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H.O. Penn

'Managing By Values' Brought the Company Back,
But Now Will it Guide its Growth?

Alexandra Barton-Sweeney¹

Joel Podolny²

James N. Baron³

Jaan Elias⁴

"My dream is that some day there will be companies designated as the 'Fortunate 500'. Size would not be the main criterion for membership. 'Fortunate 500' companies would be profitable, but also place a high emphasis on such factors as the quality of life available to employees and the quality of services given to customers."

- Ken Blanchard, Norman V. Peale,
The Power of Ethical Management (1988)

In 1991, Tom Cleveland, CEO and owner of the Caterpillar dealership, H.O. Penn Machinery Company, Inc., found himself contemplating the sale of his poorly performing business, which had been in his family for nearly three decades. After he was unable to reach an agreement with a particular buyer, however, Cleveland re-committed himself to H.O. Penn, determined to turnaround its fortunes. He introduced a management system called 'Managing by Values' (*MBV*), with the objective of infusing explicitly stated values and goals into every facet of the company's operations. At first, employees were comfortable with the concept, but as Cleveland implemented the process he encountered a great deal of resistance. He persevered, convinced that *MBV* could have positive and enduring benefits for all of the company's stakeholders. Eventually, employees embraced the new system. Over the next 15 years, both company morale and financial performance improved markedly. Perhaps nothing demonstrated H.O. Penn's emerging cohesiveness more powerfully than the firm's nationally recognized work to rapidly supply and support heavy equipment and generators in the rescue, recovery, and restoration efforts in the aftermath of 9-11.⁵

In 2006, Cleveland faced pressure to grow the business over the next five years. In view of H.O. Penn's recent performance, Caterpillar had high expectations for future growth, pressuring the company for even faster expansion of market share. Cleveland considered a number of options to meet Caterpillar's and his own growth expectations, and speculated which one(s) would fit best with 'Managing by Values.'

The Dark Days

After the real estate bubble burst in 1989, Tom Cleveland spent nights awake, worrying about the future of his company. Cleveland, a Yale college graduate, was the owner and CEO of H.O. Penn, a Caterpillar dealership. Based in Poughkeepsie, New York, H.O. Penn provided heavy machinery, service, rentals, and parts to contractors throughout New York and Connecticut. In most years since its creation in 1921, H.O. Penn had been a reasonably profitable business. But, in 1991, the company reported a loss for the first time in its history, and its financial performance was one of the worst among all Caterpillar dealerships nationwide.

When a neighboring Caterpillar dealership offered to buy H.O. Penn in 1991, Cleveland seriously entertained the offer. He knew that the business could not continue with such poor financial performance, but lacked ideas for altering its course. Even though H.O. Penn had been owned by his family for three generations, Cleveland felt it was time to move into another line of business. Negotiations carried on for more than a year, and the change in ownership appeared imminent. Employees, aware of what was transpiring, braced themselves for the transition. Many searched for positions elsewhere. As negotiations progressed, Cleveland could not help but reconsider the value of his family business—not just financially, but also personally. He came to realize that the company was worth more to him than anyone else. At the last moment, the deal fell through after the buyer asked for further price concessions. Cleveland later reflected:

It was the best thing that ever happened to me. I came away energized and excited about going forward with the business. I wanted to prove the buyer wrong. They kept giving me all these reasons that the price should be lower than what I felt the company could really be worth. It was the first time since I took over as president after my father in 1985, in which I was no longer in his shadow. I was here and I was in charge.

The following day, Cleveland informed employees of a change in ownership, but it was not the one they were anticipating. The “new” Cleveland was “buying the company back.” A number of employees noticed an immediate change in him. He seemed more engaged, eager to communicate, and “had a rock-solid commitment to making the company work.”

Cleveland knew there were a number of daunting obstacles to reviving H.O. Penn. First, there were influences he could not control, like the state of the economy. The U.S. economy was in a brutal recession, and building contract awards had dropped 55% between 1990 and 1993. As a result, H.O. Penn’s customers were cutting back purchases and rentals of equipment.

An even more daunting challenge, however, was improving the company’s internal processes. H.O. Penn lacked overall statements of operational policies, goals, and strategies. The organization was fragmented. The company was spread across ten locations at the time, each with its own sales, service, and rental divisions; each ‘silo’ looking after its own interests and avoiding communications with other parts of the company. Additionally, nearly every department of the organization had developed its own dysfunctional culture and club-like atmosphere. In parts of the company, there were fraternity-type games and hazing that dated back forty years. Cleveland recalled with dismay that at a funeral for a former employee,

A number of workers were talking about what they enjoyed most about the company. They reminisced about getting drunk together at the company picnic. And others recalled how they played football with the turkeys we gave out for Thanksgiving.... A lot of employees loved working for the company, but for all the wrong reasons.

While employees focused on department specific activities, there was a general lack of concern for the company's overall well-being. Despite H.O. Penn's financial losses, the employees remained complacent about the fate of the company. Cleveland noted,

Everyone thought their performance was better than it really was. They all thought they were doing well individually and blamed others. Some departments made themselves look good at the expense of other people. There was no incentive to help other departments out since each cared only about what was good for them, which may have not been good for another department or for the company.

