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JoAnn C. Carland, Western Carolina University

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EDITORIAL BOARD MEMBERS

JoAnn C. Carland, Editor
Western Carolina University
carland@wcu.edu

Joe Ballenger
Stephen F. Austin State University
jballenger@sfasu.edu

Barbara Bieber-Hamby
Stephen F. Austin State University
bbieberhamby@sfasu.edu

Thomas M. Box
Pittsburg State University
tbox@pittstate.edu

Carol Bruton
CSU- San Marcos
Cbruton@mailhost1.csusm.edu

Robert A. Culpepper
Stephen F. Austin State University
rculpepper@sfasu.edu

Barbara Fuller
Winthrop University
fullerb@mail.winthrop.edu

David E. Gundersen
Stephen F. Austin State University
dgundersen@sfasu.edu

Dale Henderson
Radford University
dahender@runet.edu

Jarrett Hudnall
Mississippi University for Women
jhudnall@sunmuw1.muw.edu

Donna P. Jackson
Stephen F. Austin State University
dcorbin@sfasu.edu

William T. Jackson
Univ. of Texas - Permian Basin
jackson_w@utpb.edu

Marlene C. Kahla
Stephen F. Austin State University
mkahla@sfasu.edu

Vinay B. Kothari
Stephen F. Austin State University
vkothari@sfasu.edu

Marla Kraut
University of Idaho
marlam@novell.uidaho.edu

Larissa Kyj
Rowan University
kyj@rowan.edu

Myron Kyj
Widner University
myroslaw.j.kyj@widner.edu

John Lewis
Stephen F. Austin State University
jlewis@sfasu.edu

Paul Marshall
Widner University
Paul.S.Marshall@widner.edu

Joseph G. Ormsby
Stephen F. Austin State University
jormsby@sfasu.edu

D.J. Parker
University of Washington Tacoma
djpark@u.washington.edu

Elton L. Scifres
Stephen F. Austin State University
escifres@sfasu.edu

J. Bert Stine
Stephen F. Austin State University
bstine@sfasu.edu

Dillard B. Tinsley
Stephen F. Austin State University
dtinsley@sfasu.edu

George Vozikis
University of Tulsa
george-vozikis@utulsa.edu

Charles White
Hardin-Simmons University
cwhite@hsutx.edu

Lone B. Wittliff
Stephen F. Austin State University
lwittliff@sfasu.edu

Thomas M. Wright
University of Nevada - Reno
taw@scs.unr.edu

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LETTER FROM THE EDITOR

Welcome to the *Journal of the International Academy for Case Studies*. The International Academy for Case Studies is an affiliate of the Allied Academies, Inc., a non profit association of scholars whose purpose is to encourage and support the advancement and exchange of knowledge, understanding and teaching throughout the world. The purpose of the IACS is to encourage the development and use of cases and the case method of teaching throughout higher education. The *JACS* is a principal vehicle for achieving the objectives of both organizations. The editorial mission of this journal is to publish cases in a wide variety of disciplines which are of educational, pedagogic, and practical value to educators.

The cases contained in this volume have been double blind refereed, and each was required to have a complete teaching note before consideration. The acceptance rate for manuscripts in this issue, 25%, conforms to our editorial policies.

If any reader is interested in obtaining a case, an instructor's note, permission to publish, or any other information about a case, the reader must correspond directly with the author(s) of the case.

The Academy intends to foster a supportive, mentoring effort on the part of the referees which will result in encouraging and supporting writers. We welcome different viewpoints because in differences we find learning; in differences we develop understanding; in differences we gain knowledge and in differences we develop the discipline into a more comprehensive, less esoteric, and dynamic metier.

The Editorial Policy, background and history of the organization, and calls for conferences are published on our web site. In addition, we keep the web site updated with the latest activities of the organization. Please visit our site and know that we welcome hearing from you at any time.

JoAnn Carland
Western Carolina University

CIRR PRODUCE COMPANY - A CASE STUDY

INTRODUCTION TO BUSINESS VALUATION

Richard H. Fern, Eastern Kentucky University

[Data for the case is adapted from the AICPA's Course: "Developing Your Business Valuation Skills: An Engagement Approach". Copyright American Institute of Certified Public Accountants. Used with permission. All rights reserved.]

CASE DESCRIPTION

This case puts the student in the role of a CPA, ABV engaged in valuing a closely held family business for purposes of buying out a disenfranchised family member. Students are exposed to basic valuation research, confront the limitations of historical cost financial statements, choose an appropriate valuation method and exercise professional judgment in a variety of valuation decisions. The issues of objectivity, client conflicts of interest and business valuation accreditation are also introduced.

The case is appropriate for junior or senior level accounting or finance majors with a solid background in financial accounting. The case can be taught in one to two hours of class time and will require four to five hours of outside preparation by students.

CASE SYNOPSIS

Jess Parker, a CPA, ABV, is hired by one his former college friends to place a value on a wholesale grocery business currently owned by him, his brother and sister. Family friction has led to the brother wanting to retire and have his interest bought by the other two siblings.

Over a three week period, Jess works with his client and one of his staff members in doing the research and preliminary work. As he responds to questions from the client and his assistant, Jess explains some of the major challenges and issues involved in valuing a non-public business. Students research some common valuation methods and select the one most appropriate to the set of conditions in the grocery valuation. As students progress through the valuation and write the report they deal with limitations of traditional financial reports, the challenge of estimating proper discount and capitalization rates and the subjectivity of the valuation process.

MONDAY, FEBRUARY 4, 2002

Jess Parker, a partner in charge of the business valuation area for Worth & Worth PSC, was going through the morning mail. On answering the phone Jess was greeted by an old college friend, Dan Cirr. Since college, Dan had been fairly successful in the wholesale grocery business with his brother Darryl and sister Ann. After the usual swapping of semi-true war stories from their college days, Dan got down to business. He needed Jess' help since a recent family quarrel was forcing Ann and Dan to buy out Darryl's interest in their family's grocery business. Dan agreed to come by the office after lunch on Tuesday.

Jess Jones, CPA/ABV had done tax consulting at Worth & Worth for twelve years before deciding to specialize in the area of business valuation. He had received his ABV (Accredited in Business Valuation) designation from the AICPA two years before and had done twenty or so valuation engagements since then. Through his valuation experience he knew that every valuation engagement had its own special character and presented unique challenges.

TUESDAY, FEBRUARY 5

Dan arrived in Jess' office and the two began discussing the valuation situation. Dan briefly summarized Cirr's operations and ownership arrangements (Appendix I).

Dan, Ann and Darryl had each inherited one-third of the shares in the business from their father, Vincent, in 1990. Since then, all three had been active in running the business and had received equal compensation. Since early 1998, however, Darryl's in-laws had been the source of some friction in the business and Darryl had asked to be bought out effective the end of last year. Dan and Ann were happy to do so.

Having faced similar family business arrangements before, Jess immediately asked: "What sort of buy-sell provisions are spelled out in the shareholder agreement?"

Dan briefly summarized it, "In short, the shareholder agreement says that the Company must pay a price equal to the fair market value of Darryl's ownership interest as of the end of the most recent business year. I guess that would be December 31, 2001."

Dan continued: "I don't know how you experts compute fair market value, but the family's already had some disagreements over how to approach this. Darryl wants to base the value on company sales since they have been growing quite well the past few years. But Ann and I think that sales alone is not an accurate view of what the company is worth. Wouldn't net profits or some combination of asset values be a better measure of fair value?"

Jess agreed with Dan that there are many ways to view a business' value and it's often much more complicated than just taking amounts directly from the financial statements.

Jess continued: "It's usually some combination of estimates taken from various measures of profits, assets and/or cash flows. As we get farther along in the process, we'll discuss some more

details about valuation methods. In the meantime, I'll need to do some background research and then run this valuation proposal by the partners group for approval. Initially, I'll need copies of your business plan, board minutes, company expectations on growth, future goals and objectives and the financial statements and tax returns for the past four years. If you can get them to me in a day or so, I can get started on the background work"

As Dan got up to leave, he said: "I'll fax the financials this afternoon. You'll get the other information tomorrow."

Dan continued: "We want to get this buy-out over and done with quickly. Also, depending on the numbers you come up with, we may need to line up some additional financing."

After Dan left, Jess confirmed that neither he nor his firm had any financial or other interest in Cirr Grocery. It was not a publicly traded company and had never been one of Worth & Worth's audit clients. Recent national publicity about "cozy" relationships between auditors and their clients had made the principals at Worth & Worth particularly attentive to conflict of interest concerns for audit clients.

Jess asked Carlos, a staff member recently assigned to the business valuation area, to get a copy of the firm's standard valuation report checklist and list of documents to be collected as part of the background research. Carlos also located some work papers on two other grocery valuation projects done by other firm partners several years ago. While no two valuations were ever the same, these work papers would help Jess in getting some general background information on the industry. As Jess had already learned, no business could be properly valued without a thorough understanding of the industry and its operating environment.

WEDNESDAY, FEBRUARY 6

Jess spent several hours searching for additional data relevant to the grocery valuation job. He went to the public library, the Internet and the firm's library to review industry and trade publications related to the wholesale grocery industry. The information that he had requested from Dan arrived in Wednesday afternoon's mail (Appendix II).

Cirr Grocery's mission was to be the premiere wholesaler of fresh fruits and vegetables in their service area (approximately 100 mile radius from their warehouse). They had built a reputation of delivering high quality produce at moderate prices.

Jess accessed a variety of sources as part of his external search. He found that the near-term sales growth prospects for most food commodities were relatively flat. He reviewed the Web resources of an industry trade organization, International Foodservice Distributors Association (IFDA) and looked for some comparable companies to use for comparisons and contrasts. However, despite his best efforts, Jess was unable to find another grocery wholesaler closely comparable to Cirr.

Overall, Jess concluded that the wholesale grocery business was an easy one to enter due to the relatively small amounts of start-up capital required. Thus, competition was likely to be strong. In addition, prices in the industry were very volatile since they depended on uncontrollable factors like weather and consumer demand.

THURSDAY, FEBRUARY 7

In the afternoon, Jess visited Dan at the Cirr Grocery distribution site. Jess reviewed the shareholder agreement, supplier and customer contracts, aged receivables and payables, inventory records, lease agreements, loan documents, wage agreements, employee manuals, insurance policies and other relevant documents.

Later, Dan took Jess on a tour of the company's operations to look at the condition of the facilities and the efficiency of the inventory handling procedures.

While touring the facility with Dan, Jess asked: "I noticed that sales took a big jump two years ago and have kept growing nicely since then. What happened?"

Dan replied: "That was about the time that we landed the Tri-States Groceries chain. We had been after that chain for several years and finally landed them. They buy a lot and they keep opening new stores every year. It's been great for business. But, those sales have only been there for two years and we don't know how long they might last. That's another reason I don't like Darryl's idea of basing our company's value on sales".

"So," Jess inquired: "Tri-States must be about 25 percent of your business. Are there any other customers that you rely on so heavily?"

Dan responded: "Well, let's see. I guess the three chains - Tri-State, Food Magnate and Produce City - have accounted for about 60 percent of our sales in the past few years."

Jess asked: "Well, any reason to think that your relationship with them will change in the near future?"

"To tell you the truth", Dan answered, "both Food Magnate and Produce City are in merger talks with a big chain on the west coast. That chain has wanted to expand into this area and either one of those stores would be a good entry for them. We don't think anything will happen for several years, but there's always that chance. Unfortunately, in this business most parent companies require their subsidiaries to use the same suppliers. And, speaking of value, it seems to me that the risk of losing those stores should have some effect on how much our company is worth. Shouldn't it?"

"You're exactly right, Dan" said Jess. "The problem is quantifying that risk. But we do have ways to do it. In the meantime, how about your produce suppliers, are those relationships in good shape?"

"You really know how to focus on the key issues for our business!" exclaimed Dan. "Our suppliers have been very good at getting us quality produce at reasonable prices. In fact, that is our market niche - affordable quality. We have worked very hard on strengthening those relationships

because we realize it is one of the keys to our profitability. I think our supplier arrangements are in pretty good shape."

MONDAY, FEBRUARY 11

In the weekly partners' meeting, Jess presented the details of what he would include in the engagement letter. Most of these were the standard items for valuation engagement letters including the purpose of the valuation, the valuation date, the specific business entity involved, notice that the financial statements included in the valuation report would not be audited, reviewed or compiled, the fee structure and variables, the estimated time frame for the engagement, the reliance on management representations and the understanding that Jess was acting as an independent, objective valuator. The letter also included a notice that the cost and time amounts were only estimates and subject to change.

With the partners' agreement, Jess sent Dan the engagement letter on late Monday afternoon. The signed response was returned on Wednesday.

THE NEXT TWO WEEKS

As they were finalizing the preparatory work for the Cirr engagement, Carlos asked: "This is my first valuation job, so may I ask what may sound like a stupid question? How do we find a value for a nonpublic company? Since we can't use stock market valuation it seems like it's going to be very subjective."

Jess smiled: "Carlos, you're very perceptive. However, we prefer to say that business valuation is primarily a function of professional judgment. The choice of valuation method is probably the most important decision that we'll make. There must be several dozen different ways to do it depending on the purpose of the valuation and the particular circumstances. Even the IRS has some guidelines on putting a value on businesses. Ideally, we'd like to use the value of another, similar company if one can be found. Unfortunately, I couldn't find one."

"In most cases," Jess continued, "I prefer to value companies with one or two of these approaches: capitalized earnings, excess earnings, fair value of net assets or asset liquidation values. Each of these is more appropriate for particular sets of circumstances and they are not really substitutes for one another. However, many valuers use a combination of methods and average or weight the results to find a composite value. This allows them to compute a value from several different perspectives and under different assumptions."

Carlos asked: "Well, what are the key variables that you need to consider when selecting a method? What criteria help you decide which one is right?"

Jess answered: "Business valuations are usually needed for liquidation purposes, sales purposes or buy-out purposes. As you get familiar with the company and the industry, you'll get

some feel for expected changes in management, potential loss of major customers or suppliers, evidence of goodwill, past versus expected earnings and cash flows and possibilities for liquidation. With all of this as background, you should then be able to choose the most appropriate valuation method or methods."

Jess added that several of the typical valuation methods required "normalized" earnings rather than the traditional reported amounts. Jess said: "Normalization means adjusting discretionary expenses to industry averages and applying GAAP where appropriate. For example, I found some averages for the wholesale grocery industry showing owner compensation as a percent of sales varies from about 1 to 3 percent. I think maybe 2 percent would be a realistic industry average for companies similar to Cirr."

Jess said: "The industry averages are the broad guidelines to which we apply our professional judgment and experience. The important thing is to make sure that the earnings and cash flow components are not substantially out of line with the rest of the industry. That's why it's called a "normalization" process."

Carlos suggested: "As far as GAAP goes, the only areas that I suspect might need reviewing seem to be their depreciation expense and bad debt provisions. Although sales have grown, the bad debt provision has not grown proportionately."

Jess replied: "Good observation. I had the same concerns but Dan assured me that most of the increased sales came from the new chain store customer who pays on time and in full. And, after my review, their depreciation methods seem proper, also."

Carlos asked, "So, we just take the client's word for that? We don't have to verify it in some way?"

Jess answered, "From an auditor perspective, your skepticism is fully justified. But remember, we're not doing an audit. If you recall, the engagement letter explicitly stated that the statements would not be audited, reviewed or assembled. We're valuing a business based on data that's presented to us by the client. We ask whatever questions that we think are necessary and document the client's responses. In fact, one part of our final report will be a list of client representations on which we relied. A key limitation to business valuation is that it's only as reliable as the information furnished by the client."

Jess, handing Carlos a report, said: "On a related topic, as you know, the typical financials report assets at cost. But in a valuation setting, we need current fair values. With Dan's permission I hired an appraiser who's come up with these fair value estimates for their assets (Appendix III). Actually, all of their current assets were about right; only the fixed assets needed adjusting."

Jess continued: "While I was waiting for those numbers, I worked on the rate of return on assets that would be appropriate for Cirr Grocery. My best estimate is somewhere around 18 percent."

Jess, anticipating Carlos' next question, added: "To get this, I used a combination of factors, including the client's existing debt arrangements, their remaining borrowing capacity and their

estimated required rate of return on equity capital. This is the most sophisticated and subjective part of business valuation and is usually the last thing that a valuator learns. We could just have well used the Capital Asset Pricing Model if we had been able to find some comparable companies. As you already know, we weren't able to do that.

Carlos, looking puzzled, asked: "How is this rate of return different from the capitalization rate? I'm confused."

Jess responded: "Good question. The return rate (discount rate) is the percentage of earnings that a company can expect to earn on its existing assets given current debt levels and remaining borrowing capacity. For example, we would expect average yearly earnings of \$1.1 million to get an 11% return on a company with net assets of \$10 million."

Jess continued: "The cap rate is used to approximate the capital investment required to buy a given amount of forecasted or excess earnings. The cap is based initially on the discount rate, but also includes a risk premium inherent in buying into a business where there are always uncertainties about continued operations and customer and vendor loyalty. For example, if no major interruptions in supplier or customer relations were likely in the next five years, a 20 percent (100% / 5 years) cap rate would be appropriate. In this valuation, Cirr's biggest risk in the near term is the possibility of losing one or two of those big chain store customers. I'm conservatively estimating that this won't happen for at least another 2 ½ to 3 years since there are no actual deals in process right now."

Carlos asked: "How long do we have to finish this job? We've been on it about three weeks now."

"Glad you asked" replied Jess. "I just had a call from Dan and he'd like some final numbers next Monday. Today's Wednesday, so we need to wrap this up in the next two days."

CASE DISCUSSION

1. In his meeting with Dan on February 5, Jess commented that amounts taken from traditional financial statements are not always appropriate for placing a value on a business. Briefly explain this statement and give examples.
2. Using library or Internet sources, briefly describe the four business valuation methods Jess uses most often. In your description, be sure to include criteria about when each method is most appropriate and the specific calculation procedures. Be sure to cite all references used. (Appendix IV lists some possible Internet references on business valuation methods.)
3. From your answer to Item 2, select the most appropriate valuation method for the Cirr Grocery valuation. Clearly explain why you chose that method and why the other methods not chosen might be inappropriate.

4. In the role of Carlos, prepare a preliminary valuation report for the client. In the report, fully describe the valuation methodology, the assumptions made, the limitations inherent in the valuation process and your final valuation estimate for Darryl's one-third interest in Cirr Grocery. Cite all references.

APPENDICES & REFERENCES

APPENDIX I

Background of Cirr Wholesale Grocery Company

Business Operations and Employees

Cirr is a wholesale distributor of fresh fruit and produce to groceries in a four-state area. Purchases are from produce brokers located throughout the United States with deliveries made directly to the Cirr Warehouse.

Customer deliveries are made daily on company-owned trucks. The Company owns the land and warehouse buildings.

