CANNONDALE'

[*Excerpted from "Cannondale: Handmade in USA"*

Today, financial analysts divide the bike industry into "Cannondale" and "everybody else." The company has prospered even when the rest of the industry was in a downturn. Though Cannondale's annual yield is hardly on par with such highly lucrative industries as computers and biotechnology, the company stands alone in its ability to maintain profitability while other bike companies endure slumping sales. In a notoriously low-margin industry, Cannondale is able to satisfy Wall Street's expectations, while it continues to expand into new markets. ¶ But one look at Cannondale's balance sheet in, say, 1987, would have left investors wondering whether the firm could stay out of bankruptcy court, much less survive to become the best-capitalized manufacturer in the bike industry. In the late 1980s, Cannondale had a great product and 40-percent annual sales growth, yet its financial picture looked decidedly bleak.

LIKE MANY ENTREPRENEURIAL COMPANIES that sprang up in the '80s, Cannondale wasn't prepared for the challenges of success. Rapid expansion jeopardized the company's cash flow; quality slipped; dealers were frustrated; and financial controls were superficial at best. It's like the old adage: Be careful what you wish for; you just might get it.

What saved Cannondale from the fate of onetime high-flyers like Atari, Chuck E. Cheese and Commodore was the relentless energy of its people. They showed up every morning, turned on the lights, and got on the phone to cred-

S COMEBACK

by Dan Wildhirt]

Joe Montgomery and son Scott in front of the train station that gave the company its name.

itors and customers to perform a delicate balancing act. They kept the company's friendly face and peerless customer service intact, at the same time as they addressed Cannondale's profound structural problems. They were motivated by the vision of being part of a company where ideas rose on their own merits, and where undue caution would never hinder progress.

CANNONDALE'S FIRST BRUSH WITH DISASTER came in 1975. The high-quality bike market tanked, dropping roughly by half. So did Cannondale's sales—from $2 million a year to $1 million.

"We had $250,000 in bad receivables and no equity in the business," says company founder and president Joe Montgomery. "The banks wanted to throw me out."

Montgomery made the banks an offer they couldn't refuse: Either liquidate the company and take five cents on the dollar, or continue supporting Cannondale and eventually get paid back in full. The banks opted for the latter.

With the creditors' reluctant blessing, Montgomery plowed the profits of his pannier company back into the business, with the goal of establishing a full-fledged bicycle company. There was never much cash around, but by 1982, there were lots of new milling machines, stashes of tubing and components, and other industrial supplies and equipment.

The company, however, was less mature than its employees believed. "Cannondale was wildly entrepreneurial, in every definition of the word," says Dan Alloway, a 17-year veteran of the company who's now vice president of sales. "We were not ready for what our vision's success would bring us. What it brought was compounded 30- to 40-percent annual growth through the mid-'80s."

All that growth blinded Cannondale to its financial and managerial sins. David Campbell, now the director of technical services, readily admits he was ill-suited to his job as the company's first purchasing manager: "We could not adequately supply the shops in terms of quantity or quality. The expansions were outpacing the money we could make in such a low-margin business. For all our innovation and unique product, we didn't have significantly higher margins. We were not mature and good at buying, so we were crushed by inventory costs."

Cannondale was pummeled by a problem that faces most sporting-goods companies. Bikes were manufactured year-round, but sold well only during the warm-weather months. This meant that expensive components, tubing and supplies sat in the warehouse for months, paid for but not bringing in revenue. Just-in-time inventory had yet to establish a firm foothold at Cannondale, or in many other U.S. firms.

Inefficiencies plagued the factory. Production bottlenecks, tooling that was hard to use, shortages of key components, and poor information systems were just some of the problems. The staff in the Connecticut corporate offices routinely worked seven-day, 90-hour weeks, but the company had grown too big, too fast, for any objective assessment of the inherent problems, and what to do about them.

"The company's excessive growth overshadowed a multitude of sins, and our lack of foundation of fundamental business practices," Alloway says. "We didn't know if we were making money or not on every bike we shipped. The question never came up because we were involved in the daily firefights of runaway growth."

