Silence Is Not Always Golden

Literary Club Paper: 11/1/04 (Monday)

This is a corporate tale of hope, energy, ambition, perseverance, success, hubris, and ultimate tragedy. It has many twists and turns. Telling it is one thing. Analyzing it is another, for it holds some lessons that the business world should heed in the Twenty-First Century.

The story is about the Baldwin Piano Company. And no, it's not the well-known and spectacular demise of Baldwin United some twenty years ago. That merits examination separately. This is about the second coming of Baldwin, about the piano business that emerged from the ruin of the financial empire.

But first some brief historical facts. Dwight Hamilton Baldwin was born in Erie County, Pennsylvania, on September 15, 1821, to a family of devout Presbyterians. At Oberlin College his ambition was to become a minister. But his constitution was not strong enough for the rigors of riding from town to town to preach, so he turned to his next love – music. After graduation, he taught music in a series of small Kentucky towns. The first record of his presence in Cincinnati came in the 1857 report of the Common Schools, where he was listed as one of four music teachers, earning $100 per month.

As a music teacher, Baldwin was frequently asked by friends and former pupils for his advice on the purchase of a piano or reed organ. As these requests increased, Baldwin decided that instead of recommending products, he would sell them himself. In 1862 at the age of forty-one he started a small piano store with $2,000 he had saved through frugal living. Four years later he opened a much larger showroom in downtown Cincinnati at 65 West Fourth Street. Baldwin was so devout he did not send out company mail on Saturday because he didn't want letters traveling on the Sabbath. But Presbyterian devotion could only go so far, as he saw no conflict in opening his new store on Sundays so that his customers could make the proper selection. He had many admirable traits, but perhaps the most significant was his ability to judge people and hire men more talented than himself. In 1866, he employed Lucien Wulsin as his assistant bookkeeper, a twenty-year old Union Army veteran who was still recovering from smallpox. Wulsin had grown up in New Orleans with no formal education beyond a year of high school. His family spoke French at home, and his command of English was limited. However, he applied himself at Baldwin, and seven years later was made a partner in the firm. A couple of years after that Wulsin was in full command. Dwight Baldwin faded into the background, leaving his name as the treasured trademark.

In 1887, Steinway, already an important manufacturer of pianos, cancelled Baldwin as a dealer and gave its line to another firm. The loss was a heavy blow, but Wulsin reacted promptly by putting Baldwin into the manufacturing business. He opened a factory in Chicago producing reed organs under the brand name Hamilton. In 1890, production of pianos began in Cincinnati with the Baldwin name.

And Wulsin had devised a business plan that could support manufacturing operations. A decade earlier, imitating the Singer Sewing Machine Company, he had begun using consigned inventory to open piano and organ sub-dealers in small towns around Ohio, Kentucky, and Indiana. As the Baldwin factory ramped up its production, this network of agents began substituting Baldwin instruments for competitive brands they had also stocked. We need to pause a few minutes to reflect on the impact of the consignment move. It means that the agents, or dealers as they are called today, could receive and put on sale Baldwin products that they did not own. The title remained with the Baldwin Company until the dealer consummated a sale. This use of company capital bound the dealer closely to Baldwin and made their interests common and supportive.

Wulsin also looked to product development to improve his wares. He hired William Macy, a gifted, self-taught engineer, to design an improved version. A grand piano of Macy's created a sensation in 1900 by winning the Grand Prix at the French Centennial Exhibition. Suddenly, Baldwin was no longer a successful regional manufacturer but a major factor in the international music world. An offshoot of this Grand Prix success was the development of Baldwin's artist program, which sought endorsement, implied or outright, from key performers in the music world. This approach proved to be a critical marketing tool for nearly a century.