There are 20 unskilled, nonunion workers who load and unload trucks, sort merchandise, pack outgoing orders and drive the trucks. All full-time employees are paid hourly, and participate in the Company sponsored group health insurance and profit-sharing retirement plans.

Shareholder Compensation

Each shareholder gets one-third of the annual expense item - Compensation of Officers. Since early 1997, each shareholder has had a company car that is used 50% for company business. Each owner repays the Company for the personal-use portion of the car expenses (gas, maintenance, insurance, etc). Depreciation on all three cars is \$20,000 per year.

Since 1997, each shareholder's spouse (none of whom work for the Company) also has had a company car. The owners repay the company for the gas, maintenance, insurance, etc. Depreciation of these three cars is \$10,000 per year.

The Company pays personal travel expenses of \$2,000 annually for each of the three shareholders.

Each shareholder gets a \$20,000 annual contribution to his or her profit sharing account.

APPENDIX II

Table 1: CIRR Grocery Company					
Income Statements For Years Ended December 31, 1997 - 2001					
	2001	2000	1999	1998	1997
Net Sales	\$17,037,000	\$15,921,000	\$11,508,000	\$11,932,000	\$10,502,000
Cost of Sales	15,314,000	14,129,000	10,239,000	10,721,000	9,241,000
Gross Profit	1,723,000	1,792,000	1,269,000	1,211,000	1,261,000
Operating Expenses:					
Officers Compensation	939,000	1,160,000	653,000	620,000	763,000
Salaries & Wages	217,000	234,000	183,000	178,000	164,000
Bad Debts	21,000	25,000	16,000	31,000	34,000
Telephone & Utilities	73,000	75,000	71,000	78,000	71,000
Insurance	18,000	16,000	16,000	12,000	2,000
Advertising	7,000	10,000	7,000	5,000	5,000
Maintenance & Repairs	43,000	38,000	25,000	41,000	24,000
Profit Sharing Contributions	91,000	96,000	82,000	69,000	63,000
Employee Benefit Programs	23,000	19,000	14,000	13,000	12,000
Depreciation	42,000	46,000	41,000	26,000	3,000
Meals, Travel & Entertainment	12,000	12,000	11,000	13,000	9,000
Taxes	40,000	37,000	34,000	27,000	25,000
Dues & Subscriptions	3,000	3,000	3,000	3,000	2,000
Gas & Oil	5,000	5,000	5,000	7,000	6,000
Legal & Accounting	18,000	28,000	17,000	23,000	15,000
Licenses & Permits	2,000	2,000	2,000	2,000	1,000
Supplies	18,000	11,000	11,000	11,000	10,000
Office Expense	9,000	9,000	9,000	8,000	7,000
Miscellaneous	2,000	0	0	0	1,000
Interest	45,000	40,000	24,000	33,000	31,000
Total Operating Expenses	1,628,000	1,866,000	1,244,000	1,200,000	1,248,000
Income (Loss) Before Taxes	95,000	(74,000)	45,000	11,000	13,000
Income Taxes	(38,000)	0	(18,000)	(4,000)	(5,000)
Net Income (Loss)	\$57,000	(\$74,000)	\$27,000	\$7,000	\$8,000

Cirr Grocery Company					
Balance Sheets as of December 31, 1997 - 2001					
	2001	2000	1999	1998	1997
ASSETS					
Cash	\$841,000	\$170,000	\$116,000	\$292,000	\$389,000
Accounts Receivable	424,000	205,000	204,000	103,000	65,000
Inventory	230,000	105,000	122,000	104,000	51,000
Loans Receivable	0	100,000	130,000	22,000	62,000
Prepaid Federal Tax	0	2,000	1,000	0	0
Advances	0	15,000	0	0	0
Total Current Assets	1,495,000	507,000	573,000	521,000	567,000
Land	20,000	20,000	20,000	20,000	20,000
Buildings	530,000	530,000	530,000	530,000	530,000
Machinery & Equipment	299,000	335,000	325,000	299,000	180,000
Furniture & Fixtures	14,000	14,000	14,000	14,000	14,000
Autos & Trucks	226,000	221,000	180,000	80,000	80,000
Total Cost	1,089,000	1,120,000	1,069,000	943,000	824,000
Less: Acc. Depreciation	(670,000)	(525,000)	(587,000)	(466,000)	(442,000)
Net Fixed Assets	419,000	595,000	482,000	477,000	382,000
Credit Assn. Bonds	37,000	32,000	21,000	26,000	31,000
Total Assets	\$1,951,000	\$1,134,000	\$1,076,000	\$1,024,000	\$980,000
LIABILITIES & EQUITY					
Accounts Payable	\$609,000	\$262,000	\$239,000	\$162,000	\$74,000
Notes Payable- Credit Assn.	115,000	319,000	209,000	262,000	314,000
Accrued Payroll Taxes	1,000	1,000	2,000	0	0
Accrued Federal Income Taxes	0	0	0	1,000	0
Total Current Liabilities	725,000	582,000	450,000	425,000	388,000
Notes Payable- Credit Assn.	617,000	0	0	0	0
Total Liabilities	1,342,000	582,000	450,000	425,000	388,000
Stockholders' Equity					
Capital Stock	40,000	40,000	40,000	40,000	40,000
Retained Earnings	569,000	512,000	586,000	559,000	552,000
Total Equity	609,000	552,000	626,000	599,000	592,000
Total Liabilities & Equity	\$1,951,000	\$1,134,000	\$1,076,000	\$1,024,000	\$980,000

APPENDIX III

Table 1: Fair Value Appraisals for Cirr Grocery Assets		
As of December 31, 2001		
Asset	Recorded Value	Estimated Market Value
Accounts Receivable	\$424,000	\$424,000
Inventory	230,000	230,000
Land	44,000	64,000
Machinery & Equipment	530,000	380,000
Furniture & Fixtures	14,000	7,000
Autos & Trucks	226,000	106,000
Other Assets	37,000	37,000

APPENDIX IV

SAMPLE REFERENCES ON VALUATION METHODS

(Note: The following Web links were valid when the case was prepared. Since Web links change frequently, they may no longer be valid.)

VentureLine.com. [Www.ventureline.com/bizval.com](http://www.ventureline.com/bizval.com)

Amrican Capital Strategies Valuation Services. www.corporate-valuation.com

Commerce Clearing House Business Owner's Toolkit: Valuation of Small Businesses
www.toolkit.cch.com/text/p11_2200.asp

Business Town.com, Valuing a Business. www.businesstown.com/valuing/index.asp

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(<https://www.appraisalfoundation.org/default.asp>).

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**"WAITRESS!
THERE'S A ROACH IN MY HASH BROWNS!"
When Pleasing the Customer Becomes Lost in Other Issues**

**Marlene C.. Kahla, Stephen F. Austin State University
Barbara Bieber-Hamby, Stephen F. Austin State University**

CASE DESCRIPTION

The primary subject matter of the case presented here focuses on how customers and employees can get overlooked when corporate officers must attend to legal issues which have been mandated in courts and published in national papers and journals. Secondary issues can be determined as students are encouraged to discuss training of employees and its impact on the five characteristics of service quality: reliability, responsiveness, tangibility, empathy, and assurance. As students discuss the characteristics of service quality, they can be encouraged to develop a perceptual map placing Denny's amongst its competitors based on the axes of quality service and training provided employees.

If the instructor chooses to address all seven questions and tasks, then the case will take two class periods to cover, approximately two hours. However, if the instructor chooses to focus on a particular question, such as Question One that focuses on the five characteristics of service quality, then the case would require no more than one class meeting, approximately forty-five minutes to an hour.

The case can be useful in the following courses: (1) Service Marketing: re-enforcing characteristics of service quality and the importance of training programs in marketing of services; (2) Principles of Marketing: influences of situational determinants and group members on consumer behavior; (3) Principles of Management: the impact of effective training programs on the service profit chain; or, (4) Principles of Finance: the impact of ROI on profit.

CASE SYNOPSIS

The case is presented from the perspective of the waitress. The readers are taken into her life, her work experience, and her current situation as life happens to her and builds stress for her throughout the evening and early morning hours. Although the students can get the idea that the person has made a career of being a waitress, they can discover that little actual training is made available for employees in her position with the franchise or corporate office.

She never mentions a training program with Denny's or even with her manager. Since she came to Denny's with actual work experience, any training was over looked. As the scenario progresses, she is quickly over taken with new responsibilities when the manager abruptly quits.

Enabling students to distinguish service quality as a result of training is a challenge. The case emphasizes a "walk in my shoes" type of perspective and will enable the students to better understand the lives of the people they will one day manage. Also, the case enables students to incorporate the five characteristics of service quality into marketing strategies and plans.

The case is designed to enhance each student's ability to differentiate each component of service quality and to better understand the significant role of first line employees in presenting the corporation to consumers and other employees. The overall goals of the case are to increase awareness that the actual physical product and service are two components of an overall service encounter; and, to enable students to understand that service delivery is a crucial element of service that revolves around training, evaluations, and effective communications within a company.

INTRODUCTION

Two A.M. Sunday morning, and here sat Thelma—thirty years old, no husband, and two sons at home with their grandmother. She took one last drag on the cigarette before going back to her station.

"Denny's," she thought, "a big name place like this would be a good place to work. Insurance. Benefits. Social Security. I wonder if I get any benefits? And, the tips would be good—everybody knows Denny's." Thelma dreamed on about her new position in the restaurant world. Before working for Denny's she had worked at a little café in town, Country Kettle. A greasy spoon type café that had closed when the owners retired, the Country Kettle had provided her a meager living with no hope of benefits.

A touch of carpal tunnel syndrome in her right arm and arthritis in her left thumb were tell tale evidence that she had been a waitress for what seemed to be all her life.

Dropping out of high school was not the smartest thing she had done. It nearly dictated that she work the long hours of being on her feet in the food service industry. But, the G.E.D. classes were being offered at the community college soon, and she planned on earning the degree she had left so long ago.

"Ring. Ring. Ring. Ring."

"Who would be calling here at this time?" Thelma thought as she reached for the phone behind the hostess station. "What is it!?" She exclaimed. "Oh, its you, Mom. Are the boys all right?"

"Just thought that you should know that Tommy has an ear ache. I know you're gonna hafta get those tubes put in his ears." Her mom always knew something that she was just "gonna hafta do." But, the four of them had been a team for about three years now, so Thelma knew to take everything her mom said with the proverbial "grain of salt."

"Well, is he crying? Does he have a fever?" Thelma was growing impatient.

"So far he doesn't have a fever, but he did wake up crying." concluded her mom.

"Look, it's two o'clock now. You know I don't get off until seven. See if you can get him to take the medicine samples the doctor gave him the last time he was sick. If he gets a fever call me back. Otherwise, wait until I get off at seven, and I will take him to the ER." she knew the routine only too well.

"Hey, Thelma! I have had it!" Roy, the cook, sober tonight for a change, remarked.

"There are more roaches in this kitchen than in the feed store where I used to work!"

He came out from the kitchen. "What a mistake. But, there are only a few people here to see or hear him, so maybe his greasy apron, messy hair, and stubbled beard won't run off customers." Thelma could only hope.

"Look, Roy, Ronnie (the manager) quit about an hour ago. I'm the only one here except you. What can I do about the roaches this morning?" Thelma was just about at her wits end. "Just be careful back there. Make sure they don't roam the counters. We will get through until the next shift comes in. They can call an exterminator. Now, get back into the kitchen. I see four customers coming up the walk." She walked to the hostess station and picked up menus, and Roy shuffled back to the grill.

"Howdy." she calmly greeted the two couples. "Follow me. Smoking or non smoking?"

"Smoking." one of the women said. They all followed Thelma to the nearest table in the remotely located smoking section. "Coffee while we decide what we want, please."

"Sure." Thelma disappeared behind the counter to check to see how fresh the coffee was. She had been so distracted by Ronnie quitting, her mom's call and Roy's complaint about the roaches that she had forgotten when the last pot of coffee was made. "Whew! This stuff pours like syrup. I'll put on a fresh pot. Surely they can wait for fresh coffee. They probably won't notice if the coffee doesn't come out until later."

"I never did see what everyone thinks is so all-fired important about coffee. I can see my momma now, sitting at the kitchen table smoking her Marlboro's and drinking her Community Coffee. When I want caffeine I drink a Coke. Cold caffeine is the way to go. "They'll probably give me a big tip if I get them fresh coffee. Well, on the other hand, people comin' in this early in the mornin' aren't too awake to think about tips. I might get nothing. I'll take my time gettin' their orders."

"Time is something that Denny's corporate thinks you have a lot of. Ronnie had been working 20-hour days for two weeks. He could try to plan a schedule, but his plans were never what really happened. Who could blame him for quitting tonight?" Thelma was in her own world.

Roy stepped up to the window with more toast for a table where the people had received their orders some time ago. "Hey, Thelma, take this toast over to the table that had the Grand Slams. They had asked for more toast, remember?"

"Sure, Roy, glad to get them what they want. And, I'll stop by that new table in the smoking section—see if they've made up their minds about what to eat. Now, Roy, you stay where you can watch that counter."

As Thelma delivered the extra toast, she stopped by the table where she had seated two couples about five minutes ago.

"Waitress, did you forget our coffee?" one of the women remarked.

"No, I'm making you a fresh pot of coffee—you wouldn't have wanted the stuff that had sat in the pot since midnight. Now, what do you want to eat?"

"A Grand Slam with over easy eggs—you know, runny yoke, orange juice, and coffee, please." said the lady smoking the cigarette.

"I'll have the same thing. Especially fast on the coffee, please," said the other woman.

"I want the order that has the pancakes, sausage patties, eggs, and biscuits with orange juice and coffee," said the man seated nearest the lady with the cigarettes. "Fry them eggs sunny side up, please."

"I want biscuits, gravy, and sausage and coffee now," said the man seated nearest to Thelma.

She reviewed the orders, took the menus from them, and returned to the hostess station where she was greeted by Roy. "What is it now!? Can't you stay in that kitchen?" she was losing any patience she might have had.

'Now, Thelma, I can't cook and swat roaches. We just might hafta do something about those critters during our shift," Roy really hated any type of insect, he was always afraid they would get into his ears and then into what was left of his brain. Or, at least that's what Thelma was thinking this morning.

"Roy, concentrate on cooking! Here, I need two Grand Slams with over easy eggs, runny yokes, a full pancake, egg, and sausage meal with the eggs sunny side up, and one biscuits, gravy, and sausage. See if you can't hurry it up. I think they're kinda grumpy about me taking my time getting them their coffee," and Thelma went to get the fresh coffee and four cups.

"Here you are, four fresh cups of coffee," said Thelma with a hint of enthusiasm.

"Well, its about time," said the woman who wasn't smoking. We are really looking forward to a good breakfast. Hardly ever do we get to go out on Saturday night, and when we do, we want breakfast early on Sunday morning!"

Thelma thought that the woman may have given her more information than she ever wanted to know about them, and dismissed herself from the table with, "Enjoy your coffee."

"When will Roy ever get those plates finished? I tell you what, Roy, I'll help you finish the plates. What do you lack?" asked Thelma.

"Those Grand Slams need hash browns added. Here, get them from this part of the grill. I just finished them. And, you can add the gravy to the biscuits and sausage on this plate," Roy concluded.

"Thanks! I'll take everything with me now." Thelma proceeded to layer the plates first in her left hand, then her right. Each plate carefully, almost impossibly, balanced on each of her arms and wrists. She glided to the table where the two couples were finishing their coffee, and the smoker had snuffed out her second cigarette.

"I believe you two had the Grand Slams with over easy eggs. You had the pancake, egg, and sausage plate, and you had biscuits, gravy, and sausage. Right?" she was looking for some type of nice response from the table of diners.

"That's it. Thanks. More coffee, please?" the man with the biscuits quickly responded.

"Sure thing," and Thelma left the table to relax while the couples ate their food.

Her thoughts about Tommy's ear ache and paying for a trip to the ER were interrupted, with one of the women from the table, in her face, asking where the coffee was and telling her that their food was cold.

"Oh, I'll get the coffee right now. I don't know why the food was cold. I can ask the cook to heat it up real quick," Thelma offered.

"No. The coffee will be all that we need for now. I'll walk back to the table with you," said the woman. Then, she stopped suddenly, lightly grabbed Thelma's arm, and said, "What's that!?"

"Oh, no! That can't be what I think it looks like. That's a roach! A roach fried into my hash browns! I thought that looked like something other than lace from the eggs!" the woman and the rest of the table became excited over the discovery of extra protein in her food.

"Wait!" the other woman said. "That's not all! You had only half a roach in your hash browns. The other half is in my hash browns! Look!"

No one knew whether to laugh, cry, or get mad. Thelma was thinking that choking Roy would be too good of an ending for him. He had ruined her job.

"What are you going to do about this?" the women asked simultaneously. "We want to talk with the manager right now!"

Thelma did not want to even think this was really happening to her. Not her. Not now.

"I would love to let you talk to the manager right now. But, he quit at the beginning of the shift, and I'm the only thing close to a manager here," Thelma said reluctantly.

Then, as she and the women were walking toward the hostess' station, a live roach scampered across the floor in front of them. Silently they let the roach escape.

"I will comp your meals and drinks. That's about all I know to do," Thelma quickly offered.

"OK. But, we want to let someone at corporate know what has happened here. Give corporate my card," offered the smoker. "I will expect to hear from them soon."

"Yes, I will do that, it's the least I can do." Thelma turned and walked away. "Have a good day," she said as the two couples left the restaurant.

"Roy! You goofed again! You fried a roach with those people's hash browns. You must have halved the critter when you separated the potatoes on the grill. I think our working here is over. I'll let corporate know what happened. If I don't, those two women will, and that will be even worse." As Thelma was taping a closed sign on the door, she was saying, "Roy, I could just kill you!"

On Monday the local health inspector came—one of the women contacted him early that morning. The franchise had ended and corporate took over the location that Sunday. Denny's at that location closed.

LOCAL FACILITY

The Nacogdoches restaurant occupies a site that has had difficulty supporting a restaurant. Built in the mid 1980s as a Ramada Inn the location was originally the Inn's food service operation. When the Holiday Inn took over the facility in the early 90s, the area was leased to a series of local food service operators. The one immediately preceding Denny's was a small hamburger chain from the nearby Tyler area that used a 50-60s rock theme. Denny's took over the lease in an apparent co-branding effort in early 1997. Denny's current "Classic Diner" upgrade has not been attempted at the facility, most likely because this is not a stand alone unit.

Competition

The most direct competition comes from another chain, the Kettle. The small Kettle chain currently contains 67 restaurants in seven states. The local Kettle is directly across the street from Denny's in a former Hot Biscuit location. The Kettle restaurant chain has its roots in Nacogdoches, the original Kettle was started in 1968 just off the SFASU campus on North Street. Since 1998 one hundred percent of Kettle restaurants are franchised. (www.kettle.com/history.html)

Although the facility has had little upgrade since becoming a Kettle, mostly exterior changes to reflect the blue and yellow color scheme, the service experience has been completely different.

