Conrad Specialty Roofing

J. Richard Anderson, (Email: janderson@stonehill.edu), Stonehill College
Jennifer Swanson, Stonehill College

INTRODUCTION

"I know it's hard to believe, Allen, but Max is dying," said Bill Levis, as he paced about the cramped, dingy office of Conrad Specialty Roofing (CSR). "He and I were partners for 15 years and friends for a lot longer than that. Mary and his kids are devastated; hell, he's only 50 years old. I don't know how she's going to get through this – you know what kind of person she is."

Yes, I know what kind of person she is, thought Allen. She's worked in this office for the past four years, if you could describe what she did as work. In addition to successfully building CSR for the past five years, Max had always taken care of Mary and the children, made even the smallest decisions for them. And now he's going to be leaving them on their own…

He's going to be leaving me on my own, too, Allen's thoughts continued. " This certainly explains Max's odd behavior over the last few months" said Allen, shaking his head. "He's pretty much put me in charge of everything lately – sales, supervision, ordering material, paying bills, the works. He hired me last year as a project manager, but he's been around here so little I feel like the owner."

"That's good," replied Bill, "because it looks like you are going to be the owner. When I saw Max yesterday, he told me how proud he was of the way you took up the slack and kept the business going smoothly over the past six months. He told me that he wanted you to own CSR and was going to see his lawyer to put something about it in his will. I agreed with him, possibly for the first time since we split up our partnership five years ago; you have really been a lifesaver for this business – without you, it would have been doomed, just like Max… You are CSR, you know."

"Now all we need to do is arrange something equitable with Mary," continued Bill. "I've known her so long… perhaps I can help."

CONRAD SPECIALTY ROOFING

Conrad Specialty Roofing had recently emerged from a previous partnership between Max Conrad and Bill Levis, who twenty years ago pooled their talents to develop a construction business called Salem Contractors. Salem began by building single-family homes, but eventually concentrated on special-purpose buildings such as churches, college dormitories, and doctor's offices. They also began to win some contracts to rehabilitate historical buildings owned by colleges or governmental units in the greater Boston area, finding quickly that the competition in this market was not as strong and the profit margins significantly higher.

In the process of completing a number of large historical rehabilitation projects, Max began to develop an expertise in the fabrication and installation of copper roofing, an expensive specialty which required a large investment in tooling and equipment and a crew of highly-trained craftsmen. Demand for copper roofing soared in the 1990's as both institutions and wealthy individuals wanted the old-fashioned look it provided, in spite of the cost. With few reliable contractors in the field, Salem began to do a brisk side business in installing these roofs, using materials purchased from one of three existing supply houses in New England.

Max was enthralled by the skill required in this new business segment and the profit potential it presented, but Bill was concerned about the $100,000 of fabrication equipment needed to compete successfully and the limited market for such expensive hand-crafted work, especially during recessionary periods. After much discussion, the partners decided to amicably end their partnership; Bill would continue running Salem and Max would form Conrad Specialty Roofing (CSR) to pursue the opportunity he saw in making new roofs look as if they were 200 years old.

CSR was an immediate success. Max's growing knowledge of the craft, his contacts within the industry, and his ability to attract qualified fabricators and installers soon made him a significant player in this small market. He quickly found that there were only a handful of firms in New England capable of doing this sort of work, and he was thus able to capture 30-40% of the work he bid on while still maintaining healthy profit margins. He also found that even when he lost a bid, he often wound up selling materials to the winning contractor, who rarely had the fabrication equipment that was needed. The business grew so quickly that after three years Max was able to afford to hire Allen Marsh as a full-time project manager to round out his office staff, which had previously only included his wife Mary and a part-time bookkeeper. Max was confident that hiring Allen would allow him to expand the business while simultaneously reducing his own workload somewhat. The first year's income statement for CSR after Allen's hiring appears as Exhibit 1.

