

## LOSS AVERSION

A major uncertainty as Owner-Managers build their businesses over the past decade is the number of decisions about and among the proliferation of marketing and selling channels—wholesale, retail, catalogue, internet, big box, boutique, branded, private label, others. A major driving force in the growth of some businesses over the last ten years has been their decision to sell to—or concentrate in—customers in the big box retail channel.

Some otherwise cautious companies have been seduced by the sheer volume and attractive growth rates of the big box retail channel as customers for their businesses. We have observed some, who working for years to build volume in small independent customers, become intoxicated at the thought of the simplicity of selling to one customer with thousands of stores. They can easily double the volume of the supplier in six months to a year. Big box customers may make you a better supplier, as they are demanding, focused, employ state-of-the-art distribution technology (and insist you do the same), are cost conscious, and filled with the promise of greater and greater sales volume for your products.

In the beginning, everything is great. But over time, Owner-Managers will find themselves making more and more impactful decisions not on the basis of increasing revenue from the big box customer, but from fear of losing it. As the big box customer becomes an increasing proportion of total sales, entrepreneurs find themselves agreeing to demands that they would never have dreamed of agreeing to from a normal sized customer. Line reviews that everyone knows always result in never ending price declines, threats of taking the business offshore, “contributions” to advertising, providing selling help in customer stores, providing consignment inventory, and ultimately, extending credit terms far beyond normal industry terms. And all this just before the big box customer (under severe consumer price pressure themselves) hires a consulting firm, undergoes some re-engineering and decides to downsize the number of suppliers it works with!

As Nobel prize winners Kahnemann & Tversky convincingly proved over twenty years ago, Owner-Managers consistently take on more risk to avoid an increasingly probable loss, than they will in expectation of gain. And there is our entrepreneurial business owner, now with one dominant customer, who is being dictated product, delivery, quality, price, terms, and conditions. Increasingly fearful of losing that now dominant customer, having expanded their capacity and fixed costs to accommodate them, they continue unhappily down that road, trying desperately to increase sales to other customers, only to capitulate to the (increasingly unreasonable) big box customer demands again and again.

This is the Age of the Entrepreneur. Our experiences have shown us that it is impossible for entrepreneurial companies to overcome the sheer scale differences when big box retailers become your most highly concentrated customer. Your choices of marketing channel have now severely limited your opportunity for a value capture (capital gain) transaction as both strategic acquirers and private equity groups (and their banks) understand and have scar tissue from the danger of investing in companies with that kind of customer concentration.