On a recent Sunday morning when the staff was caught unprepared by the influx of customers caused by the University's Parents Weekend the two waitstaff, one busboy and cashier/hostess were able to serve, keep the buffet filled, and clear tables in a reasonable time frame. The service experience took 45 minutes from entrance to exit. The food ordered from the menu was served within 15 minutes of ordering, served hot, coffee refilled, all of the order arrived together, and despite some obvious cleaning needs (dirty vent over buffet, missing base board trim in restroom hall, tile floor needing to be moped from all the traffic) there were no additional protein items (roaches) included in either the buffet items or menu ordered items. The menu, while not as extensive as Denny's, is very similar. Breakfast is the feature meal, standard lunch and dinner meals are also available.

COMPANY BACKGROUND

In 1953 Harold Butler opened the first Denny's Donuts in Lakewood, California, by 1954 more stores opened and the name changed to Denny's Coffee Shops to reflect the expanded menu. By the end of 1959 the chain had expanded to 20 stores serving the California market. In 1963 the company started franchising and by the years end 79 coffee shops were open in seven western states. The first public offering occurred in 1966 on the Pacific and American Stock Exchanges. The first tiptoe into international waters began in 1967 with the opening of the Acapulco Denny's. Merger and acquisition expanded the chain to 192 shops in 1968 and the chain starts an eastward migration. The Grand Slam Breakfast, still the most popular meal in the chain was introduced in 1977. By 1981 the chain grew to 1000 coffee shops and had become the country's leading family restaurant. TW Services purchased Denny's Coffee Shops in 1987, adding the chain to its other restaurants. To streamline and reduce costs, TW Services moved Denny's headquarters from its California roots in Irving to Spartanburg, SC in an effort to centralize Operating Management and Support Services in 1991. (www.dennysrestaurants.com/who/history)

By February 2002, Advantica had formed FRD Acquisitions (a wholly owned subsidiary) and filed for Chapter 11 protection for the Coco's and Carrows chains. According to information available in September 2002, Denny's was composed of 1,723 restaurants, 591 company owned, 1,114 franchised, and 14 operating under licensing agreements. (www.dennysrestaurants.com/aboutus/)

In an interview on NPR's Motley Fool, Nelson J. Marchioli, current CEO, stated that Denny's Inc. was highly leveraged since the firm had become an operating company instead of a holding company. With this in mind they were aggressively looking at the ROI of all corporate owned stores. The most critical factor to be considered in store operations was customer per day, entire order. Core corporate stores were being carefully examined and those stores not profitable were being closed where the leases permitted termination. (NPR, August 16, 2002)

Although the company has the legacy of past discrimination suits, the former CEO Jim Adamson had instituted a rigorous training program that has resulted in the current status as a leader in diversity. Mr. Marchioli feels that this is a solid foundation for turning the firm towards increased profitability (NPR, August 16, 2002).

Discrimination Actions

On April 1, 1993 a Consent Decree was filed by the US District Court for the Northern California district as a result of a 1991 incident involving several college students. The decree issues specific steps to be taken by the company (now called Flagstar) to train its managers, both corporate and franchise, in diversity and discrimination issues. The decree finds the company in

violation of several sections of the Civil Rights Act of 1964. (www.usdoj.gov/crt/housing/documents/dennysettle2.htm)

The same day that the Court issues its decree a Denny's in Annapolis refuses service to six black Secret Service Agents who were with a party of 21 total agents. (The Washington Post, May 24, 1993, Lynne Duke, staff writer) A round of Civil Rights suits follow, resulting in an 1994 nationwide settlement of 54 million dollars, paid to various plaintiffs and Civil Rights organizations. During the same period Flagstar enters bankruptcy. Also in 1994, the company becomes the largest single corporate supporter of the Save the Children charity. In 1995 the corporation signs an agreement with the Hispanic Association on Corporate Responsibility. The company emerges from bankruptcy in 1998 under a new name, Advantica, to better reflect the new directions of the firm. ([Http://www.advantica-dine.com/advantica](http://www.advantica-dine.com/advantica)) As of September 2000 Advantica is composed of three chains; Denny's, Coco's, and Carrows. The largest, Denny's, now has approximately 1,784 restaurants; 835 Company owned, 930 franchised, and 19 operating under licensing agreements. (<http://www.advantica-dine.com/advantica/Devweb.nsf>)

SETTLEMENT EFFECTS

As a result of the various discrimination lawsuits, especially the 1993 Consent Decree, manager and franchise training was adapted to include diversity and sensitivity training. All company officers were also required to take part in the new training. A new executive position, Chief Diversity Officer, was also created. For the years 1998 and 1999, Advantica has ranked within the top ten of Fortune Magazine's list of "The 50 Best Companies for Asians, Blacks, and Hispanics". The January 2000 Working Woman issue cited the company as one of the top ten employers for executive women. Women currently make up 20% of the Board of Directors, 35% of corporate officers, and 30% of the CEO's management team. (www.advantica-dine.com/advantica)

Advantica has also taken a more aggressive stance in the awarding of franchises to minorities. As of second quarter 1998, 74 of the 736 franchisees were minorities, collectively they owned 258 restaurants, 35 % of all franchised restaurants in the chain. One hundred and fourteen of these restaurants were African American owned. However, 63 of these African American restaurants are owned by one family, former U of H great, and Houston Rockets star Hakeem Olajuwon. (www.virtualval.com/_enuf/_dennys.html)

These accomplishments have not, however, stopped the law suits. In the spring of 1998 a woman manager filed suit in Arizona claiming sexual harassment and discrimination, these charges are based on claim that her salary was not the same as her male peers. (www.progressive.org/mpmilian1098.htm) In the spring of 1999 a group of Asian-American Syracuse University students filed a discrimination suit against a local Denny's stemming from a

1997 incident. The case was dismissed in July 2000 and the restaurant's security guards and local law enforcement officers had the charges against them dismissed. (www.nylj.com-stories-00-07-071800ab.htm)

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CONDUCT UNBECOMING: ALLEGATIONS OF SEXUAL MISCONDUCT AT THE UNITED STATES AIR FORCE ACADEMY

Charles R. Emery, Lander University
James E. Benton, Lander University

CASE DESCRIPTION

The primary subject matter of this case involves the detection of cause factors and proposal of corrective actions to eliminate chronic sexual misconduct in an organization that rewards machismo. Despite the Academy's emphasis on officer integrity and honor, previous attempts over the last decade, to correct these problems have failed. Secondary issues examined include leadership, ethics, whistle blowing, sexual harassment, and the confidentiality of reporting along with how to develop character and plant seeds for organizational change. The objective is to make the students develop an investigative process that examines interrelated and often subtle cause factors to develop well justified corrective actions. This case is appropriate for junior or senior undergraduate students as well as graduate students studying business policy or strategy, human resource management, organizational behavior and ethics. This case can be easily varied in its scope through the array of focused discussion questions. The case is designed to be taught in one class hour and is expected to require three to four hours of outside preparation depending upon the level of sophistication; it is ideal for either individual or team assignments/presentations.

CASE SYNOPSIS

Imagine the outrage if one out of five female American P.O.s said they had been sexually assaulted by Iraqi. Well, that's how many female Air Force cadets say they have been assaulted -- not by the enemy, but by men supposed to be their comrades in arms. This case study chronicles the June-September, 2003, investigation of a decade of alleged sexual misconduct at the United States Air Force Academy. A panel of investigators, appointed by the Secretary of Defense and headed by the Honorable Tillie K. Fowler, examined the awareness of misconduct and the Academy's organizational culture, climate, structure, curriculum, reporting and response procedures and leadership (internal and external) in an attempt to identify root causes and to provide lasting recommendations for the prevention and intervention of any future abuses.

BACKGROUND

It was September 17, 2003 and the Honorable Tillie K. Fowler sat in her temporary office in Washington D.C. contemplating what recommendations her Panel of six investigators might give Congress next week that would finally resolve a decade of sexual misconduct at the United States Air Force Academy. Tillie, a former Congressional representative from Florida (1993-2001), had been chosen by Secretary of Defense, Donald Rumsfeld, to execute Presidential Order H.R. 1559; the review of sexual misconduct allegations at the United States Air Force Academy (USAFA). This Panel was given ninety days to investigate and prepare a report of findings and conclusions to Congress. The Panel's prime directive was to (1) review actions taken and contemplated by Academy and other Air Force personnel in response to allegations of sexual assault, (2) review the effectiveness of the process, procedures and policies used at the Academy to respond to allegations of sexual misconduct, and (3) review the relationship between the command climate for women at the Academy, including factors that may have produced a fear of retribution of reporting sexual misconduct, and the circumstances that resulted in the sexual misconduct (Senate Armed Services Committee, 2003). Note: this was the fourth investigative team chartered during 2003 to examine sexual misconduct at the USAFA and the only one not formally affiliated with the Department of Defense.

Pressure for results (and in some cases, heads) was coming from all directions and the press was fanning the flames of outrage. Government statistics indicated that three percent of women in college report rape or attempted rape-it was over seven percent at the Air Force Academy. Further, there was reason to believe that there was a higher rate of unreported cases at the Academy than a typical university. Sixty female cadets had come forward within the last year to allege that they were raped or assaulted. Sadly it appeared that senior civilian and military leadership of the Air Force and the Air Force Academy were aware of serious and persistent problems of sexual assault and gender harassment at the Academy since 1993. While numerous cause factors had been identified by previous teams, their recommendations had failed to resolve the problem. Also, it's particularly surprising that the problems haven't been resolved given that a high percentage of female cadets come from military families. Certainly, this begged the questions of whether the root causes had been truly identified and whether corrective actions had been taken with resolve.

For example: in February, 2003, Senator Wayne Allard, member of the Senate Armed Services Committee, presented the Secretary of the Air Force with a two-page letter requesting investigation and/or clarification of several constituent complaints. The following are key excerpts from that letter (McAllister, 2003).

1. There is some confusion about the number of cadets that have been raped or sexually assaulted at the Academy. Provide the number of cadets that have reported rapes and sexual

-
- assault to each of the following: the CASIE Program, the counseling center, and the Academy hospital.
2. Several cadets who may have been raped or sexually assaulted were punished before the rape or assault investigation was completed.
 3. Some former and current cadets have reported difficulties in securing the rape kits and investigative reports. The AFOSI stated that their rape kits and investigative reports were lost.
 4. A number of victims have complained about not being permitted to bring someone with them to AFOSI questioning sessions or to meetings with senior Academy officials.
 5. All of the former and current cadets have expressed concern about not knowing whether or not their alleged assailant was punished.
 6. When a cadet is raped or sexually assaulted, in many cases, alcohol is involved. While it is well-known that cadets are not permitted to drink, it appears that the consumption of alcohol is common practice. What is the Academy doing to discourage underage drinking?
 7. What, if anything, did the Academy do with the 1994 General Accounting Office (GAO) recommendations to reduce an environment conducive to sexual harassment?

In March 2003, findings of the Allard investigation and interim findings of the Air Force General Counsel's investigation, prompted the Air Force to issue an immediate "Agenda for Change" - a series of preliminary efforts to improve the safety and security of every cadet and regain the trust and confidence of the American people in the Academy. It was developed by officers and leaders with experience at the Academy, other academies, and Air Force ROTC in an effort to swiftly start the process of implementing decisive changes. Shortly after the "Agenda for Change" was issued, the Secretary of the Air Force directed the Air Force Inspector General to undertake a parallel investigation (to the General Counsel's) into every case where a victim felt that justice had not been done so as to assess command accountability. While the Air Force must be commended on its sense of urgency, it should be noted that many of the strategies touted as reforms are actually measures that have been tried under past administrations. Of 25 items on the "Agenda for Change" that affect cadets directly, at least nine aren't new at all.

In June 2003, Air Force General Counsel Mary L. Walker released The Report of the Working Group Concerning Deterrence of and Response to Incidents of Sexual Assault at the U.S. Air Force Academy (hereafter referred to as the "Working Group Report"). The Working Group Report covered many aspects of cadet life, Academy policies and sexual assault reporting procedures in place at the Academy during the last ten years. While the investigation found factors contributing to an unhealthy climate for female cadets (e.g., perceived negative consequences for reporting assaults), it stated that there was "no systemic acceptance of sexual assault at the academy, institutional avoidance of responsibility, or systemic maltreatment of cadets who report sexual assault. In short, it avoided any reference to the responsibility of Air Force Headquarters for the

failure of leadership which occurred at the Academy. Recommendations from the "Agenda for Change" and the General Counsel's final report were translated into 63 action items for implementation and tracking (Senate Armed Services Committee, 2003).

On July 11, 2003, James Roche, Air Force Secretary, announced that General Dallager, the commander of the Air Force Academy from 2000 to 2003, will be demoted as he retires. Roche said, "He failed to detect and stop the school's sexual-assault crisis." "He should have taken notice of the indicators of the problems and he should have aggressively pursued solutions to them." The rebuke represented a reversal for Roche, who originally said the general and other academy leaders shouldn't be blamed for long-standing problems (Soraghan, 2003). (Note: The three star to two star demotion is equivalent to a fine of \$10,000 per year in retirement pay)

Over the past month, at least 22 other women-13 former cadets and nine currently enrolled-have made similar charges, accusing academy officials not only of failing to investigate sexual assaults but of actively discouraging women from reporting them, and retaliating when they did. In the past decade, only one academy cadet had been court-martialed on a rape charge and that cadet was acquitted. One cadet summed up the victims' feelings toward leadership by saying, "the guy who did this to me knew nothing would happen to him" (Thomas, 2003).

Last week, the DoD IG released its follow-on report on the United States Air Force Academy Sexual Assault Survey. The survey of 579 female cadets in the Academy classes 2003-2006 (87.9% of the total female population) found that: 43 cadets (7.4% of all respondents) - including 15 members of the Class of 2003 (11.7% of that class) - indicated they had been victims of at least one rape or attempted rape in their time at the Academy; 109 cadets (18.8% of all respondents) indicated they had been victims of at least one instance of sexual assault in their time at the Academy; Cadets indicated that only 33 (18.6%) of the 177 sexual assault incidents were reported to the authorities; 143 (80.8%) were indicated as not reported; 143 of the 177 sexual assault incidents were recorded by the victims as not being reported to any authority because of embarrassment (in 77 incidents), fear of ostracism by peers (in 66 incidents), fear of some form of reprisal (in 61 incidents) and the belief that nothing would be done (in 58 incidents). The top two reasons given for why cadets thought that victims were not reporting (after embarrassment) were fear of ostracism by peers and fear of being punished for other infractions. Especially disturbing was the finding that 88.4% of cadets who were rape or attempted rape victims disagreed or strongly disagreed with the statement that "most cadets are willing to report a sexual assault incident regardless of loyalty to the offender." Obviously, things didn't appear to be getting better at the Academy despite this year's intense press coverage and investigative attention. (Panel of House Armed Services; 2003, p.63).

The last 83 days of the investigation, under the harsh spotlight of public opinion, had been intense, illuminating and at some times frustrating. Early in the investigation, there were the typical cries of "witch hunt" and "whitewash" and one of our panelists was pushed to resign after telling AP Radio that, "Due to the fact that many of the women making the allegations were involved with drinking, partying, strip poker, what I call high-risk behaviors... the veracity of these allegations

may be suspect" ("United States", 2003). As the investigation progressed, however, the press and the general public became one of our most valuable sources of information. It truly appeared that the problems were long-standing and deeply imbedded in the fabric of the Academy. Further, they appeared to be specific to the Air Force Academy; interviews with officials at the other military academies and the U.S. Coast Guard Academy and the Merchant Marine Academy said they had relatively few cases of sexual assault, and that they had rigorous systems to ensure that complaints were thoroughly addressed. We realized there weren't going to be any quick fixes. Our investigation examined the awareness of misconduct over the last decade and the Academy's organizational culture, climate, structure, curriculum, reporting and response procedures and leadership (internal and external). We experienced the gravity of this crisis first-hand. We were stunned to hear stories from victims, many still too afraid to go public with their stories and, more disturbing, too afraid to make an official report of the crime. They shared with us how their lives have been torn apart by a violent assault and an aftermath that most of them suffered alone and in silence because of an atmosphere of fear and retribution by peers aided by either indifference, incompetence or a combination of both by an Academy leadership they believed failed them. Now was the time to pull all of our findings together, identify the root causes and provide lasting recommendations for the prevention and intervention for any future abuses.

WARNING SIGNS: A DECADE OF AWARENESS

Prior to 1993, few sexual assaults were reported at the Academy. This infrequency combined with the perceived high quality of entering cadets may have caused Academy leaders to believe the institution was virtually free of sexual assaults. That perception ended sharply in 1993 when 16 cases of sexual assault were reported. The surge of sex crimes at the Academy contrasted sharply with the low rates at other military academies. In response to the incidents, Brig. General Hosmer, then-Superintendent, reached out to the cadet population, and to female cadets specifically, to gain a better understanding of the cadet experiences and perceptions about sexual assault and sexual harassment. His meeting with female cadets made it clear that the problem was significantly greater than he previously suspected. A few days after meeting with the women, the general met with all the male cadets to get their perceptions. Interestingly, while more than 50 percent of all the female cadets had said they knew of sexual harassment cases, only 9 percent of the men did. (Panel of House Armed Services; 2003, p.25)

General Hosmer attempted to improve the Academy environment by making changes to the Academy's sexual assault response program, including establishing an informal policy of confidential reporting. He commissioned the Academy's Center for Character Development to improve the overall character of the cadet population through educational and training programs. He also created a sexual assault hotline operated outside of the chain of command that offered

counseling to victims of sexual assault with the assurance of confidentiality. Another change was the institution of a victim amnesty program to encourage the reporting of sexual assaults. Under the amnesty policy, the chain of command could forego punishment of victim misconduct in order to encourage the reporting of sexual assault. (Panel of House Armed Services; 2003, p.25).

In January 1994, the General Accounting Office (GAO) released a report on sexual harassment at each of the Service Academies which indicated that women were subject to harassment at all of the Service Academies at a level that portended a serious threat to the mission of the Academies to educate and train future military officers. While the focus of the GAO report was sexual harassment and not sexual assault, it should have provided a significant indicator of culture and climate problems with the treatment of women. Further, it should have prompted an investigation at the Air Force Academy; particularly in light of the previous year's incidents. However, there is no evidence that the Academy took any direct action in response to this GAO report. Another more direct indicator in 1994 of the extent of sexual assault problems at the Academy was the formation of an "underground" support group initially comprised of five cadet victims of sexual assault who did not have confidence in the Academy's formal reporting system. Some female cadets who were victims of sexual assault did not want to report the incidents to law enforcement. Instead, they chose to obtain support from other victims and not make formal reports that would involve the chain of command. (Panel of House Armed Services; 2003, p.26).

