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Parting Is Such Sweet Sorrow: DHR Patio Homes, LLC and Family Firm Management

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Case Study

Parting Is Such Sweet Sorrow: DHR Patio Homes, LLC¹ and Family Firm Management



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I quit.” Those two little words were dropped like an atomic bomb and seemed to explode across the dinner table at the Davis residence. The meal had not yet been served though everyone was at the table engaged in a lively discussion, which of course included their business, DHR Patio Homes, LLC. Immediately, a bush descended upon the Davis family and their guest, close friend, and business associate, Stephen Hodgetts, as an imaginary mushroom cloud filled the room. No one could move or say a word although numerous glances of varying nature were being exchanged in rapid succession. The somberness of the situation was quickly broken, however, by another barrage of discontent. “I’ve had it, I quit. Find someone else to act as the contractor for the company.” With those words, RJ Davis quickly vacated the dining room and zoomed upstairs into the Davises’ spare garage apartment.

Company History and Background—Part A D&H Management, LLC—A Real Estate Management Firm

It all started back in August 2002 when the Dow Jones Industrial Average dipped under 8000. Richard Davis and Stephen Hodgetts, academics, friends, and coauthors, were lamenting their ever-shrinking retirement funds. Neither was getting any richer on a faculty member’s salary nor expected any windfalls from relatives, their book sales, or lottery tickets. As Hodgetts was fond of saying, “America believes in education: The average professor earns more money in a year than a professional athlete earns in a whole week.”²

After a long discussion, they decided to become masters of their own economic fate and jump into an entrepreneurial venture. Davis had done enough preliminary research on the real estate market in their area to convince Hodgetts that becoming a landlord was a good idea.

Davis and Hodgetts, with the assistance of the Davis’s real estate agent, found six families in three months and worked with these families to find them homes³ in the \$175,000 price range that the families would be happy to lease from Davis and Hodgetts and eventually purchase. The deal was so attractive that they even had a waiting list for new tenants. The six homes, though, had gobbled up their initial investment of \$100,000 and required an additional \$80,000 (which Hodgetts loaned the company) while their monthly cash

flow yielded a net profit of \$ 1,500/month. Adrienne, Davis’s wife, managed the day-to-day operations of the firm.

DHR Construction, LLC—A Home Residential Construction Company

The construction company started off as just another small entrepreneurial undertaking to raise venture capital. Hodgetts and Davis would finish off the basements of their rental homes, get the homes reappraised, and then remortgage the properties pulling out an additional \$10,000–\$20,000 per home. These funds could then be used as down payments for future rental homes.

Davis and Hodgetts were approached by one of their renters to perform all of the nonlicensed work (i.e., framing out the basement, wall boarding, taping, plastering, trimming, painting) to finish off all of the other basements of their tenants. Davis explained to the renters (Alan and Wilma) that they would have to form their own LLC and act as any other subcontractor. Based on the additional funds raised by finishing off the basements, Davis and Hodgetts went on to purchase six more homes, five of which had their basements completed by Alan and Wilma (as A&W Construction, LLC).

Alan and Wilma enjoyed working on these basements since it yielded them additional income of \$2,000/month. They approached Davis and Hodgetts about figuring out a way that they could keep occupied year round, however, there was nothing that Davis and Hodgetts could do for Alan and Wilma at that time. Yet a few days later, the situation changed dramatically.

One of Davis’s students who was designing their basements said Davis and Hodgetts could cut out the middleman in terms of their rental business if they built their own homes. Davis thought his student was crazy at the time but they talked after class and the student said that he would be happy to act as the general contractor and that he knew all of the subcontractors who were needed to construct new homes. Alan and Wilma would do all of the interior work, and Alan could hire part-time workers to help. In any event, Davis and Hodgetts could build the rest of the homes they wanted to rent under a different company name, sell it to themselves for a profit, and then make a profit renting the homes. On a \$150,000 home Davis and Hodgetts would net about a 20 percent profit, that’s around \$30,000 over a two- to three-

month time period (the time it took to build a 1200 square foot three bedroom, two bath home).

The profit derived from this entrepreneurial venture led Davis and Hodgetts to backward integrate their operation; they were now going to build homes not only to be purchased by D&H Management as possible rental units but also for public consumption. In May 2003, DHR Construction broke ground on their first construction site in the St. Andrews development.

