A CHAIRMAN'S DILEMMA: SELECTING A POST - ACQUISITION HEADQUARTERS

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CASE DESCRIPTION

The primary subject matter of this case concerns strategic management. Secondary issues examined include: Top Management Team (TMT), corporate strategy, geographical dispersion, mergers and acquisitions, organizational design, organizational change, and Resource Based View (RBV). The case has a difficulty level appropriate for advanced undergraduate and all graduate levels. The case is designed to be taught in one class hour and is expected to require two hours of outside preparation by students.

CASE SYNOPSIS

The case focuses on analyzing EatUp, which was a privately held, business to business (B2B), high margin, craft food producer with two sites. After 20 years of private ownership it was cash strapped and in need of capital improvements. It was sold to EQFunds, a private equity firm whose goal was to increase value and to sell the company in about 5 years for a profit.

At the time of sale to EQFunds, EatUp had five Top Management Team (TMT) members, only two of which remained after the change in ownership. EQFunds immediately appointed five new TMT members including a Chairman. None of them lived near either of EatUp's sites. The new Chairman was faced with increasing the value of the company with a geographically dispersed TMT and an existing headquarters (HQ) site that was physically unattractive and of inadequate size to house the infrastructure required for the new growth strategy. His goal of increasing the value of the company necessitated larger office space for the required staff and a convenient location for the TMT to meet. He made an executive decision to search for a new HQ. The Chairman undertook a search for a new HQ, with five possible locations considered. He also pondered his alternatives to get the five remote TMT members to work from the same HQ. Where should the Chairman place the new HQ? How does the Chairman accommodate and manage his remote TMT to create the most synergy and value?

The identity of the company, TMT members and the private equity firm have been changed in the case as a condition of use by the Chairman. One of the co-authors had first-hand experience with TMT and the Chairman of this company as well as its records and data.

INTRODUCTION

Cash strapped EatUp was bought by EQFunds, a private equity firm with the intent of creating value and selling it for a profit in about 5 years. The new Top Management Team (TMT) put in place by EQFunds were geographically dispersed with no new members living anywhere near EatUp's existing locations and none being expected to relocate. The new Chairman strongly believed that telecommuting was not an option for executive personnel. He had to decide whether to retain the existing headquarters (HQ) site or establish a new one where the TMT would work face-to-face and how to accommodate the TMT who would not relocate for this venture. His self-imposed deadline for decision and full implementation was within 12 months 2015.

BACKGROUND

Founded in the 1980's, EatUp was a middle market[1] B2B premium food manufacturer headquartered in a major city in the Western United States. The company's approximately 300 employees produced a wide variety of pure, healthy, premium and custom-crafted products for national food service purveyors. The HQ's five-acre site also housed the company's plant and administrative offices with approximately 125 employees. The company's other site, located in the Southeast United States (Eastern site), housed about an equal number of employees, with the balance being remote sales employees.

Early expansion: Spreading out to the East

Over a ten-year period, the company grew steadily first selling to local customers and later spreading throughout the Western US and subsequently to the Eastern US and Canada. Expansion was a positive sign but to sustain it, the company needed more capacity. To accommodate its growth, the company acquired a plant in Southeast US in the 1990's. The company HQ remained at the Western site. Although its products were selling well at high margins, the company was managed inefficiently, suffering from a cash shortage and in need of capital to update its plants. It sought new investors.

COMPANY SALE

The company was sold to EQFunds, a private equity firm based in New York City. Its objective was to closely manage EatUp by creating value through efficiency, growth, and acquisitions and to sell it in about five years for a profit. EQFunds' immediate priority was to appoint a proven TMT that would create value by closely managing EatUp, growing its business organically and through acquisitions, and realizing efficiencies.

Upon sale to EQFunds, only two TMT members remained with the company. EQFunds immediately appointed a new Chairman, Joe Growth (pseudonym) and four other TMT members

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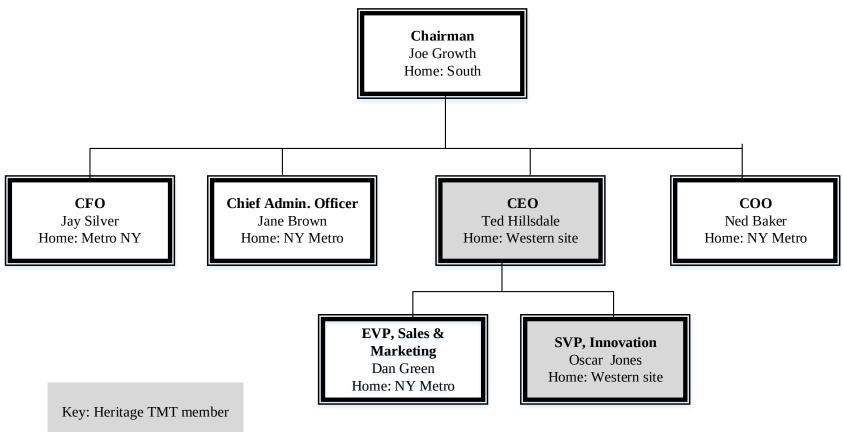
[1]. The middle market is defined by Deloitte as US-based companies acquired through buyout transactions between $25 million and $1 billion.