Also, in 1994, a sophomore cadet alleged in a lawsuit that during the vigorous and realistic Survival, Evasion, Resistance and Escape program, fellow cadets choked her into unconsciousness, splattered her with urine and shook her so hard she received chest injuries. One cadet, acting in the role of captor, took her into the woods, made her take her shirt off and lie down while he simulated a rape. An Air force investigation dismissed 15 of her more serious complaints, including a claim that male cadets had videotaped her undergoing the simulated rape and that she had been maliciously targeted. The service, however, acknowledged she had been slapped, shaken, called obscene names and forced to walk with a stick in her pants to simulate masturbation. (Pearce, 1996).

In March 1995, the GAO issued a follow-on report to its 1994 investigation of sexual harassment, and concluded that the issue had not improved at any of the Academies. Female students interviewed for the study said, overall, that they had seen no improvement in the atmosphere for reporting sexual harassment and that they continued to fear reprisals from male students and commanders if they did report incidents. William E. Beusse, an assistant director of the accounting office said that "The indications are there's been relatively no change, despite what the services have done to sensitize cadets and midshipmen about the issue and dealing with cases when they come up." The 1995 report also found that 78 percent of the Air Force Academy's female cadets claimed to be harassed on a recurring basis - a significant increase from the 59 percent reported in the 1990-1991 study. The most common forms of harassment were verbal abuse or personalized graffiti. Female cadets at the Air Force Academy noted, "We've been called so many names that sometimes it doesn't even register that they are inappropriate. The lack of respect that

the men have here for women is appalling, and challenging their actions only ostracizes women from the unit." (Schmitt, 1995)

In 1996, Air Force Headquarters recognized that the procedures to address sexual assault, were not working at the Academy as expected. It was hoped that the counselors within the confidential reporting system could encourage or persuade the victims to report the crimes to the Academy's Air Force Office of Special Investigation (AFOSI) and the chain of command. It appears that over time, counselors did not perform this function and the investigation and prosecution of sexual assaults became secondary to victim treatment and counseling. The result was the confidential reporting program provided counseling for sexual assault victims but interfered with the timely investigation and prosecution of assaults. The majority of cases were going unreported and even those that were reported were reported a number of days after the incident. The AFOSI stated that the Academy's program of confidentiality promoted the perception of cover-ups, jeopardized the safety of other cadets and the ability to bring offenders to justice, and could result in the commission of an unsuitable officer (Panel of House Armed Services; 2003, p.28).

On June 3, 1996, a psychiatric consultant working for the Air Force Surgeon General briefed the then-Chief of Staff of the Air Force that "the problem of sexual assault and victimization continues at the Academy in large measure due to a cultural or institutional value system. This climate promotes silence, discourages victims from obtaining help, and increases the victim's fear of reprisal." Additionally the consultant stated that the Academy lacked a coordinated policy linking the various support agencies into a safety net for the traumatized victim, and expressed concern about the policy that allowed victims of assault to determine if they would identify the perpetrator or press charges (Panel of House Armed Services; 2003, p.31).

By 1998, the Academy's leadership had every reason to believe sexual misconduct was an issue worthy of attention. The Chief of Sexual Assault Services at the Academy provided a briefing entitled "We Have a Problem" to the school's leadership ("top six") which estimated that 24% of female cadets responding to the 1997 Social Climate Survey indicated that they were sexually assaulted since coming to the Academy. It is not evident what the leadership did in response to learning that a sizable portion of the female cadet population reported being sexually assaulted after arriving at the Academy. (Panel of House Armed Services; 2003, p.35).

In 1999, the Academy was rocked by another highly publicized rape. Freshman cadet Fullilove had joined some friends to watch a movie at a lecture hall on school grounds where no alcohol is allowed. As Fullilove and three girlfriends were leaving, an upperclassman they knew offered them a ride to their dorms. Fullilove was the last to be dropped off. She recalls that she wasn't particularly worried when he pulled over and locked the doors. However, seconds later "He forced himself on me. I tried to scream and fight, but of course everybody's in shape at the Academy. Me against him was no fight." Dazed and confused, she told no one in the days afterward what had happened. He was an upperclassman who could ruin her career with just one accusation. She knew all too well from older female cadets the consequences of reporting a rape.

"We were told if you want to stay at the academy, don't report it. They'll get you [thrown] out." But when her attacker walked unannounced into her dorm room two days later, saying he was "sorry if he had done anything inappropriate," she realized the threat would always be there. She decided to leave. Four months later, she decided to report the rape but that proved fruitless; even for an officer's daughter ("Rape scandal", 2003).

In August 2001, a Task Force assessing the Academy's Honor Code, Honor System, and the conditions surrounding the Honor System reported that confidence in the Honor System had declined and stated that "the honor environment and culture needs constant scrutiny and frequent review by Academy's leadership to insure accomplishment of the school's character-building mission. (Panel of House Armed Services; 2003, p.41).

At the beginning of 2003, a new round of sexual assault allegations surfaced in the press. Also, a survey conducted by Inspector General of the Department of Defense reported that nearly 12 percent of the women who graduated from the USAFA this year were the victims of rape or attempted rape in their four years at the academy with the vast majority never reporting the incidents to the authorities. Just last week, embarrassment arose again when a senior cadet was charged with using his computer and the academy's network to arrange group sex (Graham, 2003). Things didn't appear to be getting better.

THE UNITED STATES AIR FORCE ACADEMY

The United States Air Force Academy is located on an 18, 500 acre campus near Colorado Springs, Colorado, at the base of the Rampart Range at an elevation of 7, 163 feet. It is the youngest of the four service academies; the first class entered in July 1955. Since then, more than 35,000 cadets have graduated in 44 classes; approximately 51.2 percent of the graduates are still on active duty. Currently there are 4, 072 students enrolled with the following demographics: 84% male, 16% female, 1% American Indian, 4% Asian, 5% Black, 7% Hispanic, and 83% White. Cadets graduate with a bachelor of science degree in any one of 30 academic majors. The most popular majors are engineering (22%), biology (9%), operations research (9%), and political science (7%). Class size is intentionally small to maximize discussion and accountability; 78% of the classes have fewer than 20 students; 22% have between 20 and 50. There are 558 full-time faculty members which equates to a student/faculty ratio of 7:1. The academic experience is primarily conducted within Fairchild Hall's 250 classrooms, 45 science labs and 13 major lecture halls. The cadets are housed in two dormitories; Vandenberg Hall (1,325 rooms) and Sijan Hall (936 rooms). They are fed within the Mitchell Hall dining room which covers 1.7 acres; the staff serves the entire cadet wing at the same time -- in and out in only 25 minutes. (<http://www.usafa.af.mil/pa/factsheets/quickloo.htm>)

By every standard, this undergraduate only institution, is considered as "most selective" by higher education rating authorities. Twelve percent of all applicants are selected and 100% of those

selected attend. The average selectee had a 3.8 high school GPA and SAT scores of 625 verbal and 649 math. Fifty-six percent were from the top tenth of their high school class, 87% in top quarter, and 99% in top half. Despite the extremely rigorous first year, ninety-two percent of the freshman return for their sophomore year. The average cost to put one cadet through the four-year program is \$282,562; the education portion is valued at about \$123,000. (<http://www.usafa.af.mil/pa/factsheets/quickloo.htm>).

The academic experience is designed to produce officers who have the knowledge, character, and motivation essential to leadership. As such, the curriculum consists of four developmental areas: military, academic, physical and character. Each of these areas is designed to instill self-discipline and ethical accountability for one's actions. Further, the experience is offered in an environment of trust and respect, where all people can achieve high productivity, are committed to organizational goals, and can reach their full potential. (<http://www.usafa.af.mil/pa/factsheets/quickloo.htm>)

The Air Force has led the way in the integration of women into the Service Academies. Although integration was not mandated until 1976, in 1972 the Air Force was the sole Service to begin strategizing the integration of women. During the first year of integration, the Air Force Academy accepted women as 10% of its incoming class (compared to 6% at the Naval Academy and 8% at West Point) and those women graduated at a higher rate than their counterparts at the Naval Academy and West Point. (Panel of House Armed Services; 2003, p.69).

Vision and Mission

The vision of the Air Force Academy is to be "Recognized worldwide as the premier developer of aerospace officers...leaders with impeccable character and essential knowledge...prepared and motivated to lead our Air Force and nation." The mission is to "Inspire and develop outstanding young men and women to become Air Force officers with knowledge, character and discipline; motivated to lead the greatest aerospace-force in service to the nation." As one can see, character development is a critical part of both the Academy's vision and mission and as such, should have quantifiable and measurable objectives; none were evident. Character is defined by the Academy as "One's moral compass: the sum of those qualities of moral excellence which move a person to do the right thing despite pressures or temptations to the contrary." In addition to the emphasis on character, several core values are established to help link the organization's culture to its vision. These core values (i.e., integrity first, service before self and excellence in all we do) form the centerpiece of a cadet's ethical standards and good conduct and are tied to the military profession's unique demand for self-discipline, stamina, courage, and selfless service to the nation. (<http://www.usafa.af.mil/pa/factsheets/quickloo.htm>)

Organizational Structure

The Air Force Academy is commanded by a Superintendent (Lt. General, 3-star) who reports directly to both the Secretary of the Air Force (civilian) and the Air Force Chief of Staff (4-star). Six organizational commanders report directly to the Superintendent: the Commandant of Cadets (1-star), the Director of Athletics, the Dean of Faculty (1-star), the Air Base Wing Commander, the Prep School Commander, and the Director of Admissions. The focus of this investigation was primarily on the organizations headed by the Dean of Faculty and the Commandant of Cadets. The Dean of Faculty among other things is in charge of the Department of Behavioral Sciences and Leadership. The Cadet Counseling Center is part of this organization. (<http://www.usafa.af.mil/pa/factsheets/quickloo.htm>),

The Commandant of Cadets is in charge of the Cadet Wing. The Cadet Wing is structured similar to an active duty Air Force Wing. The Wing is broken out into four Groups, and each Group is further subdivided into nine squadrons. The First-Class cadets make up the Cadet Officer leadership, and Second-Class cadets fill the Cadet Non-Commissioned Officer leadership positions. Each Squadron is assigned an active duty officer, Air Officer Commanding ("AOC") and an active duty non-commissioned officer, Military Training leader ("MTL"), to mentor and assist the cadet leadership and entire squadron in its training and educational missions (Panel of House Armed Services; 2003, p.66). (Note: Over the last 5 years, approximately 20% of all AOCs and MTLs have been female and approximately 15.5% of the 155 cadet First-Class leadership positions have filled by women.)

Cadet Training

Only the best and brightest, the top 20% of their high school class, have a chance at admission; this is the most selective of the service academies. The male to female ratio is maintained at approximate 8-1 to reflect that of the active duty Air Force. Over the last decade athletes have been actively recruited; currently, recruited athletes represent 25% of the freshman class. Each cadet is on a government-paid scholarship following a congressional or presidential appointment, and each graduate is required to put in at least five additional years of military service. Interestingly, the Air Force Academy has the lowest alumni giving rate, 18% versus 42% and 30% at the other academies. A significant organizational aspect of any military academy, which differentiates it from the purely academic focus of a civilian university, is its military training component. The cadets are held to a higher moral standard than most college students ("The Best", 2003).

Training begins with Basic Cadet Training ("BCT"), conducted under the umbrella of a training structure known as the "Fourth-Class System." Freshmen are known as Cadets Fourth-Class. The rest of the cadets are considered upperclassmen and are divided by class as well.

Sophomores are referred to as Cadets Third-Class, juniors are Cadets Second-Class and seniors are Cadets First-Class. The purpose of the Fourth-Class System is to place new cadets into an environment in which their intellect and resources are tested under continuous stress to learn how to perform with competing demands. In general, the military conditions people to use force to accomplish objectives. The training at the academies focuses on the use of control and power in command -- some take it too far. Further, the panel recognized that any system in which people are placed in a position of power over others has the potential for abuse. The cadet authority structure establishes a disparity of power that may make subordinate cadets, particularly female Fourth-Class cadets, more vulnerable to upper class male cadets who might abuse their authority. (Panel of House Armed Services; 2003, p.68). According to a 1998 graduate, a typical example of this type of abuse was when upperclassmen order pajama-clad female cadets to do push-ups in bed so they could glimpse their breasts. Now in basic training, freshmen women are told "you're not required to go to an upperclassman's room alone or walk out in the woods with an upperclassman in the middle of the night." In addition, females in basic training are currently given various forms of prevention and awareness training to prevent sexual assaults. However, even given these interventions, 53 percent of the sexual assaults victims were first-year students. (Graham, 2003)

The potential for abuse of power at the Academy exists due to many factors, including close living conditions, the Academy and the cadet area's remote location from the rest of the base population and facilities, the controlled and disciplined environment in which all cadets (especially Fourth-Class cadets) are expected to live, the supervisory role upperclassmen have over Fourth-Class cadets, and the mission of transitioning cadets from civilian life to a military environment that emphasizes teamwork but is based upon rank structure. Freshmen are openly called "doolies," derived from the Greek word for slave. A "firstie," as a senior is known, is defined on a website run by cadet parents as "the immortal, having superhuman powers and disposed to acts of great wonder and cunning" ("Roots of sexual", 2003).

In late 1992, the GAO reviewed all the Service Academies' Fourth-Class Systems and their relationship to one form of abuse of power: hazing. It found that internal investigations and major overhauls of the Fourth-Class System at West Point in 1990 and the Plebe System at the Naval Academy from 1990-1992 resulted in a significant drop in hazing. The Air Force Academy did not conduct similar internal reviews of hazing cases and therefore failed to see any decrease in hazing complaints. (Panel of House Armed Services; 2003, p.80).

Another common criticism of the Fourth-Class System is that the nature of BCT tends to instill or foster an ethic that promotes loyalty to peers above loyalty to values. This contributes to a tolerance of behaviors that can lead to sexual assault and in some instances a failure to report sexual assault. Beginning at BCT, cadets are placed in situations which tend to unify them in an effort to accomplish a particular goal or mission or to survive a shared experience. Over time, and perhaps not even as a conscious decision, cadets grow to rely on and trust each other above all else. Violations of that trust have severe consequences. (Panel of House Armed Services; 2003, p.81).

Moreover, for some cadets, the fear of retribution, reprimands and shunning prevents reporting of abuses. In the past, when Fourth-Class cadets arrived at the Academy, they were immediately indoctrinated into a harsh discipline system that involved constant yelling. This type of discipline continued throughout BCT and most of the Fourth-Class year until recognition in the spring. While at BCT, cadets were challenged physically, emotionally and mentally in an effort that some believe is intended to "break their spirit" and help them "adjust" to the military. The Fourth-Class System is actually intended to eliminate factors such as economic status, background and race and gender issues while teaching the value of teamwork, dedication to the mission and putting the unit above oneself. However, a consequence of such treatment is often a lowered self-esteem and a sense that to survive the environment one must wholly rely on one's peers to help make it through this shared experience. During BCT, one first-year cadet said that an upper classman offered to store her contraband: CDs, radio, and DVDs which are not permitted for freshman. The male cadet then threatened to expose the arrangement to coerce sexual acts. (Note: That kind of scenario, however, has prompted the Academy to now grant amnesty from minor infractions when allegations of sexual assault are involved.) Another female cadet told investigators, "I feel sexually harassed daily and feel I have no where to go and no one to tell. I get poor military grades from officers and cadets due to my gender. It makes me sick what I have to go through every day, and I think about quitting all the time." Female cadets left the school at higher rates during their early years. In the class of 1981 (the second class with females), for example, 58 percent of female cadets left the academy, compared with 40 percent of the men. While the gap is closing, a double-digit gap still exists. (Panel of House Armed Services; 2003, p. 81).

ORGANIZATIONAL CULTURE

Organizational culture is generally defined as the values, beliefs, expectations, norms, symbols, myths, rituals and heroes that influence behavior (Schein, 1985). A strong culture (i.e., one in which the majority of members have the same beliefs) is highly resistant to change. Our interviews indicated that the Academy has an extremely strong culture and one whose very fiber celebrates excessive machismo and a male dominated power structure. This attitude and structure places young women under the unquestioned authority of male upperclassmen and emphasizes teamwork and loyalty over the safety and well-being of its most vulnerable charges. Outside experts say a culture like the Academy's - where males dominate and the youngest women have little or no power - commonly fosters female harassment and opens the door to sexual assault and rape. "Harassment denigrates women and contributes to a 'lesser than' mentality. Under this type of environment, it's easier to violate them, hurt them or cheat them in some way," said Nelson, an Ohio psychotherapist who wrote the book "For Love of Country: Confronting Rape and Sexual Harassment in the Military." Firestone, a University of Texas sociologist, concurs that the really

bad stuff, like assault and rape, almost never happens if the environment is free of harassment ("Roots of sexual", 2003). Similarly, a University of Iowa study noted that rape, sexual harassment and discrimination are related to negative attitudes toward women. These negative attitudes contribute to a climate of acceptance, i.e. that it is OK to do these kinds of things.

Climate Survey

Social Climate Surveys are a standard tool used by commanders across the Services to keep informed about sensitive issues and the attitudes of service members. In turn, these surveys should be used to generate corrective actions. The Academy conducted climate surveys on such issues as adherence to the Honor Code, alcohol use, fraternization and discrimination. In 1996, the surveys began to include questions on sexual assault. There was no evidence that any of the survey years had generated corrective actions. (Panel of House Armed Services; 2003, p.66).

In order to determine the actual cultural climate for women at the Academy (e.g., negative attitudes, incidents of harassment), we requested the Social Climate Surveys from 1976 through 2003. Unfortunately, the Academy was unable provide us with information on climate surveys prior to 1998. Further, they indicated that they did not perform a climate survey in 1999 and that the surveys performed in 1998, 2000, 2001 and 2002 were statistically invalid. Yet, interestingly, the Academy officials failed to provide an acceptable explanation of why they repeatedly administered invalid surveys with no apparent efforts to develop a valid survey tool. Even given unrepresentative findings, cadet responses and written comments should have alerted leadership that improved questionnaires would provide valuable insights, and that certain issues were worthy of immediate investigation. For example, the 2003 survey of 579 female cadets found that nearly 70 percent said they had been the victims of sexual harassment, of which 22 percent said they experienced "pressure for sexual favors. Nineteen percent said they had been the victims of sexual assault and more than 7 percents said that assault took the form of rape or attempted rape. Four out of five of these women never came forward to report that they had been assaulted." The 2001 survey showed that 47% of the female cadets said they had been sexually harassed by other cadets, 63% reported derogatory comments and 66% felt they had been discriminated against by other cadets on the basis of gender. (Panel of House Armed Services; 2003, p.66).