Given the success of consignment sales to its dealers, Baldwin then moved in the early 1900's to finance the sale of its products to consumers. Again, this was a powerful tool to attract outstanding local businessmen to its line. A good dealer now did not need a lot of capital to go into business, but he had to be a shrewd salesman. The innovation led to a tripling of Baldwin sales volume, and within a decade 90% of its pianos were sold on an installment basis. Other manufacturers farmed out their inventory consignment and installment contracts to third parties such as banks and financial loan companies. But Baldwin transformed these activities into profitable businesses of their own, while keeping its interest charges marginally below those of the outsiders and thus strengthening the performance and loyalty of its network.

By 1910, all these factors had made Baldwin one of the largest and most prosperous American piano makers. In addition to tangible assets that were the envy of the industry, the company also boasted a potent organization that was a unique combination of founder Dwight Baldwin's Presbyterian rectitude and Lucien Wulsin's business acumen. Wulsin's hardnosed approach was reflected in company lore. In 1910 when a sales manager died at a hotel in Pittsburgh, Wulsin's response was a wire to search the body for all unfilled orders.

His drive was tempered by a commitment to fair play, which fostered near fanatical loyalty among employees. People who joined Baldwin rarely left, in large part because they were treated well and saw opportunities for advancement, which was only on a promotion from within philosophy. The result was that Baldwin was managed by those who had spent their entire careers at the company.

This business model and the strength of its management carried it through some difficult times. The collapse of the player piano market in 1926 followed by the Great Depression sent over one hundred piano makers into bankruptcy. Baldwin managed to eke out a modest profit in all but two years between 1927 and 1939. More recently, in the 1980's, Baldwin and Steinway were the only major U.S. manufacturers able to survive the onslaught of Korean competition and the collapse of the home organ industry. Ironically, Baldwin's skill in managing retail and consumer finance led to a catastrophic stumble in 1983. That story has its own twists and turns and merits a retelling at a later date. It culminated in the bankruptcy of Baldwin United. At this point the separately managed piano division had become a minor part of the larger finance-driven enterprise. But its apartness meant that it was unscathed by the demise of the parent company.

Now we must turn our attention to the manager who would put all the pieces together and revise and strengthen the basic instrument business. His name is Dick Harrison. A native of Cincinnati, Dick was born in 1931 and educated at prep school, Kenyon College, and Cornell Business School. In 1955, he joined Baldwin as assistant treasurer. He was named head of the music operation in 1974. When the parent company foundered, he had twenty-eight years company experience and a deep knowledge of the piano business. He saw an opportunity. Moreover, chance offered him an important role.

During the turmoil of the parent company's death throes, Harrison was approached by General Electric to take over the financing of the piano consignment inventory. Better known as a producer of jet engines, turbines, light bulbs, household appliances, and owner of NBC, GE's most profitable division in recent times has been its finance arm. It seeks out special opportunities that other lenders often shy away from.

Harrison was just winding up a meeting with GE representatives, and they were headed for the elevator. One of them commented, “If you are ever interested in buying out the company, let us know as we might be able to help." Harrison seized the moment and said, "Let's go back and talk it over."

The result was a leveraged buyout by Harrison and long-time manufacturing head, Harold Smith. The two of them came up with $4,000,000 in capital with General Electric providing the bulk of $65,000,000 in financing to support the operation. Talk about financial leverage and trust! The deal was closed in 1984.

To scrape up his share of the required cash, Harrison went to his mother and persuaded her to make available funds held for his inheritance. So his words came from the heart when he spoke to Baldwin management in 1985 with typical directness, saying, "Everything I have is in Baldwin. I have no choice but to make it successful." Relentlessly focusing on cash flow and cost control, Harrison and Smith made paying down Baldwin's heavy debt a priority. Payrolls were cut. Employees were forced to justify every expense and marketing outlays were reduced or eliminated. Cost control was relentless. Five years later, Baldwin's $65,000,000 in borrowing had been cut to $7 million. GE was so impressed that they featured the experience in its annual report as a case study/ Harrison justified his tightfisted approach, saying, “With $65,000,000 in debt, we didn't have the luxury of focusing on growth. We had to build up our balance sheet."

