SILVER SERVICE®

THE FOUNDATION OF A MANAGEMENT PHILOSOPHY

BY ALVIN RICHER

with Lance Newman

SILVER SERVICE

The Foundation of a Management Philosophy

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There are many people to thank over the years.

Kayden Bell, however, is worthy of special mention. He has been with Arnold Machinery Company and me for over 26 years, starting as Controller, CFO, Executive V.P. and now President/CEO. It was he that not only supported this project but helped me get started and frankly nudged me on.

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Lance Newman, Associate Dean of the School of Arts and Sciences at Westminster College in Salt Lake City, spent many hours and days reading my articles; listening to my recorded speeches; attending breakfasts and luncheons with our associates, as well as our monthly review meetings; joining us at our year-end satellite broadcast and our annual shareholders meeting. Through his skill as an English Professor and a writer, he was able to craft, after many drafts, a manuscript that hopefully will be beneficial to you, the readers.

And, of course, my wife, Helene, has always supported my business adventures and risks. She has been my partner during good and bad times.

Thank You!

PREFACE

This book is a statement of the management philosophy that has guided the growth of Arnold Machinery since I acquired the company in 1984. It is intended to be used by future generations of management and to help all of our associates understand the company culture that is the engine of our growth. If managers or aspiring managers at other companies find it helpful or applicable to their business, so be it. We are happy to share our experience.

I developed these ideas over the course of many years of experience with several companies and through my exposure to many different industries. During those years, I tried to learn from the good and discard the bad. The philosophy that resulted from this process has produced almost three decades of profitability in highly cyclical industries and a ten-fold increase in sales volume. During that time, the company has moved from virtual bankruptcy to a net worth in excess of $70M. As of December 2012, we had paid over $25M in bonuses to our associates and another $30M in dividends to our shareholders. And we had expanded from four locations in two states to branches in 21 cities in 10 states.

It was first requested that I commit my management philosophy to writing in 1991 when the editor of *Material Handling Equipment Distributors Magazine* decided to run an article on the success of Arnold Machinery. Subsequently, when I was President of Associated Equipment Distributors in 1998, I published a series of articles in *AED Magazine*, in which I explained my ideas in more detail. However, this book is the first place that my philosophy has been presented completely from start to finish.

To the future management of Arnold Machinery Company: Do not discard that which time has proven effective. To others: Try it. It works. But know that success will take hard work, dedication, and discipline!

Alvin Richer
Chairman of the Board, Arnold Machinery Company

Chapter One

TURNING ARNOLD MACHINERY AROUND

Al Richer had a clear vision of how to transform Arnold Machinery into a successful and growing enterprise, and over the next few years, he made that vision a reality by transforming the company culture.

In July 1983, Al Richer began working as a consultant for Arnold Machinery. What he found was a company that had both a strong track record and great potential for future success. The company had been selling farm implements, construction equipment, and material handling equipment in Utah and surrounding states for more than half a century. It was a stable business-to-business enterprise with a strong customer base, and it was not subject to the whims of consumer sentiment. However, the company was fettered by ineffective management practices.

For instance, there was no meaningful financial planning. Instead of trying to accurately forecast income and expenses for the coming year, the controller would simply add three percent to each division's budget from the previous year. Other accounting practices were unacceptable too. The books claimed that the company was worth $3M, but there were contingent liabilities that totaled $3M. These liabilities included questionable customer debt guaranteed by the company, as well as receivables that were more than two years old. When receivables got to be so old that they were obviously worthless, they would simply be redated.

There was also no control of assets or cash flow. One manager showed Richer a chart that tracked the value of his inventory against the consumer price index, which is a meaningless comparison. On the other hand, he had given no thought to how his inventory related to his division's sales, which might have helped him plan his purchasing effectively.

More importantly, no one in the company gave any thought to return on assets. As a result, a big loader had been sitting on display under a canopy outside the main office for more than two years, tying up tens of thousands of dollars. Hundreds of thousands of dollars' worth of old parts were gathering dust on the shelves. And millions of dollars' worth of farm implements were out on consignment, rusting in the mud on dealers' lots.

At the same time, the employees, from technicians to salesmen to managers, were being micromanaged so intensively and inconsistently that they could not do their jobs well. The senior officers would tell the division and branch managers how much inventory to order and where to set prices. They would berate salesmen about their hotel bills and force them to sleep two or more to a room. Yet, when a frustrated employee was rude and arrogant toward a customer, nothing would be done.

Despite such poor management, the company had been able to survive during the 1970s. But the economy tightened up in the early 1980s, and the company's situation changed dramatically. By 1985, Arnold Machinery had lost money for three out of the five previous years and was nearly bankrupt. Nevertheless, the senior officers awarded an across-the-board cost-of-living salary increase in every one of those five years. Not surprisingly, it was a constant challenge just to meet payroll.

The poor management that Richer saw at Arnold Machinery was common at equipment dealerships across the country. Most independent dealerships were momand-pop operations. They had done well during the boom years after World War II, even though their owners had little business acumen. By the 1980s, though, most of them were operating on the slimmest of margins, and many were going broke.

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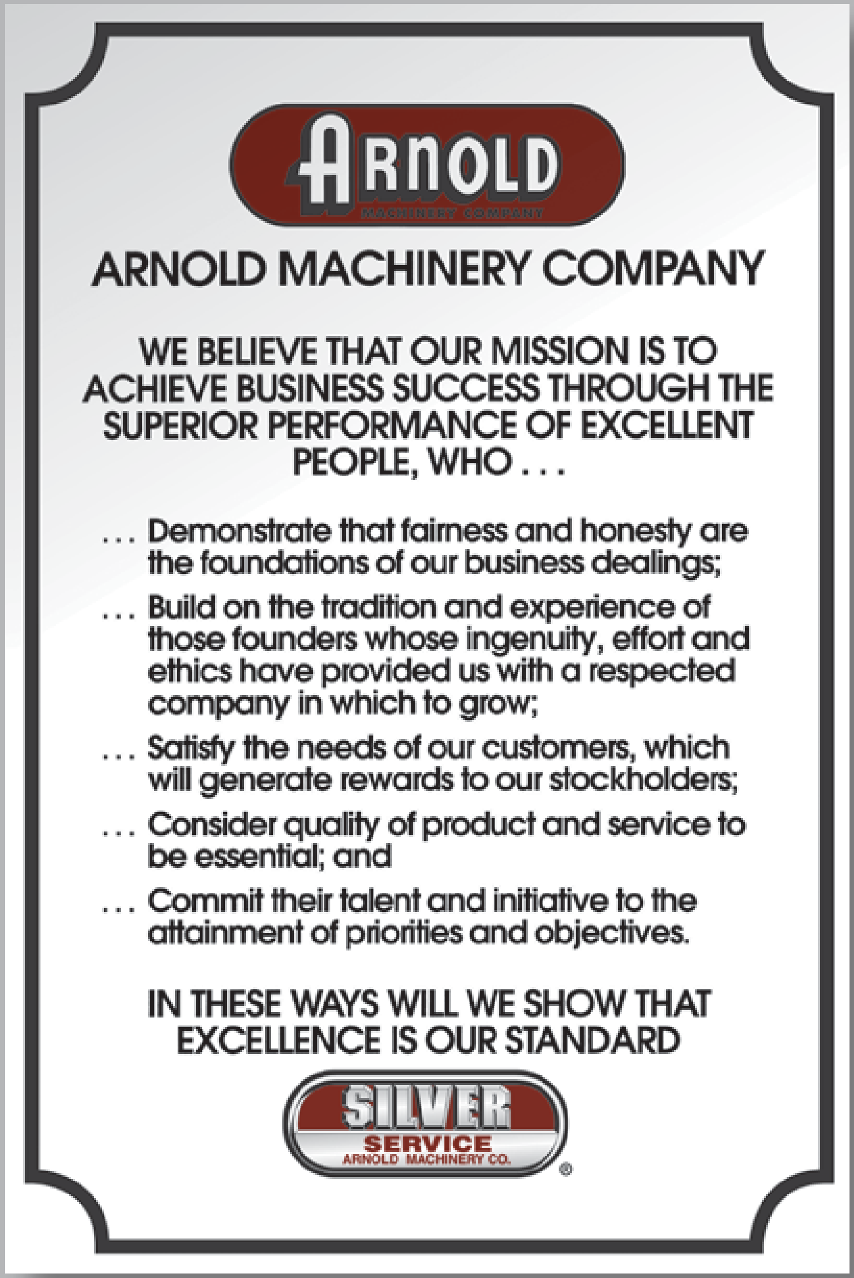
Richer not only saw an opportunity to turn Arnold Machinery around by instituting effective management practices, he also saw the possibility of growing the company by acquiring struggling competitors. So, just a few months after he started consulting for the company, he made an offer to buy it outright. His offer was accepted, and on October 1, 1984, Richer became the controlling shareholder, president, and CEO.

Richer had a clear vision of how to transform a failing company into a successful and growing enterprise, and over the next few years, he made that vision a reality by transforming the company culture. He accomplished that transformation by instilling the values of integrity, discipline, and empathy throughout the company, and then by establishing a strong customer service orientation, firm financial controls, a powerful incentives program, and effective communications.

Before he could do all that though, Richer had to stop the financial bleeding, in part by reducing personnel costs. He faced a choice: either he could lay off one third of the associates, in which case the company could not operate effectively, or he could ask everyone, including himself and



the executive team, to take a 10% reduction in salary until the company's finances were back in order. Most of the associates agreed to his bold proposal of across-the-board pay cuts, and the first step in the company's turn-around was complete. With the help of this pay cut, the company returned to profitability, making more than $300K by the end of Fiscal Year 1986. At that time, the pay cut was restored, and a discretionary bonus fund of $30K was issued to all associates based on their salary as a percent of the total payroll.

Next, Richer reviewed the financial performance and the operations of all of the divisions with the goal of closing units that were not contributing to the bottom line. As a result, Construction Equipment branches in Missoula and Reno were closed, and the overall head count at the company dropped from 198 to 149.

Richer discovered that the General Implements Division was losing $1M a year, in part because it was involved in a joint venture with Lundahl, a manufacturer of hay-cutting equipment. When they were operating properly, Lundahl machines were very efficient, but they would break down constantly. A field technician had to accompany every machine that was shipped. Richer extricated Arnold Machinery from the joint venture at a total cost of $1M. He also closed an underperforming General Implements branch in Pasco. The division went from 39 employees to 9, and its sales volume dropped from $8M to $2M, but within a year it was turning a profit and contributing to Arnold Machinery's bottom line.

Finally, Richer defined the company's role in the marketplace with a clear strategic statement: *Arnold Machinery is a distributor of non-consumer products headquartered and operating in the western part of the United States*. There are many reasons why independent distributors are irreplaceable in the market. Independent distributors stock new inventory, carry accounts receivable, maintain rental fleets, buy used equipment, accept trade-ins, ensure parts availability, and provide ongoing service. There is also the real, but unquantifiable, value of being part of the community and knowing the individual customer's wants and needs.

Soon after he developed the strategic statement, Richer crafted a mission statement to guide how, on a daily basis, Arnold Machinery's associates would pursue the company's strategic objectives. That mission statement emphasizes the fundamental values and convictions that allow associates to make ethical decisions that contribute to the bottom line. Over the next several years, the core elements of the company's mission statement—*especially its focus on customer service as the guarantee of profitability* and its balance between individual initiative and fiscal discipline—would evolve into the management philosophy stated in this book.

Richer often recalls the moment when he knew the turn-around of Arnold Machinery would succeed. He was giving a speech to the executive team, managers, and salesmen at the Marriott Hotel at the University of Utah. Richer used the phrase “I believe” as a refrain to list a series of goals for the company. For instance, he said, “I believe Arnold Machinery can achieve $100M in sales at 5% return on sales and 10% return on assets.” In the middle of Richer’s presentation, one of the salesmen stood up and called out, “I believe!” One by one, the rest of the people in the room rose to their feet and repeated, “I believe!” As it happened, the company hit Richer’s goal of 5% return on sales and 10% return on assets in 1989, and by 1993, annual sales exceeded $100M.

December 2, 1985

DEAR ASSOCIATES:

This is the first of what will be a quarterly report as to the "state of affairs" of our company.

Last year (fiscal year ending 9/30/85) was a year of transition. It was a year of adjustment in which we chose to fully recognize our problems and take appropriate action to "clean-up" as much as possible.

This process particularly impacted our GID division where it was necessary to correct past practices that were unsound and untenable over the long term. GID has lost money for the last 3 years – hopefully the actions taken in 1985 will position us to make a profit in 1986 and future years, regardless of the vicissitudes of the farm economy. We owe a debt of gratitude to all those GID people who "endured the pain" and whose hard work and dedication made it happen.

As you know, we closed our branches in Missoula, Reno and Pasco. In addition, we converted our Material Handling branches in Twin Falls and Idaho Falls to "service only" locations. The reason for taking these actions were simple and straightforward – they were simply too small (in terms of dollar sales volume) to generate a profit. In fact these branches lost, in 1985 alone, $382,000 without counting or charging them with their share of divisional or corporate expense. This action alone should greatly enhance our ability to achieve our 1986 profit objectives.