ALLEN MARSH

Allen Marsh seemed to be the right sort of person to fill Max's need for a "right-hand man." The son of an Ohio doctor, he had obtained an engineering degree from Case-Western Reserve University in Cleveland, then moved to Massachusetts to follow his college sweetheart. Fifteen years later Allen had lost his college girlfriend, but he had gained extensive experience in most phases of the construction industry- estimating, purchasing, drafting, crew supervision, and overall project management. He had also acquired a wife and a young daughter to support. This concerned him greatly, since at age 37 he had not yet achieved any significant financial independence; he and his family still lived rent-free with her parents as they tried to save enough money to buy their own home. "A guy with my education, experience, and willingness to work hard ought to be doing better than this," he frequently complained to his wife. "I keep bouncing around from company to company; I can't seem to find the right position."

The opportunity at CSR seemed to be the right situation. While the starting pay was somewhat modest, Max had given him the chance to learn the whole business, and had recently begun to teach him a very important skill: how to sell specialized construction services where price was not the overriding concern. This was a tough lesson to learn, but after a year of following Max around on sales calls, Allen was finally starting to get significant new work on his own. Since Max had only two daughters who were not keen on roofing as a lifetime occupation and had often expressed a desire to "live the good life" as he got older, Allen began to picture a future in which control over CSR gradually passed from Max to him over the next 5-10 years, with his compensation rising accordingly. Someday he might even own this thing, he mused. But now Max's illness had changed all that…

SIX MONTHS LATER

"Do you know how long it's been since I've had a day off?" Allen complained to Bill over coffee. "It's been four months since Max died; I worked six days a week while he was sick and seven days a week ever since. And I do it all for $45,000 a year… How did I get into this situation?"

The situation Allen was in was not a pleasant one. Max's death from cancer was mercifully quick; he died within a month of Allen's first conversation with Bill. Now Allen was totally on his own and in charge of everything at CSR. At first he had responded to the crisis, working even longer and harder to be able to assure the Conrad family that the business was in good shape. He hadn't known Max all that long, but he had liked him and felt strongly that keeping CSR running smoothly was the best way to "pay his respects". Mary hadn't returned to work after Max's death, but what little work she previously did was easily covered by extra effort from Allen and the bookkeeper. She had given Max power of attorney to sign contracts and tax returns, but for the most part she remained in hibernation, refusing to speak much to anyone about Max or CSR. Indeed, about the only time Allen saw her was when she came in to pick up the weekly $3,000 paycheck that Max used to take. It seemed unlikely that she would ever return to work at CSR.

Meanwhile, Allen had taken over making the hard decisions usually reserved for the owner. He had to decide by himself how much to bid for a large new job, whether to buy a new piece of fabrication equipment, and whether to fire a talented installer who had taken to coming to work slightly drunk. The employee decisions were the hardest, because they were the heart of the business and he had built up a good rapport with them; but that was before he had total responsibility for them. To his extreme frustration, Mary had rebuffed his repeated attempts to significantly improve his pay; she seemed to want only to maintain the status quo and not be bothered with anything about CSR. To top it all off, last week Max's will had been probated – CSR ownership had been left to his wife, and Allen's name had not been mentioned at all.

STUDENT ASSIGNMENT

- What are Allen's options at this point in time?
- How profitable is CSR? If Allen owned it and was willing to run it without any other office help except the bookkeeper/receptionist, how much profit/salary could he earn at current sales levels?
- Assume Allen would like to own CSR and design a negotiation strategy to purchase the business from Mary, indicating the strengths and weaknesses of your bargaining position. What do you think is a fair price to pay for the business? Where would you get the money?

Conrad Specialty Roofing
Income Statement

Sales		$735,868
Cost of Sales:		
Materials	$150,090	
Labor	177,270	
Overhead	95,468	422,828
Gross Margin		$313,040
Overhead Expenses:		
Officer's Salary	$179,369	
Office Salaries	55,484	
Rent and Utilities	21,374	
Office and Telephone	17,423	
Other Expenses	21,627	295,277
Pre-tax Income		$17,763

Note: Included in other expenses was approximately $17,000 of vehicle leases, travel, entertainment and life insurance expense directly related to the Conrad family.

TEACHING NOTES

Objective Of The Case

The main objective of this case is to allow students to develop a negotiation strategy for the potential leveraged buyout of a business by its current manager. Its major focus is on the strengths and weaknesses of the manager's negotiating position, as well as the options this individual has.

