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INSTRUCTORS' NOTES

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QALO: WHEN IS IT TIME TO EXIT?

Jeff Cohu, Lipscomb University

TEACHING NOTES

CASE DESCRIPTION

The case follows the origin story of the startup company QALO from its inception and launch through the first few years of scaling up the business to a potential exit decision. The case is intended to be used in undergraduate entrepreneurship or sales and marketing courses at the junior and senior level. The case is designed to illustrate the challenges of scaling a fast-growing startup and to evaluate the options of a founder's exit strategy. The case is useful to demonstrate concepts such as lean startup methodology, sales channel selection, startup business model development, and exit strategy choice. The case also illustrates the challenges of the emergence of differing visions and preferences of co-founders.

CASE SYNOPSIS

QALO Co-founder KC Holiday has a decision to make. Should he exit QALO, the company he co-founded, or stay? The case describes the origin story of the startup company and outlines the successes and challenges of scaling a bootstrapped organization from ideation to millions in sales revenue. The case shows how an idea became a brand and how a startup scaled from a small ecommerce business to large multi-channel company. Students will be asked to apply entrepreneurship concepts to the origin story and consider the potential exit decision.

Learning Objectives/Teaching Points

In completing this assignment, students should be able to:

1. Identify how lean startup methodology (i.e., Hypothesize, Test, Iterate) is used in an early-stage startup to create a viable business model.
2. Evaluate the unique challenges of scaling a high growth startup.
3. Assess the sales and distribution channel options available for a consumer product startup.
4. Formulate an exit strategy for a startup founder.

General Discussion

This case provides a great example of an organic, high-growth startup and the process of launching a bootstrapped business from ideation to major scaling steps. The case also illustrates how a disruptive innovation in a mature industry can be launched using a problem discovery approach rather than a product discovery approach. There are many key concepts of lean methodology present in the narrative of the company origin. It is likely these that these theoretical concepts have previously been presented in an undergraduate entrepreneurship course and can now be directly illustrated in the case narrative. If lean methodology has not been discussed in class, then a good supplemental reading for this case would include the work by Ries (2011) on the *Lean Startup*.

Some key *Lean Startup* principles and terminology would include:

Lean thinking: The process of continual experimentation and drawing upon the knowledge and creativity of an organization's human capital to develop customer value by focusing on a problem-centric approach rather than a product-centric approach to creating new product and services. In lean thinking anything not providing a benefit to the customer is considered waste.

Validated Learning: A process of gathering empirical data through customer discovery which is more accurate than traditional forecasting methods.

Build-Measure-Learn Feedback Loop: A process of using experimentation and validated learning to determine next steps in the product and business model development rather than relying on unvalidated assumptions.

The Experiment Phase: A phase within the startup process which begins with a clear hypothesis defining what is supposed to happen.

The Value Hypothesis: A hypothesis which tests whether a product or service really creates value for the customer.

The Growth Hypothesis: A hypothesis that tests how new customers will discover and react to a new product or service.

Minimum Viable Product (MVP): An MVP is an early version of a product designed to capture the greatest amount of customer information with the least amount of time, effort, and cost.

Early Adopters: These are the individuals most likely to initially buy your product because they have the problem you are solving, they know they have the problem, and they are actively searching for a solution.

Pivot: A major or dramatic change in a product or business model to better meet the needs of the market. It usually takes the form of a structured course correction to test a fundamentally different hypothesis.

Iteration: A minor change in a product or business model to better meet the needs of the market. These changes are generally small "tweaks" to the current hypothesis designed to better align with new validated learning data.

The challenges of scaling a high growth company can also be discussed and illustrated from the case. Choosing distribution and sales channels is the third major learning objective in the case. The first three learning objectives can be discussed using the story as a descriptive format case study. It could also be useful to have students apply Osterwalder & Pigneur's (2013) business model canvas to the QALO business model prior to class discussion to ensure they have identified key issues within the origin story.

The final learning objective is focused on the exit strategy decision. This part of the case is decisional and will stimulate strong discussion. An excellent supplemental reading for this case study would be Wasserman's (2008) work in *The Founder's Dilemma*. The case illustrates *The Founder's Dilemma* concepts very effectively with a twist that in this situation each of the co-founders have chosen different sides of the famous framework. Figure 1 illustrates this tradeoff decision matrix. Students can be divided into groups supporting the decision to exit or the decision to stay. A secondary teaching point includes the challenge of keeping co-founders from falling into conflict under the stress of launching a startup.

