ZOOTS -- The Cleaner Cleaner

When we did the research, we found that dry cleaning does not scream, "Opportunity!" All our interviews and our industry analysis indicated that people were willing to accept the mediocrity they were getting. They weren't particularly price sensitive; they weren't worried about the environment; all they wanted was to get their clothes back -- clean, on time, and with all the buttons on.

Todd Krasnow, CEO, ZOOTS

On October 29, 1998, Todd Krasnow, CEO and co-founder of ZOOTS, welcomed the entire "clean team" staff, investors, and friends to the company's grand opening. The "invitation only" party began in the late afternoon at ZOOTS' first retail dry cleaning establishment (Store #001) in Danvers, MA. It then moved on to ZOOTS' state-of-the-art central cleaning facility in Wilmington, MA. For the team, the party was an opportunity to share with family and friends the results of nine months of work that included securing funding, finding the right retail locations, staffing and training, and designing the firm's Internet site. For Krasnow, it was the first time he was willing to provide anyone outside ZOOTS' immediate family a look at what they were doing.

Still, he was extremely cautious about calling attention to the new enterprise. Because of his high profile in the retail community, members of the press were very interested in learning what his new venture was all about. Krasnow, however, was not interested in the notoriety. He was determined to launch ZOOTS quietly so that he and his team could work out any operational issues in relative obscurity. His plans called for running in "stealth mode" until he had at least three ZOOTS stores open, so even as he acted the genial host of the party, he kept an eye out for uninvited guests. When he discovered some gatecrashers, he quietly escorted them out. It was clear they had not crashed for the "party experience."

Though the mood was festive, the celebration was deliberately kept simple. No champagne or chocolate truffles were served in the new 10,000-sq. ft. cleaning lab—only white wine, finger sandwiches and packaged cookies. Nonetheless, the opening was a momentous event. On the one hand, it represented the culmination of extraordinary efforts. On the other hand, it marked the beginning of ZOOTS' "real work." Shortly after the party trimmings came down the next morning, the lab would be filled with thousands of pounds of dirty clothes that would have to be sorted, repaired, cleaned, packaged, and delivered back to their rightful owners within days.

Professor Myra Hart and Research Associate Sharon I. Peyus prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

Krasnow moved among the guests, chatting with employees and investors, laughing easily and congratulating each individual on his or her accomplishments. As he walked to the front of the room to offer the evening's few formal remarks, he chuckled to himself. He wondered what his Harvard Business School (HBS) classmates would think of his career in dry cleaning. Certainly, neither he nor they could have foreseen his choice when they graduated from HBS 15 years earlier.

Origins

Todd Krasnow

Todd Krasnow grew up in Westchester County, New York. He graduated from Cornell University in 1979 with a BS in Chemistry and, for the next 2 years, he applied his knowledge of chemistry as a food technologist at General Foods. His product line, Crispy Cookin', was intended to bring the taste of fast food into the home. His group patented a process that made it possible to retain the crispness of frozen fried food when heated in the oven. Krasnow himself received a patent for a quick frying process he developed that sealed a batter dipped piece of fish without cooking the fish itself. The finished frozen product bore a strong resemblance in taste, texture, and appearance to the fish served at the Arthur Treacher's restaurants.

Krasnow enjoyed the challenges of his work, but he was well aware that the technologists were not the key decision-makers in the company. After 2 years at General Foods, Krasnow left for Harvard Business School where he received his MBA in 1983. During his 2nd year at HBS, Krasnow took time out from his studies to co-author the school's annual musical. The 1983 spoof, <u>Soul Proprietors</u>, was a take off on <u>Damn Yankees</u>, in which two prospective HBS students sold their souls to the devil to get into HBS. "It had a happy ending, however, " Krasnow recalled.

Krasnow worked at Star Market, a division of the Chicago-based Jewel Companies in the summer between his first and second years (1982). He joined the food and drug retailer after graduation, becoming one of the company's select group of fast track management trainees, informally (and somewhat irreverently) referred to as the "Jewel Jets." Krasnow's first 18 months on the job included a rotation through store operations areas including grocery, produce, deli, service, and store management.

He became Marketing and Media Coordinator in 1985. He worked closely with Marketing Director, Myra Hart (HBS MBA '81) and took responsibility for preparing the weekly sales forecasts for the chain. After Hart told her marketing group that she would be leaving to join Tom Stemberg in the Staples start up as VP of Operations, Krasnow approached her privately and indicated that he would be interested in joining the team. A few months later, in March 1986, he became Staples' Director of Marketing, charged with responsibility for selling the public on the office superstore's value proposition. His success with both traditional and direct marketing campaigns later earned him the title of Executive Vice President of Marketing. Krasnow maintained a strong role in setting the chain's marketing direction throughout his years at Staples, though his career path included several years in California helping to launch the west coast operations, an assignment running the company's international joint ventures, and the launch of the company's catalog operation. Along the way, Krasnow introduced many innovations, among them free *next day* delivery of office supplies.

For 10 years, Krasnow never considered looking outside the company for new opportunities. In 1996, the Executive Vice President of Sales and Marketing was completely committed to the company and to his longtime friend and mentor, Tom Stemberg who was the President and CEO of Staples. He was continually challenged by the work and, even more important, he was still having fun. However, when a group of investors approached him in late 1996 and asked him to consider joining their new venture as CEO, he found that he was tempted—not so much by the specific opportunity as by the idea of taking such a step. Stemberg was still young and deeply engaged in the leadership of Staples. It was unlikely that Krasnow would have the opportunity to lead Staples for many years to come, yet he was ready for such a challenge. He decided to discuss the offer with Stemberg.

Tom Stemberg

Tom Stemberg was a retailer through and through. After completing his education at Harvard (AB, 1971; MBA, 1973), he joined the Jewel Companies as a "mentored" management trainee. During his first months on the job, he spent his days bagging groceries, stocking shelves, and cleaning fish, but he also had regular meetings with a senior officer who had agreed to be his mentor during the training period. Assigned to Jewel's Star Market division in Boston, Stemberg quickly moved up the ladder. When he was named Vice President of Sales and Marketing just before his twenty-eighth birthday, he was the youngest senior officer in Jewel's history. His innovative marketing programs bolstered the supermarket's business and his aggressive leadership in marketing caught the attention of other major supermarket chains.

In late 1982, Stemberg joined Ohio-based First National Supermarkets (FNS) as Senior Vice President of Sales and Merchandising of its Eastern Division. In 1983, he was named president of the Connecticut-headquartered Edwards-Finast division. While at FNS, Stemberg concentrated his efforts on building a network of Edwards Food Warehouse stores, a high-volume, no-frills operation that offered low-priced merchandise, much of it under the Edwards-Finast label. In spite of his division's success, Stemberg decided to leave First National when, in January 1985, he realized that his differences with board chairman, Bob Samuels, were irreconcilable.

Stemberg conferred with his old friend and supermarketing colleague, Leo Kahn, as he sought the right opportunity. The two agreed to join forces and, with Kahn's encouragement, Stemberg wrote the business plan for Staples, the Office Superstore. Over the next 12 months, Stemberg recruited a senior management team, raised more than $4 million in initial funding, and opened the first of over 1000 retail stores in the US. His Staples concept and the team's execution of the concept changed the way small businesses and consumers bought office products. Initially, Stemberg was President and CEO and Kahn was Chairman of the Board. When Krasnow approached him in 1996 to discuss the possibility of leaving Staples to become the chief executive of another business, Stemberg was Chairman and Chief Executive Officer of Staples. He was also a director of both PETsMart and Cornerstone Brands. He served on the executive committees of the City of Hope, the National Office Products Council and was co-chair of the Friends of Harvard Basketball.