In November 2003 Davis and Hodgetts bought out the student's interest in DHR Construction due to differences in management and business philosophy. By January 2004 they had completed three homes at St. Andrews. They then shifted their building site to another location, Florence Development, which they felt had a more upscale look and would allow them to build nicer and more expensive homes. By April 2004 they had built three homes in Florence, had plans to build five more in that area, and were looking at other developments for future growth and expansion. On April 12, 2004, the Florence Development Corporation developed cash flow problems and decided not to pay their landscapers. Each of the properties that were owned by Davis and Hodgetts in the development had a mechanic's lien placed on it by the landscapers for \$450,000 per property.

DHR Patio Homes, LLC—A Second Home Construction Company

While a deal was being brokered to clear Davis and Hodgetts' liens, Davis, acting in his usual entrepreneurial manner, located a brand new development in June 2004, about 10 miles east of where they currently were building. The new development, called Snowy Mountains, was a unique project since the developers had built lakes, a golf course, and clubhouse (including a three-star restaurant) and had very specific designs for community development. The housing currently in the development (phase one) ran the gamut of homes, from two-bedroom condominiums (that started around \$140,000) to multi-million-dollar estate homes

on the lake. Every member of the community was given access to the clubhouse (which included a pool and a playground) and the several lakes dotting the development, as well as given a discount at the restaurant and golf course. The developers also sponsored fishing, golfing, boating, and concert events and even had an island that could be rented for weddings and other parties. The island had fully equipped restrooms with showers, electricity, and a kitchen service cabana.

DHR Patio Homes, LLC was established in August 2004 by Davis and Hodgetts to legally separate their construction projects in Florence (run under the corporate name of DHR Construction, LLC) from their latest project, Mountain Trails, a section of the Snowy Mountain development. Davis and Hodgetts kept the "DHR" designation in the firm's name since they thought that the DHR name had some brand recognition and wanted to show a linkage of ownership between their two construction firms. DHR developed a simple business model. Homes would be priced at 20 percent above cost with Davis acting as the architect and head of construction operations. His job was to work with the subcontractors to ensure that their work met schedule and building code requirements and to make sure that subcontractors' bills coincided with the work provided. Alan would work with Davis as the acting foreman on the job by helping to coordinate the subcontractors as well as continue his own subcontracting work dealing with wall hanging, lining, spackling,

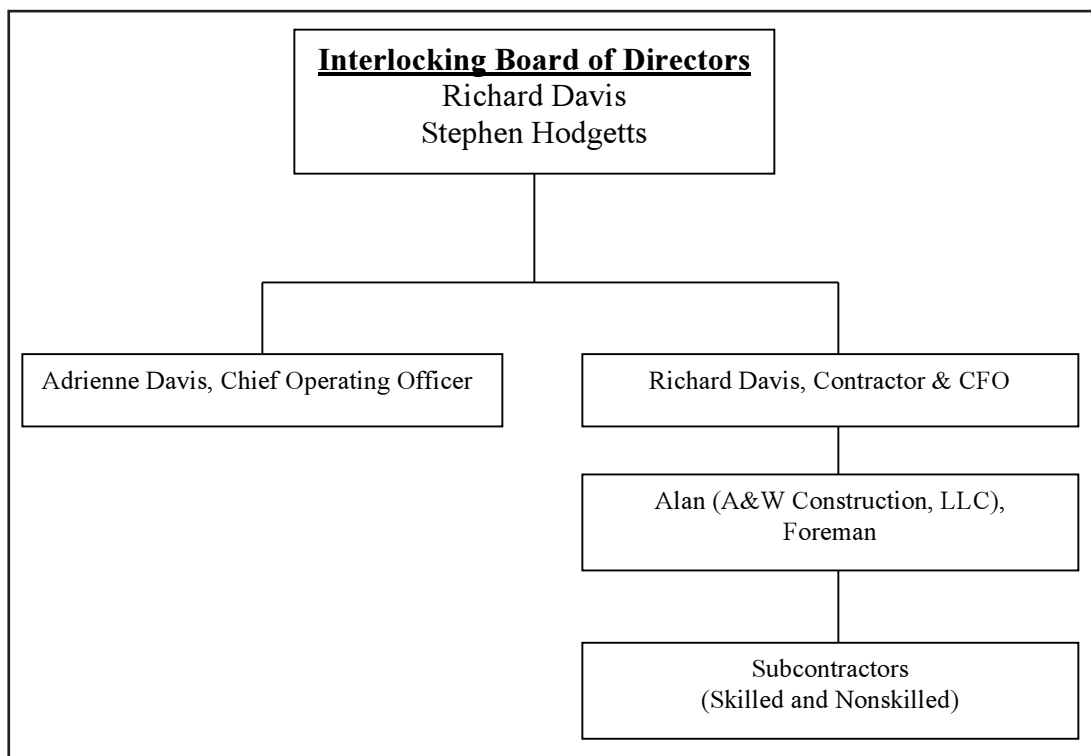


Figure 1. D&H Management, DHR Construction, DHR Patio Homes (June 2004)

molding, and painting. Wilma worked along side Alan (though Wilma was paid by Davis and Hodgetts directly) while Alan also hired his younger brother Marvin to help out as there was plenty of work to do and Alan wanted people he could trust. Alan's LLC received \$6,000 a month in which to pay himself and his brother and pay federal income tax.

