Dan Gordon

Dan Gordon sat at his desk, a blank pad in front of him. It was September 1988, and Dan had finished his first month on the job as chief operating officer of Club Sports International (CSI).

Dan was a 1983 graduate of Harvard Business School who had been hired as chief opera-ting officer to help consolidate the firm's existing operations and to build a base from which the company could grow. As Dan thought back over his experiences at the company so far and reviewed the goals he had been given by the firm's founders and financial backers, he wondered where to begin.

> Initially, I was brought into CSI on a consulting basis, which gave me something of an advantage in that I could position myself as an "objective outsider" who had been hired to help the company. The situation was along the lines of what you'd expect in a small, fast-growing company. There was a high level of energy and enthusiasm but a definite lack of structure and systems; this created a fair amount of flexibility at times, but it also created frustration within the clubs because people felt that they were continually reinventing the wheel, and they were uncertain about what was expected of them.
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> After a few months, I had helped refine the strategy and developed a more realistic financial plan for the business. I had also developed a good relationship with the founders, Andy and Jay. They asked me to become COO. This would create three managing partners, each with a specific area of responsibility: Andy with construction and industry and investor relations; Jay with new club development; and me with the responsibility for the performance of existing clubs and managing the day-to-day headquarters functions. Essentially, the challenge was to bring some structure and discipline to the operation. This was required to improve the financial performance of existing clubs and provide us with the funds with which to grow. Moreover, we would need sound operations to both develop the service reputation required to open new clubs and to allow corporate management to focus its efforts on growth, rather than on the day-to-day operating issues.

Professor Michael J. Roberts prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

Background

CSI was founded in 1983 by Andy Bowman and Jay Arthur. Andy had earned an undergraduate degree in business as well as an MBA, and also had some experience as a tennis pro. Andy had come to Denver in 1973 and became a partner in one of the country's first multipurpose athletic clubs, Racquet World. The club had started out as a tennis club, and in 1976 added racquetball, weightlifting equipment, and a basketball court, which was then a unique concept. Jay Arthur joined Andy in the late 1970s as the sales director at Racquet World, and the two built the club into one of the most profitable operations in the country. The concept was later expanded into one of the first new multi-purpose athletic clubs, the 135,000-square-feet Racquet World Inverness, located in southern Denver. When it became apparent that the real estate developer with whom they had worked in Denver was not going to expand beyond the two clubs, the two decided to go out on their own and started Club Sports International.

A key element of the strategy was to avoid the massive investment in real estate and equipment by managing clubs for others, much as Marriott might manage a hotel for an investor group. By 1988 the two had built a company with seven clubs under management, located primarily in Texas. The company had $10 million in total system revenues and 400 employees. As with any new company, creating and managing cash flow was an ongoing challenge, and it became increasingly difficult to continue to both develop the relationships that were needed to build new clubs and at the same time manage the day-to-day operations of the existing clubs. During this period, several of the markets which they had initially pursued, including Dallas, Houston, and San Antonio, suffered the real estate crash of the late 1980s. This made the task of sustaining profitable results at the existing clubs even more important, and some of the company's investors encouraged the founders to look for some help with the operating side of the business.

Dan was looking for a job and doing some consulting in the fitness industry:

> I had gone to work for Weight Watchers International (WWI) after graduating from HBS. I knew I was interested in the health and fitness industry, and at Weight Watchers I had the opportunity to be responsible for new business development. My first job there was to start an aerobics business within WWI designed specifically for overweight women. Unfortunately, it was not a success. However, I learned a tremendous amount about field operations and the service business, and the process of starting up and implementing a new business.
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> Because of my experience in working with the field during the market testing of the aerobics business, I was promoted to General Manager of Operations Support, with responsibility for providing operations, financial, training and organizational development support to the $60 million division of WWI which was company-owned. I was very fortunate in that I was given a lot of freedom and the ability to rebuild a department which had previously been the "company graveyard." I was able to hire new people with excellent experience in service industry management from Hertz, TWA, and a national aerobics company, and I learned a great deal from them about service operations.
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> After four years, Weight Watchers had grown tremendously and it became more of a big company environment, especially in light of its relationship with its corporate parent, H.J. Heinz. I became increasingly uncomfortable with the planning and