Searching for Opportunity

When Krasnow told him about the offer, Stemberg agreed that the time was right to consider such a move – Krasnow should either start his own venture or takeover the helm of a substantial existing enterprise. Stemberg cautioned him, however, to think carefully about which opportunity to pursue, reminding him that there would be many good ones out there. Stemberg then went a step further, offering to help Krasnow develop a viable business concept, work with him to test the idea, write the plan, and secure funding.

Stemberg recalled the process he had used in 1985. When he decided to launch his own venture, he had started by taking a personal inventory of his skills and knowledge (which were in high volume, low margin retailing and distribution), then looked for market needs that could be served by these skills. After determining which areas of specialty retailing were growing the fastest, he conducted an industry analysis to determine what the size of the opportunity might be and what competitive action he could anticipate. Stemberg and Krasnow agreed to undertake a similar quest in February 1997, with Stemberg playing much the same role for Krasnow that Leo Kahn had done for him in 1985.

As a starting point, they determined that the new business venture should be in retail, should serve very basic needs, and should provide goods or services that required frequent "repeat" purchases. Krasnow was also committed to building a business that was based on strong customer relationships. As the two thought about the business models they might choose, they agreed that large footprint category-killer stores (e.g., Staples, Home Depot, and Toys 'R Us) no longer represented the unique opportunity they had 10-15 years earlier. This decision freed them to explore business opportunities that would be profitable with much smaller scale operating units. One idea on which Stemberg had been keeping a file for several years was "dry cleaning."

They met frequently and compared notes on the retail experiences that they had personally found were less than satisfactory. They considered what it would take to change the way the products or services were delivered, then reviewed the industry structure and the likelihood of competitive or imitative responses. As Krasnow and Stemberg sifted through the many ideas they generated, they found that dry cleaning continued to intrigue them. Both had more than their share of frustrating dry cleaning experiences with complaints ranging from missing shirt buttons to inconvenient hours, poor customer service, and cash only operations.

Each put up $250,000 to underwrite the research process and organized the new venture as a limited liability corporation that they called C.C., Llc (Limited Liability company). The "C.C." represented their commitment to building a Cleaner Cleaner, but their use of initials only was one of many steps they took to keep the focus of their new venture under wraps for as long as possible. A dozen years earlier, they had learned how quickly "me too" operations would spring up in the wake of a new concept introduction. Staples saw 22 office superstore operators open within 2 years of its launch. With both men even more visible in the retailing industry in 1997, they chose to delay the inevitable imitative flurry for as long as possible.

Defining the Territory

Krasnow began to research the dry cleaning universe, using both "bottom up" and "top down" approaches. He interviewed family and friends to get more information about their customer experiences. He was particularly interested in identifying individual hot buttons. He used the data he collected to build a profile of customer expectations about quality, convenience, service, and turnaround time. He also began to get a sense of the product mix his acquaintances had cleaned or laundered and what their heavy usage times were.

At the same time, Krasnow wanted to learn more about the business from the supplier's point of view. He convinced a local dry cleaner to help him understand all aspects of the business, particularly the marketing and operating issues. Using a year's worth of the cleaner's point of sale data provided, Krasnow built a more robust model of usage, product mix, and general cleaning requirements. He also gained new insights about the demographics of heavy cleaning users. Though the research was conducted in Boston, he felt confident that he could extrapolate from these findings and make projections for other East Coast markets.

Krasnow also hired a consulting firm to survey 13 local area dry cleaners. In return for their cooperation, he agreed to share the survey results with all of them. He began to build a database of dry cleaning transactions in the greater Boston area with the expectation that he could use the information to develop more detailed demand and demographic information. He charted seasonality, consumer cycle times (time between drop-off and pick-up), and geographic concentration of customers. The survey corroborated his earlier findings and provided additional demographic data, product mix details, and even some information about individual business operating characteristics. He was pleased with the information he was able to amass through his own research and that of his consultants. He recalled:

> I'd never been a dry cleaner, but we were able to gather all kinds of knowledge – of how many shirts a dry cleaner does; how many and how often people come back (the next day, a week later, or more than six months later). We learned how often people come in only once and you never see them again. We determined how often high income people use dry cleaners versus low-income people; whether they were homeowners or renters, single or married, male or female. All of it was information that we could get our hands around. One thing that the research made clear was that customers were generally accepting of the status quo in the industry.

The Dry Cleaning Industry

For the most part, the business units in the highly fragmented industry were family-owned. The low capital required for start up and the relatively low level of skill needed made the industry particularly attractive to immigrants who often employed their entire families in the business. The International Fabricare Institute (IFI), a non-profit founded in 1883, was the industry association of dry cleaners, wet clearners, launderers, apparel and textile manufacturers, suppliers and other practitioners in the fabricare industry that kept track of business growth and development. IFI estimated that in 1999 there were approximately 45,000 dry-cleaning stores generating approximately $8 billion in revenues. Projected sales for 2000 were $9 billion industry-wide (IFI). The 50 largest operators in the industry captured approximately 5% of total market share; 97% of all companies in the industry operated five stores or fewer.

One of the largest companies in the industry, Johnson Service Group PLC, operated dry cleaning companies in the UK and posted annual sales in 1999 close to $327 million[1]. The group also operated franchise dry cleaning outlets in the United States under the name Dryclean USA.

There were some newer venture capital backed companies that had national aspirations. For example, *Hangers of New England,* a retail franchise of professional garment care stores, operated one store in Wilmington, North Carolina and had announced plans to open up to 100 retail stores in 7 states (including Massachusetts) by the end of 2000. *Hangers* was unique because it used the patented and environmentally friendly Micare system developed by Micell Technologies. The cleaning process used no heat and relied on liquid carbon dioxide (CO_2) -- a natural substance found in carbonated soft drinks -- to remove spots and dirt rather than on traditional dry cleaning solvents.

Anton's Cleaners, a Tewksbury, MA-based chain of 40 stores was another potentially formidable competitor. Anton's was one of the largest dry cleaners operating stores and plants in Krasnow's target area of eastern Massachusetts and southern New Hampshire. Because Anton's provided on-site cleaning, it was able to offer same-day service to customers.

[1] Source: One Source

In spite of the fact that there were a few larger players, competition was generally assessed on a very local basis. Every dry cleaner within a three-minute radius of a retail outlet was considered a potential competitor. Because of this, each of the retail cleaning stores in a chain, even those within the radius of a single central cleaning plant, would operate in its own distinct competitive market. The fact that an individual dry cleaning establishment might be a part of a larger chain did not necessarily make it any more formidable than a well-run "mom and pop" operation.

Building the Business

Defining the Business Concept

In spite of the fact that customers seemed to be willing to put up with inadequate dry cleaning service and that the dry cleaning industry appeared to defy rationalization, Krasnow was determined to go ahead. He planned to build a nationwide dry cleaning chain that focused on the customer experience. Though his new venture would use the web to attract customers and to track orders, the concept was, at its core, a "brick and mortar" business. Stemberg and Krasnow believed that the hundreds of branded stores they envisioned would do for dry cleaning what Staples had done for office products—provide better service at reasonable prices.

The value proposition was simple. Their new venture would get the customers' cleaning done right, reliably, and conveniently. "We know that it's a winning formula and the customer is telling us that it's a winning formula," Krasnow emphasized. His cleaning team would not only meet, but also would surpass the expectations of the new economy's time-challenged consumers. It would offer customers a variety of convenient ways in which to take care of their dry cleaning needs.

Financing the Start-Up

Krasnow used the data he collected from customers, cleaners, consultants and industry information to build his financial assumptions. The revenues (pricing, average order size, customer counts, individual store volume) and operating costs (rents, store staffing, central facility operations) were estimates well documented by research. Krasnow relied on his own marketing experience and industry data to estimate other costs. He went so far as to have his team conduct time and motion studies of employee activities (shirt pressing, clothes sorting, as well as counter service at the retail stores) to provide the detail necessary for staffing and payroll models. He developed multiple scenarios that allowed comparison of revenues and profits for alternative operating models (e.g. on-site cleaning vs. centralized plant).