Everything seemed to be going smoothly. Alan was working out quite well, taking over as the foreman and after a while Davis gave Alan carte blanche as to how to run the operational aspects of the construction business (see Figure 1).

The Latest Debacle

In early January 2005, Davis and Hodgetts changed from using a part-time bookkeeper to an accountant who worked with numerous home construction businesses. A two-year audit conducted by the accountant on all three businesses revealed that about \$25,000 of expenses connected to Alan's corporate credit card account were either for nonbusiness items (i.e., Christmas trees), multiple questionable charges (i.e., filling up the company truck six times in one day), and, at times, was signed by someone other than Alan (signatures on receipts did not match Alan's signature).

After a discussion with their lawyer, Hodgetts and the Davises agreed to confront Alan with their accountants' findings. Evidence was presented as to the inappropriate credit card charges, multiple purchases of gas and tools, and felonious signature on certain credit card charges. Further evidence was presented to Alan that matched his wife's signature to those on the credit card receipts. Alan neither agreed to nor denied the charges. That being the case, Richard took the keys to the company truck and tool shed from Alan and then described to Alan what their continued working relationship would be. Rather than being fired, Alan would be working under his brother (who would form his own company) and his brother's company's monthly check would be docked approximately \$4,000 a month until all of the losses had been recovered. Alan still made no comments and left the meeting.

When In Doubt, Hire Family

Alan's demotion and separation from the business left a wide managerial gap. So who was going to take over as foreman for the month it would probably take to hire a new one? Richard Davis's plans to retire that year and work the business full time had been stymied by the poor cash flow of the business; there was just not enough positive cash flow to pay Davis a salary that was not even half of what he was earning at the university. Davis would continue to act as the firm's CEO but could not devote the time necessary to act as the chief operating officer (foreman). Hodgetts had pursued several academic undertakings (books, articles, and research) in the last year or two with the understanding that he was going to

have to be the lead author of this "dynamic duo." He had neither the knowledge of the operational aspects of the construction business necessary to serve in a managerial capacity nor the time needed to supervise home building. None of the owners could then serve as foreman.

Davis and Hodgetts agreed that they would need to recruit a foreman but needed someone immediately (i.e., tomorrow) to fill the position while their search moved ahead. There were two likely candidates who immediately came to mind, both family members. Adrienne Davis, Richard Davis's wife, had an MBA and was managing many of the back office functions for Davis and Hodgetts' three firms. She was quite good at dealing with renters, potential buyers, and suppliers, and served as the information hub for the three firms. RJ, Richard and Adrienne's only child, had already graduated from college and served as an administrative assistant to both a local lawyer and the president of their local hospital. RJ was currently working as the assistant to the president of a personal services firm that happened to be one of Davis and Hodgetts' suppliers and was also providing advertising services through a separate business.

The family, including Hodgetts, had a get-together to discuss this matter and decided that RJ would be the most likely candidate to fill the bill. RJ had the free time, had worked in a very tough and stressful environment (a legal office and a hospital) and excelled, and seemed to have both the interest and tenacity to learn the contracting portion of the business. From Davis and Hodgetts' perspective, this would provide an opportunity to determine whether RJ would want to be the one to eventually take over the family business.

Richard Davis then spent a few days at the work site with RJ to introduce RJ to the numerous subcontractors (plumbers, HVAC, electricians, framers, insulators, carpenters, masons, etc.) and their employees and to spread the word that RJ was going to take over the job of foreman while the business was searching for an experienced person. RJ was pleased to discover that many of the subcontractors had worked together on previous jobs for Davis and Hodgetts as well as for other small local contractors and therefore had developed good working relationships with one another.

No specific managerial training was provided since neither Richard Davis nor Hodgetts had undergone their own managerial training prior to any of their entrepreneurial ventures. Richard did give RJ a copy of all of the building blueprints, work charts (showing which subcontractor had to be working at what time point in each home and what work the subcontractor would perform), and had RJ surf the net to read up on the basics of subcontracting. RJ was a very quick learner and after having several question-and-answer sessions with both Richard and Adrienne, they decided that RJ was ready to go solo on the job site.