The general attitude led to counterproductive behavior by managers. Cleveland observed,

Managers hid their shining-star employees, even though they may not have been in the best place within the company, just so they would not lose them to another department. The service department did not pay close attention to what they were charging internally and was overcharging the construction equipment sales department for rental units. Because there were no processes to communicate interdepartmentally, construction equipment sales absorbed the interdepartmental overcharges, and service profited off the lack of transparency.

The work environment for employees was volatile, with uncertainty over job security permeating the organization. Turnover was high. Managers "came and went like the wind." Employees were continually apprehensive about looming layoffs. A union employee observed,

When things slowed down, you knew the axe was coming down within weeks. Of course, they wouldn't even tell you in advance. Instead, they would call you into the office the day you were let go and escort you out, so you didn't steal anything on your way out the door.

Management was constantly in trouble with the union. More than half of H.O. Penn's employees belonged to the International Union of Operating Engineers. Union employees asserted repeated mistreatment and filed numerous grievances. Billy Nilsson, a union technician from the Bronx, recalled: "We never had a voice. They treated us like the trolls that were down in the caves." Managers accepted the complaints from unionized employees and the adversarial situation as inevitable. Some rolled their eyes and explained, "We can't do anything with the unions. This is our lot."

Making a Commitment to Values

Once Cleveland "bought the company back," he faced the enormous task of turning it around. He held meetings with Caterpillar and then with management from all ten facilities to discuss plans for moving H.O. Penn forward. Afterward, he called weekly meetings with senior management. He recounted,

In 1992, we did alright as a result of following the plans. There was a lot of enthusiasm and the business climate was not so bad. The following year, however, things did not go quite as well. We were perpetually in fire-fighting mode. Every week in our meetings we were sitting there and saying, 'We need to put another program of the month in place.'

Finally, Jeff Mitchell, a senior manager who later became executive vice president and general manager in November 1998, argued "We can't continue to do this. We need to find something that is more long-term." Over the next three months, Cleveland and senior management searched for

something that they could build around, rather than another short-term fix to an immediate problem. They first considered initiating a strategic planning process. Next, they looked into creating a pay-for-performance compensation scheme. Finally, after hearing a tape by Dr. Ken Blanchard, entitled *Becoming a Fortunate 500 Company*, which advocated the use of Managing by Values (MBV), Cleveland believed he'd found the company's new direction. The tape made a connection between leadership and company values, arguing that businesses must focus on values to create a high-performance work environment. Cleveland was excited by the insight. Several companies, including a Caterpillar dealership in Texas, credited MBV with improving their performance, especially financial. Cleveland contacted Dr. Michael O'Connor, the creator of the Managing by Values process, and, with his help, began implementation of MBV in November of 1993.

MBV was a systematic approach by which a company could align its culture and business practices with its core values to create win-win solutions for all stakeholders in all situations. The implementation process consisted of three phases: defining the company's values; communicating those values; and aligning actions with those values. In a co-authored book, *Managing by Values*, Blanchard and O'Connor imagined the system as an ongoing process that would realign an organization continually based on a changing environment.

As a first step, Cleveland and the senior management team, under O'Connor's guidance, drafted H.O. Penn's mission and values. As part of the process, cross-sections of employees from various locations and functional areas of the company gave their input, clarifying the mission and values in terms of how they wanted the company to be, not how it actually was. Caterpillar was also consulted. After the values were agreed upon, they were then prioritized and given practical definitions, which would form the basis for decision-making in every area of the corporation. This first phase of MBV took nearly six months to complete. In the beginning of 1995, Cleveland and the senior management team communicated H.O. Penn's mission, values, and goals to all parts of the organization through kick-off meetings, presentations, pamphlets, and focus groups, articulating the four core values: "Ethical, Success, Quality, and Communication." (See Exhibit #1 for current values statement and definitions.) Cleveland noted, "They may seem like motherhood and apple pie, but they were hard to live up to. The values set very high standards."

Meanwhile in the summer of 1994, the company issued anonymous 'Pathfinder' surveys, developed by O'Connor, to employees in order to identify organizational strengths and concerns and to measure company alignment with the core business values. Employees were asked to rate their agreement with such statements as: "The people I work with care about my concerns and my well being," "People in our area consistently try to do the right thing," "My work is personally satisfying to me," "I can do my job and still have enough time for family and community," and "My supervisor treats me fairly." Responses to the surveys allowed management to analyze gaps between the values they espoused and reality within the company and marketplace. After the results were tabulated, brochures describing the data were distributed to employees.

As part of MBV, management used the data to hold focus groups, in which groups of a dozen employees from each department of the company met to find solutions to areas the survey highlighted as being out of alignment. The MBV criterion for all solutions was that they be win-win for all stakeholders, namely employees, customers, owners, Caterpillar, and lenders, and consistent with value definitions. For example, if management made a decision that favored the employee at the expense of the shareholder, such a decision was considered 'unethical' since it was not reflecting the interests of all stakeholders. The plan was that six months later, follow-up focus groups would address whether solutions from previous meetings had their desired effect.

The company immediately acted upon one concern expressed in the first Pathfinder survey. Many employees made it clear that they wanted more opportunities for promotion and better pay. They desired information on what positions were available and what was required in order to qualify for them, expressing an interest in help from the company to develop the necessary skills. In response,

management posted all job opportunities and qualifications. In keeping with MBV's win-win philosophy, the new system surprisingly improved the quality of applicants. Susan Steffanci, vice-president of human resources, observed, "We were amazed because names that we had not thought of ended up being the best for the job or most ready for the training."

