# Lincoln Electric's Harsh Lessons from International Expansion

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## Executive Summary

LESS THAN HALF AN HOUR after Donald Hastings became chairman and CEO of the Lincoln Electric Company in July 1992, he got the shocking news: losses from the company's European operations were so steep that Lincoln was at risk of defaulting on its loans and being unable to pay its employees their year-end bonus. Since the bonus was the foundation of the company's unusually successful manufacturing operations, Hastings knew that failure to pay it could lead to the company's unraveling.

How had Lincoln gotten into this predicament? By a program of rapid foreign expansion. Lincoln was primarily a U.S. company until the mid-1980s, but recession at home and competition from abroad led executives to dream that the company could become a global power.

Between 1986 and 1991, Lincoln took on unprecedented debt in order to finance foreign acquisitions, mostly in Europe. A number of factors doomed the venture: recession in Europe, unfamiliarity with Europe's labor culture, lack of international expertise at the top. But the root cause, Hastings admits, was overconfidence on the part of Lincoln's leaders in the company's manufacturing abilities and systems.

Hastings, now chairman emeritus, recounts how the company suffered through the early 1990s and then returned to prosperity. It wrote off most of its European operations, ramped up domestic production and sales, and hired top managers and board members with international experience. As a result of strenuous efforts at all levels of the company, it managed to keep paying the bonus and to largely regain the trust of its people.

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AT 5:01 P.M. ON THE LAST FRIDAY OF JULY 1992, I took over as chairman and CEO of the Lincoln Electric Company. I had worked at Lincoln for 38 years and had reached the pinnacle of my career. But my exhilaration lasted exactly 24 minutes.

At 5:25 P.M., while I was engaged in small talk in the hallway, Ellis Smolik, our chief financial officer, walked up and said, "I've got some grim news. The numbers just came in from the European operations, and they're bad. Very bad. They lost almost $7.5 million in June, and that means we'll have to report a second quarter loss. We'll violate our covenants with the banks and default on our loans."

Driving home an hour and a half later, I agonized over what I had just learned. The profits from our main operations in the United States wouldn't be enough to offset our losses abroad. And while Europe was our biggest problem, we also were losing money in Latin America and Japan. We would have to report a consolidated loss of $12 million for the quarter. In the 97-year history of the company, we had never experienced a consolidated loss. I could imagine the headline in the local newspaper: "New CEO at Lincoln Electric Fumbles in First 24 Minutes on the Job." It was a horrible night for me. I got very little sleep. In fact, it would be almost two years before I would have a good night's rest.

During the next week, I confirmed the magnitude of the crisis through conversations with our managers in Europe and our international people at home. When I asked them whether they might be able to turn around their businesses quickly, they were pessimistic—the third quarter in Europe is traditionally the weakest due to shutdowns for vacations and holidays. They expected even poorer results. In addition, there was no indication that our problems in Latin America and Japan were going to diminish. Our financial situation was clearly going to get a lot worse.

My thoughts raced ahead to December, when we were scheduled to pay out the annual incentive bonus to our U.S. workforce. Despite a soft economy, our operations in the United States had done well. Our 3,000 U.S. workers would expect to receive, as a group, more than $50 million. If we were in default, we might not be able to pay them. But if we didn't pay the bonus, the whole company might unravel.

To understand why the bonus is so important, you have to understand a few things about the company. Lincoln Electric was founded by John C. Lincoln in 1895, and manufacturing has been its heart and soul. For decades, the company has been one of the leading manufacturers of arc-welding products in the world. At the end of World War II, more than 50 manufacturers of arc-welding products competed in the United States; today only six major manufacturers remain. The vast majority, including such corporate giants as General Electric and Westinghouse, withdrew from the business primarily because Lincoln sold high-value, high-quality products at competitive prices and with outstanding customer service.

The company also makes industrial electric motors, but arc-welding products are the mainstay business. In 1992, they accounted for more than 87% of our $853 million in total sales. Lincoln then had a leading 40% of the domestic market for electrodes and welding wires, the consumables that constitute the heart of the business, and it was neck and neck with Miller Electric Manufacturing of Appleton, Wisconsin, for the lead in machines.

Lincoln's incentive system, which combines a bonus with piecework—the practice of paying each factory worker on the basis of how many units he or she produces instead of hourly wages or salaries—is an integral part of the company's culture. The system has long distinguished Lincoln from other U.S. companies and has been the subject of a popular case study at Harvard Business School. Historically, bonuses have constituted more than 50% of our U.S. employees' annual incomes. And the system has allowed those people to rank among the highest paid factory workers in the world. Hundreds of them have earned $70,000 to $80,000 in a year, and several handfuls have made more than $100,000.