Though he did careful planning, Krasnow did not create a formal business plan. Since the first round of financing was provided by Stemberg, Krasnow, and a few selected associates, such a document was not required. "We had every important data point we needed in the plan that we circulated. We didn't include the market potential—but we thought we knew the answer based on our preliminary research."

In May 1998, Krasnow closed a $3.5 million series A round of financing. He and Stemberg contributed $1 million each and they raised an additional $1.5 million from a small group of family and friends. Krasnow also put in place a $5 million line of credit with a major Boston bank that was to be used to fund equipment purchases and working capital needs.

More Research

Krasnow hired independent marketing consultant, Phyllis Wasserman (HBS 1977), to conduct additional customer research. Wasserman, who had worked with Krasnow at Staples for seven years, had recently retired from her position as Sr. Vice President of Advertising and Communications. Krasnow had been deeply involved in creating and executing Staples' marketing strategy, but in his new venture, he found that his responsibilities as CEO consumed most of his time. His experience in working with Wasserman and his trust in her abilities led him to call her in on a consulting basis to take charge of several important marketing projects.

As Wasserman dug into the research, she found that dry cleaning was "a low-interest" category. Customers apparently gave little thought to choosing a dry cleaner, even though most expressed some dissatisfaction with the dry cleaning service they currently used. Wasserman noted that quality was a major weakness in the existing dry cleaning environment. "I pushed very hard on that score, and we wasted about a month trying to articulate our brand positioning statement—trying to define what we meant by quality and how we would communicate that to our potential customers," she recalled.

Krasnow recalled, "We started out thinking that we should emphasize environmental friendliness, convenience, and price, but the environmental piece didn't resonate with potential customers." The message that he believed would be most powerful was one of unequalled convenience and uncompromising quality. The C.C., Llc customer should be able to drop off or pick up clothes at any hour of the day or night and to do so with the assurance that a favorite shirt or skirt wouldn't be missing any buttons when it was returned. If an item of clothing were missing a button, it should be replaced automatically. The company's quality pledge would be, "Cleaning Done Right Or It's Free." In spite of his insistence on getting things done right, Krasnow believed it was most important to emphasize the convenience message, rather than quality. Wasserman agreed that convenience was a clearer and more concrete message around which she could build the brand. She elaborated:

> Building a brand name that would convey that message was critical. It was to be our unique selling proposition. Furthermore, convenience would be as our customers defined it—not as we defined it. We wanted to give our customers as many different ways to do business with us as they wanted, and we asked them to choose. Our message was, "We're not asking you to do business in our way, rather tell us how you want to do business with us."

Some of the conveniences the company would offer were: extended hours, drive through drop off and pick up, and secure lockers that would provide the same kind of round-the-clock access that ATM's had introduced to banking customers. Computer systems would be built to provide customers order-tracking capabilities. Though there were still many logistical issues to work through, total customer convenience would be the company's defining difference.

Real Estate and Store Planning

Krasnow determined that centralized cleaning was the most efficient way to run the business. He planned to create regional "hub and spoke" networks of 7-10 retail stores serviced by a central cleaning plant. He anticipated that one of his prototype stores could produce three times the industry's average revenue, but he planned to use the Boston market to test his hypotheses and refine the operating model.

The store design would be kept clean and simple. Though not all locations would be built to exactly the same specifications, the prototype would include a 2400-sq. ft. facility with dedicated parking and space to accommodate a drive-through lane. In addition, each store would have a secure lobby area stocked with individual clothes lockers that would be accessible 24 hours a day. A proprietary system would enable customers to pick up and drop off clothes at any hour of the day or night using a key coded locker system and personalized garment bags. (See **Exhibit 1**).

Densely populated, affluent areas, which had been identified as pockets of "heavy users" were targeted first. In early 1998, Krasnow signed leases for a retail store in Danvers and a site in Wilmington, MA, to be the "cleaning lab." He began looking for additional locations in metro Boston Nashua, NH, and Worcester and Springfield, MA. All of these stores were to be serviced by the Wilmington plant. The initial stores leased were in suburban locations. Once the Boston hub was functioning well, Krasnow planned to replicate it in other high volume markets.

Building the Brand

Krasnow and Stemberg had already selected a company name and logo but they wanted Wasserman to take the next steps in developing the company's identity. She was delighted with the name, which she described as, "*in your face*, bold, different, yet likeable." She believed that people not only noticed, but also remembered **ZOOTS** because the name was short, playful, and easy to remember. It conjured up images of slightly zany "Zoot suits" and its individual components worked well. The letter "Z" was unusual both visually and audibly and the double "O's" lent themselves to bold graphics. Wasserman was confident that the ZOOTS name would translate well to electronic as well as print media.

She focused her energies on the challenge of store design. The operations group determined the physical layout of the facility, but she was responsible for creating ZOOTS' visual identity. She hired an experienced retail design firm and set out on her own to visit the best of branded retailers to see how they conveyed their messages through physical space. She and Krasnow spent hours discussing the image that they wanted ZOOTS to convey and ways in which they could express that image through the store design and décor. A dark wood interior would create a relaxed and comfortable store environment, but a minimalist approach with stark white surfaces would convey the "clean" image. Bold colors and powerful graphics would be more memorable. Wasserman argued for a clean and modern look—one that signaled fast and efficient service. "Everything we do needs to communicate *bold, different, revolutionary, modern*, and *fast*," she told Krasnow.

Together, Wasserman and Krasnow reviewed design proposals, selecting elements they liked from each. Light colored woods, bold graphics and crisp, bright colored signage were combined to create the ZOOTS image. Blue was the background color of choice because of its association with water and cleanliness. Once they agreed on the key elements, Wasserman and her design team completed a set of drawings for Krasnow. She dropped them off early on a Friday, then left for a long weekend on Nantucket with her family. When Stemberg looked over the package later that afternoon, he was disappointed because he thought the overall effect was "boring."

Wasserman had been at her "getaway retreat" only moments when the phone rang. When she picked up the receiver, she heard Krasnow's voice in which she detected a note of barely controlled panic. He quickly brought her up to date on Stemberg's reaction and asked, "What can we do about it now?" Because the Danvers project was set to break ground on the following Monday, there was little time for making substantive changes. Wasserman looked down at the purple jacket that she had tossed on the bed when she came in. She told Krasnow to relax. She would have the problem solved by Monday. She called the design firm, described the color of her jacket, and asked them to change all the blue surfaces to purple in the drawings.

When she handed the revised drawings to Krasnow on Monday morning, his first response was, "Oh my God, they are really *purple*." She tacked the drawings to his walls and suggested he live with them for a few hours. Twenty four hours later, he concurred, "We're going to be purple." "The color shouts," Wasserman declared. "The first thing that you see is a building that is different and announces, 'I'm here.'"

Wasserman selected an ad agency and began hiring staff. In the summer of 1999, Krasnow asked her to come on board as the full time senior marketing person or to find her own replacement. She agreed to join the ZOOTS team because, as she recalled, "It was a marketer's dream opportunity to develop a brand that hasn't existed before as opposed to trying to communicate and enhance or change a brand that already has an image in customers' minds."

