Volume 15, Number 2 *2008*

Allied Academies International Conference

Reno, NV
October 15-17, 2008

International Academy for Case Studies

PROCEEDINGS

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RECEIVABLES MANAGEMENT: A CASE STUDY

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ABSTRACT

In this case study Delta Inc , a discount broker, has almost 60% of its receivables due from one client, Pink Tree. The case examines various issues related to receivables management and the impact of the client's financial distress on Delta's cash flows and a new business venture. The case encourages students to use financial accounting data to challenge Pink Tree's going concern principle and come up with new business strategies when the unexpected happens to Delta Inc. This case study is suited for students in an introductory accounting course at the graduate level.

JAMBA JUICE

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CASE DESCRIPTION

The primary subject matter of this case concerns business strategy and explores Jamba Juice's growth options in the context of the fast food and smoothie retailer industries. A Secondary issue examined includes an exploration of the resources and capabilities in the internal environment of a uniquely creative competitor operating in an unconventional industry space. This case has a difficulty level appropriate for senior level undergraduate courses. This case is designed to be taught in one hour and is expected to require two hours of outside preparation by students.

CASE SYNOPSIS

Jamba Juice Company (originally named Juice Club) was founded April 1990 and quickly grew utilizing a franchise strategy. In 1995, the company changed its name to Jamba Juice Company to provide a point of differentiation. Jamba Juice Company went public in November 2006. As of April 2008 there were 707 Jamba Juice stores.

The highly interactive Jamba experience is uniquely designed to attract customers with the enticing aroma of fresh fruit, vegetables, and wheatgrass and the high-energy sounds of whirring blenders. Jamba worked with a retail design consultant to formulate a model plan for its stores that would showcase natural materials used in construction and highlight the high-quality natural ingredients used in Jamba's products. The layout offers a casual bar-type atmosphere using interior stools and exterior tables and chairs.

Jamba Juice stores offer customers a range of blended beverages made with natural ingredients, nutritional supplements, and healthy snacks. To supplement the natural nutrients in Jamba smoothies, Jamba offers supplements in the form of Boosts and Shots. Jamba also offers a small selection of baked goods made with natural ingredients and high in protein and/or fiber. Smoothie and juice products depend heavily upon supplies of high quality fruits and vegetables. Jamba purchases all of its projected requirements for the coming year from suppliers at the height of the season for that particular type of produce. The produce is flash-frozen and stored by the supplier(s) for shipment throughout the year.

In 2007, Jamba was the smoothie industry leader and had several fairly strong competitors with similar health and fitness focuses, including Juice It Up!, Planet Smoothie, and Smoothie King. In addition to being a leader in the smoothie industry, Jamba is also a formidable competitor within the broader quick-service restaurant (QSR) arena. Jamba smoothies and baked goods could serve as an alternative to fast food meals or sweet treats, as functional foods (foods with targeted health benefits) and energy beverages.

THE TROPICAL FISH FARM: TRANSITIONING FROM HOBBY TO BUSINESS

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ABSTRACT

This case traces the transition of one person's leisure interest in tropical fish to the development of a successful business in direct competition with large established domestic producers and international importers. This entrepreneurial case study is appropriate for undergraduate students at all levels. It includes essential business-building concepts such as product quality, differentiation, market research on a shoestring, premium pricing strategies, relationship selling, dual channels of distribution, and cost controls. Since many students have had aquariums or known friends that have had them, the case is easy for them to relate to on a personal level. As the case unfolds, the hobbyist expands and progresses through a series of expansion phases that soon involves several retail and wholesale buyers. The decision presented to the students is whether to expand into a major player within the region and, if so, which of three expansion alternatives should be pursued.

THE RUSSIANS ARE COMING: LUKOIL'S GLOBAL ENERGY REACH

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CASE DESCRIPTION

The primary subject matter of this case concerns the global energy reach of Russia's largest integrated oil company, Lukoil. Secondary issues examined include political risk, ethics, and strategic management. The case has a difficulty level of three, appropriate for junior level students. The case is designed to be taught in one class hour and is expected to require three hours of outside preparation by students.

CASE SYNOPSIS

Russia's largest integrated oil company, LUKOIL, has partnered with the American energy giant, ConoPhillips in order to expand the Russian retail presence in the United States, and to explore more energy sourcing. The case examines the importance of this Russian company to the global energy market, its implications for American consumers and investors, and the potential geopolitical implications of Russia's energy resources.

LUKOIL is Russia's largest vertically integrated oil company (Figure 1). The private company constitutes over 19% of Russia's oil production and 2% of world oil supplies (Lukoil, Russia's largest oil company by Isabel Gorst). Besides aggressive oil exploration, the company has formed a strong alliance with GAZPROM, the state owned gas company and most recently has expanded into petro-chemicals in order to diversify its portfolio.

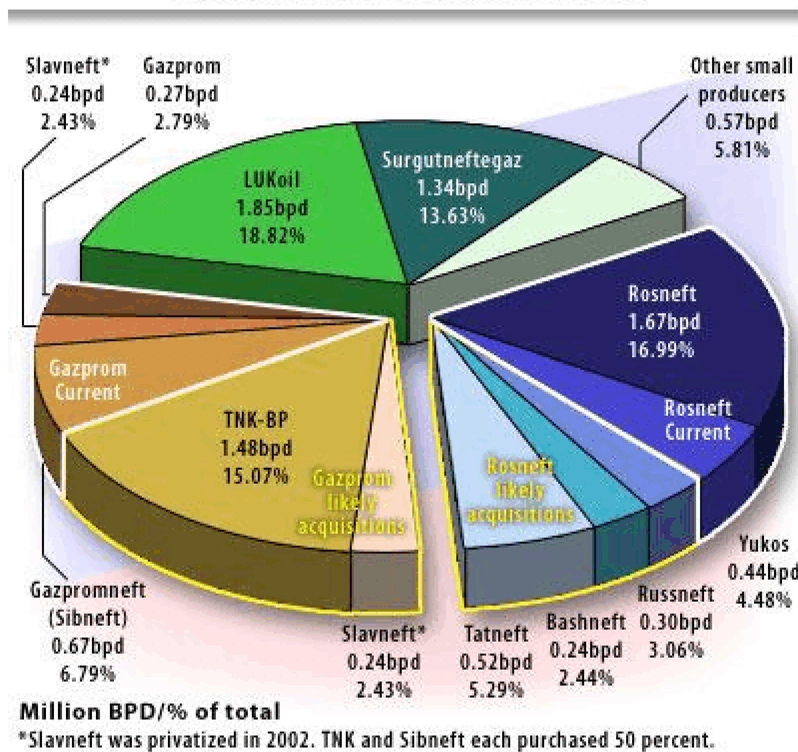
The oil giant has invested in the Caspian region, the Middle East, Europe, North Africa, North America and South America. It is a truly global company with a base in a volatile transitioning economy. Increasing oil prices are driving governments and oil companies to push for new field exploration. In the case of Lukoil foreign fields constitute only five percent of the total output, but in the long term, the firm's CEO, Vagit Alekperov, has committed to increasing this proportionately to twenty percent. This is a sign of Lukoil's commitment to diversification and less reliance on the influence of the Russian government, and swings in public policy.

Lukoil's diversification strategy has investments in oil processing and gasoline retail outlets in the countries of Ukraine, Romania, Bulgaria, Finland, Belarus, the Baltic states, former Yugoslavia as well as the United States. It is significance that most the countries in which Lukoil has focused have traditionally had strong political ties with Russia. It could be asserted that Lukoil's seemingly valid business-oriented strategy is rooted in trying to continue Russia's domination of the

ex-Soviet bloc countries by continuing their reliance on Russian oil imports. Lukoil's CEO, Vagit Alekperov has publicly stated that "The efficient development of reserves directly linked to national security…it preserves the economic integrity of the country…it strengthens national positions in the international arena. The concept has always been the same: in the Russian Empire, the Soviet Union and Russian Federation. It will remain this way, until the 'oil era' is over. (Vagit Alepkerov speech on National Oilmen's Day, September 2005). With this statement, Lukoil is affirming the company's interests to the Russian government. Not only is Lukoil seeking to spread its influence throughout Europe, the firm has also established a separate arm to focus on investment in the North and South America called LUKOIL AMERICAS. (LUKOIL AMERICAS.com). Through the purchase of the Getty retail chain, American consumers now are purchasing some of their gasoline directly from this Russian company.

Figure 1

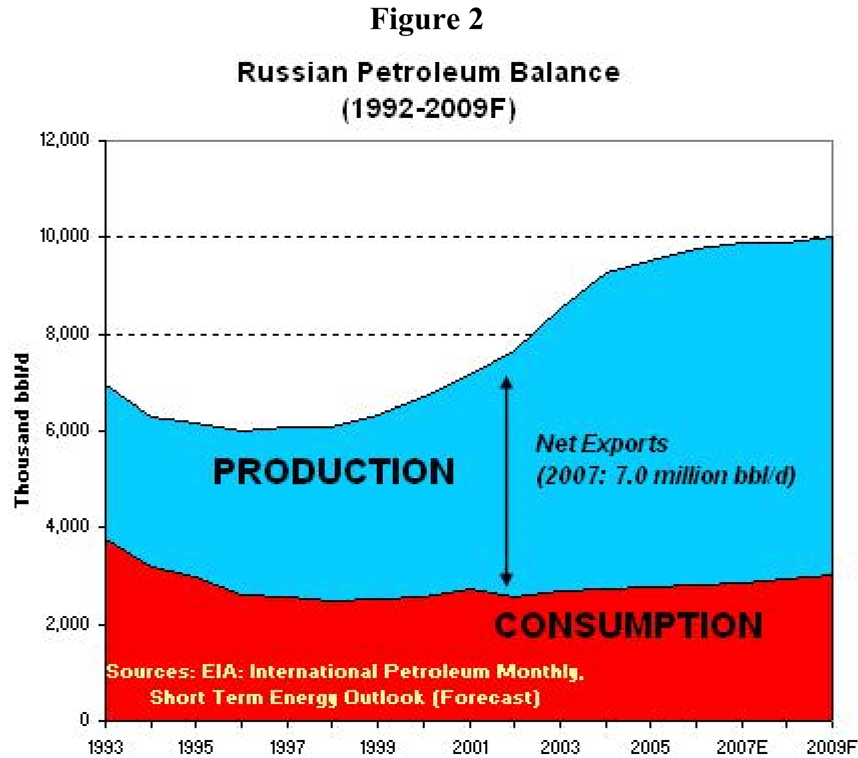
RUSSIAN OIL PRODUCTION 2006



The United States and other developed countries rely heavily on oil to grow their economies. As the world's appetite for oil continues to grow, Russia will continue to emerge as an important player in the global energy market. With the rising of the Indian and Chinese economies, global demand for energy has risen faster than production, causing prices to rise and allowing Russian oil companies to reap the benefits of these rising commodity prices. As can be seen in Figure 2, Russian oil output has exceeded domestic demand, and is expected to continue to do so for a number of years

to come. The abundance of excess energy allows Russia, and firms like Lukoil to increase their standing in the global community. Some see this situation as an opportunity for foreign investment, others express concerns about the safety of such investments.

Figure 2



Initially Lukoil's aim has always been to act as a decentralized company that is free of Russia's political influence. Some would argue that this is not possible. The firm lists its shares on the London Stock Exchange and the New York Stock Exchange through American Depositary Receipts (ADRs). The value of the ADRs has done well over the past five years (Figure 3), however, it can be argued that the stock is underperforming due to the political risk investor's see in Russia today (Figure 4). It may be reassuring to American investors that Conoco Phillips has had a 20% stake in Lukoil since 2005. The acquisition of a fifth of Lukoil's shares by a US owned company, and LUKOIL's openness to scrutiny by an independent outside accounting commission, should indicate that LUKOIL is making a great effort to shed the image of being a corrupt Soviet style national oil giant. What is troubling to some is the recent action by the Russian government in terms of the confiscation of another private Russian oil company (Yukos), and it's even more recent aggressive stand with foreign investors.

Figure 3

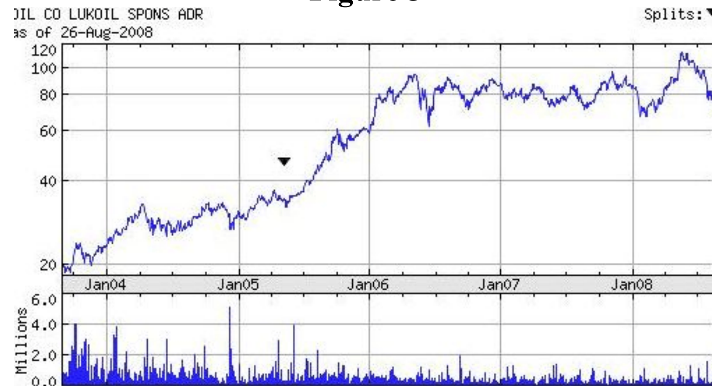
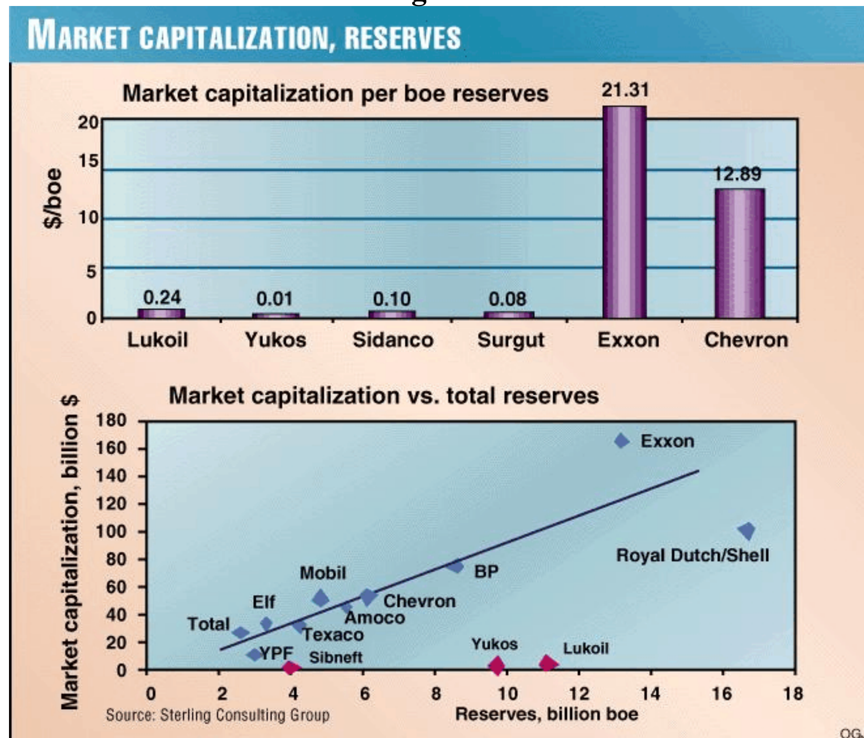


Figure 4



Discussion Questions:

1. What are the geopolitical implications of the rising prominence of Russian oil companies such as Lukoil?
2. Do you feel that Lukoil is a good investment for American investors? Explain your answer.
3. If Russia continues its aggressive foreign policies, will American consumers reject the Lukoil brand? Explain.

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Note: Additional references (such as that of the case's figures) are available upon request and have been omitted due to page restrictions.

A UNIQUE PURCHASE DECISION

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CASE DESCRIPTION

The primary goal of this case is to ask students to analyze sales and operating information and then to make a recommendation to a group of friends on whether they should purchase an existing retail business, even when the purchase price is minimal. The actual purchase price is unique as well as the type of store in the case. The store's primary focus is art, antiques and upscale gift merchandise. The present owner of the store leases the building and then subleases space to individual vendors who rent booths to display their merchandise. The vendors pay a monthly rental fee (based on the size of their booth) and 10% of each sale for their space. The store owner collects and remits all sales taxes for the dealers, pays employees, and pays for all operating expenses. Sales by month for the past three years and average operating expenses are provided in the case and are based on information obtained from the present owner of the store. The case is based on the actual experience of one of the authors.