Despite the quick change in posting jobs, most early steps in the MBV process were difficult on all parts of the company. Even senior management had trepidation. A senior manager commented, "We had to take a look at ourselves, which scared a lot of people." In the first Pathfinder survey in 1994, responses to over 40% of the surveyed items raised concerns that had to be addressed. A senior manager remembered, "We were shocked. We didn't realize that the employees felt we had so many concerns. We thought that the company was more in alignment with its values."

While senior managers were distressed, rank and file employees distrusted the entire MBV process. When faced with his first focus group, a long time union employee scoffed, "What kind of malarkey is this?" Union employees were unused to two-way communication with management and some believed that management was trying "to put something over on us." O'Connor led the first focus groups with unionized employees without management in the room. Nonetheless, employees were suspicious, fearing reprisal for voicing concerns. Indeed, union employees swapped shirts with their names stenciled on them so that O'Connor could not identify them.

Mid-level managers were equally uneasy about MBV, many refusing to embrace its policies and practices. Some managers tried to stop the process, attempting to cover-up problems that surfaced. According to senior management, "It was a battle to convince managers to keep it up. They claimed that we were 'turning over the keys to the inmates.'" Managers criticized MBV on multiple grounds. Some claimed that the MBV process was actually creating problems that had not previously existed. Others found that MBV was stealing time from selling construction equipment in order to "get all cozy about our values."

Customizing MBV

Despite the cool reception MBV received from practically every section of the company, Cleveland remained committed to the process. Over the next few years, he complemented MBV with additional systems, programs, and incentives to insure that it was taken seriously. Initially, Cleveland's team included senior management, O'Connor, and Pete Refakis, a retired Caterpillar dealer executive who had experience successfully implementing MBV in a Texas and an Ohio Caterpillar dealership. In 1997, an advisory board was established that included Cleveland, his son, Rob Cleveland, Mitchell, O'Connor and Refakis.

First, senior management created a system to analyze individual performance and set yearly employee, departmental, and company improvement goals. Key results areas and critical tasks were defined for every employee position in the company. Each employee was given goals for the year. Employees were reviewed on their performance of their goals, their alignment with the company's values as well as the key results area and critical tasks of their position. The company implemented a new compensation system; if the corporation surpassed a minimum profit goal, all employees would receive a yearly bonus, which would be augmented to the degree that an employee met or exceeded his or her individual performance goals. Cleveland rewarded exemplary individuals and departments with teamwork and service awards, such as a Champion of the Month award. A "Gap Alignment" program addressed weaknesses in individual and departmental performance by offering targeted training. Cleveland noted, "Some employees needed more direction, some needed more support, and some were highly developed and needed to be managed less." For example, if an employee was a poor communicator, managers and/or human resources personnel would coach him or her, one-on-one. In addition, Mitchell explained, "If a department's results were below the targeted standards, we would

bring a group of those employees together via a focus group to discover the root of the problem, so we could then put an improvement plan in place.”

The company created a leadership development program for managers and potential managers. Led by O’Connor, the program stretched over a year and a half, with enrolled managers meeting in five or six three-day sessions to improve leadership skills. Sessions were focused on different company stakeholders: first, the employees, then the customers, followed by the owners, Caterpillar, and the lenders. Lower-level employees were given the option of attending training programs to develop career-enhancing skills. Despite the transferability of these skills to positions at other companies, Cleveland justified the program in terms of H.O. Penn’s values. “We do what is good for our employees and helps them long-term, because we want them to be successful in life. We look at our program as more than just helping them to do a better job, but as something that helps them become stronger as individuals.”

The company also changed the recruitment and promotion systems to align better with MBV. With the help of experts in each position, job duties were clarified to reflect their enactment of the values, as well as the tasks that the position implied. For example, the role of the manager was defined as a position where the incumbent was first to manage, then to coach and develop people, and lastly to focus on tasks. Human resources profiled new candidates based on their value sets as well as their ability to perform the critical job competencies. Jeff Mitchell observed,

When we bring a candidate in for an interview, we already have a set job profile. From then on, we do behavioral interviewing. We want to make sure that when we hire people, they are good hires.... When you hire someone who isn’t right, it hurts everyone – it hurts the company and the individual who might have left another job to come here. We have greatly improved the ratio of people who succeed in the positions versus people who don’t.

Human resources and management paid close attention to defining the sales role, especially because the job duties emphasized selling what the company *represented*, not just its equipment and services. Other roles were clarified to eliminate interdepartmental conflict. Some service technicians were transferred to the construction equipment sales department to handle rentals, ending the transfer-pricing arrangement between service and sales. Those remaining in the service department focused on generating external service work to gain hard revenue.

Cleveland brought in other systems to monitor and develop sales, as well as build the stakeholder relationship with the customer. He acquired two customer-relationship management programs from Caterpillar. The company also hired an outside firm to conduct telephone surveys of a representative sample of customers twice a year. These surveys allowed the sales, parts, service, and credit departments to address concerns raised by customers and align company treatment of the customer with MBV.

Walking the Talk

As new processes were being implemented, O’Connor and Cleveland persevered with focus group meetings. The focus groups centered on issues ranging from the toilet paper to a new crane; the groups did not end until every problem was addressed. Indeed, Cleveland let himself and his management style be the subject of one focus group. After that focus group, one senior manager recalled,

There was a complete change in [Cleveland's] persona. He remade himself in a whole different image. Previously, he was cynical and did not walk the talk. Now, he was more approachable and open.