To customers, dealers and investors, Cannondale in the mid-'80s appeared impulsive, without clear

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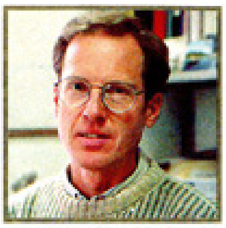

" For all our innovation and unique product, we didn't have significantly higher margins. We were not mature and good at buying, so we were crushed by inventory costs."

- DAVID CAMPBELL

direction. Cannondale frames had legitimate claims of technical superiority, but the company was diluting the frames' high-tech identity by competing on price with their low-tech rivals. Cannondale bikes were priced only slightly higher than cookie-cutter steel bikes from Japan with similar components, and far less than the revered Italian brands. To make matters worse Cannondale held winter frame sales for several years to raise badly needed cash.

Montgomery was fully aware that deep discounting was a cardinal sin in managing a high-end brand, but these were desperate times. They called for desperate measures like two-for-one sales on frames. "That's a pretty serious inventory problem, if you can't even sell the second bike for $100," recalls Mark Charpentier, who is now national sales coordinator.

Still, Cannondale management failed to realize the hole they were digging for themselves with their quixotic approach to managing the business. "We thought of ourselves as the best street fighters," Alloway says. "We falsely prided ourselves on that ability. We were fast to change, solve problems, and react to anything. And every day we felt validated.

"There was a misleading feeling of productivity by putting out brush fires, by building an empire without a foundation. But we were missing maturity in the business sense: in controls, systems, procedures and discipline. Joe was a wily entrepreneur who had not yet made the transition to becoming a corporate CEO."

IN THE MID-'80S, PRACTICALLY ALL BUT the biggest bike brands were sold to dealers through independent distributors. These middlemen reduced the need for each manufacturer to maintain a sales force, but at the cost of a hefty commission. Cannondale again bucked the system, this time by selling its bikes direct to dealers.

It was an idealistic plan that would, in theory, save Cannondale from giving away a 20- to 30-percent commission to a distributor. There was no budget, though, for a corps of traveling sales reps to service Cannondale dealers. "We did it all via the phone," says company director Scott Montgomery. "If you called and asked for a bike, we'd sell it to you. We didn't qualify whether you were the biggest shop in town, or whether you were really committed to selling Cannondale."

Without road reps, there was no one to check dealer inventories, give sales clinics or handle warranty issues in the field. And without exclusive territories for dealers, there was little incentive for individual shops to make a long-term commitment to Cannondale. "Rather than having one dealer in a city selling 100 bikes a year," Montgomery continues, "we'd have three dealers selling 20 bikes each."

By 1987, the growth was no longer disguising the company's systemic problems, and the bike industry knew that Cannondale was in trouble. Inevitably, customers and suppliers were drawn into the whirlpool.

"While the product drove the soul of the company, our strategy circled around cash flow," Alloway says. Thus the winter frame sales continued, along with other seemingly reckless moves. "We would frequently aggressively discount product just because we needed cash so badly. We'd do that during the prime season, spring, when everyone else was charging full price. If we didn't, there'd be a bank note or payroll that wouldn't be met."

As Cannondale fell behind in its payments to vendors, speculation about the company's future was rampant. "Most of my conversations with vendors were about rumors of our bankruptcy," Campbell says. "I constantly told them, 'Please ship us the parts so we can continue to talk about the parts orders we'll place with you later this year.' If they had decided not to ship, we couldn't have continued."

Scott Montgomery flew to Japan "to beg for supplier mercy," he says. "I asked for 180-day terms, 'or else you won't get the million dollars we owe you,'" he recalls telling one supplier. But Cannondale's cash-flow problems only accelerated the downward spiral. "Because we were so late paying vendors, we'd have to spend more on air freight just to ensure that parts would arrive on time," Scott says.

Joe Montgomery took action to start the healing process, but not without first ripping open Cannondale's wounds even wider. On a Sunday afternoon in 1987, he asked his top managers to rank all Connecticut-based employees in order of importance to the company. That evening, they gave Montgomery the list.

"Read off the bottom 30 people," Montgomery told them. "Tomorrow morning, you need to lay those people off. We need to downsize or we will not survive. Even with these changes, we might not survive."