CASE SYNOPSIS

This case is appropriate to use in an Intro to Small Business Class or Entrepreneurship Class as the size of the business is ideal for any course that emphasizes small business or entrepreneurship. The information in the case is relatively easy to understand and it requires the students to integrate elements of accounting, finance, and marketing in the decision making process. The first question assignment in the case asks the students to analyze the case and to prepare a memo on their initial recommendation to the potential buyers.

A second phase of the case analysis allows for group projects on further topics including: (1) recommending a marketing plan, including an analysis of the various type of advertising options and their costs; (2) recommending to the potential buyers the type of business to form (i.e. Corporation, Sub-S Corporation, Partnership, LLP); (3) evaluating and then recommending a line of business to add to increase revenues of the business; and (4) investigating whether such a business should sell "on-line" and if so the best strategy to undertake. Overall, the case presents students with an actual real-life purchase decision. The case could also lead to relevant class room discussion on current issues faced by small businesses.

CASE HISTORY

Three of the present dealers (Patricia Robbins, Laura Lewis and Mary Farley) were approached by Lucy Taylor, in early fall of 2007, to determine their interest in purchasing the business. The potential purchasers were very familiar with the business however; none of the three

individuals had retail experience. One of them, Mary Farley, was a CPA and could lend financial expertise to the store. The other two individuals did not presently work and would have the time to devote to the business on a day to day basis. Lucy Taylor was looking for someone to purchase the business and retain its current retail focus and the purchase price she was asking for the business was minimal.

The store had been in its present location for approximately four years. It had previously opened in a smaller location a few blocks away in 1998 with two partners, Lucy Taylor and Sally Owen. In 2003, when the business moved to its new location, Sally sold her interest to Lucy. The new building space allowed for 28 booth rentals and 14 wall spaces for rent (Table Three). At this new location, Lucy Taylor stated the business was profitable in the early years. However, sales had been on the decline in the past few years due to construction in the downtown area on the city streets. The construction was scheduled to be completed by the end of 2007.

In the late summer of 2007, Lucy decided to sell her interest in the store. The building space was leased but Lucy had spent approximately $30,000 renovating the building for its current use. The purchase price would include two computers; computer retail software (specifically written for the consignment store); build-outs for the booths including electrical outlets for each, a large front counter for the cash register with a laser printer; a kitchen area with a free-standing ice maker, a refrigerator, a microwave, sink, and built in cabinets; two bathrooms; all wrapping products; a small inventory of books; an installed security system; and a sound system. The present owner basically wanted to walk away from the business and leave everything.

THE PURCHASE DECISION

Table One details the sales by month for the store for the last three years. Table Two lists assumptions regarding operating expenses. From this information, the students are asked to construct pro-forma cash flow statements based on their assumptions on sales levels, occupancy levels and some operating expenses. Additional questions in the case ask the students or group of students to research other lines of business that the potential buyers could add to the store to complement the present merchandise presently being sold by dealers. Since there is a cap on revenue at 10% of commissions, the potential owners want to investigate other sources of revenue if they decide to purchase the business. The students are given some ideas on lines of business to research.

Table One
Sales by Month

Month	2004	2005	2006
January	$29,044	$20,115	$13,441
February	$26,807	$26,863	$20,107
March	$55,987	$23,742	$20,170
April	$32,554	$19,304	$20,863
May	$33,069	$31,246	$30,158
June	$30,853	$23,255	$22,322
July	$31,715	$18,881	$21,646
August	$21,600	$19,451	*$22,468
September	$22,029	$27,199	*$30,158

Month	2004	2005	2006
October	$27,446	$22,690	*$32,450
November	$53,884	$40,408	*$49,278
December	$81,744	$76,684	*$85,332
Totals	$446,732	$349,838	$368,393

*Projected as the initial decision process started in August 2007

Table Two Estimated Monthly Operating Expenses	
Rent on Building	$4322 monthly
Utilities	$800-$1000 monthly (higher in summer months)
Wages	$1500 a week (there are no employee benefits others than payroll taxes)
Insurance	$2200 annual liability and workmen's compensation premium
Janitorial Service	$75 weekly
Advertising	The current owner has been spending approximately $800 a month on advertising. To supplement the advertising cost, each vendor pays either $100 (booth renters) or $50 (wall renters) to the store twice a year.
Telephone	$350 a month for a two-line phone and fax line. No Internet is included.
Other operating expenses	Store supplies average $200 a month. Wrapping and packing products cost up to 2% of sales.
Gross Receipts Tax	.03% of sales is paid to the City for Gross Receipts Tax

Table Three Rental Space and Rates		
Space		**Rental Amount**
Booth 1	A Beau Collection	$360
Booth 2	Farm Friends	$240
Booth 3 & Wall 4	Just for Ewe	$540
Wall 5	POP	$60
Booth 6 And Wall 30	Portebellos	$490
Booth 7	AEW	$300
Booth 8	ASLR	$300
Booth 9	Wildwood Antiques	$375
Walls 10& 11	Vacant	$50
Booth 12	Market House	$140
Booth 13	Vieux Carre	$250
Wall 14	Jo	$42
Booth 15	Fifty Fingers	$100
Booth 16	KRJ Antiques	$220
Wall 17	Vacant	$30
Booth 18	Martha's	$250
Wall 19	Helen	$30
Booth 20	Envision It	$250

Space		Rental Amount
Booth 21	Our Friends	$490
Wall 22	Vacant	$50
Booth 23	A Beautiful Touch	$270
Booth 24	Blueberry Hill	$270
Wall 25	Vacant	$50
Wall 26 And Booth 27	Spunky Skunk	$280
Wall 29	JT's Collectibles	$30
Booth 30	Cottage	$220
Wall 32	Vacant	$40
Booth 33	Vacant	$250
Booth 34	LOGO	$130
Wall 35	PCJ	$42
Booth 36	Soiree	$300
Booth 37	Collectibles Unlimited	$300
Booth 38	Book Bugs	$360
Booth 39	NAF Interiors	$300
Booth 40	Vacant	$240
Booth 41	Nancy's Jewels	$240
Booth 42	Miss Joni's	$360
Booth 42	Lyndee's	$480
Booth 42	Erwin's	$390

CASE QUESTION

Should the three individuals purchase the business? If they do decide to purchase it, what type of business organization should they form? Are there other lines of merchandise they could add to the store to increase direct sales that would complement the current merchandise and not compete with it? Should the store look into having an "on-line" presence and if so, should they try to sell their unique merchandise online?

THE EFFECT OF CONVERGENCE OF U.S. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND INTERNATIONAL FINANCIAL REPORTING STANDARDS ON GLOBAL ENTITIES

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CASE DESCRIPTION

The primary subject matter of this case concerns strategic decisions that global entities, their executives, and accountants face in light of the almost certain convergence of U.S. Generally Accepted Accounting Principles (GAAP) to International Financial Reporting Standards (IFRS). Secondary, the effect of convergence to IFRS on the financial statements of U.S. based global entities, on financial statement users, and the accounting profession is explored. This case has a difficulty level of three to four and can be taught in about 45 minutes. Approximately two hours of outside preparation is necessary to fully address the issues and concepts. This case can be utilized in Intermediate Accounting as part of the coverage of pending changes in U.S. financial accounting and reporting, in an International Accounting course, or in a more advanced graduate accounting course focusing more extensively on underlying conceptual issues and the research components of this case. The case has analytical, critical thinking, conceptual, and research components. Utilizing this case can enhance students' oral and written communication skills.

CASE SYNOPSIS

In December 2007, the Securities and Exchange Commission (SEC) issued a rule entitled, "Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP" (SEC, 2007). This new rule eliminates the typically costly reconciliation of financial statements prepared using International Financial Reporting Standards (IFRS) to U.S. GAAP that previously was required of non-U.S. companies reporting to the SEC. This rule is likely to significantly affect foreign entities, U.S. multinational entities, financial statement users, and especially the accounting profession.

The SEC's decision is part of a broader movement in the U.S. toward the acceptance of IFRS and is supported by the Financial Accounting Standards Board (FASB). The SEC also is considering allowing U.S. companies to choose between U.S. GAAP and IFRS when reporting to the SEC and may require that all U.S. public companies utilize IFRS by the year 2014 (SEC, 2008).

While no final decisions have been reached, it is virtually certain that the U.S. will be moving away from the traditional U.S. GAAP and toward a convergence with IFRS, which already are required or permitted in more than 100 nations. U.S. and global entities, the accounting profession, accounting majors, financial statement users, and educators must prepare for this change.

The primary focus of this case concerns U.S. convergence to IFRS and explores the effects of IFRS on global entities' financial statements, financial statement users, and the strategic decisions accounting professionals and entities may face.

This case can be taught at the same time that pending changes in U.S. financial reporting are discussed in Intermediate Accounting or in a more advanced accounting course focusing primarily on underlying concepts and the case's research components. The case has critical thinking, analytical, conceptual, communication, and research components.

INTRODUCTION

For several decades, global organizations, such as the European Union, the International Organization of Securities Commissions (IOSCO), and the International Accounting Standards Committee (IASC), supported international efforts to harmonize financial accounting standards and reporting. For example, the IASCO consistently recommended the "adoption of a set of high-quality accounting standards for cross-border listing" (Doupnik & Perera, 2007, 78). Consistent with the IASCO's goal, during the 1990s the IASC focused on developing a set of international standards that would be accepted for cross-border listing (Doupnik & Perera, 2007) and issued 41 International Accounting Standards (IASs).

In 2001, the IASC reorganized and the International Accounting Standards Board (IASB) was created. In 2002, the Financial Accounting Standards Board (FASB) and the IASB signed what is commonly referred to as the Norwalk Agreement. In this agreement the two major standard setting organizations concurred to work together to develop a high-quality single set of accounting standards that would be utilized internationally for "domestic and cross border financial reporting." (FASB, 2002).

To achieve their high priority goal, the FASB and IASB agreed to eliminate existing differences between U.S. GAAP and International Accounting Standards and to coordinate their efforts on future standard setting projects (FASB, 2002). Currently, the standards issued by the IASB and its predecessor, the IASC, consist of 41 IASs and eight IFRS. These standards now are collectively referred to as IFRSs. As a result of the joint efforts by FASB and the IASB, IFRS and U.S. GAAP are compatible in many areas. However, some significant differences still exist and have to be reconciled if a global set of standards is to emerge.

The Sarbanes-Oxley Act of 2002 (SOX), an Act of Congress that was issued to improve financial reporting and protect investors, requires that the SEC conduct a study regarding the adoption of a principles-based set of accounting standards (U.S. Congress, 2002, HR 3763, 108, 2d). IFRS generally are considered principles-based standards, while U.S. GAAP is considered more rule-based. SOX specifies that the U.S. standard setters should consider "the extent to which international convergence on high quality accounting standards is necessary..." (U.S. Congress, 2002, 108, 1Av).

U.S. GAAP has influenced accounting standards in many countries. A decade ago, some still expected that U.S. GAAP will eventually become globally accepted, but this no longer is likely (Herz, 2008). Many nations have adopted IFRS for financial reporting purposes. Today, more than 100 nations either require or permit the use of IFRS for financial reporting. (KPMG, 2008). It is very likely that IFRS will soon become globally accepted. Robert Herz, Chairman of FASB, supports

convergence to IFRS. In a recent interview with the *Journal of Accountancy*, Mr. Herz estimated that within the next five years, convergence to some form of IFRS will occur (Herz, 2008).

In December 2007, the SEC issued a rule that allows non-U.S. companies to choose between U.S. GAAP and IFRS when reporting to the SEC (SEC, 2007). This rule has affected foreign issuers quite significantly. The SEC currently also is considering allowing U.S. public companies to choose between IFRS and US. GAAP when filing their financial statements with the SEC and just announced that it would issue a proposal for public comment that may require that U.S. public companies adopt IFRS by 2014 and may permit early adoption in 2010 (SEC, 2008).

Professional organizations, such as the American Institute of Certified Public Accountants (AICPA) also support convergence efforts. For example, on May 15, 2008, the AICPA launched a website "AICPA.IFRS.com" to help inform and educate accounting professionals about the expected change.

Standard setters, accounting educators, public accounting firms, global entities, and many U.S. entities are preparing for the expected convergence to IFRS. Current accounting students - the future accounting professionals - must become knowledgeable about IFRS, the effect on companies' financial statements, consider strategic decisions entities may face on the path toward convergence, and must prepare for the pending convergence. This case addresses many of the issues that arise during this process.

CASE DESCRIPTION*

Elisa Hartwald is the Chief Financial Officer (CFO) of Wichtel Corporation, a multinational company, whose parent company is headquartered in the U.S. The company is a consolidated entity currently consisting of the parent and seven majority owned vertically integrated entities. All of its subsidiaries are located in Western Europe. The U.S. parent company purchases and imports parts from its subsidiaries as well as from unaffiliated entities. The European subsidiaries are listed on European stock exchanges and prepare financial statements consistent with IFRS.

During the past, Wichtel has raised capital selling stocks and bonds only in the U.S. Because of the cost of compliance with SEC regulations, the company's European subsidiaries also have raised capital exclusively in their home countries. Wichtel Corporation's board of directors recently voted on a new expansion project that would allow it to gain global market share. The company currently is exploring the possibility of raising additional capital either in the U.S. or the European markets.

Elisa, who is a Certified Public Accountant, has closely followed developments toward global harmonization of financial accounting and reporting. She is very familiar with the differences between U.S. GAAP and IFRS and the difficulties and challenges of consolidating entities utilizing different GAAP. She also is aware of the trend toward convergence of U.S. GAAP to IFRS. Elisa already has prepared a list of current significant differences between IFRS and U.S. GAAP. This is shown below:

*This is a fictitious case. Any similarities with real companies, individuals, and situations are solely coincidental.

Inventory Cost Flow Assumptions:	LIFO is not permitted under IFRS.
Inventory Valuation:	Market is defined as net realizable value; lower-of-cost-or- market write-offs may be reversed under IFRS.
Property, Plant, and Equipment:	IFRS allow use of market values.
Intangible Assets:	IFRS allow use of market values.
Development Costs:	Development costs can be capitalized under IFRS.
Extraordinary Items:	This category is prohibited under IFRS.
Convertible Bonds:	Consistent with IFRS, the issue price of the convertible bonds is allocated between liabilities and equity.
Differences in terms:	Retained earnings commonly is referred to as "reserves" under IFRS.

Elisa is in charge of preparing consolidated financial statements for the parent company and its European subsidiaries. In completing this process, Elisa must translate and reconcile the IFRS-based statements of Wichtel's European subsidiaries into U.S. GAAP and combine the financial statements applying U.S. rules of consolidation. This is a complicated process. Selected information from the most recent income statement and balance sheet show that Wichtel carries its inventory at LIFO cost, recognizes a significant amount of property, plant, equipment, and intangible assets; has issued convertible bonds, recognized research and development expenses, and recognized an extraordinary loss.

The Chief Executive Officer (CEO), James Miellers, asks Elisa to consider their company's position regarding the SEC proposal to permit U.S. companies to utilize IFRS. James also asks Elisa to consider the company's strategic plans to raise additional capital in light of the expected changes in financial reporting rules and to consider their implementation strategies if the SEC requires (or permits) use of IRS for all public companies. She decides to consider the issues, discuss them with the CEO, and also to draft a comment letter to the SEC.

ASSIGNMENTS

Answer the questions assigned by your instructor. Provide concise answers.

Questions:

1. Consider the information provided about Wichtel Corporation's most current financial statements. What would be the likely effect of adopting IFRS on Wichtel Corporation's financial statements? How would use of IFRS affect the company's key financial ratios?
2. How could use of IFRS affect Wichtel Corporation's cost of capital? How could this affect Wichtel Corporation's strategies regarding future sources of capital?
3. What would be the advantages and disadvantages of preparing financial statements utilizing IFRS?
4. What would be the likely effect on financial statement users if the SEC allows U.S. companies to choose between either U.S. GAAP and IFRS for preparing their financial statements? What do you recommend that Wichtel Corporation should choose in that situation?

5. What would be the likely effect on financial statement users if the SEC does not permit companies to choose between U.S. GAAP and IFRS, but instead requires that all U.S. public companies utilize IFRS for preparing their financial statements?
6. Draft a concise letter addressed to the SEC to express your opinion regarding the issue of whether U.S. companies should be (a) permitted or (b) required to prepare financial statements consistent with IFRS.
7. The SEC is considering requiring that all public companies use IFRS by the year 2014. How will this affect the accounting profession?