Despite all the effort, management and employees remained dubious. MBV was only begrudgingly accepted by most, but Cleveland was determined to carry out a full integration of the system throughout. In October of 1995, Cleveland announced a major reorganization of senior management. Two senior managers left the company and Cleveland reduced the number of managers reporting to him from ten to five.

Even more than the departure of recalcitrant senior management, two particular incidents – one in 1995 and one in 1996 – stand out in the firm's collective memory as having shaken things up and shown skeptics how seriously Cleveland, Mitchell, and their team were committed to the program. 1995 was the first year since implementing MBV that H.O. Penn failed to meet the minimum profit goals set by management, Refakis and O'Connor as a trigger for bonuses. Especially for senior management, bonuses represented a large portion of their compensation. In the past, when performance targets had not been met, there was much finger-pointing and excuse-making; in the end, however, some type of bonus was inevitably approved. Yet in 1995, Cleveland stood firm – the company had not achieved the minimum threshold, so there would be no bonuses. According to Mitchell,

This was a major event. Every year previously, we gave out bonuses no matter where the company stood financially. This year, however, we had to prove that we were serious and that we stuck to our word.

The incident that most reverberated with the rank and file occurred the next winter, at the H.O. Penn facility in Long Island. It was Christmas Eve and the heating system failed. Workers shivered as the temperature dipped to 40 degrees. Such occurrences had usually taken weeks or months to fix, but as soon as management became aware of the situation, they dispatched a crew immediately to address the problem.

After the Christmas incident, employees realized that they could work with management to get results. Soon after, focus groups at the Long Island facility revealed that the real problem was deeper than a heater. Mitchell noted,

Employees complained about the ventilation when they really had a problem with a manager. Once we gained their confidence, however, the real issues came to light. At our Long Island branch, the employees related that there were significant problems with a particular manager, and it was apparent that he would not change. Consequently, we removed him. In that instant, the employees knew that we were serious about this. We saw results improve and things accelerated.

Once word spread of what had occurred in Long Island, employees and managers began to grasp how MBV could engender positive change and began to alter how they related to one another. Steffanci, observed, "MBV was a learned behavior that required repetition. Employees at all levels within the company had the same values and coworkers promoted it, not just management." Values management changed employee's perception of their personal behavior as they worked with management to create more 'ethical' practices. Steffanci noted,

By 1997, employees had become so committed to practicing the values that, when they took sick days off to do personal stuff, they felt guilty. They came to us and said, "Here's the problem, we're lying to you and we don't like it. In addition to the 10 days sick leave, can we get 3 or 4 flex personal days?" We researched the issue, looked at other company practices, and considered the financial implications. We changed it

to 7 sick days and 3 personal days that could be used as sick days. It was a win/win solution for the company and for the employees.

In the late 1990's, the company started to improve financially. In 2000, H.O. Penn's operating income rose significantly, and their ranking put them in the top half of Caterpillar dealers nationwide.

9-11 and Its Aftermath

Perhaps no event displayed the growing cohesiveness of H.O. Penn better than the company's response to the terrorist attacks on the World Trade Center on September 11, 2001 and how it treated employees in the recession that followed.

Soon after the twin towers fell, H.O. Penn employees sprang into action. As a supplier of large, emergency power-generation equipment, H.O. Penn was in great demand. Tom Cleveland recounted in an article:⁶

Our Power Systems Division was immediately called into action, both as an emergency supplier of portable generator sets [gensets] to Con Edison and as a provider of equipment and support to a large number of companies that already had generators.... We brought in emergency gensets from dealers all over the Northeast. We put some in our Poughkeepsie location and some were put in our neighboring Caterpillar dealer, Foley's Hightstown, New Jersey, yard.⁷ Caterpillar sent their entire supply of just-completed, two-megawatt portable gensets to our Poughkeepsie yard, just in case.

After the first couple of days, Mayor Giuliani assessed the damage and announced that the New York Stock Exchange and the other major exchanges would be up and running again on Monday, September 17th. It was no mean feat to pull this off. Our Power Systems phones began ringing off the hooks. Truckers were contacted, and our fleet of trailers was on its way to Lower Manhattan.... We needed technicians to set up our gensets, wire them to our transformers, lay cable to the buildings, and stay with them full time after they were running. Also, many of our existing customers wanted our technicians on site, full-time, to oversee their gensets.... We had support people working around the clock on-site, at all of our facilities and at Con Ed's emergency center. We set up a trailer as our emergency center in a passageway next to 180 Maiden Lane on the East Side, not far from the South Street Seaport. While the World Trade Center was on the West Side, most of our generators were on the East Side. Even so, Lower Manhattan is a small enough area that we could get around to all of our sites easily and quickly from there.

Working as a team non-stop with Con Edison, we pulled it off. Shortly after daybreak on Monday the 17th, the traders, brokers, and other people that support the largest financial operation in the world began to return to work. All of the exchanges opened on time and have continued to run since then.

H.O. Penn supplied other equipment as well. Cleveland noted,

Well over 75% of our type of heavy equipment working on the [World Trade Center] site is Caterpillar. There are mostly excavators, but there are also wheel loaders, track loaders, articulated dump trucks, and several skid steer loaders. We have supplied additional equipment and work tools as well as round the clock manpower and support for the equipment.... Caterpillar and H.O. Penn are seen all over the area. There are also service vehicles and technicians from Foley and another

neighboring dealer, Southworth Milton, to support customers' machines. H.O. Penn and its technicians are blanketing the area. No matter what street you go down there is almost always an H.O. Penn service truck, PM truck, parts truck, or hose van in sight.