An earlier survey indicated that 42 percent of the female cadets said they had been subjected at least once in the past year to "physical, gender-related behavior that interfered with their performance or created a hostile environment, or unwelcome, deliberate physical conduct of a sexual nature. Additionally, forty percent indicated that they would hesitate to report sexual harassment for fear of reprisal (Schmitt, 1995). Additionally survey statements such as the following should have been cause for concern:

"Though I have not been subject to sexual assault, two of my friends have been during the spring semester. Both were raped by other cadets, and neither disclosed this information. I think this serves as testimony to the unstable social climate at USAFA, a fact not everyone seems conscious of."

"It was typical for a female (freshman) cadet to wake up in the middle of the night, and have a male cadet with his hands in the wrong places."

"Fourth Class male cadets are rewarded by upperclassmen for audacious female harassment or lewdness."

"It is tough having to constantly put with up an attitude that sexual harassment is funny. For example, on several occasions I've had to take down Playboy centerfold hanging in the dormitory with my roommate's face pasted onto the picture".

"Male upperclassmen often tell male "Fourth Class" cadets to disregard orders from female upper class cadets."

"We heard about assaults...people getting into trouble, but it is taboo to bring it up."

"At times the three of us (roommates), all of who are physically strong and not inclined toward fearfulness, slept in our room with the light on and chairs stacked in front of the door."

"Retaliation is unavoidable for anyone reporting any offense to a higher level. Sexual harassment and improprieties were common and retaliation for reporting them is particularly severe and persistent."

"It happened to me and I am afraid it will happen again."

"My chain of command told me that I was the one that had the problem, and if I was uncomfortable with the situation, I should leave because I would not make a good officer."

"The campus climate considers women to be weak."

"If you make it through all four years without being sexually assaulted, you're lucky. If you want to have an Air Force career, you should not report it."

Further, our interviews with female cadets indicated a high degree of fear on many levels. Fear of being punished by command; fear of having their friends punished by command; fear of being harassed or ostracized by other cadets; fear of having to remain in contact with the perpetrator; fear that they will not be believed or supported; and fear of the impact on their reputation or status at the Academy or on their Air Force career. Further, it wasn't just sexual-assault victims who had such fears. Other cadets, chaplains and officers also said that cadets fear the consequences if they report an assault. Because these problems remained unaddressed from year to year, it is not surprising that some cadets doubted whether their responses could make a difference.

While some female cadets indicated an improving environment within the last six months, male cadets have grumbled that the Academy is getting too touchy-feely and risks drifting from its main mission. "It seems they're teaching all these women's issues when they should be focusing on issues for everyone." Additionally, some female cadets expressed concern that increased attention on female safety and harassment was suffocating and hurting the concept of a truly integrated training experience and ultimately an integrated Air Force. "Frankly, the men blame us for all the changes. As a result, explicit sexual harassment seems to be evolving to more of a gender harassment." (Schmitt, 1994).

Character Development

The American public expects military officers to perform their duties in our nation's defense while maintaining the highest standards of integrity. This public obligation is instilled at the Academy from the very beginning of a cadet's career through many avenues, the foremost being the Honor Code. The Honor Code is meant to represent the "minimum standard" of conduct for cadets. This minimum standard is often referred to as the "letter of the code" and is the foundation upon which each cadet builds a personal concept of professional ethics and character. The current Dean of Faculty quickly acknowledges that "Some [cadets], because of the way they grew up or where they grew up, don't have a moral compass. If they don't have it coming in here, no amount of shaping or reinforcing will give it to them. The academy's job is to weed them out." ("Roots of sexual", 2003)

Clearly, sexual assault in the environment of the Academy represents a failure of character, and that sexual assault is a character-related problem. The development of character - personal integrity - is a fundamental mission of the Academy. The cornerstone of the Academy's culture is two-fold: (1) the Honor Code; and (2) the Air Force's Core Values." The Honor Code mandates that cadets "will not lie, steal, or cheat, nor tolerate among them anyone who does." "The Air Force Core Values require Integrity First, Service Before Self, and Excellence in All We Do." The cadet environment and organizational culture at the Academy revolve around these pillars; however, by their actions, perpetrators of sexual assaults do not hold these same ideals. Because character deficiencies are a key aspect in the deterrence of sexual assault, it appears that deficiencies in either

the Honor Code System or in the character development programs may contribute to or foster the occurrence of sexual assault at the Academy (<http://www.usafa.af.mil/pa/factsheets/quickloo.htm>)

Academy officials have often battled widespread cadet indifference to the code; particularly the notion that cadets should turn in fellow cadets for breaches to the code. According to interviews and records, cadets wouldn't turn in their classmates because they feared physical retribution, were reluctant to punish friends, and didn't want their own transgressions revealed in return. Further, cadets often suggest that sexual harassment and assault are not literally part of the code and as such, doesn't require one to turn in offenders. The current Commandant, however, is quick to clarify that cadets are clearly accountable to the UCMJ and that the Honor Code is a minimum standard. Failure to meet this minimum standard should result in expulsion ("Roots of sexual", 2003).

The Center for Character Development's present mission is to facilitate character development programs and activities throughout all aspects of the Academy experience. The CCD's objective is to graduate officers with forthright integrity and who voluntarily decide the right thing to do and do it. In furtherance of its missions, the CCD is divided into four divisions: Honor, Human Relations, Character and Leadership Development and Excellence. The Honor Division provides Honor Code education instruction equivalent to one academic course throughout the cadets' four years at the Academy. In the first two years, this instruction focuses on understanding and living under the Code. In the final two years, it focuses on helping others live under the Code. The Code is the foundation upon which a cadet builds a personal concept of professional ethics and a minimum standard of integrity, and demands complete integrity in word and deed. The Human Relations Division focuses on programs that encourage respect for human dignity, and is designed to develop officers equally valuing individuals of different races, national origins, religions, gender and cultural backgrounds. The programs involve classroom instruction and activity-based exercises for Third- and Fourth-Class cadets, an experimental on-site program for Second-Class cadets, and participation in a Character Capstone program for graduating First-Class cadets. (Panel of House Armed Services; 2003, p.77).

The Character and Leadership Division organizes symposiums, operates an adventure-based learning program to encourage character development and conducts seminars, including various Academy Character Enrichment Seminars ("ACES"), which provide an opportunity for members of the Academy community to consider their role in creating the best possible environment for cadets. (Panel of House Armed Services; 2003, p.77).

The Excellence Division provided cadets opportunities for practical application of their character and leadership education through various programs. The National Character and Leadership Symposium brings together distinguished scholars, armed forces leaders, corporate presidents and others to explore various dimensions of character and leadership. During the 2002-2003 academic year, 48 speakers attended. Furthermore The Falcon Heritage Forum, held twice a year, creates opportunities for cadets to interact on a personal level with highly distinguished military veterans, including representatives from each branch of military service, numerous Medal

of Honor recipients, Tuskegee Airmen and many former prisoners of war. While the CCD offers several programs related to character development, none is a prerequisite for graduation or commissioning. (Panel of House Armed Services; 2003, p.78).

In May 2000, the Character Development Review Panel's assessment of the character development program indicated that there weren't any methodologies for assessing results. The report suggested that the Academy consider several indicators to assess the strength of character of the Cadet Wing, to include indicators of loyalty to individuals over loyalty to unit, acts of reprisal, and poll data reflecting fear of reprisal and sexual misconduct, especially involving abuse of authority. There was no evidence to indicate that actions had been taken to consider the panel's recommendations. (Panel of House Armed Services; 2003, p.37).

Masculine Culture

Clearly the Academy's cocky flyboy culture is structured to reinforce the characteristics of masculinity. Unfortunately, this has the potential to create a gender bias against anything feminine. As such, feminine characteristics are viewed with a negative attitude. As recently as the 2002 Social Climate Survey, one in five male cadets believed that women do not belong at the Academy. These statistics are particularly striking when one considers that the first women graduated from the Academy 23 years ago in 1980. Additionally, in this survey, some male cadets took the time to respond with specific written derogatory comments regarding the presence of women at the Academy including "even with women in the Armed Forces, they should not be at the military academies," and "women are worthless and should be taken away from the Air Force Academy". Similarly, our interviews noted the popular male attitude that women are not wanted at the Academy, because they will potentially be taking up cockpit space that belongs to men (Roots of sexual, 2003).

We also received reports that members of the graduating class of 1979 routinely attend Academy functions, including athletic events, and display license plates, caps, and t-shirts with the logo "LCWB." The logo supposedly stands for "Last Class With Balls" or "Last Class Without Bitches (or Broads). Officially the men state that the letters came from the four honorable words - loyalty, courage, wisdom and bravery." While some may find this public display of animosity toward the presence of women at the Academy humorous, it contributes to an environment in which female cadets are made to feel unwelcome. In the same vein, the cadets, faculty and staff had repeatedly voted to maintain the sign, "Bring Me Men" over the ramp that leads to the main quad on campus. Only after this year's embarrassing press coverage on the Academy's gender bias was the sign finally brought down (Roots of sexual", 2003).

A major contributor to tensions between male and female cadets is the tendency to value physical prowess above all else, and to look down on students who can't perform at the highest level. Women cadets, despite being in the top one percent of the female population physically, are often

weaker than their male colleagues and thus often the subject of scorn. Young men typically goad their female classmates, telling them they were too slow or too weak to be warriors. Typically, the young women grit their teeth and take it, determined to show they would make it no matter what.

Females are clearly the subject of abuse and often treated as objects. For example, females were referred to as "wall bang" and "jail bait", were asked when they last shaved their legs or masturbated, and were criticized if their bra straps were visible through their uniforms. Female cadets who gained weight were given the "Colorado Hip Disease" award. Sometimes the abuse was disguised as a game. For example, one male cadet described a game called "midget tossing". Cadets pick the smallest in their group of females and throw her down a mattress-covered hallway. The group making the farthest pitch is declared the winner ("Roots of sexual", 2003)

Security

The fact that over half the investigated allegations of sexual assault occurred in the dormitories has prompted officials to investigate the supervision of cadets in the dormitories, alcohol consumption and policies, and rules on emergency access to telephone. Prior to this year, the dormitories were effectively unsupervised from 30 minutes past Taps (10:30 p.m. weekdays, 12:00 a.m. on training weekends, and 1:30 a.m. on non-training weekends) until 6:00 a.m. The AOC and MTL offices are located in the dorms, but the staff would normally depart in the early evening during the week and by mid-afternoon on training weekends. (Panel of House Armed Services; 2003, p.71)

This year, the "Agenda for Change" called for clustering of women in dormitory rooms near the women's bathrooms. Some cadets, however, indicate they are starting to feel a little isolated from their male colleagues because of the physical separation. One cadet leader finds it harder to stay in touch with the eight men whom she oversees; instead of running into them in the halls and chatting causally, she now communicates more by e-mail and has fewer personal encounters. (Graham, 2003) (add the knock on door quote)

At least 50% of investigated cadet-on-cadet sexual assault allegations involved the use of alcohol by the cadet suspect, the cadet victim, or both. This year the Academy mandated that the use of alcohol would result in immediate disenrollment of cadets using or providing alcohol to an underage cadet (Panel of House Armed Services; 2003, p.72).

Further, some female cadets expressed concern to us that gaining access to phones to register a complaint, call the hotline, or seek help for a sexual assault would be difficult or near impossible. They stated there are a limited number of phones, and expressed concern about the locations of the phones and the requirement that Fourth-Class cadets get permission to use them. Third-Class cadets may purchase and carry cellular phones for personal use. (Panel of House Armed Services; 2003, p.73).

In the recently released findings of the DoD IG's survey of female cadets conducted in May 2003, an overwhelming majority (over 90%) indicated that they feel "very safe" or "safe" in every location at the Academy, except when "alone on the Academy grounds during hours of darkness." However, some legislators appear unconvinced that these steps by the Air Force leadership will have any meaningful effect. Representative Dian DeGette, Democrat of Colorado, called them "window dressing." Noting that one proposal requires cadets to knock before entering another cadet's dorm room, she said, "If someone's hellbent on raping a female cadet, they're not going to knock first." Representative Heather A. Wilson, Republican of New Mexico, questioned plans to cluster female cadets in dormitories around the women's bathrooms. "This is not about segregating women from men," said Representative Wilson, who graduated in the very first class of women cadets at the academy in 1980. "It's about segregating rapists from the academy." (Schemo, 2003b)

LEADERSHIP

In June 2003, Air Force General Counsel Mary L. Walker released The Report of the Working Group Concerning Deterrence of and Response to Incidents of Sexual Assault at the U.S. Air Force Academy ("Working Group Report"). The Working Group concluded that there was "no systemic acceptance of sexual assault at the Academy or institutional avoidance of responsibility." Further, another team of investigators focusing on the 43 assault allegations involving cadet victims and suspects from 1993 to 2002, concluded that Academy leaders correctly handled all but one. Senator Wayne Allard, Republican of Colorado empathetically disagreed with both these findings. "Clearly, given the history involved and the lack of attention paid in the past, an external review [to the USAF] is necessary to examine the internal and external supervision of the Academy [i.e., the Academy's command structure and external supervision, such as the Air Force Secretary, Air Force Chief of Staff and Air Force Inspector General]."

Command Supervision of the Academy

During the last decade, attention to the Academy's sexual assault problems ebbed and flowed depending on the interest of the leadership. It appears that the transitory nature of Academy leadership assignments may have disrupted institutional knowledge and the ability to anticipate and find long-term solutions for complex problems like sexual misconduct. For example, over the past twenty years, Superintendents have served for an average of three years, and Commandants of Cadets typically have served for 18-24 months. (Panel of House Armed Services; 2003, p.54).

One might say that Academy leadership first recognized that they had a sexual misconduct problem with the 18 allegations reported in 1993. General Hosmer, then-Superintendent, attempted to improve the Academy environment by making changes to the Academy's sexual assault response program, including establishing an informal policy of confidential reporting. Further, he

commissioned the Academy's Center for Character Development to improve the overall character of the cadet population through educational and training programs. He also created a sexual assault hotline operated outside the chain of command that offered counseling to victims of sexual assault with the assurance of confidentiality. Another change was the institution of a victim amnesty program to encourage the reporting of sexual assaults. Under the amnesty policy, the chain of command could forego punishment of victim misconduct in order to encourage the reporting of sexual assault (Panel of House Armed Services; 2003, p.26).

Beginning in 1995, the next Superintendent established a Social Climate Process Action Team (PAT) comprised of cadets, faculty and staff, to study sexual assault issues at the Academy. The PAT concluded that "most cadet sexual assaults are not reported," that "the institution is unaware of the extent of the problem and cannot plan how best to respond," and "that a major impediment to the reporting assault was a lack of trust in the system." Several changes were implemented throughout the year, including establishment of the Sexual Assault Services Branch within the Cadet Counseling and Leadership Development Center and establishment of the Sexual Assault service Committee (SASC). The committee's purpose was to integrate the various sexual assault services at the Academy, facilitate the exchange of information among its participants and permit discussion of sexual assault cases and issues. (Panel of House Armed Services; 2003, p.50).

Despite these efforts to resolve the sexual misconduct problems, the victims consistently characterized the Academy's leadership as unbelieving, unsympathetic and unresponsive. For example, some victims were called liars, made to feel that voicing allegations would tarnish the reputation of the Academy, and generally told to keep their mouth shut. One former cadet told KMGH-TV of Denver that she had left the academy after commanders responded to her rape complaint by charging her with violating rules against drinking, fraternizing with upperclassmen and having sex in the dormitories. Similarly, several female cadets said they were aghast, that after summoning the courage to make formal reports, they were given swift punishment for breaking rules against socializing with upperclassmen and for minor infractions while their assailants went about their lives as usual. Routinely victims were placed in a restricted status (e.g., loss of privileges) until an investigation of the allegation was complete. While the leadership claimed this was not punishment, it was certainly perceived as such by the cadets. Further, leadership often suggested that incidents of sexual misconduct were the result of a few "bad apples". Also, it was suggested that the occasional abuse of power is a normal risk to the operation of training officers. In other words, some senior cadets may give inappropriate orders and set inappropriate goals for those under their command but that's a suitable risk. ("Pentagon panel", 2003)

Statements by two of the top leaders in 2003 at the Academy seem to validate the students' perceptions. For example, the Academy Commandant defended the school's conduct in a written response to questions about one reported assault, in which a cadet said she had been raped after a night of drinking and a strip poker game. After a hearing, the Academy decided not to press charges against the man she named as her attacker. Further, the Commandant specifically criticized her

conduct and not the attacker. He said there was "no justification" for the reported assault and added: "When you put yourself in situations with increased risk, you have to take increased precautions to mitigate those risks. For example, if I walk down a dark alley with hundred-dollar bills hanging out of my pockets, it doesn't justify my being attacked or robbed, but I certainly increased the risk by doing what I did" ("Pentagon panel", 2003).

Another example came from the Colonel in charge of cadet conduct and discipline. She said that she had never seen a case of "true rape" among cadets, by which she meant a "true violent assault." Rather, she said, the problem was rampant alcohol use and a permissive environment, which led women who had consented to sex to later cry rape. Further she said that she was unaware of the Air Force's definition of rape and seemed to hold the attitude that cadets claimed sexual assault only to receive amnesty from other violations (e.g., drinking, fraternization). Essentially, she created an environment where the perception of fear, punishment and reprisal became an accepted reality. Further, her treatment of some victims had a negative impact on the willingness of cadets to report any incidents of sexual misconduct (Schemo, 2003a).

The current Secretary of the Air Force, Mr. Roche, readily acknowledges that the amnesty concept has in fact been selectively applied. He admits that in the vast majority of cases that did not lead to formal prosecution, investigators subsequently charged the cadets making the accusations with the very infractions they had promised to overlook. The practice contributes to the sense that it was more dangerous, for the victim and friends who might have been present when assaults occurred, to report rape than to remain silent. Further, he stated the Academy misstated the legal definition of sexual assault, raising "unrealistic expectations of prosecution in the minds of victims" (Senate Armed Services Committee, 2003).

External Oversight -- Board of Visitors

The Board of Visitors, like a corporation's Board of Directors or a University's Board of Trustees, was established to provide oversight of the Academy's leadership. The Board is required under its charter to visit the Academy annually and to inquire into the morale, discipline, curriculum, instruction, physical equipment, fiscal affairs, academic methods, and other matters relating to the Academy which the Board decides to consider. The Board is comprised of 15 members. The President of the United States appoints six members. The other nine board members are from either the US Senate or House of Representatives. The Vice President of the United States or the President pro tempore of the Senate designates three members, two of whom are members of the Senate Appropriations Committee. The Speaker of the House of Representatives designates four members, two of whom are members of the House Appropriations Committee. The Chairman of the Senate Armed Services Committee or its designee, and the Chairman of the House Arms Services Committee or its designee fill the last two positions. (Panel of House Armed Services; 2003, p.45).