A major decision made by the Harrison/Smith team in 1986 was to take the company public. The initial offering of 1,153,500 shares at $11 each allowed them to reduce their equity position while still remaining the major stockholders. The offering was fully subscribed and the stock rose as high as $18 within the next couple of years. The newly incorporated firm needed a board of directors, and Harrison turned to local friends and businessmen to meet this requirement. One of them was a distinguished lawyer from a leading Cincinnati family. Another was an entrepreneur who had built up his own high tech firm and then sold it out at considerable personal gain. Another was successful manager of a T.V. conglomerate. All told, there were six, including Harrison and Smith.

By 1993, new highs were set in both sales and net profits with the long-term debt being further reduced. By this time, Harrison was sixty-two years old and the board, with his concurrence, was seeking a successor. A headhunter was retained, and each board member also made inquiries. But after some months, no viable candidates had been found.

In frustration, Harrison called a neighbor, who was a long time Procter & Gamble executive, and asked, "Do you know anyone who could run Baldwin?" The reply was a suggestion about a former P&G manager who had left three years prior and had a succession of jobs. That man turned down the idea, but suggested that the board contact a woman who had also worked at P&G and was currently a division manager of Dial Corporation in Arizona.

Enter the femme fatale of our story. Her name was Karen Hendricks. A 1971 chemical engineering graduate of Ohio State, she had worked almost twenty years in product development at P&G. In the late 1980's, she had shifted to marketing when the company was reaching out to promote women to fast track management positions. She seemed tailor-made for the job at Baldwin. Moreover, she was bright, articulate, and personable. So she was hired without any probing of her performance at P&G.

Equally important as her obvious qualities was the aura of success that came from her P&G association and background. The ranks of P&G alumni who have risen in the corporate world are long and distinguished. For example, the current chief executive officers of General Electric, Microsoft, 3M, E-Bay, General Mills, and Intuit all were recruited and trained originally by P&G. And if these are the top names, you can imagine the dozens of others in major positions throughout American industry who occupy posts of major importance. The P&G stamp usually means a lot.

So it all seemed like a natural. When Karen Hendricks came on board in November 1994, the board was so impressed that she was immediately made the Chief Executive Officer, with Harrison moving to board chairman and given the job to oversee and train her in the piano business. The reasoning was that the company would be better served by one transition, i.e., making her immediately the CEO, rather than two, which would require her to be the assistant to the president for a year or so before Harrison relinquished the top job.

She arrived with favorable fanfare and was quoted in gushing terms by the press. "I've always been attracted to products that have high socially redeeming qualities," adding, "The piano is a wonderful instrument that enriches so many lives." Her initial reception by the dealers was favorable. She unveiled a new product strategy to create a three-tiered "super line," using the Baldwin name for premium products, the Chickering trademark for mid-price brands, and Wurlitzer for entry level instruments. She closed the dealer meeting with a statement, "Baldwin is committed to growth - not just a program of the month but real growth." She received an enthusiastic ovation.

But while dealers were impressed by these actions, employees at the headquarters in Cincinnati were beginning to have misgivings. With Dick Harrison as CEO, his office had always been open and employees encouraged to drop in to share ideas or just chat about the business. One of Hendricks' first acts was to move her office to an alcove well behind a secretary's desk so she was inaccessible to anyone without an appointment. It was a small thing, but for most long-time Baldwin employees, it struck a sour note. Having spent most of her business career in product development where many decisions are based on consumer research, she found it unimaginable that a manufacturer would actually call a dealer to ask for advice about a product or a market program. This made for immediate clashes with the Baldwin sales and marketing team that viewed talking with dealers as an integral part of the job.

In contrast, the mention of dealer suggestions was typically greeted by Hendricks with an icy stare and comments about the danger of basing decisions on "unprofessional" or "unproven" information. One ex-employee said, "If an idea wasn't backed by a huge market research project, she wasn't interested." Early on, she made it clear that she thought anyone who had spent his career in the piano industry was "plain stupid." Quickly, her attitudes were labeled "The P&G Approach" by employees in contrast to the previous Baldwin modus operandi.