(2 heritage + chairman + 4 new = 7 TMT members). All were either known to EQFunds or were highly recommended by the new Chairman. Four of the five including the Chairman knew each other from a previous industry venture where they had created exceptional increases in value. In the previous venture, the Chairman and the TMT quadrupled the value of a company in less than 3 years. They firmly believed this type of value creation in such a short period of time was only possible when they worked together in a face-to-face environment. None resided anywhere near EatUp's sites and expected near 100% travel. None would be required, nor would they agree to relocate since the hold period for EatUp was five years or less. All had substantial equity in EatUp and were in total agreement on the amount of travel required. As one said, "I will be anywhere from Monday through Friday and weekends if needed." None of the new TMT members except the Chairman had young children. Chairman Growth realized that it was not uncommon for Private Equity (PE) firms to hire a top executive that commutes from a remote home location to the HQ but having almost the entire TMT remote was quite unusual. Figure 1 depicts the post-acquisition TMT with the heritage players shaded. Addressing the geographic dispersion of the TMT became a priority of Chairman Growth.

Figure 1: Post Acquisition TMT



POST PURCHASE: TOP PRIORITIES

With the new TMT appointed, the Chairman could now decide where the HQ should be located and how to maximize collaboration of the largely remote TMT. His previous venture with three of the TMT members resulted in unprecedented value creation and profitability when they interacted face-to-face. Post purchase, Ted Hillsdale (the former majority owner/CEO) and another TMT member from the heritage company stayed in the original HQ location. None of the five new TMT members lived near either of the two plants: four lived in the New York Metro area and one was in southern Florida.

Under the new Chairman, Joe Growth, now Hillsdale's boss, EatUp became even more passionate about safety, financial visibility, sustainability, growth, procedures and efficiency. This required close management of the organization and its operations and close collaboration of the TMT. It also required additional staff and resources, which required extra office space. Finding an optimal HQ location and maximizing TMT collaboration became Chairman Growth's top priorities.

HQ location

Joe Growth decided that existing space at the Western HQ site was barely adequate to house the existing administrative staff and had extremely limited meeting space. He knew it could not accommodate the additional resources needed to fulfill the new ownership's goals of growing the company both organically as well as through acquisitions to achieve its exit strategy. Additionally, the plant's productive capabilities could not be compromised by ceding any more space from production to administration. Mr. Growth also faced the crucial issue of how the largely (five of seven) remotely located TMT members would maximize their collaborative efforts to manage the company.

TMT collaboration

Due to the limited meeting space at the plants, the geographically dispersed executives worked from home offices with monthly scheduled meetings at the Western and Eastern sites or nearby hotels. Chairman Growth quickly realized this was not an ideal situation for aggressively realizing its strategy for several reasons. First, important cross-functional TMT interactions were not as robust or as frequent as he wanted or as he had experienced in the previous venture. Working remotely, interactions were somewhat cross-functional, but the TMT seemed to be spending too much time on task-oriented transactions. The company was improving rapidly but Mr. Growth, as well as the new TMT members, realized it could be exponential if the team were working physically together. All recognized the value they were creating, while far above any standards, was not as high as they knew they were capable of in a face-to-face environment. All wanted to interact in-person. Second, day-to-day supervision of subordinates was sub-optimal with the TMT finding that in-person supervision was highly preferable to remote supervision. Third, the ability to attract the level of talent needed to grow the company was hindered by the lack of space as well as the unattractiveness of the plant administrative space and its location. Finally, the travel expenditures became quite high without getting enough in-person collaboration to satisfy the chairman or the TMT members. It was clear that this arrangement could not support the types of activities required for growth and acquisitions in an aggressive time frame. To help in his decision-making process, the Chairman examined his options summarized in Table 1.

Table 1 SELECTING A POST ACQUISITION HEADQUARTERS Top Management Team Work Options		
TMT Options	**Option Description**	**Potential Option Issues**
Work Remotely	**Work from home offices meeting together monthly**	Experience shows value creation in TMT interactions that are not possible with remote working and limited when only meeting monthly
Rotate Work Locations	**Rotate meeting weekly at or nearby the 2 sites**	There are high costs and some value creating interactions through this option but rotating sites does not provide a stable work base
Office Rental Space	**Co. rents space at Regus or similar at a TBD site**	Costly option with no guaranteed availability of conference space, contiguous offices or use after hours
New HQ Site	**Company finds suitable space for its HQ**	TMT would be required to be present a designated amount of time weekly; non-production staff functions transferred to the new HQ

HQ search

Chairman Growth made an executive decision to identify a new HQ office for the TMT, so it would have a regular "home" in which to work together. He wanted the TMT members to travel efficiently to minimize travel time and inconvenience and prevent frequent travel fatigue and maximize the value of time spent together. The new HQ would need to satisfy the criteria listed in Table 2.

