

Final Exam

You have just received great news. You've just come to agreement with three other business students from Concordia University to start a new business – ShoeFly.

James Cole is a graduating MBA student with a background in Finance. Before returning to school James was the Finance Controller for a local sporting goods retailer with three outlets in the Portland, OR plus two more in Seattle, WA. James played a central role in helping the company transform itself from a single store local business to a rapidly growing multi-store regional player.

Sam Helms is going to school part time while working at Nike as a Product Manager in Marketing. Sam is responsible for all the new golf clubs brought to market under the Nike name. Sam has been in this role for five years now. He joined Nike as a new college graduate direct from Stanford where he was captain of the men's golf team.

Kelsey Emberlin is also a graduating senior in the MBA program at Concordia. Kelsey came to the school to pick up some business skills. She has an undergraduate degree from Reed College in design and has spent the last ten years as a free lance artist. As a relative newcomer to the art world Kelsey was very successful. She has work in some of the finest homes in Portland, one piece in the permanent collection of the Musee d'Art in Gresham, and another piece on permanent display on the streets of Lake Oswego. Kelsey prides herself of her innate feel for "form" and "color" in design.

Of course, these skills, when packaged together with your background in Sales, form a dream team for a new business venture. In fact, the Sales team at the last company that you worked at, Freightliner, is still talking about the 350 convertible all-terrain vehicles with 32 inch chrome rims, spinners, and high-end audio gear you sold to the Afghanistan National Army. Somewhere in the Middle East soldiers can "Rock the Casbah" thanks to you. This helps explain why you were the leading salesperson every year.

Still, the current venture is going to take a little different direction. You have secured the rights for a new device that will customize athletic shoes with a completely new look. The inventors of the device, a company based in Sri Lanka, have given you exclusive rights to use this new system in commerce in the United States. They have retained the rights to use the system outside the United States. They have filed a provisional patent application on their technology and promise to protect you from imitators.

The process of creating custom shoes starts with the customer selecting a shoe design from inventory. The un-modified shoes are supplied by either a single industry partner or a group of partners who design and market the un-customized shoe through standard retail channels. The choice of industry partner or partners for the "stock" shoes still needs to be made.

Once the basic shoe is selected by the customer it is then installed in an automated device that creates a completely new color/graphic design on the surface of the shoe using a combination of markers, paint, and colored resins. After the machine has completed its work then a Design Specialists can hand touch the shoes with an air brush to assure a unique finished look unlike anything else available.

The graphic design and colors used by the system are derived from original artwork that is created by artists on the staff of ShoeFly and, when needed, outside artists under contract to the company. Even though the system has many custom designs already loaded into it, the customer can specify specific color schemes and the operator of the machine can make small changes to the design to make sure that every set of shoes is totally unique. The system includes specific internal safeguards to assure that no two designs that are produced are exactly the same.

Initial company research shows that consumers will pay extra based on the fact that the company can “guarantee” that no one else will ever wear or even see another pair of shoes just like theirs. The design information is also kept in a permanent database so that customers can re-order exactly the same shoe, put their design on a new shoe, or modify the old design to create a related, but entirely new design. In essence it becomes “their” personal design – forever!

The team feels that a retail store will be essential as they are starting out so that customers can get a look at the products first-hand and even try on a pair. They will start with one store in Portland and then expand rapidly as the idea gathers momentum. You also feel that it is essential that the company have a presence online. The initial demographic will be a younger audience (16-28) who is used to searching the Internet and ordering products online. Plus, this will give you market reach far beyond The Pearl District in Portland where your first retail store and fabricating facility will be located.

You also feel that there is an opportunity to create unique intellectual property that can be used either online or through kiosks in the retail stores. The idea is to create an interactive design wizard that will allow customers to select a shoe, select a design treatment (similar to what the machine would apply), and then see a simulation of the shoes that would be produced. The customer could customize colors and designs (and airbrush touch-up) until they come up with a design that they love. This design can then be submitted for automated production and delivery to the customer. Local customers can also pick-up their custom shoes at the local retail store as long as they are paid for in advance.

The only problem with this idea is that you have been told by a number of software engineering experts that a system like this would be very expensive to build. The front-end eCommerce functions are fairly typical, but the company would require a Web-based free-form interactive design tool that would be completely new. This tool will need to understand all the shoe designs and how the different design techniques are applied as well as the properties of the materials.