Operational Plans

Store Operations

Krasnow's decision to focus on convenience defined the kind of services that would be available. ZOOTS customers could expect courtesy and efficiency at the counter, as well as reliability and quality in cleaning services. However, the real ZOOTS' difference lay in extended store hours (7:00 am–8:00 pm daily, 8:00 am– 6:00 pm Saturday, and 11:00 am–6:00 pm Sunday), drive-through drop off and pick up facilities, and 24 hour access through a secure personal locker system. ZOOTS planned to offer Internet access to track order information, web-based coupons and promotions, and automated credit card billing. ZOOTS also provided Goodwill Industries drop boxes in every store. Customers could bring in their discarded clothing and get a receipt for the donations. ZOOTS then cleaned and delivered the donated clothing free of charge.

Though some of these services were available at competing dry cleaning establishments, others were completely novel -- for example, the 24-hour pick up service. Customers interested in the service pre-registered, then received a personalized, bar coded ZOOTS garment bag and a personal pin number. Clothes could be packed in the garment bag and deposited in store drop boxes at any hour. When customers wanted to pick up their orders, they could call the store (or enter the request through the web site) to request that their clothes be put in a locker. An electronic bulletin board inside the store vestibule/locker area would display the customer's name and locker number that could be accessed by keying in the pin number.

Drive-through accommodations provided a more conventional convenience alternative for customers who wanted to avoid the hassle of parking. A ZOOTS customer service representative came out to greet the customer and pick up any dirty clothing, then returned with finished cleaning orders and hung them up in the back seat. Consumers who rated this service particularly convenient were likely to have children or dogs in the car. In spite of the many alternatives available, the vast majority of customers preferred the more conventional way of doing business, taking the time to come inside so that they could point out spots and discuss special handling with the counter person.

Inside each ZOOTS store, large menu boards displayed available services and their costs. (ZOOTS services included laundering, clothing repair and alteration, professional wet cleaning, shoe polishing and repair, garment storage, wedding gown cleaning and boxing, drapery and curtain cleaning, and leather cleaning and restoration in addition to dry cleaning.) These menu boards also informed customers what was included in normal processing and what was not. For example, repairing hems and cuffs was complimentary, but ironing a garment that had eight or more narrow pleats would cost an additional $4.

Home delivery service was one convenience that was <u>not</u> part of the business model that Krasnow crafted in 1998. Although he knew that some dry cleaners offered that amenity, he decided that he would not include that service, at least initially, choosing to focus all attention on opening retail stores.

Each store had a full time manager and several regular part time counter people who worked at least 20 hours per week. All went through a training program and were actively encouraged to make suggestions for operational improvements.

Store personnel greeted customers, cataloged and "detailed" the garments (entered a description of the garment and how each was to be cleaned or handled into the computer). They asked questions about any unusual fabrics, noticeable stains or damage, specific customer requests and preferences, and the date the items were required. While creating the customer invoice, the counter person also generated a "quick slip" with the detailed instructions that was inserted into an individual cleaning bag with the customer's order. The store clerks then sorted the individual orders according to the specific services required (cleaning, laundering, rush, repair) and bundled them in large transport bags marked with its own store number.

Plant Operations

ZOOTS' trucks picked up dirty laundry and returned finished orders to the retail stores twice daily, dropping dozens of clearly marked bags of dirty clothes at the central cleaning facility as it made its circuit. At the plant handlers opened the transport bags and removed the smaller detail bags, each of which included a copy of the "quick slip" with cleaning instructions, total number of pieces, and expected return date.

Approximately 20 people were stationed in booths tagging the garments individually. They used the quick slips inside each bag to determine what tags to affix. The tags denoted the originating store, special handling or repair instructions, and "rush" status. Because one garment could have multiple instructions, it was possible to have as many as 4 or 5 tags attached by staple, plastic tag, or safety pin through the manufacturer's label. Once the items were tagged, they were put into lots of approximately 100 garments, sorted by date needed and type of handling required.

After this initial tagging and sorting, the bins were moved to the cleaning area where there were five large (80-lb.) and three small hydrocarbon processing machines. Though the machines did a good job, many items had to pre-washed or pre-spotted before going into the machines. The plant team put pressure on the stores to tag spots more carefully so that they wouldn't be missed the first time around.

The cleaning process took approximately one hour. When it was completed, the clothes were again sorted. Shirts were batched for pressing while sweaters were sent through a steam tunnel on hangers. Approximately 40% of the items placed on hangers did not have to be pressed, including such items as silk blouses and dresses. These garments were placed on a conveyor rack that took them directly to the assembly area.

Suits, shirts, and pants generally required pressing. Once a garment had been pressed, it too was placed on the conveyor and sent to the assembly area where the garment was inspected for missing buttons, stains, or incorrect pressing. Experienced tailors were on hand to make repairs or mend any items that were discovered during the cleaning process whether or not the customer had pointed the problem out at the store. When process was completed, garments were sorted and hung on racks that corresponded to the tag color and delivery date.

An inspector then verified that the tags matched the garments and that the overall quality of the cleaned garments was acceptable. A "completion inspector" put a hole punch through the invoice and then a "bagger" bagged the garments using twist ties to secure all the items listed on the invoice.

Depending on the number of steps required in the processing of a garment, as many as 10 or more people might handle a particular garment between drop off and pick up by the customer.

Running the Business

Off to a Rocky Start

When the last remains of the opening night party were swept away on the morning of October 30, 1998, the cleaning lab was ready "to let the games begin." The Danvers store was open and ready for business. All the systems were in place, the staff had been hired and trained, and the plant had already completed several test runs. However, all the best-laid plans quickly began to unravel. The office manager of ZOOTS headquarters failed to show up for work that morning. Not only had she decided to quit without giving notice, but she also drove off with all the cash register forms, garment tags, store coupons, and bank deposit slips in the trunk of her car. The Danvers store team had to scramble with manual back up systems while the plant had to make the best of a jerry-rigged tracking system.

Fortunately the business started slowly. Just as Krasnow had deliberately kept a low profile on the business start up, he also planned a very soft opening for the first store. No major fanfare, no radio or TV ads, only some local mailings with coupons. He wanted to start on a small scale so that he and the team could work through all the details. In the face of this minor opening disaster, he was relieved that they could make the necessary adjustments in relative obscurity. After a quick recovery from the opening fiasco, the ZOOTS team settled down to work on perfecting its systems for handling high volume and delivering on its promise of high quality service.

Quality and Efficiency Challenges

Soon after the cleaning lab opened, one of the cleaning lab employees stood at the entrance to the manager's door lamenting, "This shirt used to have sequins." The de-nuded shirt was one of many problems that surfaced as the crew learned the dry cleaning process—certain clothes just shouldn't be cleaned. What were occasional problems in "mom and pop" operations could easily become an almost daily occurrence at ZOOTS because of its anticipated high volume. "Rejects" or problem garments provided learning opportunities that enabled improvement, not only at the lab, but also at the retail store where garments were first received and inspected. The plant manager saw the sequined shirt as a call to action to develop a handbook for store personnel that would provide detailed instructions on what items should and should not be accepted for cleaning. Her goal was to eliminate unnecessary disappointment for the customers, but at the same time to control damage claims.

Claims were made because of damage to delicate fabrics or unusual materials, shrinkage, mysterious holes, fading, or missing buttons, but the most significant losses were those created by lost or missing items. If a tag fell off a garment or if the wrong tag was attached at the outset, it was extremely difficult for that garment to find its way back to its rightful owner. Because of the high volume at the ZOOTS plant, several new "orphaned" articles of clothing were created daily.

