CASE 2

The Wallace Group

Laurence J. Stybel

FRANCES RAMPAR, PRESIDENT OF RAMPAR ASSOCIATES, DRUMMED HER FINGERS ON THE desk. Scattered before her were her notes. She had to put the pieces together in order to make an effective sales presentation to Harold Wallace.

Hal Wallace was the President of The Wallace Group. He had asked Rampar to conduct a series of interviews with some key Wallace Group employees, in preparation for a possible consulting assignment for Rampar Associates.

During the past three days, Rampar had been talking with some of these key people and had received background material about the company. The problem was not in finding the problem. The problem was that there were too many problems!

Background on The Wallace Group

The Wallace Group, Inc., is a diversified company dealing in the manufacture and development of technical products and systems (see **Exhibit 1**). The company currently consists of three operational groups and a corporate staff. The three groups include Electronics, Plastics, and Chemicals, each operating under the direction of a Group Vice President (see **Exhibits 2, 3,** and **4**). The company generates $70 million in sales as a manufacturer of plastics, chemical products, and electronic components and systems. Principal sales are to large contractors in governmental and automotive markets. With respect to sales volume, Plastics and Chemicals are approximately equal in size, and both of them together equal the size of the Electronics Group.

Electronics offers competence in the areas of microelectronics, electromagnetic sensors, antennas, microwaves, and minicomputers. Presently, these skills are devoted primarily to the engineering and manufacture of countermeasure equipment for aircraft. This includes radar detection systems that allow an aircraft crew to know that they are being tracked by radar units on the ground, on ships, or on other aircraft. Further, the company manufactures displays that provide the crew with a visual "fix" on where they are relative to the radar units that are tracking them.

EXHIBIT 1
An Excerpt from the Annual Report

To the Shareholders:

This past year was one of definite accomplishment for The Wallace Group, although with some admitted soft spots. This is a period of consolidation, of strengthening our internal capacity for future growth and development. Presently, we are in the process of creating a strong management team to meet the challenges we will set for the future.

Despite our failure to achieve some objectives, we turned a profit of $3,521,000 before taxes, which was a growth over the previous year's earnings. And we have declared a dividend for the fifth consecutive year, albeit one that is less than the year before. However, the retention of earnings is imperative if we are to lay a firm foundation for future accomplishment.

Currently, The Wallace Group has achieved a level of stability. We have a firm foothold in our current markets, and we could elect to simply enact strong internal controls and maximize our profits. However, this would not be a growth strategy. Instead, we have chosen to adopt a more aggressive posture for the future, to reach out into new markets wherever possible and to institute the controls necessary to move forward in a planned and orderly fashion.

The Electronics Group performed well this past year and is engaged in two major programs under Defense Department contracts. These are developmental programs that provide us with the opportunity for ongoing sales upon testing of the final product. Both involve the creation of tactical display systems for aircraft being built by Lombard Aircraft for the Navy and the Air Force. Future potential sales from these efforts could amount to approximately $56 million over the next five years. Additionally, we are developing technical refinements to older, already installed systems under Army Department contracts.

In the future, we will continue to offer our technological competence in such tactical display systems and anticipate additional breakthroughs and success in meeting the demands of this market. However, we also believe that we have unique contributions to make to other markets, and to that end we are making the investments necessary to expand our opportunities.

Plastics also turned in a solid performance this past year and has continued to be a major supplier to Chrysler, Martin Tool, Foster Electric, and, of course, to our Electronics Group. The market for this group continues to expand, and we believe that additional investments in this group will allow us to seize a larger share of the future.

Chemicals' performance, admittedly, has not been as satisfactory as anticipated during the past year. However, we have been able to realize a small amount of profit from this operation and to halt what was a potentially dangerous decline in profits. We believe that this situation is only temporary and that infusions of capital for developing new technology, plus the streamlining of operations, has stabilized the situation. The next step will be to begin more aggressive marketing to capitalize on the group's basic strengths.

Overall, the outlook seems to be one of modest but profitable growth. The near term will be one of creating the technology and controls necessary for developing our market offerings and growing in a planned and purposeful manner. Our improvement efforts in the various company groups can be expected to take hold over the years with positive effect on results.

We wish to express our appreciation to all those who participated in our efforts this past year.

Harold Wallace
Chairman and President

In addition to manufacturing tested and proven systems developed in the past, The Wallace Group is currently involved in two major and two minor programs, all involving display systems. The Navy-A Program calls for the development of a display system for a tactical fighter plane; Air Force-B is another such system for an observation plane. Ongoing production orders are anticipated following flight testing. The other two minor programs, Army-LG and OBT-37, involve the incorporation of new technology into existing aircraft systems.