Another problem that has plagued the corporation has been Bad Debt Expenses. Since 1981 our Bad Debt losses have ranged between $375,200 to $432,000 per year. Prior to 1980 our losses never exceeded $100,000. This was caused by Tax credit analysis, bankruptcies and selling with "full recourse", which means we are ultimately responsible if a customer does not pay, even if a CIT or other finance company "takes the contract". We want to do everything we can to sell as much as we can – but , selling and not getting paid is a hollow victory.

The tough competition and the advent of the "Gray Market" has caused serious deterioration of our Gross Margins. This is very serious because these are the dollars that pay the bills – and salaries. The answer is obvious – we must either get more Gross Margin or pay out less. I am sure none of us wants to get paid less – so we must get more Gross Margin!

As a result of all of the above, I am sorry to report that we lost money in 1985. In fact the corporation has lost money the last 4 out of 6 years resulting in a cumulative loss since 1980. It wasn't always so – in fact up until 1979 the company had good growth and solid profits. The challenge for all of us is to re-capture "the Glory Days". I have the utmost confidence that we can and will do just that. Here's why I believe we can –

1 – We have taken appropriate actions to plug major "profit leaks" (Branches, A/R etc).
2 – Last year we cut our losses in Idaho by 50% and we look forward to Boise and Idaho Falls being profitable in 1986 after five long years.
3 – We have re-organized GID so that they have a shot at profitability in 1986 after 3 years of losses.
4 – For the first time in a long time our parts inventory shortage was minimal which indicates tighter control and greater concern in regards to our major financial asset. (By the way, congratulations to all those who participated in our year-end inventory taking – you did a great job.)
5 – Our budgeting for 1986 was very well done – best ever. we have budgets which are realistic and most importantly – attainable.
6 – We have excellent Management Control Reports in place, which will bring to our attention any major deviations on a monthly basis. It is now up to us, all of us, to take immediate corrective actions, when necessary, so that we may achieve our objectives (budgets) on a monthly basis. If we pay attention to each month, the year will take care of itself.

In summary, we have a great future – a fine, solid company with a 56-year history of integrity, employee good will and ownership, customer service and a founding family that imbued us with all the good things that have epitomized our great country and free enterprise system. It is now up to us – "the next generation" to make Bob, Ray and "Doc" Arnold proud of us. Let's show them that their hard work, devotion, integrity and sincerity have built a foundation and platform which can catapult us to new heights. There aren't any short cuts – the same hard work, devotion, integrity and sincerity on the part of all of us will make it happen. I am proud to be part of this "family" and am counting on each of you to do your part in achieving our goals.

Sincerely,

Alvin Richer
President

Chapter Two

THE CHARACTER TRAITS OF A STRONG LEADER AND A GREAT COMPANY

Aside from having a clear vision that you can communicate to others and the confidence to make hard decisions, what are the essential attributes of a strong business leader? According to Richer, it's simple. You must have solid moral character, because strong leadership starts with creating a company culture that is based on strong values.

Al Richer often remarks, “I run Arnold Machinery on the belief that 98% of the people we deal with are honest, rather than worry about the 2% who are not.” Richer’s values are clearly implied in the mission statement that he developed when he took over the company. However, he first stated them explicitly when he was giving a presentation to an MBA class at the Gore School of Business at Westminster College in Salt Lake City. A member of the audience asked, “What are the qualities of a great CEO?” Richer thought for a moment and then wrote on the whiteboard: “Integrity, discipline, and empathy.” Since then, these three terms have been integrated deeply into the company culture. Along with their definitions, they appear on posters, on buttons, on the company website, and in all of the company literature. The associates at Arnold Machinery are continually reminded that, as Richer likes to say, “You can’t be part pregnant.” Either you are ethical or you are not. Either you behave with integrity, discipline, and empathy, or you do not.

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Integrity means you act with sincerity, honesty, and candor. Having integrity means you return phone calls promptly. If you say you are going to do something on Tuesday, you do it on Tuesday, or you call your customer in advance and tell them why you can’t. Richer often tells Arnold Machinery associates, “I will not lie to you, and I do not expect you to lie to me, but above all, we never lie to our customers or to our vendors.”

It is especially important to act with integrity when you need to make decisions that will make life difficult for others. For instance, in the early 1980s, construction equipment was a very stable industry. Many manufacturer/distributor relationships had lasted 20 or even 30 years. Suddenly, one of Arnold Machinery’s important contracts was canceled during a wave of consolidations instituted by a manufacturer who wanted all its products represented “under one flag.” However, the termination of this relationship was conducted in a very forthright and honorable way. Arnold Machinery was compensated for the market and infrastructure it had built. When the negotiations were finished, the parting was very amicable. There was no animosity, no acrimony, and no legal action. In the end, the dealer who was given the line went bankrupt, and Arnold was asked to represent the manufacturer again. In subsequent years, the relationship expanded, and the companies now enjoy a long-standing, profitable partnership.

On another occasion Arnold Machinery was in discussions with a manufacturer regarding representation. However, they already had two existing dealers in the proposed territory. The manufacturer insisted that they would not cancel contracts with their long-time distributors. Instead, they stated that, if it was possible to negotiate a fair and equitable acquisition of the existing dealers, they would give Arnold Machinery their line. The acquisitions were accomplished, and as a result the manufacturer maintained its high standards of honor and ethical behavior, the two dealers were able to comfortably retire, and Arnold gained a valuable product line.

My father was a fruit wholesaler in upstate New York and New England. The farmers he worked with were always anxious about the future, so he would commit to buy their entire crop while the apples were still on the tree. He never signed a contract, and he made every deal on a handshake. Sometimes, after the harvest, the apples didn't end up looking like they should. Once, a farmer said to him, "You don't have to take these apples. We don't have a contract." My father looked at him and said, "No. I gave my word, and I shook hands." He could have lectured me about integrity until he was blue in the face, and it would never have taught me as much as the way he acted that day.

–Al Richer

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Discipline means you must always exercise self-control and self-restraint. Discipline means that you gather accurate data about your business, you review this information in a timely manner, and you use it to guide your decision-making.

For instance, at Arnold Machinery, monthly financial review meetings are planned a year in advance so that every associate involved is sure to attend. These meetings are part of a set of controls that instill financial accountability throughout the company. Every month, associates in all of the branches review their financial results and determine whether they are meeting the goals they have set for themselvers. If not, they must explain why, figure out the problem, and they must make a plan to fix the situation.

Another important ritual at Arnold Machinery is annual self-evaluations. Instead of checking off boxes on a form, all of the associates review their personal performance in their own words. They take a few hours to think about the previous year, and then they write a report in which they identify their successes, explain their failures, and set specific goals for personal improvement. Each supervisor then reviews the self-evaluations of all the associates who report to him, and he meets with them individually to provide feedback. Finally, the CEO reads all the self-evaluations, which gives him a feeling for morale in each branch and across the entire company. Doing so also gives the CEO a sense of each associates' ability to express himself in writing, since he will see everything from a neatly typed and thorough presentation to a quick scrawl on a sheet from a legal pad.

The self-evaluation process not only helps associates improve their performance, it also gives them a voice so that they can help identify areas for improvement in their branches and divisions.

When you are disciplined, you make plans, and you execute them faithfully. You make realistic budgets, and you meet them. If problems arise, you find solutions. If you fail, you never blame it on someone else or the weather. Instead, you take responsibility for the failure, and you figure out what it will take to succeed the next time.

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Empathy is intellectual or emotional identification with another. It is the capacity to experience another person's feelings or ideas. In business, this means that you must always put yourself in the position of the customer. In order to structure a deal that satisfies the customer, you must always take the time to truly understand his needs and concerns.

For instance, on one occasion, a buyer for a construction company was planning to buy a Dresser wheel loader, but was worried about what would happen if Arnold Machinery were to stop representing the manufacturer. Richer acknowledged the buyer's concerns and promised that if he dropped the line, then he would buy back the machine at the customer's named price and replace it with an equivalent loader from the replacement line. A short time later, Arnold Machinery did drop Dresser and took on Volvo in its place, and Richer was true to his word. As a result, more than two decades later, the construction company remains a loyal customer.

I learned about the importance of accountability when I was a division manager for a group of department stores in Chicago. I ran a big promotion, but there was a bad snowstorm, so sales were terrible. I was stuck with a big backlog of inventory. The president of the company called me into his office and asked, "What happened yesterday?" When I blamed the poor sales on the snowstorm, he said, "If I want a weather report, I'll call the weather bureau." He walked on to the main floor of the store, started pulling merchandise off the shelves, stacking it on the bargain tables, and changing prices right then and there. Within a few minutes, customers were standing around the tables waiting for him to put things down, and he said, "If you're priced right, it doesn't matter what the weather is."

–Al Richer

I will not allow an automated phone answering system in any location. The phone must be answered by a human being with empathy in his or her voice. Imagine you are a customer whose equipment has broken down. You are losing production and money the longer the situation goes on. Do you want to hear, “For service, press 1” over and over, or would you rather talk to someone who can help you immediately (or get someone who can).

–Al Richer

When the economy is in recession, it is doubly important to understand what the customer is going through. Arnold Machinery’s Fleet Replacement Program, which was launched in 2008, is based on this insight. When a customer is short on liquid funds, Arnold Machinery will offer to buy his used equipment for cash, while also offering him generous long-term credit terms for the purchase of new equipment. The buyback program does not necessarily operate on a one-to-one basis; Arnold Machinery may buy back five pieces of equipment and replace them with two or three, depending on the customer’s current operations. As a result, the customer gets both the equipment he needs as well as a much-needed infusion of cash to operate his business.

It is important to empathize not only with customers, but with fellow associates. Richer is fond of telling associates, “You don’t criticize another person until you have walked a mile in his shoes.” Even if it becomes necessary to fire someone, a supervisor must handle the situation with empathy. Once, when Richer was president of the May Department Stores in Florida, the merchandise manager for menswear lied to him about an aspect of the store’s operations. Aside from this one incident, the manager had been an reliable and productive employee, but Richer felt he could no longer be trusted and decided to terminate him. Richer met with the manager, delivered the decision with as much empathy as possible, and explained the reasons for it. Of course, the manager was not happy, but he understood why he was being let go, and he respected

Richer for his candor and compassion. Over the years, he stayed in touch, and Richer became a business mentor to him as he rebuilt his career.

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The three character traits that Al Richer believes are most important for success in business—integrity, discipline, and empathy—define the company culture at Arnold Machinery. The next four chapters of this book will explain the four management principles—customer service, controls, incentives, and communication—that put the company culture into action by guiding the associates every day in their interactions with suppliers, customers, and each other.

Chapter Three

SILVER SERVICE®

The most important element of the Arnold Machinery company culture is a total commitment to customer satisfaction that starts at the top of the organization with the Chairman and the President/CEO and that influences everything we do every day.

Early in his career, Al Richer was general manager of a department store in Hartford, Connecticut. The store was a subsidiary of G. Fox and Company, a business that had been started in 1847 and was the pride of southern New England. G. Fox and Co. was run by Beatrice Fox Auerbach, who had taken control when both her father and her husband died.

Mrs. Auerbach didn't think about people as the customers; she thought about them as *her* customers. And because she was so passionate about serving their wants and needs, she was able to build a million-square foot store in downtown Hartford. In 1965, she sold her company to the May Department Stores for over $50M. Mrs. Auerbach was a reserved and refined lady, who would never have dreamed of publicizing her attitude toward her customers.

However, while he was working for Mrs. Auerbach, Richer saw an example of how effective it can be for a company to promote its guarantee of customer satisfaction. Bill Savitt, who was one of Richer's mentors, owned a small jewelry store in downtown Hartford. In the jewelry business, most customers don't know how to tell the difference between 12-carat gold and 24-carat gold or between natural and manufactured diamonds, so they have to trust the jeweler. Television was a new advertising tool at the time, and Savitt saw its potential. He ran quirky ads in which he appeared on screen upside-down and said, "P.O.M.G.: See Savitt, and you'll have it." P.O.M.G. stood for "Peace-of-Mind Guaranteed." Savitt had the same customer service

orientation as Mrs. Auerbach, but he promoted it creatively, and his business grew by leaps and bounds.

After they acquired G. Fox and Co., May Department Stores promoted Richer to President of the Florida division. When he arrived in Florida, he adopted Beatrice Fox Auerbach's attitude toward customer service and Bill Savitt's methods of promoting that attitude.

For instance, he recognized that in the retail business, customers return thousands of gifts after Christmas. Most companies have restrictive returns policies that are designed to minimize their financial losses. But Richer instituted a new unlimited holiday returns policy, and he ran ads that invited customers to bring back anything they weren't completely satisfied with. Then he extended this policy to the whole year and made sure the customers knew about it

by running ads about eye-catching examples, like the time his store accepted the return of a 20-year-old comforter.

On another occasion, a bride ordered six bridesmaid gowns, and they were not going to arrive in time for her wedding. Richer paid the manufacturer to ship the dresses overnight by air and then delivered them by helicopter to a small town in south Georgia. The bride picked them up in person on the high school football field. Richer alerted television stations in South Georgia and North Florida, and they covered the story on the evening news. Subsequently, he ran ads in the local newspapers that let the readers know May's would spare no expense to make the customer happy.

Promoting your commitment to customer satisfaction not only lets the public know where you stand, but it's also good for your organization. When you make a commitment publicly, your employees have to perform so as not to make you, the company, and themselves look foolish. By using this strategy, Richer took May's Florida Division from one downtown Jacksonville store and one branch that was losing money to five stores that were making solid profits.