The incentive system was created in 1934, and bonuses had been paid every year since then. To someone like me who was raised at Lincoln—I joined the



company as a sales trainee in 1953, shortly after graduating from Harvard Business School—not paying the bonus was unimaginable.

## The Rush to Globalize

How had we gotten into this predicament? By a program of rapid foreign expansion. Although Lincoln had had manufacturing and marketing operations in Canada, Australia, and France for more than 40 years, all three were independent of one another and were treated like colonies. Lincoln was primarily a U.S. company, and its two main plants were—and still are—in the Cleveland area. It was our more recent, much bigger ventures overseas that got us into trouble.

Since the deep U.S. recession of the early 1980s, we had been talking about expanding abroad so that we wouldn't be so dependent on the domestic market. But William Irrgang, who headed Lincoln from 1965 until 1986, adamantly opposed the idea. Then in 1986, Bill Irrgang died and was succeeded by George E. "Ted" Willis, and I was named president of North American operations.

Ted dreamed of Lincoln's becoming a global power. He immediately purchased Harris Calorific, a manufacturer of oxyfuel cutting equipment that had plants in Italy and the United Kingdom. At that time, we also got a sharp wake-up call from the market when ESAB, a major manufacturer of arc-welding products based in Sweden, suddenly bought two midsize manufacturers in the United States. ESAB, which was already operating in the Far East and Latin America, obviously had global ambitions. We feared further incursions on the U.S. market by

ESAB, which would be able to use its non-U.S. profits to buy market share. But we could not buy domestic competitors ourselves because of antitrust laws. So we decided to take the battle to ESAB's markets in Europe and Latin America. Our response would have to be quick—and substantial.

During the next five years of the Willis regime, we spent almost $325 million on expansion, a huge sum for a company of our size. We built three greenfield plants in Japan, Venezuela, and Brazil and purchased operations with eight plants in Germany, Norway, the United Kingdom, the Netherlands, Spain, and Mexico. Many of those acquisitions were made at the peak of their market cycles and cost top dollar. For example, we bought an operation in Barcelona just after the 1988 Olympics, when the Spanish economy was booming and the construction market was incredibly strong. In less than a year, the Spanish economy fell into a deep recession.

Ted made the acquisition decisions, took charge of the negotiations, and required all the new foreign operations, with the exception of those in Canada and Mexico, to report directly to him. Of our board's 15 directors, 12 were insiders—current and former Lincoln executives and members of the founding family. None of us had any significant international experience. No one on the board, including me, ever seriously challenged Ted. We believed that because we were so successful in the United States, we could be successful anywhere.

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In fact, when we examined the manufacturing operations of the foreign companies on our acquisition list, we saw tremendous opportunities to reduce costs by applying our manufacturing expertise, equipment, and incentive system. We also knew that we could not afford to export consumables, namely certain electrodes and wire, from the United States. That was and still is a cutthroat commodity business; had we exported those items, the shipping costs and duties would have prohibited us from being price competitive.

But we also made several mistaken assumptions. For example, without truly exploring the idea, we assumed that the incentive system would be accepted abroad. We found, however, that the European culture of labor was hostile to the piecework and bonus system.

In addition, we concluded that we could not export arc-welding machines to many European countries, especially Germany, the major market in Europe. Our distributors, along with our French and Norwegian managers, told us repeatedly they could not sell products designed and manufactured in the United States to Europeans because of their bias toward their own goods. The managers insisted that it was impossible to establish a foothold in Germany unless we bought an established local player. Unfortunately, we listened well, accepted their assertions, and then acted on them—without testing them.

In April 1991 we concluded our largest acquisition: certain assets of Germany's Messer Griesheim, including a plant that manufactured arc-welding machines, at a cost of more than $70 million. At the time, we were counting on the German economy to remain strong. We did not foresee the consequences of German reunification. The government's huge outlays to rebuild eastern Germany led the inflation-wary Bundesbank to raise interest rates, one of several events that triggered the deepest recession in Europe since World War II.

After the Messer acquisition, Ted assigned John Gonzalez, vice president of engineering, the job of managing the European factories. John had no international experience and was not expected to focus on sales or marketing. Indeed, some of the European managing directors continued to report directly to Ted. It is doubtful that John ever really wanted the assignment; he never relocated to Europe. In early 1992 he gave up the responsibility and returned to Cleveland to head our R&D efforts.

