The Vermont Teddy Bear Co., Inc.: Challenges Facing a New CEO (Revised)

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"A teddy bear is almost a 100-year-old product that has been made in every conceivable size, style, fabric, and price combined with a saturated market. Yet the teddy bear industry stands as a model of strength and durability. Every year, bear makers create and market hundreds of original models."[1]

Vermont Teddy Bear Company was founded in 1981 by John Sortino selling handsewn teddy bears out of a pushcart in the streets of Burlington, Vermont. Since this time, the company's focus has been to design, manufacture, and direct market the best teddy bears made in America using quality American materials and labor.

Until 1994, Vermont Teddy Bear experienced a great deal of success and profitability. Problems arose in 1995. Since 1995, the company has had two CEOs. It changed its name to The Great American Teddy Bear Company and then changed it back to The Vermont Teddy Bear Company when customers got confused. From its inception, Vermont Teddy Bear had been known for its Bear-Gram delivery service. In 1996, the company decided to shift emphasis away from Bear-Grams to other distribution channels. By 1998, the company decided to renew its emphasis on Bear-Grams. Vermont Teddy has always been proud of the fact that its teddy bears were made in America with American materials and craftsmanship. In 1998, the company changed this philosophy by exploring the offshore sourcing of materials, outfits, and manufacturing in an effort to lower costs.

Elisabeth Robert assumed the titles of President and Chief Executive Officer in October 1997 and began to cut costs and position the company for future growth. According to Robert, there were many reasons to invest in The Vermont Teddy Bear Company. "I believe that there is growth potential in this company. We are going to regain our balance this year. This is a rebuilding year. We are taking key steps to reposition the company. The move offshore is going to provide this company an opportunity to become more profitable. We will gain additional flexibility with price points. There is opportunity for us to expand from a regional brand to a national brand. While we continue to emphasize the premium teddy bear gift business, we intend to expand into larger markets. There is now a whole new opportunity for us in the corporate incentives and promotions market as well as the wholesale market. We have weekly inquiries from companies who recognize our brands. These companies would love to buy and resell our product or use our product as a corporate gift. Our growth will come not only from expansion of our radio markets but in the corporate and wholesale markets as we use offshore manufacturing alternatives to move to broader price points."[2]

According to Robert, "our competitors are the people who sell chocolates, flowers, and greeting cards. We target the last minute shopper who wants almost instant delivery."[3] Gift purchases account for 90% of the Company's sales.[4] "We thought we were in the teddy bear business," said Robert. "In fact we are in the gift and personal communications business. Our competition isn't Steiff [the German toy manufacturer]: it's 1-800 Flowers."[5]

On one beautiful June day in Vermont, Elisabeth Robert reflected on the enormous tasks to be accomplished. She wondered if she could successfully reposition her company and return it to profitability. Was she making the correct strategic decisions?

History: Why a Bear Company?

The Vermont Teddy Bear Co., Inc., was founded in 1981 by John Sortino. John got the inspiration for the teddy bear business shortly after his son Graham was born. While playing with his son, he noticed that Graham had many stuffed animals, but they were all made in other countries. Sortino "decided that there should be a bear made in the United States."[6]

He decided to design and manufacture his own premium-quality teddy bears. To turn his concept into reality, Sortino taught himself to sew and enrolled in drawing classes. In 1981, his first creation, Bearcho, was a bear whose thick black eyebrows and mustache resembled those of Groucho Marx. His first bear line included Buggy, Fuzzy, Wuzzy, and Bearazar, the bear with super powers. In 1982, Vermont Teddy Bear Company began limited production of Sortino's early designs using five Vermont homesewers. In 1983, Sortino took his operation to the streets where he sold his handmade bears from a pushcart on the Church Street Marketplace in downtown Burlington, Vermont. Four days later he sold his first bear. By the end of 1983, 200 bears were sold. He concluded from his selling experiences that customers "want bears that are machine washable and dryable. They want bears with joints. They want bears that are cuddly and safe for children. They want bears with personality."[7]

In 1984, Vermont Teddy was incorporated under the laws of the State of New York and Sortino's pushcart business had turned into a full-time job. To facilitate bear manufacturing, local homeworkers were contracted to produce an assortment of the founder's original designs. Even though the company opened a retail store in Burlington, Vermont, in 1985, the majority of the company's products were sold through department stores such as Macy's and Nieman Marcus during the 1980s. As the retail industry consolidated through mergers and store closings during the late 1980s, Sortino realized that a new market needed to be found for his bears. In search of a new customer base, Sortino turned to a local radio station and began advertising the company's products. This advertising strategy paved the way for the "Bear-Gram," where customers could send the gift of a Vermont Teddy Bear by placing an order through the company's 800 number.