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In June of 1986, a little more than a year after Al Richer bought Arnold Machinery, the executive team held a strategic planning meeting, and Richer set out to change the senior managers' attitudes toward the company's customers. He wanted to instill a customer-service mindset in every person in every phase of the company's operations. So he asked, "What makes Arnold Machinery unique?"

The division managers said, "We've got parts." Richer replied, "Our main competitor, Caterpillar, has more." The managers said, "We've got trucks." And he said, "Caterpillar has more." Finally, Richer reminded everyone at the table that Caterpillar was known for taking good care of their big accounts, but ignoring their little ones. In the end, everyone at the meeting realized that the company's attitude toward its customers had the potential to set it apart in the marketplace. If that's true, Richer said, then our attitude needs to be a promise and a policy. He decided to call the new policy, "Silver Service®," after the Silver Room at the Stein Eriksen Lodge at Deer Valley where the strategic planning meeting was being held. Also, Arnold Machinery's service trucks were silver-grey with red and white stripes, so the new phrase picked up the company colors. And soon, it would become a defining feature of the company's identity.

After all, committing to customer satisfaction cannot be a promotional ploy. It must be woven into the fabric of the organization. Richer knew that the key to delivering Silver Service® would be to get a personal commitment from every single associate that customer service is not just a policy, it's an obligation. In order to get people on board, he gave a dollar a day to everybody who would wear a "Silver Service®" button. A few months later, in the spring of 1987, Arnold Machinery started running "Silver Service®" ads that publicized the company's commitment to customer satisfaction. After a while, Richer stopped giving people the dollar, but the associates kept wearing the button. The slogan reminded everyone at the company that they were there to serve the customer.

Since then, Silver Service® has become the glue that holds Arnold Machinery together. It is an attitude. It is a commitment. It is a rallying cry for all of the associates. The phrase appears on virtually every piece of the company's corporate literature, from letterhead to brochures. It is even used as a verb when associates say, "I Silver-Serviced the guy." All of the associates understand that the company's success depends on the customers' conviction that they will receive better service from Arnold Machinery than from their competitors. The associates also understand that no machine is more reliable than the people who stand behind it. And most importantly, they understand that a customer who is unsatisfied for any reason will soon become someone else's customer.

People sometimes question the value of the company's commitment to Silver Service®, but consider the alternative. If you fight with the customer, then even if you give in afterward—and eventually you will give in—the customer is so angry that you have lost them. Besides, if you dig down deep enough to find out why the customer is unhappy, you almost always find out that you did something wrong. Sometimes it is something as simple as not returning a phone call. A policy of total customer satisfaction helps you find out what your business is doing wrong.

Arnold Machinery tells its associates only one thing to guide them in their interactions with customers: You will never be fired for doing too much for the customer (as long as it is ethical), but you surely will be in hot water if you don't leave the customer smiling. If the company tells its associates that

When the Silver Service® program was developed, there were people in the company who had very different attitudes. For instance, one of the division managers at the time was a hot-tempered guy. Once, before I bought Arnold Machinery, there was a phone call for him while I was in the room. He took it, and the customer said something he didn't like. He tore the customer apart, and the president, who was present, didn't say a word. I thought, "If that's the attitude toward customers around here, no wonder they are broke." The same manager was at the first strategic planning meeting we held after I bought the company, and he said to me, "Silver Service® is a terrific slogan for this month. But what's it going to be next month?" I said, "As long as I am around, it's not a slogan. Silver Service® will be woven into the fabric of our business." He couldn't tolerate it, and he left shortly thereafter. I didn't have to fire him.

–Al Richer

I have always said that no company I run will have a policy book. That's because one time when I was working in retail, I wanted to do something for a customer, and when I told my boss what I wanted to do, he pulled out a policy book. He looked at it and said, "It's not in the book, so you can't do it." I've been adamant about it ever since. Then one day, Kayden Bell was holding a meeting with all the managers and salespeople in the company. He got up and said, "We now have a policy book." I wanted to get up and smack him. But he came up with a policy book the size of a business card that quoted my favorite piece of advice for our associates about how to put Silver Service into action. Now, we could hand a card to an associate or a customer and say, "This is our policy, and we stick to it!"

–Al Richer

they will be dismissed for failing to keep the Silver Service® commitment, the associates have to know that the company will back them up when they take a risk to satisfy the customer, regardless of the cost. In fact, these expenditures on Silver Service® are the company's best assurance of continued profitability, since they keep the customers coming back. From the customer's perspective, the Silver Service® policy is the best assurance that Arnold Machinery sells only top-quality product, since they stand behind everything they sell.

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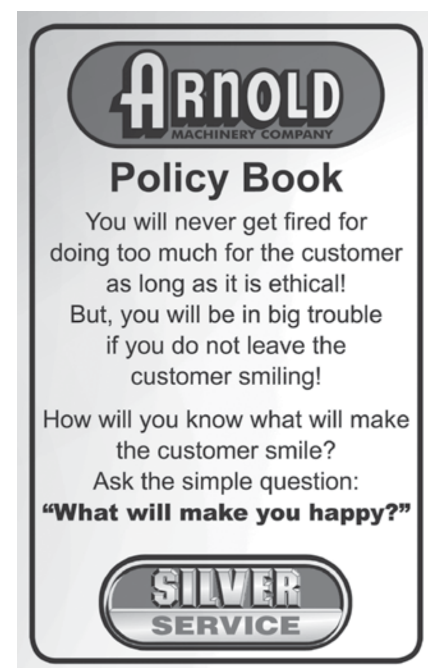
Unlike many corporations, as part of its financial analysis, Arnold Machinery tracks an expense line called "Policy Adjustments" that shows the cost of delivering Silver Service®.



In other words, the company accounts for the cost of all the extra things they do to make customers happy, and the total sometimes runs as high as $900K a year. However, this expense is more effective than any advertising.

Once, Richer gave an unhappy customer a check for $500K. The customer had purchased a sand plant, and the salesman gave them inaccurate advice about how the equipment would perform. The field technicians could not get the machines to work satisfactorily, so the purchase price was refunded, and the customer kept the equipment.

On another occasion, Arnold Machinery sold two stackers to the Echo Bay Mine in Nevada, and they broke down not long after they were installed. The mine had hired a national engineering firm to design their process. The engineering firm had established the specifications for the various pieces of equipment to be used in the process, including the stackers. Arnold had then given the stacker specifications to a manufacturer who provided a very competitive quote. They won the bid, the manufacturer built and delivered the stackers, and Arnold's technicians installed them according to the specs. As soon as the machines started operating, they collapsed.

The customer threatened to sue, so Richer asked the president of the company that manufactured the stackers to fly out and visit the mine with him. He replied, "We built those machines to spec, so it's the customer's problem." Not only that, he flatly refused to contribute a dime to fixing the situation. Nevertheless, Richer convinced him to come to a meeting with the customer. While they were driving to the mine through the barren Nevada desert, Richer said, "If you can't back me up on what I'm about to do, then you better promise to keep your mouth shut when we get there. Otherwise, I'm going to kick you out of the car right now."

When Richer and the president of the manufacturing company got to the meeting at the mine headquarters, everyone in the room was grim-faced. Richer said, "If I can't belly up to the table when things are tough, I'm going to take this stupid, hokey button off. I'm here to tell you that you're right. We're going to buy those stackers back."

The machines had sold for $300K, and Richer didn't know if Arnold Machinery had that much cash on hand, but he had made the Silver Service® commitment, and he was going to live up to it. The stakes were high, and he bet his business on the importance of customer satisfaction.

There was utter silence in the meeting room, until finally, the general manager of the mine said, "Oh, come on, just get those stackers fixed, will you?"

In the end, fixing the stackers cost about $25K. True to his word, the manufacturer did not contribute a dime. But, a year later, the mine bought a Hitachi EX-3500 shovel for close to $3M. Within the next few years, they bought three more EX-3500s. And they purchased the first Hitachi EX-5500 sold in the United States. For years, Arnold Machinery maintained a full-time service technician on site. Including sales, parts, and service, Arnold Machinery did $25M in business with the mine before it closed in 1998.

After the experience with Echo Bay, Richer regularly asked Arnold Machinery Associates, "Who wouldn't give \$25K to get back \$25M?" After all, Silver Service® is an investment, and it pays off.

A few years later, a big cleaning supplies company in Salt Lake City ordered a fleet of gas-powered forklifts, but they failed to take into account that they would be using them in a closed warehouse most months of the year. Of course, emissions were a problem. Arnold Machinery took all thirteen machines back, without any obligation on the part of the customer. Then the company bid on replacing the gas machines with electrically powered lifts. Arnold got a \$1M sale, and became the customer's materials handling supplier nationwide.

• • •

Despite the early proof of the Silver Service® program's success, some of the company's associates just could not get on board. The vice president of Material Handling and a branch manager in Phoenix were dismissed after a focus group found that they did not take care of their customers. A branch manager in Denver was let go for the same reason. His excuse was that he was new, but it was clear that he would never be able to put the company policy into practice. At Arnold Machinery company, associates are not only empowered to provide Silver Service®, they are obligated to leave the customer smiling.

Have there have been occasions where a customer has taken advantage of the company's generosity? Yes, it happens from time to time. Once, a new division manager was

SILVER SERVICE® IN THE CUSTOMERS' WORDS

It's a matter of a phone call, no matter what piece of equipment we need, or if I need service for our equipment, Arnold is on it and has someone back to us within an hour to tell us what they can do, and when it can be done. You can bank on it. It gets done. Silver Service® to us is the fact that Arnold makes the commitments and backs up those commitments with no qualms. If we need the equipment serviced, that equipment is fixed, repaired, or replaced within the time-frame Arnold promised us.

The reason why we have gone with Hyster and Arnold Machinery is because of the Silver Service® package they give us. Since we started to use Hyster, Arnold Machinery has been true to their word. I believe that commitment has come through the good quality of the people they have and their follow-through. That is Silver Service®.

It's true that you can't do today's work with yesterday's equipment and be in business tomorrow! Service from our distributor is also important, and we count on Arnold Machinery's service department. Our experience with Arnold has been absolutely excellent. What they say they'll do, they do.

SILVER SERVICE® IN THE ASSOCIATE'S WORDS

Silver Service® means taking pride in your relationship with the customer.
–Bryan

It means treating people according to the Golden Rule.
–Kathy

We take good care of our customers, but we treat each other right too.
–Vern

Silver Service® means I own every call I take at the reception desk.
–Nancy

I never let a customer walk away disappointed.
–Eric

If you decide to go above and beyond, the company has your back.
–Tim

The associates are empowered to make executive decisions.
–Tom

When we treat a customer right, they want to take care of us too.
–Cathy

working with a customer who had a problem with a piece of equipment, and the manufacturer wouldn't do anything about it. The manager asked, "What will make you happy?" The customer named a huge price, several times what the machine was worth. But Arnold Machinery cut the check, not only because it was important to stand by the new manager, but also because, in the long run, the benefits of Silver Service® far outweigh the disadvantages.

Silver Service® is a more effective way to build a business than conventional advertising. With conventional ads, it is impossible to know who they will reach. But with Silver Service®, Arnold Machinery is building long-term relationships with individual customers. The policy is an investment in the future.

Instead of running conventional ads, Arnold Machinery advertises the Silver Service® policy directly to the customer (see pages 40-45). In order to ensure consistency and continuity, these ads are not charged to the divisions, since division presidents might be tempted to cut their advertising budgets in lean times. Instead, corporate pays to run Silver Service® ads in industry-appropriate magazines. At least one ad runs in one magazine every month, and in each publication once a quarter. Product specific ads are paid for by the divisions.

Richer often remarks, "Silver Service® is the engine of our growth." When the program began, Arnold Machinery's sales volume was approximately $30M a year. In 2012, the company's sales volume was $307M.

A few years after Richer started the program, he was asked to make a presentation at the annual convention of the Material Handling Equipment Distributors' Association. He was concerned about the fact that the competition would be there, so he called his attorney and asked him to seek trademark registration for the phrases "Silver Service®" and "Customer Service is Our Only Policy®." As it turned out, Richer's concern was well-founded. Several times over the years, it has proven necessary for Arnold Machinery to pursue legal action to prevent other companies from using these phrases in their promotional materials.