Table 2 SELECTING A POST ACQUISITION HEADQUARTERS Headquarters Location Key Criteria
•Accessible transportation (e.g., major airport, public transportation)
•Access to high-level talent recruitment pool
•Reasonable commuting time with multiple direct fights for remote TMT members
•Proximity to reasonably priced quality housing for remote TMT members
•Easily accessible and attractive for customers, acquisition due diligence players and eventual buyers
•Lease with attractive termination provision (in the event a new buyer did not want it)
•Proximity to nearby quality hotels

Given the constraints listed in Table 2, a search was commenced for the new HQ location. The cities of the Western and Eastern sites were examined. Particular attention was given to the NY Metro area and a major city in Florida where EatUp's industry had a strong presence, quite distant from the Eastern plant. The industry presence in FL was an added plus since there was no significant industry presence in the existing HQ location.

Once the new alternative sites were identified as possibilities, the question of corporate and individual tax rates was raised. The heritage HQ site had nationally average corporate and individual tax rates. Whether the alternative sites would be better or worse for the company as well as the TMT members (who had significant equity and therefore taxation burden upon exit strategy) were examined. The cost estimates are listed in Table 3 with a ranking of the potential sites' corporate and personal income tax rates. The New York Metro area was attractive since four of the TMT members lived there and there was a robust labor pool to fill the positions that would be relocated from the existing HQ. None of the existing HQ personnel was to be relocated to the new HQ but would be provided severance. However, the company's industry was in the West and the South with a strong presence in the Southern Florida city and New York had unfavorable tax issues.

Table 3
SELECTING A POST ACQUISITION HEADQUARTERS
Cost Estimates

Cost Category	Western site	Major city near Eastern site	NYC (Manhattan)	NY Metro (Tri-State Area of NY- NJ - CT)	Major Southern FL City
HQ Moving Costs	$10,000	$10,000	$10,000	$10,000	$10,000
HQ Furnishing Costs	$100,000	$100,000	$100,000	$100,000	$50,000
Rent / Sqft	$23	$23	$50	$40	$37
Annual Rent For 10K Sq. ft.	$230,000	$230,000	$500,000	$400,000	$370,000
Related Costs at 5% of rent	$11,500	$11,500	$25,000	$20,000	$18,500
Corporate tax rank from 1 (lowest) to 5 (highest)	2	1 (tie)	4	3	1 (tie)

Selecting new HQ location: Remote TMT member options

As part of the search for the new HQ site, Joe Growth pondered how the five remote TMT members would manage the company if New York was not selected for the new HQ. It was decided that the five new TMT members would be required to be at the new HQ office at least three full days a week, unless they were travelling for company business. This was acceptable to all.

To address high costs associated with frequent travel, Chairman Growth considered several options for the five remote TMT members. The two TMT members with offices in the Western plant would remain there: they would travel to the new HQ as needed. However, some other non-production staff departments reporting into TMT members would be relocated to the new HQ site. None of the existing employees would relocate; they would be replaced with local talent.

Options for housing the five remote TMT members at the new HQ site came down to two alternatives: stay in hotels or company rented apartments. Although the apartments would only be used three nights or so a week, the overall costs would be less than hotels for the TMT members commuting. Chairman Growth estimated annual costs for the various HQ location options, which are listed in Table 4.

Table 4
SELECTING A POST ACQUISITION HEADQUARTERS
Travel Costs

Total TMT HQ Est. Travel Costs	Western Site	Eastern Site City	NYC (Manhattan)	NY Metro	South FL City
Hotel option	351K	300K	165K	162K	279K
Apartment or additional residence option	351K	300K	174K	162K	352K

Chairman Growth now had to make multiple decisions related to where to place the HQ. He needed to figure out how to accommodate the remote TMT members' priorities while also selecting an option that would be most optimal for the company as a whole and in line with their strategy. Table 5 shows the Chairman's decision regarding the alternative sites' fit to his criterion. "Yes" meant it fit and "no" meant it did not fit.

Table 5
SELECTING A POST ACQUISITION HEADQUARTERS
Priority Items and Alternative Sites

Priority Item	Western site	Major city near Eastern site	NYC (Manhattan)	NY Metro (Tri-State Area of NY-	Major Southern FL City
•Accessible transportation (e.g., major airport, public transportation)	no	no	yes	yes	yes
•Access to high-level talent recruitment pool	no	no	yes	yes	yes
•Reasonable commuting time with multiple direct fights for remote TMT members	no	yes	yes	yes	yes
•Proximity to reasonably priced quality housing for remote TMT members	yes	yes	yes	yes	yes
•Easily accessible and attractive for customers, acquisition due diligence players and eventual buyers	no	no	yes	yes	yes
•Lease with attractive termination provision (in the event a new buyer did not want it)	yes	yes	yes	yes	yes
•Proximity to nearby quality hotels	yes	yes	yes	yes	yes

While cost was a consideration, the fit of the HQ site was the primary driver for Chairman Growth. As a middle market company, the difference in expense between the sites was not substantive to EatUp. Taxation rates were more of a concern than the cost of the HQ itself.