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HI AND DRI

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CASE DESCRIPTION

The primary subject matter of this case is the mastery of basic accounting concepts and issues that are part of the FASB's Conceptual Framework including: asset and liability recognition; measurement attributes; measurement unit; entity concept; and relevance versus reliability; The purpose of this case is to provide an entertaining and interesting avenue for the introduction to and discussion of these concepts. This case has a difficulty level of three to four and is targeted at accounting students in intermediate accounting or an accounting theory course. One hour of class time should be sufficient to handle the case discussion and students should budget 1-2 hours of time for case preparation.

CASE SYNOPSIS

Two moisture farmers on a dry, desolate planet far, far away are arguing over which of the two is wealthier. The argument has grown out of hand and two rival families/clans are on the brink of war. You, the case analyst, have been dispatched to the planet by the Supreme Councilor of Planetary Peace to mediate during this tense moment in galactic history. The whole future of the planet and possibly even the galaxy rests in your ability to provide a fair and just resolution to the conflict. By applying basic accounting concepts you learned at the Academy of Accurate Accounting (AAA) and other planetary wisdom you have gained during the many years of serving in the Dajo Temple you can bring this conflict to a peaceful end by deciding who is the wealthier moisture farmer.

THE CONFLICT

Across the galaxy on a dry, desolate planet called Kandoline, two moisture farmers, Hi and Dri, have spent many hot, arid afternoons sitting in the local cantina sipping on a local beverage called Kandu. Most of these afternoon meetings have culminated in the two farmers arguing their relative positions in life, an argument for which no one has been able to provide an adequate answer. The issue has been the source of much tension between the two and their clans for years. Recently the arguments have grown in intensity and the two rival families (clans) are on the brink of war. You have been dispatched to the planet by the Supreme Councilor of Planetary Peace to mediate during this tense moment in galactic history. The whole future of the planet and possibly even the galaxy rests in your ability to provide a fair and just resolution to the conflict. By applying basic accounting concepts you learned at the Academy of Accurate Accounting (AAA) and other planetary wisdom you have gained during your many years of serving in the order of Dajo Knights you can bring this conflict to a peaceful end.

Upon arrival on Kandoline you quickly make your way to Mosely Sandd the village that lies between the Hi and Dri clans. In a meeting with the local Governor, a good mediator in his own rights, you have learned that the two men and their clans have agreed to accept your judgment as to which farmer is "better off," an agreement that all are hopeful they will maintain. In your meeting with the local governor you have obtained the following information.

Dri claims to have 400,000 liters of water and that Hi possesses only 340,000 liters of water. Therefore Dri has concluded that he is the wealthier moisture farmer. Hi, on the other hand, argues that he has 300 square kilometers of land while Dri has only 200 square kilometers; Hi also asserts that Dri's land was inherited and therefore is not worthy of counting while Hi, himself, had given 30,000 liters of water for 150 square kilometers of land 15 years ago, and this year he gave 45,000 liters of water for 150 square kilometers of land. Hi also observes that of Dri's liters of water, 35,000 belong to Choppa the Putz and that he merely keeps them safe and clean. Dri counters that he has a large comfortable, quiet 4-seater speeder that he built himself. He claims that he has been offered 12,000 liters of water for the speeder. Besides these things, Dri claims to have a thermal detonator, which was a gift from a friend and is worth a couple of condensers; two anti-gravity sleds which were given him in a trade for a 1,000 rocky square kilometers of land; and an oil bath unit which he had acquired for 5,000 liters of water.

Hi goes on to say that his wife has orders for six housekeeping droids to be made from materials already on their homestead. She will receive 24 condensers for them. His wife has 9 condensers already, 3 of which had been received in exchange for 3,600 liters of water just last year. He (Hi) has an oil bath unit which he acquired in a trade for 3,000 liters of water. He also has one anti-gravity sled which cost him 2,000 liters of water. Hi's two-seat speeder, even though smaller in dimensions than Dri's, should bring him 30 square kilometers acres of desirable land in a trade. Dri is reminded by Hi that he owes Chew-E three thousand liters of water for providing security for the past year.

Given the information you have obtained and utilizing your accounting knowledge you are to determine who is the wealthier moisture farmer, Hi or Dri.

*This case is based upon "The Sheepherders" originally published in Accounting Education: Problems and Prospects, ed. James Don Edwards (American Accounting Association, 1974), pp. 365-69.

CAPE CHEMICAL: CAPITAL BUDGETING ISSUES

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CASE DESCRIPTION

The primary subject matter of this case concerns the issues surrounding evaluation of capital expenditures. Case provides a systematic approach to evaluating capital expenditures including a review of alternative capital budgeting methods and the relationship between the cost of capital and capital budgeting. The case requires students to have an advanced knowledge of accounting, finance and general business issues thus the case has a difficulty level of four (senior level) or higher. In particular, an understanding of capital budgeting practices and cost of capital issues is necessary to solve the case. The case is designed to be taught in one class session of approximately 1.25 hours and is expected to require 3-4 hours of preparation time from the students.

CASE SYNOPSIS

The case tells the story of Ann Stewart, President and primary owner of Cape Chemical. By most measures, the performance of Cape Chemical has been very good over the last three years. Double-digit sales growth has been achieved, new product lines have been added and profits have more than tripled. The growth has required the acquisition of equipment, expansion of storage capacity and increasing the size of the work force.

The unexpected withdrawal of one of Cape Chemical's competitors from the region has provided the opportunity to increase its blended packaged goods sales. However, Cape Chemical's blending equipment is already operating at capacity. To take advantage of this opportunity, additional equipment must be obtained, requiring a major capital investment. It is estimated that Cape Chemical must increase its annual blending capacity by 800,000 gallons to meet expected demand for the next three years Annual capacity of 1,400,000 gallons is necessary to meet projected demand beyond the next three years. The firm has no systematic capital expenditure evaluation process.

BACKGROUND

Cape Chemical is a relatively new regional distributor of liquid and dry chemicals, headquartered in Cape Girardeau, Missouri. The company, founded by Ann Stewart, has been serving southeast Missouri, southern Illinois, northeast Arkansas, western Kentucky and northwest Tennessee for five years and has developed a reputation as a reliable supplier of industrial chemicals. Stewart's previous business experience provided her with a solid understanding of the chemical industry and the distribution process. As a general manager for a chemical manufacturer,

Stewart had profit and loss (P&L) responsibility, but until beginning Cape Chemical, she had limited exposure to company accounting and finance decisions.

The company reported small losses during its early years of operation, but performance in recent years has been very good. Sales have grown at double-digit rates, new product lines have been added and profits have more than tripled. The growth has required the acquisition of additional land, equipment, expansion of storage capacity and more than tripling the size of the work force. Stewart has proven to be an expert marketer, and Cape Chemical has developed a reputation with its customers of providing quality products and superior service at competitive prices.

Despite its business success, Cape Chemical is still a "large" small business with Stewart making all important decisions. She recognized the need to develop a professional managerial staff, particularly in the area of finance. Recently, she hired Kate Clarkson as the company's first finance professional and placed her in charge of the company's accounting and finance activities. Cape Chemical's board of directors is composed of Stewart, her brother and the company's attorney. The board's existence satisfies state regulatory requirements for corporations but provides no input to business operations.

CHEMICAL DISTRIBUTION

A chemical distributor is a wholesaler. Operations may vary but a typical distributor purchases chemicals in large quantities (bulk - barge, rail or truckloads) from a number of manufacturers. They store bulk chemicals in "tank farms", a number of tanks surrounded by dikes to prevent pollution in the event of a tank failure. Tanks can receive and ship materials from all modes of transportation. Packaged chemicals are stored in a warehouse. Other distributor activities include blending, repackaging, and shipping in smaller quantities (less than truckload, tote tanks, 55-gallon drums, and other smaller package sizes) to meet the needs of a variety of industrial users.

THE SITUATION

The unexpected withdrawal of one of Cape Chemical's competitors from the region has provided the opportunity to increase its blended packaged goods sales. That's the good news. The bad news is Cape Chemical's blending equipment is operating at capacity, thus to take advantage of this opportunity, additional equipment must be obtained, requiring a major capital investment. It is estimated that Cape Chemical must increase its annual blending capacity by 800,000 gallons to meet expected demand for the next three years   Annual capacity must increase by 1,400,000 gallons to meet projected demand beyond the next three years.

Stewart is considering two alternatives proposed by the company's engineer. The first is the acquisition and installation of used equipment that will provide the capacity to blend an additional 800,000 gallons annually. The used equipment will cost $105,000 to acquire and $15,000 to install. The equipment is projected to have an estimated life of three years. The second option is the acquisition and installation of new equipment with the capacity to blend 1,600,000 gallons annually. The new equipment would have a substantially higher cost of $360,000 to acquire and $60,000 to install, but have a higher capacity and an economic life of seven years. The new

equipment is also more efficient thus the cost of blending is less than the blending cost of the used equipment. Stewart asked Clarkson to lead the evaluation process.

Stewart thinks the used equipment could be obtained without a new bank loan. The acquisition of the new equipment would require new bank borrowing.

The evaluation of each alternative will require an estimate of the financial benefits associated with each. The marketing and sales staff estimated incremental sales of blended package material will be 600,000 gallons the first year and increase by 15% each year thereafter. During the last year, the average selling price for blended material has been near $4.05 per gallon and material cost (not including a cost for blending the material) has been approximately $3.53. The marketing staff anticipates no significant change in either future selling prices or product costs; however they do estimate variable selling and administrative expenses associated with the increased blended material sales to be $.20 per gallon.

PROJECT EVALUATION PROCESS

The company has no formal process for evaluating capital expenditure projects. In the past Stewart had reviewed investment alternatives and made the decision based on her "informal" evaluation. Clarkson plans to develop a formal capital budgeting process using the Cash Payback Period, Discounted Cash Payback Period, Net Present Value (NPV), Internal Rate of Return (IRR) and Modified Internal Rate of Return (MIRR) evaluation methods.

Weighted Average Cost of Capital (WACC)

Using input from an investment banking firm, Clarkson estimates the company's cost of equity to be 18%. Their bank has indicated a long-term bank loan can be arranged to finance the new equipment at an annual interest rate of 12% (before tax cost of debt). The bank would require the loan to be secured with the new equipment. The loan agreement would also include a number of restrictive covenants, including a limitation of dividends while the loans are outstanding. While long-term debt is not included in the firm's current capital structure, Clarkson believes a 30% debt, 70% equity capital mix would be appropriate for Cape Chemical. Last year, the company's federal-plus-state income tax rate was 30%. Clarkson does not expect the income tax rate to change in the foreseeable future.

Used Equipment

The used equipment will cost $105,000 with another $15,000 required to install the equipment. The equipment is projected to have an economic life of three years with a salvage value of $9,000. The equipment will provide the capacity to blend an additional 800,000 gallons annually. The variable cost to blending cost is estimated to be $.20 per gallon. The equipment will be depreciated under the Modified Accelerate Cost Recovery System (MACRS) 3-year class. Under the current tax law, the depreciation allowances are 0.33, 0.45, 0.15, and 0.07 in years 1 through 4, respectively. The increased sales volume will require an additional investment in working capital of 2% of sales (to be on hand at the beginning of the year).

New Equipment

The acquisition of new equipment with the capacity to blend 1,600,000 gallons annually is the second alternative. The new equipment would cost $360,000 to acquire with an installation cost of $60,000 and have an economic life of seven years and a salvage value of $60,000. The new equipment can be operated more efficiently than the used equipment. The cost to blend a gallon of material is estimated to be $.17. The equipment will be depreciated under the MACRS 7-year class. Under the current tax law, the depreciation allowances are 0.14, 0.25, 0.17, 0.13, 0.09, 0.09, 0.09 and 0.04 in years 1 through 8, respectively. The increased sales volume will require an additional investment in working capital of 2% of sales (to be on hand at the beginning of the year).

REQUIREMENTS

Assume the role of a consultant, and assist Clarkson to answer the following questions.

1) Calculate Cape Chemical's weighted average cost of capital (WACC). Note: round to the nearest whole number. Discuss the theory used by Clarkson to determine Cape Chemical's optimum target capital structure (30% debt and 70% equity).
2) Since the used equipment will be financed with internal capital and the new equipment with a bank loan, should the same discount rate be used to evaluate each alternative? Explain.
3) Explain why an accurate WACC is important to a firm's long-term success.
4) Evaluate the strengths and weaknesses of the Cash Payback Period, Discounted Cash Payback Period, NPV, IRR and MIRR capital expenditure budgeting methods. Prepare a recommendation for Stewart regarding the capital budgeting method or methods to use in evaluating the expansion alternatives. Support your answer.
5) Calculate the Cash Payback Period, Discounted Cash Payback Period, NPV, IRR and MIRR for each alternative. For these calculations, assume a WACC of 15%. Based strictly on the results of these methods, should either option be selected? Why? Solution requires preparation of a spreadsheet.
6) Stewart is concerned that the projected annual sales growth rate of 15% for incremental blended material may be optimistic. Recalculate the Cash Payback Period, Discounted Cash Payback Period, NPV, IRR and MIRR for each alternative assuming the annual sales growth rates of 10% and 5%. Assume a WACC of 15%. Does the change in growth rate alter the recommendation made in question 5? Solution requires preparation of spreadsheets. Explain.
7) The projected cash flow benefits of both projects did not include the effects of inflation. Future cash flows were determined using a constant selling price and operating costs (real cash flows). The cash flows were then discounted using a WACC that included the impact of inflation (nominal WACC). Discuss the problem with using real cash flows and a nominal WACC when calculating a project's Discounted Payback Period, NPV, IRR and MIRR.

8) What other issues should Stewart and Clarkson considered before a final decision regarding the expansion alternatives is made?

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THE DAILY EXAMINER: STRATEGIC INITIATIVE 2013

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ABSTRACT

CEO William Rogers is well aware that the internet poses a significant threat to traditional print newspapers like The Daily Examiner, a regional, employee-owned newspaper. Therefore, Rogers hired Skip Van Wart as CFO because of his reputation as a strategic change agent for staid industries. Although Van Wart has limited experience in the newspaper industry, he has initiated turnaround strategies in other companies. During his 10 months with the company, Van Wart conducted a study of all areas of operations as well as readership patterns. The study concluded that The Daily Examiner faced a strategic dilemma, determining that two major changes were strategically necessary: 1) the newspaper must develop an online newspaper segment; and 2) the current printing operation should be outsourced. The conclusions of the study are based on the increasing age demographic of the Daily Examiner readership, the growing online market, as well as the opportunity to reduce what could become excessive operational costs, i.e. capital outlays in replacing the printing presses. Immediate implementation of the plan is complicated by two major elements: (1) there are three years remaining on the lease of one of the printing presses and (2) outsourcing the printing operation would affect about 30% of the employees. Having worked in the printing area, Rogers has strong interpersonal ties with many of the employees there. In addition the printing employees, collectively, own 42% of the company's stock and include the single largest shareholder, Buck Johnson, who had served as Rogers' mentor. Rogers therefore, faces a tough decision: reject the initiative and stay true to the paper's historic roots and support the long serving employees, or adopt the initiative and make radical changes in order to meet perceived future needs?

APL – DAVID WRAY

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CASE DESCRIPTION

The primary subject matter of this case is leadership. Secondary issues examined include culture, diversity, decision-making, and risk-taking. The case has a difficulty level of three, appropriate for junior-level students. The case is designed for an in-class discussion and should take 15 to 20 minutes of discussion once the students have prepared the case. Preparation time should not consume more than 30 to 45 minutes of time if it is assigned as homework.

CASE SYNOPSIS

Arising from the sands of the Arabian desert, on the Gulf of Arabia, is the fabled City of Gold reaching out with the tallest buildings in the world to announce her presence. The fastest growing city in the Middle East has become one of staggering building and infrastructure growth. Island cities, towering property developments, mega-malls, world-class athletic facilities, sky-trains, and more are the norm rather than the exception in Dubai in the United Arab Emirates. In this small country over a quarter of the world's building cranes are located. While the rest of the world is reeling from collapses in the property markets, Dubai's developments are sold out before the first concrete is poured. This has provided one of the hottest opportunities for organizations in the construction industry. Within this industry is Arabian Profile Co., Ltd. (APL) and the man who leads it. APL is an example of one of the many construction-related companies that has profited from this massive construction effort. This case provides an excellent example of an expatriate business leader, profiling leadership abilities.