> reporting requirements which are necessary in a company of that size, and I decided to leave to pursue ownership of a Weight Watchers franchise. A partner and I, also from WWI, raised the $7 million we needed to buy an existing Weight Watchers franchise, but we were unable to complete the transaction when WWI exercised its right to block the sale. The company was pursuing an aggressive strategy to buy back franchises wherever possible and tried to acquire the franchise itself.
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> I hooked up with CSI through a "friend of a friend of a friend," and I agreed to do some consulting for them, primarily on business strategy and financial issues. Fortunately, I ended up getting along with Andy and Jay, and at the end of the consulting assignment, they asked me to stay on as COO. This was exactly the kind of job I was looking for, and it provided me with the opportunity to earn equity in the company over time. (See **Exhibit 1** for CSI corporate organization chart.)
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> To outsiders, the athletic club business may not even seem like a "real" business. However, many of the facilities cost between $6 and $12 million to build, and they generate between $2 and $3 million in annual revenues. The club industry is basically fragmented, with lots of individual owners/managers and no major chains at the top end of the market. Many of the employees within the industry have more of an athletic or service background and may not have any of the "classical" business training that is found in other industries.

Andy Bowman offered his perspective on the company's growth, and the rationale for hiring Dan:

> Jay and I were well-suited to the task of starting the business and growing it to six or seven units. But, as we looked at growing the company beyond that point, we realized that we didn't have the disciplined, detail-oriented approach required. We needed someone to add these skills to the team, and take over the day-to-day. That's why we brought Dan on board.

Industry Overview

The health/athletic club business is a $5.5 billion industry (with 16 million members) which remains extremely fragmented. Most clubs are local, owner-managed businesses. Based on his work in the industry, it was Dan's view that there were five principal segments:

- Health club chains: These clubs emphasized the hard-sell, low-priced, multi-year contract, and often positioned themselves as "singles" clubs. The segment was dominated by Bally under the Holiday, Jack LaLanne, Scandinavian and Presidents brand names.

- Racquet clubs: These clubs were primarily tennis clubs that may have added racquet ball or other facilities as the market changed. They typically had an annual fee structure with moderate pricing.

- Boutiques: These clubs were small, one-of-a-kind exercise studios that offered special classes or personal training, and charged by the session.

- City dining clubs: The clubs were in downtown locations, emphasized dining and business entertainment, and had a high initiation fee and high monthly dues.

- Full-service athletic clubs: These clubs offered the largest range of athletic and fitness services, including tennis, fitness, aerobics, and swimming. Initiation fees and monthly dues ranged from moderate to high, depending on the service level.

CSI's strategy was to focus on this last segment, at a premium price and service level. The senior management group felt that, in order to compete with single-site "mom & pop" operators with on-site owner managers, CSI needed to develop a standardized, systemized management approach:

> There are advantages to multi-club operations, including the ability to provide training and a career path for management, marketing expertise and purchasing economies. However, we must offer a service level that is competitive with other operators in the market. For customers, this translates into exceptional cleanliness, especially in locker room facilities, up-to-date equipment, and outstanding programs.

CSI's model of the business suggested that there were several important factors that contributed to the success of a club:

> The financial structure of the club makes it easy to identify the critical factors impacting financial performance. The main source of revenues (typically 80% to 90%) is monthly membership dues, which range from $50 to $100 per month depending on club side and type of membership. 5% to 10% comes from the initiation fee a new member pays when joining, which ranges from $75 to $300, depending on club size and type of membership. The remaining 5% to 10% comes from ancillary revenues such as guest fees, locker rentals, massage.
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> This means that the critical tasks are:
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> 1. Getting and keeping new members. The upscale athletic club segment is different from some of the chains which emphasize new members, but which place little emphasis on service. Since our "bread and butter" is monthly dues, we need to focus on retention.
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> 2. Disciplined expense management. The key is not "cost cutting" but "cost efficiency." If we're going to spend a dollar, we should be spending it smart and on something that will directly benefit the members or staff. The main components of expense are salaries, which typically account for at least 50% of what we classify as "controllable" expenses (variable and semi-fixed costs).