CANNONDALE'S CASH CRUNCH WAS SO EXTREME that, by any normal standard, the company should have folded its tent. "We had $18 to $20 of debt for every dollar of equity," says Charpentier. Business schools teach that a 1:1 debt-to-equity ratio is a sign of a healthy company, while 5:1 is very aggressive. Cannondale's 20:1 ratio effectively put the company on life support.

"We were an asset-based borrower," says John Moriarty, the company's treasurer. "From a financial standpoint, you can't get any farther out on the limb, and still stay in business. At that point, the banks are loaning you cash based on your asset value. You're reporting to the finance company on pretty much a weekly basis. If your asset base—mainly your receivables—isn't high enough, they're just not going to give you any cash."

Some Cannondale employees could no longer take the constant stress of wondering whether the doors would stay open another day. "A lot of people said, 'I'm not interested in putting that much heartache in my life,' and quit," Charpentier recalls. "The fortitude you needed to stay here during the crash-and-burn era was immense."

The ones who stayed paid with their flesh and blood. Alloway developed an ulcer at the age of 25. Charpentier talked openly of quitting his management job and becoming the company's groundskeeper.

They continued to struggle with the company's lack of controls. "We spent hours in meetings trying to figure out what we had in stock," Charpentier says. "If something was hot, we wouldn't have it for five months. If it was slow-moving, we'd have twice as many as we could sell. Sometimes, we'd not order parts because we thought we had them, and find out too late that we didn't have them."

It wasn't much fun talking to disgruntled customers under those conditions, but strong customer service kept dealers in Cannondale's corner. Charpentier says he took an average of 100 phone calls per day from dealers. "If you worked the phones, you were sales, service—and spin control."

THE DEALERS HAD PLENTY TO COMPLAIN about, things like "potato-chipped wheels, paint flying off, bowed tubes, corrosion," Charpentier recalls. "When we had warranty problems, we often couldn't ship the warranty frame for two months."

Randy Clark of Bicycle Garage Indy, a longtime Cannondale retailer in Indianapolis, remembers the worst of it. "They were incapable of simple blocking and tackling—of getting the basics right," he says. "The basics were that I'd place an order, and they'd input it correctly into their system and have the product to ship it." Clark says that Cannondale was unable to consistently execute even these elemental functions. "And they had their fair share of technical issues," he adds.

Frank Coombs of Bike Masters in Chandler, Arizona, confirms that the technical issues were many. "Quality on bikes, initially, was average," he says. "They were touting 'made in America,' but the welds were sloppy."

Coombs notes that the bikes took more time and attention than competing brands. "Most companies' bikes required a 30-minute assembly. A Cannondale required one or two hours. You basically had to build them from scratch. For example, the chain came in the original box from Shimano. You had to cut the chain and put it on. You had to cut every cable and put them on. If parts were installed, you had to double-check and make sure they were tight. Maybe 10 or 20 percent of the time, you had to hone out the seat tube to make a seatpost slide up and down easily."

That assumed, of course, that the shop had received the seatpost and all the other components with the frame. While most new bikes are shipped to dealers partially assembled in a single carton, Cannondale dealers were vexed by the company's idiosyncratic two-box shipping. The frame would come in one box, while the components arrived separately. But often a frame would arrive without the correct parts kit. Other times, one of the boxes wouldn't arrive on the same day—or at all.

Despite these problems, and the availability of no-fuss bikes from other companies, most dealers remained loyal to Cannondale. One reason was that the company not only listened to its retailers' complaints, but acted upon them. "I don't think there's a company more interested in learning how to be better," says Clark. "It's real hard to give up on somebody who knows things aren't right and continues to ask how they can be better."

Building a network of conscientious sales reps was essential to Cannondale's success at the dealer level, says Charpentier. "We asked the dealers, 'What are the characteristics of the best reps you deal with?' We went out and found people like that in other industries. We wanted people who were cycling enthusiasts who had business acumen. We were able to recruit a lot of people who were better than the pay we offered them. I recruited one guy away from selling chemicals for about $15,000 less than he would've earned at his old job."

EVEN THOUGH CANNONDALE HAD PRACTICALLY invented the market for aluminum bikes, the company found it increasingly difficult to establish a strong identity for itself in the minds of consumers. In the years since the first Cannondale frame appeared in 1983, most of the firm's competitors had come along with their own interpretation of the welded, fat-tube aluminum frame, nearly all of which were knocked off by anonymous factories in the Far East.

