



BRYAN D. BERTHOT, MICHAEL J. FLOOD

HERO PLUMBERS: THE TRANSITIONAL CHALLENGES OF A FAMILY-OWNED BUSINESS¹

Mike Flood was the Founder of Corporate Board Services (CBS), a private corporate governance and interim executive services firm operating out of San Diego, CA. In 1998, Mike was approached by R. J. Hyatt, the CEO of Hero Plumbers, a family-owned plumbing firm whose home office was in Southern California. Mike was a recognized expert on small business challenges involving generational transition, strategic business plans, leadership training, and bridge leadership during corporate leadership transitions. Being an expert in the plumbing industry but not in business management, R. J. Hyatt already had made the decision to abdicate the authority for decision-making on developing and implementing the plan for Hero Plumbing when he contacted Mike.

Hyatt and his wife Jean had concerns about Hero's long-term future. There were several challenges confronting the company. One was the lack of a generational transition plan, a common dilemma for many family-owned businesses. That is, someone had to take over for R. J. eventually, and there was no succession plan in place. So, both short-term and longer-term leadership was a concern, complicated by the firm's family dynamics.

Hyatt also was concerned about the future roles of his two children who were in the company – son Ted and daughter Courtney. R. J. voiced his priorities to Mike – to foster a leadership role for someone in his family and to provide continued, long-term employment for his loyal employees.

Another issue was one of crafting Hero Plumbing's identity for the future. Right now, Hero was a reputable company with a solid brand that focused primarily on residential plumbing services: Drain maintenance and repair; water heaters; sewer, water, and gas lines; garbage disposals; and water leak detection.

Hyatt posed several questions for Mike Flood to consider in his analysis. What direction should Hero go in terms of future leadership? How should Ted and Courtney be included in this plan? Should Hero expand to the potentially lucrative commercial arena? How could Hero's strengths be leveraged to ensure a prosperous future? How could Hero compete in an industry where the trend was for conglomerate "one stop shops" to dominate the market share? In preparing his final presentation to Hyatt, Mike constructed a plan to address the questions. Hyatt then would sell the plan to family members and employees.

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Generational Transfers of Family Businesses

Several factors impact a successful generational transition of a family business such as Hero Plumbing. This case will first address high-level issues such as the business's ownership model, its level of succession planning, the potential successor's leadership abilities, the notion of bridge leadership, and the state of the residential service industry at the time of the case. Then it will apply this expository information as it delves into some of the specifics of Hero Plumbing and CBS's impact on the situation.

Ownership Model

Baron & Lachenauer (2016) described a model of family business ownership that included owner-operator, partnership, distributed, nested, and public ownership (*See Exhibit 1*). The *owner-operator* branch mirrors the single owner role, where the proprietor (or a couple) controls the company. The *partnership* method allows the leaders of the business to share ownership and to benefit financially; downsides of this strategy are that consensus between the partners may be required to make decisions and that achieving partnership comes from invitation by the existing partners. In the *distributed* manner, the business ownership may be passed down to all family members; thus, family members not in the business may be included. In the *nested* approach, the family operates the core business as a profit-making enterprise and distributes dividends to designated family members; one con is that the business may be underfunded to create more family dividends. Finally, in the *public* mode the firm's shares are publicly traded or the company behaves like a publicly traded entity even when privately held.

Succession Planning

Family-owned businesses comprise about 60 percent of the market share in the U.S. and account for 70 to 90 percent of the gross domestic product (GDP) around the world (Dhingra & Shah, 2022; LeCounte, 2022). Despite their importance to the economy, family-owned firms often struggle to survive generational transitions. The reasons include poor family dynamics, the lack of strategic business and succession plans, knowledge hoarding among subject-matter experts (SMEs) in the older generation, and lack of leadership skills in the younger generation (Dhingra & Shah, 2022).

Wang (2010) observed that succession planning in family-owned businesses frequently excludes daughters who are part of the business, ostensibly due to longstanding biases and stereotypes. When this occurs, the result is hurt feelings and missed opportunities to include some of the company's best talent. To avoid this pitfall, the family must recognize the daughter's contribution to the business and include daughter candidates in the plan.