Case Positioning / Uses

This case can be used in any course in Entrepreneurship / Small Business Management which discusses the buying of an existing business, or any Management course which deals with negotiation strategy. It is primarily intended for use at the undergraduate level and does not require any significant industry background, accounting knowledge, or exposure to advanced management topics.

Student Assignment

The student assignment at the end of the case should be sufficient to allow students to prepare for class discussion. With less advanced groups, however, instructors may want to add a few “leading” questions:

- What role can Bill Levis play?
- Where do the trained installers fit into the situation?
- Does delay in forcing the issue help or hurt Allen?
- Does Allen’s previous experience with Mary help or hinder the negotiations?
- What kind of arguments/presentations are likely to be more effective with Mary?

Case Analysis / Discussion

At the current decision-point, Allen has at least five viable options:

- Stay on under the current situation
- Quit and look for work elsewhere
- Quit and try to start a competing business
- Push harder for major changes in his compensation to reflect his new role
- Attempt to buy the business from Mary

Given Allen’s present unhappiness and the imbalance between the work he’s doing and the rewards he’s getting, retaining the status quo does not seem to be a reasonable long-term option for him. He feels some sympathy for Mary’s position but has no great liking or respect for her, and thus feels aggrieved when he compares his own $45,000 paycheck to her $150-180,000 annual compensation, especially when she is unlikely to contribute anything substantial to CSR. This inequity wasn’t a problem when Max ran the business because Allen could appreciate the obvious value of Max’s contributions, and Max was helping him by giving him an education in the specialty roofing business.

Quitting to work elsewhere or starting a competing business are viable alternatives, but the first requires him to abandon an industry in which he has developed expertise and contacts, while the second requires significant capital (see below). Allen views CSR as an excellent business opportunity with growth potential that he would hate to abandon. Also to a great extent Allen feels that his leaving CSR would probably kill it, since the business depends greatly on the constant attention of a well-trained, devoted manager, and it does not have the financial resources needed to support it while a new manager is hired and trained. As someone who has spent his work life building things, Allen hates the thought of being responsible for destroying a strong business that represents Max Conrad’s legacy.

Fighting for increased compensation to remain as CSR’s manager is a reasonable alternative which, although it has failed so far, could well be successful later when Mary is thinking more coherently or Allen’s persuasiveness improves. However, Mary’s total lack of involvement with CSR would appear to be a continual problem for Allen, both operationally and psychologically. Even if he gets a substantial raise, he will continue to do all the work while Mary receives $125-150,000 of annual compensation for doing nothing except to interfere with his operation whenever she wants. Buying the business from Mary seems to be the most desirable alternative, since it:

- satisfies his desire to be a continuing part of CSR.
- satisfies his desire to "call the shots without interference", as he phrases it.
- gives him eventual rewards commensurate with his efforts and accomplishments.
- gives her fair compensation for her ownership rights.
- saves her from worrying about the future of CSR.

CSR Profitability

For advanced groups, the profitability of CSR is obvious, but for beginning students who tend to focus only on the "bottom line", a quick exercise in recasting profit under Allen's ownership is worthwhile. A worksheet such as Exhibit 2 could be developed in class or handed out by the instructor for discussion. As the Exhibit shows, Allen would have the potential to earn about $250,000 in annual salary and/or profit from CSR without making any improvements in the business. Thus he has great motivation to make a deal with Mary, if at all possible. If he owned the business and was content to make $200,000 per year, he could even hire an assistant to reduce his workload, much as Max had done.

Negotiation Strategy

The Parameters

While students can readily see that Allen's buying the business from Mary is the "right" solution to the case from Allen's point of view, a much harder problem is to figure out HOW to get her to sell it to him. Before designing negotiation strategies students should be encouraged to draw a list of critical parameters that will come into play. Our list includes:

- Allen's knowledge of CSR and contacts in the business
- Mary's vulnerable situation, lack of knowledge about roofing and lack of motivation
- Allen and Mary's experience with each other and existing feelings about each other
- Allen's lack of capital to fund a new venture
- CSR's strong current position, which allows it to earn at least $150-175,000 per year above what Allen earns as a paid manager
- The unusual current situation, in which Allen's ability and hard work allow Mary to collect a large unearned paycheck
- Bill's potential role as a mediator in the negotiations

Types Of Negotiation

If Allen attempts to buy the business from Mary, the process could be both difficult and time consuming. The instructor can begin this work with a general discussion of the two main negotiation strategies, distributive and integrative.

