HEALTHY KIDS PLAYGROUND EQUIPMENT, INC.

INTRODUCTION

You are members of the management consulting team from INSIGHT, LLC. Your firm has been engaged by the CEO of Healthy Kids Playground Equipment, Inc. to analyze a number of serious issues faced by the business and recommend strategic and tactical actions to strengthen the Healthy Kids organization for long-term viability and growth, most importantly restoring the company's reputation for integrity.

BACKGROUND

Kate Sunderland is the CEO of Healthy Kids Playground Equipment, Inc., based in Minnetonka, Minnesota. Kate's father, Harry Sunderland, started the company in his garage 27 years ago because he was not satisfied with the quality of the swing set he had bought for his own backyard. Harry decided he could make his daughter a better swing set himself, and from that resolve grew a career – and eventually a successful business – designing, manufacturing, and selling a variety of playground equipment all over the United States.

Healthy Kids was grounded in two fundamental core values that guided Harry's business growth: to make high-quality, safe playground equipment and to do business with the utmost integrity at all times. Harry cultivated long-term relationships with customers based on trust. He grew his business to be a significant presence in the playground equipment market: Healthy Kids has annual revenues of $290 million and approximately 3,000 employees in four locations. Its headquarters (150 employees) is co-located with the original factory, now evolved into the primary design/engineering, sales, and manufacturing site (1,200 employees), in Minnetonka, Minnesota. The other three locations are Rochester, Minnesota (570 employees), Cleveland, Ohio (980 employees), and Keene, New Hampshire, which opened about a year ago, with only 100 employees so far.

KATE'S CAREER TRAJECTORY

Kate worked at Healthy Kids during vacations and semester breaks through high school and college, with stints in human resources, marketing/communications, pattern making, and the paint shop. After graduating with a liberal arts degree, she landed a job in a chain of department stores and was promoted to manager in record time. Six years ago, Kate went back to school to earn an MBA.

Shortly before graduation, Kate's parents called and told her that Harry's health was failing. Harry asked her if she would consider coming back to work at Healthy Kids and reminded her it was his hope that she would eventually take over running the family business. She accepted the offer and moved back to Minnetonka.

After six months in Accounting and another six months in Quality, Kate was appointed Deputy General Manager of the Cleveland facility to gain leadership experience, profit and loss responsibility, and a broader management viewpoint. Kate excelled in her job in Cleveland for two years, learned rapidly, and built good working relationships with the headquarters' top management team: Vice President of Finance, Steve Caffarella, Vice President of Operations, Tyrone Davis, Vice President of Human Resources, Mike Norsted, Vice President of Sales, Sally Pierson, and General Counsel, Catherine Lee. Kate had just agreed to relocate to Keene, New Hampshire as General Manager of the newest location when her father's health deteriorated rapidly, and he died.

After her father's death, and with the support of the management team, the board elected Kate CEO of the company one year ago.

GOVERNANCE, RISK MANAGEMENT, ETHICS, AND COMPLIANCE

Although Healthy Kids Playground Equipment, Inc. is a family-owned company, Harry Sunderland created a board of directors years ago. He felt it was important to ensure that the company was well-managed and believed that he needed wise and objective guidance, especially as the company grew. Many of the ten board members were trusted old friends and business acquaintances of Harry's. Most of them are local professionals in industries like law, banking, insurance, and advertising. However, there is also a surgeon, a dentist, and a restaurant owner. In addition, Harry's younger brother, Jeremy, a CPA with a local accounting firm, is on the board – and he also owns a 3% interest in the company. Most of the board members have known Kate for years and, while they respect her as smart and accomplished, they display a generally avuncular attitude towards her. While Harry was at the helm, they all trusted him implicitly to do the right thing and thus, most of them – except for Jeremy Sunderland – did not pay much attention to the details of the company's management and operations.

Healthy Kids does not have an ethics and/or a compliance function *per se*. The company has a statement of guiding principles about integrity that Harry wrote many years ago. This framed, one-page sheet emphasizes honesty in dealing with customers and appears around the company in facility lobbies. Legal compliance issues are always referred to the Legal Department. When Kate asked her father about compliance in the past, he said, "We build quality into every product and the quality function takes care of compliance." Kate's MBA program had made her aware of corporate ethics and compliance programs with things like codes of conduct and ethics hotlines and once, when she had asked Harry if Healthy Kids had an ethics hotline, he had responded, "We don't need one. We hire good people to begin with and we have an open-door policy."