The company initiated its Bear-Gram marketing strategy in 1985 in the Burlington, Vermont area. Local radio advertisements aired on WXXX in Burlington and customers called an 800 number to order the product. It was not until shortly before Valentine's Day in 1990 that the company introduced radio advertising of its Bear-Gram product on radio station WHTZ ("Z-100") in New York City, positioning the Bear-Gram as a novel gift for Valentine's Day and offering listeners a toll-free number to order from the company's facility in Vermont. The test proved to be successful, and the Bear-Gram concept was expanded to other major radio markets across the country. These radio advertisements were generally read live by popular radio personalities. John Sortino believed that the radio had been a successful medium for the Bear-Gram for several reasons. He believed that the use of popular radio personalities lent credibility to the product. In addition, because the disk jockey could give away a few bears, more air-time was spent on the product than the paid "60 seconds."[8] He also believed that radio advertising allowed for flexibility in the use of advertising copy, which could be adjusted as the company changed its marketing focus.

Due to the success of the Bear-Gram concept, Vermont Teddy's total sales of $400,000 in 1989 rose to $1.7 million in 1990 and over $5 million in 1991.[9] As sales increased, a larger manufacturing facility was needed. In 1991, the company leased and moved into a new factory space and guided factory tours began. The larger production facilities made it possible for Vermont Teddy Bear to begin producing bears in bulk and to enter into larger sales agreements with retail establishments. In 1992, *Inc.* magazine listed Vermont Teddy as the eightieth fastest growing company in the United States with sales totaling $10.6 million.[10]

Vermont Teddy Bear went public on November 23, 1993. By this time, sales totaled $17 million.[11] In 1993, the company was named the first national winner of the Dun & Bradstreet "Best of America" Small Business Award and was ranked as the fifty-eighth fastest growing company in the United States by *Inc.* magazine.[12]Also in 1993, the company was the recipient of the Heritage of New England Customer Service Award. Previous recipients of the award included L.L. Bean, Inc., Boston Beer Company, and Ben & Jerry's Homemade, Inc.[13]

In 1994, construction began on a new factory and retail store in Shelburne, Vermont, which opened for business in the summer of 1995. In 1994, *Inc.* magazine listed Vermont Teddy Bear, with sales totaling $20.5 million, as the twenty-first fastest growing small, publicly owned company in the United States and named the company "Small Business of the Year."[14]

Prior to 1994, Vermont Teddy Bear had experienced a great deal of success and profitability, with sales growth in excess of 50% for three consecutive years.[15] However, 1994 marked the beginning of the company's financial troubles. The company's expenses increased in accordance with its anticipated growth, but sales did not increase as rapidly.

Vermont Teddy Bear's rapid growth during the 1990s taxed the organizational structure and efficiency of the company's operations. Due to the company's declining financial situation, on June 20, 1995, the company's Founder, President, and Chief Executive Officer, John Sortino, resigned. Sortino recognized that the future success of the company "depends on the transition from an entrepreneurial company to a professionally managed organization." He further stated, "I wanted to assist the company in positioning itself for the arrival of a new CEO. I will provide guidance to the company in a consulting role, and I will retain my position on the Board of Directors."[16]

On August 2, 1995, R. Patrick Burns was appointed as President and CEO. Also in 1995 Elisabeth Robert joined the company as Chief Financial Officer. Outside observers wondered if the company could successfully make the transition to a new CEO and generate enough sales to pull itself out of debt and remain profitable.

In its attempts to turn the company around, the new management team eliminated several unprofitable marketing ventures (such as its sponsorship of a NASCAR circuit race car and driver) and reduced general and administrative cost. By 1996, the new team had generated a profit of $152,000.[17]

During the later part of 1996, Vermont Teddy Bear took on a new trademarked name, "The Great American Teddy Bear Company," in an attempt to broaden brand appeal and take advantage of national and international distribution opportunities. Even though the "Vermont" name gave good name recognition in the Northeast, the company felt that it had less impact in other parts of the country. They were wrong. Customers became confused, and Disney's entry into the personalized teddy bear gift market with their "Pooh-Grams" added to the confusion. The confusion contributed to a decrease in Bear-Gram sales. By Valentine's Day, the company returned to its established mark, The Vermont Teddy Bear Company.

Late in 1996, the new management team began to explore opportunities for growth. They believed that the emphasis of the company should shift from the Bear-Gram business to other distribution channels. Their new five-year plan included opening new retail stores and expanding the catalog.