EXHIBIT 2
Organizational Chart: The Wallace Group (Electronics)

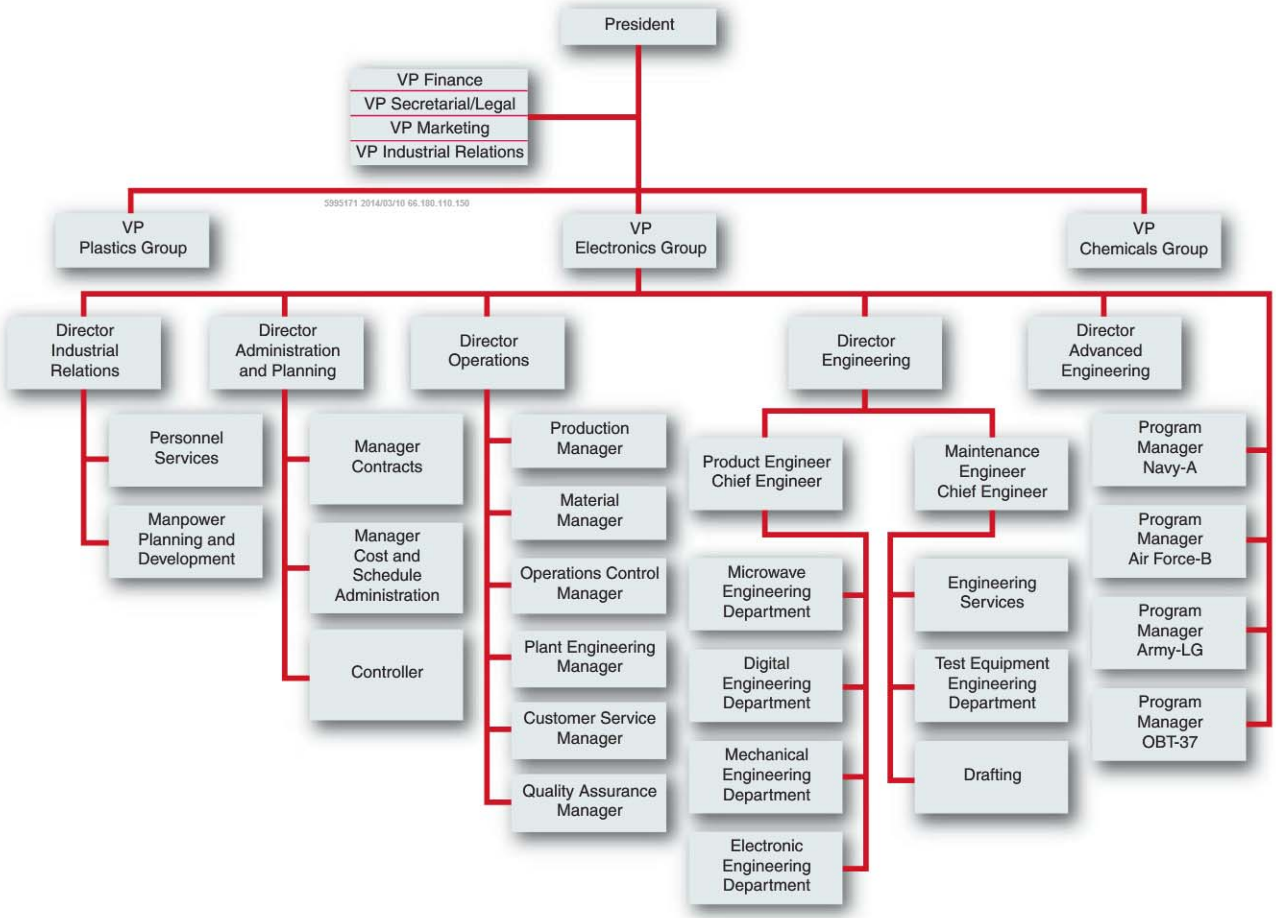


EXHIBIT 3
The Wallace Group (Chemicals)