There are three primary entities on the national stage that establish compliance standards for the manufacture, installation, and maintenance of playground equipment. The federal Consumer Products Safety Commission (CPSC) publishes guidelines in the Public Playground Safety Handbook. ASTM International (originally known as the American Society for Testing and Materials) is a nonprofit organization that develops and publishes international voluntary consensus standards for materials, products, systems, and services in a broad array of industries, including playground equipment. The U.S. Department of Justice (DOJ) publishes enforceable accessibility standards for accessible design pursuant to the Americans with Disabilities Act (ADA).

At least sixteen states have passed legislation or regulations governing playground safety, including California, Connecticut, Illinois, Michigan, and Texas. Many state regulations incorporate requirements to comply with all, or parts of, the CPSC guidelines and ASTM International standards.

United States Outdoor Playground Organization (USOPO) is the major industry association for playground equipment manufacturers. From a compliance viewpoint, USOPO helps member companies ensure they are up-to-date on all the applicable regulatory safety standards. They conduct onsite inspections of manufacturing processes and finished products, and they issue certificates of compliance for each product line that meets the standards on an annual basis. Playground equipment manufacturers who fail to earn, or who lose, the USOPO "seal of approval" generally suffer from sales downturns because the certification is widely recognized. In addition to communicating and certifying compliance with standards, USOPO also holds two major trade shows every year where manufacturers and vendors come together to learn about industry trends and innovation. Jeremy Sunderland sits on the board of USOPO.

THE PLAYGROUND EQUIPMENT INDUSTRY

The global playground equipment market has maintained a healthy annual growth rate of 9.6% over the past four years. It has grown from $2.75 billion in 2013 to $3.62 billion in 2016. Market research indicates that the market will continue to expand and, by 2021, it should reach $5.92 billion.

There are seven manufacturers of playground equipment, four based in the United States, that account for 85% of the worldwide market. Many more small businesses make up the other 15% and these tend to specialize in just one or two product lines. The largest manufacturers have expanded by adding adult outdoor fitness equipment to their product lines; this segment is growing too. Healthy Kids only sells playground equipment for children, and only to domestic customers (they currently hold a 20% share of the U.S. market), but their newly-revised strategic plan includes an objective to expand sales internationally, beginning in 2018.

Healthy Kids' annual revenues were $290 million in 2017, down 2% from 2016, and its gross margin was a respectable 4.6%, but that was slightly down from 2016, when it had reached 4.7%. Prior to 2017, annual revenue growth had steadily averaged around 6.0% per year, except for the downturn years of 2008-2009, when it held to the 2007 level.

Playground equipment design and manufacture has gone through a major transformation over the past 40 years. Swings, slides, see-saws, jungle gyms, merry-go-rounds and the like, used to be mostly gray or dark green in color, made of metal or wood, and they were placed on surfaces that ranged from grass to sand to cement. Playground injuries, some serious and even fatal, were not uncommon. Nowadays, playgrounds are colorful spaces with structures made of a variety of environmentally-friendly, often recycled, materials conforming to modern safety standards, where the focus is on providing intellectual and social development opportunities, as well as physical activity, for youngsters of all physical and mental abilities. Shredded rubber and similar materials are used as ground cover to minimize danger from falls, the primary cause of playground injury. Children can now play on climbing walls and zip-line type structures made of fabric and ropes, and even find outdoor musical instruments, such as giant xylophones and drums, in playgrounds. Aesthetically, as well as functionally, playgrounds have evolved significantly.

KATE'S FIRST YEAR AS CEO

During her first year in the role of CEO, Kate focused on learning the parts of the business to which she had not previously been exposed, and on improving her grasp of the big picture. During the time she had spent in Cleveland, she had participated in regular conference calls and meetings with the headquarters management team, as did the other facility general managers. But soon after taking the reins as CEO, she realized that there were some important issues that she had not known about – and neither had Harry, partly because, due to his declining health, he had been unable to attend to detail the way he previously had done, and partly because the senior management team had shielded certain things from him. They cared deeply for Harry and respected him as a father-figure and they didn't want to upset him. Plus, they thought they could fix things and the problems would go away.