Cleveland credited H.O. Penn's heroic response to the spirit instilled into the company by MBV:

I am very proud of the employees of H.O. Penn. All of the efforts that we have made over the last few years to improve our operation with our Managing By Values process really paid off. While the demands and pressures of the situation were enormous, the efforts and teamwork put forth were well beyond what anyone could reasonably expect. The only orders that were frequently disobeyed were the orders to go home and get some rest. People have worked continuously for days on end. Many have lived at the site, sleeping either in their vans, cars or hotels in the area.

H.O. Penn's ability and nimbleness in the face of a disaster were duly noted by public officials, leading to more emergency response work. Cleveland noted,

Since 9-11, we have been involved in a number of disaster responses. We were the emergency-generators vendor for Con-Edison when there was a blackout in Queens in August of 2006. We are the preferred vendor for Garner in the south for hurricane relief efforts. When they call us at 2 o'clock in the morning because they need 200 megawatts of power brought down to Florida, they know that we're going to be able to get that to them.

But in the months after 9-11, the construction industry experienced a deep downturn. The stock market plunge hit the market for new buildings, and contractors stopped buying and servicing equipment. Jeff Mitchell noted:

We had a \$75 million drop in sales, but every dealership showed a downturn. What we are most proud of is the fact that our ratio of profit to sales did not change. We still maintained a high level of profit and had the ability to adjust to different circumstances. With the old H.O. Penn, the response of the dealership to the downturn would have been cataclysmic.

In 2002, the company manifested its commitment to the employees by postponing lay-offs, paying technicians to sweep the floor for six months while there was no service work, absorbing \$1 million in non-revenue time. Mitchell recalled,

We tried to hold on to everyone because we spent a lot of time training and developing them, and they are a resource we don't want to lose. It is hard to develop trust with your employees when they feel that you are only interested in them as long as you can use them. We look at them as an essential part of the organization.

Employees were grateful to H.O. Penn for sticking by them. A union employee recalled,

They gave us a heads up. They said 'we care about you. This is what we're going to do. We're going to wait one more week.' It really boosted morale. Years ago, you were just a number. Now, you're a person that means something to them. They would have mechanics clean the building, sweep floors, or do maintenance before laying them off. We even painted the shop twice.

MBV continued to raise the working standards at H.O. Penn. The satisfaction of all stakeholders rose each year. Employee survey results improved each year (see Exhibit 3). One of the highest scores in

the 2006 survey was “I enjoy working for an organization like ours by comparison with other ones.” The company’s relationship with the union greatly improved. By 2006, union employees rarely filed grievances. According to a union employee,

The majority of members are more than happy since we are now part of a team that is moving forward. We feel as though we now have a voice, so we go to Human Resources before we go to the Union.

According to Mitchell,

They understand that we are always straight with them. If we can’t do something, it’s because we can’t do it. We do not always agree, but continue to get along and show respect for each other.

Since strategies and goals were now defined by the enterprise and filtered down to each branch within each department, workers began to view company practices as “consistent and fair.” Mid-managers felt empowered to make decisions. One manager noted, “Before we felt paralyzed because if we were wrong there would be consequences. Now, if we are wrong, we talk about it.”

Cooperation has supplanted interdepartmental competition. According to Steffanci, “Politics no longer exist within the company. Now, everyone benefits when the corporation benefits.” She reports that the process is never adversarial:

In the past 12 years, we have not come across an issue that we did not find the answer to in one of our value commitments. MBV covers processes, strategy, culture, all of it.

In 2006, more than 94% of customers surveyed were satisfied with the company as a supplier. H.O. Penn significantly improved its ranking among Caterpillar dealers and its relationship with Caterpillar had become extremely close, especially with district representatives, who provided support for marketing, goodwill and warranties. Mitchell observed,

Because of MBV, Caterpillar believes that we have them as a stakeholder. It is therefore much easier to get their support because they trust us to make the right, all-win decisions.

The Future

In the heavy machinery industry, the relationship between manufacturers and their dealers could be delicate even though both had a common interest in maintaining the reputation of the brand. Manufacturers invariably preferred that their dealers sell as many machines as possible even if that meant the dealer had to charge lower prices, since higher volumes translated into lower per unit manufacturing costs due to scale economies. In contrast, dealers were sensitive to the sales margin and preferred to sell at prices that maximized their gross margin even if that meant lower volume. Service and parts were also another potential source of tension since the manufacturer derived no revenue from any service that fails to translate into new parts, whereas service constituted a major revenue source for dealers.

H.O Penn and Caterpillar had always shared a close relationship, which the MBV process had only enhanced. What tensions existed tended to be revealed in the expectations around growth. In 2005, Caterpillar had set a goal of 15 to 20 percent compound annual growth in earnings per share from 2005 to 2010⁸, which meant its dealers would be under considerable pressure. Caterpillar’s sales targets seemed aggressive in light of slowing and even declining home construction in the Northeast.