> Given these main financial "drivers," the focus of the clubs is on 1) getting new members, and 2) keeping members. Expense management should not be a major issue if people are doing their jobs properly.
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> Membership turnover in the industry is fairly high—4% a month or roughly 50% a year. Even a top performing club will have 3% monthly turnover. Some of the turnover is inevitable, as people relocate or find themselves unable to sustain a fitness program, but we can manage it by providing consistent, good service.
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> Turnover of members is something that is going to happen, but we can try to manage it by giving good service. This means cleanliness, good athletic programs, quality equipment—all of the things you would think. But it is also something intangible, hard to measure and hard to manage. If the associates at the club know the members names, greet them when they come into the club, can ask them about their jobs, their spouse, their kids, it all creates an atmosphere that makes people want to stay. Personality is an important factor. If a GM spends half of the day in the office instead of out on the floor talking to members, then the club is going to reflect that personality. These people are hard to find. It is much easier to give a real "people person" some financial skills than it is to turn a finance whiz into a real rah-rah guy.
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> The same factors that lead to good service also lead to member referrals, which account for 70% of our new members.

When CSI managed a club, the owner provided the capital required and the funding for any operating losses. CSI was responsible for administering all the funds, and billing and collecting all the revenues. As part of the budgeting and planning process, CSI would have to present its requests for capital improvements (new equipment, pool resurfacing, etc.) CSI was compensated with either a fixed management fee or percentage of revenues, and a portion of the profits. Dan explained the effect of this arrangement:

> CSI is paid a management fee, and the owner provides the capital for all investments and to cover any operating losses, if required. All of this is negotiated in accordance with a budget prepared by CSI and approved by the owner. However, most management contracts include an incentive fee which is tied to an improvement in operating income, giving us an incentive to manage the clubs as if we owned them. In fact, in many cases, we run the managed (not-owned) facilities more tightly because we feel accountable to the owners and meet with them each month to review our performance.

The Organization

In 1988, CSI operated seven clubs as follows: Dallas (3), San Antonio (1), Denver (1), Indianapolis (1), and San Francisco (1). All of the clubs, with the exception of Denver, were managed rather than owned. Each club was organized along similar lines: four to six department heads reported to a general manager, who in turn reported to Dan through an operations manager. (See **Exhibit 2** for typical club organization chart.) He explained each of the department's functions:

The accounting department is responsible for billing members, cash collections and cash management, as well as financial statement preparation. Their primary task is the timely billing and collection of member dues and charges. The accounting function in a club is relatively simple; the main challenge results from the volume of transactions. A large club may have over 2,000 memberships, sometimes with an average of 1.5 to 3 people per membership (because of family memberships), and there are ongoing member charges in the restaurant, pro shop, and for other services such as tennis lessons, massage, and personal training.

There has been no industry standard for software, so one of the challenges within CSI has been the development of a standardized accounting software system to manage the club.

The athletic department is responsible for much of the service delivery function in the club, including maintaining the exercise equipment, orienting new members, running aerobics, ensuring that there is staff on the floor to help members and answer questions, and organizing leagues and activities such as basketball, racquetball, and volleyball. In this department there are some technically oriented staff who have all the necessary educational qualifications, and at the other end of the spectrum there are "camp counselors" who are friendly, member-oriented individuals. The challenge is to find staff who have the necessary technical knowledge and also have the personality. Surprisingly perhaps, this is often a difficult combination to find.

The sales function in the club is probably the most difficult to manage and the most difficult in terms of recruiting. Clubs succeed or fail on the basis of their sales staff because even a well-performing club will lose over one-third of its members each year due to relocation, financial issues, and a general lack of participation on the part of members. Sales people in the club industry are responsible in most cases for generating their own leads through member referrals, cold calls, and personal direct mail pieces. A sales director is the person who must build the team and keep them motivated. There are not many industries that operate on such a specific monthly cycle, where on the first day of the month there is a whole new scorecard and the cycle must begin again.

The front desk staff are usually the lowest-paid associates in the club, and it is primarily a part-time job for college students or people recently out of school. Yet the front desk, as with many service industry positions, has the most frequent member contact and can make the biggest impression, particularly a negative one. The front desk supervisor is responsible for hiring, training, and scheduling. The job is more difficult than it looks, with front desk associates responsible for checking membership cards upon member entry to the club, handling most member telephone inquiries about schedules and programs, referring prospective member inquiries to the sales department, and maintaining an overall cheerful attitude while standing in place for four to six hours at a time.