Kate worked hard on building a good relationship with the other members of the management team during her first year. She was confident they had grown into a team characterized by open communications and trust. Over the course of her first year in the job, she learned about several issues that they had been trying to address, but had not totally resolved.

For example, she learned that two months ago, the company had received a letter from the U.S. Department of Justice stating a complaint had been filed alleging that Healthy Kids Playground Equipment, Inc.'s equipment in a park in Oakland, California, did not meet the required standards for ADA compliance. The letter ordered them to conduct an independent assessment and provide the report to the DOJ within 90 days. Catherine Lee assured Kate that the independent assessment was being conducted and she should receive the draft report soon to review. Catherine told Kate, "I would have sworn we were 100% in compliance with the ADA, but to be honest, over the past year, I've heard a few comments – just in passing, nothing specific – that made me slightly concerned about whether our processes were still as robust as they used to be."

And, according to Steve Caffarella, Healthy Kids' financial situation had been very strong until this past year, when some red flags started to appear, signaling problems with declining sales of certain products and customers moving to other providers – slowly at first – then gaining momentum. The declines seemed to be mainly in a few of the products that were usually sold one-at-a-time to the middle, elementary, and pre-school market, who tended to purchase one slide, or one swing set, or one climbing net igloo, when one of theirs broke or wore out. A decline had also been observed in the spinning products manufactured only at the Rochester facility – notably the Seat Spinner, normally a best seller.

When Kate asked Steve why he had not elevated these concerns earlier, he responded somewhat sheepishly that he had thought his team, working with Operations, would be able to identify the root causes of the issues and only tell her after they had solved the problems. Unfortunately, when he and Tyrone Davis tried to look into the issues, they were unable to learn very much. They tried to dig deep into the organization around the usual chain of command, but the Finance and Operations staff they spoke with in Rochester just said everything was fine, it was probably a temporary glitch, and there was no need to worry. There was a new general manager at the Rochester plant, "Red" McIntyre, who'd been hired from a competitor 15 months earlier. Steve and Tyrone assumed he was getting up to speed and would work out any kinks in the processes there. Plus, Kate was the new boss, and no one had wanted to give her bad news until she'd been on the job for a while – after all, her father had just died. Kate asked Steve to get together with Tyrone and try once more to dig into the problem areas. She said it was critical that they get a grip on what was causing the problems. That was a month ago.

THE MONDAY EVENING REVELATIONS

Every week, Kate holds a management update meeting on Tuesday morning for the whole management team. Last Monday afternoon, Steve Caffarella and Tyrone Davis asked to meet with Kate to brief her on a couple of issues in advance of the management update.

Steve and Tyrone told Kate that they finally were beginning to learn where some of the financial issues were coming from. Healthy Kids' previous vice president of sales had left the company three years ago, saying there was no future for him and nowhere to go in a family-owned company, and his Director of Sales, Sally Pierson, had been promoted from within to replace him. Steve said he sat down with Mike Norsted in Human Resources and asked to review the details of the sales incentive program Sally implemented about two years ago. Mike explained that the new incentive program pays the biggest bonuses for sales of complete playground "kits" and certain higher-margin pieces of equipment. The sales force is therefore focusing all its energy on selling these items, with a resulting decline in sales for some single pieces of playground equipment. In addition, playground kits are usually purchased by municipalities and states, as opposed to schools or retailers to private consumers. Mike told Steve a couple of the HR reps said they had heard rumors that some of the sales people were boasting about spending lots of time and money wining and dining potential customers, particularly some Parks and Recreation staff in Indiana, Illinois, and Ohio. Mike told Steve the HR reps had been hearing these rumors for months, but didn't report them because the sales force was "always going around bragging about their exploits" and they didn't want to cause trouble for anyone.