Like March, Coming in Like a Lion

The next day RJ was at the construction site checking in with all of the subcontractors (who were all in the midst of doing their jobs) to make sure that everyone knew what needed to be done by whom and in what order. RJ specifically reminded the electrician that an electrical inspection was to be done in two days on the house he currently was working on and he assured RJ that the he'd be done on time. The electrician was having real problems tracking down some problems he and his coworker were having, both in the basement (the light switches turned on the wrong lights) and in the first floor dining room (electrical outlets were not working and he could not trace the trouble). RJ asked if the inspection should be cancelled or put off for another few days and the electrician again assured RJ that he'd be done on time. (Richard Davis had told RJ that inspectors seemed to get quite mad if they inspected a house that did not seem to be ready. More importantly, the second inspection would be far more thorough and inevitably the inspector would find something on which to fail the electrical inspection.) RJ then called the town hall to ensure that the inspection was properly scheduled and to see what the inspector would need (i.e., blueprints) for his visit.

RJ came home from the first day of the job exhausted and a bit disgruntled. At the dinner table with Richard and Adrienne, RJ described how the electrical problems still had not been solved and how the electrician guaranteed that he'd get the job done even if he had to work through the night to do it. Other problems kept cropping up (i.e., there was a scratch in one of the kitchen cabinets that was delivered and the lighting company shorted them one fixture) and RJ had to be "the problem solver." Many of these problems would throw the building schedule off and RJ was having to constantly shuffle around the subcontractors to accommodate the numerous mishaps found in each home. Richard and Adrienne were empathetic and offered some kindly advice. Richard kept emphasizing how RJ needed to keep the subcontractors up-to-date on the work schedule, while Adrienne asked about the work climate and how the subs were adjusting to their new boss. RJ complained that the temporary nature of the job and RJ's lack of practical construction work experience probably made it more difficult to deal with the subcontractors. How could they respect someone who had never worked in construction before? Like every other challenge, however, RJ would rise to the task.

Richard, in the interim, had found, through a friend of the family, a retired gentleman who had worked in the construction industry for many years. He really only wanted to work part-time, three to four days per week, and felt that he could serve as a foreman if someone else would pitch in to assist

on his days off. Richard was really looking for a full-time foreman but kept this gentleman in the back on his mind, just in case.

A Failed Inspection and Tempers Flare

After a day or two on the job, RJ felt like the work was getting out of control. The lighting fixture supplier still had not delivered one fixture and the electrician seemed absolutely baffled as to what the problem was with the wiring in the dining room, yet did not inform RJ of this until the inspector was at the work site. The inspector subsequently failed the electrical work on the house and left in a huff.

In the interim, problems were starting to arise with a second home since the insulation subcontractor accidentally insulated the house before it could be inspected for framing; the inspector was absolutely livid when he examined the home and refused to inspect it unless all of the insulation was removed. Meanwhile, he noted that there were problems with the framing of the ceiling (warped wood) and that the metal supports for the joists were poorly installed.

RJ's reaction to all of this was very simple. After "playing nice" with the subcontractors who were giving RJ problems, RJ decided to turn hard-hitting and give the subcontractors a tough talking to. The electrician took the brunt of RJ's anger since he did not call RJ in time to cancel the electrical inspection—two houses failing in two days was not a track record that RJ could deal with. The electrician, though apologetic, did not take lightly to RJ's heavy-handed remarks, and returned RJ's comments with some harsh words of his own.

That afternoon RJ confided to Hodgetts, "I feel overwhelmed on the job. How can I handle all of these responsibilities on top of the work I still had to complete for my own small business of writing promotional advertisements?" Hodgetts listened intently to RJ's comments and suggested that RJ either cut back on one of the jobs or speak with Richard and Adrienne about the situation.

The Calm Before the Storm

The night of the failed electrical inspection, Hodgetts was invited over to the Davis home for dinner so they could discuss the business and see how RJ's first few days on the job were working out. Hodgetts had not revealed his conversation with RJ to the Davises, but the Davises were astute enough parents to know that something was wrong at the work site since RJ seemed more agitated than usual. The dinner conversation started out in its usual jovial manner and then slowly shifted to the progress being made on the construction site.

RJ gave a summary of the past few days, including the failed inspections and the tough time RJ was having managing

the contractors. RJ pointed out who all the “good” and “bad” contractors were, and therefore who ended up on RJ’s like and dislike list. The Davises and Hodgetts were absolutely silent through RJ’s description of the situation (a very difficult task, indeed, for both Richard Davis and Hodgetts) and everyone tried to keep their body language as controlled as possible. RJ finally came to an abrupt finish. This left a long pause for everyone else at the dinner table to fill with table talk or comments about the business. Before anyone could ask RJ a question about the building projects, RJ quit the job and left the room.