By 1997, retail sales were the fastest growing part of Vermont Teddy's business. Sales for the factory retail store in Shelburne for the fiscal year ending June 30, 1996, were 19% ahead of 1995.[18] It appeared obvious to top management that retail was a growing profit center for the company. The company's factory store had become a major Vermont tourist destination and had averaged 130,000 visitors a year since opening in July 1995.[19] As a result, the company became interested in high tourist traffic areas for retail expansion, hoping to duplicate this success at other retail locations.[20]

The location for the company's second retail store was North Conway, New Hampshire, a major tourist destination in both winter and summer months. The store opened in July 1996. The third retail location opened at 538 Madison Avenue in New York City in February 1997. The New York City location was chosen because it had been the number one market for Bear-Grams since the company began advertising on radio in 1990. The company believed that the New York store would benefit from the millions of dollars of radio advertising that the company had invested in this market. The fourth store opened in Freeport, Maine, on August 16, 1997, two doors down from L.L. Bean.

Fiscal 1997 was a disappointing year for Vermont Teddy. After a year of controlling costs and a return to profitability in 1996, they had set out in pursuit of revenue growth in 1997. The 1997 initiatives included an expanded catalog and the new retail stores. As part of the shift away from Bear-Grams, the company downsized their radio media buying department. The company lost money on their catalog programs, and the new retail stores were not as profitable as expected. Resources diverted to expanding secondary marketing channels, coupled with accelerating changes in the radio industry, contributed to a decline in Bear-Gram sales. The end result was a loss of $1,901,795 in fiscal 1997.[21]

Because of Vermont Teddy Bear's declining performance, R. Patrick Burns chose to step down as President and CEO in October 1997. Elisabeth Robert assumed the title of President and CEO and retained the title of Chief Financial Officer.

According to CEO Robert, "When we made the decision to expand our distribution channels in the areas of retail and catalog, our focus was on being a teddy bear category killer. We thought we were in the teddy bear business. Now what I believe is that we are in the Bear-Gram business, the gift business, and the impulse business. This is a completely different marketplace. Our competitors are the people who sell chocolates, flowers, and greeting cards. We target the last-minute shopper who wants almost instant delivery."[22] She further stated that "the primary focus of the company would return to maximizing returns in the radio Bear-Gram business, which constituted the majority of the company's annual revenue."[23]

In 1998, the management team began seriously looking at the profitability of their various retail locations. They also began looking at the catalog, intending to optimize its size and product offerings to ensure its future profitability.

Corporate Governance

As of June 30, 1998, The Vermont Teddy Bear Co., Inc., had a total of seven Board members and two Executive Officers, both of whom were also members of the Board of Directors.

BOARD OF DIRECTORS AND EXECUTIVE OFFICERS[24]

The Board members, Executive Officers, and their experience and qualifications were as follows.

R. Patrick Burns (53) had been President and CEO of Vermont Teddy Bear from 1995 until 1997. He had been a Director of the company since 1995. He planned to remain active as a consultant to the company focusing on developing strategic marketing partnerships for the next two years. Prior to joining the company, he was the Chief Executive Officer of Disney Direct Marketing. He had also held senior management positions at J. Crew, Inc., and at L.L. Bean, Inc.

Joan H. Martin (74) was a private investor who had been a Director of the company since 1991. Martin had no business experience during the past eight years apart from managing her private investment portfolio.

Fred Marks (70) became a Director of the company in 1987 and became its Treasurer and Chairman of the Board in 1989. He served as the company's Chief Financial Officer until January 1995 and Treasurer until 1996. Previously Marks had served as Chairman of the Board of two privately held companies: Selection, Ltd., a manufacturer of remote controls for computers and televisions; and Contaq Technologies, a manufacturer of ultrasonic instruments.

Elisabeth B. Robert (43), Director, Chief Executive Officer, President, Treasurer and Chief Financial Officer, joined the company in 1995 as the Chief Financial Officer replacing Stephen Milford. She was appointed a Director of the company in January 1996 and Treasurer of the company in April 1996. She assumed the titles of CEO and President from R. Patrick Burns who stepped down from the positions in October 1997. Before joining Vermont Teddy, Robert served as the Chief Financial Officer for a high-tech start-up company specializing in remote control devices, where she was also a founding partner.

Spencer C. Putnam (52), Director, Vice President, and Secretary, joined the company as its Chief Operating Officer in June 1987 and continued in this role. He had been a Director of the company and Secretary of its Board since 1989. Before joining the company, Putnam was the director of the Cooperative Education Program at the University of Vermont.