Upon hearing this, Steve had gone to the office of one of the sales managers that he had known for 20 years and asked him to tell him, candidly and confidentially, what was going on in the Sales Department. Steve learned that, in general, Sally uses a "get results and meet your numbers on time no matter what" approach, but she only communicates that in a downward direction to the sales force, not to the rest of the company. Anyone who crosses her is made to feel like a traitor and exiled, no longer included in anything, so most of the sales force is intimidated, afraid to push back on anything, and afraid to speak up. Kate was shocked to hear this, as Steve had been also, because in the meetings with the rest of the management team, Sally projected a totally different management style.

Tyrone then told Kate what he had learned about problems related to Healthy Kids' interactions with USOPO, the United States Outdoor Playground Organization, on two major fronts.

Tyrone said he had a source in the Rochester plant, who confided that the facility has been having serious quality and performance issues on its spinning chair products. They have been struggling to identify the reason for the quality failures. The USOPO inspectors were going to withdraw the certification on the spinners, but the product quality staff managed to persuade the USOPO inspectors to delay the certification for a few months and come back to do it again, to give Healthy Kids a chance to fix the problems. Tyrone asked, "How did they get the inspectors to back off for a few months?" His contact said the head of quality in Rochester has a plush hunting and fishing lodge on Lake Vermilion, and he has let the inspectors and their families use it for vacation trips.
The other issue Tyrone heard about concerning USOPO had to do with the trade shows where Healthy Kids exhibits every year. USOPO has a long-standing practice of allocating booth space to vendors using a lottery system, so everyone has a fair chance to get a desirable booth for their display. Tyrone reported that he'd heard that since Sally became VP of Sales, "everybody knows" that Healthy Kids will always get the best booth, because Sally is dating the guy who's the director of trade shows for USOPO.

After the discussion with Steve and Tyrone, Kate called Sally. Sally acknowledged that she had a couple of dates with the trade show director at USOPO, but denied that the relationship had any influence on the company's display booth placement. She said "If you want to know why people think Healthy Kids gets preferential treatment on booth assignments, go ask your uncle!" Then Kate asked Sally about the sales incentive program and related what she'd heard about the culture in the sales organization. Kate told Sally she now understood why some schools and smaller retailers were leaving Healthy Kids and starting to purchase from other vendors. "Some of these are long-time customers – relationships that my dad began and cultivated and treasured – and now we're losing them because we act like we don't care about them any longer!"

Sally responded that the stories about her mandate to get sales "no matter what" were exaggerations and besides, she had no alternative but to adopt this type of incentive plan to keep the company's revenues and profits where they needed to be. She said Healthy Kids has been slow to adapt and change its product lines to compete with the other major players: "Whenever I've tried to discuss this with Tyrone and the folks in design and engineering, to make them understand we need new, different, and creative products, which will also, by the way, have higher margins, I get nowhere. They tell me we are changing some products, it's expensive to change too much at one time, and I need to be patient. But I'm warning you, the competition from the rest of the big boys is getting more intense! If we lose a few of the itty bitty customers, I can live with that. They can get by with equipment from someone else and we can get by without them. But we have to re-design and re-engineer our playgrounds – especially when we start expanding into Europe and Asia next year!"

That evening, Kate made a couple phone calls to colleagues with whom she had worked closely in Cleveland and asked a few pointed questions. She learned that, rumor has it, the quality and performance problems in Rochester are related to Red McIntyre's initiative to cut operating costs by 12% across the board. This surprised Kate, because Red had told her and Steve he was cutting costs by 8%. Apparently Red also had quite a reputation as a flirt and a ladies' man, so many of the women in his organization were wary of interacting with him unless others were present. Kate also learned that Healthy Kids' reputation is suffering because word is getting around that Healthy Kids is more concerned with making sales than it is with safety or quality, and it no longer cares about long-term trusting customer relationships.

"What has happened to Healthy Kids' culture!?" thought Kate. "Dad would be heartbroken if he heard these things." Kate realized if she and her team did not act to repair the company's reputation for doing business with integrity in a very short time, the business could pay a huge price. She resolved to find outside consultants to help.

This case was prepared for the Daniels Fund by Anne R. Harris, Principal of Ethics Works LLC, and a consultant to the Ethics & Compliance Initiative.