Distributive negotiations are "win-lose" situations in which each party is trying to claim portions of the same pie, and one party must lose in order for the other to win. Relationships are often sacrificed as the parties focus only on their own self-interests. Distributive negotiations can take two forms: competitive or accommodative.

Competitive (hard) negotiation takes place when each party holds out to get its own way. This approach is highly antagonistic, with each party seeking dominance over the other while trying to maximize its own self-interests. Allen is likely to be drawn to competitive negotiation tactics for a number of reasons: he is an inherently competitive person who sees business as a series of win-lose confrontations, he has spent years in hard negotiations for jobs in which the result each time was a "win" or a "loss", and he sees Mary as more of an impediment or an adversary than as a de facto partner. He is likely to see his expertise in the industry and knowledge of CSR as providing him with a negotiating advantage over Mary, who lacks experience, motivation, and the desire to "win" a buy-sell negotiation. Given his lack of respect for Mary and his patronizing attitude, he is likely to regard this as an easy negotiation to win.

At this point, instructors can ask their classes what is likely to happen if Allen aggressively pursues a competitive negotiation strategy. Given that Mary has a stubborn resolve forced upon her by widowhood and a strong impression that Allen is merely a hired manager of limited ability who is both arrogant and chauvinistic, it is likely that a hard negotiation will quickly alienate her to the point where she may withdraw and refuse to make any decision. If Mary does not negotiate, a "lose-lose" situation results. Allen will have to find another job or start his own competing firm, which is very costly (See Exhibit 3), and Mary will have to quickly find an experienced new manager or risk losing the entire business. Although many widows do find the inner courage to take over a deceased husband's business, in this case Mary's personality traits and the demands of this industry make it very unlikely that she could manage it successfully herself.

Stakeholder's loyalties also come into play here. Construction firms like CSR succeed mainly because they have built up good working relationships with employees, suppliers, and general contractors. In this case the ties were very strong, but they were strictly ties between Max Conrad and these constituencies, without any involvement on Mary's part. As Max faded from the business, these loyalties were slowly transferred to Allen, who earned them partly by his knowledge, hard work, fairness, and reliability, and partly because each group saw him as Max's approved successor. Because of his apprenticeship, at this point Allen would be viewed as a reliable person to work for, sell goods to, or sign a contract with; Mary would have no such credibility with these groups. This "goodwill" factor is unquestionably the most valuable asset of the business; while the goodwill is legally owned by Mary, it is in fact controlled almost exclusively by Allen. Without him the business has physical assets but very little remaining goodwill. Thus if the negotiations are unsuccessful, both parties lose- Allen loses his chance to own a lucrative business, and Mary retains ownership of a business whose earnings power and market value are drastically reduced.

In accommodative (soft) negotiation one or both parties give up something in order to reach agreement. Typically, one party is willing to make extraordinary concessions to get the process over with. Entering the negotiations, Allen very likely envisions that Mary's personality and situation may lead her to make significant concessions – to sell him the business quickly, cheaply, and on favorable payment terms. However, he may have underestimated her emotional attachment to CSR as a memory of Max, in spite of her seeming lack of interest in it.

Integrative negotiation is less confrontational, as it tries to develop a "win-win" orientation in which both parties achieve their objectives. Both sides engage in cooperative problem-solving and the identification of solutions that are mutually satisfying.

Integrative negotiations have three dimensions: attitudinal, informational, and behavioral. The attitudinal dimension includes the ability to trust the other party, the willingness to share information, and the ability to ask reasonable, concrete questions. The informational dimension requires each party to know what is really important to themselves and what is important to their negotiating partners. Each party needs to develop minimum acceptable solutions (reservation points) and their own best alternative to a negotiated solution (BATNA). From here, bargaining zones can emerge with hopefully an overlap between Mary's and Allen's reservation points.

Behavioral foundations involve the ability to separate people from the problem, not letting emotional considerations affect the negotiations, focusing on interests rather than positions, avoiding premature judgments, and using objective standards to evaluate possible agreements.