As Caterpillar set targets for its dealers, the company had to be responsive to local variations in market conditions without being *too* responsive. Caterpillar could not let a dealer justify a lower market share by claiming that the demand in the dealer's particular market was weak or that the competition was especially intense. At the same time, regional variation in new construction was evident across the country. Because of rising oil prices, there was a construction boom in Texas and the Rocky Mountain states, and the dealers in these regions benefited from the boom. However, rising oil prices did not have the same effect in the Northeast.

Given Caterpillar's sales growth expectations from 2005 to 2010, Tom Cleveland (and his son Rob who became president of H.O. Penn in 2006) knew his company faced a significant challenge and had to decide among the various options for continued profitability and growth. One option Cleveland was considering was expanding the sales of small construction equipment. Certainly this was in accord with Caterpillar's hope that dealers would pursue the smaller construction equipment segment with the aim of capturing contractors early so they would develop a relationship with Caterpillar as they grew. However, the smaller machine segment was more transactional. The typical buyer was an individual builder, who might buy only one piece of equipment every 5 or 10 years, although there were abundant opportunities to enhance the profitability of such sales by selling accessories and "add-ons" that enhanced the functionality of these smaller machines. Cleveland knew that it would be harder to cost-effectively provide the same type of service quality to this segment as H.O. Penn delivered to its larger customers. H.O. Penn's value proposition depended on providing not just equipment and parts, but also top-notch service. While some within the company worried that a lower level of service would actually be inconsistent with the company's values, others felt that different types of customers have different expectations of the value of the company's offerings. For example, a small builder with only one or two machines may not require as much consultation about a machine's capacity or require as rapid a turnaround in fixing the equipment.

Another option Cleveland was considering involved expanding the product line by introducing complementary products from non-Caterpillar brands. For example, H.O. Penn could offer a trailer to transport a Caterpillar machine. Caterpillar allowed dealers to add new product lines as long as they did not directly compete with products offered by Caterpillar. Given H.O. Penn's strong reputation for quality support and service, Cleveland thought it was possible to leverage this reputation across different products that would be valuable to their clients on their construction sites. Expansion into complementary product lines and becoming more of a "one-stop shop" might be especially appropriate given a goal of trying to attract the smaller buyers who would be purchasing fewer pieces of Caterpillar equipment. However, part of the reputation for service quality hinged on automated systems that were specific to Caterpillar, and H.O. Penn's management team had to think seriously about whether they could maintain the same service quality without these Caterpillar-specific systems.

In order to sell more machines, H.O. Penn would need to increase the sales force, which could increase the risk of layoffs and pose problems because talent was increasingly difficult to find. The challenge of attracting talent had been gradually percolating over the decades. When Cleveland and Mitchell had been children, construction equipment was regarded as a technologically advanced business, drawing top-notch technicians, engineers, and salespeople. However, in the 21st century, few thought of construction equipment as high technology, and those interested in technology were increasingly likely to gravitate to other industries. In addition, the talent pool was generally limited to men, because few women chose to enter the industry. Cleveland and Mitchell both knew that their success in building a great and enduring company depended to a considerable degree on attracting leadership talent and strong technical staff; although they had been quite successful in doing so, they worried that they were facing an ever-declining pool from which to draw this talent. Cleveland and Mitchell also feared losing existing talent because the relatively high tenure of its labor force limited opportunities for upward movement for newer entrants. It was hoped that growth would create new opportunities for promotion, increasing the retention rate of high-performers.

Another growth option would be to build up a consulting business around MBV. Cleveland felt that he, Mitchell, and the rest of the senior management team had learned a lot about how to build an organization that could provide benefits to the shareholders, the employees, and the customers, and he felt that other businesses could benefit from what they had learned. In fact, after some of the press that H.O. Penn had received for their turnaround due to MBV, businesses had contacted Cleveland to find out more. Although consulting obviously represented a very different type of business, Cleveland wondered if diversification of this type might allow him to attract the type of leadership talent that he needed to carry H.O. Penn forward.

This Yale School of Management case has been made possible in part by the generous support of the Robert J. Silver '50 Fund for Innovation in Management Education at the Yale School of Management.

This case has been developed with the cooperation of the management and employees of H.O. Penn for pedagogical purposes. The case is not intended to furnish primary data, serve as an endorsement of the organization in question, or illustrate either effective or ineffective management techniques or strategies.

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Endnotes

¹ Case Writer, Yale School of Management.

² Dean & William S. Beinecke Professor of Management, Yale School of Management.

³ William S. Beinecke Professor of Management, Yale School of Management.

⁴ Director of Case Study Research, Yale School of Management.

⁵ H.O. Penn paid tribute to the collective contributions of their personnel by publishing a high-quality hardcover book, *9-11-01/Never Forget*, containing photographs, personal remembrances, and press coverage documenting employees' tireless and heroic work in support of the recovery effort. The company refrains from distributing the book to actual or prospective customers or using it in any fashion that would suggest a marketing effort, in order to not undercut the intended message and recognition for employees.

⁶ Cleveland, Tom, "Update & Reflections on the Attack on America," <http://www.Accountability-Central.com>

⁷ Foley Incorporated, based in Piscataway, New Jersey, is a neighboring member of the Caterpillar dealership network.

⁸ "Positive Message From Cat[®] CEO at Annual Meeting," Caterpillar Corporation Press Release, June 12, 2006.