APL – DAVID WRAY

Situated in the southeast of the Arabian Peninsula on the Arabian Gulf, the United Arab Emirates (UAE) continues to enjoy a rapidly growing economy in comparison to the rest of the world. Most notable is the boom in the construction industry with enormous projects like the Palm Islands, the World Islands, the Burj al-Arab Hotel, and others taking shape every year. In such an industry exists the Arabian Profile Co. Ltd. (APL).

Founded in 1986 by the leading industrial group GIBCA, APL was developed to extend the group’s interest in the manufacture of construction materials. With its business spanning over 20 countries and specializing in the production of an extensive range of complementary cladding materials and insulating products, the company is considered to be one of the largest manufacturers of profiled pre-painted steel and aluminum cladding – protective insulating layers that get fixed to

the outside of buildings or on top of metal layers – in the Middle East. Some of the projects undertaken by APL include power plants in the UAE, Vietnam and Qatar, as well as water transmission lines, lease buildings, and large villas in the UAE. In the Burj al-Arab Hotel, APL was responsible for the Atrium (i.e the sky-lighted central area) sail walls, the mirror finish stainless steel balcony fascia, the 3 lower atrium floors, the VIP entrance, the complicated structures of the Water Cascade and Fountain in the Atrium, and aerodynamic roof structure for the swimming pool area of the Bab al Yam Restaurant.

The Leader

David Wray, the "visible" figure from the upper management who is directly and deeply involved in all the strategic decisions, is the General Manager of APL. He is also known to be in direct contact with the employees and works hand-in-hand with his superior, the Managing Director, in making top-level decisions. In addition to the Managing Director, Wray reports to the board of directors of the GIBCA group. His goals and tasks are identified and agreed upon in the operational and capital budgets handed to him periodically. In achieving his stated goals, he is responsible for the effective handling of everything at APL including recruiting personnel, performing salary reviews, establishing departmental budgets, rewarding and motivating workers, allocating resources, and approving projects.

His Early Years

David Wray was born in the United Kingdom in 1948. After the demise of his father and at the age of 15, he had to quit school and find a job to support his family. Upon the advice and help of friends and relatives, he entered the construction industry. Motivated by his longing for school and education, he decided to become a tradesman, wherein he attended school once a week. He later acquired technical qualifications and was qualified after a number of years in the industry as a chartered instituted builder with his Higher National Certificate in Construction. He pursued his career in the construction industry for a considerable time both in the UK and overseas between 1969 and 1998. He travelled to Africa and the Far East, eventually settling in the Middle East. Throughout the years, he climbed the ladder of organizational hierarchy from a builder, to a construction supervisor, and then to an operations director until his skills and experience qualified him to become a General Manager in Thailand and Saudi Arabia for construction companies. He then changed his field of interest from pure construction and civil engineering to a related field: supplies to the construction industry. In 1998, he worked as a GM of one of GIBCA group companies called ALICO (an Aluminum company) for 6 years. Throughout his career at ALICO, he specialized in Aluminum Curtain Walling (i.e. curtains of glass and Aluminum). After that, he assumed his current position as a GM at APL. He has been with APL for the past two years.

Leader Profile

In order to be a successful leader, Wray finds it essential to have a plan that gives a sense of direction, to know what the target is and to have a team of comfortable people to work with. According to Wray, business is a process that undergoes constant change and there is no single way to manage or lead. What is important one week might be less important the next week and not at all important the week after. Just because a method of action worked once does not mean the same

method will work again. Being calm and vigilant, and gaining thorough understanding of the situation at hand is the first step towards moving forward. Add to that the power of effective decision making and there emerges a leader.

Decision-making

Wray agrees that decision-making is a difficult task and that there is no guarantee to a decision being right or wrong. He feels that even though a decision made may not be fully right, it is never fully wrong either. What is important is that there is a decision and once made, everybody complies with it. Even a bad decision is better than no decision since lack of decision relates to lack of direction and this in turn creates feeling of insecurity in the workers. When finding it difficult to make a decision, Wray feels comfortable seeking advice from people with expertise. He believes that everybody's input is valuable and that shared decision making will yield better decision acceptance. He, however, does not feel insecure about having to make a firm decision when necessary. Wray accepts that there is always a chance of failure. He treats failures or bad decisions gently and gives room for his staff to make mistakes as well. He believes that unless people make mistakes, they live in fear. What he expects of himself and others is to learn from the failures/mistakes and improve.

Risk-taking

Wray is not much of a risk-taker. He would rather choose a business that has slightly lower return, but is less risky than a business that has a higher return but is risky. Wray says, "I would tend to look for supply-only project in the UAE than one with supply and installation in Bahrain. I can get gross profit for this project in this market of 17% as compared to 25% in Bahrain. I would tend to go for the business here, which gives a good return, but not the sort of huge return on a job in Bahrain. The reason for that is that I consider that to be risky. It's a stand-alone job; I don't have an infrastructure to support it. Lot's of people do, and goes and takes jobs in Bahrain and Qatar. I am not saying I wouldn't. I am just saying I prefer often a lower risk."

Diversity

The work environment in which Wray operates is characterized by strong cultural diversity as workers (whether low-level employees or managers) come from different backgrounds, have different religious beliefs, and different values and orientations. The workforce at APL is primarily composed of Indian and Pakistani workers and a mixture of Arab, English and Indian managers. Wray believes in being sensitive and understanding of the diversity. Wray uses participative leadership with those followers who are more aware of the universally changing attitudes towards formal authority, the ones with relatively higher professionalism and more aspiration to empowerment. He uses participation primarily with the western managers who report to him as well as those managers from other cultures that take the initiative and display their willingness to give their inputs. However, he knows that the Arab and Asian cultures in general tend to be more status conscious and have high power distance combined with high uncertainty avoidance. He responds to this by providing detailed guidance and demonstrating tolerance to failure. So far, he has been able to create a cooperative work environment despite the cultural differences among members of the workforce.

Wray has been working at APL for over two years. According to one of his subordinates, Wray is an ideal leader. He is strict about meeting deadlines, but flexible and understanding of the work environment. APL is progressing well under Wray and he credits his efforts and his staff for the continued success of APL.

QUESTIONS

1. Wray's subordinate claims Wray to be an ideal leader. Do you feel the same way? Why or why not?
2. Is it true that shared decision making would yield better decision acceptance?
3. Workforce diversity is an essential business concern. Is it absolutely necessary to be sensitive towards diversity?
4. Is Wray's approach on risk taking appropriate?

AMCO APPAREL MR. RASHID ANWAR PART A

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CASE DESCRIPTION

This case is a good example of an entrepreneurial venture of an expatriate in the UAE. This study also points out important lessons for individuals initiating new businesses. It shows how external factors can create severe obstacles that make the business seemingly impossible to prosper. It clearly show how the acknowledged best in the business have to struggle to survive. This implies that an entrepreneur would have to willing keep working to achieve his or her goal and not to give up with the first dilemma he comes across. The case allows the student to easily identify many of the mistakes made by the entrepreneur and external challenges that arise but not so easily to identify a corrective course of action that will lead to a successful venture. The case is designed to be completed in a single class section having been assigned for reading and preparation before class. It is appropriate for classes in entrepreneurship, leadership, and strategic management. The authors recommend junior and senior level students as the appropriate levels.

CASE SYNOPSIS

This case is about an expatriate entrepreneur, Mr. Rashid Anwar, who established his apparel manufacturing concern in the UAE approximately 20 years ago. The case discusses his family and business history and how he stepped onto the sands of the Arabian Desert of the UAE with a dream to achieve entrepreneurial success. The case outlines the initial development he went through with the establishment of his company and the challenges, both internal and external, faced in the company's initial years. The case ends with a common crisis point faced by many entrepreneurs: survival of the business. What, if anything, can be done to overcome the challenges he faces?

FOUNDER'S HISTORY

The family origins are traced back to Africa where Mr. Anwar's great grandfather's family ran a cattle business. Later, the family migrated to the city of Gugrat in Hindustan where they setup an optical business. In 1927, his grandfather, Sheikh Mohammed Hussan went to Japan on his first business trip to buy optical supplies. Following which he made several additional trips to purchase supplies.

In 1937, his father, Sheikh Mohammad Anwar and mother, Begum Habib migrated to Kobe, Japan for the sourcing of optical products from Japan to Bombay. His father affectionately became know as Germany-Walla. This name was due to his migration abroad. At the time the people of

Gujrat, Hindustan had the impression that the only country outside of Hindustan was Germany. During this time, his family had invested in an optical business, "Eastern Optical Company" in Bombay, Hindustan. This was at the time their primary business.

The impact of World War II on the Japanese economy prompted the family to move back to Bombay, Hindustan at the end of the war in 1945. The family was just settling into their business when the partition of Hindustan in 1947 broke out. Since the family's hometown was Gujrat which was now part of Pakistan, the family decided to migrate from Bombay to Pakistan. Instead of going to Gujrat, they moved to Karachi as it was a commercial city and offered better business prospects and growth opportunities. In 1949, Mr. Rashid Anwar was born as the second son in the family and fourth sibling. The optical business in Hindustan was liquidated and the capital was brought to Pakistan for the establishment of new business venture. After the 1947 partition of Hindustan, there was an economic boom in Pakistan. To enter into this market, Mr. Anwar's father decided to utilize his expertise in sourcing from previous businesses. From 1947 to 1951 the family was looking for a new business to venture into, they tried a few ventures that didn't work out and then in 1951, Kaiser Sewing Machine Co. (KSM) was founded which imported sewing machines from Japan to Pakistan. The machines were imported due to the rapid growth of the clothing industry in the 1950's.

In 1957 Mr. Rashid Anwar's father passed away. The business was left in the hands of the eldest son, Mr. Khursheed who was at the time only in 9th grade. Mr. Rashid joined the family business by working summers beginning in 8th grade, 1965. He finished his 10th grade in 1967 and then started working full time. Mr. Rashid continued his education, taking evening classes for his Bachelors Degree. In 1971 he graduated from Karachi University with a Bachelors Degree in Commerce.

Mr. Rashid, while browsing old correspondence his late father had with companies in Japan, thought of starting an export business. He followed up his idea by visits to the Karachi Chamber of Commerce and various libraries to find out which items would be worth exporting. This helped him in realizing that there was a market for hand crafted apparel. Using his father's old letters as a template for communication, he pushed ahead with his idea. He selected the United States of America as the primary market because his research showed a very high, per capita income as compared to other countries. Other target countries included Germany, United Kingdom, Japan and Australia.

In 1969 the first apparel shipment was sent to the USA with only two people working on this project. This project was undertaken by Mr. Rashid's own initiative and was later founded in 1972 as Kaiser Arts and Kraft (KAK). By 1978 KAK has grown to 1,000 employees. This was made possible largely due to a great demand from the US and lack of significant competition. The initial capital for KAK was taken from father's old business. The family realized that there was potential in export business, thus creating two family businesses, KAK and KSM. In 1975, the eldest, Mr. Khursheed and the second youngest brother, Mr. Naveed and Mr. Rashid were partners in KAK. In 1984 Mr. Khursheed bought all the shares for KSM and is running KSM till the present, along with his own setup of an apparel business. Mr. Rashid concentrated on his passion for apparel business.

In 1976 the New York office was set up with a name Indus Imports Inc. Mr. Rashid believed that New York was the main hub for garment import into the United States of America. The company's main business was handcrafted garments. Prior to opening the office in New York annual revenue was only $10 million. After 2 years of operations of the New York office, annual revenue

jumped to $27 million. This was also the period when USA and Europe imposed a quota restriction. After imposition of import quotas into US, the company continued to maintain their revenue until 1987. However, after a decade of success the demand in the market shifted to basic/casual garments and the demand for hand crafted garments declined. The NY office had to close in 1994.

KAK over the years proved itself again and again. It won the, "Best Export Performance Trophy", which is given based on the highest export value, every year from 1976 to 1987. At this time, Mr. Rashid received great recognition for his efforts. He was nominated as Businessman of the year in 1984 from the Federation of Pakistan Chamber of Commerce & Industry. In 1981 Mr. Rashid formed an association for apparel, "Pakistan Cotton Fashion Apparel Manufacturing & Exporter Association (PCFA). He not only created this association, he also wrote the Article & Memorandum of Association and was the Chairman of the Association. The reason for creating this unique initiative was that he saw lack of industry representation for the cotton manufacturers and he thought this association would help them. During his time as Chairman, he organized the very first Fashion Apparel Fair (FAF), in 1987 which was held in Karachi, Pakistan. The first FAF attracted 230 buyers and over 2,000 visitors. The second FAF hosted 480 buyers and 10,000 visitors. The demand for the Fair grew so much that the third fair was by invitation only. This fair moved in 1994 to Lahore, Pakistan and in 1996 the last FAF was held. Mr. Rashid during this time worked actively with the Pakistan government, especially on promoting the cotton industry.

COMPANY FORMATION

Mr. Rashid even after his graduation in 1971 kept up with current events, trends and business developments. He supplemented this through regular reading of newspapers, various magazines and attending seminars at the Karachi Chamber of Commerce. Mr. Rashid worked on his hunch that the export market was the way to go. He kept up his research into which countries would be the best to export to. This has led him in 1988 to an idea to venture out even further.
After expanding and being a successful businessman in Pakistan, Mr. Rashid wanted to venture out to new opportunities. Due to the quota restrictions in Pakistan, Mr. Rashid couldn't see any new prospects to grow further in Pakistan. At that time, there was much talk in the market about the United Arab Emirates (UAE) and the opportunities the country was offering. On one long weekend Mr Rashid decided to visit the UAE with some friends to see what opportunities were actually available. He was very impressed by the stable economic conditions and government laws and regulations in UAE. He visited existing manufacturing plants as well as the free zones. After gathering all information and evaluating all options, he realized that UAE was the country to establish new ventures in. The country offered various opportunities which he saw as an added advantage rather than expanding in Pakistan.

In 1988, he visited the Jebel Ali Free Zone (JAFZ), with the intention of setting up a garments manufacturing plant. However, JAFZ had already issued 18 licenses for apparel related factories so Mr. Rashid's application was denied for that year. Looking at Mr. Rashid's high profile in Pakistan, JAFZ requested him to open a completely integrated plant for fabric dying and printing plant. Mr. Rashid, however, had his mind set on a garment manufacturing plant. He then visited Umm Al Quwain Free Zone (UAQFZ). At that time, the zone had only one company in operation. During his visit, Mr. Rashid had a chance to meet with Sheikh Khalid bin Rashid Al-Mualla, the

ruler of Umm Al Quwain. Although the zone was not as developed as JAFZ, the standards set by Sheikh Khalid gave Mr. Rashid confidence that setting up a plant in Umm Al Quwain was quite feasible. After a detailed analysis and completion of all the procedures and formalities, Mr. Rashid set up a business in UAE.

AMCO Apparel Manufacturing came into existence in November 1989 when the company license was issued by the Umm al Quwain Free Zone with a start-up investment of $3 million. The factory started production from November 1990 with a workforce of 350 workers. These workers were primarily from Sri Lanka, Pakistan, India and Bangladesh. AMCO is derived from his mother's and family's name as it means Anwar Mother Company.

THE EARLY YEARS

Product - The initial set-up of the factory was specialized in producing dress collar shirts for men mainly for export to Western markets.

Production Operations - The production facility was equipped with high end machinery & equipment fit for the production of basic garments. There was also specific machinery for the sewing of collar & front placket of shirts.

Quality Control - Quality Control was a basic measure for the company when it first started. As the company was into the shirts market, the collar & the front placket were the major focus for quality control. AMCO was equipped with the basic quality inspection machines to test collars & front plackets of shirt for any defects and other measures. However, there was not an organized quality control team set in place. There was no system to audit quality at various stages in the production process. Management did not give much significance to quality control, as they saw no direct and immediate result or benefit.

Technology - The whole gamut of technology in garment manufacturing is vast and covers wide ranging areas starting from information technology, design, product development, grading & marker making, spreading cutting, sewing, finishing, material handling and utilities. In the beginning there was investment in machinery technology, but very minimal in terms of PC's and software. All sewing machines were fitted with built-in computers used for the setting of the timing & number of stitches required on every task. There wasn't any other requirement for IT.

