Open for Business? Now What?

Opening a fitness club takes broad thinking and careful market analysis. Here's what happened to one would-be entrepreneur.

Michael Scott Scudder

In the last "Money" column (January 2001), I addressed what it takes to start a new fitness facility. As you may recall, I introduced "Mark," a real-life entrepreneur who lives in "Smithville," a fast-growing suburb on the U.S. East Coast. Despite my warnings, Mark opened a 10,000-square-foot club with $100,000 of his money and additional funds from investors. His competition was a slightly aging YMCA, a licensee of a popular fitness chain, an older racquets-based club and a small "ma and pa" operation.

Here's why I advised Mark against the plan:

1) He did not have enough personal equity going into the deal.

2) Lack of personal equity and ownership experience would make financing difficult (banks would care little about Mark's 11 years as a fitness director).

3) He would have to convince his landlord to give him some healthy financial credits toward all the improvements ("build outs") he wanted to make to the property.

4) With limited cash reserves, he would have to lease much of the exercise equipment needed for the facility (dangerously increasing his monthly fixed expenses against operating income).

5) He would have to get some investment partners for the project (endangering his ownership position).

What does it take to open a top-notch fitness facility in today's competitive market? It takes money, patience, more money, dedication and much more money. It also takes listening to—and following—expert advice.

The Dream

Despite my advice, Mark remained headstrong. His dream was to capture a fast-growing market with a high-quality facility. Moreover, he simply *wanted* to do it. With only $100,000, though, this would-be entrepreneur was going to need some generous investors. He proceeded with vigor.

After securing some build-out credits from his landlord and leasing as much equipment as possible, Mark still needed about $400,000 in cash to open the facility at the level desired—another $200,000 for the remaining work to the building and an additional $200,000 for equipment.

To raise the cash, Mark approached the personal training client who initially offered to help him and landed $250,000. Another $100,000 came from his brother-in-law. The final $50,000—plus some minor funds for operating capital—was generated from his parents, who refinanced their home.

The Facts

Looks like Mark did okay, right? Well, dear reader, let's examine the facts.

- First, Mark was a *minority* shareholder in his own business. He owned less than 25 percent of the stock issued by the company (even with a "sweat equity" allocation to him by the other partners for all the hours he was working).
- Second, he had a highly leveraged operation. His fixed costs exceeded $18,000 per month—and that was just for rent and equipment leasing.
- Third, Mark thought his operating expenses per square foot (payroll, payroll taxes, administrative costs, utilities, insurances, maintenance/repairs, adver-

tising/marketing and so forth) would not exceed $40. Once the facility opened, he quickly learned that he needed to almost *double* the monthly sales originally projected—and that was just to break even.

• Fourth, this new business owner could not take a full salary, because the money was not there to be taken! His investment partners agreed to rework it so Mark started out with a small base salary. Still, compared to his former fitness director job, he now was working double the hours for half of the earnings.

• Fifth, Mark thought he would build *the* great modern health club and people would automatically flock in based on its high-quality appearance, equipment and services. This logic did not compute.

During its first full year in operation, Mark sold 1,200 memberships to "Smithville Quality Fitness." Of these memberships, 1,050 remained on the books after 12 months. Unfortunately, Mark discounted the fees for most of his initial customers, charging them $275 for prepaid annual memberships, or $25 per month in dues guaranteed. He thought these cut-rate prices would attract a lot of people from the other clubs. In reality, less than 20 percent of Smithville Quality Fitness' members came from the other clubs.

During the second year in operation, Mark's rates were $29 per month, with a $79 initiation fee (which he regularly cut to $50 as an incentive to buy).

Mark pledged "great service" as one of the reasons to start his club. He soon had to let go staff members to pay his monthly operating expenses. Nonmembership sales (income from the pro shop, juice bar, personal training services, special programs and so forth) only amounted to 15 percent of his total gross. Moreover, he had to cut operating hours to conserve expenses.

While Smithville Quality Fitness had a fantastic grand opening month (profitable by $10,000) and a pretty decent second month (profitable by $2,000), the operation ended up losing money (more expenses than income) every month thereafter for the rest of the year. In fact, Mark owed his disgruntled but understanding landlord two months' back rent at the end of the first year.

Time for a Visit

Around the end of Mark's first year as a fitness facility owner, I happened to be in the vicinity of Smithville on a speaking engagement. So I decided to stop by and see how he was doing.

Mark's club looked impressive. It had an attractive entrance, good road signs and ample parking in a nice area of Smithville. Upon entering, I was greeted by Mark's mom, who remarked cheerfully, "I'm filling in to help Mark out." Besides Mark and his mom, no other employees were present. Since Mark was with a personal training client, I decided to look around.

Smithville Quality Fitness was attractive and well done for a limited-budget operation. It featured modern equipment in good shape. At 11 AM, maybe a dozen members were in the club. Everything looked fine until I reached the men's locker room. The early morning traffic left paper towels on the floor, a toilet blocked up, and standing water on the floor near the showers.

While I waited for Mark to finish the one-to-one session, a man and woman came in asking about the club. Mom pleasantly greeted the couple, informed them that Mark was "the one to talk to," handed the pair a price sheet, and instructed them to "walk around and look at the club." No guest form was filled out, no tour was provided. The couple were in the club for five minutes maybe.

Finally, Mark finished with his client and walked over to the front desk. Mark asked his mom about the couple, masked a frown at her response and asked me to lunch.

While we ate, Mark said he wished he had listened closer to my original advice about either opening a smaller club or just a personal training studio. He lamented about working more than 60 hours every week. He told me his partners had serious questions about how the club was being operated as well as having to throw even more money at their investment. Before we parted, Mark wrote down both partners' names and telephone numbers and asked if I would call them.

In the next "Money" column (May 2001), we will look at what happened to Smithville Quality Fitness. The beginning of the end or of a potential turnaround?

Michael Scott Scudder is owner of Fitness Focus in Taos, New Mexico. An international health club management trainer and inspirational speaker, he has owned and managed clubs in the fitness industry since 1976. Contact Scudder at (505) 751-4236 or Fitfocus@aol.com.