Here I must interject some words of defense of my former employer. During my thirty-four years on the job, marketing managers were required to learn the business from the ground up. This meant a four to six month period shortly after employment in an active sales role on theGround. Furthermore, getting into the field to make periodic store checks was emphasized to make sure individuals did not lose sight of current conditions. And while these approaches have been adjusted to meet the changing nature of the retail trade, particularly in major markets, close contact with key accounts is considered essential. For example, P&G now has some three hundred full time employees working in Bentonville, Arkansas, the headquarters of Wal-Mart, to coordinate company plans with this largest of all worldwide retailers. Having a "hands on" feel of any business is a key to successful management.

Dick Harrison was one of the many, but perhaps the most visible, Baldwin lifers whom Karen Hendricks treated with undisguised scorn. She didn't copy him on anything. She tried to exclude him from everything. A thirty-two year Baldwin veteran who had held senior posts in advertising and sales reported she went around saying, “Everything about the company was broken and it was all his fault.”

Dick was someone the organization respected and liked, and the way she treated him left people shaking their heads. By the end of her first year, long-time Baldwin executives were being pushed toward the door to be replaced by new recruits from the package goods industry.

Two high level imports from Procter & Gamble vaulted over the heads of the other managers, one as executive vice president and the other as VP for sales. A vice president of manufacturing came on board from Dial Soap. Other important posts, including director of human resources, head of contract electronic manufacturing, and chief financial officer were filled by individuals with consumer goods experience. And these newcomers came with a price, being paid two to three times the ones they replaced.

Internal tensions rose. Dealers would spend most of their time talking to the few veterans left, which stirred resentment from the new hires and made any semblance of teamwork difficult. Bringing in selected new management is often the way of a new CEO. But a wholesale change can be tricky, risking the loss of key knowledge. This danger was echoed in the universal complaints from old time employees and dealers alike. “They never learned or understood the piano business."

Moreover, Karen Hendricks was unable to work effectively with her new executives. Since the company's founding, its organization had been stable, even being criticized for being too inbred. This stability gave way to a revolving door in the executive suite. During her six-year tenure, she went through multiple manufacturing vice presidents, marketing heads, chief financial officers, contract electronics division managers, and human resource managers. One of her ex-manufacturing heads attributed the turnover to an ego out of check. "From the day she took the job, I think Karen was convinced that she was destined to be a great success, and she was determined to receive 100 percent of the credit. When I left, I told her that if she wasn't willing to share some of the credit, all she'd end up with is 100 percent of the blame.” An old time employee added, "She had delusions of personal grandeur and complete confidence in her judgment. She didn't think she needed to ask, to do her homework, or do any due diligence, she knew she was always right."

The internal turmoil began to take its toll by mid-1996, eighteen months after she took over. At the June board of directors meeting, Hendricks reported that Baldwin was in violation of several loan covenants by building up too much inventory and extending credit lines. Dick Harrison, who was a board member, saw this as a serious warning. Up till then he had supported her wholeheartedly and stepped aside to giver her room. But the admission of inept management of sales and inventory caused him to make discreet inquiries among Baldwin employees and dealers.

He took the bull by the horns. After a month of fact seeking, he sent a memo to the board as follows: "We need to do three things. One, dismiss Karen immediately; two, find an interim replacement; and three, begin the search for a new CEO. Any procrastination will cause irreparable damage to the company. Prospects for improvement are very poor based on her management style of total control, no delegating, fear, and by definition, no empowerment. As the largest shareholder on the Baldwin board and having nominated most of the sitting directors, Harrison expected that his words of warning would be taken seriously. But the board was under her sway and gave her unquestioning support, saying, "She just needs more time. Harrison submitted his resignation.

By this time Hendricks had isolated herself from the Baldwin organization and dealer network. Lacking a grasp of the market and unwilling to trust anyone on her staff, she continued to make a series of ill-considered decisions that made Baldwin's collapse all but certain. First, she sold the consignment business to a Wall Street finance firm. You'll recall that this type of help to the dealer network had been pioneered by Lucien Wulsin in the 19th century and was an important cement that bound the dealers to the company. While the move temporarily improved Baldwin's balance sheet, it antagonized the dealers.