Management - During the first 4 years, the company was run by three main key people, the Managing Director, Mr. Rashid Anwar, a Factory Manager, Mr. Nayyar Abbas and General Manager, Mr. Syed Asad Haseeb. These three people were equally involved in the day to day matters. All final decisions were made by Mr. Rashid. The Merchandising, Human Resource, Finance, Administration and Marketing Departments were under the Mr. Syed Asad Haseeb. Each department had one manager and an assistant. Some of the personnel were new in the field while some had worked with Mr. Rashid in Pakistan, bringing vast experience to share with AMCO. While on the production side, the factory manager was responsible for floor production. There weren't regulations for a code of conduct. Incentive programs were not existent. Situations were handled on a case basis by Mr. Rashid. No IT department existed at this stage as the only technology was in the sewing machines themselves. Working hours were 10 hours a day, 6 days a week.

Marketing Strategies - Since its inception, the company had stressed marketing their products and trying to find new customers in Western markets. The primary target market was

Europe, emphasizing Germany. Europe was a quota free region and was the primary reason why AMCO ventured into this market. The marketing campaign was based on print media where they developed the company corporate catalogue and mailed them to top apparel importers worldwide. Faxing was also used as a popular and effective method of targeting prospective customers. Mr. Rashid and top managers from the department visited various apparel related exhibitions worldwide to acquaint themselves with upcoming apparel trends & meet prospective customers.

Finance - Huge investments were made in fixed assets during the initial set-up of AMCO. Bank borrowing were done for short term investments and buying inventory. In order to function smoothly, cash was being injected by Mr. Rashid through either short term bank loans or subsidized from the family business in Pakistan.

Difficulties Faced - During the first four year of company existence, AMCO incurred losses due to irregular orders, inefficiencies, and mismanagement and mostly due to effects of the Gulf War.

Production Operations – A seamless production process is essential for a successful garment manufacturing. As a new manufacturer, AMCO faced several problems in its production operations. Initially, there were conflicts between the workers. This resulted in worker inefficiency and affected the quality drastically. There was a lack of a streamlined procedure for the production operation. The workflow of the production operation was ill-defined and every step of the manufacturing process was open to interpretation.

Quality Control - The lack of quality control measures led to a number of problems. The company faced a defect rate of 7% from 1990 till 1994. The industry average was less than 2%. Consequently, there were numerous complaints from customers. Repeat orders from customers not made. To improve the standard or quality of their orders, the management started to establish certain quality measures. There were inspection forms filled out by the production line supervisors at various stages of the production process. These different quality inspection checks proved helpful from pushing the defect rate from 7% to 5% in 1996. However, the company was still facing losses due to the defect rate. Quality inspection equipment such as a trimming machine was installed to check for the flawless cutting of threads for the machines. A thread sucking machine was also introduced to rectify the complaint of loose threads on the finished garments.

Technology - Many businesses around the world do not see technology as a problem and especially factories and production facilities. They all follow the, "if it isn't broken, then don't fix it" philosophy. The problems that occur is lack of vision and investment in new technology. This was not the case with Mr. Rashid, he had sufficient level of technology in the early years of the company, however this was limited to production machinery. Mr. Rashid, however, forced implementation of his policies with a, "My way, or the highway", a very autocratic style. He read an article detailing the advantages of a paperless office and pushed for it in the company. The management staff was resistant initially, but later accepted and appreciated it once they realized the benefits. Another problem faced by the company was the learning curve. Throughout the company, people were learning the new technologies slower than acceptable. Outside technology consultants were brought in to accelerate the process.

Management – The major problem faced by the management was the conflict between the General Manager and Factory Manager. Both had different areas of expertise. The Factory Manager had the operational knowledge for the apparel industry and organizing the production requirements

while the General Manager had a managerial background. The lack of coordination between these two people which caused many of the inefficiencies in the production processes. AMCO ran on an assembly line system. Any delays or quality issues in one area were pushed throughout the system. This resulted in numerous problems related to efficiency and quality. Many of the floor staff were new in the factory as well as the country. They were homesick and lacked the motivation to perform. Lack of communication in the production process caused work overloads. The increased stress in the workers resulted in incompetence in their performance. All this helped to produce a bad reputation for the company.

Marketing Strategies - Looking at the prosperous Western markets, the company had expected breakeven in 2 years. Unfortunately, this was not the case. AMCO suffered huge losses as the Gulf War started a few months after the company was established. The shirt business was less profitable and because of the war, most Western customers preferred to buy the products from Bangladesh. Due to cheap labor and duty exemption from the low-income country, Bangladesh was able to give a better price and capture much of the Western markets. There was no duty exemption to customers from UAE which caused much ofthe market drift to Bangladesh, thus eating away at AMCO's potential customer base.

CRISIS POINT

By 1994, the bank liabilities at AMCO had increased tremendously. The company was facing difficulties in all respects. The production operations were not streamlined with the workflow process. AMCO was late in paying the factory workers their monthly wages. As a result, the workers productivity dropped considerably. The quality inspection procedures were ineffective. AMCO could not retain customers with such defect rates in its products. At the same time, it could not even attract new customers. AMCO was struggling to bear the cost of the labor force as it was three times the cost of maintaining any labor force in India, Pakistan, Bangladesh or Sri Lanka. Producing basic clothing items such as shirts was expensive in UAE given the labor costs in other apparel manufacturing countries. AMCO could manufacture at competitive prices compared to Bangladesh who came out as a low cost basic items producer. Subsequently, AMCO was losing its customer base and failing to attract new customers.

After running the factory on a loss for over 3 years, Mr. Rashid decided to sell the factory. He cut down on expenses and started searching for prospective buyers for the factory. To meet with the running expenses of the manufacturing plant, the factory started running on a cutting and making basis (In the Apparel industry, factories at times provide a cutting and making service at a charge for buyers who come in with their order and use the cutting and making facilities). At the end of 1994, AMCO received an order for outerwear windbreaker jackets from a USA importer. This order was critical because outerwear apparel had a higher margin for such value added apparel and allowed the higher skills of his workers to be used. This customer's order also kept AMCO afloat financially. AMCO operated on overhead basis with no profit or loss from 1994 to 1997. At the same time, the search for prospective buyer was not productive. No reliable buyer was willing to purchase the manufacturing plant with high liabilities as it had been mortgaged with the bank. Nevertheless, Mr. Rashid was still seeking the option of selling the plant and cutting the losses he was suffering.

QUESTIONS

1. Perform a SWOT analysis of the business. What are the primary internal strengths and weaknesses of AMCO? What external opportunities and threats are present in the environment?
2. Does Mr. Rashid possess the necessary leadership skills to turn AMCO's situation around? Explain.
3. What do you recommend Mr. Rashid do with AMCO? Explain.

CURRENCY DEVALUATION: SOME LESSONS FOR A CEO FUNCTIONING IN A GLOBAL ECONOMY

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CASE DESCRIPTION

The case focuses on how to analyze the economic implications of devaluation from the perspective of the CEO of a company that trades with or has operations in a country in which the currency devaluation is imminent. The case requires students to assess the impact of devaluation on the income and balance sheet of a company; analyze the threats and opportunities presented by devaluation, use the Porter's five forces model to analyze the effects of devaluation on the profitability of a company; assess the effects of devaluation on short-term financing with and without taxes and with exchange rate risk and design strategies for product design, input mix, production allocation, plant operations and investment in anticipation of currency devaluation. The case is truly interdisciplinary and is appropriate for senior or graduate level strategic management, managerial economics, finance and business policy courses. The case has a difficulty level of four and is designed to be taught in three class hours and is expected to take five hours of preparation outside the class.

CASE SYNOPSIS

The case describes the circumstances and policies that led to the Mexican financial crisis and its aftermath. While the 1994 devaluation of peso was not the first, it was certainly the most dramatic. Within one month from the installation of New President Ernesto Zedillo, the ceiling on exchange rate band was lifted and on December 20th, 1994 the Mexican government announced a 15 percent devaluation of peso. However, with limited and dwindling foreign exchange reserves, the government was unable to purchase pesos to support the currency within the band. Accordingly, on December 22nd, the moving band policy was abandoned and peso was allowed to find its level in the free market. As a result, peso dropped by 100 percent in value. Such an unexpected and dramatic drop in the value of peso was dubbed as the first financial crisis of the 21st century.

The conditions and policies prior to and after devaluation provide a fertile ground for student learning experiences. The case can be studied from both macro and micro perspectives.

INTRODUCTION

President Ernesto Zedillo had just returned from his glorious inaugural ceremony. It was indeed an exhausting day although it was marked with unprecedented pomp and show. After bidding good- bye to his state guests, President Ernesto Zedillo and his wife retired to their living quarters.

President Ernesto Zedillo eyes were heavy with sleep, but he did not want to call it a day. He wanted to reminisce what had been accomplished and challenges that lay ahead.

He was relieved that the Mexican economy had finally turned the corner. The debt crisis was a relic of the past. As he pondered over the events that led to the debt crisis that almost wrecked the Mexican economy, he wanted to remember the external shocks and economic policies that led to the disaster. He looked at the majestic portrait of Luis Echeverria Alverez, who was the President of Mexico from 1970 to 1976. It was indeed a turbulent period. The Mexican economy was saddled with huge public sector deficits. Because of excessive foreign investment regulation and controls, foreign investment was not enough to finance these deficits. The Mexican government instead of raising taxes or scaling back government expenditure or borrowing money in the domestic market decided to borrow money from abroad to finance these deficits. This further put pressure on pesos and in August 1976, President Alverez had to let peso float. The peso found its true level, but not before it depreciated 40 percent against the US dollar. The was a watershed period in history of the Mexican economy in that currency devaluation marked the end twenty years of exchange rate stability.

Foreign Exchange Crisis

As President Ernesto Zedillo strolled in the memory lane, he vividly remembered how mother Nature subsequently helped the Mexican economy turn the corner. The hydrocarbon 11 billion barrels reserves of oil discovery in 1976 were almost God sent. The expected annual revenues from the newly found oil were more than enough to balance the budget. However, the oil bonanza did not last for long. The world-wide recession in 1981 decreased demand for oil and depressed oil prices, balance of payment deteriorated dramatically and inflation rate that plagued the Mexican economy worsened by 1987 even further (see Table 1). Mexican economy had insufficient foreign exchange reserves to cover the interest payment due on its foreign debt. Mexico was in full-fledged foreign exchange crisis. In desperation, on August 1992, Jacques De Larosiere, the then Finance Minister of Mexico, made frantic calls to the Chairman of the Federal Reserve Bank of the United States and the International Monetary Fund Managing Director, to request rescheduling of the payment that was due. The debt crisis further reduced the inflow of foreign capital and the Mexican economy thus began a period of long term decline. The per capita GDP declined every year since 1985 (see Table 1) resulting in such a dramatic decline in real wages that by 1987, they were barely 60 percent of its level in 1981. Unnerved by dismal economic situation, the government announced its three cornerstones of the stabilization policy: Control inflation, reduce the role of the government sector and stabilize the currency. The hallmark of the stabilization was the pact (called Pacto) among the government, organized labor and business sector. Under the Pacto, the business and organized labor sectors agreed to freeze prices and wages, the government agreed to follow restrictive monetary and fiscal policies, reduce the role of government sector, and open the financial and foreign trade sectors to international competition.

As Zedillo gazed at the next portrait of President Carlos Salines de Gorland which adorned the palace wall, he was reminded how effective he was as a leader in combating foreign exchange crisis during his reign 1988-1994. President Gorland continued to implement the economic policies of President Alvarez. By 1991, about three thousand sectors were deregulated; the average tariff level dropped from 27 percent in 1987 to 13.1 percent in 1992. Restrictions on imports were reduced

dramatically – almost 66 percent of imports were free of any restrictions. Within ten years, 98 percent of imports from its largest trading partners were free of tariff. The government did equally well on its promise regarding the role of government sector. Within a decade the number of state owned enterprises from 1155 to 217. The revenue from the sale of state enterprises was used to finance the public debt.

The peso exchange rate was fixed in terms of the US dollar in 1988. The peso could depreciate against dollar daily so long it conformed to the pre-announced rate. The task of keeping the peso depreciation was indeed exacting and accordingly, after three years, the policy was abandoned in favor of keeping the peso exchange rate within a pre-determined upper and lower band. Fortunately, the newly found oil reserves, rise in oil prices and inflow of foreign capital provided enough foreign exchange reserves to keep the peso exchange rate within the bands.

The initiatives included in Pacto paid off and the Mexican economy turned the corner. The real GDP growth increased to 3.6 percent from a modest average rate of growth of 1.6 percent during 1980-1990. Capital account balance increased to $11.13 billion in 1990 from a negative $2.92 billion in 1988 (see Table 1). During the same period, the current account deficit increased to $7.7 billion from $3.8 billon (see Table 1). Normally, current account deficit should not matter if capital account surplus is used to create enough productive investment. However, this was not true in case of Mexico. A perusal of import composition would reveal that Mexico squandered away its reserves by importing consumer goods and intermediate goods needed for manufacturing consumer durable commodities (see Table 1) instead of investing in capital goods.

Calm Before the Storm

President Zedillo counted his blessings and saluted the Portrait of Carlos Salines de Gorland for bequeathing to him a Mexican economy that was vibrant and growing at a brisk pace. Zedillo pulled the economic report of President Gorland, brushed the dust on it and began reading it. He was pleasantly surprised by what he read. The report stated that by 1994, the Mexican GDP registered an annual growth rate of over 4.5 percent and the stock market was booming. Between 1990 and 1993, the Mexican stock index increased by more than four hundred percent. Thanks to the Pacto with labor, the inflation rate declined dramatically from 159 percent in 1987 to 9.7 percent in 1993 (see Table 1) and 4.5 percent in 1994. The real wages that were only 60 percent of the wages level in 1987 did catch up with its 1987 level by 1994. The budget was balanced and foreign investment was showing signs of revival (see Table 1). The free inflow of capital allowed the Mexico to build $35 billion reserve. Foreign investors were so impressed by the Mexican's economy that they poured into Mexico almost one fifth of the total investment allocated for all developing countries (see exhibit 2 and 3).

Favorable economic conditions and pegging of the Peso exchange rates against the US dollar within a narrow band, glowing reports by the International agencies like the IMF and the World Bank and signing of the North American Free Trade Agreement (NAFTA) created an environment for a dramatic increase inflow of foreign capital. The international agencies had nothing but praise and accolades for the Mexican economy. Satisfied that the good times were ahead. President Zedillo wrapped up his journey into the past and decided to join his wife in bed. Little did he know that the uncanny calm was a prelude to a storm.

An Era of Dramatic Devaluation

Next morning when President Zedillo reached his office, his Chief of Staff handed him five different newspapers. All newspapers carried the headline that Presidential candidate, Donaldo Colossio was assassinated. What ensued was beyond Zedillo's imagination. The assassination unleashed divisive forces in the country. Massive peasant uprising in the town of Chiapas was unprecedented in the current century. The political instability spooked foreign investors and they began withdrawing funds from Mexico (see Table 1 and exhibit 1). NAFTA further worsened the balance of trade situation. Free trade encouraged the imports of consumer goods and intermediate goods needed for consumer durable commodities (see Table 2). U.S exports to Mexico increased by 22.3 percent in the very first year of NAFTA. Strict controls over the currency exchange rate resulted in overvalued peso and further contributed to worsening balance of trade. For a while, Mexico could use its reserves to maintain the exchange rate at 3 pesos per dollar down from 3.11 pesos in April 1994. The declining trend in trade balance which started in 1990 ballooned to $18.4 billion by the end of 1994 (see Table 2). The balance of payment pressure set the stage for devaluation. On December 20th 1994, President Zedillo announced a devaluation of Mexican peso by 15 percent. The upper band ceiling was raised to 4.1 from 3.4 pesos per dollar. Within one day from its announcement of higher ceiling, the pesos dropped further by 13 percent. With dwindling foreign reserves, Zedillo had no choice but to abandon the moving band policy and opted in favor of a free float policy. As expected peso continued its free fall and within a few days the peso depreciated against the dollar by 100 percent. By the time the dust had settled, the peso exchange rate stood at 6.5 pesos per dollar (see exhibit 2)

Aftermath of Devaluation

Devaluation often carries in its bandwagon some undesirable consequences. The most immediate effect is on the general price level of goods and services. With imports being more expensive and exports cheaper, the prices of goods and services with import component begin to rise. Increased diversion of goods and services to the export sector reduce the supply of goods available for domestic consumption. With a loose monetary policy, devaluation often provides the fuel for inflation. The attempt by the monetary authorities to reign in inflation, result in an increase in interest rates. The higher interest rates increase the servicing cost of debt and, cetris paribus; dampen the growth rate of the economy. This is precisely what happened in Mexico. To cope with inflation, President Zedillo tightened of the fiscal and monetary policies and raised interest rates to (a) protect the peso declining exchange rate, (b) retain the existing short term foreign investment and (c) attract inflow of foreign capital. The government increased the value added tax from 10 percent to 15 percent and committed to a 10 percent real spending cut. These policies eventually yielded results: the public sector deficit of 1.7 billion pesos was transformed into a welcome surplus of 815 million pesos by the end of 1995 and Mexico's international reserves amounted to $16.02 billion.