SILVER
SERVICE
ARNOLD MACHINERY CO.
BUYER
BEWARE
SILVER SERVICE® eliminates the concern of Buyer Beware when you deal with Arnold Machinery Company. It is a commitment by all Arnold associates to provide a safety net for you, our customer, and provide the best service anywhere!
When we say it we mean it . . . Customer Satisfaction Is Our Only Policy®!
ARNOLD
Construction Equipment Division | Mining Equipment Division | Material Handling Equipment Division | General Implement Distributors Division
Salt Lake City | Idaho Falls | Boise | Twin Falls | Elko | Reno | Las Vegas | Phoenix | Tucson | Flagstaff
Portland | Billings | Gillette | Casper | Denver | Johnstown | Colorado Springs | Grand Junction | Minneapolis
www.arnoldmachinery.com


SILVER
SERVICE
ARNOLD MACHINERY CO.
YOU WON'T LEAVE HERE WITHOUT IT!
The old phrase "Leave 'em smiling!" applies to Arnold SILVER SERVICE®. Our associates are not only empowered, but they are obligated to make you, our customer smile! How is it done . . . we ask one simple question . . . "What will make you happy" and then Do It! That is why when we say it we mean it . . . Customer Satisfaction Is Our Only Policy®!
ARNOLD
Construction Equipment Division | Mining Equipment Division | Material Handling Equipment Division | General Implement Distributors Division
Salt Lake City | Idaho Falls | Boise | Twin Falls | Elko | Reno | Las Vegas | Phoenix | Tucson | Flagstaff
Portland | Billings | Gillette | Casper | Denver | Johnstown | Colorado Springs | Grand Junction | Minneapolis
www.arnoldmachinery.com


SILVER
SERVICE
ARNOLD MACHINERY CO.
FINE PRINT
You will not find any fine print in our SILVER SERVICE® policy.
It is straight forward, what we say is what we mean . . .
Customer Satisfaction Is Our Only Policy®!
ARNOLD
Construction Equipment Division | Mining Equipment Division | Material Handling Equipment Division | General Implement Distributors Division
Salt Lake City | Idaho Falls | Boise | Twin Falls | Elko | Reno | Las Vegas | Phoenix | Tucson | Flagstaff
Portland | Billings | Gillette | Casper | Denver | Johnstown | Colorado Springs | Grand Junction | Minneapolis
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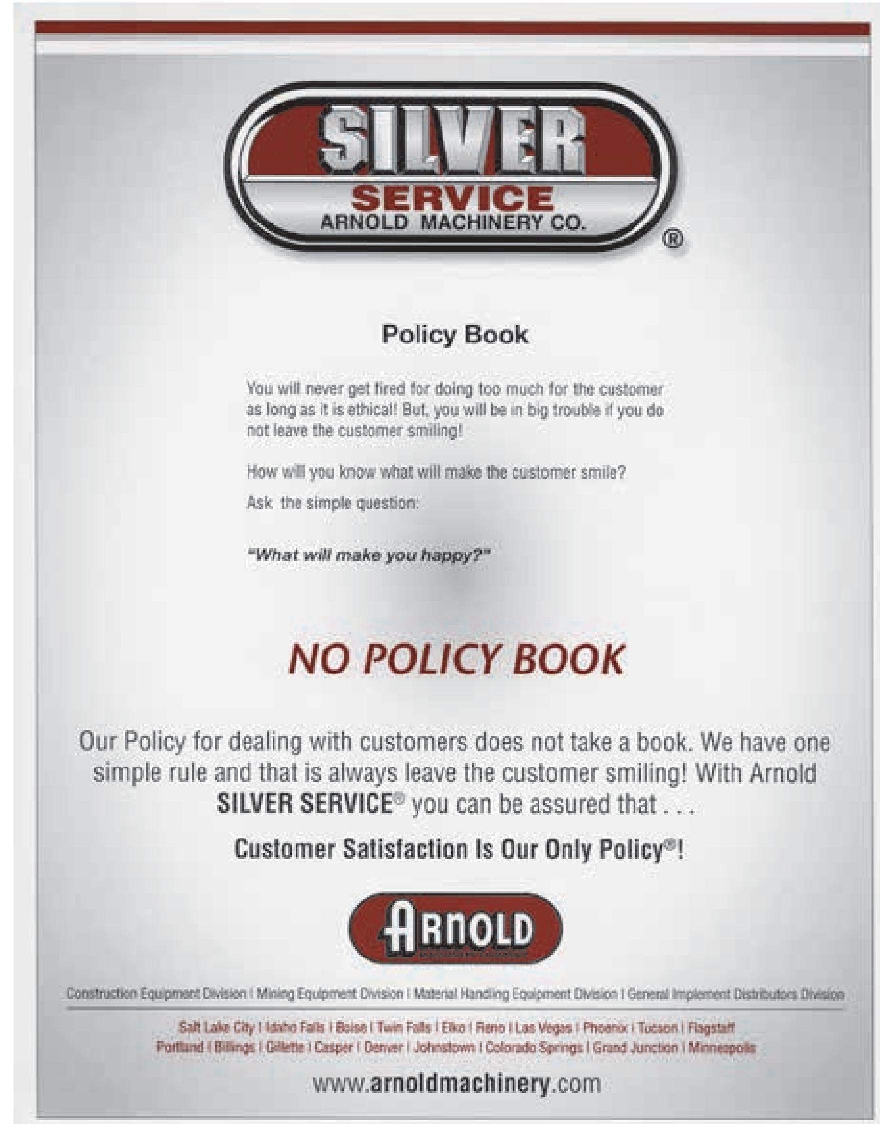
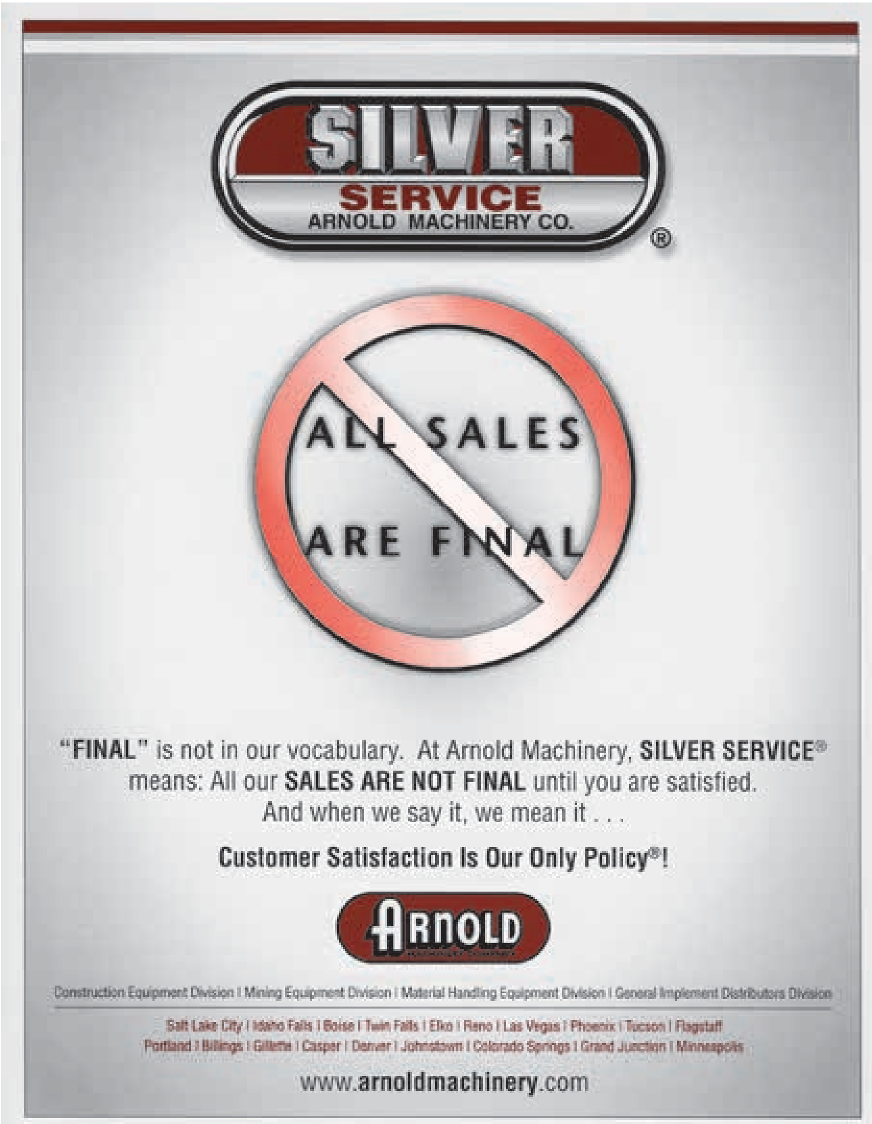

SILVER
SERVICE
ARNOLD MACHINERY CO.
Policy Book
You will never get fired for doing too much for the customer as long as it is ethical! But, you will be in big trouble if you do not leave the customer smiling!
How will you know what will make the customer smile?
Ask the simple question:
"What will make you happy?"
NO POLICY BOOK
Our Policy for dealing with customers does not take a book. We have one simple rule and that is always leave the customer smiling! With Arnold SILVER SERVICE® you can be assured that . . .
Customer Satisfaction Is Our Only Policy®!
ARNOLD
Construction Equipment Division | Mining Equipment Division | Material Handling Equipment Division | General Implement Distributors Division
Salt Lake City | Idaho Falls | Boise | Twin Falls | Elko | Reno | Las Vegas | Phoenix | Tucson | Flagstaff
Portland | Billings | Gillette | Casper | Denver | Johnstown | Colorado Springs | Grand Junction | Minneapolis
www.arnoldmachinery.com


SILVER
SERVICE
ARNOLD MACHINERY CO.
®
ALL SALES
ARE FINAL
"FINAL" is not in our vocabulary. At Arnold Machinery, SILVER SERVICE® means: All our SALES ARE NOT FINAL until you are satisfied.
And when we say it, we mean it . . .
Customer Satisfaction Is Our Only Policy®!
ARNOLD
Construction Equipment Division | Mining Equipment Division | Material Handling Equipment Division | General Implement Distributors Division
Salt Lake City | Idaho Falls | Boise | Twin Falls | Elko | Reno | Las Vegas | Phoenix | Tucson | Flagstaff
Portland | Billings | Gillette | Casper | Denver | Johnstown | Colorado Springs | Grand Junction | Minneapolis
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SILVER
SERVICE
ARNOLD MACHINERY CO.
®
TRADEMARK
A United States registered trademark is something unique and exclusive. You will find our SILVER SERVICE® to be more than just a trademark. It is our symbol of assurance to you that . . .
Customer Satisfaction Is Our Only Policy®!
ARNOLD
Construction Equipment Division | Mining Equipment Division | Material Handling Equipment Division | General Implement Distributors Division
Salt Lake City | Idaho Falls | Boise | Twin Falls | Elko | Reno | Las Vegas | Phoenix | Tucson | Flagstaff
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Chapter Four

CONTROLS

Fiscal controls allow Arnold Machinery to delegate decision-making to the associates and make them accountable for the results of their decisions.

It is one thing for a company to grow, but it is something else to make a profit. Instituting financial controls is the toughest of the four elements of the Arnold Machinery company culture because it requires a very high level of discipline from individual associates, as well as from the organization as a whole. By regularly reviewing a wide range of data points that track the company's performance along multiple dimensions, the executive team can consistently identify problems, their causes, and their solutions. This system of financial controls also focuses the entire organization on hard data, it prevents decision-making based on personalities and popularity, and it ensures that at Arnold Machinery, results are what matter.

When Richer bought Arnold Machinery, all the decisions were being made in the offices of the President and CEO. But Richer planned to expand, and he knew he could not micromanage a company with operations in several states. So he adopted a new company-wide system of local management based on a simple but powerful principle, "Inspect, don't expect." Richer gave individual managers control of their budgets and the authority to make decisions about the day-to-day operations of their units. For many associates, being empowered to think and act for themselves was unnerving at first, but people really stepped up to the plate.

One of the key principles behind the system of controls is summed up in the motto, "You may delegate authority, but you do not abdicate responsibility." You can ask someone to do something for you, but you are responsible

Early in my career, I was the buyer of infants' and toddlers' wear for a chain of 16 department stores. I never came in contact with customers. One day, I asked my boss, "I know where to buy things like diapers and those kinds of things. But how many should I buy?" He said, "You got to feel it in your gut." I was all of 23 years old, and I felt nothing in my gut except panic. I knew there had to be a better way. Having started off life as an engineering student, I was good at math, so I figured there must be a statistical basis for determining how much we could sell. Soon, I was completely absorbed in figures. How many units did we sell overall? How many did this store sell? How low is our inventory?

–Al Richer

for the outcome. This goes for everyone from the shop floor to front office. For example, even though Richer delegates most of the day-to-day decisions, he is ultimately responsible for everything that happens at Arnold Machinery. In order to hold himself and all of the company's associates accountable for their decisions and their performance, Richer devised a system of annual strategic planning meetings and monthly review meetings.

Prior to each strategic planning meeting, all of the division presidents are provided with a ratios and comparisons report for their units. The report gives a five-year history of the following operating elements: net sales, gross profit dollars and percent, expense dollars and percent, net operating profit dollars and percent, payroll dollars and percent, interest dollars and percent, bad debt dollars and percent, average inventory, ending accounts receivable and percent current, average FIFO assets, accounts receivable to sales days, inventory to cost turnover, profit to assets percent, asset turn, sales percent increase, payroll to gross margin percent, associate count, sales per associate, and gross margin per associate. In addition to these division reports, the presidents are given the same information for the corporation as a whole.

The division presidents prepare for the strategic planning meetings by holding preliminary meetings and discussions with their management teams. Then they come to the strategic planning meeting with their budget objectives and present them to the other division presidents, as well as to the Chairman of the Board, the CEO, and the COO. In their presentations, they explain the strategies and plans that will

support their objectives for the new fiscal year, and then they are subject to critique. Not surprisingly, their sales projections are usually too low, and their profit and inventory numbers are too high.

After thorough review, discussion, and appropriate revisions, the budgets for each division are approved, and the sum of them becomes the corporate budget for the coming year. Subsequent to the meeting, a detailed profit-and-loss statement is worked out by each division for each branch and each department for the entire fiscal year. This detailed budget is then reviewed and approved with the understanding that it must conform very closely to the objectives approved at the strategic planning meeting.