One member of the lab's management team took the initiative to create a spreadsheet of "orphan garments." He sent the sheet, which included detailed descriptions of the garments and their manufacturers, to the stores daily. Store personnel would then try to match up the items against specific customer complaints. Once the formal "orphan garment" program was organized, the average number of garments needing to be matched to their rightful owners was reduced from several full racks to approximately 15-20 at any given time (Orphaned garments were donated to

Goodwill Industries if they were unclaimed after 90 days.) Krasnow commented on how and why garments got lost in the first place:

> One problem we had initially was losing garments. The computer system we had was a store-based system and it didn't allow us to split an order in the production facility. If a garment/order had 5 pieces and one piece got pulled out for a stain or extra treatment or something, we didn't have a good system for matching it back up with the original order. It would get into a different queue that might take a couple of days. By the time it got back to the re-assembly point, the lot number sequences were cycling through again. This "old" piece would come up and somebody assembling the order at 2:00 am in the morning would just look at a number and stick it on in with the next round of lot numbers. Then, off went the shirt to another customer who was expecting to get a dress back. We have fixed that, but it's the kind of problem you don't anticipate until it happens.
>
> The operating part of the business is proving to be absolutely mind-boggling in terms of the challenge to have good service recovery and not make the mistakes in the first place. That's really where the opportunity…it's not like other dry cleaners have solved the problem—they just have it on a much smaller scale. We need to do it at scale.

A five-person team was established to identify critical problem areas and to develop solutions. Krasnow reviewed the store and plant problems daily and made frequent site visits as he and the team struggled to get the operations running smoothly. The items that topped their list included: accurate order assembly, increased efficiency and streamlined handling, improved handling of special care garments. The ZOOTS team regarded the customer complaints as a report card. Though they might be specific, they almost always raised issues that could be addressed and corrected across the board with all accounts, stores, and customers

When there were damages, as in the case of the once-sequined shirt, ZOOTS used the Fabricare Institute's guide for determining claims or appropriate reimbursement to the customer. In some instances, a claim could be made against the manufacturer for faulty merchandise. As far as meeting efficiency goals, the cleaning lab still had a long way to go. Seasoned pressers could handle up to 50 shirts an hour, but the new pressers in the ZOOTS' lab averaged far less than that.

Cranking Up the Volume

The second and third ZOOTS stores opened in West Roxbury and South Attleboro, MA, in early 1999. When it had operated only one store, the ZOOTS team could overwhelm operating challenges with personal attention from the store manager, the plant supervisor, or headquarters staff. However, with multiple stores up and running, the systems had to take over.

ZOOTS ran its first major promotion, an insert ad in the Boston Globe with a $5 coupon, in late March 1999. At the same time, Krasnow granted his first newspaper interview to an old friend at the Boston Globe. At long last, he was willing to disclose the basic business concept and outline his plans for ZOOTS' growth. (**Exhibit 2**).

The article was very positive and the $5 coupon that ran with the ad brought people into the stores in droves. However, the incredible spike in demand resulted in a ZOOTS systems meltdown. The Wilmington facility knew it was coming, but was simply not ready to handle the volume. Krasnow was the first to admit that, in spite of his retailing experience, the operations in this service-intensive business were quite different than they were in office supplies and food retailing. He recalled:

> Many people in dry cleaning have run $1 million dry cleaners. The issues that we have with dry cleaning are not the actual dry cleaning or the pressing. It's the process management of thousands and thousands of garments a day that are all different, that have to go through the factory and come out on time—all while dealing with exceptions or premium service for special treatments—it adds to the complexity.

The marketing group immediately cut back on advertising and promotions. The challenge the ZOOTS team faced going forward was not in getting customers to try the service, but in figuring out how to get the dry cleaning done to their satisfaction. Krasnow admitted that the team underestimated the "manufacturing" process. He elaborated,

> If I've made a mistake it's been in not being quick enough to bring in a full partner who was an operator, because we underestimated just how difficult the executional side of the cleaning production is. It is outside of my range of previous experience. We went in thinking that it was not that hard, but what has been hard is the execution.

Another Option

The ZOOTS news item piqued the interest of Cliff Sirlin, a co-founder and owner of Cleaner Options. Sirlin's partner, Andy Applebaum, was on his honeymoon in Hawaii, but Sirlin was so intrigued by the article that a Boston friend had faxed to him, that he picked up the phone and called Krasnow immediately. He explained that he and Applebaum owned a home delivery dry cleaning business that operated in joint ventures and franchising agreements with local dry cleaners. He wanted to know how the two companies could work together. Within 2 months, Krasnow had completed his due diligence, had acquired the business, and had introduced ZOOTS first home delivery route in the Boston market.

Growth Plans

ZOOTS raised a $9 million second round of angel funding in January 1999. Individual investors included Stemberg, Krasnow, and friends and family. By April 1999, Krasnow and Stemberg began to discuss raising a large round of venture capital to fund more aggressive growth. The first 3 stores were performing well against the targets that Krasnow had established, based on the performance data he had gleaned from the 13 dry cleaners included in his original research. The board urged him to accelerate the rollout of the business. Though Boston was a promising market and its expansion was a priority, finding good real estate was extremely difficult, so growth there would be slower than anticipated.

Furthermore, once news of the ZOOTS concept was public knowledge, the board felt it was important to claim as many geographic markets as possible before competitors blossomed in every city. The Connecticut market was the most obvious next step. It would be a new hub with its own cleaning facility and a separate marketing umbrella, but it was proximate enough to headquarters for frequent site visits and close management supervision. Several sites were leased in the Hartford, CT market and a central facility was underway in Wallingford, CT. The ZOOTS management team expected that the new stores would produce revenues and, eventually, profits at the same rate as the three stores already operating in Massachusetts.

Krasnow and his board began to push beyond the Connecticut borders to consider markets that were not so real estate-constrained. The goal was to locate profitable markets where more stores could be opened quickly. Krasnow, Stemberg, and other Staples board members pointed out that Staples had initially concentrated its growth in major metropolitan areas thinking that secondary markets would be more difficult to run efficiently and that they would be less profitable. When they opened those markets in later years, they discovered that, in fact, these investments were very profitable. That experience suggested that if ZOOTS ran into difficulties finding locations in the major metropolitan areas, it could move directly into secondary markets and build a profitable enterprise much more quickly.

When Boston Markets (formerly Boston Chicken) declared bankruptcy, it closed a number of stores and put the real estate on the block. Krasnow's team reviewed the list and found that there were sites available in the Virginia Beach, VA area that might provide ZOOTS a strong entry opportunity. Several members of the senior management team flew to Virginia Beach to investigate the potential of the Boston Market sites. Though the team rejected all of the Boston Market sites, they did find several other potential stores available that met their expansion criteria. They also found satisfactory space for the central plant. The operating economics looked good and a large labor force was nearby.

In July 1999, Krasnow signed a lease for a new cleaning lab in Portsmouth, Virginia. The team spent the next few months working on getting permits, building the central facility, and securing store sites. Krasnow was closing in on his goal of creating a profitable business model that could be replicated in multiple geographic locations.

Krasnow was also making plans for entering the Philadelphia market. His real estate team located a site for the central cleaning facility and was scouting the neighborhoods for appropriate store locations.

Another major consideration was the purchase of a chain of dry cleaning stores in Ohio. Widmer's had both brick and mortar retail stores and a successful home delivery service. The Cleaner Options acquisition and integration had gone smoothly and Krasnow saw acquisition of well-operated chains as another way to speed ZOOTS growth.

In June 1999, ZOOTS completed a confidential offering memorandum for 14,000,000 Class G shares at $2.50. Krasnow arranged his schedule to meet with venture capitalists around the country. In September 1999, ZOOTS closed a $38 million round of financing with Charlesbank Capital Partners, Chase Venture Capital, Weston Presidio Partners, and Dorset Capital as well as Krasnow, Stemberg and many of the individual investors who participated in the earlier rounds.

