

## Five Easy Ways To End Up In Hot Water

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There's an interesting trend that's been developing since the rather dramatic collapse of our nation's stock markets. It seems, at least from my vantage point, that a growing number of individuals and investment groups are taking the plunge in creating new entertainment-based businesses throughout the United States. The overwhelming sentiment among these developers and investors is that the risks of the once-predictable stock market now outweigh those of speculative "start ups" such as indoor entertainment centers, water parks, and other leisure-based venues. Frankly, they might be right. With no identifiable market growth on the horizon, individuals from varied backgrounds are now researching the tried-and-true business of entertainment. This should mean good news for our industry's suppliers and manufacturers in that product sales will likely climb, however, such growth always comes at a cost, particularly if the growth is not controlled. Of the projects that I've observed or researched over the last year, here are the top five pitfalls that can turn your development plan into a twisted mess:

### 1. Team Up With The Wrong Partners

This one seems like a no-brainer, but as many projects move from concept stage to development stage, the demand for capital becomes great. In an effort to prevent further delay, some developers end up accepting investor capital from individuals that they do not know or have not thoroughly researched. All money is green, right? Well, not exactly. It is imperative that your goals match those of your partners or investors, otherwise the chaos will begin shortly after opening the doors. In my years of working with investment groups and private lenders, I can clearly state that there are two types of capital partners - those that are looking for quick returns and those that aren't. A "quick return" partner is looking for cash distributions from the business right from the inception, sometimes to the detriment of the operation itself. Typically, any new business will need to be fed, that is, replenished with cash generated from operations. This becomes critical to insure that the business reaches its optimum operating position as quickly as possible. Additionally, amusement businesses require frequent reinvestments in new attractions and theming to keep the crowds coming, all of which require even more cash. It's important that all partners and investors understand not only the business cycle of the operation but the specific needs of an amusement venue BEFORE joining the team. The issuance of dividends or even executive salary draws may not be feasible in the early periods.

The long term investor has other ideas in mind. Unlike the "quick return" guys, the long term investor commonly does not want to receive any form of income in the short term but instead demands strong appreciation over the business' life cycle. While this might sound good initially, it's important to understand that this investor will likely receive a disproportionate share of value down the road, should the business succeed and be purchased by an outside source. Consider this: an investor provides \$500,000 on day one to get your business off the ground, which is added to your own investment of \$250,000. Over the next five years, you help to grow the business by working 80 hours per week, give up your social life, and contribute all of your energy to the operation. You're rewarded for your success by building the business into a showcase facility in your region, which attracts the eyes of a national entertainment chain. Negotiations ensue and when it's all done, a decision is made to sell the business for the tidy sum of \$3,000,000 (net of debt). To your surprise, your investor, who's been sunning himself on the French Riviera, shows up to collect his \$2,000,000 check, leaving you with a "paltry" \$1,000,000. It now occurs to you that if you had borrowed the \$500,000 from a third party lender, the interest cost during the five year period would have been roughly \$108,000. So, after paying back \$500,000 in borrowed capital and \$108,000 in accrued interest, the net realizable sale value would have adjusted downward to \$2,392,000, but guess what? There's no partner to share it with!

In the real world, third party financing doesn't always exist, so at times we must rely upon private investors and financiers to achieve our dreams. When possible, limit the investment return level of the investor or structure a buyout clause in the investment agreement that stipulates the level of "reward" provided to the investor in the event of sale or partner buyout. After all, it's your concept and your sweat equity - if anyone deserves the bigger slice of the pie, it's you.

### 2. Forget About The Feasibility Study

Oftentimes, project developers comment that they know their market area well and are confident that their entertainment concept will "work". This may in fact be true, but in the eyes of most lenders and investors, why put large dollars at risk without confirming the capabilities of the market? There hasn't been an assignment that my firm has undertaken that did not uncover something alarming about the market - things like other planned entertainment projects, retail shopping hub

shifts, roadway realignments, zoning or licensing conflicts - you name it. Any of these can have a devastating effect on an entertainment project, as our industry relies upon consumer spending, high visibility locations, and appropriately-zoned real estate for success. Without these, attendance and revenues suffer.