Despite its wealth of senior leadership and experience, the Board of Visitors was minimally involved in monitoring any actions at the Academy. Typically, members were provided only a "good news" slide show stating the institution's accomplishments, met with only one or two handpicked cadets and were taken on a tour of the Academy. Further, meetings of the Academy's Board of Visitors were not well attended by its members. Some Board members have apparently not attended any meetings, while other were credited with attending the entirety of multi-day meetings at which they were present for only a few hours or less. Attempts to hold meetings in Washington, D.C. to accommodate the schedules of Congressional members, including scheduling meetings in August during the Congressional recess, had not substantively improved attendance. Less than one-half of the Congressional members typically attend, while two-thirds of the civilian members attend. In 2001, the Board of Visitors had no formal meeting. In short, the Board either did not know about sexual misconduct at the Academy or unquestioningly accepted the Academy's assurances that matters were under control. Also, the Academy found it difficult to get the Board to approve agendas for and reports of its meetings, even though the Academy would prepare proposed drafts for the Board's input, approval and criticisms. The academy has also had problems in getting the Board to address issues deemed substantive or important by the Academy, and has found that the meetings often tended to be little more than social gatherings. (Panel of House Armed Services; 2003, p.45).

Headquarter USAF

Understandably the Air Force Chief of Staff and the Air Force Secretary have a host of priorities, but it appears there was little effort to investigate, resolve and monitor follow-up corrective action prior to 2001. For example, although the Air Force IG regularly conducts compliance investigations of the Major Air Force Commands every three years, it did not conduct any inspections of the Academy during the last ten years other than in response to individual complaints. Further, there is no evidence that actions were taken to resolve the past findings of GAO and DoD IG inspections on sexual misconduct.

In August 2001, the new Commandant of Cadets was given his marching orders by the Air Force Chief of Staff, to fix the discipline and standards at the Academy. In response, he took a number of actions to instill accountability, enforce existing standards regarding wear and appearance of uniforms and improve the physical condition of the cadet area. But he was told by senior Academy members that while the Academy previously had problems with sexual assaults it had implemented the Cadets Advocating Sexual Integrity and Education ("CASIE") program in response. The CASIE program was considered a model sexual assault response program by other schools and Service Academies. (Panel of House Armed Services; 2003, p.40).

In March 2003, shortly after the interim Working Group Report, Mr. Roche raised the possibility that earlier administrations at the academy could also be held responsible for failing to

address hostility toward women cadets. He vowed that if Defense Department investigations show that "credible information came to their attention that they should have acted upon, or that they failed to follow due process, they will be held accountable." Mr. Roche also asked: "Was there information available to recent leadership that should have raised their awareness of climate problems? Did any administration put in place additional barriers that prevented victims from coming forward?" This reversal came less than a week after the Secretary of the Air Force and the Chief of Staff made statements that appeared to exonerate the Academy's leadership even before the Air Force General Counsel's investigation was complete. (Note: their preemptory exoneration had prompted considerable Congressional ire). Further, the Air Force Secretary publicly acknowledged for the first time that a longstanding policy guaranteeing amnesty to victims of rape who come forward had in many cases been ignored. (Schemo, 2003c)

On August 14, 2003, Secretary Roche directed the Assistant Secretary of the Air Force for Manpower and Reserve Affairs (SAF/MR) to prepare and implement other oversight processes. Specifically, he directed the Assistant Secretary to work with and oversee the Academy superintendent to ensure effective implementation of the 65 recommendations of the Working Group and the Agenda for Change and any agreed to recommendations of our panel. Further, he directed the establishment of "permanent processes (e.g. oversight, support and assessment) to insure that the Secretary and Chief of Staff of the Air Force are frequently, regularly and adequately informed of significant matters relating to sexual assault and sexual harassment at the Academy".

The Assistant Secretary is considering other initiatives to provide continual oversight of the Academy, including the following: The Air Force Chief of Staff's annual climate survey shall now include the Academy; the Air force IG shall conduct regular compliance inspections of the Academy at least every three years; the Air Force Auditor General shall conduct regular audits of the Academy; the function of liaison with the Board of Visitors shall be moved from the Academy to the Air Force Secretariat; and there shall be additional emphasis on Academy issues at all CORONAs, especially the Fall CORONA held at the Academy. (Note: CORONA meetings are attended by the Secretary and Chief of Staff of the Air Force, all Assistant Secretaries, the General Counsel, all four-star Air Force generals, and the Superintendent of the Academy.) In addition, the Air Force is directing the development of a permanent performance management system (with specific goals) for the Academy. (Panel of House Armed Services; 2003, p.56).

Congress

As part of Congress' oversight of the Executive branch, the House and Senate Armed Services Committees are responsible for oversight of activities at the service academies. In the past, these committees demonstrated little follow through of discrepancies noted in inspection reports from the GAO, DoD Inspector General, and AF Inspector General. For example, in 1994, the GAO conducted an investigation into whether Department of Defense military academies were complying

with the Department's requirement for sexual harassment eradication programs (Report #NSIAD 94-6). The GAO found that between half to about three quarters of academy women experienced various forms of harassment at least twice a month. In 1995, the GAO issued a follow-up report that indicated things had not improved. It is particularly significant that these reports were early signals of problems and the need for and monitoring of consistent and aggressive corrective action. In short, it appears that until Sen. Wayne Allard's 2003 comment, "Enough is enough - it's time to take action", Congress failed to demand a comprehensive investigation of alleged misconduct at the Air Force Academy despite a decade of constituent reports (McAllister, 2003).

It should be noted, however, that Congress is moving quickly to make up for a decade of neglect. The 'proposed' National Defense Authorization Act for Fiscal Year 2004 contains several provisions to address sexual misconduct at the Service Academies. The legislation requires an annual assessment of each Academy's policies, training and procedures to prevent sexual misconduct and an annual report on sexual misconduct. The legislation requires transmission of the annual report to the Secretary of Defense, the Board of Visitors and the Committees on Armed Services (Panel of House Armed Services; 2003, p.62).

REPORTING AND RESPONSE

Statistics indicate that a lot of sexual assault cases go unreported. It's natural for any female victim to hesitate because of embarrassment, self-doubt or even false guilt, human relations. Perhaps not reporting incidents is even more likely at the Academy because of additional pressure. Reporting is seen as betrayal of the unit. Almost 50 percent of the women indicated that they feared reprisals (e.g., ostracism by some members of their squadron, thereby making life at the academy very uncomfortable). Further, they see what happens when their peers report sexual assault. They fear that they're going to lose their career, be thrown out of the academy, and receive never ending harassment. Also, when women or men leave the academy early before their commitment is over they are sometimes forced or liable to pay for the tuition that they have incurred. Cooper, 2003)

Reporting

In late 1996, the Academy realigned the Cadet Counseling Center and placed it under the Dean of Faculty to separate the counseling services from the disciplinary process [under the Commandant of Cadets]. Also, the Academy's Social Climate Surveys for the first time included questions on sexual assault. Additionally, a 24-hour rape hot line was set up in 1996. Since then, there were at least 99 calls reporting some form of sexual assault, from inappropriate touching to rape. However, most female cadets reportedly were afraid to use it because it's staffed by fellow cadets. One cadet shared, "I kept it all inside because the first thing you learn is to keep your mouth shut and not make waves. Reporting to the hot line could be like broadcasting it over the campus"

("Pentagon panel", 2003). Additionally, the Academy requested and was granted the Headquarters USAF approval to waive the requirement for Academy medical personnel to report sexual assault incidents to command and AFOSI. The Academy believed the waiver would encourage the reporting of sexual assaults by respecting victim privacy, confidentiality and desires. Unfortunately, this waiver would have an unintended effect on the investigation and prosecution of cases. In addition, General Nardotti, Commander of AFOSI, suggested that the anonymous hot line left the authorities with no means to investigate allegations of assault, and wondered if the former Superintendent, had anticipated that he was "creating a systemic problem." (Schemo, 2003b).

In June 2003, the Working Group Report acknowledged that the USAFA has a less than optimal environment for responding to allegations of sexual assault against female cadets because of inadequate reporting procedures, inattentive commanders and a lingering resistance to women at a formally all male institution. Further, the report faulted a system of reporting allegations of abuse that shielded the confidentiality of victims from commanders at the school and largely left to the victim the decision whether to prosecute. Consequently, there was often very little information to act upon in dealing with assailants. The AFOSI noted that delays in cadet decisions to provide information can significantly impair the ability to obtain the evidence necessary to a successful prosecution. Additionally, this has the result of impairing the academy leadership's ability to assure justice and to prevent commission of cadets who are not fit for military service. In May, confidentiality was abolished thereby bringing the system in line with that of the regular Air Force, which requires reports go to commanders and investigators (Pam Zubeck, 2003).

Our interviews with the victims, however, raises concern over the policy outlined in the "Agenda for Change" that eliminates any form of confidential reporting of sexual assaults. Stripping away all confidentiality takes the Academy backwards to 1995 when the lack of confidentiality resulted in underground support groups and unreported crimes. It seems that a balance must be maintained between the support and treatment of victims and the prosecution of assailants. Confidentiality is the fulcrum on which that balance can exist and it must remain an option for all victims of sexual assault at the Academy. Further, the "Agenda for Change" overlooks an established form of privileged communication that is currently available throughout the Armed Forces and could benefit cadet victims: the psychotherapist-patient privilege. This method of confidentiality has been available to the Academy since the psychotherapist-patient relationship was recognized in 1999 by Presidential Executive Order, and implemented in Military Rule of Evidence 515. It is in use by both West Point and Annapolis (Panel of House Armed Services; 2003, p.88).

Additionally, the Working Group concluded that the sexual assault prevention and awareness training was ineffective for the following reasons: (1) The definition of sexual assault used in Academy Instruction 51-201 was confusing, not in compliance with the law associated with sexual assaults and inconsistent with the definition used throughout the Air Force; (2) The Fourth-Class cadets who received the training during BCT were too tired to process the information. The training was conducted at 7:00-9:30 p.m. following twelve hours of in-processing; (3) The self-defense

training given to Fourth-Class women often occurred too late in the semester to be effective; and (4) The training had little focus on the moral, leadership or character component of deterrence. Also, the investigation also found that while the Academy's leadership was engaged in sexual assault issues in the early 1990s when it launched a program to deter it, attention gradually waned. That, along with other factors, produced an environment less attentive to victim concerns and factors in Academy life affecting sexual assaults, and which was less capable of a coordinated response to individual cases than in earlier years (Panel of House Armed Services; 2003, p.83).

Response

Each academy has largely refrained from pressing criminal charges against cadets accused of rape, allowing them to resign rather than face court-martial. In the 27 years since West Point first admitted women, one cadet has faced court-martial for rape; he was acquitted. By comparison, an Air Force Academy official said, "142 sexual assaults were reported since 1993, 56 were investigated and only two cadets have been charged with rape. One was acquitted and the other pleaded guilty at a court-martial and was sentenced to seven months in jail." In eight other cases, the Air Force Secretary has allowed the cadets to resign rather than face court-marshals. Sadly, repeated offenses are not uncommon; four of the alleged assailants were accused of attacking more than one woman. ("USA: Women cadet", 2003) Further, it is noted that sixteen Air Force Academy graduates accused of rape or sexual assault while attending the academy are still on active duty as officers in the United States military ("Accused academy", 2003).

Unfortunately, despite all the press coverage, investigation and intervention activities, sexual misconduct continues. Between April and August 2003, the academy's sexual-assault response team was activated 12 times for reports of four alleged rapes, six alleged sexual assaults, one case of inappropriate sexual contact and one case of sexual harassment (Emery, 2003). Clearly, the Academy continues to have conduct unbecoming an officer and gentleman.

CONDUCT UNBECOMING AN OFFICER AND GENTLEMAN

Article 133 of the Uniform Code of Military Justice (2002) dictates that any commissioned officer, cadet, or midshipman who is convicted of conduct unbecoming an officer and a gentleman shall be punished as a court-martial may direct. Conduct violative of this article is action or behavior in an official capacity which, in dishonoring or disgracing the person as an officer, seriously compromises the officer's character as a gentleman, or action or behavior in an unofficial or private capacity which, in dishonoring or disgracing the officer personally, seriously compromises the person's standing as an officer. There are certain moral attributes common to the ideal officer and the perfect gentleman, a lack of which is indicated by acts of dishonesty, unfair dealing, indecency, indecorum, lawlessness, injustice, or cruelty. Not everyone is or can be expected to meet

unrealistically high moral standards, but there is a limit of tolerance based on customs of the service and military necessity below which the personal standards of an officer, cadet, or midshipman cannot fall without seriously compromising the person's standing as an officer, cadet, or midshipman or the person's character as a gentleman. This article includes acts made punishable by any other article, provided these acts amount to conduct unbecoming an officer and a gentleman. For example, knowingly making a false official statement; dishonorable failure to pay a debt; cheating on an exam; opening and reading a letter of another without authority; using insulting or defamatory language to another officer in that officer's presence or about that officer to other military persons; being drunk and disorderly in a public place; public association with known prostitutes; committing or attempting to commit a crime involving moral turpitude [e.g., rape, sodomy, attempted sexual assault]; and failing without good cause to support the officer's family.

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NEVADA GAMING: A STATISTICAL ANALYSIS CASE

Thomas L. Wedel, California State University, Northridge
Wonseon Kyung Son, California State University, Los Angeles
Chi-Chuan Yao, California State University, Northridge

CASE DESCRIPTION

This case study requires students to apply their knowledge of statistical analysis when acting as consultants to Nevada Gaming, Inc., a manufacturer of video gaming machines. Students are required to utilize their statistical skills to make recommendations to reduce cost and improve efficiency in two departments at this fictitious company. The case has been successfully used as both team and individual projects in introductory statistics classes where the students are typically sophomores or juniors. The level of difficulty would therefore be a two or a three. Student feedback indicates that the case is realistic, engaging and challenging without being excessively complex.

CASE SYNOPSIS

The Nevada Gaming Case focuses on a manufacturer of video gaming machines that has to resolve two operational issues. The first issue involves the potential acquisition of hand-held computers for assembly line workers to use to record production data. Hypothesis testing is utilized to determine whether the reduced cost due to increased assembly line productivity exceeds the cost of the computers. The second issue involves identifying which screening tests should be employed by the Human Resources Department as part of the selection process to hire new assembly line workers. Linear regression and correlation analysis are utilized in resolving this matter. Students play the role of statistical consultants for this company and prepare a report to analyze the situation and provide recommendations to management.

THE NEVADA GAMING CASE STUDY

Congratulations! Nevada Gaming, Incorporated has just awarded you a statistical consulting contract. Nevada Gaming is one of the world's leading suppliers of microprocessor-based gaming devices, including video poker machines and both video and reel-spinning slot machines. These

devices are sold to casinos worldwide. Nevada Gaming is a publicly held corporation was founded in 1980 by gaming legend Jack "the King of Video Poker" Potts. Potts noted the popularity of Atari video games and came up with the idea of a slot machine looking and operating the same way as a machine at a video arcade. He transformed traditional mechanical spinning-reel "slots" into video-screen gaming machines. Nevada Gaming developed an entire genre of video gambling machines with popular culture themes including Elvis, Terminator, Betty Boop and the Wheel of Fortune. It is estimated that such machines currently account for 60% of casino revenue in Las Vegas and 75% of casino revenue worldwide.

Sales growth for Nevada Gaming has averaged 20% per year for each of the last five years, with 50,000 units being sold in the last year. Replacement demand for slot machines is being driven by Nevada Gaming's innovative machines and by the rapid acceptance of cash-in/ticket-out technology (CITO) by the casino industry. CITO significantly lowers slot floor overhead and increases play. It provides a proven and convenient solution to the "pay-out" problem of coin-operated machines. Most of the existing installed base (over 700,000 machines domestically) are coin operated and will not support CITO technology and are therefore potential targets for replacement. In addition, the prospects for continued demand growth are strong as many states consider legalizing gaming as a way of obtaining additional tax revenue without raising income or sales taxes. The continual growth of the Indian gaming industry is another positive trend contributing to Nevada Gaming's sales.

Nevada Gaming employs over 1,500 workers with its main administrative offices and sole production facility located in Jean, Nevada. The manufacturing division employs 800 assembly line workers who are regularly rated on their job performance in building the video machines. A high rating indicates superior speed, consistent quality and dependability. Unfortunately, there is a significant turnover rate among these employees and Nevada Gaming is constantly hiring additional personnel.

Although the sales trends for Nevada Gaming are positive, the company is under pressure from its stockholders to increase the stock's earnings per share. Most of the company's competitors have moved their production facilities to Pacific Rim countries where the labor costs are significantly less. The company has pledged to produce its machines domestically and is looking for alternatives to reduce its production costs to remain cost competitive. Nevada Gaming is considering the proposal made by its Information Technology Department of equipping each of its assembly line employees with a special hand-held computer to automatically capture production data. Currently, assembly line workers manually record on a copy of the work order the start time, stop time, quantities, and other data associated with each completed operation and then later key the data into Nevada Gaming's manufacturing information system. These hand-held computers were tested with 36 randomly selected employees. These employees were given a 4 hour training course in the use of the computers and were tested to verify proficiency. These individuals then utilized the computers on the production floor for one month and their performance ratings were recorded.

The results with and without the computers are included in the statistical data shown in Table 1. Nevada Gaming estimates that each point increase in a job performance rating reduces costs by 10 cents per hour per employee due to the increased efficiency. Nevada Gaming doesn't want to acquire these computers unless it can be 95% sure that the economic benefit from increased productivity will exceed the additional cost of the computers.

In addition to the hand-held computer procurement decision, the Human Resources Department also has questioned the accuracy of the screening process it currently uses in selecting new assembly line workers. As mentioned earlier, Nevada Gaming employs 800 assembly line workers and there is constant turnover for this type of employee. The Human Resources department currently requires each assembly line job applicant to take both a general aptitude test and a manual dexterity test as part of their initial interview. The general aptitude test measures general intelligence and practical problem solving. The manual dexterity test measures coordination and other physical abilities that are essential in assembly line work. The applicant's qualifications, references, and the results of the two tests are analyzed to determine who should be hired. Obviously, the company wants to hire employees that will become productive workers. Nevada Gaming subscribes to two testing services to provide updated general aptitude and manual dexterity exams at a significant cost. These tests also take a substantial time to administer, grade and analyze. Nevada Gaming wonders about the accuracy of each test and whether both tests are really necessary as part of the screening process.

The general aptitude and manual dexterity scores of the same 36 workers were extracted from the company's personnel files and are also shown in Table 1.

REPORT INSTRUCTIONS

Your task is to prepare a typewritten, professional looking consultant's report of five pages or less. The overall purpose of the report is to provide you with the opportunity to explain in words some of what you have learned about statistics this semester. Include a brief cover letter addressed to Jack Potts with your report. Assume that Jack has completed a course in elementary statistics. Your report should have an introductory statement followed by two sections of statistical analysis. These two sections should address the following topics:

1. Briefly discuss hypothesis testing. Use your knowledge of hypothesis testing to determine if the hand-held computers should be purchased. How sure are you that procuring the hand-held computers will be cost effective? If the 800 assembly line employees work 40 hours per week, estimate the net savings per week and per year.