Getting Results

In August 1999, ZOOTS had broken ground for the Porstmouth/Virginia Beach cleaning facility and it was building out several retail store sites. The grand opening was planned for December 1999, but Krasnow was very uneasy about the decision long before the first store opened. He commented:

> The plan going into Portsmouth -- it's almost laughable now – if it weren't so painful. We were going to open up 8 stores in the Virginia Beach/Portsmouth market by the end of 1999. That's how easy we thought the real estate was going to be. It turned out that getting the right real estate was every bit as hard as it was in New England. Our initial assessment of easy real estate was incorrect.
>
> Besides the real estate challenge, another important obstacle surfaced in mid-to-late August. We began to develop a new sales projection model based on the data we were getting from our own stores and it really gave me cause to worry. Our initial real estate model was based on the 13 dry cleaners that we had gotten data

> from before we started ZOOTS. When we began to get reliable data from our own stores – which, by mid summer, included good and bad stores – we tightened up the criteria. The new model we built indicated that there was far less potential for building strong new stores in the Portsmouth market than we had anticipated. We ran the new model for the first time in mid-summer. We realized, 'Oops, because of the tight real estate market, we aren't going to have the number of stores we anticipated and the stores we do have aren't going to produce the sales we projected. How are we going to achieve the economies of scale we need in the plant?'
>
> Based on our new info, it was clear that the Portsmouth and Virginia Beach sites didn't have as much potential as we had first thought. We did the math and discovered that we would not be able to fill the Portsmouth facility with the eight stores we had planned in the Virginia Beach and Norfolk markets.
>
> We were under construction and couldn't turn the process around. We had just started the delivery business (the acquisition of Cleaner Options in NY), and had to ask the question of 'how are we ever going to get ourselves working properly in Virginia Beach?'

The original model had indicated that ZOOTS could open eight stores in the Portsmouth/Virginia Beach area, each of which would do "x" amount of business. By late August, Krasnow concluded that, "we could only open four stores, not the eight as planned, and that each of the stores would only do two thirds of the business expected. That means that we would have only one third of the volume that we used to justify this move. More sales were needed—the question was 'from where?' "

October 1999

The shareholders letter of October 12, 1999 chronicled both the successes and the misses of the most recent quarter. (**Exhibit 3**) Though investors were very optimistic about ZOOTS' future, Krasnow had some serious concerns that he wanted to talk over with Stemberg first, then bring them to the board. The first of his concerns was the quality of service and efficient operations. The second had to do with the specifics of the Portsmouth market. ZOOTS was committed to the market, but it was already beginning to look like a potential disaster on paper.

An overarching concern was how to manage growth. The financing round had been very successful. Though they took $38 million, the round was over-subscribed by a factor of 3. There was tremendous optimism about ZOOTS' concept and its leadership team. There was a strong mandate for rapid growth, but Krasnow did not want to grow the business without correcting the operational issues first. He realized that both his new and his old investors were looking for a rapid rollout and that he couldn't focus all his attention on correcting the operational issues, but he also realized that not meeting customers' quality expectations would be the end of ZOOTS. He noted:

> That's the balancing act. We've been all over this issue and have gone from 'let's open in 20 markets in two years' to 'let's shut down the growth and focus on getting the operational stuff perfect.'
>
> There is a very big different between understanding this stuff intellectually and having a little spreadsheet that calculates this stuff for you and actually doing what you need to do. If it snows for 3 days in a row and you tell people to go home, they quit because they think, 'What kind of job is that, if I don't get paid?' Now you're back to hiring and training people and they are performing poorly—it gets into all those human dynamics.

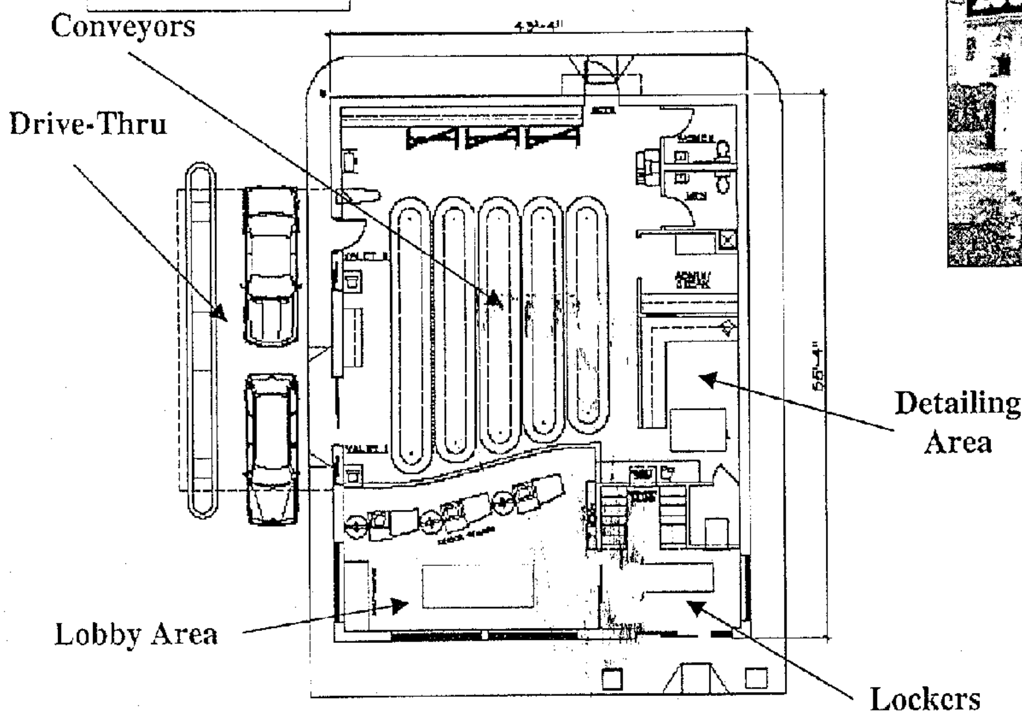
> The challenge of being in multiple geographies while still identifying and really fine tuning the business model, while trying to grow, those are the challenges of being a start-up. I actually don't think there's anything particularly unique about these challenges. Individual elements are specific to my business, but this is what it means to be a start-up. I think that every business that has a lot of growth potential goes through this. My belief is even companies that are incredibly sexy from the outside, like e-Bay, etc. totally different type of business and workforce—everything is different—but they have the same issues.

Krasnow considered all the many challenges he had already overcome in launching ZOOTS (**Exhibit 4**) and knew that he would have to come up with some good answers about how to balance the operating challenges with the imperative for growth.

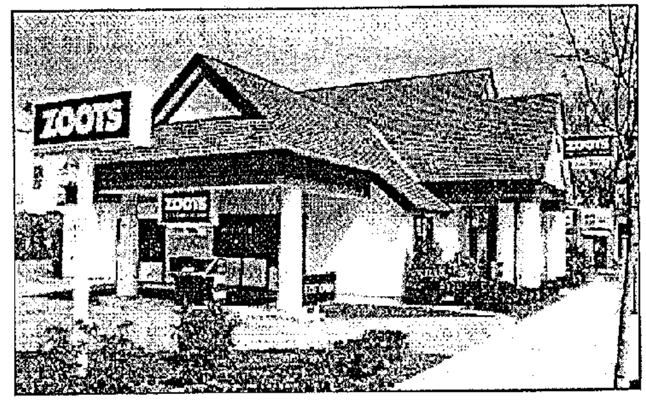
Exhibit 1 Store Prototype

STORE CONFIGURATION

Floor Plan Prototype



Exterior Store Design



Interior Store Design

Exhibit 2 Boston Globe Article

Business

THE BOSTON GLOBE • WEDNESDAY, MARCH 31, 1999

Looking to clean up

With Zoots, duo that helped create Staples aim to be national players in dry-cleaning business

By Chris Reidy
GLOBE STAFF

PAULA NEWTON, WHO commutes nearly 100 miles a day, is delighted with Zoots, the new dry-cleaning chain started by some of the same folks who made Staples Inc. a retail phenomenon.