The best succession planning is a proactive approach that: 1) emphasizes written documents shared in advance with the vested family members; 2) identifies an administrator who is responsible for implementing the plan; and 3) fosters family satisfaction and continued profitability (Dhingra & Shah, 2022; LeCounte, 2022; Venter, Boshoff, & Maas, 2005). Ideal plans include (LeCounte, 2022; Venter et al., 2005; Wang, 2010):

- A direct successor or leadership team;
- Inclusion of daughter candidates in the plan, where appropriate;
- Specified leadership training for family members in advance of any transition;
- The firm's long-term vision, strategic business plan, and financial plan;
- An archive of documents critical to the continued operation of the firm; and
- Family satisfaction with and commitment to the plan as evidenced by signatures.

Leadership Training

Shenk (2018) reported that there is often a gap between when employees get their first leadership position in an organization and when they receive leadership training. Moreover, when leadership training does occur, it is often negatively affected by trainee time constraints and the fact that a trigger for the training is that the firm is undergoing an organizational transition (Shenk, 2018).

Cabrera-Suárez (2005) stressed two factors that affected whether or not the leadership transfer in a family-owned organization was successful – the quality of the leadership training received by the successor and the successor’s level of commitment to the family firm. Family successors tend to have a higher level of commitment to the firm that do non-family members.

Thus, leadership training is more effective when it occurs prior to the individual’s assuming a leadership position and when it does not occur hurriedly in the midst of an organizational crisis. Successors prefer some form of mentorship to academic training, including scenarios where the successor is given responsibilities and supported by the predecessor (Cabrera-Suárez, 2005; Shenk, 2018).

Bridge Leadership

Bridge leadership focuses on promoting best practices within the organization as well as stakeholder interests (McMullen & Adobor, 2011). It may take the form of mentorship where an outside bridge leader coaches the successor. A successful bridge leader displays specific behaviors during a critical transition for a firm and ideally those behaviors (as well as the company’s mission) are transferred to and embraced by the employees. Such behaviors include (McMullen & Adobor, 2011):

- Building relationships and goodwill as a means of fostering personal obligations on the part of internal and external stakeholders;
- Championing the mission of the organization and installs & reinforces it with employees;
- Employing symbolic behavior and ceremonies to reinforce the leadership bridge;
- Creating opportunities for individual and team goal achievement;
- Using frequent communication to make organizational goals acceptable to stakeholders;
- Modeling behaviors for others to observe and start employing; and
- Observers adopting the behaviors displayed by the bridge leader.

Common examples of a critical transition are a generational transfer of power or a merger and acquisition scenario.

McMullen & Adobor (2011) reported that while a bridge leader (e.g., an interim CEO) may not have the same direct positional power as a regular leader, that individual may compensate by substituting other influence strategies. One way of attaining influence and gaining employee cooperation is for the bridge leader to rely on the legitimate authority of the outgoing leader.

U.S. Residential Services Industry

At the time of the Hero Plumbers case, four major players were competing for a \$40 billion residential services market in the U.S. – American Residential Systems (ARS), Comfort Systems USA, Group Maintenance America Corporation, and Service Experts, Inc. (Smith, 2000). These firms each had a hub

and spoke model in which they acquired specialty firms such as Hero Plumbers to serve customers while they maintained national corporate headquarters elsewhere (Smith, 2000).

Industry Consolidation Trend

The industry was undergoing a consolidation trend whereby independent plumbing, HVAC (i.e., heating, ventilation, and air conditioning), and roofing contractors were being assimilated by this group of large residential services firms (*See Exhibit 2*).

During the 2000s, the residential service companies expanded in several ways: 1) A *horizontal merger*, where a firm expanded its geographic footprint by acquiring a competitor; 2) A *vertical merger*, where a firm acquired a firm elsewhere in the supply chain, such as a plumbing supply company; or 3) A *conglomerate merger*, where a firm acquired a complementary business that specialized in a related field, such as plumbing, roofing, or HVAC (Pilsbury & Meaney, 2009).

Under this rubric of “all services under one roof”, these residential service companies strived to increase their market share by becoming one-stop shops for both residential and commercial services, including: air conditioning; heating & furnace; plumbing; indoor air quality (IAQ); attic insulation; electrical; commercial systems; and HVAC (ARS, 2023; Smith, 2000). As the technology improved, both fire suppression systems and the Internet of Things (IoT) verticals (e.g., cell phone remote home thermostat applications) were added to the model.

Hero Plumbers

Hero Plumbers was a family-owned plumbing business founded in 1972 by R. J. Hyatt. The firm’s base of operations was San Diego, CA. Over the years, Hero had expanded to 150 service centers throughout the U.S. that brought in an average annual revenue of \$80 million.

