

Developments in Business Simulation & Experiential Exercises, Volume 11, 1984

THE H.E. / L&P MERGER

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ABSTRACT

Any time one organization takes over another there are bound to be some differences of opinion about what changes are necessary as the transition occurs. In this exercise you have an opportunity to play a part in how the initial stages of such a transition come about.

DIRECTIONS

1. Your instructor will brief you on force field analysis and then assign you to one of two teams - the Hayes Management team or the Lorrillard transition team.
2. When instructed, you should read the background provided for your team and begin working on the tasks outlined. Your instructor will indicate how much time is available for each phase of the exercise.

BACKGROUND FOR THE HAYES ELECTRIC MANAGEMENT TEAM

You are part of the management team at the Hayes Electric Company (H.E.). Recently a major conglomerate called Lorrillard & Pullman (L&P) acquired your company for \$250 million. For the most part you are quite excited about this merger because Lorrillard can infuse the needed capital to put Hayes into the big time. Your team has been asked, in the week before new management takes over, for its input on changes necessary. Lorrillard has assured you that the present management team will remain intact provided you are willing to help facilitate any needed changes.

Hayes has been a family owned and operated business for 50 years. Mr. Hayes, the president, and only grandchild of "Pop Hayes" the founder, has been offered a position as special consultant. A general manager has yet to be named to take the helm of Hayes, but Lorrillard top management has indicated a willingness to consider promoting one of the present Hayes' managers.

Your team has selected the vice-president of manufacturing of your team. (Fill in one team member's name here.) You have selected this person because of his/her expertise in manufacturing and electronics and because the team agrees that Hayes could benefit if he/she was named general manager. Besides you feel the strength of your management team lies in the production/engineering areas.

Hayes produces a variety of small household appliances -- hair dryers, mixers, blenders, etc. While Mr. Hayes, your president was an idea man, he was incompetent as a financial manager and consequently was unable to obtain the funding for badly needed new equipment necessary to remain competitive. At a minimum, Hayes will require an immediate \$25 million in capital investment to make a solid turnaround. At the time of merger negotiations, this fact was played down some. In fact, figures in the \$5-7 million range were frequently cited, coupled with a caveat that this would not be enough in the long run. Your team did not want to

scare off potential buyers, especially Lorrillard, which as a multi-billion dollar conglomerate should find your capital improvement needs a drop in the bucket.

Hayes has been experiencing a steady decline in profits for the last 5 years -- and in the last 2 years incurred losses of \$5 million and \$6 million respectively on sales revenues of \$150 million each year. As a management team, you attribute most of these losses to three factors: (1) poor financial management by Mr. Hayes, who also served as treasurer; (2) a steady decline in the quality of your products because of old and ill-maintained equipment; and (3) some long-term customer reluctance to stock your products, given premium prices, because quality has been declining.

The entire management team is committed to Pop Hayes' motto: "Quality always sells." The company was founded on this notion and consequently emphasized quality over price and durability over style. Your products have always enjoyed the reputation of being the Cadillac of the small appliance industry. Unlike some of your competitors, your workers are all skilled craftsmen -- making your product more labor intensive but of much higher quality. Your workers are also loyal Hayesites. Given that Hayes is the major employer in your small town and Pop Hayes' philosophy to pay his people quite well, you have never been unionized -- in fact, you are almost like one very large family. The recent agreement by the Hayes family to sell has strained this family feeling; however, your management team was able to dampen some employee attempts to unionize: "before its too late."

Your team feels strongly that the Hayes tradition can be profitable again and you feel the vice-president of manufacturing is just the person to lead you into a new era of "quality always sells."

Your Task

You have been asked by the top management of Lorrillard to submit a written proposal on the changes you would like to recommend as the takeover is completed. Your proposal is to be sent to the head of Lorrillard's transition team which has agreed to send you a copy of the transition team's proposals as well.

- (1) Your team should first prepare a force field analysis to diagnose the present level of profitability at Hayes and to determine what driving and restraining forces need to be altered to improve profitability. Once the force field analysis is complete, your team should prepare a memo outlining your proposals. Be sure to include your recommendations on the general manager position, the necessary capital investment outlays and any supporting information to make your case.
- (2) The instructor will tell you when your memo is to be delivered and will also obtain a copy of the Lorrillard team's proposal as agreed. Once your team has reviewed their proposal, you are then asked to respond to it in a second memo written to the Lorrillard transition team.

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- (3) After exchanging and reviewing the second set of memos, a pre-takeover meeting will be called at Lorrillard headquarters (front of room) between the two teams. Two members of your team will be asked to attend, the other members may act only as observers. At this meeting all necessary changes must be finalized.