Exhibit 1: H.O. Penn Values Statement

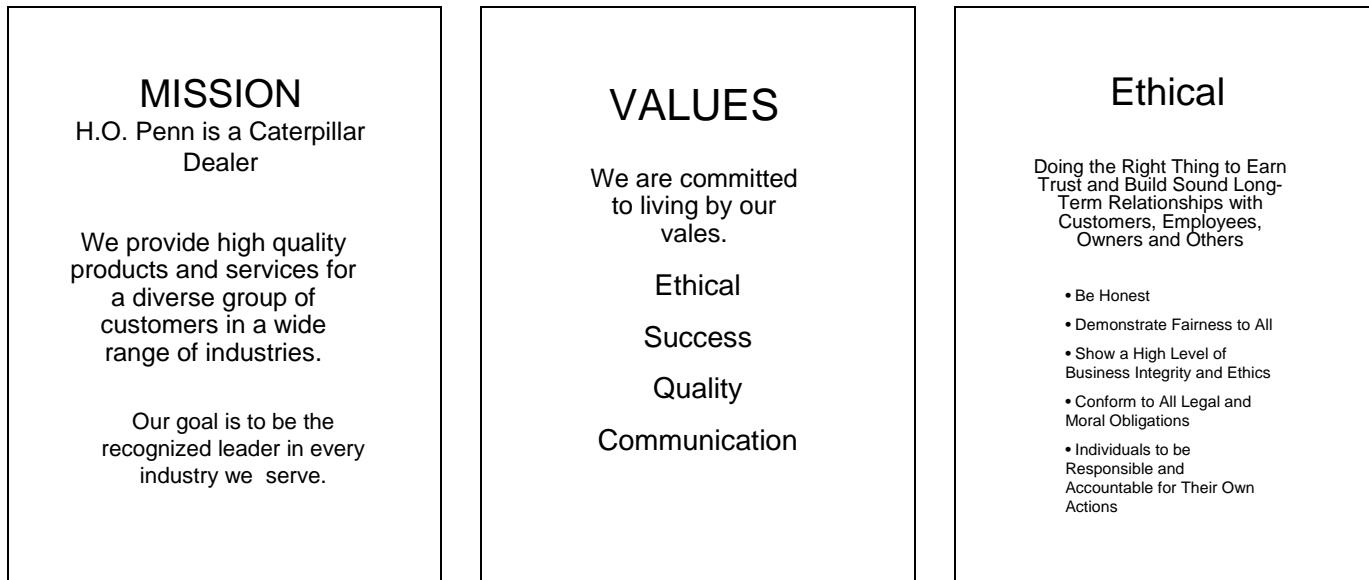


EXHIBIT 1 (CONTINUED)

Success

Strive for Financial Stability and Growth of Customers, Employees, Owners and Others

- Successfully Sell and Deliver Superior Value
- Be Profitable and Cost-Effective
- Generate Cash to Meet Obligations
- Continue to Develop and Invest in People and Financial Assets
- Recognize Employees for Their Contributions to Our Success

Quality

Meet or Exceed Expectations of Customers, Employees, Owners and Others

- Deliver What We Promise in a Timely Manner
- Anticipate and Identify Needs and Provide Solutions to Meet Those Needs
- Continually Improve Performance and Productivity

Communication

Provide a Positive, Productive and Fulfilling Work Environment for Customers, Employees, Owners and Others.

- Understand and Respond to Needs: "Do Unto Others as They Want To Be Done Unto" (The Platinum Rule)
- Encourage Personal Initiative
- Encourage Teamwork
- Openly Listen and Cooperate in Seeking Solutions that Benefit all Parties without Fear of Reprisal
- Clearly Define, Discuss and Focus on Company Goals, Measurements and Follow-up