In hindsight, I realize that John's appointment reflected a broader problem: our corporate management lacked sufficient international expertise and had little experience running a complex, dispersed organization. Our managers didn't know how to run foreign operations; nor did they understand foreign cultures. Consequently, we had to rely on people in our foreign companies—people we didn't know and who didn't know us.

Ted turned next to Rolf Jonassen, the head and former co-owner of Norweld—a Norwegian company with factories in Norway, the United Kingdom, and the Netherlands—which we had acquired before our purchase of Messer Griesheim. Rolf was named to lead the management company that we set up to run Lincoln's European operations. With his experience running a multinational, he seemed like a solid choice. He reported directly to Ted.

My own involvement in the international arena was minimal at this point. As president, the only foreign operations that reported to me were the ones in Canada and Mexico. And before becoming president, my responsibility as vice president of sales for 15 years was limited to the United States.

As a director and as president, I did see the budgets and financial reports submitted by our foreign opera-



tions. By 1991 none of them, with the exception of those in Canada and Australia, were performing well. (Profits had often been elusive at our French operation, which should have stood as a warning about global expansion.) The operation in Brazil had been a sinkhole from the beginning, and the operations in Germany, Japan, Mexico, and Venezuela had never made money. The rest were marginally profitable when we bought them, although none had world-class factories. Our manufacturing expertise and systems could easily bring them up to that standard, we thought.

## Warning Signs

For more than a year before becoming CEO, however, I witnessed a troubling pattern. The individual European businesses would submit extremely optimistic sales and profits targets in their budgets. But they invariably missed the targets—often by quite a bit—and the gaps were getting bigger and bigger. Even more worrisome, nobody seemed to have a handle on why the targets were being missed or what to do about the gaps. When asked, the businesses' managers would say, "We were too optimistic. The recession is worse than we thought. We'll downsize the budget." There was absolutely no fire in their bellies to correct the problem of declining sales.

In April 1991 the board informed me that the top job would be mine at the end of July 1992. My unease about Europe was deepening, but Ted did not seem unduly worried. He did, however, have me take two short trips to Europe in late 1991 and early 1992. I was aghast at the managers' lack of concern about the need to boost revenues. They seemed perfectly content to just ride out the recession.

Understandably, given Lincoln's history, Ted looked at the situation primarily from a manufacturing standpoint. He was a brilliant engineer and manufacturing executive. All four of my predecessors as Lincoln's chairman had engineering and manufacturing backgrounds, and all four were of the firm belief that if you had the lowest-cost, highest-quality manufacturing operation, you would automatically dominate the market.

With my background in sales and marketing, I knew that quality, low-cost manufacturing would not be enough. Having a stellar manufacturing operation and a good product is a wonderful advantage. But if you don't have proper distribution, competitive delivery times, relationships in the marketplace, and people who can understand and help customers, you won't succeed.

Ted operated very much on his own. Part of the reason for that was his personality, but part of it was the company's heritage. Ted's predecessors had handled an enormous amount by themselves. Everything of importance went directly to the CEO.

Our second chairman, James F. Lincoln, the founder's brother and the company's leader from 1929 until 1965, once wrote that no company should ever grow larger than one man could administer or manage. We exceeded that size even before we began the foreign expansion, but it took the crisis to make us realize that we had reached the limits of the management approaches and skills that had served us so well when we were a smaller, simpler company.

When it became clear that Ted was primarily focused on improving the worldwide manufacturing operations by increasing efficiency and reducing costs, I decided to take my concerns to the board's nominating committee. I asked that the succession be accelerated and that I be



given responsibility for Europe—I would use my sales and marketing background to increase revenues. "We should make a change," I said. But out of deference to Ted, the committee said, "No, you've got to wait until next year."

With the onset of the recession in 1992, the European operations began to deteriorate rapidly. The numbers reported in May and June were not good—the profits were marginal—and then came the awful news in July. The magnitude of the second quarter loss caught everyone by surprise. Even I, who'd been openly worried, never imagined that the losses would be big enough to throw the entire company into the red.

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Although Ted knew that the foreign operations were in trouble, he continued to be outwardly optimistic. He was confident that Lincoln's manufacturing prowess would enable us to make a success of the foreign operations.

Ted had tried to help the sales forces in Europe in October 1991: he sent Jim Clauson, our New England regional manager, overseas to teach them sales and marketing techniques that were successful in the United States. But Jim was rebuffed by his European counterparts. It would take CEO status—on-site—to catch their attention.