The maintenance department is responsible for physical plant maintenance and housekeeping. CSI's clubs are distinguished by the high level of cleanliness, which is again achieved primarily through a part-time staff. Organization, attention to detail, and the ability to motivate an often unmotivated part-time staff are critical elements of success.

> At the club level, the financials are basically driven by net adds membership change—the net number of new members, after subtracting members who cancel. This is because most of the expenses are fixed or semi-fixed and any incremental increase falls to the bottom line. Since most of our revenues are from dues, the most important thing is to increase membership. (See **Exhibit 3** for typical club financial statements.)
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> In terms of the people who fill the General Manager jobs, their experience varies according to the size of the club. Our larger clubs are $3 to $4 million operations, while the small clubs are less than $1 million. The large club GMs ranged in age from 35 to 50, with the majority of their experience being in the small club industry, usually from athletics or operations. Small club GMs are more in the 27-32 age range, typically with experience in sales or athletics. In the small clubs, we are trying more to have a "functional" GM who doubles as a department manager in athletics or sales.
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> Department managers vary similarly. In large clubs, the department managers are usually 25-35 years old, again with most of their experience in the club industry. Sales staff will be the most likely to have had experience in other industries. Skills most needed and most lacking are budgeting and staff management. Many people are good "do-ers" and need help in becoming managers.

In addition to the club-level organization, certain corporate staff roles were in place, and reported to Dan:

- National Operations Manager: Each of the club's general managers reported to the operations manager. He focused on ensuring that clubs achieved monthly budgets.
- National Sales Director: The sales manager worked closely with the sales director at each of the clubs to help them in training and motivating staff, to develop sales projections and marketing programs and to manage the sales process.
- Controller: The controller worked closely with the accounting managers at each of the clubs on cash management, receivables and payables.

Early Impressions

Dan offered his views based on his first month on the job:

> At the strategic level, it is clear that CSI should pursue management contracts rather than club ownership. The financial risk and capital requirements of *owning* the clubs is simply too great. It is also clear that the full service, high-end of the athletic club is the place to be. This in turn, requires a focus on cleanliness, personal service, a "hotel-like" presentation. During the past month, I have gone around and talked to the GMs at each of the clubs. I asked them what they liked about their jobs and what

they didn't like. I asked them what they thought the company did well, and what it didn't do so well. (See **Exhibit 4** for excerpts from Dan's notes.)

I know there's a lot to do; the question is where do I start. I can't afford just to "fix" the problems I see. We really need to build a base for growth. The plan calls for having 15 clubs by 1990, and twice that many by 1992.

Exhibit 1 Club Sports International Organizational Structure—1988

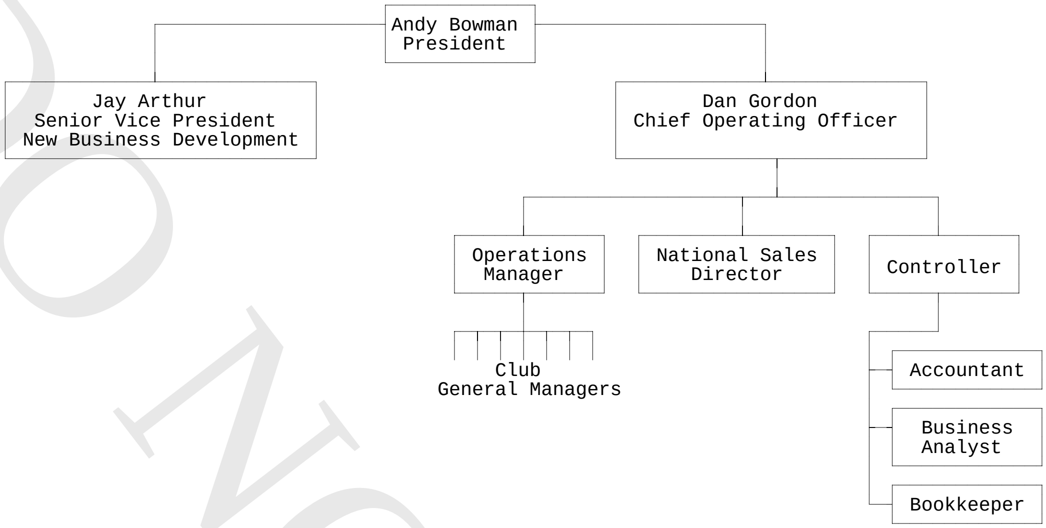
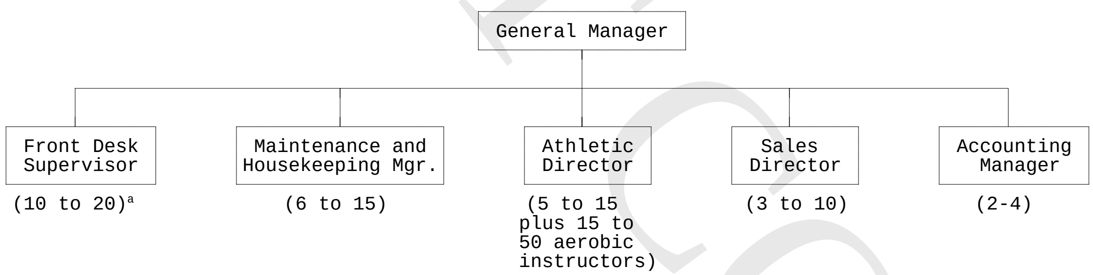


