

“You are Chair of the Board in a Hatfield vs McCoy Family Business Situation”

By Josh Chernin

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Jerry Hatfield, the 70-year-old Chairman of the Board of Smith Industries, leaned back and frowned. He had just received a call from his bank’s lending officer informing him of “deep concern” about Smith’s ability to repay a long-term loan and also that the bank would not increase Smith’s line of credit, which was already nearly fully utilized.

Although Smith was current on its debt, Jerry could understand the bank’s standpoint. Smith Industries had made a profit in just one of the last 42 months, was in violation of two of the three loan covenants, and had lost most of its credibility with the bank by repeatedly coming short of forecast.

Smith was a 110-year-old manufacturer of a largely commodity product involving some degree of customization. The market for these products was, overall, growing at just 1-2%/year and customers’ requirements were changing; they were demanding more customization and more frequent runs of smaller orders. Although Smith had good technology and the capacity to adapt it to market needs, the market didn’t appear willing to pay more for it, so price competition was fierce. Smith had about 200 active customers and shipped about 40 orders a day, running 24/7. The workforce was non-union and with a few exceptions hadn’t received raises in two years. Brand-new machines cost more than \$3 million each, although there was a thin market for used machines. In any case, at the present time, Smith couldn’t afford them.

The President and Vice-President were members of the two founding families, the Hatfields and the McCoys. Each family controlled 50% of the stock. Jerry was the last surviving management member of the third generation; his partner, Perry McCoy, had just died. Jerry’s son David Hatfield was now the VP of Sales, and Perry’s son Eric McCoy was President; there was no CEO. Each family controlled four seats on the 8-member Board, and David and Eric were both members. All board members were also members of the two families; there were no non-family C-level insiders or any outsiders. Two of the McCoy directors were women, and one of the Hatfields, but none had any direct management experience at the company.

The company’s sales had been stagnant at about \$45 million for several years, although Jerry believed that most of the blame belonged with operations, which had not adjusted well to the market. Indeed, during busy times of the year, Smith had turned work away because their lead times weren’t fast enough.

Should We Accept Help from Reed Capital?

Two weeks later, the lending officer placed another phone call to Jerry Hatfield.

The bank “suggested” Smith Industries to accept the help of Reed Capital, a medium-sized turnaround/restructuring firm and investment bank.

By “suggest”, Jerry understood that he hadn’t much of a choice; if he didn’t “accept”, the bank might pull the loan. “Accept” also meant paying \$500/hr for Reed Capital’s services.

After consulting Eric McCoy and David Hatfield and notifying the rest of the board, Jerry accepted, hoping for the best.

Reed Capital did their best; by jiggering the balance sheet, pointing out some inventory inefficiencies, helping to sell off a piece of real-estate and helping Smith find a company to lease part of their underutilized warehouse next door, Red did buy Smith some time. Maybe six months.

But the underlying operational and organizational issues that had caused the problems in the first place hadn’t been solved. And Reed Capital, who was being paid by Smith Company but was really working for the bank and had its own reputation to protect.

That’s when Reed Capital called John Cane.

John Cane was an experienced General Manager with a history of successfully leading a variety of manufacturing companies in the US and in Europe. He had set up a consulting firm a few years ago and was now leading turnarounds. The instructions he got from Reed Capital: “Go in there and figure out what’s going on”.

John Cane showed up with no more than a telephone introduction and was ushered in to meet with the President, Eric McCoy, who welcomed him in with warmth somewhat suspicious given that it was his own performance that was under scrutiny and for \$500/hr to boot, since Cane was being billed by Reed Capital. Eric readily admitted that operations, which reported directly to him, were a mess and invited John to have a look around.

John spent a full day looking around and he did see a mess. Then he met with David Hatfield, the VP-sales. David was quick to point the finger at operations and indirectly at Eric McCoy. But in contrast to Eric, David did have some decent, if inexperienced ideas about what to do, and John could see quickly that one big problem was that David and Eric weren’t getting along.

Back on the floor for a week, Cane quickly identified four big buckets of savings that added up to the difference between losing and making money. None involved either layoffs or capital expenditures – they were all process improvements. He began putting four project plans together and presented the first – on reducing setup times, with names, tasks, and due dates – at a staff meeting attended by Eric, David and four others. With minor changes, the plan was approved, and John left for a few days.

When he returned, little had been accomplished. Apparently, accountability, or lack of it, was also an issue.

Digging in some more, Cane discovered that:

1. The process improvements were relatively easy to implement -- on paper -- but Eric McCoy, to whom operations reported, wasn't holding his people accountable for getting the tasks accomplished.
2. The VP-Sales, David Hatfield, was enthusiastic about the changes but couldn't push Eric to make them and didn't feel he had the authority to do so, even though his father was chairman of the board.
3. Eric McCoy had a temper problem, witnessed first-hand by Cane, and wasn't trusted by his floor supervisors. As a result, he didn't have the credibility to push changes through.
4. Eric's salary was \$70,000/yr more than David's.
5. The bank had formally notified Smith Company that it was giving them 90 days to start showing progress or it would call the loan.

John shared his findings with Reed Capital and with Jerry.

Jerry Calls a Board Meeting.

Jerry called a Board meeting. By now the situation was dire enough that people were paying attention, although there was no less acrimony than in the previous meetings since Perry McCoy had died. Jerry and Perry had managed to lead most decisions to consensus.

But after Perry's death, only Eric among the McCoys had any operational experience and neither his performance nor his interpersonal skills inspired confidence, and he and David were now in almost open warfare. In the last few board meetings had dissolved into arguments and several 4-4 votes.

Jerry opened the meeting with a recitation of the current situation. The Board was alternately finger-pointing, arguing about what the problems really were, and expressing concern. Jerry asked the Board to make the following decisions:

1. What should their stance be with the bank?
2. Should there be changes in the organizational structure?
3. How to ensure that the needed operational improvements were implemented?
4. And, what if any changes to board structure and governance should be made?

You are Jane Smith, the only "independent" Board member who is not a family member. But you are also the partner of the CPA firm that audits the company's books. You have known both families for years and they trust you.

What do you do?