One of them said, "When Baldwin stopped consignment, they became just like every other manufacturer. For years their slogan to dealers had been, 'It's not a sale for us until it's a sale for you'. Once consignment was gone, the company didn't care how much inventory you had or how your business was going. All they wanted was to load you up." This move also cost the company market share, as many once-exclusive Baldwin dealers now took on competing keyboard lines.

The Baldwin factories, originally designed to service a much larger market than the current one, were in need of consolidation by the mid-nineties. At the time of her arrival, the possibility of closing a large facility in Mississippi and consolidating operations in two locations in Arkansas was being explored. She took action all right, but it defied basic logic. First, she invested over $2,000,000 in a product upgrade at one of the Arkansas plants, introducing this improvement with considerable publicity at a national show. But two months later she reversed herself, closing that plant and moving major operations to a second one. Thirty days later she reversed herself again, with the upshot being that some parts would be made in one plant and then trucked three and one-half hours to a second, where they would be finished and then returned for final assembly. One ex-Baldwin employee stated, “The way she structured it, it cost more than keeping both plants open full time.” One of her new manufacturing heads stated, “After you got behind all the bluster, she just couldn't seem to make a tough decision."

As the dismal quarterly earnings reports followed one another, she made frantic efforts to spin the results with the aid of a high price New York public relations firm. After showing a two and one-half million dollar loss in one quarter, she declared, “The encouraging news is that dealer inventories have now returned to normal seasonal levels.” But three months later the loss welled, and she commented, “Baldwin has made significant investments in streamlining its musical product offerings. Many of these actions will produce financial benefits that will not be felt until next year."

Seeking some self-justification, Hendricks claimed that Baldwin's woes were the result of an "Asian Financial Crisis" which had caused Korean and Chinese manufacturers to flood the US market with cut-priced pianos. She persuaded the local member of the U.S. House of Representatives to push the International Trade Commission to investigate potential dumping by Asian producers. The ITC conducted a lengthy hearing and called other piano makers to testify in Washington. But it could find no credible evidence of a flood of Asian underpriced products.

Shareholders were growing restive, and not accepting the promises of improvements “next year". One of them, who had acquired a significant 7% stake in the company, wrote a stinging letter to Hendricks in August 1999 stating “Under your leadership, a company with 138 years of independent operation is being dismembered. I would be remiss by not demanding that you take responsibility . Faced with this, the board ought to ask for your resignation, appoint an interim CEO, and be thankful there is still a semblance of fig leaf left for their reputations."

Major dealers were also in revolt. In October 1999 they sent a letter to the board of directors imploring a change in management and offering to address their concerns with them. Their forceful communication began, "Current management has failed ....". They even recommended an interim CEO, a longtime Baldwin employee who had their confidence. The response was silence except for the cryptic message, "She's refocusing the company."

An investment fund that had acquired an 11% stake was equally scathing. They wrote in November 1999 as follows, "Dealers have expressed the concerns and outright displeasure with Ms. Hendricks. The board's response/in keeping with a corporate culture that treats Baldwin as a personal fiefdom, is to continue their unmerited support of the present regime, despite all evidence pointing to the need for a change." And who were these board members that remained silent despite the growing economic turmoil. They were respected and well-connected Cincinnati business leaders. A former key manager, whom Hendricks had brought in, reported that numerous board meetings were right out *of Alice in Wonderland.* He stated, "The rules of accountability for performance were completely suspended. They would lob softball questions to her and take her answers at face value without any digging." A long time Baldwin veteran called her relationship with the board a case of reverse discrimination." Here were these older successful men, and they looked on Karen as a bright young woman they wanted to help succeed. If she had been a man, I'm sure they would have been a lot tougher.