Also at the strategic planning meeting, each division president presents a three-year, long-range plan consisting of sales, gross margin, expenses, net profit, and additional capital required. It is uncanny how close the company has consistently come to hitting the targets set at these meetings.

Once the annual budget has been established, it is imperative to regularly review each division's performance. The branch managers review performance reports with their parts and service managers, then the division presidents review the numbers with the branch managers, and finally the Corporate President/CEO and COO review them with the division presidents (for many years, Richer conducted the meetings personally, but he now participates once a quarter). The theme of these review meetings is, "If it is broken, how do we fix it. If it is good, how do we make it better?"

Monthly review meetings are hard work for everyone involved. The reports are thick, and the team goes through every detail. The key to success is having accurate and timely figures and reports. At Arnold Machinery, monthly reports are ready just five working days after the month ends. Reviewing all aspects of the company's performance in a timely fashion ensures that surprises are eliminated. All problems cannot be corrected immediately, but there are no surprises beyond one month.

The team reviews monthly income statements that provide data on sales, gross margin, expenses, and net profit by department, by location, and summarized by division and for the corporation. Sales are detailed by department (new, used, rental fleet, parts and service). Gross margin calculations show the detailed cost of goods. Expenses are detailed by location and department. Net profit is then generated, again by location and department. All reports show actual vs. budget and last year.

Just as important, if not more so, are a series of detailed subsidiary monthly reports as follows:

- *Summary of earnings* showing (See pp. 56-57) sales, gross margin, expenses, net profit, actual vs. budget and last year, FIFO assets, return on assets and inventory vs. budget, by location and by division, both for the month and year-to-date.
- *Cash flow* by month, based on three levels of possible profitability.
- *Accounts receivable* aging report, by location and division.
- *Forecast statement* by division, detailing actual results by department vs. budget and last year for each month of the year.
- *Full-time equivalent head count* by location and division showing history by month for the previous two years.
- *Payroll analysis* showing payroll as a percent of sales and gross margin by location and division.
- *Benefits analysis* showing benefits expenses as a percent of sales and gross margin by location and division.
- *Parts-aging report* by location and division showing dollars and percent of inventory over 12, 24, and 36 months.
- *Old work order report* detailing open work orders over 30, 60 and 90 days, again by location and division.

In the heavy equipment industry, where inventory is the major investment, the most important report details sales and inventory. An income statement shows where the company has been, and a balance sheet gives a picture of the present, but in order to make decisions about the future, the team must look at history and current trends.

The sales and inventory report shows, by department, the relationship between sales, inventory, purchases, and gross margin on a monthly basis, and it allows the team to make mid-course adjustments based on long and short-term trends. If it was necessary to choose just one report to run a distribution business, this is the most critical, because it allows the team to adjust inventories on a monthly basis by location and by department (see pp. 58-63).

ARNOLD MACHINERY COMPANY — SUMMARY OF EARNINGS — CURRENT MONTH — Feb-12

	Sales FY 12 Actual $	Sales FY 12 Plan $	Sales FY 12 Plan %	Sales FY 11 Actual $	Sales FY 11 Lst Yr %	Gross Profit FY 12 Actual $	Gross Profit FY 12 Actual %	Gross Profit FY 12 Plan $	Gross Profit FY 12 Plan %	Gross Profit FY 11 Actual $	Gross Profit FY 11 Lst Yr %	Expenses FY 12 Actual $	Expenses FY 12 Actual %	Expenses FY 12 Plan $	Expenses FY 12 Plan %	Expenses FY 11 Actual $	Expenses FY 11 Lst Yr %	Pre-tax profit or loss FY 12 Actual $	Pre-tax FY 12 Actual %	Pre-tax FY 12 Plan $	Pre-tax FY 12 Plan %	Pre-tax FY 11 Lst Yr $	Pre-tax FY 11 Lst Yr %	Assets Ending Fifo $	ROA Actual %	ROA Plan %	ROA Lst Yr %	End Inventory FY 12 Actual $	End Inventory FY 12 Budget $
CONSTRUCTION EQUIPMENT																													
Salt Lake	736	854	-13.8	964	-23.6	161	21.9	230	26.9	240	24.9	185	25.1	170	19.9	139	14.4	-24	-3.3	60	7.0	101	10.5	9,554	-0.3	0.6	1.5	8,383	5,816
Idaho Falls	804	390	106.2	452	77.7	127	15.8	112	28.6	118	26.0	68	8.5	68	17.3	62	13.8	59	7.3	44	11.3	56	12.3	2,024	2.9	2.2	2.4	1,275	1,914
Twin Falls	161	475	-66.2	206	-21.9	68	42.5	92	19.4	68	32.8	57	35.6	63	13.3	61	29.9	11	6.9	29	6.1	6	3.0	1,202	0.9	2.4	0.6	784	2,114
Boise	112	248	-54.9	336	-66.7	42	37.4	61	24.6	70	20.9	67	60.2	63	25.4	61	18.1	-25	-22.8	-2	-0.8	9	2.8	1,095	-2.3	-0.2	1.3	948	935
Reno	2,609	900	190.0	652	299.9	539	20.7	284	31.6	200	30.6	163	6.2	130	14.4	119	18.3	376	14.4	155	17.2	81	12.3	14,211	2.6	1.1	0.7	10,126	15,325
Las Vegas	370	133	177.9	198	86.3	44	11.9	48	35.7	38	19.3	78	21.2	76	57.3	74	37.3	-34	-9.3	-29	-21.6	-36	-18.0	2,060	-1.7	-1.4	-1.8	1,836	1,835
Phoenix	1,170	2,198	-46.8	1,239	-5.6	157	13.5	282	12.8	163	13.1	161	13.8	173	7.9	175	14.1	-4	-0.3	109	5.0	-13	-1.0	7,437	0.0	1.5	-0.2	6,095	5,565
Tucson	1,041	164	534.8	168	518.5	121	11.6	46	28.1	34	20.0	47	4.5	58	35.7	49	29.3	74	7.1	-12	-7.6	-16	-9.4	2,263	3.3	-0.5	-1.1	594	1,200
Divisional						0		0		0		131		127		96		-131		-127		-96		393				0	
TOTAL CE	7,002	5,361	30.6	4,216	66.1	1,260	18.0	1,155	21.5	930	22.0	958	13.7	928	17.3	838	19.9	302	4.3	227	4.2	92	2.2	40,239	0.8	0.6	0.3	30,041	34,704
MATERIAL HANDLING EQUIPMENT																													
Salt Lake	1,708	1,481	15.3	1,425	19.8	457	26.8	385	26.0	408	28.6	321	18.8	286	19.3	261	18.3	136	8.0	99	6.7	146	10.3	11,861	1.1	0.8	1.7	9,362	9,668
Boise	311	217	43.4	276	12.6	94	30.3	67	31.1	72	26.1	67	21.6	63	29.0	59	21.2	27	8.7	5	2.1	14	4.9	1,558	1.7	0.3	1.0	1,152	1,937
Twin Falls	214	310	-31.1	273	-21.8	78	36.5	88	28.4	78	28.4	63	29.7	65	20.9	58	21.4	14	6.8	23	7.4	19	7.0	1,125	1.3	2.0	1.5	862	921
Idaho Falls	227	222	2.4	193	17.9	60	26.5	70	31.3	59	30.8	50	21.8	51	22.8	42	21.9	11	4.6	19	8.5	17	8.9	1,086	1.0	1.7	1.8	591	643
Las Vegas	866	530	63.3	376	130.2	164	19.0	150	28.3	116	30.8	110	12.7	116	21.8	110	29.3	54	6.3	34	6.5	6	1.5	2,650	2.1	1.3	0.2	1,442	1,745
Phoenix	1,101	990	11.2	797	38.1	233	21.2	286	28.9	233	29.2	242	22.0	249	25.2	238	29.9	-9	-0.8	36	3.7	-6	-0.7	8,387	-0.1	0.4	-0.1	6,548	5,450
Flagstaff	142	286	-50.3	277	-48.7	42	29.8	89	31.2	81	29.2	62	43.9	65	22.6	62	22.3	-20	-14.1	24	8.6	19	6.9	913	-2.2	2.7	2.1	405	510
Tucson	1,073	595	80.5	375	185.9	190	17.7	135	22.8	141	37.6	114	10.6	91	15.3	90	24.0	76	7.1	45	7.5	51	13.6	2,715	2.8	1.6	3.0	1,287	1,334
Denver	1,053	1,029	2.3	956	10.2	304	28.9	281	27.3	259	27.1	267	25.4	273	26.6	282	29.5	37	3.5	8	0.8	-23	-2.5	6,082	0.6	0.1	-0.5	4,475	3,643
Johnstown	420	280	50.0	211	99.0	124	29.5	64	23.0	52	24.7	77	18.3	64	22.8	59	28.1	47	11.2	1	0.2	-7	-3.4	1,980	2.4	0.0	-0.8	1,070	1,071
Co Springs	130	183	-29.0	208	-37.4	42	32.7	46	25.0	54	25.8	39	29.9	44	23.8	55	26.3	4	2.8	2	1.2	-1	-0.5	883	0.4	0.3	-0.1	482	715
Eagan	1,101	924	19.2	676	62.9	275	25.0	267	28.9	236	34.9	190	17.3	202	21.8	190	28.1	85	7.7	66	7.1	46	6.7	4,357	1.9	1.5	1.8	2,772	2,870
House/Division	376	0		220	70.9	10	2.7	0		-100	-45.5	139	36.9	127		149	67.6	-129	-34.2	-127		-249	-113.1	2,821	-4.6	-4.5	-0.4	441	100
TOTAL MH	8,722	7,047	23.8	6,265	39.2	2,075	23.8	1,929	27.4	1,688	26.9	1,741	20.0	1,694	24.0	1,657	26.4	334	3.8	235	3.3	31	0.5	46,418	0.7	0.5	0.1	30,888	30,605
MINING EQUIPMENT																													
Unit Sales	1,123	4,880	-77.0	5,866	-80.9	152	13.6	523	10.7	878	15.0	40	3.6	96	2.0	62	1.1	112	10.0	427	8.7	816	13.9	2,077	5.4	20.6	80.4	948	9,500
Rebuilt	1,201	649	84.9	660	82.0	323	26.9	159	24.5	133	20.1	58	4.8	65	10.0	56	8.5	265	22.1	94	14.5	77	11.6	9,164	2.9	1.0	1.3	7,460	6,474
Elko	2,396	2,086	14.9	2,104	13.9	849	35.4	733	35.2	552	26.3	266	11.1	225	10.8	185	8.8	583	24.3	508	24.4	367	17.4	14,774	3.9	3.4	3.0	11,187	10,480
Gillette	676	490	38.0	374	80.9	247	36.5	197	40.1	143	38.3	95	14.0	88	18.1	81	21.6	152	22.5	108	22.1	62	16.7	3,237	4.7	3.3	2.5	1,315	1,050
Divisional						0		0		0		98		90		100		-98		-90		-100		178				0	
TOTAL ME	5,396	8,105	-33.4	9,004	-40.1	1,571	29.1	1,611	19.9	1,707	19.0	557	10.3	565	7.0	484	5.4	1,014	18.8	1,047	12.9	1,223	13.6	29,430	3.4	3.6	5.4	20,910	27,504
GENERAL IMPLEMENT DISTRIBUTORS																													
Salt Lake	538	460	17.0	392	37.3	151	28.1	129	28.1	109	27.9	117	21.7	135	29.3	118	30.2	34	6.3	-6	-1.2	-9	-2.3	6,085	0.6	-0.1	-0.3	2,769	2,100
Boise	431	386	11.7	347	24.4	123	28.5	117	30.4	98	28.4	72	16.7	70	18.0	65	18.8	51	11.8	48	12.3	33	9.5	2,266	2.2	2.1	2.0	874	1,000
Portland	200	210	-4.7	129	54.8	58	28.9	68	32.3	32	24.8	61	30.4	56	26.7	40	31.2	-3	-1.5	12	5.7	-8	-6.4	818	-0.4	1.5	-1.0	408	880
Billings	346	343	0.9	297	16.4	105	30.4	107	31.1	94	31.5	68	19.8	68	19.9	62	21.0	37	10.7	39	11.3	31	10.5	1,766	2.1	2.2	1.9	1,012	960
Jamestown	618	567	9.1	0		188	30.4	192	33.8	0		116	18.7	162	28.6	0		73	11.7	30	5.3	0		4,248	1.7	0.7	0.0	3,576	3,500
TOTAL GID	2,134	1,966	8.5	1,165	83.1	625	29.3	613	31.2	334	28.6	434	20.3	491	25.0	286	24.6	191	9.0	122	6.2	47	4.0	15,182	1.3	0.8	0.6	8,640	8,440
Financial Services																													
Financial Services Expense												435		436		419													
Corporate												276		278		217		-276		-278		-217		10,010				343	
TOTAL CO	23,254	22,479	3.4	20,650	12.6	5,531	23.8	5,309	23.6	4,658	22.6	3,966	17.1	3,955	17.6	3,481	16.9	1,565	6.7	1,353	6.0	1,176	5.7	141,279	1.1	1.0	1.1	90,822	101,253