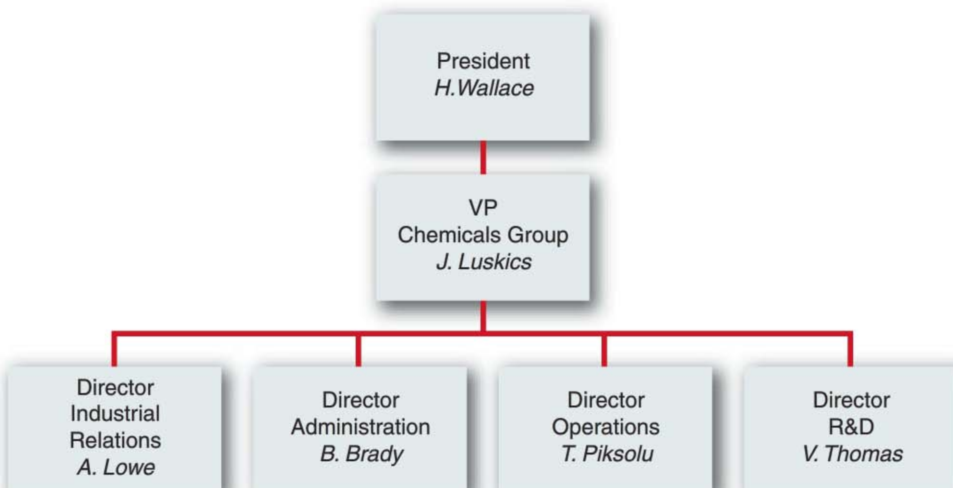
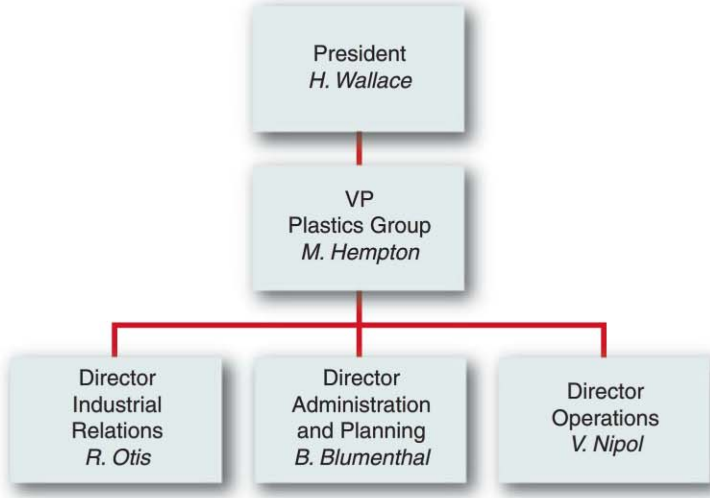


EXHIBIT 4
The Wallace Group (Plastics)



The Plastics Group manufactures plastic components utilized by the electronics, automotive, and other industries requiring plastic products. These include switches, knobs, keys, insulation materials, and so on, used in the manufacture of electronic equipment and other small made-to-order components installed in automobiles, planes, and other products.

The Chemicals Group produces chemicals used in the development of plastics. It supplies bulk chemicals to the Plastics Group and other companies. These chemicals are then injected into molds or extruded to form a variety of finished products.

History of The Wallace Group

Each of the three groups began as a sole proprietorship under the direct operating control of an owner/manager. Several years ago, Harold Wallace, owner of the original electronics company, determined to undertake a program of diversification. Initially, he attempted to expand his market through product development and line extensions entirely within the electronics industry. However, because of initial problems, he drew back and sought other opportunities. Wallace's primary concern was his almost total dependence on defense-related contracts. He had felt for some time that he should take some strong action to gain a foothold in the private markets. The first major opportunity that seemed to satisfy his various requirements was the acquisition of a former supplier, a plastics company whose primary market was not defense-related. The company's owner desired to sell his operation and retire. At the time, Wallace's debt structure was such that he could not manage the acquisition and so he had to attract equity capital. He was able to gather a relatively small group of investors and form a closed corporation. The group established a Board of Directors with Wallace as Chairman and President of the new corporate entity.

With respect to operations, little changed. Wallace continued direct operational control over the Electronics Group. As holder of 60% of the stock, he maintained effective control over policy and operations. However, because of his personal interests, the Plastics Group, now under the direction of a newly hired Vice President, Martin Hempton, was left mainly to its own devices except for yearly progress reviews by the President. All Wallace asked at the time was that the Plastics Group continue its profitable operation, which it did.

Several years ago, Wallace and the board decided to diversify further because two-thirds of their business was still defense dependent. They learned that one of the major suppliers of the Plastics Group, a chemical company, was on the verge of bankruptcy. The company's owner, Jerome Luskics, agreed to sell. However, this acquisition required a public stock offering, with most of the funds going to pay off debts incurred by the three groups, especially the Chemicals Group. The net result was that Wallace now holds 45% of The Wallace Group and Jerome Luskics 5%, with the remainder distributed among the public.