For example, it does not make sense to use a marker on the metal eyelet of a shoe because the ink will not absorb or adhere. So, in this case, the tool would need to understand the detailed characteristics of each base shoe, the materials that can be applied to each one, as well as the appearance and layout – all available in real-time while the customer designs their own, soon to be foot-powered, masterpiece.

The system will also require a database to store customer order history and profiles, unique designs for each customer, base shoe models, and all the information associated with design and materials for each shoe that will be stocked. In addition, an interface will have to be created to work with the production system that will actually make the shoes.

The “back-end” will need to capture the orders, queue them for production, transfer the designs, track production progress, and report back to customers as their order moves through the production process to shipping. In fact, the UPS or FedEx tracking number will also be entered into the system when the order ships so that the customer can track it right to their own front door.

The team believes that this level of online interactive design and visibility into production will justify a further premium from customers. Plus, automating the process will greatly increase internal capacity and efficiency for manufacturing allowing the company to produce shoes faster and less expensively. Higher prices with lower costs will lead quite naturally to greater margins and cash flow. Still, the cash required to build this online tool is much more than the company can afford at this point.

ShoeFly is poised to launch their new business and forever change the market for athletic shoes. The company has the idea, the “dream” team, and they have also locked down the exclusive rights to use the manufacturing system in the United States. Your job is to complete this exam and help the company get to market (and liquidity) with a winner!

- (1) The company has the ideas and the team, but they are still going to need capital to pay for the license and buy the system, lease the retail store, acquire initial inventory, and hire production people and store clerks. The team believes that it will take ~\$2,000,000 to pay for these items, open the store, and operate for the first year. V8 Ventures, a local venture capital firm with extensive industry experience is interested in funding this venture. The \$2 million figure is too small for most Silicon Valley firms and much too large for most Angel investors. This is the only offer on the table. What alternatives should the company consider to finance their new business?

(2) ShoeFly was your idea and you have worked hard to get it to this point. As CEO and founder you have 50% of the common stock. The other three founders own 10% each and the balance is in a stock option pool for current and future employees. You believe that based on your work and the exclusive license the company has a pre-money valuation of \$2,000,000. If an investment group led by V8 Ventures puts in the entire round of \$2,000,000 what is the post money valuation, how much does each stakeholder own, and what is the valuation of each stakeholder's share?

(3) Coming up to the end of the first year of operation the company has performed exactly as promised for investors (a little harder in real life! ☺). The company currently expects to close out the first year with sales of \$1,000,000 and expenses that are double that figure. You feel that in order to take sales and marketing to the next level, expand production to meet this increased demand, and move the firm to profitability, the ShoeFly will require another \$5,000,000. V8 Ventures has been able to help you put together a new round of \$5 million led by a new Silicon Valley venture firm that they have a relationship with. This new firm believes that valuations should be in the range of 5x trailing twelve month revenues. What is the post-money valuation, how much does each stakeholder own, and what is the valuation of each stakeholder's share?

- (4) Five years from now ShoeFly is wildly successful mostly because of your management skill, leadership, intuitive (and almost freakish) sense for market timing. The company successfully negotiates the sale of the company to winter clothing maker Spyder who is looking to diversify into non-seasonal sporting products. The sales price is \$400 million. What is the return to each stakeholder assuming that no further rounds of financing have been done?
- (5) Your executive team decides that ShoeFly must have the advanced online application in order to be successful. However, even with the initial \$2 million venture cash infusion, you are still well short of the capital or Engineering resources required to build and support an application that sophisticated. The application has uses in design and manufacturing that extend well beyond what ShoeFly wants to use the system for. It may be possible to convince a community of developers to contribute to the application if they can also use it for other purposes. What options would seem to be feasible? What are the pros and cons of these options?
- (6) The business plan for the online portion of ShoeFly grows rapidly for the first five years until the volume exceeds 10% of annual sales for this category of shoes nationally. The volume of mail-order shoes in this same category is only 5% of national sales. Given this metric is this a realistic forecast? What would you use as the upper limit for a sales forecast?

- (7) As you develop the online application what browsers should you support? What factors should you consider in making this choice? Is overall browser market share the only consideration?
- (8) The Internet is commonly used in three ways: (a) as a communications substrate, (b) as an information repository, and (c) as a sales/information channel. Most applications leverage the Internet to perform one or more of these tasks. Which of these elements will the ShoeFly application be leveraging?
- (9) ShoeFly would like to sell products online through their Web site. What forms of payment would it be common to accept? Would this be different if this were a Business-to-Business application rather than a Business-to-Consumer application?
- (10) Because consumers will not be able to see the shoes in person (or try them on) before purchasing them for the first time, ShoeFly is considering offering a money-back guarantee. What factors should they consider? How will they cover the cost of returns? How does this case differ from a customer who purchases a sports coat that is the wrong size and returns it?