David W. Garrett (55) had been a Director of the company since 1987. He was a Vice President of First Albany Corporation, an investment banking and brokerage firm. Garrett was also President of the Garrett Hotel Group, a private hotel development and management firm and President of The Black Willow Group, Ltd., a private company which owned and operated The Point, a luxury hotel in Saranac Lake, New York.

Jason Bacon (64) became a Director of the company in 1997. He was a consultant to nonprofit organizations and a private investor focusing on real estate and securities with international perspective. Prior to his involvement with Vermont Teddy Bear, he served as a Managing Director at Kidder, Peabody & Company.

OWNERSHIP

As of June 30, 1998, there were 5,183,733 shares of the company's common stock outstanding held by 1,553 shareholders.[25] Approximately 2,551,300 shares or approximately 49.2% of the stock was owned beneficially by the current directors and officers of the company. These figures did not include options or warrants held by current directors and officers, their spouses or minor children to purchase shares of the company's Common Stock or Series B Preferred Stock.[26]

In November 1993, the company made an Initial Public Offering (IPO) of 5,172,500 shares of common stock. The stock ranged from $17.19 to $11.44 from offering to December 31, 1993. Prior to the IPO, 4,000,000 shares of common stock were outstanding and held by nine shareholders. Ninety shares of nonvoting Series A Preferred Stock were held by shareholder Joan H. Martin. This preferred stock had an 8% cumulative dividend and liquidation value of $10,000 per share. On July 12, 1996, the company privately placed 204,912 share of Series B preferred stock. This stock was held by 12 shareholders and was not entitled to any dividends or voting rights. The 204,912 Series B shares were convertible into 482,441 shares of common stock.[27]

The following individuals owned more than 5% of the company's stock as of June 30, 1998.[28]

Beneficial Owner	Number of Shares	Percent Owned
Joan H. Martin	1,840,975	35.5
Fred Marks	600,500	11.6
Margaret H. Martin	267,000	5.2
Spencer C. Putnam	84,000	1.6
R. Patrick Burns	17,625	0.3
Jason Bacon	5,500	0.1
Elisabeth B. Robert	2,700	0.1

Notes were deleted.

Vermont Teddy has never paid cash dividends on any of its shares of common stock. The high and low stock prices for 1998 were[29]

Quarter Ending	High	Low
June 30, 1998	$1.63	$1.06
March 31, 1998	$1.63	$0.75
December 31, 1997	$2.13	$0.88
September 30, 1997	$2.56	$1.06

Company Philosophy

From its founding by John Sortino in the early 1980s until 1998, the company's focus has been to design and manufacture the best teddy bears made in America, using American materials and labor. The company believed that apart from its own products, most of the teddy bears sold in the United States were manufactured in foreign countries, and that the company was the largest manufacturer of teddy bears made in the United States. The company's Mission Statement can be seen in **Exhibit 1**.

This philosophy was modified significantly in 1998 with the company's decision to explore the offshore sourcing of materials and manufacturing alternatives in an effort to lower the company's cost of goods sold and to broaden its available sources of supply. Company customer surveys revealed that price was more important to potential customers than the "Made in America" label.[30] During 1998, the company began purchasing raw materials for bear production and some teddy bear outfits from offshore manufacturers. Vermont Teddy felt that plush materials from offshore were of better quality and less costly than those produced in the United States. They felt that importing these materials would enable them to produce a better, lower cost product and would provide the flexibility to meet a broader range of price points in response to customer needs.[31] The company planned to continue to handcraft the 15-inch "classic" teddy bear in Vermont for those customers interested in an American-made product. The new label read, "Made in America, of domestic and foreign materials."[32] The company also planned to explore opportunities to introduce new teddy bear products made offshore to their design specifications at significantly lower cost points for sale initially into the wholesale and corporate channels.

With this change in philosophy, the company was committed to understanding its potential offshore partners and to ensuring that its partners provided decent, lawful working conditions. It required that all offshore vendors sign a written statement to this effect prior to any business dealings.[33]

Exhibit 1

Mission Statement: The Vermont Teddy Bear Co., Inc.

The Vermont Teddy Bear provides our customers with a tangible expression of their best feelings for their families, friends, and associates. We facilitate, communicate, and therefore participate in caring events and special occasions that celebrate and enrich our customers' life experiences.

Our products will represent unmatchable craftsmanship balanced with optimal quality and value. We will strive to wholesomely entertain our guests while consistently exceeding our external and internal customer service expectations.

The Vermont Teddy Bear brand represents the rich heritage of the "Great American Teddy Bear" begun in 1902. We are the stewards of a uniquely American tradition based on the best American virtues including compassion, generosity, friendship, and a zesty sense of whimsy and fun.