Background

R. J. was a master plumber who obtained his California contractor’s license and launched Hero Plumbers to meet a community need and to provide a comfortable living for his family. He worked long hours shoulder-to-shoulder with his wife Jean and two of his four children, Ted and Courtney.

In terms of management style, R. J. had no formal training. He tended to make autonomous decisions in areas where he had subject-matter expertise (i.e., plumbing tasks). In recent years, he had become more collaborative with Ted and Courtney on business planning issues, often soliciting their viewpoints – but he was always a firm decision-maker once he felt that he had the information. On most issues involving business management, R. J. was non-confrontational with his employees and when he didn’t know the answer, he relied on consultants to guide him (Benfari, 2013).

Hero’s value system was built on mutual respect and loyalty between its management and its employees. He wanted these characteristics to continue.

Company Expertise and Niche

Hero Plumbers was a recognized leader in the plumbing industry. Hero’s niche was plumbing, which included: plumbing and drain services; water heaters; sewer and water lines; garbage disposals; sump pumps; and water leak detection. All of its service centers were company-owned, a rarity in the industry. The company was known for innovative marketing and for being an early adapter of technical advances

well ahead of other industry leaders. There was a strong family culture promoted by the Hyatts which enhanced employee morale and loyalty. Hero had a recognized brand, with cartoon images of the “hero plumber”, catchy television and radio jingles, and a customer image that portrayed trustworthiness and good value for the money (*See Exhibit 3*).

Ownership Model

Although Hero Plumbers was a legally incorporated firm in California for tax purposes, R. J. and Jean had always retained the owner-operator model for the business, whereby they retained control of Hero for themselves. Two of the four Hyatt children were part of Hero Plumbers. R. J. was primarily concerned with continued long-term income for these family members and his employees; his other children had careers of their own and he was not worried about providing for them. One of Mike Flood’s tasks was to recommend one of the ownership options going forward.

Family Dynamics

R. J. Hyatt was a subject-matter expert on residential plumbing issues. Jean managed aspects of advertising, HR, and accounting. Jean was very opinionated and most business decisions at Hero went through her. Sometimes, Jean and other family members had different opinions on how the business should be run. However, she always deferred to R. J. on important business and industry-related decisions.

Son Ted had joined the company as a Service Center Manager after serving in the Marine Corps. Daughter Courtney had a double degree in accounting and business management; she was starting to take over some of the business operational work from Jean. While R. J. expected Ted to assume a leadership role, he vacillated on how best to reward Courtney’s contributions to Hero.

In the past two years, a tragic medical situation had interrupted the family’s efforts to do succession and leadership planning for Hero Plumbers. R. J. and Jean had backed away from their roles to deal with the crisis. During this time, a family friend and financial adviser was running the company. However, the adviser lacked executive management experience. As a result, the business slowly started to flounder.

R. J. deemed that now was the time for a focused turnaround to address succession planning, the future leadership of Hero, and Hero’s strategic position in the industry. The Hyatt family was relying on Mike Flood to present them with a plan for Hero’s long-time survival.

Corporate Board Services (CBS)

Mike Flood founded Corporate Board Services (CBS) in 1993 as a private corporate governance consulting and interim executive services firm that operated out of San Diego, CA. Its business was based on identifying structural corporate governance issues and correcting them by inserting interim C-level executives that could lead corporate culture transitions.

Business Consulting

One role that CBS had was in providing “business therapy” to firms struggling with growth and succession issues. This included analyzing a company’s business practices, strengths and weaknesses, ownership model, and family dynamics. Recommendations for improvement were based on aligning the firm’s capabilities with management and industry best practices.

Bridge Leadership

Another service that CBS offered was to find and install a bridge leader for a company while it was undergoing a critical change, such as a generational or merger transition. Sometimes, Mike served this role himself. For example, while serving as an interim CEO for a firm, Mike would model behavior for a designated successor, establish relationships both within and outside of the company, and implement best practices that would be documented and carried forward.

Broker Role

CBS also served as a private broker for commercial lending (*See Exhibit 4*). In private commercial lending, the criteria for qualifying for a loan are lower than traditional bank loans, with higher interest rates that are typically in the 10 to 15 percent range. Private loans tend to be higher risk, ostensibly because a subset of the borrowers cannot qualify for or are reluctant to apply for traditional loans. Another difference from traditional loans is that the private (i.e., alternative) loans are funded by private investors.