Exhibit 2 Typical Club Organization



[a]Numbers in parentheses represent number of employees in each function with the lower figure representing the number in a small club, and the higher figure the number in a larger club.

Exhibit 3 Typical Club Financial Statement (for August 1988)

	Actual Current Month	Budget Current Month
Revenue		
Dues	$168,868	$187,000
Initiation fees	20,665	4,375
Other	19,227	18,800
Total revenue	$208,760	$210,175
Controllable expenses		
Salaries	44,351	47,000
Commissions	3,632	1,500
Payroll taxes and benefits	9,000	6,000
Administrative	9,274	8,500
Repairs and maintenance	7,071	8,000
Contract services	1,085	1,500
Professional services	1,330	1,000
Outside advertising	8,012	4,350
In-house promotion	2,606	2,650
Utilities	14,494	14,000
Other miscellaneous	5,334	3,000
Total controllable expenses	$106,190	$ 97,500
Net margin	$102,570	$112,675
Fixed expenses	24,903	24,635
Operating income (loss)	$ 77,667	$ 88,040
Debt service and lease payments	74,686	65,751
Net income (loss)	$ 2,981	$ 22,289
Percentage rent due	$ 0	$ 11,420
Net income after percentage rent	$ 2,981	$ 10,869

Exhibit 4 Dan's Notes from Interviews with General Managers

(Note: items in quotation marks are quotes from the GMs that Dan recorded in his notes. Items without quotation marks are Dan's own impressions.)

- "We are asked to prepare budgets and then Andy revises them based on his experience and knowledge."
- Budgets: Lack of back-up documentation and build-up from assumptions.
- Sales staff compensation (straight commission on new members) is a source of contention. Some in other areas think sales staff paid too much.
- "Marketing programs are responses to short-term sales problems. No real strategy."
- Many club GMs are not "marketing-oriented."
- "We are frequently in the position of reinventing the wheel on sales, accounting, operating issues. There aren't a lot of standardized procedures or approaches, and training from corporate."
- Clubs are well-designed, well-appointed, good equipment.
- "Instead of just telling me what my goals are, I'd like some help in developing plans to help me reach those goals."
- Budgets are all in different formats.
- "We don't know what is really expected of us in the way of operating procedures. I'd also like more regular feedback on how we're doing."
- "CSI is more professional than the average club. More attention to quality and staff."
- "Other than when something goes wrong, you don't really know how you're doing. The budgets often start out pretty unrealistic, so by the time we're into the second quarter, it's hard to use as a yardstick."
- Turnover of low and mid-level club staff is high.
- People are afraid to make a mistake.
- "People at corporate are so busy with new clubs that it is difficult to get someone's attention when you need to."
- "I wish I knew more about what the other clubs were doing so that I could learn from their ideas and their mistakes."

- Much more emphasis on cost control than revenue generation.
- Some resentment that corporate shows up at club without calling.
- Little guidance to clubs on personnel issues—salaries, interviews. Club managers budget own raises.
- Few policies and procedures for club level accounting.
- "Would like budgeting procedures and guidelines."
- "We don't get enough time and attention from corporate. It's hard to get in touch with people because they travel so much."
- "Would like more performance appraisal and skill development."