## Should We Pay the Bonus? Could We?

Lincoln had always been ultraconservative financially. Before making the acquisitions, we had a cash reserve of more than $70 million and no debt. By 1990 we had used up that surplus and taken on a small amount of debt. In 1992 our debt soared to nearly $250 million, or 63% of equity.

Our directors—myself included—had known that Lincoln would have to borrow to finance the acquisitions. What we had not fully considered, however, was that the very fact of borrowing would be a major cultural shock to our employees. Most people at Lincoln saw the taking on of *any* debt as reckless, a view that had its roots in our incentive system. Ever since the bonus was introduced, management had explained to employees that it was a cash-sharing rather than a profit-sharing bonus. First we had to use the company's profits to take care of our shareholders with dividends and to invest in Lincoln's future. Only after those needs were met could we pay the bonus. If there was no cash left, there would be no bonus.

As soon as it became apparent that we were going to have to borrow to finance the foreign expansion, employees became concerned. They could see it affecting their incomes. And, as our level of debt increased, they grew deeply worried—and they let senior managers know it.

Lincoln has long preached and practiced open communication. Any employee who feels the need to speak to the CEO can see him. And many do. The same holds true for other Lincoln executives; all have open doors. In this instance, employees—individually and through our 29-member employee advisory board—made their fears known. "How can there be a cash bonus if we don't have any cash that's ours?" people repeatedly asked our executives.

After taking over as CEO, I was faced with a terrible predicament. We could pay the bonus by taking the company deeper into debt. Or we could announce that there



would be no bonus and lose our people's trust—hence sacrificing the company's long-term competitive edge.

Except for the workers at the newly acquired Harris Calorific, all our U.S. employees were eligible for a bonus. Rank-and-file factory workers were graded twice during the year on four types of performance: the quality of their work, the quantity of their work, their dependability, and their cooperation. The first two ratings motivated workers to do their individual best. If the grading stopped there, we probably would have had chaos; everyone would have been out for himself. The last two ratings encouraged people to work together and contribute ideas that would help everyone.

Because of the bonus and piecework pay, employees at our Cleveland-area factories and in our sales, distribution, and customer service centers throughout the United States act like entrepreneurs. The bonus is payment for outstanding performance. Lincoln employees do perform—and not just in terms of high productivity and quality. Absentee and turnover rates historically are very low. In 1992 absentee rates were between 1.5% and 2%, and the turnover rate, including retirement but excluding new employees (people employed for 90 days or less), was 3.5%. When we have severe snowstorms, most of Cleveland shuts down, but Lincoln people make it in.

Because our system draws out the best in people, they don't require much supervision. The foreman-to-worker ratio at Lincoln's main U.S. plants is 1 to 100. In a typical factory in the United States, the ratio is 1 to 25; in some auto assembly plants, it is 1 to 10. The savings from having relatively few supervisors helps the company pay the bonus. It was clear to me at the time that if we dropped the bonus, we would have to hire more employees because our productivity would go down. In other words we couldn't try to save money by cutting out the bonus.

In the second week of August 1992, we got a break. Harry Carlson, the company's vice chairman, met with two major Cleveland banks: National City Bank and Key Bank. They wanted to help. They immediately agreed to relax the covenants, provided that we seek a higher line of credit with a larger group of banks. They even promised to help us negotiate a new line of credit. One worry had been alleviated: we would be able to pay the bonus.

## Still Bleeding in Europe

That same week I left for Europe. I had no choice, even though I lacked extensive international experience. None of the other senior managers had any either. The CFO, Ellis Smolik, who joined me on the trip, didn't even have a passport; we had to scramble to get him one at the last minute.

During the next 11 months, I would go to Europe twice a month on average, staying from seven to ten days at a time. My first priority that August was to meet with all the European managing directors and their sales managers. I assigned them the job of developing plans, complete with detailed sales strategies, for turning around their businesses. The plans were to cover the fourth quarter of 1992 and all of 1993. The goal was to create profitable operations in 1993. The managing directors—along with our other foreign directors—were asked to submit their plans by early October.

In October we brought in Orin Schaeffer, the former CFO of Goodyear, as a consultant. Schaeffer, who had international financial experience, worked with J.P.



Morgan to put together a ten-bank consortium that included National City Bank and Key Bank. True to their word, both banks stepped up to the plate by strongly supporting us in front of the other banks.

At the end of that month, we reported our third quarter results. Our quarterly consolidated loss had increased to $9.2 million. But the business plans for the foreign operations had arrived on schedule. We were able to show the ten banks that we had a strategy for dealing with the crisis, and we began negotiations with them in November. We were seeking a credit line of $230 million to replace our existing line of $75 million—and we got it.