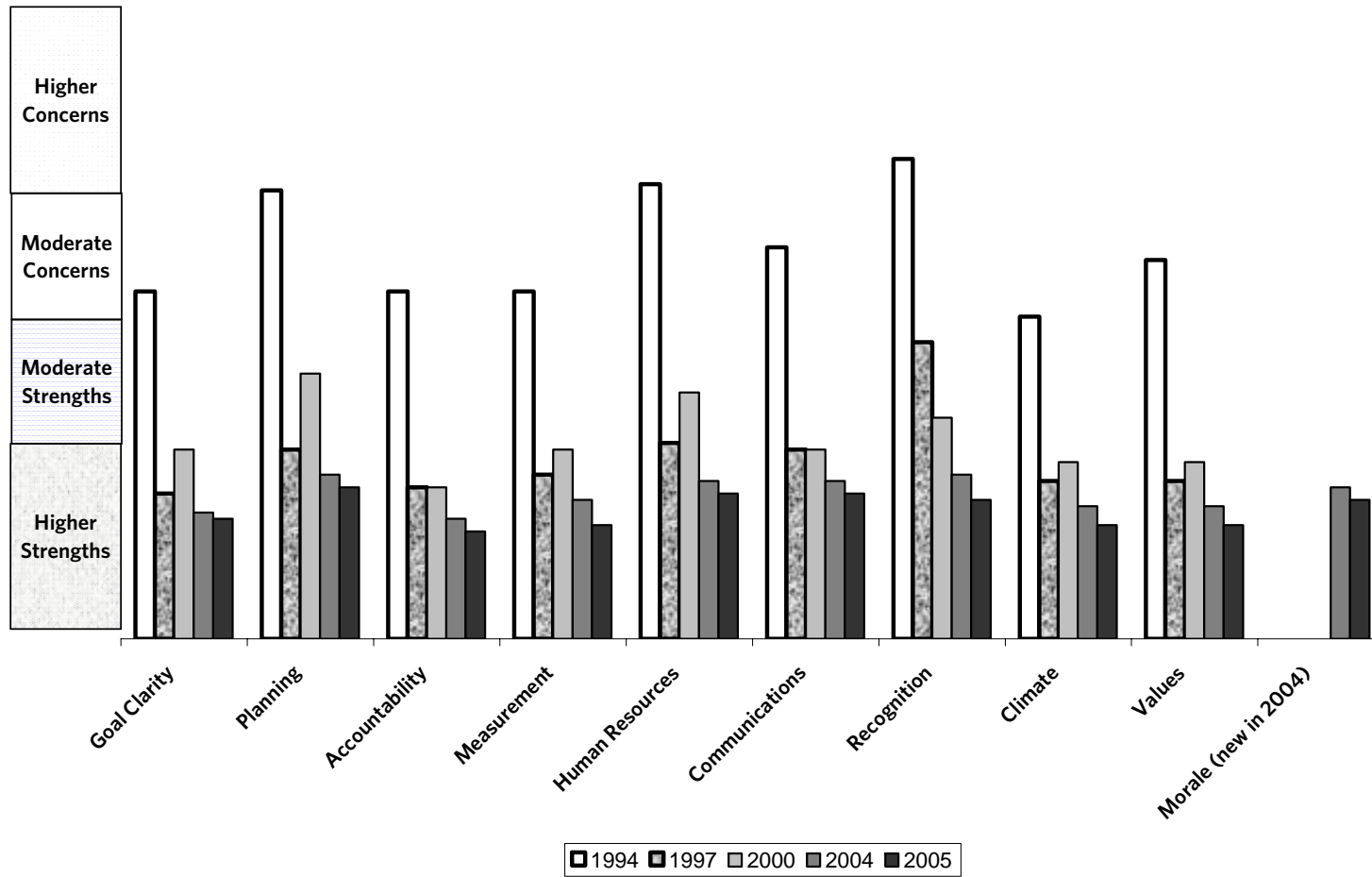
Exhibit 2: Consolidated Statements of Income - H.O. Penn and PennRents

For Years Ended December 31, 1991 - December 31, 2005

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Sales	150,364	152,526	176,581	206,940	209,083	184,393	209,196	205,243	241,216	322,315	360,463	275,761	285,107	340,191	327,527
Cost of Sales	118,393	120,591	144,525	169,257	173,753	147,253	165,979	162,539	190,358	258,377	280,133	206,365	213,895	257,505	243,686
Gross Profit	31,971	31,935	32,056	37,683	35,330	37,140	43,217	42,705	50,858	63,938	80,330	69,396	71,212	82,686	83,842
% of Sales	21.3%	20.9%	18.2%	18.2%	16.9%	20.1%	20.7%	20.8%	21.1%	19.8%	22.3%	25.2%	25.0%	24.3%	25.6%
Expenses	34,061	30,339	29,841	32,304	31,160	31,267	36,582	34,474	40,333	47,584	58,419	61,060	58,213	65,242	70,764
% of Sales	22.7%	19.9%	16.9%	15.6%	14.9%	17.0%	17.5%	16.8%	16.7%	14.8%	16.2%	22.1%	20.4%	19.2%	21.6%
Operating Income	(2,090)	1,590	2,214	5,379	4,171	5,872	6,635	8,231	10,524	16,353	21,912	8,319	12,999	17,444	13,077
% of Sales	-1.4%	1.0%	1.3%	2.6%	2.0%	3.2%	3.2%	4.0%	4.4%	5.1%	6.1%	3.0%	4.6%	5.1%	4.0%

Note: The above table includes disguised data and does not represent H.O. Penn's actual statement of income.

Exhibit 3: Pathfinder Survey Results



YALE SCHOOL OF MANAGEMENT

EXHIBIT 3 (CONTINUED)

2005 Higher Strengths

Top 10 of 64 Higher Strengths reported by all employees – favorable percentage shown

2005 Rank	Item	2005 % All	2004 % All
1 st	I know what actions are expected of me in my job as an employee in our company.	97%	96%
2 nd	I normally understand what I am expected to do when assigned a work task.	95%	96%
3 rd	I know who is responsible for supervising and evaluating my work performance.	94%	93%
4 th	I usually understand what is required of me.	93%	93%
5 th	People in our area consistently try to do the right thing.	90%	86%
6 th	I enjoy working for an organization like ours by comparison with other ones.	90%	88%
7 th	I believe most supervisors and managers in our organization are primarily interested in results.	90%	86%
8 th	My present job responsibilities keep me fully occupied in meaningful contributions to our company's goals.	90%	92%
9 th	My work is personally satisfying to me.	89%	90%
10 th	Employees in my work unit genuinely care about providing good performance.	89%	88%

2005 Higher Concern Items

(Unfavorable Responses reported by 35% or more of all employees)

2005 Rank	Item	2005 % All	2004 % All
1 st	I perceive many people in my work unit who are frustrated.	46%	53%
2 nd	Our work area is congested and difficult to effectively work in.	41%	41%
3 rd	Major variations in my workload are not reduced because of ineffective planning.	40%	45%
4 th	Changes in my area are not typically well planned.	39%	49%
5 th	A backup individual or process does not exist that can satisfactorily perform my job functions in an emergency (such as illness, work overload).	35%	37%