Figure 1 The Founder's Dilemma (Rich vs. King)

Source: Wasserman (2008).

Discussion Questions

1. How does the origin story of QALO demonstrate many key concepts of lean startup methodology?
2. What were the biggest challenges QALO experienced as they scaled the company? Are these challenges common? What lessons can founders take from the QALO growth story?
3. What recommendations would you make regarding the necessity to acquire some basic business knowledge (e.g., how to write a business plan, accounting knowledge), before starting a business?
4. How would you assess the sales and distribution channel choices QALO made as they scaled the company? Would you have done anything differently?
5. Should KC exit QALO? What are the pros and cons of an exit decision for KC at this point in the company's history?

Answers to Discussion Questions

1. **How does the origin story of QALO demonstrate many key concepts of lean startup methodology?**

The origin story at QALO demonstrates many of the key concepts of lean start-up. First, the creation of the product followed a process of problem discovery. The two co-founders were searching for a solution to a specific problem that they had both experienced. The first version of a QALO ring was an excellent example of an MVP (minimum viable product) as was the Shopify webpage that was initially used to test the market demand. The process of experimenting with different suppliers, molds, and product styles while subsequently iterating production processes also illustrates lean methodology practices.

Probably the fundamental lean concept best illustrated in the case was the focus on identifying early adopters of the product. As the team focused on married people with athletic lifestyles, they were successful in using these early adopters to create a word-of-mouth community of product advocates which helped the company to grow by leading others to adopt the product. Early adopters by definition are people who have the problem, know they have the problem and are actively seeking a solution. The QALO team did a remarkable job of identifying and targeting their early adopters.

2. What were the biggest challenges QALO experienced as they scaled the company? Are these challenges common? What lessons can founder's take from the QALO growth story?

QALO experienced many challenges as they scaled the company, and most of these issues are common to the startup process. First, finding quality vendors that can produce your post-protype product in the volumes needed is a challenge. Often order quantities are very high for a small startup, requiring significant capital, and as the case illustrated managing the quality of the supplier's production is often an issue that can cause problems. Second, forecasting demand as you are introducing a new product is also very difficult. As demand goes through surges and stages of growth it is hard to anticipate how much inventory is needed to service the customers. QALO struggled with inventory management throughout the company launch. Certainly, managing cash flow is a constant challenge for a startup, especially when forecasting is so hard to predict. In addition, hiring the right staff to keep the company moving forward is a challenge common to all growing startups. The choice of an employee in a small company is disproportionately more critical than in a larger company with more staff. The risk of a bad hire can do reputational harm to the company. Each of these challenges and others are common issues when scaling a startup and the key lesson for founders is to be prepared deal with these challenges as they arise. Awareness of these potential problems is important.

There were a couple of additional challenges in the QALO scaling process which are not necessarily common to all startups but do occasionally occur and need to be accounted for in the launch process. First, the occurrence of a viral moment which produced exponential sales growth is not common but is always possible. Startups should have a contingency plan for some type of viral event which dramatically increases demand. This would involve having conversations with suppliers and lines of credit available in these types of unique scenarios. Finally, the differing visions of the co-founders might not have been anticipated early in the launch process but certainly some frontend discussions about long-term goals and exit strategy preferences could have possibly prevented some of the later tension found in the closing scenario of case. Open communication between co-founders even before the company is successful can often mitigate these problems later in the company expansion.

3. **What recommendations would you make regarding the necessity to acquire some basic business knowledge (e.g., how to write a business plan, accounting knowledge), before starting a business?**

This case illustrates the importance of start-up founders acquiring some basic business knowledge to increase success during the company launch. All aspiring entrepreneurs need to understand some basic accounting knowledge and become proficient in managing cash flow. Operational knowledge is also useful particularly in the areas of supply chain and inventory management. Understanding the basics of human resource management is also necessary as start-up companies often need to staff up quickly to meet consumer demand. Finally, the ability to write a business plan is also a critical skill for founders to develop as this process helps to bring the whole business model into a state of clarity and forces the founders to think about the critical challenges they must face.