On December 4, 1992, we paid a $52.1 million bonus to our U.S. workforce. The board also approved a shareholder dividend to keep our continuous record intact. It was all borrowed money. In January, we learned that our fourth quarter consolidated loss was $19.8 million. That amount included a $7.4 million operating loss abroad and a $23.9 million restructuring charge. To put the foreign operations in a stronger position to stage a rebound, we had decided to write off unneeded and obsolete machinery and questionable inventories. Although the foreign operations had not broken into the black by year's end, we were still hopeful that the turnaround plans would work. Our loss for the whole year was $45.8 million.

In the meantime, Rolf Jonassen had resigned. He had become very wealthy when we purchased Norweld, and as the problems mounted in Europe, he apparently had had enough. In early 1993 I named Keith Cowan, the head of our Welding Technology Center, to be president of our European operations. Keith had both sales experience and the engineering skills needed to revive the manufacturing operations.

In March we signed the credit agreement with the ten banks. We thought we were over the hump. The European directors had assured us that the worst was behind them, and they seemed to be following their business plans.

But the business plans had not—and could not have—foreseen the deepening of the European recession. The plans were obliterated, and the European results for the first quarter of 1993 were again bad: an operating loss of $14.4 million. Once again, the European managers had been overly optimistic, and I had been overly trusting.

In the spring of 1993, I finally chanced to learn why the European operations had chronically missed their sales and profit targets. The operating budget of the management company in Norway was funded by the individual businesses in each country, and the size of its budget was based on the forecasted, rather than the actual, sales and profits of those businesses. To inflate the management company's own operating budget, its leaders had encouraged the businesses to submit optimistic—rather than realistic—forecasts. I was shocked.

In mid-May we received the numbers for April. They were devastating: Europe lost $8.2 million and the foreign operations as a whole lost $9.6 million. We seemed certain to violate the covenants in our new credit package. Once again, I had to draw on every strength in order to remain outwardly positive to our employees and board members.

## A Plan to Revive the Patient

The way I saw it, we had two choices: we could resort to massive layoffs and cut executive salaries to save money,



or we could make extraordinary efforts to increase revenues and profits. I never seriously considered the first option. I believed that downsizing violated everything Lincoln stood for. Our longtime covenant with our workers guaranteed them at least 30 hours of work per week. Downsizing could only result in deterioration of morale, trust, and productivity. It's bad long-term business. If employees are just numbers, maybe it's easy to downsize. But when I walked into our cafeteria or onto the factory floor, I knew most of our people personally. I knew their families. I regarded Lincoln's employees as resources, not liabilities.

***Rather than downsize, we turned to our U.S. employees for help.***

I also didn't buy the argument that the only obligation that responsible corporations have to their employees is to guarantee employability, not employment. We invest an enormous amount in our people and run dozens of training programs. People are trained to stay, not to be ready for dismissal.

So rather than downsize, we turned to our U.S. employees for help. I presented a 21-point plan to the board that called for our U.S. factories to boost production dramatically and for our sales force to sell our way out of the crisis. The plan called for the U.S. operation to generate a pretax, prebonus profit of $52 million, instead of the $39 million in the original budget. I also offered to move to Europe to try to minimize the hemorrhaging, once implementation of the plan was under way. The board enthusiastically endorsed the plan and my offer.

In June I went to our U.S. employees and said, "We could do what other companies have done and downsize, but we're not going to. We're going to make the U.S. company profitable enough to offset the losses abroad, remain within our bank covenants, and borrow the money again to pay the annual bonus in December. We're going to do it by increasing the top line, not by cutting back and hurting our people."

Our executives explained the company's situation and the action plan in small meetings with frontline employees. We explained the plan to our employee advisory board and circulated the minutes of the session throughout our plants. We made a video and gave people copies to take home to watch with their families. In the video, I was blunt. Management and the severe recession were to blame for the disastrous foreign expansion. "We blew it," I said. "Now we need you to bail the company out. If we violate the covenants, banks won't lend us money. And if they don't lend us money, there will be no bonus in December." That statement appealed not only to their loyalty but also to what James F. Lincoln called their "intelligent selfishness."

We then brought in our 35 district sales managers. We told them we expected them to come up with ideas and promotions that would sell the products we were gearing up to make. We also instituted a financial education program so that employees would understand that no money was being hidden from them and would see exactly how much money the U.S. operation needed to generate in order for us to be able to pay the bonus.