CBS excelled at matching interested private investors with commercial borrowers. Frequently, the borrowers wanted to expand their businesses and were generally good investment risks, but sometimes they could not meet the higher threshold criteria that banks had to qualify for commercial loans. The private investors funded the loans and earned 10 to 15 percent interest, minus CBS's loan processing fee (Good Deed Investments, 2023).

SWOT Analysis

After two weeks of making observations and interviewing key employees, Mike performed a SWOT analysis (i.e., strengths, weaknesses, opportunities, and threats) of the company (*See Exhibit 5*). Hero had several strengths, including a strong family tradition, good corporate values, a solid reputation and brand, and demonstrated plumbing industry competency. Moreover, the firm's finances were impressive. The company had no debt, a solid revenue stream, and good credit.

Weaknesses were that the company had no generational transition strategy, limited leadership training in the younger Hyatt generation, and its overall underappreciation of daughter Courtney's contribution to Hero. Its internal processes were largely undocumented and it was reliant on tacit knowledge of employees; when somebody left Hero, that knowledge went with them. Sometimes heroic efforts were needed to get a job done – not on the technical side, but primarily on the business management of the work.

In terms of opportunities, Hero Plumbing could expand. Such an expansion could take several forms, including a horizontal merger, a vertical merger, or a conglomerate merger. In the merger scenario, Hero could be either the acquiring or the acquired entity. However, any such opportunity needed to be preceded by fixes to Hero's leadership and internal processes. That is, there may be a phase-gate process to get to the opportunity.

One of the potential threats for Hero was the strength of their competitors in the aforementioned large residential services firms. Given its local reputation and its recent history of solid revenue, Hero itself was an appealing target for being acquired.

Hero Plumbers Evolving in a Competitive World

In addition to the SWOT analysis, Mike had developed succession, bridge leadership, and financing options as well as a strategic business plan to ensure Hero's long-term survival. Mike Flood went into his meeting with Hero Plumbers CEO R. J. Hyatt with several possibilities in mind.

Some of the recommendations he presented to Hyatt were:

- Option 1: *No change*. Have R. J. and Jean step back into their original leadership roles while grooming children Ted and Courtney to lead. During this process, the company could focus on issues such as succession planning, leadership training, and documenting its business processes.
- Option 2: *Take on investors*. Create an offering prospectus and raise capital to employ a professional management team to expand the business more rapidly. In this case, the new management team would remediate Hero's management problems in collaboration with the Hyatts.
- Option 3: *Sell the business to a competitor*. Approach one or more of Hero's large plumbing competitors to purchase the business with cash or milestone payments. In this scenario, the long-term futures of Ted and Courtney Hyatt would be defined as part of the sale.
- Option 4: *Sell the business to Hero employees*. Create an employee-owned company with a long-term payout of the purchase price. Again, the roles of Ted and Courtney would be defined as part of the sale.
- Option 5: *Sell to a large publicly traded company*. Sell the company for cash, a loan, stock, or a combination to one of the large residential services firms. Here, Hero Plumbers was a valuable commodity for a residential services firm interested in expanding its industry footprint.

Each of these pathways had its advantages and disadvantages. However, each would address issues such as the future of Hero employees, the roles of Ted and Courtney Hyatt, the company ownership model, and standardizing business processes. Mike knew that the present was bright, but the future could be even better for Hero.

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Acknowledgements

This case came from an original idea from Mike Flood, based on real world events. Names have been changed and some of the essential facts have been augmented, both to generate classroom discussion and to honor Mike's non-disclosure agreements (NDAs).

Biography



Bryan D. Berthot, PMP[®], CSM, is a doctoral student in the DBA program at the University of South Florida. He holds master's degrees in Supply Chain Management (Penn State University), Project & Program Management (Brandeis University), and Business Administration (University of Maryland University College). He is a project manager and scrum master practitioner, with expertise in coaching scrum teams and helping firms make the “waterfall-to-agile” paradigm shift.



Michael J. Flood was the Founder of Corporate Board Services (CBS), which was a private corporate governance consulting firm. Presently, he is the Founder of Good Deed Investments (GDI), a firm specializing in private commercial mortgage banking. He received both his undergraduate degree in Business Administration (Accounting) and his MBA (Management Science) from the University of Michigan. Mike is a licensed California Real Estate Broker. He has over 40 years of professional and senior executive experience, including 17 years with IBM.