2. Briefly describe linear regression and correlation analysis. Use your knowledge of regression and correlation analysis to determine if the general aptitude test and/or the manual dexterity test should be used to screen potential employees. How should the regression results be used in screening potential employees? Your paper should have a short final paragraph of summary and conclusions.

Subject Number	Score on General Aptitude Exam	Score on Manual Dexterity Test	Performance Rating Without Computer	Performance Rating With Computer
1	239	230	116	124
2	230	212	112	119
3	213	210	109	114
4	211	202	107	114
5	150	176	107	109
6	258	228	123	129
7	90	124	85	89
8	164	156	94	99
9	135	142	99	104
10	179	158	94	104
11	245	254	117	124
12	224	148	114	119
13	198	236	107	109
14	103	86	91	94
15	226	204	115	119
16	137	166	89	104
17	194	160	104	109
18	101	126	91	94
19	120	144	95	99
20	269	226	136	134
21	122	148	90	99

Subject Number	Score on General Aptitude Exam	Score on Manual Dexterity Test	Performance Rating Without Computer	Performance Rating With Computer
22	209	194	114	114
23	194	192	105	109
24	119	226	72	84
25	247	226	117	124
26	228	208	113	119
27	215	218	108	114
28	211	86	119	114
29	152	184	103	109
30	262	236	121	129
31	149	122	92	94
32	118	140	96	99
33	133	134	100	104
34	137	150	101	104
35	196	168	101	109
36	86	116	87	89

PEACH BLOSSOM EXPRESS: A RECENT COLLEGE GRADUATE LEARNS ABOUT "MAGIC MONEY"

Martine Duchatelet, Barry University

Mike Broihahn, Barry University

Charles Rarick, Barry University

CASE DESCRIPTION

The primary subject matter of this case concerns business ethics. Secondary issues examined include diversity and small business management. The case has a difficulty level of three indicating 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

Mike, a recent college graduate, gets his first 'real' job working for a family friend's small chain of Deli stores. He discovers the dark side of small business. In a one long day, he is humiliated in front of co-workers by racist remarks, underpaid but overworked, and invited to break the law.

Mike graduated from college in December 2002 and he was still looking for a job, any job three months later. He was discouraged; payment on his student loans would start in ninety days and his parents wouldn't continue to support him in the modest apartment he rented outside Atlanta with another student. A close friend of his parents, Sybil, heard of Mike's situation and suggested he work part-time at one of her three deli stores. He would operate the espresso machine as another employee was taking a long leave for travel. She proposed Mike work every week day morning, earn enough to cover rent (the figure of \$10.00 per hour was discussed) and still have the afternoons free to look for a "real" job corresponding to his college degree and his ambitions.

Mike agreed to work for Sybil on a temporary basis, as he needed to pay for his rent and other expenses. Although Mike knew Sybil and her husband, Phil, and got along with their children, he felt a bit uneasy working for family or friends as it smacked of a favor done for his parents rather than an accomplishment based on his abilities.

Sybil and Phil's three deli stores, Peach Blossom Express, were in downtown Atlanta and within walking distance from each other. Situated in the ground floors of high-rise office buildings, they catered to the needs of the office workers in their building and vicinity. The stores opened at 7:30 am each week day morning to serve a variety of gourmet coffees, juices, hot and cold cereals, muffins, and pastries. Most of the business was take-out but each store had a small seating area for the few who wish to eat on the premises. Mid-morning was slow, but from 11:00 a.m. to 2:00 p.m. the staff was busy serving and selling prepared sandwiches, soups, salads from a salad bar, cookies and other desserts. The main store served as the headquarters where Sybil and Phil had offices. This store location had a large kitchen facility in the rear where a staff of twelve prepared the soups, sandwiches, and salad bar offerings, and also baked the pastries, cookies, and desserts for all three stores. Phil drove a van carrying food and supplies from the main store to the other two stores while Sybil supervised the store operations.

Mike's first day on the job did not start well. Sybil asked him to come in at 7:00 a.m. so she could show him how to operate the espresso machine. Mike arrived 10 minutes late: his one-way trip on MARTA (the Atlanta rapid transit system) cost \$1.75 and lasted over an hour.

Sybil greeted him warmly as he came through the door. She made him a latte while showing him how the coffee machine worked and whispered quite loud, "Mike, I can't tell you how happy I am to have a white face manning the espresso machine." Mike squirmed, looked around and realized that he was the only Caucasian employee in the front of the store. The other workers were within earshot, stacking pastries and fruit in the display cases.

Sybil showed him the office area, the prep kitchen and the storeroom in back, before returning to the front of the store near the two cash registers. She spoke rapid-fire about the proper way to use a register. "Something very important, Mike," Sybil continued, "Anytime you speak to the staff in the kitchen, make sure you tell them three times. They're so stupid... plus they don't speak English!"

Sybil positioned Mike at the espresso bar and walked away. Mike first concentrated on serving every variety of coffee, milk and flavoring. After an hour, he felt relaxed enough to kid around with the customers. Sybil heard one of his comments and stopped the customer, asking "Isn't it great not to have an uneducated moron manning the lattes for a change?"

During the mid-morning lull, Sybil showed Mike how she wanted the twenty pound bags of oatmeal (from a local club wholesale chain) split into one pound ziplock bags to be distributed among the stores for easy preparation during the morning rush. Mike thought this strange: preparing one pound bags seemed slow and messy, whereas scooping a pound out of a larger bag to prepare a batch of cereals in the morning seemed so easy.

At 11:45, the lunch crowd arrived in earnest and Mike still hadn't taken a break. He asked how long Sybil would need him to stay. "Until 3:30 p.m.," she airily replied, and then insisted he run one of the cash registers, despite his lack of familiarity with it. Mike was confused as to when he could leave, but obviously this was not the time to argue: he furiously concentrated on totaling the

customers' purchases. Sybil went to another register, chatting up a storm. In a matter of minutes, a subtle shift in the lines occurred as people drifted to his register. Sybil noticed his longer line and took him to task, "More speed, Mike. You've got to keep up. Look at me, I'm ahead of you." Mike was stunned by the comment. The customer he was ringing up said to him, "Don't worry, kid. No one wants to deal with the crazy lady."

At noon, Sybil took a phone call at her register, pulled out a set of car keys, and yelled to Mike to make an emergency delivery to the other two stores. Phil was at a Chamber of Commerce meeting all morning and still hadn't done his usual deliveries. Mike found the van crammed with 5-gallon soup pails, racks of sandwiches, and cases of beverages. When he arrived at the other stores, he found disgruntled staff and edgy customers waiting for the goods. He rushed back to the main store where the line at the check out was by now very long. Sybil greeted him with relief, yelling, "I'm glad you're back. I don't like to put a Black at the till. They would rob me blind!"

At 1:30 p.m., Sybil came by to turn off the recorder on Mike's cash register after doing the same on her register. She winked at him and explained, "From now until closing, it's Magic Money time." Sybil instructed Mike place the cash from any purchase in a wooden drawer under the counter. At 3:00 p.m. when the store closed, Sybil walked by each register, removed the bills from the wooden drawers and stuffed them into her purse without counting them. She asked Mike to bring the register drawers up to her office where she would show him how to do the cash counts.

Mike was surprised Sybil didn't use bill or coin counters, but Sybil blithely claimed that she was faster than any machine and proceeded to rapidly count the bills and to eyeball the value of the coinage. Sybil didn't simply count the total amounts of cash present, she insisted on counting separately the totals for each register, to reconcile with each register's tape. Since each register had made change for the other without recording it during the day, neither register totals matched the corresponding tape total. Sybil was upset; worse yet, the total cash amount across the two registers didn't reconcile either: they were short \$220 for the day. When Sybil was called out of the office to talk to the kitchen staff, Mike meticulously recounted the cash and found out that Sybil's count was \$60.00 too high, they were actually short \$280 for the day! Sybil came back and revealed, "It's not so uncommon: some days, we are short, some days we are over." Mike then asked if he should prepare cash drawers for each register to start the next day. "Oh no," Sybil answered, "it takes too long: I'll just stuff some bills and coins in quickly."

It was now 4 p.m. and Sybil asked Mike how he liked his first day. Mike politely asked her to confirm his working hours, duties and rate of pay. In a rapid fire response, Sybil snapped, "7:30 a.m. to 3:30 p.m., five days a week with a paycheck every two weeks. You'll earn the minimum wage of \$5.15 per hour for half your time, and for the rest, you'll get cash at \$8.00 an hour, paid at the end of each week." Mike protested that this was different from their previous understanding and he also didn't want to be paid under the table.

"I can't possibly pay you on the books," said Sybil, "The stores aren't profitable enough with all those people stealing from me behind my back! You saw it for yourself; we're short for the day."

Mike replied calmly, "I don't think you can say that for sure since you don't know how much cash is in each register at the start of the day, you move money in and out of the registers, and you turn off the registers before the end of the day."

"Getting edgy, are we?" retorted Sybil. "By the way, have you had anything to eat today? I wouldn't want your parents to think I wasn't feeding you properly. Grab yourself a sandwich on your way home. That's one of the benefits of working here - you get great food for free!"

Sybil continued, "I am so happy to have you on board. You're so bright and you catch on so quickly. Besides, I know I can trust you not to steal from me. You know, next week, Phil and I will be out of town and we'll leave you in charge of the stores. I know you're up to the challenge!"

Mike stood dumbfounded.

"Here," said Sybil, "I have a going away present for you for the day." She handed him a tattered copy of the State's food service handler's guide. "You can study this while you ride on MARTA. The store needs a licensed employee on the premises and it has been a long time since we had one. Don't worry; we'll pay the fee for the exam."

Mike spent his \$1.75 on MARTA to get home. He was trying to process what happened to him that day. What should he say to his parents? What should he do about tomorrow?"

CROSS-CULTURAL BUGS IN A U.S. - MALAYSIA HIGH-TECH PROJECT

Robert C. Condron, Sonoma State University
Karen J. Thompson, Sonoma State University
Sarah L. Dove, Sonoma State University

CASE DESCRIPTION

The primary subject matter of this case concerns cross-cultural relations between the American and Malaysian partners of a high-tech joint project based in Penang, Malaysia. Topics such as cross-cultural communication styles, cultural self-awareness, and preparation/training for cross-cultural joint projects are all explored in the case. Secondary issues include corporate culture and expatriate selection. The case has a difficulty level of 3-5, and is appropriate for junior, senior, and first-year graduate levels. It is designed to be taught in 1-2 class hours and is expected to require 1-2 hours of outside preparation by students.

CASE SYNOPSIS

This case is based on the actual experiences of an American engineer based in a high tech manufacturing firm in northern California, USA. It focuses on the problems that arise when his U.S.-based team forms a joint project with a Malaysian team based in Penang. The Americans, assuming that the English-speaking Malaysians behave and do business just like Americans do, do not properly prepare themselves to work with the Malaysian culture. They simply believe that the strong organizational culture of their company will provide a framework for a successful joint project.

The Americans select a project manager who is successful in the California setting but who turns out to be ineffective at dealing with the natives in Malaysia. His counterpart, a Malaysian engineer, struggles with the American management style which conflicts directly with many characteristics of the Malaysian management style. Culturally-based issues regarding the use of time and communication styles arise on a daily basis when the Americans arrive in Malaysia to do business. The same issues continue to plague both partners as they attempt to communicate long distance after the Americans return home. Even the structuring of work processes is done differently in Malaysia than in California, an issue that frustrates both partners. The two teams struggle to find common ground where they can operate efficiently and effectively.

[This case was written as a vehicle for discussion rather than to illustrate either the effective or ineffective handling of business situations. The information in this case is factual and based on actual situations; however, the real names of the company and individuals have been changed. In this case, the word 'Malaysian' is used to mean the inhabitants of Malaysia (which include Chinese, Malays, and Indians).]

As Kurt Rudd prepared for his seventh trip to Penang in three years, he took note of how efficient he had become in packing. His carry-on bag was already loaded with passport, Malaysian ringgit, Singapore dollars, Pepto-Bismol tablets, and other essentials for the flight. On his first trip in May of 2000, Kurt had chuckled when he'd seen other travelers blowing up their inflatable neck pillows and wearing blinders over their eyes. Now, he was one of them. Traveling in the air for twelve hours to Hong Kong followed by another six hours to Singapore was difficult. He had learned the hard way how essential these travel articles can be. This was also a good description of how he and his American coworkers at Advanced Precision Components had developed their working relationship with their Malaysian counterparts. The American team had first had to learn the hard way before adapting and becoming more efficient. As Kurt finished his packing, he reflected on the journey he and his company had made on its United States-Malaysia joint project. Advanced Precision Components (APC) began transferring its product assembly operations from California to Penang in 1999. The Penang facility was now 600,000 square feet and had an employee base of roughly 3,000. This was approximately equal to the size and workforce of APC's facility in California. In 1999, APC decided that it needed a supply base in Penang to shorten the supply chain of lower level mechanical parts and support the increasing amount of product assembly being done in Penang. Until 2000, this transfer was spearheaded by Kong Ooi, an engineer working out of APC Penang. Kong pulled as much technical information as he could from various sources in APC California and managed the supplier base on the receiving end back in Penang. Soon, the project responsibilities outgrew what one employee could handle, and APC California realized they needed a dedicated project team on their end to assist Kong at APC Penang.

APC California opened up new positions for a project manager and an engineer to establish a project team that would help Kong manage the parts transfers. The many qualified candidates for project manager were narrowed down to two individuals: Pete Loren and Dale Bodeen. Both were strong candidates, but they had very different management styles.

Pete Loren was a soft-spoken, humble engineer. He was an analytical type with previous experience overseeing the assembly transfer of APC products from California to Penang. Pete had spent four weeks in Penang during previous product transfers and enjoyed working with the Malaysians. He was easy to work with and had a pleasant sense of humor. Dale Bodeen was a confident, take-charge type who was working on his Masters Degree in Engineering Management.

He had a track record in APC as a strong engineer who had successfully managed a few domestic projects, although he had no overseas experience. Dale stood at 6'4" and was always vocal in his opinions. After lengthy consideration by upper management, Dale was awarded the position because it was felt that this project would need strong leadership.

Kurt Rudd applied for the engineering position on the project team and was hired in March of 2000. Born and raised in Northern California, Kurt had never traveled outside of North America. He was no expert in the technology that needed to be transferred, but he had a strong foundation in engineering. Also, he liked the idea of being the hub for information between Malaysia and America. Kurt excelled in communication skills, and he enjoyed working with a wide variety of people and personalities. Kurt had supported manufacturing and production at APC California for the past seven years and interacted effectively with people at all levels (including R&D engineers, production operators and assemblers, and graveyard shift material handlers).

At APC Penang, a parallel team with its own engineers and project manager was being established. Kong was awarded the project manager position in Penang based on his solid performance to date. Kong had previous experience as an expatriate working in the U.S. and interacted well with APC California. He enjoyed the project and was thrilled to get the project manager role. Kong, a detail-oriented engineer and MBA student, loved to play host to American visitors from APC California, taking them out to restaurants each weeknight and to local tourist sites on weekends. To help him build the APC Penang team, Kong was initially allowed to hire two engineers who would report to him.

The U.S.-Malaysia joint project had, in effect, two managers. Dale and Kong were both project managers assigned to the same project, each had engineers reporting to him, and each had the same amount of authority for overseeing the transfers. There were some differences in how the teams were structured, however. The U.S. team was configured so that each engineer was directly aligned to a commodity; one was responsible for sheet metal parts, another for plastic parts, and so on. In contrast, the Malaysian team was configured with respect to upper level assemblies. Each Malaysian engineer was assigned an assembly and all of its parts, thereby making each engineer responsible for the full range of commodities making up the assembly. With the two teams created, and half a world away from each other, a cross-cultural group project had been formed to accomplish the same APC objectives. They were to transfer machined parts from U.S. suppliers to Malaysian suppliers without disrupting the assurance of supply.

After the formation of the cross-cultural team, Kong took his first business trip to APC California where he met with the California team. This was Dale and Kurt's first face-to-face meeting with Kong, or anyone from Penang, in fact. Kurt was told that everyone he would be working with on the U.S.-Malaysia project spoke English; therefore, he assumed that any interaction would be relatively easy. However, he was surprised at how much difficulty he had understanding Kong's English. Kong spoke quickly and with a heavy accent. To be polite, Kurt often nodded his head and smiled in understanding, even though he didn't know what Kong said. Sometimes this

worked and sometimes it did not. As Kong and Kurt conversed more throughout the week, Kurt began to ask Kong to repeat himself. This did not work well either because, more often than not, Kurt still could not pick up the words Kong was saying and was reluctant to ask him to repeat himself a third time. Thus, Kurt would finish a conversation without comprehending everything that was said by Kong. Later when the same topic was being discussed, Kurt found himself sometimes asking the same questions again. Kong was gracious and seemed to appreciate Kurt's effort to clearly understand what he was telling him. However, Kurt worried about making a poor first impression on Kong with his redundancy in questioning. When conferring with his American coworkers, Kurt would sometimes get clarification, but other times he found that he was not the only one who did not fully understand Kong.

After Kong returned to Penang, Kurt began to communicate about parts-related issues with the Malaysian team members through e-mail. However, e-mail was often not a speedy form of communication because Penang was sixteen hours ahead of California. An e-mail that Kurt would send on one day would not be answered until the next day, and sometimes he would receive no reply for another day after that. This communication lag occurred even when issues were urgent.

According to Dale, Kurt's responsibilities would include selecting and initiating all parts transfers to Penang. This meant that Kurt was in charge of which APC parts would transfer from U.S. to Malaysian suppliers. APC Penang was free to make requests for specific parts, but it was Kurt who had final approval. Occasionally, Kurt would find out about a part being transferred that he had not approved. Kong was accustomed to selecting parts on his own prior to working with Kurt and sometimes this practice continued, leaving Kurt out of the loop. Whenever problems like this arose, Kurt sought the advice of his project manager. Dale relished the role of removing obstacles so that his subordinates could get their work done. He would schedule teleconferences with Kong, and the two managers would work out their differences on the phone. Kurt believed that Dale was handling the situation well because issues seemed to get resolved quickly.

It wasn't until five months into the project (July, 2000) that Kurt made his first trip to Penang with Dale and a procurement representative. In preparation for Kurt's trip to Malaysia, APC California sent him to a nurse for several shots and a stern lecture on the "do's and don'ts" of traveling in Malaysia. He should not drink the water or anything with ice in it. He was also told to avoid eating any fruit that had been pre-sliced or peeled because the utensils used on the fruit might have been dirty or cleaned with unfiltered water. Also, Kurt was always to wear DEET mosquito repellent since mosquitoes in Malaysia can carry malaria. Finally, Kurt was to keep several emergency phone numbers handy in case of any health problems or emergencies.