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AMERITECH IN THE PHILIPPINES: FAILURE TO ADJUST TO FILIPINO CULTURAL NORMS?

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ABSTRACT

An American computer supply company moves its operations to the Philippines in an effort to be more cost competitive but experiences cultural shock as it attempts to institute greater efficiency. The case details the struggles of the plant manager, William Dawson, as he learns the challenges of managing the "Filipino way." The case includes issues such as pakikisama, face saving, and collectivist behavior.

INTRODUCTION

AmeriTech was started in Lexington, Kentucky by a small group of former IBM employees who accepted a buyout package offered by the company when the Lexington division was reorganized in 1991. Originally, AmeriTech produced computer supplies such as ink cartages, cables, and other small computer supplies in a facility in North Carolina. The operation proved successful as the demand for such products rose globally, however, over time AmeriTech found itself less competitive in terms of cost over rivals from a number of Asian countries. In an effort to reduce labor costs, the founders moved their operations to Mactan Island near the city of Cebu in the Philippines. Instead of starting a Greenfield operation, AmeriTech was able to purchase an underperforming Korean firm that was operating in the economic zone of the island. AmeriTech purchased the facility and retained the entire workforce of the former Korean owned business. AmeriTech had hoped to continue its efficient and quality-oriented production techniques from North Carolina in the low wage environment of the Philippines.

THE PHILIPPINES

The Republic of the Philippines is a country in Southeast Asia consisting of over 7,000 islands (Figure 1). The capital is Manila, located on the island of Luzon. The Philippines was "discovered" by Ferdinand Magellan in 1521, who claimed the islands for Spain. The country was named after the Spanish King Philip (Felipe) and missionaries converted most of the population to Catholicism. The Philippines is unique in being the only Christian country in Asia. While Magellan

met his death soon after arriving in the Philippines, the country was under Spanish control for a number of years. The Philippines came under the rule of the United States in 1898, when Admiral Dewey defeated the Spanish, and Spain ceded the islands under the Treaty of Paris. While Tagalog, or Filipino is the official language of the Philippines, English is widely spoken, especially among educated Filipinos.

In 1935 the Philippines became a self-governing commonwealth, and there continued to be a strong push by the Filipinos for complete independence. This independence movement was interrupted by World War II when the Japanese invaded the country. With the help of the American forces, the Filipinos defeated the Japanese and gained their independence in 1946. After a number of different administrations, strongman Ferdinand Marcos ruled the country for a number of years and maintained strong ties with the United States. With increasing discontentment of the Filipino people, a "people's revolution" occurred and Marcos was forced to leave the country. Political instability resulted for a time; however, democracy quickly retook a firm hold in the Philippines. Fidel Ramos became president of the Philippines in 1992, and he opened the economy to market forces and encouraged foreign investment, including the establishment of export processing zones (EPZ) and incentives for foreign firms to establish a presence in the Philippines.

AMERITECH IN THE PHILIPPINES

With an increasing wage rate in North Carolina and the incentives offered by the Philippines, AmeriTech made the decision to close its American facility and begin operating in the Mactan Economic Zone of the Philippines. The area is in the part of the Philippines called the Visayas. With a compatible operating facility being offered for sale, AmeriTech relocated with the hope of gaining a competitive advantage with lower labor costs and access to the emerging markets of Asia. The only employee from North Carolina that would be making the move to the Philippines was William "Bill" Dawson. Dawson was the son of a tobacco farmer in North Carolina, who while deemed by his teachers and peers to be highly intelligent, never attended college. He worked in a number of manufacturing jobs after high school, and through hard work and ability, gained a number of supervisory positions. He was hired by AmeriTech when the firm first began operating in North Carolina as a first line supervisor. Through an unusual series of personnel turnover and one death, he was promoted to plant manager in a few years after first being hired. Dawson instituted a number of quality improvement and inventory management techniques and gained the respect of his superiors. While Bill could be intimidating to some (he was a large, and somewhat heavy man, with a loud voice), he was generally well liked and respected by the employees at AmeriTech. Bill was known for being "firm, but fair." He was very informal with his employees and dressed in a casual, or some would say "sloppy" fashion. The employees appreciated the fact that he was just a "regular guy." Bill was looking forward to his new assignment, however, he feared he would miss watching his beloved North Carolina Tar Heels play basketball on television. While he had never been to the Philippines, he did have a favorable impression of the country from the stories his uncle, who served in World War II, had told him about the Philippines, and the courage of the Filipino fighters. Bill also learned that basketball is a favored sport in the Philippines and so "maybe the place wouldn't be so bad after all."

With an unusually easy transition, AmeriTech took control of the former Korean facility. While adjustments had to be made in the production process, and many of the workers could not be used during this time, AmeriTech generated goodwill by paying the employees their normal salaries during this startup period. The employees that were needed to work were paid their normal salaries plus a 50% bonus during this time. AmeriTech realized that there were going to be additional costs during the startup, including increased training in the "AmeriTech way." In general the employees welcomed the new owners, and many commented that they much preferred working for an American company than a Korean one. One new hire was Miguel Santos, a 26 year old MBA graduate of De la Salle University in Manila. Miguel was hired as an assistant to Bill, and someone to help Bill with any cultural difficulties he might experience in his assignment.

TENSIONS BEGIN

Miguel was born and raised in Manila and did not consider himself to be a Cebuano (someone from Cebu or the surrounding area). The employees in the plant were mostly Cebuanos and were at time untrusting of people from Metro Manila. They felt that they were too urban, too serious, and too self-centered for their tastes. Miguel was very deferential to Bill Dawson, refusing to call him by his first name and always referring to him as "Mr. Dawson," and sometimes, "Plant Manager Dawson." Miguel was not as cordial with the lower level employees at the plant, however, and at time had strained relations with employees. Miguel also was not very happy with the fact that he had to leave his family in Manila, and because of the distance, only see them every few months.

The productivity level of the plant remained low for a number of months and Bill had decided that it was time for a change. While he had expected that it might take some time for productivity to reach the levels achieved in North Carolina, he was beginning to feel as if without some intervention, things would not improve. Of particular concern to Bill was the amount of "wasted time" he observed in the plant. Employees would often take extended breaks, chat endlessly among themselves, and often engage in non-work activities while on company time, such as celebrating an employee's birthday. Miguel explained to Bill that it represented "pakikisama" and was quite common in Filipino culture. Bill seemed unconvinced, but proceeded with caution and allowed this to situation to continue, as he was in a phase of "employee relations building" with the employees. After a few more months productivity still had not improved, and Bill decided it was time to take action.

In North Carolina, Bill had learned that when employees were "schooled" in the ways of productivity, they improved their performance. The North Carolina plant also had an individual incentive plan which acted as a strong motivator. Bill reasoned that he should now begin to change the corporate culture of the plant. With the help of Miguel, he organized after-work training sessions and stressed the importance of reducing "wasted time" on the job. Most of the employees were females and many had not worked previously in a manufacturing environment. The training sessions were a bit frustrating to Bill as he could not get the employees to participate nor contribute their thoughts. He felt that if he allowed for employee input, he could win over the employees to his ideas for productivity improvement. The only employee who spoke frequently was a middle aged woman named Millet, who often joked and teased Bill during the training sessions. Bill had gotten the impression that Millet was romantically interested in him, and he was unhappy with the situation.

After yet another training session in which little was achieved, so Bill thought, except the asking of personal questions from Millet, Bill decided to have her fired. He instructed Miguel to terminate her employment immediately. Miguel warned Bill that Millet was a productive employee who had worked for the previous company for many years, and that she was very well liked by her peers. Bill responded that he was tired of her teasing and personal questions and that "it was nobody's damn business if he is married or not." Miguel did as he was told and informed Millet she would not be returning to work tomorrow.

The mood of the employees, especially those in Millet's department, changed almost immediately. While it was common to hear cheery voices and laughter in the plant, in the days and weeks that followed, the plant was void of much humor. Employees seemed to be more formal and less warm to Bill, however, there was a slight improvement in productivity. This made Bill happy. He thought that, just maybe, he needed to use a firmer hand in dealing with the workers. He was a bit concerned that employee turnover had increased, but he reasoned that it was probably just employees who did not want to really work. Bill turned his thoughts to ways to introduce a monetary incentive program and to start a quality improvement program.

While Bill pondered such issues, Miguel informed him that another industrial plant was opening in Mactan and that he feared that AmeriTech might lose more employees. Bill was unconcerned, but finally agreed with Miguel that he would call a meeting and announce the incentive program he had been developing. The meeting was scheduled after work hours, and a number of employees did not attend. This angered Bill and he expressed his displeasure by calling out the names of the employees who were not present. He suggested to the gathered employees that maybe those missing employees would not be returning to work next week. The meeting went on, with the rather complex incentive program being explained. The basic idea was that employees would no longer be "entitled" to a salary, but that they could, if properly motivated, earn more money. Within a week, close to 20 percent of the workforce resigned.

TIME FOR CHANGE, AGAIN

With turnover becoming a problem, and the resulting disruption to production, Bill was under fire from his superiors to turn the situation around. Bill decided to have yet another meeting with his employees, but this time to pay them for attending. Bill expected 100% turnout for the meeting but instead, roughly half the employees attended. Bill was outraged and proceeded to lecture the employees present that the work culture of the company must change. After a very tense 10 minutes of hearing this, Miguel politely interrupted Bill with the suggestion that a break be taken and food delivered to the plant for the employees. This suggestion was not well received by Bill, who then proceeded to criticize Miguel for not understanding the importance of profitability. The meeting ended with a somber mood, as it had begun, and employees quietly left for home. Miguel was one of the first employees to leave the building.

The following day Miguel called in sick, complaining of stomach troubles. Bill decided that maybe he had been too hard on Miguel and the other employees. As he sat at his desk wondering how to proceed, the assistant director of human resources called him to tell him that the director of HR had resigned, for "medical reasons." The department had been busy attempting to fill the vacancies created by the turnover and Bill worried that he was losing the respect of his employees.

Bill decided to host an event for all employees in nearby Cebu City, honoring the most dedicated and outstanding employees. When Miguel returned to work the following day, Bill informed him of his decision. Miguel seemed less than excited about the idea. When pressed for an explanation, Miguel admitted that a party was maybe a good idea, but that he, Bill, should not take a very active role in the event. Surprised by this recommendation, Bill pressed Miguel for answers. After much pressuring Miguel blurted out that the employees had a nickname for him – “baboy.” Bill was told it meant pig in Tagalog. With this revelation Bill decided to cancel any plans for a party and to resume his normal style of management. He instructed Miguel to begin looking for a new HR director and to ramp up the recruitment of employee replacements.

Discussion Questions:

1. What mistakes, if any, did Bill make in his management of the plant?
2. Was it necessary for Bill to change, in any way, in his new assignment in the Philippines? Explain.
3. What is the significance of the nickname the employees gave to Bill?
4. If you were advising Bill, what would you suggest?

Sources: L. Francia. *Passport Philippines*, 1997, San Rafael, CA: World Trade Press; U.S. Department of State, *Background Notes: Philippines*, 2008; T. Gochenour. *Considering Filipinos*, 1990, Yarmouth, ME: Intercultural Press. Personal experiences of the author interacting with the Filipino business community and American Chamber of Commerce of the Philippines in 2007.

Note: This case is completely fictional and not intended to represent any real company or persons.

PUBLIC FUNDS, PUBLIC POLICY, AND FREE ENTERPRISE IN ALASKA

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CASE DESCRIPTION

The primary subject matter of this case concerns marketing. A secondary issue concerns public policy and public administration. The case has a level of difficulty of three to five, depending on the depth of analysis. The case is designed to be taught in 1.5 to 2.5 class hours and is expected to require 2-4 hours of outside preparation by students.

CASE SYNOPSIS

Rural Alaska Community Action Program, Inc. (RurAL CAP), an Alaskan nonprofit organization dedicated to serving the economic and welfare needs of rural Alaskans, particularly native Alaskans, launched a new catalog operation in 1993. The catalog had several purposes, one of which was to generate funds to support other social programs. In 1995, after two years of heavy losses and the investment of more than $600,000 of public money through Alaska State administered grant programs, controversy and uncertainty swirled about the contentious new venture. Investors in a private catalog operation, including a leading state politician, were very concerned about competing against a heavily subsidized operation that clearly did not have to make a profit. In addition to competing in the same markets, the two organizations competed for the talents and products of the same producers. RurAL CAP, Inc. argued that the losses were to be expected in a start-up operation, that they needed more time and money to become profitable, and further claimed that they did not compete unfairly with private enterprise.

This case can be used to raise and address a number of interesting issues appropriate to classes in public administration, marketing, and entrepreneurship

INTRODUCTION

The Rural Alaska Community Action Program, or RurAL CAP, is a leading nonprofit organization in Alaska whose mission is "to protect and improve the quality of life for rural Alaskans through education, training, direct services, advocacy and strengthening rural people's ability to advocate for themselves." RurAL CAP began in 1965 as a consequence of the 1964 Economic Opportunity Act. In pursuing its mission it has started or otherwise managed well over a dozen statewide programs, including Head Start, weatherization assistance programs, information services, programs related to alcohol abuse, AmeriCorps, and a program to provide legal assistance to villages. By 1995 RurAL CAP's annual budget exceeded $8 million, and it had over 200 employees.

As a nonprofit social agency the majority of RurAL CAP's funds come from federal and state grants. However, RurAL CAP does obtain some funds from Rural Electric Enterprises (REE), a profitable wholly-owned subsidiary formed in 1987. REE grew out of an effort to import and sell cost saving, efficient, affordable heating sources to rural native Alaskans through rural product dealerships. The initial feasibility analysis was funded by a grant from the Department of Energy, and was initially supported by Community Service Block Grant funds. REE is a profitable operation that wholesales various energy saving products, including Toyostoves, to more than 60 dealers in the United States and Canada.

THE AURORA CATALOG EXPERIENCE-PLANNING

In February, 1992 the Board of Directors of RurAL CAP gave the go-ahead to the staff to begin examining the feasibility of producing a catalog that would feature products made by rural, native Alaskans. As subsequently stated, the following were the goals/mission of the project:

Develop income opportunities for Alaska Natives that promotes increased self sufficiency;
Develop wider markets for Alaska Native arts, crafts and products;
Create value for the subsistence way of life and distinct Alaska native cultures by providing accurate education and information about rural Alaska; and
To supply RurAL CAP with an unrestricted source of funds to help support other programs and activities.

The executive director, accompanied by several board members, traveled to nine villages to discuss the project and to buy representative sample products. At this point it was made clear that artisans would be paid what they asked for their products - there would be no haggling or negotiations. Further, they were informed that goods would be purchased when it was convenient for the artists and producers. Rural residents showed overwhelming support for the project.

Throughout 1992 staff members began to become acquainted with the catalog industry. Based on discussions with representatives from other catalogs, such as the catalog operations of the World Wildlife Fund and Robert Redford's *Sundanc*e catalog, RurAL CAP decided to hire an experienced, highly recommended catalog consulting firm from San Francisco to help in the analysis and planning of a catalog.