The all-out communication effort was critical because we needed everyone's total commitment. Rumors had created anxiety and fear on the factory floor. We needed to give people an accurate picture of the company's problems and let them know that we had a plan to fight back.



The plan called for our U.S. operation to increase sales from $1.8 million per day to $2.1 million. That was a tall order, given the still-soft U.S. economy. Some in the rank and file said, "This is foolish. We're going to gear up and by September, we'll all be on 30 hours a week." But I had faith in our sales force and knew they could sell everything we could produce. The bigger challenge would be to boost production. We were operating at 75% to 80% of capacity. The plan implied a utilization rate of more than 100%.

We got moving immediately. The factory managers were asked to eliminate every bottleneck they could possibly find. The main bottleneck, they responded, was a shortage of people. So we started hiring new employees right away.

The new people, however, needed to be trained. It can take two to three years for someone to learn how to run some of our equipment properly. It became apparent that with holidays and the traditional two-week shutdown in August, we would not have enough capacity to meet the sales targets.

That's when we started asking the veterans in the bottleneck areas to work the holidays and postpone their vacations. They came through. About 450 people in the bottleneck areas gave up 614 weeks of vacation, and some people worked seven days straight for months on end.

The employee advisory board worked closely with me and the other executives. We'd had an advisory board since 1914. It had long been a trusted means of communicating between employees and management. We used the board to apprise the workforce of our progress and maintain the momentum.

I also turned to a handful of veteran rank-and-file workers who I knew would be completely straightforward with me. I asked them to let me know when there was a potential problem—bad attitudes, bottlenecks, parts shortages. They knew how close we were to violating the covenants and that we could not afford to wait for such information to filter up through the hierarchy. We didn't have the luxury of time.

## Transatlantic Culture Shock

In early June 1993 I moved to England along with my wife, Shirley, and my executive assistant, Marylee Baller. We set up a European "headquarters" in a flat in Sunningdale, an easy drive to Heathrow Airport. The U.S. operation was left in the able hands of Fred Mackenbach, a Lincoln veteran who had succeeded me as president. I didn't cut myself off totally. I received a great many faxes and phone calls each day from Fred and other managers in the United States. Fred largely ran the North American operations, while I focused on Europe and Harry Carlson, our vice chairman, dealt with the other foreign businesses.

Keith Cowan left the company shortly after I arrived in England. I had hoped to work with him, but he seemed to think my move to Europe showed a lack of confidence in him. In fact, I felt that the job was simply too much for one executive to handle alone. The crisis required someone with a stronger background in sales, and I was reluctant to transfer other executives; we needed them at home. (As a result of a virtual hiring freeze in the 1960s and 1970s, our senior ranks were now much too thin for a company of our size and complexity.) With the company on the brink of disaster and losses escalating daily, I also felt that the CEO had to be on the scene in order to



make radical decisions quickly. Finally, I worried that the "barons" in the European operations would not listen to anybody but the CEO. At any rate, I was sorry to see Keith go.

As soon as I arrived in Europe, I began holding group meetings with every major sales force that handled Lincoln's products. In those meetings, every salesperson described his territory and customers and said precisely what he intended to do to get new business. It was the first time any of them had ever been required to commit themselves to a plan in front of other people.

During those months, as I met with the sales forces and managers and visited the factories, my hopes for turning around our businesses without a radical restructuring faded. Every factory was operating at 50% or less of capacity. The severity of the recession was horrifying. When I pushed managers to develop a plan for increasing their market share, they told me, "The only way you increase market share is to buy another company. You never take an account from a competitor because they will retaliate and take one from you."

***What I saw in the German plant really alarmed me. People were not working!***

What I saw in the Messer plant really alarmed me. People were not working! On one visit that had been announced in advance, three "workers" were found sleeping on the job. After seeing things like that, I went to the board and said, "We have got to get out of there. We've got to close the plant no matter what the cost. It's going to sink us." We had never gotten around to trying to install the Lincoln incentive system in the plant. How naive we had been to believe that we could have.

The incentive system is transferable to some countries—especially in countries settled by immigrants, where hard work and upward mobility are ingrained parts of the culture. But in many other places, it won't easily take root. It is especially difficult to install it in a factory that has different work practices and traditions. For example, even though German factory workers are highly skilled and, in general, solid workers, they do not work nearly as hard or as long as the people in our Cleveland factory. In Germany, the average factory workweek is 35 hours. In contrast, the average workweek in Lincoln's U.S. plants is between 43 and 58 hours, and the company can ask people to work longer hours on short notice—a flexibility that is essential for the system to work. The lack of such flexibility was one reason why our approach would not work in Europe.