- (11) What are the key elements required to process credit cards? Which organization or organizations will be involved in this transaction from start to finish?
- (12) When ShoeFly sells shoes to customers today how should they handle the collection of sales taxes? What rate should apply? What is the concept of nexus?
- (13) Once ShoeFly is wildly successful it will have over a million unique visitors to the site monthly. However, only 5% of those customers will actually make a purchase. What factors do we need to consider to assure that we can deliver a positive user experience?
- (14) With this level of traffic are there other things that we can do to either (a) increase the revenue for the site, or (b) reduce costs for our customers to create a competitive advantage?
- (15) ShoeFly would really like to get the user community involved using a social network style of Web site experience that supplements their existing Web site. This new feature set will serve to get customers more involved and create additional customer loyalty. What is one idea that would allow them to offer this kind of experience?

- (16) If ShoeFly was to open another store in Los Angeles and they received an order from a customer in Los Angeles from their online site how would they handle sales tax? What rate would apply?
- (17) Current “best practices” suggest that you need to integrate your online offerings with your offline offerings so that customers receive a seamless shopping experience. What will you do to make sure that the user experience in your retail store is linked to your online presence? What kind of programs would you offer?
- (18) The company has allocated \$100,000 for online advertising and promotion in its first year of operation. How will you spend this money? What elements are mandatory? What is first? Please describe your marketing mix in detail.
- (19) What is the definition of Web 2.0? What is a blog? What is a wiki?

- (20) What is the role of an electronic newsletter in your marketing mix? How does this differ from a blog? How can the two be used together to accomplish both goals?
- (21) One of the most important marketing tools online is search engine optimization (SEO). What do we mean by SEO? What is the difference between SEO and Pay-per-click (PPC) campaigns? When does it make sense to invest resources in PPC campaigns?
- (22) The company has also allocated \$100,000 for offline advertising and promotion. The only caveat is that any offline promotions must tie back to our online efforts so that we have a cohesive online and offline promotional strategy. How will you allocate this budget?
- (23) The inventors of the system in Sri Lanka have offered to file patents to protect your exclusive rights to use the system in the United States. How much protection will this actually provide? When will this protection really be available to you?
- (24) The reach of the Internet is global. So how do you guard against firms that may operate in other regions, offer a similar service online (using knock-offs of your designs), and shipping products into your local markets? What is your competitive distinction?

- (25) Each shoe that is designed is an original piece of intellectual property (art). How does ShoeFly create a structure so that customers cannot (legally) take their shoe to another vendor and have them reproduce an exact duplicate of the design on other shoes?
- (26) To add additional value on the Web site the company is displaying “snippets” of text and selective photo’s from a book called “Getting a Hot Foot – A Photographic Study of the Modern Athletic Shoe”. Is using this material on the Web site legal? What is the benefit to the author of the book? What will the company need to do to guarantee that this usage is legal?
- (27) You have the option of doing a sole source deal with Nike, Adidas, or another vendor for the basic shoes; or you can pull together a non-exclusive deal with several of these partners/suppliers. What strategy should the firm pursue? How can this choice be used to further enhance the business of the company and the online marketing efforts?
- (28) In order to provide the maximum selection for customers yet minimize the amount of capital required to finance inventory what kind of an inventory model should be adopted? What type of systems would be required to support this model? What is this type of integration called?
- (29) How are you going to handle customer support? What elements do you need to provide to assure that customer’s questions/concerns are handled in a timely fashion?

(30) As ShoeFly puts together its Web site it wants to make sure the business terms and the way that the company handles customer data are spelled out so that there is no misunderstanding. What two documents do they need to post to make sure this is accomplished? What is the additional document that is posted to answer questions that customers ask all the time called?

As the next Internet billionaire, based on the success of ShoeFly, you are being interviewed by an editor for Forbes Magazine. She has a number of important questions for you that will undoubtedly influence tens of thousands who will follow in your shoes.

(31) What three things from this course would you say were the most pivotal to your success?

a.

b.

c.

(32) What three things would have been even more valuable?

a.

b.

c.

(33) What will you do with all that money?

(34) Would you consider a donation to the School of Management at Concordia? ☺

(35) Would you agree to come share your story with a class?