Given the situation at CSR, integrative negotiation is very desirable. Mary's relatively comfortable financial situation (she received the proceeds of a $500,000 insurance policy at Max's death) allows her to be reasonably accommodating on price and terms of sale, while Allen's perceived opportunity to step into the ownership of a highly-profitable small company should make him very willing to satisfy any of Mary's non-cash concerns. The problem may well be in getting Mary to identify what her key concerns really are – she may want to sell but yet may be uncomfortable in selling to Allen and may not be able to pinpoint exactly what her problems are with the sale. With the distant, somewhat uncomfortable relationship that currently exists, it will be quite difficult for Allen and Mary to have an open, sharing form of negotiation. For Allen, a hard, competitive negotiation format is second nature, while for Mary it is almost unthinkable. For Mary, trust, openness, and sharing of feelings is critical, while for Allen they indicate weakness.

Max's unfulfilled dying wish that Allen should own the business can be a troublesome factor for students. Legally this promise is meaningless since it did not become part of Max's will, but it still may have value in the negotiation process if used wisely. Obviously Max did not intend to GIVE Allen ownership of CSR as a gift, but it does seem clear that he wanted Allen to carry the business into the future as more than just a paid manager. Had he lived longer and been able to wrap up his affairs, Max may well have negotiated a buyout plan himself that gave ownership to Allen in exchange for a fair purchase price paid to Mary over time. (And indeed, Max and Allen could probably have carried on a spirited but fair competitive negotiation over price and terms.)

The fact that a deal was never finalized and that Max didn't clearly indicate his desires to Mary has created the main problem that this case addresses.

Bill Levis may hold the key to developing a sound negotiating strategy for Allen. Bill can be pictured in a number of roles:

- As a protector of Mary's financial interests
- As an interpreter of what Max would have wanted
- As an advisor to Allen in how to approach and satisfy Mary's needs
- As an intermediary in the actual negotiations

Given Mary's distracted mental state and her often difficult relationship with Allen, Bill's intervention may be critical for a successful negotiation. For Mary, he represents a long-time friend who is knowledgeable enough to advise her about CSR and objective enough to fairly balance her interests with Allen's. Without help from a trusted source, she may be unable to carry on a negotiation or possibly even to recognize the necessity for a change in ownership. Bill is willing to help, and it is incumbent on Allen to use him to help Mary come to a decision to sell.

Implementing A Strategy

Our recommendation to Allen is that he begin by getting Bill to have a quiet talk with Mary about the reasonableness of selling CSR and about Max's expressed wish that she do so. In order for negotiations to proceed, she has to at least accept the idea that a transfer of ownership is in the best interests of both parties, and Bill is in the best position to convince her of this.

If Mary is willing to discuss such a proposition, Allen's next step is to get her formal permission to have an outside CPA evaluate its worth. Ideally, Mary and Allen could jointly choose a CPA and subsequently accept his/her opinion as a fair, objective valuation for CSR.

If this is not possible, the outside CPA can be paid by Allen and considered as his advisor in formulating a serious offer to buy the business. During this time frame Allen must be very careful in dealing with employees, suppliers, and customers; if he later chooses to start a competing firm, he does not want to be accused of soliciting the help of these groups while still employed at CSR.

The first face-to-face negotiation with Mary should be very simple and should include Bill. Allen's main goal here is to make a formal statement that after independent review he is interested in buying and that payment will have to be spread over time (essentially payment will have to come from the cash flows of the business). Since Mary does not have a pressing immediate need for cash, Allen can assume that she is primarily interested in an income stream over time and in non-cash considerations. If possible, during this meeting Allen should try to make his "buy or leave" position known, but in a non-threatening way. The goal at this point is not to place Mary in the position of having to choose between two undesirable alternatives (being forced to sell to Allen or replace him), but rather to gradually allow her to become acclimated to the idea that something must happen – the status quo is not a long term option. Allen's goal is to get Mary to say "I will sell you the business if we can work out the price, terms, and conditions," even though such an acceptance may require some time. Allen must temper his natural desire to hurry the negotiation along to an agreement; while it is a business opportunity to him, it is an emotional decision for her to relinquish a very tangible memory of Max.