As a steadfastly product-driven organization, Cannondale had, compared to its major rivals, historically devoted only a small fraction of its budget to image-building. "If we had a dollar to spend, we put it into research and development," recalls Joe Montgomery. "If there were some pennies lying around that we forgot about, we put them into marketing."

Dan Alloway spells out the reality: "Through the '80s, at a time when our competitors were spending millions of dollars a year on bicycle advertising, Cannondale may have been spending $100,000 or

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Fast growth, slow profits

Sales grew steadily for 15 years before the company saw a significant return

$150,000." Yet the company's sales were increasing 30 to 40 percent a year.

Despite the remarkable growth, Cannondale remained, in the words of Scott Montgomery, "a third-tier supplier," dwarfed by industry leaders Trek, Specialized and the pre-bankruptcy Schwinn, and hovering just below second-tier brands such as Diamondback and Univega. Cannondale was held back by an idiosyncratic, almost avant garde image that Thomas Dooley, president of Cannondale's ad agency, keenly summarizes as "the dentist's bike"—appealing to well-to-do professionals who were more impressed by technological nuances than flashy advertising.

Ironically for this most American of bike manufacturers, the company's salvation may have originated not on its home soil, but on foreign shores. In the late 1980s, the growth of mountain biking could only be termed explosive, as the sport caught on around the globe. Internationally, the sport was perceived as an American phenomenon, symbolic of Americans' love of freedom and innovation. While many of Europe's most venerated framebuilders introduced their own off-road lines, overseas consumers clamored for bikes made in the U.S., or at least those that had American-sounding names. Though Cannondale bikes weren't officially distributed in Europe before 1989, plenty of them found their way into eager Continental hands.

"I kept hearing these stories about these airline pilots who would go back [to Europe] from places like New York and Miami," Joe Montgomery relates. "They would go into a bike shop and buy three or four bikes at a time, ride them around the block so they were 'used,' then go back in the store and have the guy break them down and put them back in the box. They'd ship them over on their airplane to Europe, put them together and sell them as used bikes over there for an enormous premium—because they were Cannondales." Many bike-savvy European tourists financed their U.S. vacations by following the same scheme, which allowed them to avoid paying import duties on their putatively "used" bikes.

Such a glittering opportunity was simply too tempting to pass up, and in March 1989, Scott Montgomery and Scott Bell left the U.S. to wage Cannondale's assault on the European market. "If you're going to roll the dice, you might as well roll them where the odds are good," Joe postulates, adding that the new venture was still a considerable gamble for a company that was already in perilous financial straits. When he called his son into his office late one night and asked him if he was willing to take on the task, he added a word of caution. "Pack light. If we're not making money in a few months, you're coming home."

"The fortitude needed to stay here during the crash-and-burn era was immense."

– MARK CHARPENTIER

Initially Cannondale Europe was a shoestring operation. With little money to hire a sales staff, the two Scotts resorted to contracting with independent agents who worked on commission—a plan Scott Montgomery now calls "one of the biggest mistakes I made. If they didn't sell very much, you didn't pay them very much. But as the company grew bigger and bigger in Europe, their 6- or 8-percent commission got pretty fat. All of a sudden, you've got a guy in Germany making a $120,000 annual commission on $2 million in sales."

With strong demand for American mountain bikes, it was almost a foregone conclusion that the European market would embrace Cannondale. By 1992, Cannondale Europe, based in Oldenzaal, the Netherlands, accounted for nearly a third of the company's sales. Success forced some difficult decisions regarding the independent sales reps. "To terminate these relationships," Scott explains, "we had to pay them a percentage of the revenue they would have earned over the next three years. We had some big settlements there."

Buying out the independent reps not only reduced costs in the long run, it eliminated middlemen who could not be as passionate about the product as would a dedicated, internal sales force. It also set Cannondale apart among foreign bike companies doing business in Europe. "When in Rome, we don't do as the Romans do," Alloway says, quoting one of Joe Montgomery's favorite aphorisms. "In Europe, it's common sense to distribute bikes with a local office in every country, because business and culture and subtleties are different in France than they are in Germany, than they are in Sweden, than they are in the U.K. That's how everyone does it." But not Cannondale.