Happily, in September 1993 another accepted way of doing things was overturned at a trade show in Essen, Germany. Traditionally, exhibitors had used the eight-day show as a venue for entertaining customers and conducting public relations, not for making sales. There were no laws or rules against selling, but tradition prevented it. My attitude at this point was tradition be damned! To spend a couple of million dollars on a trade show and not use it to land desperately needed sales seemed absurd. I saw the show as a sales opportunity, and during our crisis we could not afford to pass up any opportunity.

We flew over three planeloads of our products from the United States and set an objective of selling 1,200 packages of semiautomatic welding equipment. We sold 1,762. By testing the conventional wisdom, we discovered that excellent American-made products *would* sell in Germany. If that was true in Germany, it undoubtedly



would be true elsewhere. We could close down some of our foreign machine-manufacturing operations and still compete in foreign markets.

## Changes at the Top

During my first nine months as CEO, the sheer severity and complexity of the crisis in Europe drove home the fact that the days when Lincoln could be run by one man were long gone. The company needed a bona fide management team. We needed more international expertise both in management and on the board. And we needed an independent board that would vigorously challenge the CEO. Even after my baptism by fire, I realized that I lacked in-depth international experience. I felt overwhelmed and needed help.

I had good reason to worry that if we ultimately had to take radical action overseas, our board might lack the knowledge and the stomach to do it. When the possibility of closing some of our operations was raised, several directors said, "We just bought them. Why should we close them down this soon? We should fix them, not throw them out." In my opinion, we needed new directors who did not have baggage from earlier decisions—people who would challenge long-standing assumptions and provoke or exasperate other board members, if necessary. I went to the board's nominating committee. They agreed that we needed new blood and expertise on the board and in top management.

At the May 1993 shareholders' meeting, we elected three outside directors to replace three insiders who were vice presidents of the company. The new directors were Ed Hood, retired vice chairman and executive officer of General Electric; Paul Lego, former chairman of

Westinghouse; and Larry Selhorst, CEO of American Spring Wire. A year later we brought on Henry Meyer III, president and chief operating officer of KeyCorp. All four were executives with strong international and financial experience.

We also brought in new talent at the top, even though it violated our long-standing policy of promoting from within. In 1993 Ellis Smolik retired and we recruited Jay Elliott from Goodyear as our new CFO. We were also fortunate that in 1995, Fred Stueber—an outstanding attorney at Jones, Day, Reavis & Pogue—agreed to sign on as vice president, general counsel, and secretary. It took almost a full year to find an experienced human resource executive who would fit in with Lincoln's culture, but Ray Vogt of FMC came aboard in 1996. Tony Massaro, a former Westinghouse executive with extensive international experience who had been a member of Paul Lego's team, signed on as a consultant in 1993 to help me in Europe. He did an outstanding job and consequently was named president of our European operations in January 1994. (Tony is currently chairman and CEO of all operations at Lincoln.) All four men greatly enhanced the thin management ranks.

In the fall of 1993, with the European arc-welding industry mired in excess capacity, we drew up a radical restructuring plan. We scaled down operations in the United Kingdom, Spain, France, Norway, and the Netherlands. We closed the entire Messer organization and shut down manufacturing operations in Brazil, Venezuela, and Japan. (Even though we had built the plant in Japan—going so far as to have the property blessed in a Shinto ceremony—virtually no one would buy our products, mainly because we had "insulted" the



Japanese by not having a Japanese partner.) Our restructuring charge for the year was $70.1 million.

## Turning It Around

Fortunately, there was plenty of good news from the United States. Under the dynamic leadership of John Stropki, who was then our general sales manager, we not only achieved the $2.1-million-a-day sales target, we even surpassed it. (John is currently president of North American operations.) By the end of 1993, daily sales had climbed to $3.1 million, and they would stay at that level throughout 1994 and beyond. We didn't miss a beat in production. Our workers are still proud of this accomplishment, and they should be.

Of course, many others played a big part. Our engineers came out with new products, such as a line for the light commercial and home market segments that we sold through Home Depot and Wal-Mart. And we offered special promotions to our longtime distributors that proved highly successful.

Lincoln also benefited from public interest in the company's incentive system and its 40-year record of no layoffs. Dick Sabo, director of public relations, parlayed this interest into a series of television specials, including a favorable *60 Minutes* segment. Such recognition introduced Lincoln's products to the general public and helped raise the top line.

