idea for PromoShop was to blend the best of the practices that Memo had seen at PromoManufacturing, Idea Man, and PromoCreative. The firm would have a top-tier sales organization. Memo planned to bring in more junior sales staff and train them himself. He also would have creative talent in house, allowing them to provide a higher caliber and more customization of merchandise for clients. And while he did not plan to bring manufacturing in house, he was going to have stronger-than-usual relationships with promotional manufacturing firms. For instance, he planned to encourage regular meetings between his sales staff and their

different manufacturers. He believed this would allow sales staff to better navigate and manage any complications that arose. He also believed such relationships would make sales staff better informed about new promotional products, while allowing them to provide feedback to manufacturers about emerging trends.

He did not plan to charge a higher price for these additional services, instead believing that this differentiation would help the firm attract and retain more clients. So if a sales person might do 1X of business elsewhere, he believed under this integrated model that same sales person could do 1.2X in business. This in turn would help PromoShop attract and retain higher-quality sales people as they would earn more under the same commission structure.

Pricing was typically done a per-item basis, with larger orders receiving a volume-based discount. From this list price, PromoShop would pay out a commission to the sales person responsible for the account and cover overhead around servicing the account (including any creative services).

But getting all of this would require capital outlay. While he could get ramped up himself and with one support person, he hoped to soon start to build a creative team. And start to hire salespeople, who required a base salary in addition to their commissions and would need administrative staff to execute customer orders. Moreover, when a salesperson made a sale, PromoShop would then place an order with one of their promotional manufacturers. These suppliers had to be paid within 30 days. But it would take 45 to 60 days for PromoShop to get paid by its clients. This required further working capital, and also could pose a bottleneck to growth. Memo himself had just \$124,000 in savings that he took to the bank. His father agreed to co-sign on a loan for \$300,000, which required personal guarantees from both of them. It was putting a lot on the line for everyone.

PromoShop's Growth and the HALO Team Opportunity

Memo began by hiring an assistant. He worked hard. He did sales and serviced customers Monday to Friday. Saturdays he came to the office to do billing. Sundays he came to the office to do payables. He did everything in Excel, which worked but was not always the most elegant solution.

The firm began to grow. Many of his prior accounts did indeed come with him. By 2001, three years later, PromoShop had grown to about \$5 million in annual sales. There were now 20 employees: 8 were in sales, 2 in creative, and 10 in administrative support. The business model worked well, and had indeed provided a point of differentiation that was attractive to clients. The culture emphasized innovation and creativity. The offices were not far from the beach. They were not, however, (yet) serving Fortune 500 companies. To help support this growth, he had also gone back to the bank a few times to increase the line of credit (of which his father was still a co-signer).

It was at this point that Memo, his family, and his parents had come to Jamaica for vacation. And then HALO announced their bankruptcy. HALO was a juggernaut and the largest player in the promotional merchandise in industry. They had also accelerated their growth through a series of acquisitions, including Idea Man after Memo had left – which was one way that Memo had so many connections to the sales teams at HALO.

Overall, about 10 new salespeople from the various West Coast offices of HALO were looking to move as a team to a new promotional merchandise company. Memo knew many of these salespeople and had a high respect for them. They expected to bring with them a book of business of about \$5 million in annual sales. This included larger accounts with Fortune 500 companies.

Such growth obviously had many attractive elements. But there were also a set of questions:

- What changes would it require to the business?
- What business activities would need to be replicated? What would need to be reworked?
- What risks and tradeoffs would be involved, and was he comfortable with those? At the very least he knew he would need more working capital – and that likely meant going back to the bank to ask for a larger loan, as well as asking his father to again co-sign.

It had been a long day. Still the athlete, Memo loved the business, its intensity, and opportunities like this. But he needed to make a decision. Should he bring on board the teams from HALO? Was PromoShop ready to grow like this? Was he?