Part B

Adrienne left the table and followed RJ to the spare garage apartment to find out exactly what the problem was. In the interim, Richard Davis and Hodgetts were sitting stunned at the dinner table. The silence was broken when Richard said, “So I guess I’m left holding the bag again! How I’m going to manage to act as contractor again is beyond me, but I’ve done it before for a short time when we dumped David Russ and I can do it again.”⁴

“Slow down,” Hodgetts requested, “let’s move into the family room and then discuss this matter in a more conducive setting.”

While Davis and Hodgetts each resumed their conversation, Adrienne joined them to discuss the matter further. “RJ needs some time to herself,” Adrienne began, “and she really is not in a mood to talk right now. Let’s give her time to compose herself and perhaps she’ll come down to chat with us.”

“That’s fine by me,” quipped Hodgetts, “I lost my appetite on the first ‘I quit.’ Adrienne, perhaps you can tell us what this is all about?”

“What this is about,” started Richard, “is the fact that I’m going to have to clean up this mess and get back into the day-to-day operations of the business. I’m going to need to get to the bottom of the problems with the subcontractors and clear up this chaos.”

“Yes, yes, yes,” jumped in Hodgetts. “That’s all well and good, Richard, but we have to get at the root of the matter with RJ—what could have made her quit in only a few days? She has been in jobs with far more pressure than this and yet here she collapses like an accordion on the first sign of trouble? What’s going on here?”

“She wouldn’t tell me,” Adrienne declared, “and I certainly was not going to pressure her. That’s all she would need right now, an overbearing mother!” With that last sentence Adrienne’s gaze quickly affixed on her husband, Richard, who clearly got the hands-off message.

The “Truth” Wills Out

About a half an hour later, RJ came down and joined the

threesome to discuss the work situation. Rather than pepper RJ with a series of questions, the group allowed her the opportunity to let her story unfold.

I knew that I was a young woman walking into a man’s world, even for a short time, and I thought I was prepared for what I would encounter—discrimination and sexual harassment. I treated everyone fairly but tough and wanted to come across as the boss, especially with those subcontractors who were not getting the job done. I wanted them to be afraid of me, that I would fire them on the spot if the work didn’t get done well and on time, that I was a person to be reckoned with; a bitch. The subs saw me replace our former foreman Alan and knew that if he could be replaced, they all could. I thought that is what I needed to do to earn the respect of the subcontractors—in a tough world, be tough.

Though they were polite enough when talking with me directly, I overheard several subs talking with their coworkers about me, and, trust me, it was not complimentary. What really got me upset was that they kept referring to me as “that woman” and that I was less than competent because of my gender.

Worse, the presence of a woman on the job site seemed to be a distraction to some of the subs’ employees, especially the younger, unmarried workers.⁵ One of them kept asking me out on a date, which, of course, I continued to say “no” to; and I explained that it was a conflict of interest for us to become socially involved. I further asked him to stop asking me out and that I felt uncomfortable with his advances. This clearly did not deter his advances, which I kept putting off. When I eventually threatened to have him fired if he didn’t back off, he finally got my point.

It was immediately clear to me that it did not matter what I said; the subs were going to do their thing and deal with Dad if there were any real problems; like failing an inspection is not a problem! I felt out of place and in the way. I quit because it was apparent that in that environment there was no way, no how, that I could work with the subs and get the work completed in a productive, timely manner.

Richard Davis’s face said it all. Anger for how his daughter was treated, regret that he had put her into an untenable situation, and guilt on his part for thinking that she had dumped this problem on him for no real reason. Adrienne also wondered how she might have prepared RJ for this situation though Adrienne had never experienced anything close to what RJ had described.

While Adrienne comforted her daughter, both Richard Davis and Hodgetts discussed the matter further, knowing that they would still have to deal with these issues as well as the need to find an immediate replacement for RJ.

Editors' Note: Anyone wishing to obtain the instructor's manual for the case study should contact Dr. Herbert Sherman at Herbert.Sherman@liu.edu.

Endnotes

1. This is a disguised case. The names of the firms and characters have been changed by request of the owners.
2. <http://www.quotationspage.com/search.php3>, August 27, 2003.
3. The location has been purposely left out to support the disguised nature of the case.
4. For an earlier case study on DHR Construction, see Sherman, Herbert, and Daniel James Rowley. 2004. Case study: DHR Construction, LLC: Parts A and B. *New England Journal of Entrepreneurship* 6, 2: 33-44.
5. These workers were a mixture of immigrants and locals and included men of Hispanic origin.



About the Authors



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