Organization and Personnel

Presently, Harold Wallace serves as Chairman and President of The Wallace Group. The Electronics Group had been run by LeRoy Tuscher, who just resigned as Vice President. Hempton continued as Vice President of Plastics, and Luskics served as Vice President of the Chemicals Group.

Reflecting the requirements of a corporate perspective and approach, a corporate staff has grown up, consisting of Vice Presidents for Finance, Secretarial/Legal, Marketing, and Industrial Relations. This staff has assumed many functions formerly associated with the group offices.

Because these positions are recent additions, many of the job accountabilities are still being defined. Problems have arisen over the responsibilities and relationships between corporate and group positions. President Wallace has settled most of the disputes himself because of the inability of the various parties to resolve differences among themselves.

Current Trends

Presently, there is a mood of lethargy and drift within The Wallace Group. Most managers feel that each of the three groups functions as an independent company. And, with respect to group performance, not much change or progress has been made in recent years. Electronics and Plastics are still stable and profitable, but both lack growth in markets and profits. The infusion of capital breathed new life and hope into the Chemicals operation but did not solve most of the old problems and failings that had caused its initial decline. For all these reasons, Wallace decided that strong action was necessary. His greatest disappointment was with the Electronics Group, in which he had placed high hopes for future development. Thus he acted by requesting and getting the Electronics Group Vice President's resignation. Hired from a computer company to replace LeRoy Tuscher, Jason Matthews joined The Wallace Group a week ago.

As of last week, Wallace's annual net sales were $70 million. By group they were:

Electronics	$35,000,000
Plastics	$20,000,000
Chemicals	$15,000,000

On a consolidated basis, the financial highlights of the past two years are as follows:

	Last Year	Two Years Ago
Net sales	$70,434,000	$69,950,000
Income (pre-tax)	3,521,000	3,497,500
Income (after-tax)	2,760,500	1,748,750
Working capital	16,200,000	16,088,500
Shareholders' equity	39,000,000	38,647,000
Total assets	59,869,000	59,457,000
Long-term debt	4,350,000	3,500,000
Per Share of Common Stock		
Net income	$.37	$.36
Cash dividends paid	.15	.25

Of the net income, approximately 70% came from Electronics, 25% from Plastics, and 5% from Chemicals.

The Problem Confronting Frances Rampar

As Rampar finished reviewing her notes (see **Exhibits 5–11**), she kept reflecting on what Hal Wallace had told her:

> Don't give me a laundry list of problems, Fran. Anyone can do that. I want a set of priorities I should focus on during the next year. I want a clear action plan from you. And I want to know how much this plan is going to cost me!

Fran Rampar again drummed her fingers on the desk.

EXHIBIT 5
Selected Portions of a Transcribed Interview with H. Wallace

Rampar: What is your greatest problem right now?

Wallace: That's why I called you in! Engineers are a high-strung, temperamental lot. Always complaining. It's hard to take them seriously.

Last month we had an annual stockholder's meeting. We have an Employee Stock Option Plan, and many of our long-term employees attended the meeting. One of my managers—and I won't mention any names—introduced a resolution calling for the resignation of the President—me!

The vote was defeated. But, of course, I own 45% of the stock!

Now I realize that there could be no serious attempt to get rid of me. Those who voted for the resolution were making a dramatic effort to show me how upset they are with the way things are going.

I could fire those employees who voted against me. I was surprised by how many did. Some of my key people were in that group. Perhaps I ought to stop and listen to what they are saying.

Businesswise, I think we're O.K. Not great, but O.K. Last year we turned in a profit of $3.5 million before taxes, which was a growth over previous years' earnings. We declared a dividend for the fifth consecutive year.

We're currently working on the creation of a tactical display system for aircraft being built by Lombard Aircraft for the Navy and the Air Force. If Lombard gets the contract to produce the prototype, future sales could amount to $56 million over the next five years.

Why are they complaining?

Rampar: You must have thoughts on the matter.

Wallace: I think the issue revolves around how we manage people. It's a personnel problem. You were highly recommended as someone with expertise in high-technology human resource management.

I have some ideas on what is the problem. But I'd like you to do an independent investigation and give me your findings. Give me a plan of action.

Don't give me a laundry list of problems, Fran. Anyone can do that. I want a set of priorities I should focus on during the next year. I want a clear action plan from you. And I want to know how much this plan is going to cost me!