We also had some luck. Just as we were beginning to boost our production, the market started to revive—although nobody in the industry felt it yet. As a result, the upturn caught our competitors by surprise; they were still cutting back. We were already cranked up and in a position to take market share, even with the price increases that we felt were necessary. Raising prices at the time was a calculated risk, but our highly trained sales-force made the new prices stick. By October 1993 it was clear that Lincoln would be okay.

Thanks to the Herculean effort in the factories and in the field, we were able to increase revenues and profits enough in the United States to avoid violating our loan covenants. The remarkable performance of the company's U.S. workers put us in a solid position to ask the banks for new covenants in November. They approved them only two days before we were scheduled to pay the bonus. On December 4, 1993, we paid a gross bonus of $55.3 million with borrowed money. Including the restructuring charge, we lost $38.1 million that year.

In the first half of 1994, we negotiated and carried out the plant closings. By mid-1994, the European and other foreign operations were in the black. Our new export strategy—which included selling American-made machines worldwide and rethinking which of our plants around the world could best serve a given market—was a smashing success. Moreover, in countries where we had closed operations, market share actually increased.

We also began rebuilding our balance sheet in 1994. I went to our U.S. workers in July and carefully explained that we were going to begin investing in the future again. The priorities were reducing our debt and increasing capital expenditures, which had been slashed during the crisis. Accordingly, we would have to reduce the individual bonuses paid that year. With prosperity returning, our people were understanding of the need to reduce the debt. In December we again paid a collective bonus of over $55 million: we didn't cut the total amount, but because of all the new hires, it was spread among more workers.



We had had a better year all the way through. Our goals for the year were for our consolidated operations to achieve the highest sales, earnings per share, and return on investment in the history of our company—and we met them. We expanded our customer base and introduced new high-tech products. After the bonus payout, we earned $48.0 million for the year, a one-year turnaround of almost $86 million. At the end of 1994, my wife, my assistant, and I moved back to Ohio. The crisis was over.

## Harsh Lessons Learned

The root cause of the crisis was that Lincoln's leaders, including myself, had grown overconfident in the company's abilities and systems. We had long boasted that our unique culture and incentive system—along with the dedicated, skilled workforce that the company had built over the decades—were the main source of Lincoln's competitive advantage. We had assumed that the incentive system and culture could be transferred abroad and that the workforce could be quickly replicated. We had scoffed at all the faddists in the business world who were jumping on the empowerment bandwagon, smugly noting that teamwork and open communication had long been a way of life at Lincoln. Yet we had ignored the loud and widespread expressions of concern from employees who saw our foreign expansion as a highly risky adventure. We had been naive to think that we could instantly become a global company with Lincoln's limited management resources. Although we went through a couple of nightmare years, we did finally learn from our mistakes.

Competing globally requires a lot more time, money, and management resources than we realized. At least five years before we launched our expansion program in 1987, we should have started building a management team and a board of directors from whom we could have learned how to proceed. We also should have allocated at least twice the money that we budgeted and assumed that we would suffer some setbacks. Instead, we jumped headfirst into a hornet's nest, confident that our manufacturing technology and incentive system would pull us through.

The company is now much more careful about foreign acquisitions. It will build a new plant but only with a partner in a joint venture. Recently, it has purchased a wire company in Canada, entered a joint venture in Turkey, and formed alliances in the emerging markets of Indonesia, Malaysia, and China.

The only new place where Lincoln has successfully transplanted the incentive system is in Mexico City. That may sound surprising because the plant, which we bought in 1990, was unionized, and piecework runs against the Mexican culture. But we introduced the system gradually. The plant had about 175 workers, and we began by asking two of them to take a chance on piecework. We also put a net under them—that is, we guaranteed them a minimum income. After they started making more money than their counterparts, people started asking if they could go onto the system, too. It took about two years, but the entire operation eventually adopted piecework. If it is done slowly and properly, the system can be introduced into some existing organizations or cultures where it might not seem to fit.

Since 1994 the company has continued to prosper; each year has brought increased market share along with record sales and earnings. The balance sheet is strong again. In 1995 revenues topped $1 billion, we had a suc-



cessful public offering, and the debt-to-equity ratio dropped from its one-time high of 63% to less than 12%. Lincoln's shareholders saw the company's value almost double from 1994 through 1998. The company continues to generate cash and recently announced a stock buyback program to further strengthen the balance sheet and improve shareholder value.

Lincoln now has an internationally experienced board of directors and management team and is a lot wiser thanks to the harsh lessons of the past. Having largely regained the trust of its people, the company can continue to move into the tumultuous realm of globalization, with a clear-eyed view of both the pitfalls and the opportunities.

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