CONSTRUCTION DIVISION
DIVISION TOTAL
NEW WHEEL LOADERS
FISCAL YEAR 2013

	Actual FY 09	Actual FY 10	Actual FY 11	Actual FY 12	Actual FY 13	Plan FY 13
T/O	1.2	1.8	13.5	7.1	1.5	2.5
GM %	6.6	7.6	8.9	7.1	4.7	8.0

	Sales FY 09 Actual	Sales FY 10 Actual	Sales FY 11 Actual	Sales FY 12 Actual	Sales FY 13 Actual	%Chg vs L.Y.	%Chg vs Plan	Sales FY 13 Plan	End Inv FY 09 Actual	End Inv FY 10 Actual	End Inv FY 11 Actual	End Inv FY 12 Actual	End Inv FY 13 Actual	Months Supply Actual	Months Supply Plan	End Inv FY 13 Plan	Purch FY 09 Actual	Purch FY 10 Actual	Purch FY 11 Actual	Purch FY 12 Actual	Purch FY 13 Actual	Purch FY 13 Plan	Gross Mar %
September									4,335	3,222	1,122	757	4,138	3.7	4.0	4,507							
YTD																							
October	919	143	287	2,719	377	-86.1%	17.7%	320	4,880	2,948	707	758	4,590	4.0	4.6	5,230	1,387	-141	-153	2,568	793	1,017	9.8
YTD	919	143	287	2,719	377	-86.1%	17.7%	320									1,387	-141	-153	2,568	793	1,017	9.8
November	1,082	412	208	2,851	496	-82.6%	-48.6%	965	5,620	2,461	1,016	1,538	5,263	4.8	4.7	5,359	1,722	-110	495	3,450	1,132	1,017	7.6
YTD	2,001	555	495	5,570	873	-84.3%	-32.1%	1,285									3,105	-250	345	6,015	1,924	2,034	8.5
December	894	331	1,139	4,073	1,290	-68.3%	-23.2%	1,680	5,004	3,010	474	1,325	5,020	4.7	5.7	6,431	194	842	470	3,550	1,021	2,618	2.1
YTD	2,894	886	1,634	9,642	2,163	-77.6%	-27.0%	2,965									3,300	592	815	9,566	2,943	4,652	4.7
January	454	423	2,126	2,419		-100.0%	-100.0%	420	5,286	2,715	600	1,882		0.0	6.4	7,230	689	77	2,055	2,799	-5,020	1,185	
YTD	3,348	1,309	3,760	12,062		-100.0%	-100.0%	3,385									3,988	665	2,870	12,383	-2,076	5,837	
February	290	9	162	2,140		-100.0%	-100.0%	1,040	6,372	2,220	911	3,290		0.0	6.4	7,284	1,354	-489	454	3,388	0	1,011	
YTD	3,638	1,318	3,922	14,202		-100.0%	-100.0%	4,425									5,350	177	3,325	15,765	-2,076	6,848	
March	445	173	348	1,450		-100.0%	-100.0%	1,219	6,528	2,387	2,231	2,872		0.0	5.9	6,625	573	340	1,634	891	0	462	
YTD	4,083	1,491	4,270	15,652		-86.2%	-61.7%	5,644									5,915	521	4,957	16,660	-2,076	7,310	
April	380	0	851	513		-100.0%	-100.0%	2,877	6,138	2,245	1,629	2,549		0.0	4.4	5,018	-47	-142	153	133	0	1,040	
YTD	4,463	1,491	5,121	16,165		-86.6%	-74.6%	8,521									5,868	379	5,110	16,777	-2,076	8,350	
May	312	0	970	1,097		-100.0%	-100.0%	1,369	5,306	2,527	903	4,588		0.0	4.3	4,884	-549	282	144	3,040	0	1,125	
YTD	4,775	1,491	6,092	17,262		-87.5%	-78.1%	9,890									5,320	660	5,257	19,813	-2,076	9,476	
June	335	171	773	624		-100.0%	-100.0%	1,054	5,232	3,571	861	3,994		0.0	4.0	4,525	241	1,206	681	-39	0	611	
YTD	5,110	1,662	6,864	17,886		-87.9%	-80.2%	10,944									5,572	1,866	5,935	19,767	-2,076	10,087	
July	163	1,479	2,084	1,397		-100.0%	-100.0%	785	4,992	2,402	1,113	4,197		0.0	4.0	4,480	-105	201	2,154	1,512	0	677	
YTD	5,274	3,141	8,948	19,284		-88.8%	-81.6%	11,729									5,480	2,067	8,089	21,402	-2,076	10,764	
August	489	1,111	804	208		-100.0%	-100.0%	950	4,202	1,477	1,185	4,809		0.0	4.2	4,765	-293	100	793	791	0	1,159	
YTD	5,763	4,252	9,752	19,492		-88.9%	-82.9%	12,679									5,190	2,167	8,874	22,157	-2,076	11,923	
September	512	176	4,244	564		-100.0%	-100.0%	901	3,222	1,122	757	4,138		0.0	3.9	4,450	-441	-174	3,516	-147	0	514	
YTD	6,275	4,428	13,996	20,055		-89.2%	-84.1%	13,580									4,746	1,994	12,388	22,017	-2,076	12,437	
Average	523	369	1,166	1,671		-89.2%	-84.1%	1,132	5,163	2,485	1,039	2,823				5,445	396	166	1,032	1,835	-173	1,036	

SALES LOW

INVENTORY LOW

MARGIN LOW

CONSTRUCTION DIVISION
DIVISION TOTAL
NEW EXCAVATORS
FISCAL YEAR 2013

	Actual FY 09	Actual FY 10	Actual FY 11	Actual FY 12	Actual FY 13	Plan FY 13
T/O	0.3	0.6	3.1	4.6	4.0	2.5
GM %	2.1	3.6	8.3	10.1	7.4	8.0

	Sales FY 09 Actual	Sales FY 10 Actual	Sales FY 11 Actual	Sales FY 12 Actual	Sales FY 13 Actual	%Chg vs L.Y.	%Chg vs Plan	Sales FY 13 Plan	End Inv FY 09 Actual	End Inv FY 10 Actual	End Inv FY 11 Actual	End Inv FY 12 Actual	End Inv FY 13 Actual	Months Supply Actual	Months Supply Plan	End Inv FY 13 Plan	Purch FY 09 Actual	Purch FY 10 Actual	Purch FY 11 Actual	Purch FY 12 Actual	Purch FY 13 Actual	Purch FY 13 Plan	Gross Mar %
September									5,881	3,858	1,747	214	1,779	3.2	2.6	1,455							
YTD																							
October	24	0	0	23	478	2023.1%	#DIV/0!	0	5,873	3,858	1,602	196	1,238	2.1	5.3	2,922	11	0	-8	140	125	1,467	6.5
YTD	24	0	0	23	478	2023.1%	#DIV/0!	0									11	0	-8	140	125	1,467	6.5
November	0	125	0	630	241	-61.7%	-64.0%	670	6,052	4,117	1,254	197	1,248	2.2	5.5	3,057	179	377	-12	558	-183	751	9.9
YTD	24	125	0	653	719	10.2%	7.3%	670									190	377	-20	698	-58	2,218	7.7
December	608	570	1,268	0	1,228	#DIV/0!	43.7%	855	4,858	3,244	1,080	196	2,009	3.4	5.0	2,757	-647	-321	959	17	1,104	487	7.2
YTD	631	695	1,268	653	1,947	198.4%	27.7%	1,525									-458	57	939	718	1,046	2,705	7.4
January	5	0	271	174		-100.0%	-100.0%	1,007	4,859	3,232	825	1,021		0.0	5.3	2,970	14	-12	0	834	-921	1,139	
YTD	636	695	1,539	826		-100.0%	-100.0%	2,532									-448	46	938	1,552	124	3,844	
February	3	692	313	18		-100.0%	#DIV/0!	0	4,799	2,510	776	1,020		0.0	6.0	3,345	-55	-35	218	-6	0	375	
YTD	640	1,388	1,852	845		-100.0%	-100.0%	2,532									-504	11	1,156	1,547	124	4,219	
March	0	238	0	41		-100.0%	-100.0%	850	4,952	1,488	777	1,176		0.0	5.5	3,060	152	-784	357	366	357	497	
YTD	640	1,626	1,852	886		119.7%	-42.4%	3,382									-352	-766	1,507	1,912	482	4,716	
April	244	305	418	123		-100.0%	-100.0%	305	4,783	1,319	654	1,472		0.0	5.9	3,255	52	119	489	353	228	476	
YTD	884	1,931	2,270	1,009		93.0%	-47.2%	3,687									-299	-647	1,996	2,265	710	5,192	
May	0	46	0	651		-100.0%	-100.0%	1,120	4,786	1,661	654	1,114		0.0	4.5	2,485	3	382	0	646	0	260	
YTD	884	1,977	2,270	1,659		17.3%	-59.5%	4,807									-296	-265	1,996	2,911	710	5,452	
June	300	132	6	1,670		-100.0%	-100.0%	615	4,376	1,957	242	2,210		0.0	3.3	1,860	-98	409	-262	1,996	146	-59	
YTD	1,184	2,108	2,276	3,329		-41.5%	-64.1%	5,422									-394	144	1,729	4,903	856	5,393	
July	0	-553	0	646		-100.0%	-100.0%	575	4,093	2,339	379	1,465		0.0	4.1	2,290	-283	-164	0	-548	0	959	
YTD	1,184	1,555	2,276	3,975		-51.0%	-67.5%	5,997									-663	-20	1,727	4,357	856	6,352	
August	5	0	174	6		-100.0%	-100.0%	670	4,095	1,928	232	1,443		0.0	4.4	2,445	6	-411	13	-228	14	771	
YTD	1,188	1,555	2,450	3,981		-51.1%	-70.8%	6,667									-645	-431	1,741	4,129	870	7,124	
September	310	0	9	801		-100.0%	#DIV/0!	0	3,858	1,747	214	1,779		0.0	5.2	2,902	77	-181	-8	726	0	457	
YTD	1,498	1,555	2,459	4,783		-59.3%	-70.8%	6,667									-556	-612	1,733	4,855	870	7,581	
Average	125	130	205	399		-59.3%	-70.8%	556	4,867	2,558	803	1,039				2,677	-46	-51	144	405	72	632	

SALES HIGH

INVENTORY LOW

MARGIN LOW

CONSTRUCTION DIVISION
DIVISION TOTAL
USED ROAD PRODUCTS
FISCAL YEAR 2013

	Actual FY 09	Actual FY 10	Actual FY 11	Actual FY 12	Actual FY 13	Plan FY 13
T/O	0.3	1.1	4.1	1.1	0.6	2.3
GM %	10.0	-9.7	7.3	-24.1	12.8	10.0

	Sales FY 09 Actual	Sales FY 10 Actual	Sales FY 11 Actual	Sales FY 12 Actual	Sales FY 13 Actual	%Chg vs L.Y.	%Chg vs Plan	Sales FY 13 Plan	End Inv FY 09 Actual	End Inv FY 10 Actual	End Inv FY 11 Actual	End Inv FY 12 Actual	End Inv FY 13 Actual	Months Supply Actual	Months Supply Plan	End Inv FY 13 Plan	Purch FY 09 Actual	Purch FY 10 Actual	Purch FY 11 Actual	Purch FY 12 Actual	Purch FY 13 Actual	Purch FY 13 Plan	Gross Mar %
September									0	1,381	305	252	616	9.9	10.5	654							
YTD																							
October	0	0	151	0	0	#DIV/0!	#DIV/0!	0	0	1,231	252	251	658	10.5	10.9	683	0	-150	86	-1	41	29	0.0
YTD	0	0	151	0	0	#DIV/0!	#DIV/0!	0									0	-150	86	-1	41	29	0.0
November	0	0	0	18	105	467.9%	-65.2%	300	0	1,179	271	233	576	12.5	6.0	373	0	-52	19	-2	10	-40	11.7
YTD	0	0	151	18	105	467.9%	-65.2%	300									0	-202	105	-3	52	-11	8.3
December	0	60	0	0	9	#DIV/0!	-62.9%	25	0	1,137	273	868	582	13.0	5.4	340	0	7	2	635	10	-10	63.4
YTD	0	60	151	18	114	518.4%	-65.0%	325									0	-195	107	632	61	-21	12.8
January	0	0	0	0		#DIV/0!	#DIV/0!	0	0	1,893	272	869		0.0	5.4		0	756	-1	1	-582	0	
YTD	0	60	151	18		1844.5%	10.1%	325									0	563	107	633	-521	-21	
February	0	0	69	57		-100.0%	-100.0%	50	458	1,893	273	828		0.0	5.4		458	-1	63	10	0	45	
YTD	0	60	220	75		377.7%	-4.6%	375									458	562	170	643	-521	24	
March	0	269	314	63		-100.0%	-100.0%	120	654	1,607	119	1,017		0.0	4.0		195	-16	131	264	0	18	
YTD	0	329	534	138		-17.8%	-77.0%	495									654	547	301	907	-521	42	
April	0	0	35	206		-100.0%	-100.0%	85	425	1,486	91	1,201		0.0	2.7		-229	-121	10	428	0	-5	
YTD	0	329	568	345		-67.0%	-80.4%	580									425	426	310	1,334	-521	37	
May	0	90	107	55		-100.0%	-100.0%	20	367	1,414	68	1,085		0.0	4.4		-58	0	74	-52	0	123	
YTD	0	419	675	400		-71.5%	-81.0%	600									367	426	384	1,283	-521	160	
June	0	190	170	133		-100.0%	-100.0%	20	497	1,346	68	976		0.0	4.5		130	99	144	6	0	25	
YTD	0	609	845	532		-78.6%	-81.6%	620									497	525	529	1,289	-521	185	
July	20	0	0	115		-100.0%	-100.0%	100	1,754	1,354	200	755		0.0	2.9		1,270	8	132	-52	0	-10	
YTD	20	609	845	647		-82.4%	-84.2%	720									1,768	533	661	1,237	-521	175	
August	3	0	0	120		-100.0%	#DIV/0!	0	1,515	1,094	202	687		0.0	3.3		-238	-260	2	34	0	23	
YTD	22	609	845	767		-85.2%	-84.2%	720									1,531	276	663	1,317	-521	198	
September	146	846	0	18		-100.0%	-100.0%	30	1,381	305	252	616		0.0	3.4		3	243	50	-56	0	34	
YTD	169	1,454	845	785		-85.5%	-84.8%	750									1,533	519	730	1,338	-521	232	
Average	14	121	70	65		-85.5%	-84.8%	63	543	1,332	204	741					128	43	61	112	-43	19	

SALES LOW

INVENTORY HIGH

MARGIN HIGH

The sales and inventory report provides a five-year history of monthly sales, inventory, and purchases, as well as a five-year history of annual turnover and gross margin. The department managers first budget sales by month, and most importantly they budget inventory on a month's supply basis (except for rental fleet and service). This allows the team to determine the optimum period based on delivery times, safety factors, and so on.