"We have one office in Europe," he continues, "and we sell direct to every country from that one office. We have foreign nationals who staff the telephones, and toll-free lines from every country, so that when a French dealer calls, a French person answers the phone, and the dealer feels like he's talking to the distributor just up the road."

Until 1997, Cannondale was also the only foreign bike manufacturer to assemble complete bikes in Europe. Import duties are much lower for bike frames than those imposed on complete bikes, so the frames are shipped from the Bedford factory to Oldenzaal, where they meet up with components shipped directly from suppliers in the Orient and Europe.

With its centralized distribution and local assembly, Cannondale is perfectly positioned to capitalize on the newly unified European market. The wisdom of this strategy was confirmed in 1998 when, for the first time, international sales accounted for more than half of all Cannondale bikes sold worldwide.

CANNONDALE FACED A COMPLETELY DIFFERENT set of problems in entering the Japanese market. Prior to 1991, Cannondale frames trickled in through a convoluted system, under which Mitsubishi Trading Company imported frames and sold them to distributors, who then found dealers. Some of the frames were assembled by the distributors using various components, but most were sold as framesets only.

Without direct involvement by the manufacturer, this system handicapped Cannondale's Japanese presence in several ways. The multiple levels of distribution and lack of direct involvement by the manufacturer, says Alloway, meant that Cannondale had little support at the dealer level. "Nobody thought of it as their own, because it had so many fingerprints on it by the time it got to the dealer," he says. "You cannot market a high-end, enthusiast product without passion, and there was none."

The first mission, then, for Cannondale Japan was to revamp its distribution system. Arrangements were made with Mitsubishi Trading to buy back frames already imported. "We tried not to burn any bridges, because it's such a tight-knit, small market," says Michael Jackson, an expatriate American who, with Scott Montgomery, established Cannondale's Japanese office. Jackson was already familiar with the Japanese cycling industry through his previous work with a domestic bike manufacturer there.

If the Cannondale model for distribution had been unconventional in Europe, it was nothing short of revolutionary in Japan. "We export direct to the subsidiary," says Alloway. "That subsidiary then sells direct to the dealer, breaking all the rules."

Streamlining distribution also made it possible to bring Cannondale prices within the reach of more Japanese cyclists. According to Jackson, before Cannondale Japan opened, the frames were selling for anywhere from $5000 to $7000, "for a standard frame, with no suspension—just a Pepperoni aluminum fork.

"Gray marketing was obviously a problem we had to deal with. It's so easy for [Japanese] shops to get products in from the U.S. We had a lot of retailers calling up shops in California and having them send over one or two pieces so that they could say that they carry Cannondale.

"We were proposing to come in with full bikes at between $2000 and $3000. The goal was to get within a couple hundred dollars of U.S. retail. By doing that, we'd be able to eliminate the gray market."

With such a radical departure from accepted business practices, retailers needed to be convinced that Cannondale Japan could follow through on its promises. The typical Japanese bike shop occupies no more than 1000 square feet, Jackson says, but "in that space, they probably carry more variety of products than most American shops do. With that in mind, we had to create an identity as a warehouse. We needed to give the shops the security that they could call up and we could have a bike to them within two to three days."

Surprisingly, Japanese dealers welcomed the new way of doing business. "In Japan, American labels and American brands are very popular," Alloway asserts. "The more unique the Cannondale brand became—whether it be distribution, product or marketing—the higher profile we enjoyed. It became something the dealers expected, rather than fought." In five years, Cannondale's Japanese dealer network grew from about 100 shops to approximately 300, and unit sales increased from just 500 frames per year to more than 7500 complete bikes annually.

Despite the fact that Japanese consumers pay a premium for a Cannondale versus a similarly equipped Japanese-produced bike, Cannondale enjoys top market share among all bikes at its price points in the Japanese market. And 1998 sales were up 11 percent over the previous year, at a time when Asia was undergoing a serious economic crisis.

"We didn't know if we were making money or not. The question never came up because we were involved in the daily firefights of runaway growth."

– DAN ALLOWAY

BY 1991, SAYS JOE MONTGOMERY, THE ONLY things holding Cannondale back were "people and money." The financial picture was strengthened that year by an infusion of $10 million by investment bankers Morgan Stanley, which amounted to an 8-percent stake in the company. "That helped tremendously," Joe confesses. "We were able to go out and hire the people that we always needed but couldn't afford. It was a combination of our people coming up to speed, and our being able to go outside to hire the missing links."