Other than that, I'll leave you alone and let you talk to anyone in the company you want.

EXHIBIT 6
Selected Portions of a Transcribed Interview with Frank Campbell, Vice President of Industrial Relations

Rampar: What is your greatest problem right now?

Campbell: Trying to contain my enthusiasm over the fact that Wallace brought you in!

Morale is really poor here. Hal runs this place like a one man operation, when it's grown too big for that. It took a palace revolt to finally get him to see the depths of the resentment. Whether he'll do anything about it, that's another matter.

Rampar: What would you like to see changed?

Campbell: Other than a new President?

Rampar: Uh-huh.

Campbell: We badly need a management development program for our group. Because of our growth, we have been forced to promote technical people to management positions who have had no prior managerial experience. Mr. Tuscher agreed on the need for a program, but Hal Wallace vetoed the idea because developing such a program would be too expensive. I think it is too expensive *not* to move ahead on this.

Rampar: Anything else?

Campbell: The IEWU negotiations have been extremely tough this time around, due to excessive demands they have been making. Union pay scales are already pushing up against our foreman salary levels, and foremen are being paid high in their salary ranges. This problem, coupled with union insistence on a no-layoff clause, is causing us fits. How can we keep all our workers when we have production equipment on order that will eliminate 20% of our assembly positions?

Rampar: Wow.

Campbell: We have been sued by a rejected candidate for a position on the basis of discrimination. She claimed our entrance qualifications are excessive because we require shorthand. There is some basis for this statement since most reports are given to secretaries in handwritten form or on audio cassettes. In fact, we have always required it and our executives want their secretaries to have skill in taking dictation. Not only is this case taking time, but I need to reconsider if any of our position entrance requirements, in fact, are excessive. I am sure we do not want another case like this one.

Rampar: That puts The Wallace Group in a vulnerable position, considering the amount of government work you do.

Campbell: We have a tremendous recruiting backlog, especially for engineering positions. Either our pay scales are too low, our job specs are too high, or we are using the wrong recruiting channels. Kane and Smith [Director of Engineering and Director of Advanced Systems] keep rejecting everyone we send down there as being unqualified.

Rampar: Gee.

Campbell: Being head of human resources around here is a tough job. We don't act. We react.

EXHIBIT 7
Selected Portions of a Transcribed Interview with Matthew Smith, Director of Advanced Systems

Rampar: What is your greatest problem right now?

Smith: Corporate brass keeps making demands on me and others that don't relate to the job we are trying to get done. They say that the information they need is to satisfy corporate planning and operations review requirements, but they don't seem to recognize how much time and effort is required to provide this information. Sometimes it seems like they are generating analyses, reports, and requests for data just to keep themselves busy. Someone should be evaluating how critical these corporate staff activities really are. To me and the Electronics Group, these activities are unnecessary.

An example is the Vice President, Marketing (L. Holt), who keeps asking us for supporting data so he can prepare a corporate marketing strategy. As you know, we prepare our own group marketing strategic plans annually, but using data and formats that are oriented to our needs, rather than Corporate's. This planning activity, which occurs at the same time as Corporate's, coupled with heavy work loads on current projects, makes us appear to Holt as though we are being unresponsive.

Somehow we need to integrate our marketing planning efforts between our group and Corporate. This is especially true if our group is to successfully grow in nondefense-oriented markets and products. We do need corporate help, but not arbitrary demands for information that divert us from putting together effective marketing strategies for our group.

I am getting too old to keep fighting these battles.

Rampar: This is a long-standing problem?

Smith: You bet! Our problems are fairly classic in the high-tech field. I've been at other companies and they're not much better. We spend so much time firefighting, we never really get organized. Everything is done on an ad hoc basis.

I'm still waiting for tomorrow.

EXHIBIT 8
Selected Portions of a Transcribed Interview with Ralph Kane, Director of Engineering

Rampar: What is your greatest problem right now?