When Mary has come to accept the idea of selling, Allen may then propose a price, which should be expressed in total dollars, even though these dollars will have to be paid out in installments over time. If Allen proposes to pay $360,000 spread over four years, for Mary this places a significant value on the business that Max built. If instead Allen phrases his offer as $7,500 per month for four years, she will naturally compare this periodic payment to the $3,000 weekly paycheck she currently draws and decide that it isn't enough, even though it may be a fair price for the business. Allen's goal is to draw Mary away from these comparisons, which are misleading because it was Max's efforts that made the weekly paychecks possible, while it will be Allen's efforts that will provide the periodic buyout payments.

Allen's initial offer should be reasonable, but it should allow him room to make one significant upward adjustment. It is quite likely that Bill will be the one to judge the reasonableness of the price, which gives Allen two goals: to make the initial offer high enough that Bill will not feel Mary is being cheated, and to allow enough room to eventually increase the price by 15-20% so that Bill will feel he has gotten Mary a better deal through his mediation efforts. Throughout the negotiations, Allen should treat Bill and Mary as a team and try to avoid negotiating with her directly, since their styles are so opposed. Mary is much more likely to be led to a decision to sell by a trusted advisor like Bill than talked into selling by Allen. Allen should also try to avoid excessive haggling over price and terms because Mary may interpret this to be a mistreatment of her husband's legacy and abandon the negotiations. The cash flows of the business allow Allen some flexibility in setting purchase price, but Mary's emotional state does NOT allow him the pleasure of the type of hard negotiation that he's used to.

To make the deal work, Allen needs to find a number of "giveaway" items to make Mary feel that she is receiving more than just money from the deal and to allow her to keep an association with the business for as long as she needs. Examples of these fringe payments include:

- Keeping Conrad Specialty Roofing as the name for 4-5 years.
- Retaining company-paid benefits (car, health insurance) over the life of the buyout.
- Providing summer employment to the Conrad children while in school.
- Allowing Mary office privileges (copier, fax machine, office space, car phone) for the next few years.

These benefits may only add 10% to the cost of the buyout, but they may be very important in allowing Mary to gradually "let go" of the business, instead of forcing her to immediately become merely an old owner collecting a monthly check. Throughout the negotiations, Allen should try to probe Mary's mind and feelings to find what she really wants (if indeed she even knows), and then try to fulfill these needs. As strange as it sounds, it may even be appropriate to involve Allen's wife in the negotiations in order to (1) get a woman's intuitive viewpoint on what is really important to Mary, and (2) give Mary someone more empathetic than Allen to talk with. For Allen, this represents a tremendous business opportunity rather than a negotiation that he has to win, and he should use his wife and Bill as tools in getting Mary to agree.

Exhibit 2
Conrad Specialty Roofing
Profit Reformulation Under Allen Marsh Ownership

	Per Exhibit 1	Adjustments	Under Marsh
Sales	$735,868		$735,868
Cost of Sales	(422,828)		(422,828)
Gross Profit	$313,040		$313,040
Overhead Expenses:			
Officer Salary	$179,369	$(179,369)	-0-
Office Salaries	55,484	(45,000)	10,484
Rent & Utiltiies	21,374		21,374
Office Expenses	17,423		17,423
Other Expenses	21,627	(17,000)	4,627
Pre-tax Profit	$17,763		$259,132

Exhibit 3
Allen Marsh
Estimated Capital Needed To Start A Copper Roofing Business

Start-up Costs:		
Fabrication Equipment (used)		$50,000
Vehicles (2 –used)		20,000
Opening Materials Inventory		10,000
Office Equipment/ Legal & Accounting Start-up		5,000
Deposits/ Prepayments		5,000
Working Capital:		
Payroll (See Below)		30-35,000
Materials (See Below)		20-25,000
Total Capital Needed		$140-150,000
Possible Financing Sources :		
Equipment Notes	$25,000	
Vehicle Notes	10,000	
Trade Credit –Materials	15,000	50,000
Owner Capital Needed		$90-100,000

Note: If Allen started a competing business with one three-person crew it would take approximately 50-70 days from the time they started their first contract until any cash was received, since billings on such contracts are usually done monthly and paid a month later. Thus Allen would have to fund approximately 60 days of labor and materials costs until customer payments begin to arrive.

NOTES