Unlike the dry cleaners near her home in the Magnolia section of Gloucester, she can drop off or pick up her laundry 24 hours a day. And thanks to the drive-through window at the Zoots in Danvers, "I don't even have to get out of my car," she says.

Zoots is the brainchild of Staples cofounder Thomas G. Stemberg and Todd Krasnow, one of Staples's first employees.

For Stemberg, Zoots may represent a retail hat trick of sorts, certifying his status as a serial entrepreneur.

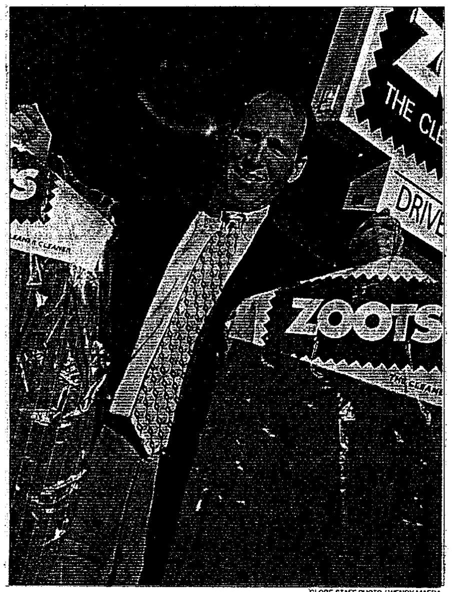
In 1986, he helped launch Staples, going from zero to $7.12 billion in sales in 12 years. He's a key investor in KaBloom, a new, local chain of flower stores.

And now he and partner Krasnow look to be national players in dry cleaning, with Krasnow running the day-to-day operations of Zoots while Stemberg remains as chief executive of Staples.

Will the Staples golden touch rub off on the mundane world of pressed pants and starched shirts?

Some in the dry-cleaning industry don't think so. They note that many

ZOOTS, Page D4



GLOBE STAFF PHOTO / WENDY MAEDA

Zoots CEO Todd Krasnow showed off some dry cleaning outside the West Roxbury store.

Retail hat trick

A cofounder of Staples Inc., Thomas G. Stemberg is a major force, and investor, in two new retail chains with ideas of going national. Staples, KaBloom, and Zoots each entered a fragmented mom-and-pop industry. All three chains seem to share the same belief: that size and efficiency will allow a big chain to better serve customers and underprice smaller rivals.

STAPLES

Established in 1986, Westborough-based Staples has gone from zero to $7.12 billion in annual sales in a mere 12 years. It operates 913 stores worldwide that sell a wide variety of office supplies at lower prices than many competitors. Stemberg is chief executive.

KaBloom

Wowed by a flower shop he saw in Germany, Stemberg helped launch a US knockoff called KaBloom last year that is trying to make Americans think about low-price flowers as an everyday purchase. Plans calls for KaBloom to grow from three stores into a national chain. Stemberg plays no role in day-to-day operations.

ZOOTS THE CLEANER CLEANER

Zoots, a dry-cleaning venture Stemberg cofounded with Todd Krasnow, opened its first store last year. The three-store chain looks to go national with Krasnow in charge of day-to-day operations, offering low prices and conveniences such as drive-through service and 24-hour access.

Exhibit 2 (cont.)

THE BOSTON GLOBE • WEDNESDAY, MARCH 31, 1999

Emerging **Business**

A REPORT ON NEW ENGLAND'S GROWING COMPANIES

Duo look to clean up with Zoots

■ ZOOTS
Continued from Page D1

Americans have gone casual, and khakis in the office often translate into flat sales at the dry cleaners.

What's more, people are emotionally attached to their clothes and don't like entrusting them to strangers; instead, folks tend to patronize family-owned dry cleaners that have been in business for two or three generations. Get too big and risk losing that all-important personal touch. That's why no dry-cleaning chain has yet managed to expand nationwide.

"This is one business you can't McDonald's-ize," says Charles Anton, vice president of Anton's Cleaners, a 40-store, Tewksbury-based chain that's one of the largest in Massachusetts.

As a customer, Newton seems less concerned with a dry-cleaner's pedigree than with price and convenience.

"By the time I get home from work, the dry cleaners near my home are closed," she says.

According to Newton, Zoots provides her with lower prices and added conveniences: She can check in advance whether her husband's shirts are ready by visiting the company's Web site at Zootscleaner.com.

Krasnow and Stemberg are betting that there are a lot of busy people like Newton from two-worker households.

"We're trying to make [dry cleaning] less of a hassle for customers," Krasnow says.

In Zoots, the pair envision a national chain with hundreds of stores that does for dry cleaning what Staples has done for office products – offering better service at a lower price.

Last week, Zoots opened a store in West Roxbury, the third in the chain. By year's end, plans call for 20 stores. Most will have drive-through windows and special lockers where customers can drop off or pick up their clothing 24 hours a day.

According to Krasnow and Stemberg, there are similarities between the highly fragmented dry-cleaning industry of mom-and-pop stores today and the office-supply market of the late 1980s.

With so many mom-and-pop stores, there's an opportunity for Krasnow and Stemberg to apply their Harvard Business School training to devise a more efficient dry-cleaning operation.

One way to achieve efficiencies is to have most of the cleaning done at a central location that serves a network of stores. Mom-and-pop dry cleaners, in contrast, tend to do most of their cleaning in the back of their stores.

Centralizing operations may offer another bonus. Many mom-and-pops use harsh cleaning solvents that can hurt the environment.

By using one cleaning facility to serve a number of stores, Zoots claims it can use "greener" high-tech cleaning techniques, something many customers seem to be interested in.

Sometime later this year, plans call for Zoots to test its business model in another, as-yet-undisclosed market.

On paper, the strategy makes sense, but there are skeptics.

"You have all these guys in the ivory tower making assumptions, but most of them have never pressed a pair of pants," says Anton of Anton's Cleaners.

GLOBE STAFF PHOTO / WENDY MAEDA

Cindy La Pointe, manager of the West Roxbury Zoots, checked finished laundry.

These aren't the best of times for the industry. Not only is there a trend toward casual clothing, but there's always the possibility that some new miracle fabric will come along that doesn't require as much dry-cleaning as worsteds and wools.

When "polyester was a tacky fad" in the 1970s, a lot of dry cleaners went under, notes David Uchic, a vice president of the International Fabricare Institute, an industry trade group.

GLOBE FILE PHOTO

Thomas G. Stemberg

Today Uchic estimates there are about 34,000 dry-cleaning stores in a nearly $7 billion industry. While some stores are doing quite well, generally business is "soft," he says.

Soft sales haven't deterred others from exploring the possibility of building a large dry-cleaning chain with stores in many different states.

Outside of New England, a company called DryClean Depot seeks to slash prices by operating giant stores with on-site facilities designed to clean large volumes of clothing.

Meanwhile, another company is pushing a technology that cleans without harsh solvents; using this technique, dry-cleaning franchises called Hangers will market themselves as an environmentally friendly alternative to old-fashioned methods.

Sam Brickle, the Rhode Island investor who holds the New England franchise, predicts 20 Hangers could be up and running in the region by the end of the year.

Zoots also has big plans with an initial investment of $20 million. Of that amount, Stemberg contributed $5 million, Krasnow $2 million.

What inspired two men who had devoted more than a decade of their lives to paper clips and legal pads to try dry cleaning?

Stemberg, it seems, keeps files on ideas for new retail chains, and his file on dry cleaning had achieved critical mass.

"I experienced a lot of problems as a customer," Stemberg says, adding: "You'd get your shirts back with two buttons missing, and the stores were never open when you wanted."

From such discontent, the idea for Zoots was born.

Anton's Cleaners once had visions of being a big chain, operating more than 100 stores in the early 1980s.