With the sales and inventory report in hand, determining inventory levels is a simple arithmetic process. First, the ideal or necessary month's supply is determined by department and branch. Assuming three-months supply has been agreed upon, if the planned sales for the next three months are $300K, then the inventory level at the beginning of that three-month period should be $300K, and the result would be a turnover of 4.0. This calculation allows managers to peak inventory prior to the peak selling periods and takes the guesswork out of planning.

Controlling inventory is essential, because inventory is dollars. If money is sitting on a shelf, the company is not earning interest or gross margin on it. One of the things that the sales and inventory report shows is that there is a clear relationship between sales, inventory, and gross margin. If sales are down, but inventory and gross margin are up, it is time to cut gross margin in order to generate sales. Doing so will also reduce inventory. On the other hand, if sales are up, and inventory and gross margin are down, it is time to buy inventory and sell it at the full market price. Richer calls this set of relationships the "hydraulic system."

After sales and inventory are determined, planned purchases are calculated by month. In industries like heavy equipment, where it is necessary to project purchases months in advance, this report gives managers a financial basis for determining their future needs.

In order to stay on top of inventory, Arnold Machinery also maintains an aging schedule that requires that every piece of new inventory be disposed of, regardless of cost, within a year. Used equipment must go in six months, parts in one year, and rental fleet in two years.

When Arnold Machinery buys a company (having made 21 acquisitions since 1989), they receive 100% for their inventory up to a year old, 50% for up to two years old, and after two years, nothing. Similarly, Arnold Machinery pays 100 percent for current accounts receivable, 85% for receivables older than 30 days, 75% for those older than 60 days, and nothing for those older than 90 days.

In addition, financial services generates a stock/sales ratio to show whether the company is on track to achieve the desired turnover. This entire report is reviewed monthly and actions can be adjusted based on the sales trend, the inventory level, and the gross margin, making it possible to maximize sales during good times and reduce inventories or commitments during down periods.

Every year, the controller produces a *gross margin/return on investment report* by department (new, used, rental, parts, service) and division. (As an aside, rental has the poorest gross margin return on investment, so the company does not emphasize the rental business.)

Most importantly, the budgets are created by the people responsible for day-to-day operations, and the executive team expects them to achieve those budgets. In fact, soon after he bought the company, Richer established the principle that not only division presidents, but all supervisors, get salary increases only if they make their budgets.

Chapter Five

INCENTIVES

The incentives program motivates associates to be entrepreneurial. In the end, the company will be more successful if all of the associates have a stake in the game.

There have been three times when it was necessary to cut salaries by 10 percent at Arnold Machinery. Each time, it was possible to restore full pay at the beginning of the next fiscal year. In 1986, just after Richer took control of the company, 16 people quit when salary reductions were announced. But in 1991 and 2002, the company didn't lose anyone. That's trust.

If people trust the company leadership enough to share the pain in bad times, then they are entitled to share the gain during the good times. That's why the term "associates" is used at Arnold Machinery instead of "employees." We are all associates. We share everything, and we are all in this together. A well-designed incentives program is like building a credit balance with the associates in case it becomes necessary to call upon them to sacrifice during the next down cycle.

Every year, Arnold Machinery awards a discretionary corporate bonus that is based on the profitability of the company as a whole. At the end of the year, a sum determined by the President/CEO and the management board is distributed to all associates, based on each individual's salary (excluding commissions, bonuses, etc.) as a percentage of the total payroll. To qualify, an individual must be employed for the full fiscal year. Usually, the corporate bonus has equaled approximately one week's salary.

Arnold Machinery also gives shares of dividend-paying stock in recognition of years of service. Associates receive ten shares after five years of service, 15 shares after ten years, 20 shares after 15 years, 25 shares after 20 years, and an additional 5 shares per year after that. A share distributed in 1999 at a value of $128 was worth $619 in 2013 and had paid dividends totaling more than $200.

The company uses a formula established in 1986 to establish the percentage of pre-tax profit that will be distributed as an annual dividend to all shareholders. When pre-tax profit is under $500K, there is no dividend; if pre-tax profit is between $500K and $750K, the dividend is 10%; if pre-tax profit is between $750K and $1M, the dividend is 15%; and if pre-tax profit is more than $1M, the dividend is 20%. During the last 27 consecutive years of profitability, the company has exceeded $1M in pre-tax profits in all but five years. Stock ownership is another way that the associates share the pain and share the gain.

The most important incentive program at Arnold Machinery is the annual return on assets (ROA) bonus, which is based on a department's net profit factored by the division's ROA. Richer first instituted ROA bonuses for division presidents in 1986. He chose to base the bonus on return on assets instead of return on investment because the division presidents can control the allocation of their assets, but they cannot control the company's equity. They can control receivables, inventory, and fixed assets, but not the amount of cash that the company borrows or how much is invested.

Richer set ROA hurdles based on each division's previous results, and he made the commitment that they would not be changed as long as a person held the job, regardless of how

The biggest benefit of good internal relations is that our associates stay with us for the long haul, and we can develop the best people into the next generation of leaders. After all, finding good people out on the street can be a real challenge. Once, when the president of one of our divisions retired, I didn't feel there was anybody within the organization who could take his place, so I hired from the outside. I had a bad feeling about it, but I went ahead. On paper, the guy was a perfect candidate. I tested him, interviewed him, and finally I hired him. It was an utter disaster. He did not believe in our management philosophy and thought our monthly review meetings were a waste of time. He lost $500K in January 1998 alone, after he had projected that he would either make a profit, or just break even. I came to the conclusion, based on that experience, that we are not going to hire from the outside, we are going to promote from within.

–Al Richer

much he earned. In other words, there was no cap. After all, if a division president earns an impressive ROA bonus, that just means the company is earning much more.

One new division president took over when his unit was posting $5M in sales, but losing money. Richer set his minimum ROA bonus hurdle at 2% of pre-tax profit if the division cleared 4% return on assets. The bonus rose to 3% if the division earned a 5% return, to 4% if the division earned a 6% return, and to 5% if the division earned a 7% return on assets. The new president consistently exceeded his top ROA hurdle, and when he retired, the division was doing $80M in sales and earning a pre-tax profit of $4M on a return on assets of 13%. As a result, in his final year of service, he earned an ROA bonus of approximately $200K.

This system of ROA incentives turns the division presidents into entrepreneurs. They have all the advantages of working for themselves and none of the disadvantages. They do not have to sign personal guarantees or mortgage their homes to raise capital, but they are still able to manage a substantial pool of assets creatively in order to maximize both the company's profits and their individual income.

Not long after the company established ROA bonuses for the division presidents, the program was extended to branch managers, and that worked well. A year or two later, everybody in the company became eligible for an annual ROA bonus, as long as they had been employed for a full fiscal year. Now, everybody participates in the ROA bonus: the chairman, the CEO, the COO, division presidents, department managers, salesmen, all parts department personnel, service department personnel, all mechanics, office managers, and clerical staff.

However, not everyone earns these bonuses all the time. If a department's ROA falls below predetermined levels, associates earn less or nothing. The more their department and division earn, the more they receive. This principle also applies to the Chairman, CEO, COO, and the Financial Services division, whose bonuses are based on the results of the total corporation. Importantly, corporate expenses such as salaries and benefits for corporate personnel are not charged to the divisions and therefore do not affect their bonuses, since the division managers cannot control them.

It is extremely important to tie each department's performance to the division's performance in order to foster cooperation among the sales, parts, and service areas, as well as between the branches. It hurts the associates' pocketbooks directly if they do not cooperate to enhance their division's aggregate results.

Salesmen are eligible for the ROA bonus within their division if they hit below a certain ratio of expenses to sales and gross margin, so even they run their businesses for themselves. The company does not tell them how much to spend on customers' lunch, but they get substantial benefits, if they keep their expenses in line with their sales and gross margin.

At Arnold Machinery, the incentives program focuses the associates on their own performance and on corporate results. There is a saying: "If I don't sleep, you don't sleep." The results are impressive. For instance, the associates in charge of collections have managed to ensure that accounts unpaid beyond 90 days total less than 1% of overall receivables.

As a result of the associates' motivation and focus, the company has gone from being nearly bankrupt to having \$71M in equity, and it has paid \$25M in bonuses and \$30M in dividends over a 27-year period.

Chapter Six

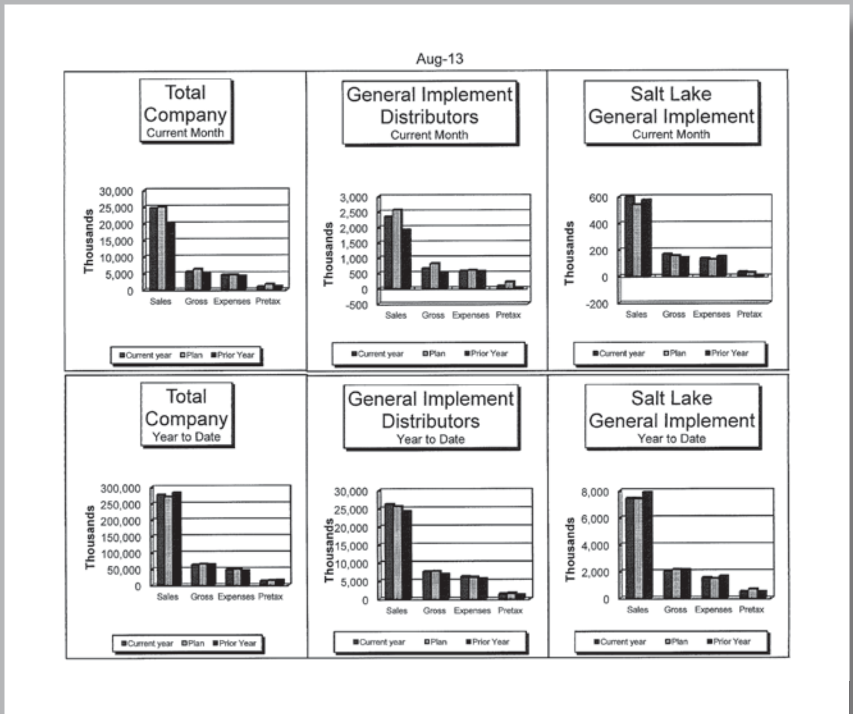
COMMUNICATIONS

A CEO may have the best ideas in the world about customer satisfaction, controls, and incentives, but if the associates are not on board, those ideas will go nowhere.

The success of any business depends on good relations between associates and management, and good relations depend on effective communication.

In order for the company's approximately 500 associates to all understand the strategic plan and work together as a team, the executive team must deliver consistent and continuous messaging. In order for the system of controls and incentives to work, there has to be effective communication throughout the organization. The responsibility for effective communication starts with the CEO, then goes to the division presidents, the branch managers, and finally to the department managers.