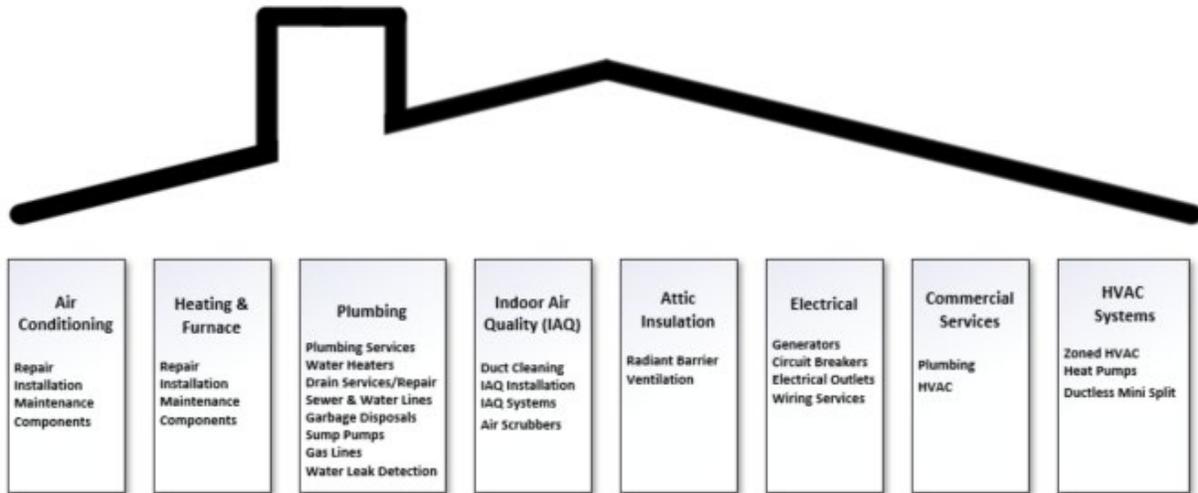
Over the last 15 years, Mike has been CEO of several companies in the San Diego, CA, area, including one of the largest San Diego-based residential design and construction companies and one of the largest San Diego-based mortgage bankers. His Good Deed Investments firm is dedicated to developing the world-class customer service, underwriting, and processing framework that his clients demand.

Exhibit 1: Ownership Models of Family Businesses

Model	Description
Owner-Operator	The simplest model, where business ownership control is in the hands of one person or couple.
Partnership	Leaders in the business share ownership and can benefit financially from it. Decisions may require consensus and entry into the partnership may come from invitation.
Distributed	Ownership may be passed down to all family members, whether or not they are in the business. Thus, family members outside the firm may profit from it.
Nested	Family agrees to hold some assets jointly and some separately. The family operates the core business as a profit-making enterprise and distributes dividends to the family members. May result in underfunding the company to create more family dividends.
Public	Company shares are publicly traded, or at least the family behaves like a publicly traded firm even though it is privately held.

Source: Baron & Lachenauer (2016).

Exhibit 2: Industry Consolidation Model: All Services Under One Roof



Source: American Residential Services (ARS) (2023).

Exhibit 3: Hero Plumbers



Exhibit 4: CBS Broker Role & Loan Guidelines

Loan Type	Alternative private loans, matching private investors with corporate borrowers.
Loan to Values (LTVs)	Capped at 50% for Land, up to 65% for Development, up to 70% for Vertical Development, and up to 70% for Bridge. Some investors who have a keen interest in the property or borrower will loan occasionally at higher LTVs.
Terms	Most loans are for a 12-to-18-month period.
Loan Fees	Paid by the borrower.
Geographic Focus	Primarily Southern California, but also operates in Arizona and Nevada.
Size	Usually ranges from \$500,000 to \$3 million. Regularly sees investment opportunities up to \$10 million.
Interest Rate	Typically, 10 to 15%.

Source: Good Deed Investments (GDI) (2003).

Exhibit 5: SWOT Analysis of Hero Plumbers

<i>Internal</i>	STRENGTHS <ul style="list-style-type: none">• Strong family legacy• Existing brand• Good local reputation• Industry competency• Finances	WEAKNESSES <ul style="list-style-type: none">• No generational transition plan• Younger generation leadership• Underappreciation of daughter’s contribution• Poorly documented procedures• Poor knowledge transfer
	<i>External</i>	OPPORTUNITIES <ul style="list-style-type: none">• Geographic expansion• Technical expansion• Commercial versus residential business• Partnerships with other firms