By all accounts, the most crucial of those missing links was chief financial officer Bill Luca, who began consulting for Cannondale in August 1993, and joined the executive team in January 1994. "Previous finance managers tried to initiate controls so that we could know the score, and those controls put Joe Montgomery in a box," Alloway says. "Those controls infringed on Cannondale's entrepreneurial culture. The CFO would say, 'Don't change so fast. We need to think, we need to measure, we need to run scenarios.' Montgomery would say, 'This is a better bike. Make it today. Ship it tomorrow. Don't slow me down with your financial bullshit.'"

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What made Luca the ideal captain for Cannondale's financial ship was his understanding of where fiscal concerns fit into the company's navigational charts. "It sounds almost dumb when you say it," Joe admits, "but you'd be amazed how many people don't understand this principle: All the offline support functions of a company are there to support the research and development, the production and sales of a product. So many of these guys get mesmerized with the fact that they're CFOs, and they get very control-oriented. They just create tremendous hurdles for everyone else in the company. I've worked with a bunch of 'em who don't understand that issue.

"You don't have to spend two minutes with [Luca] on why something is important to do in marketing, or R&D, or sales or manufacturing, because he understands that the financial and computer departments don't have a life of their own."

Also joining the executive team was Len Konecny, a longtime associate of Luca's, who was appointed vice president of purchasing. Upon his arrival, he says, Cannondale's purchasing department was in turmoil. "Schedules were not being met and the factory was working much too hard to make our monthly shipments. Materials were not arriving on time and purchasing was under fire."

Among the most significant decisions Konecny made was to switch aluminum vendors. "Alcoa was brought in to reduce lead times, improve quality, save money and to have a technological partner to move forward with," he says. Within six months of the changeover, lead times had dropped from between 16 to 18 weeks to a range of six to eight weeks. Quality improved from a reject rate of 4.5 percent to less than 1 percent. "We also have a technical center less than two hours from Bedford to explore technological issues," Konecny adds. "This transition to Alcoa satisfied the single biggest issue in the fabrication part of the factory."

Though the company now had a highly capable team of senior managers on board, Cannondale was still under a dark financial cloud. "We had been 50/50 partners with the banks since I started the company," Joe Montgomery says. "The company had a 15 to 1 debt-to-equity ratio for most of its life—it was always way under water. The banks were the ones that made all the money. We worked our asses off seven days a week, often including Christmas Day, because we didn't have a choice. We didn't have any money to go out and hire somebody."

There was only one solution, says Scott Montgomery. "We had invested so much money in building a factory and Cannondale Europe and Cannondale Japan, the only way we were going to get the debt off the books was to either sell the company to someone who could finance the debt, or go public and use the proceeds from the initial public offering to pay down the debt. We all dreamed of going public, because we would maintain control of the company."

But that existing infrastructure was exactly what would make Cannondale attractive to Wall Street as a candidate for a successful IPO. "Because of the way we had structured the company, we had the earnings stream to allow us to go public," says the elder Montgomery. "Namely, we were product-driven, we had our own research and development department, we had these foreign subsidiaries that Scott had set up, we had our own manufacturing and therefore our profit margins were way above anybody else's in the industry."

Cannondale shares began trading on the NASDAQ market November 15, 1994, and it marked a significant turning point in the company's financial history. "Once we went public," Scott Montgomery says, "our interest rate and the amount of money we were borrowing immediately went down. Once you put $30 million or $40 million of equity into a company quickly, you can go back and renegotiate your loans at a lower rate."

The transition to a publicly held corporation made subtle changes in the Cannondale culture as well. In the 22 years of corporate life prior to the public offering, according to Dan Alloway, Cannondale had never met a single quarter's budget projections. "I'll be the first to admit that I didn't make very many sales forecasts before the IPO," he confides. "Since going public, we have met or exceeded analysts' expectations 13 out of 15 quarters.

"The accountability of being public did something excellent for this company. We were never shy on entrepreneurial spirit or enthusiasm or passion. But as a public company, it was plain and simple. We had to mature to a higher level, or we would be high-profile, embarrassing washouts." ■

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