By late 1999, five years after she took command, Baldwin's piano business was in tatters and losing prodigious amounts of money. With no clear idea of how to solve the problem she had created, Hendricks, with the blessing of the board, started to sell off assets to raise much-needed cash. The highly profitable consumer finance operation was disposed of in January 2000. Again, you'll recall that this was a key element of the successful business plan that the company had put together a century earlier. Next to go were the electronics contracting division and some retail stores the company operated. Also put on the block were factory buildings in Juarez, Mexico, and Fayetteville, Arkansas. By February 2001, all that was left of the company was the trade name, $30,000,000 in debt, and two money-losing piano plants. At this point, Hendricks announced that she would step down./What was not published was the grant to her by the board of a $1,300,000 severance bonus. A former executive of another keyboard firm was brought in as interim CEO. It was too late. The new man was dumbfounded by the state of disarray. "I've never seen such a disaster in my life," he said. Factories were in a complete state of chaos with half-built products and parts littered about. Pianos had been sitting for days uncovered on factory loading docks, and the work force was idling in the absence of any clear direction from above. Key suppliers were going unpaid, but the company was still spending $20,000 a month for public relations consultants.

I owe much of this story to a trade publication that ran down a lot of these details. The rest comes from interviews with various former employees, both the old timers and new hires. What I am missing are comments from the ex-board members themselves. They refuse to be interviewed or to answer written questions “under advice of legal counsel". Rumors of shareholder lawsuits may be the reason. But at this late date that appears doubtful. Instead, the reticence seems more a sign of embarrassment or shame.

As for Karen Hendricks, she has been equally elusive.

That's too bad/for I feel the board and she must have something to add to the story. But for the moment, there's only silence.

I also encountered a lot of the anguish of the employees. They lost their jobs; they lost their pensions; they lost their health insurance; and they were demoralized to see their small, scrappy, and successful company driven into the ground. I invited several of them to come tonight, but they declined on the basis that the experience was too painful to relive.

Officially/the Baldwin name and certain assets were sold to the Gibson Company of Nashville,Tennessee, at the end of 2001. But to my surprise, the brand is not dead. After concluding an interview with one of the major piano dealers in Columbus, who had handled Baldwin for years, I was startled to walk through a display area filled with Baldwin pianos. And no, these were not remnants from the old inventory, but new units produced by the new owner, who is trying to revive the brand.

In researching this paper I also found some clues on Karen Hendricks' management ability from her earlier employment at P&G. Although the company will never provide an evaluation of a former employee for fear of litigation, fellow workers are often willing to fill in the blanks. On this basis I learned that she had a difficult and unsuccessful time in switching from her original product development work to line management. She ran the Vidal Sassoon operation for a couple years, and the results were so disappointing that she was moved to a staff position that was thought a better fit for her talents. She judged this rightly as a sideways step and left to take a management job at Dial Soap. How well she did there is another mystery, because her former employer declines to provide me any information. So the handwriting was on the wall before she took over at Baldwin.

There seems a larger question in this morality tale. As American capitalism enters the 21st Century more and more questions are being raised on the make up of the boards of publicly traded companies and the responsibilities of the directors. Not too long ago most boards were made up of insiders, i.e. executives within the firm who owed their positions to the CEO who had appointed them. Trends over the past twenty odd years have eliminated most of the insiders, replacing them with well-known figures, not all from the business sector, who have distinguished themselves in their individual fields of endeavor. However, the glue that binds them to their board sets still comes from the CEO, who has been responsible for their appointment. That's not a scenario to protect shareholder interests in tough times.

The courts and Securities and Exchange Commission are now putting forward ideas to improve corporate governance, making directors more responsible for their actions, or lack thereof. It seems an obvious and necessary next step to demand that the true owners of any public corporation, the stockholders, are adequately represented. This might even involve the democratic process with two or more candidates running for each board seat.

So perhaps, just perhaps, sad experiences like tonight's story can serve a purpose to justify a more open and effective control of public corporations by their true owners in the future.

Kingston Fletcher

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