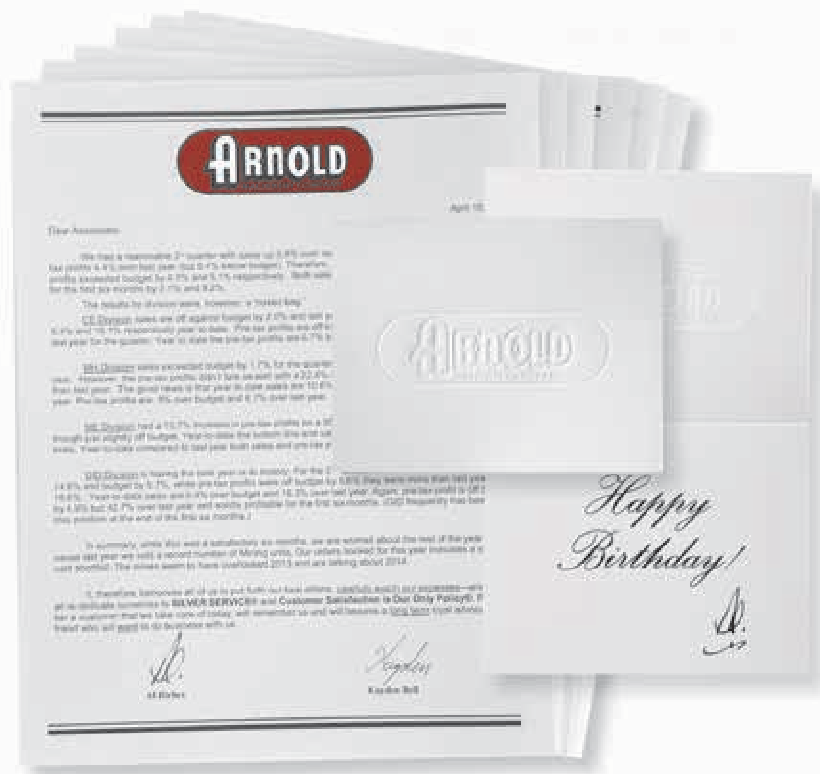
Branch and department managers hold monthly meetings in which they share the latest results with their people, their technicians, their parts people, and their salespeople. They share their own branch's results, the division's results, and the corporation's results. All of these figures are published every month, and they're available to everybody. If the associates are shareholders, and they are working hard to earn their dividends, they need to know what the score is. In addition to holding monthly results meetings, the management team sends a quarterly letter that tells how the company has been doing. Every month, Arnold Machinery sends all of the branches charts that compare planned performance with actual results. The charts are posted on bulletin boards for all of the associates to see (see p. 77). If the company is losing money for the first part of the year, there are a lot of long faces. Everybody knows it is time to pick up their game and make a profit by the end of the year.



When I was in Hartford, a union was trying to organize our truck drivers. I said to our operations manager, "I need to get to our drivers." He told me they went out at 8 o'clock, so I said, "Let's get them breakfast at 7 o'clock, bacon and eggs, the whole nine yards." At breakfast, I sat down with them, and I asked them what their problems were. One had a hole in his floorboard. Another said he wanted air conditioning. It was all small potatoes. I told the operations manager, "Make sure that any complaints they have are taken care of immediately." I had another breakfast with them and another, and pretty soon they began to listen to me. I learned that if I get up and make a speech, I'm just a boss making a speech. I'll be lucky if half of the people in the room remember half of what I say. But if I sit down and eat with somebody, it sends a subliminal message of equality, and people open up.

–Al Richer

At the end of every year, there is a company-wide financial results report that is broadcast via satellite from Salt Lake City to all the branches. The CEO and the Division Presidents present every single branch's sales, gross margin, expenses, pre-tax profit, and return on assets. The same numbers are presented for the company as a whole. At the end of the broadcast, the Chairman announces the total cash amounts that will be distributed as corporate and ROA bonuses, and checks are handed out at the end of the meeting at each branch.



Associates look forward to the financial results meeting all year long, not only because they will learn about the amount of their annual bonuses and about the financial performance that creates the value of their shares, but also because they get to measure their own performance against all of the other associates in the company. Some branches and divisions do better than the rest, while a few have bad years and need to be shaken up. Making everyone's performance very public and tying it to immediate financial rewards keeps everyone honest and creates a healthy rivalry within the company.

On the other hand, communications must also be a two-way street. Richer and the President make it a high priority to get to know all of the associates personally, to listen to them, and to reward them for working hard and taking the initiative to do the right thing. They share a meal, usually breakfast or lunch, with every one of the company's associates at least once a year at their locations. The associates are encouraged to ask questions and make suggestions for improving the company's operations. Some of the company's acquisitions were suggested by associates at these meals. At the end of each meal, Richer and the President ask the associates one by one to describe what Silver Service® means to them, and their response becomes their personal commitment to them and to the company's management philosophy.

Finally, in order to drive home the message that everyone is an important part of the team, the Chairman sends a birthday card and the President makes a personal visit or call to each associate on their birthday.

You cannot negotiate via email!
The best way to negotiate is face to face, because you can judge body language and expression. The second best is by telephone, since you can at least hear changes in voice.

During one of our recent acquisitions, our negotiator was emailing the seller. The seller was emailing back. The two lawyers were emailing each other. Finally, our negotiator became frustrated and was ready to cancel the deal. I suggested he call the seller directly. After a one-hour conversation, everything was settled. There developed a "trust" between the parties, and the acquisition proceeded smoothly.

Email, like a letter, can be used to memorialize a verbal agreement, but not negotiate an agreement!

–Al Richer

Chapter Seven

CONCLUSION

The Arnold Machinery company culture is the engine of our growth.

The three character traits that Al Richer believes are essential for success – integrity, discipline, and empathy – matter not just at work but in all areas of life. If you translate these three character traits into principles for managing a business, the results are the four pillars of the Arnold Machinery management philosophy: Silver Service®, Controls, Incentives, and Communications.

These principles are like the legs of a stool; all four must be in place in order for the stool to remain strong and stable. The policy of Silver Service® ensures customer satisfaction, builds the reputation of the company, and generates increasing revenue. The system of controls allows associates to be entrepreneurial in serving the customer's needs, while still ensuring that the company maintains strict financial discipline. The incentives program encourages the associates to work hard and work together, and it rewards them for their success. Finally, effective communications ensures good relations between the associates and the management team, helps management to identify and fix problems as they occur, and gives all the associates the information they need to make good decisions about the day-to-day operations of the company. Because all four principles are being implemented systematically and simultaneously across the company, Arnold Machinery runs like a well-tuned engine. It creates happy customers, solid profits, steady growth, healthy bonuses, and high levels of job satisfaction for over 500 associates in ten states.

At a time when too many American corporations care far less about their customers and employees than they do about maximizing short-term profits in order to please distant shareholders, Al Richer's management philosophy is about honor and compassion. It's about real people sitting down face-to-face to make deals that meet the needs of everyone at the table. It draws on the lessons of decades of experience in a variety of businesses. It is simple and straightforward, and it can be adapted to many different industries. Above all, it works.

As a result of Richer's strong leadership and powerful ideas, Arnold Machinery has enjoyed 27 consecutive years of profitability, and 2012 was the most profitable year in its history. Annual sales have grown from about $30M to $307M. The company's net worth has increased from near bankruptcy to $71M. And annual pre-tax profit has moved from a net loss to $21M. Finally, the Arnold Machinery team has grown from 149 associates in five cities to 500-plus associates at 21 locations in ten states. The management philosophy described in this book will ensure that this strong record of success continues for decades to come.

INTEGRITY

Utter sincerity, honesty, and candor.
Avoiding the appearance or act of deception, expediency, or artificiality of any kind.

DISCIPLINE

Self-control and self-restraint.
One's systematic, willing, and purposeful attention to their performance of personal and Company objectives.

EMPATHY

The intellectual or emotional identification with another. The capacity for participating in or a vicarious experiencing of another's feelings or ideas.

MANAGEMENT PHILOSOPHY

Customer Service
- Silver Service®.
- Customer Satisfaction Is Our Only Policy ®.

Control
- Inspect, don't expect.
- You may delegate authority, but you do not abdicate responsibility.

Incentives
- For all associates.
- Entrepreneurial: "Share the pain, share the gain." "If I don't sleep, you don't sleep."

Communication
- CEO.
- Division manager.
- Department Manager.

Appendix

HOW TO MANAGE DURING A PERIOD OF STAGFLATION

In the spring of 2008, it was clear that the collapse of the real estate market would cause a deep and lasting downturn in all sectors of the economy. On May 23 of that year, Al Richer distributed the following essay to the associates of Arnold Machinery in order to help them navigate the tough times ahead.

DEFINITIONS:

- Stagnant—Lacking briskness or activity, as life or business; dull; inert; sluggish.
- Stagnation—The condition of being stagnant; stagnation in trade.
- Inflation—Expansion or extension beyond natural or proper limits or so as to exceed normal or just value; specifically, over issue of currency or the state resulting therefrom; also increase in price levels arising from mounting effective demand without corresponding increase in commodity supply.

BACKGROUND:

The country suffered with stagflation during the late 1970's and early 1980's during which time the "misery index" exceeded 20 (combination of the inflation rate and the unemployment rate). As a result there were two distinct recessions, partially caused by the necessity to abort this economically devastating condition. It took the courage of Paul Volcker, the new head of the Federal Reserve, to allow rates to rise (to 21%) to break the back of the inflationary spiral. One of the reasons for the increase of inflation was the steep rise in oil prices in 1973/74 (it happened again 1979/1980).

The Nixon/Ford administration tried price controls which exacerbated the situation, causing shortages which in turn caused long lines at gasoline stations and other artificial shortages in the economy. There were too many dollars chasing too few goods. And the result was a weak dollar and inflated commodities (Gold at $800 + at the time; in today's dollar about $1200 to $1500).

To worsen the situation our esteemed President Jimmy Carter donned a sweater and told the country that there was a "malaise" abroad. His "solution" was lower your thermostats and drive 55 miles per hour. If recessions are caused by fear he sure helped. (We had recessions in 1970/71,1974/75, 1979/1980,1982/83). Now fast forward to the present: Gasoline $4.00/gallon; Gold hit over $1000, now hovering in the $900 range; Steel in short supply and priced at an all time high; Copper about $300/pound (remember $0.65); Corn at $5.00, last year about half; Airlines and retailers going bankrupt; U.S. auto sales projected at 14.7 to 15.1 million, down from 17 million in 2005, lowest since 1993; A very weak dollar; Worst housing slump in 20 years; and of course the credit crunch. Also don't forget the trade deficit and the fiscal (budget) deficit. The only thing that has not joined the parade (at least not yet) is unemployment. It has risen slightly to 5.1 %, which is not bad. Some of our states are even better—Utah, Idaho in particular.

We are already experiencing significant and consistent price increases from our manufacturers (i.e., GID has one vendor which increased his prices to us by approximately 30%). Certainly we are aware of the effect of the economy on our business. CE is the most impacted and has the toughest challenge to remain profitable. MH has been hurt by the housing industry and is having difficulty refocusing on other customers, especially in Phoenix. ME unit sales are down partially because of demand and most particularly by availability of product. It is being sustained (as is the rest of the corporation) by parts and service on all the shovels previously sold and by the growth of the Gillette branch. GID and the farm industry have been doing very well based on the rise in the prices of farm products. Faced with rising cost, should commodity prices fall, farmers will find themselves in a cash bind. Will this bubble burst and when?

THE MANAGEMENT PLAN

We must manage for cash! The old adage—"you don't go broke if you have cash"—is true. The overall guidelines are debt/equity and cash balances (in our case cash availability).

Asset Management:

1. Inventory: First of all we must be "murder" on old/slow moving inventory. Old parts, units and rental fleet not utilized or under utilized, cannot be tolerated. Second, closely scrutinize months supply and be prepared to adjust accordingly. Pay particular attention to the planned purchases. Moderate and adjust, but do not stop the flow of fresh inventory.
2. Accounts Receivable: "Velvet glove over iron fist" best describes course of action during this period. We must collect but not alienate customers—even have empathy and work with our "good" customers. Remember the economy will improve and we want them back and loyal to us.
3. Capital Expenditures: Ask—"Do we need this right now?"

Expense Control:

1. Payroll: This is our biggest expense. Carefully scrutinize and evaluate on a monthly basis—head count, payroll to sales and payroll to gross margin, by branch, by department. If the person or persons are not productive and cannot improve, action must be taken but with empathy. If it is not the associate, but the situation, consider a transfer to another department, branch or division. We do not want to unnecessarily upset the troops, nor do we want to lose good associates.
2. Non-Payroll Expenses: See Capital Expenditures above: Ask—Do we need this right now?

Marketing & Sales:

We must be aggressive and creative! For instance, by aggressively pricing the old inventory we want to dispose of, we can create interest and open doors, while maintaining our gross margin on the new and more desirable inventory.

The Fleet Replacement Program:

To my knowledge no competitor can or will offer this to customers. It does several good things. One, it replaces competitive machines with ours with its future parts and service business; Two, it can be a source of some good used equipment; Three, from the customer's point of view, it gives him interest-free money to help cash flow during tough times (with extended terms on the new equipment). It also allows him to reduce his fleet to more closely meet his immediate needs. Very importantly it builds customer loyalty in the future, when the economy improves.

It is the ultimate SILVER SERVICE® and an investment in the future.

Interest Rate Programs:

We have an excellent and creative Credit Department. As the situation arises or the economy demands we can, as before, create unique, customer friendly programs (i,e, 1-2-3). Caution: this is to be done only under the auspices of the Financial Services Division. No individual creativity on this one!

"WHOA!" you say. "Isn't this the same thing we have been doing, or trying to do for the last 20+ years?"

Yes, you are right! You see, I lived through the last stagflation and learned from the experience. Upon sober reflection it occurred to me that this is the best, most prudent way to run a business regardless of the economy. In good times it can only improve your results, in bad times it can keep you alive.

Therefore when I bought out the Arnold Family, with the company in dire straits, what better way to make it healthy and prosperous. And it worked! During stagflation, you just have to do it with more intensity and focus. You have less margin for error, and procrastination will kill you.

One Final Thought

The measure of good management is not how well you do when the economic wind is in your sails, but how well you perform during economic storms. Sometimes just to eke out a profit during bad times is a better measurement than a substantial return during good times.

INTEGRITY

DISCIPLINE

EMPATHY

-Alvin Richer