In those days, it, too, used centralized cleaning facilities. But ultimately, it decided to retrench and went back to having its stores do most of their cleaning on the premises.

The cost of shipping clothes back and forth from stores to a central facility erased any savings, Anton says, and cleaning on-site makes it easier to offer same-day service.

"This is a business about personal relationships," he says. Dry cleaning is "not a commodity. . . . The minute you have to get on a plane, you know your [dry-cleaning] chain is too big."

Krasnow and Stemberg have heard nay-saying before.

In its early days, no one gave Staples much of a chance either; the computer was to make office supplies obsolete.

"Society was going to go paperless," Stemberg recalls.

It's the same thing with dry cleaning and casual days, he thinks. Jeans may be showing up more at the office, but many people have less time than ever to wash and press them.

"Staples was a revolutionary idea, and this could be as revolutionary as Staples," Stemberg says of Zoots.

It won't be industry experts who will determine whether Zoots succeeds, adds Krasnow. "It will be the customers."

Exhibit 3 October 1999 Letter to Shareholders

ZOOTS THE CLEANER CLEANER™

October 12, 1999

Dear valued shareholders,

The third quarter has been an active one for Zoots. We have seen our business develop in a number of important ways, but we have also missed several targets.

1 Acquisitions: On September 15th, we acquired Widmer's, the leading dry cleaning chain in Cincinnati. Widmer's operates 8 stores and 15 home delivery routes. In addition, they use a 30,000 square foot production facility for their cleaning, which is consistent with Zoots' centralized production philosophy. Given the excess capacity of this plant, we believe we can more than double the volume processed there, by opening Zoots stores and routes in areas not currently served by Widmer's.

2. Real Estate: We finished the quarter with 8 Zoots stores in operation, 2 fewer than our target. We believe that we will miss our year end target (20 stores) as 4 stores slide into early 2000. The delays have been caused by challenges in financing development sites and permitting. More importantly, the missed targets tell us we need a far more robust real estate pipeline to meet our 2000 objectives. In part, the pipeline is behind because of difficulty in staffing the real estate department. We anticipate resolving our staffing issues in the 4th quarter.

   During the quarter, we began construction on two 30,000 square foot cleaning laboratories: one in Portsmouth, Virginia and the other in Wallingford, Connecticut, just outside of Hartford. Both are scheduled to open late this year or early next year.

3. Operations: Store revenue has continued to exceed our expectations for the stores that are open, although, in total, store revenue is behind our budget due to the delayed openings. Home pick-up and delivery revenue is also exceeding our plans. At the end of the quarter nine routes were in operation in the Boston market. Store, cleaning lab and delivery expenses were in line with expectations.

   On October 4th, we began providing dry cleaning service for Streamline.com, a Boston based home delivery grocery service. Streamline.com is a publicly traded company that has offered dry cleaning as part of its service mix since its inception. We are providing the dry cleaning under the Clean'r Cleaner name (a trademark owned by Zoots).

4. Human resources: Bob Anarumo joined us in August as Chief Operating Officer. A copy of our internal announcement about Bob is attached.

19 Needham Street, Suite #2, Newton, MA 02461-1622
Tel: 617-558-9666 Fax: 617-558-9667

Exhibit 3 (cont.)

Phyllis Wasserman joined us as Vice President, Marketing. Phyllis had been Senior Vice President, Advertising at Staples, where she successfully built a strong brand image through print, catalog and broadcast advertising. After leaving Staples, Phyllis consulted to a number of companies, including Zoots.

Paul Tritman joined us on October 11th, as Vice President, Production. Paul fills a critical position in which he will lead our efforts to improve cleaning quality and reliability while increasing efficiency. He was Director of Manufacturing and Controls Engineering for Kidde-Fenwal, Inc.

5. Financial: We recently closed a $38,000,000 equity financing, our first financing involving institutional investors. Our lead investor was Charlesbank Capital Partners. Other institutional investors include Chase Venture Capital Associates, Weston Presidio, and Dorset Capital. Mike Eisenson of Charlesbank and Steve Murray of Chase have joined our Board.

   We expect to extend our bank credit facility from $5 million to $12 million in the coming month.

Finally, it is worth noting that our Danvers store celebrated its first anniversary last week. It has certainly been an exciting year since that first store opening day in October, 1998. On behalf of everyone at Zoots, thank you for giving us the support which has allowed us to build our business quickly.

Sincerely,

Todd Krasnow

Todd Krasnow
C.E.O.

Exhibit 3 (cont.)

ZOOTS THE CLEANER CLEANER™

August, 1999

To the Zoots Family:

I am delighted to announce that Bob Anarumo will be joining Zoots on August 30th as Chief Operating Officer.

For the past six years, Bob has been President and CEO of the largest franchise group in Boston Market, with a territory spanning from Canada to Virginia and revenue of over $400 million. Bob opened or acquired 360 restaurants, and ran the most (and often only) profitable franchise group within the Boston Market network. Prior to Boston Market, Bob ran a 300 restaurant division of Pizza Hut. He also led the development of Pizza Hut delivery, which required the creation of locations and processes completely outside of the existing restaurant business. His drive to create well-run, customer focused operations are clearly demonstrated and fit our own culture exceptionally well.

As soon as Bob learns the Zoots business and gets to know our people, he will assume responsibility for all day-to-day operations. This includes store, home delivery and cleaning lab operations, as well as our distribution, logistics and human resource functions. This will allow me to spend more time with our marketing team to drive sales and our real estate team to explore significant real estate opportunities. Marketing and real estate will report to me. In addition, I shall focus on Zoots' long range development, including acquisition opportunities, financing, and other projects. Tom Sager and his team, along with JJ Pellegrino will report to me in these efforts. Larry Kennedy and the systems team will work closely with Bob, Tom and me to insure the continued development of systems that support our operation and enable rapid growth.

Bob and his family will be relocating from New Jersey. Please join me in welcoming him to Zoots.

Sincerely,

Todd Krasnow

19 Needham Street, Suite #2, Newton, MA 02461-1622
Tel: 617-558-9666 Fax: 617-558-9667

Exhibit 4 ZOOTS Timeline

OPERATIONS

Fall 1996—talks about leaving Staples; search for business idea

1997—Staples merger delayed

Jan 1998—Launch of ZOOTS, The Cleaner Cleaner

Oct 1998—
- Opened first store in Danvers, MA.
- Third office manager quits on opening day with printed forms, cash register forms, deposit slips, tags for garments, customer sign-up forms, etc.) in trunk of car.
- Open house celebration—Wilmington Cleaning Lab

Mar 1999—
- Opened S. Attleboro and West Roxbury stores
- First public commentary appears in *Boston Globe*, March 31, 1999

Second article appears in *Wall Street Journal*, April 27, 1999

May 1999—
- First acquisition—Cleaner Options in New York
- CFO hired
- Pressure to grow business increases

June 1999—
- Selected new sites in Connecticut and additional Boston markets
- Identified new sites in Virginia Beach and Portsmouth, VA
- Lease signed on Portsmouth Lab

Aug/Sept 1999—
- Realized Portsmouth plant would not meet economics
- Discuss Portsmouth with Stemberg
- Budget planning for 2000
- Lease signed on Connecticut lab
- Serving 50,000 customers per week; operational and manufacturing issues increase
- Missing garments biggest nightmare
- Five-person team assigned to solve customers' negative comments

Oct - board discussions of growth

1996 1997 1998 1999

1997—$500,000 (Krasnow & Stemberg each contributed $250,000 towards researching business concept)

May 1998—$3.5 million (Krasnow & Stemberg each contributed $1 million—balance came from friends and family)

Jan 1999—$9 million (individual investors)

Sept 1999—$38 million (VCs and individual investors)

FUNDING