Kane: Knowing you were coming, I wrote them down. They fall into four areas:

1. Our salary schedules are too low to attract good, experienced EEs. We have been told by our Vice President (Frank Campbell) that corporate policy is to hire new people below the salary grade midpoint. All qualified candidates are making more than that now and in some case are making more than our grade maximums. I think our Project Engineer job is rated too low.
2. Chemicals Group asked for and the former Electronics Vice President (Tuscher) agreed to "lend" six of our best EEs to help solve problems it is having developing a new battery. That is great for the Chemicals Group, but meanwhile how do we solve the engineering problems that have cropped up in our Navy-A and OBT-37 programs?
3. As you know, Matt Smith (Director of Advanced Systems) is retiring in six months. I depend heavily on his group for technical expertise, and in some areas he depends heavily on some of my key engineers. I have lost some people to the Chemicals Group, and Matt has been trying to lend me some of his people to fill in. But he and his staff have been heavily involved in marketing planning and trying to identify or recruit a qualified successor long enough before his retirement to be able to train him or her. The result is that his people are up to their eyeballs in doing their own stuff and cannot continue to help me meet my needs.
4. IR has been preoccupied with union negotiations in the plant and has not had time to help me deal with this issue of management planning. Campbell is working on some kind of system that will help deal with this kind of problem and prevent them in the future. That is great, but I need help now—not when his "system" is ready.

EXHIBIT 9
Selected Portions of a Transcribed Interview with Brad Lowell, Program Manager, Navy-A

Rampar: What is your . . . ?

Lowell: . . . great problem? I'll tell you what it is. I still cannot get the support I need from Kane in Engineering. He commits and then doesn't deliver, and it has me quite concerned. The excuse now is that in "his judgment," Sid Wright needs the help for the Air Force program more than I do. Wright's program is one week ahead of schedule, so I disagree with "his judgment." Kane keeps complaining about not having enough people.

Rampar: Why do you think Kane says he doesn't have enough people?

Lowell: Because Hal Wallace is a tight-fisted S.O.B. who won't let us hire the people we need!

EXHIBIT 10
Selected Portions of a Transcribed Interview with Phil Jones, Director of Administration and Planning

Rampar: What is your greatest problem right now?

Jones: Wheel spinning—that's our problem! We talk about expansion, but we don't do anything about it. Are we serious or not?

For example, a bid request came in from a prime contractor seeking help in developing a countermeasure system for a medium-range aircraft. They needed an immediate response and concept proposal in one week. Tuscher just sat on my urgent memo to him asking for a go/no go decision on bidding. I could not give the contractor an answer (because no decision came from Tuscher), so they gave up on us.

I am frustrated because (1) we lost an opportunity we were "naturals" to win, and (2) my personal reputation was damaged because I was unable to answer the bid request. Okay, Tuscher's gone now, but we need to develop some mechanism so an answer to such a request can be made quickly.

Another thing, our MIS is being developed by the Corporate Finance Group. More wheel spinning! They are telling us what information we need rather than asking us what we want! E. Kay (our Group Controller) is going crazy trying to sort out the input requirements they need for the system and understanding the complicated reports that came out. Maybe this new system is great as a technical achievement, but what good is it to us if we can't use it?

EXHIBIT 11
Selected Portions of a Transcribed Interview with Burt Williams, Director of Operations

Rampar: What is your biggest problem right now?

Williams: One of the biggest problems we face right now stems from corporate policy regarding transfer pricing. I realize we are "encouraged" to purchase our plastics and chemicals from our sister Wallace groups, but we are also committed to making a profit! Because manufacturing problems in those groups have forced them to raise their prices, should *we* suffer the consequences? We can get some materials cheaper from other suppliers. How can we meet our volume and profit targets when we are saddled with noncompetitive material costs?

Rampar: And if that issue was settled to your satisfaction, then would things be O.K.?

Williams: Although out of my direct function, it occurs to me that we are not planning effectively our efforts to expand into nondefense areas. With minimal alteration to existing production methods, we can develop both end-use products (e.g., small motors, traffic control devices, and microwave transceivers for highway emergency communications) and components (e.g., LED and LCD displays, police radar tracking devices, and word processing system memory and control devices) with large potential markets.

The problems in this regard are:

1. Matt Smith (Director, Advanced Systems) is retiring and has had only defense-related experience. Therefore, he is not leading any product development efforts along these lines.
2. We have no marketing function at the group level to develop a strategy, define markets, and research and develop product opportunities.
3. Even if we had a marketing plan and products for industrial/commercial application, we have no sales force or rep network to sell the stuff.

Maybe I am way off base, but it seems to me we need a Groups/Marketing/Sales function to lead us in this business expansion effort. It should be headed by an experienced technical marketing manager with a proven track record in developing such products and markets.

Rampar: Have you discussed your concerns with others?

Williams: I have brought these ideas up with Mr. Matthews and others at the Group Management Committee. No one else seems interested in pursuing this concept, but they won't say this outright and don't say why it should not be addressed. I guess that in raising the idea with you I am trying to relieve some of my frustrations.