BACKGROUND FOR THE LORRILARD TRANSITION TEAM

You are part of a transition team organized by your company, Lorrillard & Pullman (L&P), to facilitate takeover of a recent acquisition -- the Hayes Electric Company (H.E.). Your company acquired Hayes for \$250 million. Your top management has asked Hayes, in the week before takeover begins, to submit any change proposals it feels are necessary. Your team is also to prepare its own change proposal. While your team has been given the final authority to make changes, you are willing to consider the Hayes management's proposals. Lorrillard has assured Hayes' present management team that it will remain intact provided it is willing to help facilitate needed changes -- to which it has responded enthusiastically.

Hayes has been a family owned and operated business for 50 years. Mr. Hayes, the president and only grandchild of "Pop Hayes" the founder, has been offered a position as special consultant. A general manager has yet to be named to take the helm of Hayes although the vice-president of manufacturing has been selected by the Hayes' management team to chair their merger team. While Lorrillard is generally willing to consider promoting a manager from within an acquired company, the candidate must be acceptable and compatible with Lorrillard's views.

Hayes produces a variety of small household appliances -- hair dryers, mixers, blenders, etc. The president, Mr. Hayes, was an idea man but totally incompetent as a financial manager. Hayes' managers have indicated in earlier meetings an investment of \$5-7 million dollars would be sufficient to provide the necessary new equipment needed to turn Hayes around. While they are probably being overly optimistic about the impact of such a small investment, you have been told by your top management that you can not invest one cent into Hayes for at least 1-2 years. At the time of the merger negotiations, your top management ignored your team's advice that Hayes was not worth more than \$200 million given the equipment it needs and got into a bidding war which pushed the offer \$50 million too high.

Hayes has been experiencing a steady decline in profits for the last 5 years and in the last 2 years incurred losses of \$5 million and \$6 million respectively on sales revenues of about \$150 million each year. Your own analysis of these losses uncovered several factors. First, there is Mr. Hayes' poor financial management -- he served as treasurer, and didn't even know the fundamentals of basic cash flow management. Second, there is an over-paid and under utilized work force -- Hayes is located in a small town and is its major employer with a non-union shop in which all workers are treated and paid as craftsmen. Employees are exceptionally loyal to the company and management is very loyal to its "family" of workers. Clearly an incentive system would separate the "wheat from the chaff" at Hayes. Third, management hangs onto an outmoded strategy, which was started by "Pop" Hayes, that "Quality always sells." This strategy has led the company to emphasize quality over price

and durability over style. Yes, they do produce the Cadillac of small appliances but the market share has been going to the cost-effective, less durable producers who have a flair for style, price and what sells. Fourth, quality has been slipping because of old and poorly maintained equipment. Given Hayes' emphasis on "hand made" or labor intensive quality being built in, craftsmen are still using methods of manufacturing on a number of smaller parts which could and should be made on modern, fully automated equipment.

The initial impetus for buying Hayes was your marketing research projections that said a number of new households will be started in the next 10 years as the baby boom generation sets up house. You saw an opportunity to acquire a company with a highly reputable name brand in need of a major over-haul. Clearly, a strong market-oriented general manager is needed -- making it unlikely to promote someone from Hayes' existing production/engineering-oriented management team. However, the over-zealous bidding war for Hayes has created a bit of a dilemma -- your plans to invest \$50 million in new automated equipment have to be shelved for at least one or two years. However, some short-term options are possible including -- emphasis on worker productivity, lay offs of some of the "craftsmen" and subcontracting of their work to more automated manufacturers, redesign of present products to incorporate less expensive electronic components and the establishment of a strong marketing orientation in management to increase sales by pricing more competitively to keep Hayes afloat until money is available to automate fully.

Your Task

You have been given the responsibility to prepare the final transition plan for Hayes. This plan should include all the changes you feel are necessary. Your proposal will be sent to the Hayes' management team for review and reaction. In addition, the Hayes team has been told to send you a copy of its proposal for reaction as well.

- (1) Your team should first prepare a force field analysis to diagnose the present level of profitability at Hayes and to determine what driving and restraining forces need to be altered to improve profitability. Once the force field analysis is complete, your team should prepare a memo outlining your proposals. Be sure to include your recommendations on the general manager's position, plus any other changes you feel need to be initiated.
- (2) The instructor will tell you when your memo is to be delivered and will also obtain a copy of the Hayes management team's proposal as agreed. Once your team has reviewed this proposal, you are then asked to respond to it in a second memo written directly to the Hayes' management team.
- (3) After exchanging and reviewing the second set of memos, a pre-takeover meeting will be called at Lorrillard headquarters (front of room) between the two teams. The Hayes team has been told to send two of its managers, you will be allowed to send up to four members of your team, the other members may act as observers. At this meeting all necessary changes must be finalized by your team. Your team should decide the format of the meeting and have someone to chair it. Remember - final changes must be announced by a spokesperson for your team at the end of this meeting.