In this case, KC and his co-founder suffered many challenges due to inexperience in business. This is not uncommon for new entrepreneurs. For the QALO team, understanding financial measures and cash flow needs had to be learned, usually through failure and crisis, but these challenges could have been anticipated by finding advisors and mentors to help. Managing the supply chain, both scope and quality, also had to be learned through experience. Contingency planning for different demand conditions would have been helpful when experiencing the viral moment discussed in the case as well as continuous high-volume growth which the company experienced. QALO's rapid growth also led to the need for a human capital plan and human resource policy needs. Each of these challenges, while not uncommon for a startup with inexperienced founders, could have been mitigated by learning to write a business plan. In addition, it should be noted, that new founders have many resources of networks for assistance such as SCORE and other non-profits that exist to support teaching and mentoring for aspiring entrepreneurs. Finally, had the founders spent more time acquiring more basic business knowledge, they would have likely found it easier to raise capital and this may have prevented the conflicted exit result.

4. **How would you assess the sales and distribution channel choices QALO made as they scaled the company? Would you have done anything different?**

QALO followed a traditional path for many consumer product startups in their sales and distribution channel selection by starting with direct B2C ecommerce sales on Shopify. They supported this organic growth model by leveraging social media marketing platform campaigns designed to target their early adopters and grow a word-of-mouth community. Eventually, QALO's leadership decided that expanding their ecommerce sales and distribution presence on Amazon was the next logical step in the scaling process. Amazon's vast ecommerce market presence and sophisticated platform made it an obvious choice for scaling and as the case outlined it is difficult to grow a consumer products company without entering the Amazon platform. Finally, QALO made the move to brick-and-mortar retail as a third sales and distribution channel choice. Utilizing major retailers such as Academy Sports and Bass Pro Shops, the company was able to reach another segment of the retail market by transitioning part of the business to a wholesale business model.

Students' opinions will likely vary regarding the question of doing anything different in the sales and distribution channel choice. Some students will question the move into Amazon when the company was already growing with their own ecommerce presence. Others will raise the issue that not utilizing the Amazon platform would have cut the company off from a whole segment of the market. Others will suggest whether becoming a wholesaler was necessary, but again the counter argument would be that the company would limit growth by not selling in traditional retail brick-and-mortar channels. Finally, it is important to note that the expansion into these segments was also occurring at the time that QALO was beginning to experience several new competitors in the category which they had created, prompting the need to continually establish and leverage first mover advantages.

5. Should KC exit QALO? What are the pros and cons of an exit decision for KC at this point in the company's history?

The choice of a founder to exit the company they have created is often a difficult decision. There are many factors which should be considered when deciding if it is time to exit (Tian, 2011). The pros of exiting at this moment for KC would be that he felt the company needed outside help to continue growing and that the business complexity had outgrown his skill set. In addition, all sales of equity by co-founders involve the possibility of cashing out, liquidating, and transferring unrealized gains into personal wealth created during the business launch. Exit decisions typically encompass two key elements: liquidity and succession. This situation involved both liquidity and leadership succession, as the sale was a liquidity event for KC and ushered in a new succession plan for leadership at QALO. Ultimately, it is likely that a new buyer will bring in the expertise to streamline inefficiencies within the company and move the company to a more stable long-term structure as they evolve from a startup to a mature company. The sale would also mean that the company would have more cash reserves to reposition to a more defensible position as they face new competition.

The cons of an exit at this time are that KC and Ted are not on the same page regarding the exit which lowers the bargaining power with a potential buyer. In addition, the differing visions of the co-founders also makes future succession planning difficult and likely will result in a leadership vacuum and loss of organizational knowledge during the transition to new ownership. This could mean a loss of the organizational culture which has been a strength of the company throughout the startup stage.

Ultimately, the exit decision is a great example of the Founder's Dilemma (Wasserman, 2008). Under this framework the question comes back to whether the founders wish to be rich or to be king. Unfortunately, in this case the co-founders come to different conclusions regarding that question. KC is more interested in seeing the company grow and succeed and create more wealth even if that means that he needs to step aside, while Ted is more motivated to retain control regardless of the risks involved for the company. Ideally, it would have been advantageous if they could have agreed on the exit strategy parameters early in the company launch so that they could have worked together to maximize the value received by a united front during the exit negotiations.

EPILOGUE

KC Holiday ultimately decided to exit QALO in early 2020 right before the pandemic hit. One month after KC's departure the new ownership group removed Ted Baker from any leadership role in the company although he has retained his equity stake in QALO. The company has continued to remain a leader in the now highly fragmented silicone wedding ring segment. For more information on the company's current products please refer to qalo.com.

After the sale in early 2020, KC went back to college to finish his degree in business and he and his wife moved to Perth, Australia where he has become a leader in an entrepreneurial and innovation incubator called *Better Labs*. KC looks at his time launching QALO as a great learning experience and has no regrets about exiting the company.

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