In this day and age, there's nothing more important than examining the attributes of a market under consideration. A good portion of the United States is encountering a significant amount of change in the way consumers travel, shop, and select recreational facilities. What worked last year or even last week may differ greatly from what will work in the months and years ahead. It's important to understand these trends while at the same time matching the needs of the region's real target market - not necessarily the target market that you wish existed. Every consumer market would enjoy the offerings afforded by a chain such as Dave n Busters, but will this concept work profitably in every market? Unfortunately not. Herein lies the differences between the facility a developer may "want" and a facility that "works".

### **3. Don't Play In The Political Arena**

Nothing's worse than heading for a planning board or board of adjustment meeting only to find that public and municipal opinion is not in your favor. It's extremely important to pre-sell any entertainment-based development project to not only the municipality, but the county, schools, neighbors, and houses of worship. Essentially, the goal is to get everyone on the same page to prevent the likelihood that zoning approval will be refused or delayed. Every piece of commercial real estate has some limitation, whether it be near a residential neighborhood, wetlands, or other natural habitat. As a result, there can be a host of zoning concerns, ranging from evening lighting, sound levels, wastewater elimination, and groundwater control. The more challenging the item, the more expensive it becomes to satisfy a wary municipality. Some issues can become so burdensome that multiple layers of legal intervention become necessary to adequately meet the needs of all parties.

Fortunately, many of these concerns can be mitigated with proper pre-selling. This can be done from various directions, including the local Chamber of Commerce president, township mayor, school board director, fire chief, and members of the zoning board. Make a point to provide individuals such as these with information about the project on a routine basis BEFORE applying for variances, permits, or other such support documentation. Utilize their feedback, and when appropriate, incorporate their suggestions into the overall design. It's much easier to create allies at this point than to battle enemies later on.

### **4. Wait Until The Last Minute To Obtain Funding**

Invariably, almost every project will require some level of bank funding to support development or ongoing operations. So why then do most developers wait until the last minute to approach a bank? More than likely, this delayed reaction results from a general fear of dealing with lenders and a lack of understanding regarding the lending process. Unfortunately, this delay now places the lender in the uncomfortable position of having to wrap his or her hands around the entire development program in a relatively short period of time. Not to mention the fact that most lenders are not familiar with the inner workings of entertainment facilities or entertainment venues in general.

The time to get the lenders in the game is upon completion of the feasibility study. An informal meeting with a regional lender will help to plant the seed and establish a time line for further contact. As with the zoning approval process, keep your lender abreast of progress and be sure to provide him with the names of the professionals on your team - the architect, engineer, accountant, attorney, and project consultant. More often than not, there may already be a relationship between one or more of these individuals and your lender's institution, allowing for continued dialogue about "the project" in common business circles. When it's time to pull the trigger, your lender will be much more comfortable in presenting your loan request to the institution's credit committee, and be more capable of pitching the project's merits and defending its shortfalls.

### **5. Bad Mouth The Competition**

I like to look at the amusement and entertainment industries as a small grouping of knowledgeable professionals capable of preserving and expanding the role of entertainment in our society. In essence, it's a small group of probably 6-8,000 facilities countrywide with a common connection being that of our national trade associations. With this in mind, consider your would-be competitor an ally rather than an enemy. If you've performed your feasibility work well, chances are that there are sufficient market niches for multiple entertainment operators in your area. Also keep in mind that the patrons that your facility is trying to lure may be current patrons of your competitor's facilities and may hold some allegiance or relationship to the management and staff of those venues. Also consider that these same competitors will be shoulder-to-shoulder with you at the industry trade shows, chamber of commerce meetings, and local PTA events, so if you can't make a positive comment about a competitor's site, it might be best to make no comment at all.

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Come to think of it, if the stock market continues to rise and fall by record numbers every day, maybe the thought of purchasing a double-spiral roller coaster really isn't that different. At least a roller coaster stops now and then to let you off.

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