The decision was made to forego undertaking an in-depth feasibility study. Rather, based on the success of catalogs such as *The Hemmeter Collection, Faith Mountain,* and *Sundance*, it was decided to proceed directly to a test market. The strategy was to develop a high quality, distinctive catalog that would appeal to the socially conscious consumer.

Expected costs associated with the first year's mailings in 1993 were much higher than expected revenues: catalog design costs, consulting fees, and other start-up costs associated with this research and development effort were understandable. A consultant's feasibility study estimated that, based on industry experience, it would take 2 or 3 years before the catalog achieved profitability. In the business plan developed by another consultant, published in January of 1993, profitability was predicted in 1994.

In pursuing its strategy RurAL CAP relied on knowledgeable consultants for overall planning, product selection, catalog copy, mailing list evaluation and choice, promotion planning and execution, and in projecting results. Fulfillment operations (order taking, billing, packing and

shipping, and information tracking) were to be contracted out to other organizations, as is common in catalog operations. RurAL CAP was responsible for the procurement of product and overall approval of various aspects of the project. It was the intention of RurAL CAP to bring responsibilities in-house, over time, as their expertise improved.

Internally one employee, the Economic Development Manager, spent the majority of her time on the catalog project. Other employees contributed according to their areas of expertise as time allowed. Some of this was quite extensive. After the first year's mailings a marketing specialist who had retail experience, as well as experience as an assistant buyer for Nordstroms, was hired to assist in the procurement and management of inventory. Shortly afterwards the Economic Development Manager had to leave Alaska because of a job offer for her husband, and the marketing specialist was thrust into that slot. Another woman was hired to assist her, and the two of them devoted all their energies to the project. One interesting practice was a weekly, one hour catalog project meeting that involved various RurAL CAP program managers and talented professionals, including the internal CPA and the Executive Director. The purpose was to brainstorm and to discuss problems and issues.

THE FUNDING CONTROVERSY

Initially the funds for planning the catalog operation, including travel, personnel time, sample acquisition, and consulting fees, were obtained by borrowing funds from child care, alcohol and abuse programs, and from the Planning and Research component of a Community Services Block Grant. The intention, of course, was that funds borrowed from programs would be returned.

In December of 1992 RurAL CAP requested an amendment of $190,000 to its current year Federal Community Services Block Grant (CSBG), administered through the State of Alaska's Department of Community and Regional Affairs (DCRA), to fund the catalog project. The request was denied, however, on the grounds that the proposed catalog was controversial and had not gone through the required application process and had not been part of the required public hearing.

The controversy regarding the project was largely the result of the president and founder, as well as the investors, of *The Great Alaska Catalog*. As a privately funded firm, *The Great Alaska Catalog* had been struggling for several years to build up its business to where it would be a viable, ongoing concern. The business required a lot of hard work, a lot of risk taking, and a lot of uncertainty. To find that a new competing operation was now in the arena was bad enough, but to find one that was run on lots of public grant money that did not have to be repaid was galling. How could a private firm, accountable to shareholders and lenders, compete against an organization that did not have to turn a profit, and could easily hire high-paid consultants and others?

The market for Alaskan products was not perceived to be overly large or expandable, and so the two catalog operations were perceived to be in direct competition for a fixed number of customers. Both were targeting the same customers with the same product mix through the same channels.

Not only were the two organizations competing for the same customers, they were also competing for supplies. Both featured a variety of native and non-native Alaskan goods. Supplies, particularly native products, were limited - there were only so many talented artists producing so many sellable products. *The Great Alaska Catalog* people argued that RurAL CAP's efforts,

particularly RurAL CAP's policy of accepting whatever prices the natives wanted, were affecting their ability to obtain products from the small number of sellable artists. A museum buyer found that none of RurAL CAP's artists were unknown and without a current market for their products.

The Great Alaska Catalog people argued that RurAL CAP, to the extent they should be allowed to compete at all, should be restricted to promoting and selling rurally produced products from unknown artists in the bush.

An official complaint against the Department of Community and Regional Affairs was filed by the president of *The Great Alaska Catalog* with the Office of the Ombudsman on April 12, 1993, prior to the first mailing, contending that:

"(1) The catalog has not been supported by an adequate departmental review for compliance with federal requirements that funded activities must have a measurable and potentially major impact on the causes of poverty in the community or those areas of the community where poverty is a particularly acute problem.

(2) DCRA's approval of federal funds for this project is in conflict with Alaska's stated encouragement of private enterprise and the development of small businesses to provide needed goods and services whenever possible."

RurAL CAP and its supporters felt RurAL CAP had the right to help develop markets for their constituents, had a mission that went beyond making a profit (although they certainly intended to do that), and were entitled to the funds. They also argued that using non-native products and well-known native artists was a legitimate way to build a successful catalog operation. RurAL CAP also contended that they were, in fact, selling little-known artists, and further, that other talented, enthusiastic natives were gearing up.

In early to mid-1993 the Department of Community and Regional Affairs brought together both groups to try to come to a reasonable compromise. At that less-than-cordial meeting RurAL CAP's planning manager rejected any joint undertaking, since, to paraphrase her, far too much money had already been invested in their current operations.

Both sides lined up supporters and argued their points. No less than 3 State Representatives and 1 State Senator actively supported the stance of *The Great Alaska Catalog*. RurAL CAP had support from at least 1 State Senator and various native organizations and native leaders. A petition was circulated during native community and village functions, and garnered well over 200 signatures in support of RurAL CAP's *Aurora Catalog* project. Legislative hearings on the issue were held in November 1994.

The Department of Community and Regional Affairs was, of course, very concerned about this. Early in 1993 the Commissioner sought advice from the Alaska State Attorney General's office. In March, 1994, approximately 1 year later, the Attorney General's office simply responded that there was no legal prohibition against using CSBG money to fund a for-profit venture. This clearly wasn't enough to decide one way or the other whether to continue funding this project.

While the controversy raged, DCRA did provide almost $600,000 to RurAL CAP specifically for the project during 1993 and 1994. The pressure to suspend future financing was intense, but so was the pressure to continue the financing.

AURORA - THE MARKETPLACE EXPERIENCE

RurAL CAP developed a beautiful catalog. In fact, it won an award at the Direct Marketing Association conference as the best new catalog of the year. There was no question it was beautiful, and that it portrayed Alaska and Alaska natives in a favorable light.

The results of the first two years was generally mixed, but most would concede were not all that great. In 1993 the *Aurora Catalog* lost more than $380,000, and 1994's loss was around $340,000. They used more than $360,000 in public money each year. Average order sizes, the response rates to the mailings, and the sales/book were all rather discouraging. Projected results indicated that changes were definitely needed if the operation was ever to become profitable. RurAL CAP was intent on pursuing the catalog for at least some time. For one thing, RurAL CAP and its consultants did not trust the numbers they got through their fulfillment houses; they believed the data they were working with was flawed, and they suspected that subcontractors were not doing a good job in fulfilling orders.

DISCUSSION QUESTIONS

1. Do you believe it made sense to forego a detailed feasibility study and instead actually put together a catalog operation, complete with products, contracts with fulfillment houses, etc.? What are the dangers of pursuing such a strategy? What are the benefits? Under what conditions does acting, rather than analysis, make sense? Under what conditions does analysis, prior to acting, make sense?

2.Are there other ways RurAL CAP could achieve the objectives and goals set out for the catalog? In other words, what other marketing strategies could be considered as competitors to a catalog operation? Do you believe that a catalog is the best means for achieving the identified goals?

3. RurAL CAP decided to target individual, upscale, socially conscious consumers. What other target groups could have been chosen or considered?

4. Do you think the position of the private catalog operators is justifiable? What about the position of RurAL CAP? Who do you side with, and why?

5. Should DCRA continue to support the catalog? Under what conditions? If you were the Commissioner of the Department of Community and Regional Affairs what would you recommend? Finally, how should the concerns of the rural natives fit into this?

6. When, specifically, do you think public money should be used to support for-profit forays by nonprofits? How about the use of public money for bailing out private businesses (e.g., mortgage lenders), individuals (e.g., those who made bad mortgage decisions), or to promote social change?

RASCAL-MILDEW, INC.: A CASE OF THE INVENTORY HOT POTATO

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CASE DESCRIPTION

The primary subject matter of this case is Inventory Management in a high tech company with a very short product life cycle due to continual product improvements. Rascal-Mildew Inc. went from one of the best managed companies in the U.K. to a company that ultimately succumbed to competitive forces, lead by severe inventory problems. The case has a difficulty level of undergraduate seniors in Operations Management or Auditing and/or graduate level MBA Operations Management or MACC Cost Accounting and/or Auditing programs. The case is designed to be taught in one class (one hour and fifteen minutes), assuming cases are presented in groups of four students, with a fifteen minute presentation per group and fifteen minutes wrap up by the instructor. Student workload should be expected to be eight hours per group or roughly two hours per group participant at the undergraduate level. Workload should increase to ten to twelve group hours at the graduate level.

CASE SYNOPSIS

The case presents students with a combination of quantitative and qualitative aspects of Inventory Management. The products' high tech nature and unusual short life cycle should have made inventory management a serious priority in the company. The company lacked any detailed sales plan that could be driven down to specific product configurations for manufacturing to produce. This lead to the Manufacturing organization building what it thought would sell due to the Sale organization's reluctance to accept Inventory level and mix responsibility. Students should examine the role of the Sales organization in forecasting sales and inventory levels and tie this information to product life cycle.

At the same time, Manufacturing was combating increased automation to reduce direct labor costs leading to excess capacity. This was evidenced by the Labor Efficiency report. Manufacturing management's response was to increase efficiency by building more inventory, instead of laying off direct labor. In addition, during this time a Manufacturing Resource Planning (MRPII) implementation was underway throughout the organization. Students should be able to pick up the change in the WIP aging, indicating a much better priority planning process than pre-MRP times.

Further complications can be examined related to the audit-client relationship. This aspect could be explored at the graduate level so students can better understand the "political" nature of the audit relationship. The circumstances could also be examined in a post Sarbanes-Oxley environment where students understand how the audit-client relationship may be different. Lastly, the student is faced with the reality of considerable excess and obsolete inventory and how to financially cope with the effects of writing it off the books.

This case was prepared solely to provide material for class discussion. The author did not intend to illustrate either effective or ineffective handling of a managerial situation. The author has disguised all names and other identifying company information to protect confidentiality.

INTRODUCTION

In June of 1986, Cost Accounting Controller Nick Trevino reviewed the latest Rascal-Mildew monthly Manufacturing Performance Reports wondering who was really in charge of the company inventory levels. Nick sat in last month's Executive Staff meeting because his boss Fernando Lopez, V.P. of Finance was out of town. During that meeting, the topic of inventory levels came up and Ken Matty, V.P. of Sales said to Ray Bucci, V.P. of Manufacturing, "we sell em and you make em".

The high tech industry is typically characterized by rapidly changing technology and Rascal's modem, data encryption, and multiplex products were in the upper end of the product life cycle growth curve. Last year's audit report by Coopers and Lybrand indicated inventory levels were approaching a high level and the obsolescence risk and related financial exposure were rapidly growing. Nick was trying to decide an appropriate inventory level, the existing and potential obsolescence risks, and the potential obsolescence write-offs. If he only knew who was really in charge of Inventory, these and other questions could be asked to the appropriate people.

History of Rascal-Mildew, Inc.

Founded in 1955 by Monty A. Mildew and based in Sarasota, Florida, the company originally manufactured electronics products under the name Mildew Electronic Corporation. Monty soon established close ties with the U.S. government and began making electronics items for the National Aeronautics and Space Administration (NASA). With the construction of Cape Canaveral in Florida, the company won many of the early contracts for manufacturing electronic equipment used in America's early, unmanned space flights.

As competition for government contracts, particularly in the field of space exploration, grew more intense, in 1966 Mildew decided to enter the burgeoning commercial communications market. The company's first contract included the design and construction of a modem (computer-telephone interconnecting device) that was capable of transmitting data over an ordinary telephone line at 2,400 bits per second in a bandwidth of 3,000 cycles per second. At the time, building a modem that could send data at such speed was regarded as highly unlikely. Yet the Mildew engineers surpassed the design specifications stipulated in the contract, and constructed a modem that transmitted data at 2,400 bits per second at 800 cycles per second, a significantly narrower band of transmission. To put this achievement in perspective, commercial modems used in 1994 will soon meet an international standard to move data at a rate of 28,800 bits per second, or ten times faster.

Mildew's success in building this modem was revolutionary because it was considered next to impossible but also because other kinds of communications such as voice and teletype messages could now be sent over the same telephone line. Thus customers were able to communicate their data twice as fast over a telephone line which could also be used for other communications. The modems Mildew had designed and built, models 4400 24 and 4400 48 were initially sold to Western Union and soon became the standard modems in the industry. Mildew found itself in the enviable

position of being the only company capable of manufacturing 2,400 bps (bits per second) modems that could operate on unconditioned switched telephone lines.

In 1969, Mildew began its relationship with Rascal Electronics Ltd., a British-based manufacturer of radio communications products. Brownie Raymond and Caldwell Custer founded Rascal as a two-man consulting firm in 1950. Seven years passed before Rascal marketed its first proprietary product: a high-frequency radio receiver. Custer died the following year, in 1958, but the company's momentum continued. Rascal went public in 1961. With revenues over $140 million in 1969, Rascal had already established an extensive network of manufacturing facilities in developing countries around the world. Rascal approached Mildew and convinced Monty to create Rascal-Mildew Ltd., a joint-venture company which would build and market Mildew's data communications products through Rascal's international network. The joint venture proved so successful that it accounted for a large percentage of Mildew's revenues and profits within a few years. The arrangement with Mildew also made a significant contribution to Rascal's revenues.

Less than a decade later, with Mildew's help Rascal had developed into one of fastest growing and most profitable European companies in the communications industry. Building upon its manufacturing and marketing network in developing countries, Rascal reported revenues of over $400 million. Rascal's revenues were increasing at a compounded rate of 33 percent per year for the last five years, while profits were increasing at a rate of 37 percent per year and its exports at the impressive rate of 40 percent per year during the same period.

Pleased with Mildew's contribution to Rascal's success, management at Rascal decided to acquire Mildew in 1977. At the same time, Digital Direct Company, a computer-terminal manufacturer located in Long Island, New York, and only half Mildew's size, also decided to purchase Mildew. After a prolonged war with Digital Direct, Rascal purchased Mildew for $60 million. The company was then renamed Rascal-Mildew.

By 1979, Rascal-Mildew reported $100 million in sales for its parent company and was regarded as one of the industry leaders in modem supplies and equipment. Yet in spite of the fact that Rascal-Mildew had recently introduced a highly innovative data-encryption device and a new product line of intelligent communications terminals, the parent company began to reduce its subsidiary's expenditures for research and development. Angry at what they perceived as British management's insensitivity to Rascal-Mildew's potential for growth, almost all of Rascal-Mildew's management team either was fired for communicating their grievance or soon resigned. Rascal subsequently tightened its control of its subsidiary by absorbing it into a new Data Communications Group headquartered in England. The engineer who had been in charge of developing Mildew's first modem back in 1966, Edward Blottner, was chosen as head of the new Rascal-Mildew and reported to management in England.

Rascal-Mildew began to experience declining profits during the early 1980s. In 1985. Rascal began to suffer from a shakeout in the information technology industry. A recession in the American data communications industry dealt a severe blow: Rascal-Mildew and Rascal-Viking, once accounting for 40% of total revenues, totaled only 27% at mid-year.

In 1984, Rascal established Rascal-Vader and entered the brand new cellular radio market in Britain. As Rascal's expansion in England and other countries continued, the company grew increasing dependent on its subsidiaries, especially American-based Rascal-Mildew, for additional revenues. Fortunately, Rascal-Mildew was having one of its most profitable years ever. A

conglomerate of some 150 medium-sized, autonomous companies, Rascal was named "best-managed company" between 1976 and 1985 by Britain's prestigious Management Today magazine.

Cost Accounting

The Cost Accounting organization was part of the larger 140 employee Finance organization, responsible for all company accounting activity. Fernando Lopez headed the Finance organization since 1980 with three area Controllers reporting to him. Nick Trevino had been with the company since 1981 and has been part of the meteoric rise in sales. During this time, the Cost Accounting department staff declined from 14 people down to 8, mainly as result of an automated cost system.

Cost Accounting was responsible for a number of financial functions. Inventory valuation, variance analysis, and the annual physical inventory which consumed an inordinate amount of time. Raw Materials activities included recognition of Purchase Price Variance, Incoming Inspection scrap analysis, Purchase Price standards development and reconciliation of sub-ledger detail to general ledger. Work in Process accounting included work order variance analysis, scrap, rework, and reconfiguration, development of manufacturing standards working with Industrial Engineering, and reconciliation of sub-ledger detail to general ledger. Finished Goods accounting responsibilities included maintaining and reconciling the serialized finished goods data base detail to the general ledger.

Each year, the auditors required Rascal-Mildew to do a complete wall-to-wall physical inventory to validate the value carried on the Balance Sheet. The planning process began four months in advance of the event and required the entire company's manufacturing operations to shut down for one week. Cost Accounting was in charge of the Physical Inventory (PI) from start to finish. These activities included complete reconciliation of tag detail, valuation of partially completed work in process and serial number specific finished goods. The PI began during the last week of January and Cost Accounting spent most of the remaining fiscal year (ending March 31) reconciling and making final adjustments to the year- end numbers.

Nick went back into his files and reviewed last year's audit "scorecard" and kept re-reading the statements related to the high level of inventory and potential for obsolescence. He then reviewed the current obsolescence reserve balances for each inventory classification while recalling the meeting two years ago with Fernando Lopez regarding an increase for those reserves. Given the recent decline in profitability, an increase in reserves meant even less profit for Rascal-Mildew's bottom line. The U.K parent, Rascal Electronics, Ltd. would not allow any further deterioration of profits, so funding additional reserves was not permitted. Instead, a more novel approach was used to convince the auditors Rascal-Mildew did not need additional obsolescence reserves. The idea was to sell these older products to emerging third world countries at current residual value. Since there was no existing market, it could easily be argued that the residual value was an appropriate cost basis for valuation. Therefore, it was anticipated the auditors would likely not require additional obsolescence reserves.

Rascal-Mildew was Coopers and Lybrands' (C&L) largest client in the Southeast, with its new office building located in Miami. Concurrently, C&L also had a very large systems consulting contract with Rascal-Mildew. Nick and Fernando had several meetings with Jim Jones, the current audit partner-in-charge to review the Inventory reserves. Jim replaced Mary Smith, the

partner-in-charge of the last three audits and knew that last year's audit report was one reason Mary was removed as partner-in-charge of the audit. The problem did not occur in the last year, but had been an accumulation of the last three year's activity and Mary's strategy was to allow Rascal-Mildew to work their way out of the problem over time. Jim realized that Rascal-Mildew has not worked out the problem and in fact, it has gotten worse.

Rascal-Mildew sales and profitability began to decline in the early 1980's as a result of product commoditization. When modem use for data transfer became popular with clients such as American Express, Mastercard, and American Airlines, the response from these companies was to lease modems, not buy them due to the high purchase price and short technology life. As speeds increased from 2400bps to 14.4kbps in three years, companies were quickly turning in their existing modems and immediately upgrading to the latest high speeds and technical advancements. These older, "Off-Lease" modems still had residual value because they were not fully depreciated and that value was still being carried on the Balance Sheet as part of overall Inventory.

From 1981 to 1986, Nick had seen modem speeds go from 2400bps to 56kbps. He had seen the cost of modems dramatically drop as manufacturing efficiencies were gained with more automation. In 1984, a new technology called surface mounted devices, emerged as a way to miniaturize the product. Competitors scrambled to tool up for this new manufacturing method, promising to reduce size to one quarter of the previous size, greatly increase quality through reducing manufacturing defects, and greatly reducing direct labor needed to produce the modems under the old technology. In fact, Mike Rohrer, Director of Manufacturing Engineering had submitted a Capital Expenditure request for $10mm for a new Flexible Automated Board Line (FABL). The payback was roughly 2.4 years and reduced the manufacturing cost of a standard 14.4k modem from $1145 to $454. This new line would be dedicated to all new modem products with the anticipated savings previously noted. This project was approved without any significant discussion regarding anticipated technological obsolescence.

Manufacturing Management

Ray Bucci was Rascal-Mildew's V.P. of Manufacturing and six Directors reporting to him including Don Wayneston, Director of Materials, and Mike Rohrer, Director of Manufacturing Engineering. Don served as Materials Director until 1983 when he was replaced by David Haley. David was the Senior Management Consultant from Coopers and Lybrand heading up the Systems Implementation project and had no significant inventory management experience. David had all materials departments reporting to him, including Master Scheduling, Purchasing, and Warehousing. Master Scheduling, headed by Clark Weston, was responsible for evaluating inventory needs, opening manufacturing work orders, deciding on the quantities of any given work order, and eventually, evaluating Material Requirements Planning (MRP) output reports. Master Scheduling determined what was going to be made in production and also the production priority. Clark operated with essentially no input from the Sales organization as V.P. Ken Matty felt that was Manufacturing's responsibility.

Ray Bucci concerned himself with primarily getting product out the door and felt that was his organization's first and most important responsibility. On more than one occasion, Ray remarked that paperwork was something he felt was an accounting responsibility, not manufacturing. His

perspective on inventory was that his organization had "custodial" responsibility for Raw, Work-In-Process, and Finished Goods inventory but not the inventory levels themselves.

CONCLUSION

As Nick entered his office late Thursday night, he wondered how he would deal with the results of his latest analytical tool - Excess and Obsolete (E&O) analysis. Roughly one half of the $130mm inventory value was classified as either excess of demand requirements beyond 12 months or obsolete with no foreseeable demand at all. Who would he advise of these results, as he thought to himself. Nick suspected Fernando knew this might be the outcome, and an entry to write down inventory by Fernando of $65mm would likely be his last. Ray Bucci had no interest in this number because his position was that of an "inventory custodian". Ken Matty could care less about the level of inventory and saw his job as to sell product, not manage it. It would be the end of Nick if he brought this analysis directly to the new partner-in-charge of the audit, as Nick was certain he would rightly insist on writing down the Inventory – an immediate $65mm bottom line negative impact.

The night was getting on and Nick was getting tired and pondered how a company that was one of the best managed in the UK had come this point.

TURNING UP THE HEAT ON WIND RIVER FARMS

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CASE DESCRIPTION

Making and handling requests, a skill used in higher-level communications strategies, often determine the success or failure of human interaction. The primary subject matter for this case concerns the development of an escalating communications strategy (mild, moderate, and strong) for a scenario where expectations have diverged between a Consignor and Consignee concerning prior verbal and written agreements. Secondary legal issues include the ethical obligations of Consignees to their consignors, Consignee expertise in conducting sales venues? This case was designed for use in an undergraduate business communications course and can be taught in conjunction with a business law course. The various communication or legal aspects emphasized in this case could be taught in three 1-hour sessions. Each assignment is expected to require approximately 2 hours of outside preparation by students.

CASE SYNOPSIS

Wind River's owner, Alan Shaw, a miniature horse breeder, initiated Wind River Farms' First Annual Consignment Sale as a way to help small farms market their registered horses in East Texas. Marilyn McKenzie thought the consignment sale would make an ideal venue for the sale of five of her horses. Despite ideal the ideal weather on the day of the sale, the event was poorly attended, and Marilyn sold only two of the five horses that day. When Marilyn did not receive payment for her livestock within the ten-day period following the sale, she repeatedly attempted to contact Shaw by phone, and left messages asking him to contact her regarding payment for the two horses she had sold at the sale. When Shaw finally answered her call, he expressed surprise that she had not yet received his check and assured her that he would get another one in the mail to her the very next day. Shaw's next check was refused for payment due to insufficient funds, and Marilyn's account was debited $25.00 by her bank because funds were not collected. Again, after several unsuccessful attempts to contact Alan, Marilyn documented her complaint in a letter sent via certified mail, with return receipt requested. Although the return receipt indicated that Shaw had received the letter, Marilyn still received no reply. At this point, Marilyn feels further compelled to document Shaw's evasive conduct with respect to paying her, to hold him to the terms of their initial agreement, and to document the deterioration of their business relationship for possible legal action.

INTRODUCTION

Wind River's owner, Alan Shaw, a miniature horse breeder, initiated Wind River Farms' First Annual Consignment Sale as a way to help small farms market their registered horses in East Texas. Shaw required a non-refundable consignment fee of $250.00 per horse, and promised construction of a marketing website and a sales catalog to be distributed prior to the sale. Shaw also specified a commission fee of 10%, along with an additional $400.00 fee for shavings. The shavings would be delivered to the Pinehurst Equestrian Center the day before the sale on Saturday, April 30, 2005. Marilyn McKenzie thought the consignment sale would make an ideal venue for the sale of five of her horses, and agreed to Shaw's terms and conditions (attached). She sent her completed entry form, fees, and promotional photos of her horses to Shaw by the specified February 5 deadline.

Shaw assured Marilyn that the event would be well-promoted in the industry and within the state. He was presently working with a website designer and graphic artist who was coordinating the production of the marketing materials for the sale. They hoped to have the website completed and the sales catalogs distributed by mid- March at the latest. Shaw would also secure the facility, hire an auctioneer, and handle all marketing efforts and sales transactions. Consignors would provide registration and transfer papers to Wind River Farms; after the buyer's checks had cleared, registration papers would be sent to the new owners, and the proceeds would be sent to the Consigners. Marilyn was optimistic that, with comprehensive advertising efforts to members of various horse associations, the sale would attract not only other horse breeders but other persons interested in owning quality miniature horses for show and pet. When Marilyn arrived at Pinemont on the Friday evening prior to the sale, she unloaded her horses and bedded them down for the night. She arrived at the Equestrian Center at 7:00 a.m. the next morning to care for her horses and field questions from buyers. The sales preview began officially at 9:30 a.m., but Marilyn began to be somewhat concerned at the obvious lack of buyers in the barn at that time. Shaw confided to Marilyn that he had encountered some delays in the production of the marketing materials. They were distributed almost a month behind schedule—just two weeks prior to the sale. Shaw quickly excused himself to complete last-minute arrangements for the auction which was scheduled to begin at 11:00 a.m.. Marilyn sold two of her five horses that day, and P.O.'d the sale of the other three horses since the reserve price was not met.

When Marilyn did not receive payment for her livestock within the ten-day period following the sale, she attempted to contact Alan by telephone, and left a message asking him to contact her regarding payment for the two horses she had sold at the sale. Her concerns escalated when repeated phone calls to Alan over the next few weeks were not returned. When Shaw finally answered her call, he expressed surprise that she had not yet received his check and assured her that he would get another one in the mail to her the very next day.

Marilyn received the $2,400.00 check on July 15 and immediately deposited it into her farm account. The following day, Shaw's check was refused for payment due to insufficient funds, and Marilyn's account was debited $25.00 by her bank because funds were not collected.

Again, after several unsuccessful attempts to contact Alan that day, Marilyn documented her request in the form of a mildly worded letter sent certified mail, with return receipt requested. Although the return receipt indicated that Alan had received the letter, Marilyn still received no reply from Shaw Marilyn then sent another, more moderately worded letter which reiterated her

initial request for payment and detailed reasons, again sent certified, return receipt requested. When she again received no response, Marilyn's strongly worded letter documented Alan's evasive conduct with respect to paying her, held Alan to the terms of their initial agreement, and documented the deterioration of their business relationship for possible legal action.

RENAULT YAHOO! ARGENTINA

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CASE OVERVIEW

This case challenges students to develop a strategy to grow Renault's business in Argentina, now that the economy is recovering from the severe economic disruptions caused by the fact that in 2002 Argentina defaulted on its debt and was declared bankrupt. The case is based on data collected by one of the authors in Argentina. The case is appropriate for senior-and level undergraduates as well as students in MBA and Executive Development programs. It is designed to be taught in a one hour and a half class session, and is likely to require at least a couple hours of preparation by students.

CASE SYNOPSIS

Mr. Pedro Gouzou is Vice President of Marketing for Renault Argentina S.A., the Argentine subsidiary of the French automobile assembler and marketer, Renault S.A. Due to Argentina's default on its sovereign debt and the subsequent deterioration in the economic environment in Argentina, Renault's sales of new cars in Argentina fell dramatically. In 2003, for the entire country of nearly 40 million people, demand in Argentina for new Renault vehicles averaged slightly more than 40 vehicles per day. At the end of 2004, however, with the Argentine economy now recovering quite strongly, Renault is eager to rebuild sales. Additional data and information in the case include:

1. *For Argentina: Historical overview, a sample of recent statistics from the World Bank, and (for benchmarking purposes), comparable statistics for the United States.*
2. *For the company (at both local and global levels): Historical overview, current performance, and numerous factors impacting that performance.*
3. *Characteristics of the local company's current strategy, including descriptive information on the product line, characteristics of the distribution system, information on the promotion and pricing strategies the company is currently using, etc.*
4. *Characteristics of the current competitive situation.*
5. *Detailed data on the attitudes and behaviors of buyers of cars in Argentina.*

BELGROVE FARMS, INC.

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CASE ABSTRACT

Students are faced with a factual setting that presents practical business and ethical issues. The client, Belgrove Farms is considering changing production from standard yellow corn to genetically modified corn. The farm has 4 sub-divisions that vary in production of standard yellow corn and genetically modified corn. Cost data is provided by an existing proposal. Future pricing of the genetically modified corn is uncertain. Using the concept of comparative advantage the student must choose the appropriate allocation of production (standard yellow corn vs. genetically modified corn) among the 4 sub-divisions, and calculate the anticipated change in profits. Students must also consider any strategic or ethical issues associated with the proposed change in production.

The primary subject matter of this case focuses on the calculation and use of comparative advantage in the allocation of resources within the firm. Secondary issues involve the use of accounting techniques and statistics to complete the business decision analysis of a profit opportunity. The case also presents strategic thinking and ethical issues related to business conduct and their affects on consumers.

The case has a difficulty of level three, appropriate for junior level courses. The case is intended to be taught in three class hours, including a class presentation by student teams. The case is expected to require a minimum of three hours of outside preparation by student teams that present a report.

This case is designed for use in an upper division inter-disciplinary business course. The purpose of the course is to enable students to utilize the knowledge they have gained in their lower division core business courses that include: one economics course in microeconomics; two accounting courses (one course in financial accounting and one course in managerial accounting); and one statistics course.

MILLION DOLLAR MANIA: THE VALUATION OF WORLD WRESTLING ENTERTAINMENT

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CASE DESCRIPTION

The primary subject matter of this case concerns corporate valuation. Secondary issues examined include financial statement analysis and pro forma financial statements. The case has a difficulty level of three and the case is designed to be taught in one seventy-five minute class session. It is expected that students will need to devote three hours of outside preparation.

CASE SYNOPSIS

In spring 2008 Vince MacMahon, chairman of World Wrestling Entertainment (WWE), began giving away $1 million dollars of his personal wealth each week beginning June 9th during the regular weekly broadcast of RAW on the USA Network. To participate, viewers had to register on wwe.com each week and then watch Monday Night RAW to acquire the secret code necessary to win if they were lucky enough to be contacted by Mr. MacMahon live throughout each Monday Night RAW broadcast. Given the high cost of energy and the slowing in consumer speding, Mr. MacMahon said, "This is my own version of an economic stimulus plan for our viewers, which will no doubt increase television ratings as well." The cash is being paid by Mr. Macmahon personally, not the public company. However, due to his insider status, accounting rules require that payments be recognized as a selling, general and administrative ezpense with an offsetting entry of a contribution to paid-in capital. Therefore, the question arises as to how long this promotion will continue. In addition to the economic slowdown, WWE is also facing increased competition, particularly for its Pay-PerView events, from from Mixed Martial Arts (MMA), as both sports cater to the young-male demographic. Mixed martial arts (MMA) is an intense and evolving combat sport in which competitors use interdisciplinary forms of fighting that include jiu-jitsu, judo, karate, boxing, kickboxing, wrestling and others to their strategic and tactical advantage in a supervised match. The case requires students to perform financial ratio analysis to evaluate the firm's current financial position. Next, students are asked to forecast the firm's financial statements given the weakening macro environment in the U.S. and the increased competition from MMA. Finally, the students employ a discounted cash flow model to determine their estimate of the intrinsic value of WWE's shares.