The day before the trip, Dale gave a briefing on what to pack for the trip and what to expect. He mentioned that they should not use their left hands for anything, as left hands are considered unclean. He also demonstrated how to properly give and receive business cards, an important business ceremony in Malaysia. With that said, the meeting ended and Dale declared that Kurt was prepared to do business in Penang.

Kurt was thrilled to meet his counterparts in Penang. The hospitality and graciousness of the Malaysian team members were overwhelming. Kurt immediately liked everyone he met. He was surprised that most of APC's engineering and management employees were Chinese, not Malays as he had expected.

Each day the Americans were scheduled to meet the Malaysian team at the APC plant at 9 a.m. Sometimes the Malaysians were there, sometimes they weren't. When the Malaysians did show up, they would chat with other coworkers and check e-mail until it was time for mum-mum, a Malaysian word meaning break. The U.S. team, ready to get the day started and accomplish their objectives, would reluctantly join the Malaysians for coffee and snacks for another twenty minutes. During mum-mum the Malaysian team would talk to the Americans about their stay in Penang and about life in America.

Each day, Dale, Kurt, and the Malaysian team made trips to meet with the outside suppliers with whom they were working. Each meeting seemed to follow the same routine. The Malaysians would specify a pick-up time for the Americans at the hotel lobby but would arrive at least twenty minutes late. The two teams would climb into the Malaysians' small cars and caravan to a supplier. At the supplier's shop, they would meet in a front office room where business cards were exchanged in the manner that Dale had described. Next, they were given a company presentation after which project discussions took place. Once in a while, questions in English by the Americans were not understood so Kong would clarify in Chinese. This would be followed with a rapid-fire exchange of more discussion in Chinese until Kong and the supplier were finished, and then smiles and gazes would be returned to the American visitors. Kurt often wished he knew what they were saying during these quick diversions.

On-site meetings were followed by lunch at a restaurant with everyone including the supplier's management team. Most of these lunches occurred at big, round tables in Chinese food restaurants and often lasted for two hours. Meals began with several appetizers, followed by a continual flow of main courses on platters. The hosts would frequently serve their American guests food from the platters whenever there was room on the Americans' plates. Chinese food in Penang was not the same as Chinese food in America. Out of politeness, Kurt sampled frog legs, ostrich, sea cucumber, raw lobster, chicken feet, venison, and some other items he didn't ask about. He also found it difficult to refuse drinks with ice or pre-sliced fruit. Discussion at lunches rarely included business but focused on the food and the sights to see in Penang.

Upon returning to the supplier and getting back out of the small cars, a shop tour took place. Kurt never seemed to get all of the things done during the tour that he had planned. This was partly due to the effects of the heavy lunch combined with the ever-present jet lag. However, Kurt also felt that he didn't have the same access to the machines and operators that he did in the U.S. At American suppliers, Kurt was accustomed to meeting with and discussing problems with the machine operators directly at their workstations. During the tours of the Malaysian suppliers, the equipment was glanced at quickly, and introductions to the operators, who seemed to avoid all eye

contact, were rare. This made it difficult for Kurt to find out the operators' skill levels and approach to fabricating APC's parts. Kurt noticed that at all of the shops the managers and engineers were mostly Chinese while the production people and machine operators were mostly Indian or Malay.

On his third day in Penang, Kurt forgot to wear his mosquito repellent and was bitten at breakfast. He was quite alarmed and worried all morning about getting malaria. Finally, he expressed his concern to a Penang engineer named Teng. Teng immediately laughed and told Kurt that the malaria-carrying mosquitoes were mostly in remote parts of Malaysia. Locals never wore repellent in the city so Kurt had nothing to fear. While he had the opportunity, Kurt asked Teng about the pre-sliced fruit and ice in the beverages at lunch. Teng assured Kurt that the restaurants they had been going to were first-class and that all the water was filtered. Kurt appreciated Teng's words of assurance and turned to him often from then on for advice.

The two-week trip flew by and, once back in the U.S., Kurt found communication with his counterparts in Penang had improved due to their face-to-face meeting. Their communications were not only business-related now but included such personal discussions as weekend plans, World Cup (soccer) games, and the Florida presidential election problems. Project-related issues that could not be solved at the engineering level continued to be dealt with between the two project managers.

As the project grew, Kurt could no longer run the tactical side of the project alone. A few months after the first trip, APC added three more engineers to the U.S. team to supplement the technology expertise needed for the project. A few months later, the California team that included Dale, Kurt, and the three new engineers traveled to Penang again.

The first day in Penang was reserved for the two project teams to meet at APC Penang to introduce new members and finalize the trip's itinerary. The Penang engineering team sat on one side of the room while the U.S. engineering team sat on the other. Everyone sat facing forward towards the front of the room. Kong put the planned supplier visit schedule on an overhead projector and began to speak. Dale quickly stated that the schedule did not match what he had agreed to on the phone prior to the trip. Kong had made some changes and began to explain them, but Dale wasn't willing to deviate from the original plan. The debate escalated until Dale's temper flared, and he assertively asked Kong to leave the room with him to continue their argument outside. The new American team members were mortified, as was Kurt who had convinced each of them that working on this project would be a positive move for them. An eerie silence fell over the room as the new members wondered what they had gotten themselves into. Then, a female engineer from the Malaysian team moved her chair over towards the American side of the room and excitedly asked what they wished to see during the upcoming free weekend.

While their managers argued outside the door, their subordinates quickly bonded. Eventually, the managers came back in; Dale had convinced Kong to stick to the original plan. The rest of the trip flowed smoothly, yet there was a detectable difference in the relationship between the two managers. The biggest difference that Kurt noticed was that Kong now came to him much more often for advice rather than going to Dale. Kurt found himself in a difficult position. He

wanted to help and give Kong all the advice he could; however, he was not the project manager for APC California. Kurt did not have the ultimate say in how things were to be handled; Dale did. In addition, Dale was less inclined to seek Kong's input. On one occasion in particular, Kurt suggested to Dale that Kong should be consulted for his opinion on a parts-related matter. Dale immediately told Kurt not to worry about Kong, and that it was up to him (Dale) and Kurt to develop and implement the parts tracking system, not Kong.

The structural differences between the two teams were quite apparent during these visits to the Malaysian suppliers who were contracted to manufacture one, specific commodity. When in Malaysia, the visiting American engineer would be interested in only the one supplier corresponding to the commodity he supported. The Malaysian engineer, however, needed to visit all of the suppliers since he worked with each commodity. The result was that the trip itinerary rarely served the needs of both teams and, thus, progress was inhibited to some extent.

With input from the new American team members and the natural evolution of the project, the project gained structure. Kurt was no longer the only channel of information to and from Penang. To ensure that all team members in both countries would be aware of all the relevant issues, a weekly teleconference was scheduled. Before this, teleconferences were scheduled only when urgent issues warranted them. Thursdays at 4 p.m. in California equated to Fridays at 8 a.m. in Penang, so this time was selected as the most convenient time for the teams to talk, even though two of the APC California team members normally worked the 6 a.m. - 2:30 p.m. shift, and the Malaysians rarely arrived at the office before 9 a.m. These teleconferences were important also because of the different configuration of the teams. If a U.S. sheet metal engineer had an issue to discuss related to a part, he would have to speak to the whole Malaysian team, not just to a single counterpart.

During teleconferences, the American team spoke directly and frankly. They gave very specific technical advice in an explicit manner. After an explanation, the Americans often sought to verify accurate understanding of the dialogue. The Malaysian team always assured the Americans that they understood. However, the same questions would come up later from the Malaysians during the next teleconference or in e-mail form. The U.S. team members found themselves repeating many topics each week and beginning to question the competence of the Penang engineers.

Another problem with the teleconferences was an often complete lack of response from the Malaysians to questions posed by the American team members. A question directed specifically to an individual or to the group was frequently followed by silence on the Penang end of the line. Uncertain as to the meaning of the silence, the Americans would rephrase the question or add more explanation. Sometimes, when no questions were asked by the Penang engineers, the American team assumed they had agreement and would move on to the next topic of discussion.

In one teleconference, for example, an American plating engineer talked about some parts that the Penang engineers had shipped to him because they had failed plating inspection. The American engineer stated that trapped air bubbles within the parts had caused the defects, and he

recommended that the Malaysian plater should agitate the parts while they were in the plating bath to remove the trapped bubbles. The American engineer asked if the Malaysian team understood what he was describing. There was no response. After several seconds, Kurt stepped in and asked if the Penang engineers understood that the parts needed to be agitated to fix the problem. Another silence was then followed by one of the Penang engineers stating that they understood. Yet, a week later, more parts had failed plating inspection, and the Penang engineers thought it was due to air bubbles again. The result was that another expensive batch of parts had to be scrapped. The American engineer then asked the Penang engineers in frustration, "Didn't we just go over this last week?" The Penang engineers did not respond. The American team restated the process in more detail, rephrasing and providing even more information. After this teleconference, the air bubble problem was rectified.

As the weeks progressed, Kurt and his fellow American employees would sit in their cubicles at exactly 3:59 p.m. every Thursday ready for the phone call from Penang. Often, the American team would wait for fifteen minutes or more before the call would come. Sometimes they would get a call from a Penang engineer stating that he or she was the only one in the office and that once everyone had arrived, they would call back.

Because of their many years of experience in the technology they were transferring, the Americans expected the Malaysian team to use them as valuable resources and to contact them whenever technical questions arose. However, defects were increasingly being caught at final inspection after parts had already been shipped to APC California. There was no hint of these problems prior to shipment even though they should have been discussed during the fabrication process, not after it. As a result, Dale referred to the Malaysian team as "renegades" because they seemingly pursued things on their own without asking for input. To counteract the "renegade" activities, Dale placed additional constraints in the form of bureaucracy. One such constraint was that parts could no longer be sourced independently; both teams had to agree.

In effect, Kong's autonomy to operate as an independent team leader was revoked by Dale. Kong, used to making quick parts-related decisions, now had to submit a request to the APC California team and wait for a reply before acting (which could take a day or so due to the time differences). Frustration resulted for Kong and often, due to time constraints and pressure from APC Penang management, he was forced to make his decision without getting prior approval from his American counterparts. These situations further strained the relationship between Kong and Dale.

What to Do?

Kurt shut his suitcase and remembered the last teleconference. The teams had been on the phone past 7 p.m. (California time), in part because they had gotten another late start. On top of that, another batch of parts had been rejected for failing inspection. Kurt wondered what could be done to improve the project.

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QUICKTROPHY.COM

Gary J. Brunswick, Northern Michigan University
Terry Dehring, QuickTrophy.com

CASE DESCRIPTION

The primary subject matter of this case concerns the growth and development of a web-based trophy and awards retail business, with primary focus on marketing strategy issues. Secondary issues examined include the identification and measurement of relevant performance metrics for an upstart firm such as QuickTrophy.com, and the relationship between strategic goal setting and the implementation of relevant strategies designed to achieve those goals. This case has a difficulty level of 3-4, and would be appropriate for junior-to-senior level students. The case is designed to be taught in 3 class hours, and is expected to require 4-6 hours of outside preparation by students. It might be helpful for students to examine other successful and failed web-based business models for comparison purposes.

CASE SYNOPSIS

The case centers around a group of entrepreneurs who recognized, develop and implement a unique web-based business model applied to the sports trophy business. QuickTrophy.com offers customers levels of customer service unparalleled in the trophy business, including an easy-to-use website, next day shipping, and a money-back guarantee. The company faces some unique challenges in developing and maintaining a consistent customer base, and is looking for additional ways of expanding their business through complimentary products and services. QuickTrophy.com is a small company, which has an interesting value proposition and the potential for significant growth.

INTRODUCTION

The idea for QuickTrophy came from the company co-founder, Stephen Roberts. While sitting stuck in traffic in suburban Detroit on a hot June Saturday afternoon he could feel his blood pressure rising. The team banquet was in 20 minutes and it looked like he would be late. Traffic was barely moving, all the radio music was bad, and none of the CDs sounded good. The thermometer read 94 degrees and the air conditioning wasn't working. Stephen had just picked up the team trophies - this was his third trip to the trophy shop - and he wasn't happy with them. With beads of sweat on his forehead, he started thinking about what he had gone through to get these trophies.

His adventure had started nearly 3 weeks earlier. Like most volunteer coaches for young soccer teams, Stephen was not only the busiest person on the team, but also in charge of getting the team trophies at the end of the season. So like all the other coaches he went to the local trophy retail shop. After a 30 minute drive to get to the shop he was faced with a line of customers, complicated forms to fill out, piles of meaningless choices to make, and a bored staff person with an attitude. Finally, after an hour in the store, he was done and ready to face the traffic for the trip home.

Two weeks later his trophies were ready. He went to pick them up, only to find out that the names were misspelled on two of the trophies, and they were all the wrong color. With the banquet just 4 days away, he had to have the shop place a rush on the corrections. They would be ready on the day of the banquet and he could pick them up at 4:30 (the banquet was at 6:00).

So today he went to get the "fixed" trophies. He found that the trophies were the right color and the two misspellings were corrected. However, a name was now misspelled on a different trophy! But there was no time to get it corrected, so he took the trophies and started for the banquet.

Sitting in his car stuck in traffic, hot, frustrated, and angry, Stephen thought: "Why isn't there an easier way to do this!" Frustration can often lead to inspiration. He figured this was a perfect application for the internet - travel could be eliminated, choices streamlined, names could be copied and pasted into engraving forms, the finished trophies delivered to his door. So Stephen looked on the web for a trophy shop and to his amazement, there were none that offered an on-line ordering service. He checked with some fellow coaches and none of them were aware of an on-line trophy company either, but they all agreed it would be a great idea. One of the coaches, Mike King, thought the idea was so good that he suggested that he and Stephen start a company to do it.

Mike did some more investigation, talked with some of his friends who had business contacts in the trophy industry, developed a business plan, and came to the conclusion that this was a viable business idea. The only thing they needed was the person to make it happen. Stephen contacted a close friend of his, Terry Dehring, to see if he would be willing to take charge and run the project. Terry agreed on the condition that it was located in Marquette. The three shook hands and QuickTrophy was born.

Terry refined and expanded the business plan, developed the web site design, contracted with a local firm to do the programming, and developed the product portfolio, supplier relationships, physical plant, computer systems, and office infrastructure. After extensive testing and refining, the web site went live on April 10, 2001.

CURRENT PERFORMANCE

Since starting, sales have grown quite dramatically with orders coming in from all over the country and even some from Japan, Guam, Germany, and Greenland. The majority of trophy orders (approximately 40%) have come from the East Coast (Boston to Washington D.C.). Approximately

25% of orders were from the West Coast (Seattle, San Francisco, and L.A.). Another 20% were from the Mid West (Detroit and Chicago). The remaining 15% have come from the rest of the country with higher concentrations of orders coming from Atlanta, Research Triangle (NC), Dallas, and Denver.

Below are business metrics by quarter for QuickTrophy since going live in April 2001. Note: many of the Site Visitors in early 2001 were likely QuickTrophy employees or their programmers as the web site was undergoing several updates and revisions during that time period.

	Site Visitors	Orders	Sales	Units
2001 Q2	24,003	162	11,474	1,408
2001 Q3	23,916	171	11,066	1,204
2001 Q4	17,720	430	30,862	3,176
2002 Q1	24,632	646	39,174	5,483
2002 Q2	30,410	880	59,283	8,046
2002 Q3	32,920	509	36,483	4,939
2002 Q4	39,019	766	50,620	6,785
2003 Q1	39,033	651	50,481	6,109
2003 Q2	38,658	989	74,206	9,309
2003 Q3	40,271	725	48,278	4,989
2003 Q4	44,295	837	61,435	6,720

CURRENT OPERATING METRICS

The gross profit margin for trophies and medals for QuickTrophy at current pricing levels was 72.9% (gross profit = (sales - cost of goods). In addition, QuickTrophy had fixed expenses of \$18,500 per month. Monthly break-even sales were \$32,325. Current retail prices for various trophy products are available on the QuickTrophy.com website.

The operating ratios listed below are from the Awards and Recognition Association 2002 survey of trophy and awards retailers. Although they provide a basis for comparison, they do vary quite a bit from QuickTrophy because the business models are quite different: QuickTrophy is an internet retailer while the average retailer is a small street level retail outlet.

	QuickTrophy	Average Trophy Retail Co
Cost of Materials	27.0%	32.3%
Employee labor	17.6%	13.3%
Employee related	4.7%	2.7%
Shipping/postage	18.8%	2.1%
Advertising	16.7%	4.1%
Insurance	1.9%	2.2%
Occupancy	3.3%	8.1%
Amortized depreciation	4.2%	3.1%
	94.2%	67.9%

THE OPPORTUNITY

The available market for trophies and related products is huge. Information from the ARA (Awards and Recognition Association) - an industry group for trophy and awards retailers and suppliers - estimates there are about 10,000 retail trophy shops nationwide, employing 80,000 people with sales of over \$2,000,000,000 annually.

The largest segment of the trophy market is the sports trophy market. Particularly for youth sports teams, like the soccer team that Stephen was getting trophies for. This is the primary market QuickTrophy was designed to supply.

The majority of the market is currently being serviced by local "Mom & Pop" retail shops. These stores service a small geographic area and need to be able to supply all trophy and award products to their local customer base. They need to be all things to some people. So every order is a "Special Order" and parts are ordered to fill each order individually. To reduce shipping costs, orders are collected and parts are ordered once a week. Once the parts are in, the orders are completed and customers are called to come and pick them up. The standard turn around time is 2 weeks. Order forms are hand written, read by the engraver who types the engraving instructions into a machine to make the trophy name plates. This process is inherently error-prone and name plates are commonly incorrect.

Compared to local trophy retail shops, QuickTrophy has several advantages. The internet is available 24/7 from home or work. The web site was designed to be extremely easy to use. The selection of trophies was simplified. Engraving instructions are easily typed in, names can be copied and pasted from the team roster. There are several opportunities to review and correct any misspelled words or names. The manufacturing process is highly automated so the engraving

information is processed automatically. Thus, there are no engraving errors. Finally, QuickTrophy stocks an adequate supply of parts so trophies can be made and shipped out by the next business day. Orders are shipped to the customers home or work address so no travel is necessary.

One of the few disadvantages of QuickTrophy compared to local retail shops is the product selection. Specifically, local shops can offer everything, because they stock nothing, as mentioned earlier. QuickTrophy maintains an inventory of parts, so can only offer certain styles and sizes of trophies on a quick turn around basis.

Since QuickTrophy started, other on-line trophy retailers have appeared (and are summarized later in the case). QuickTrophy still had advantages over them. For example, QuickTrophy.com still has the easiest to use web site, particularly for engraving. The 24 hour turn around is still the fastest in the industry. Some on-line competitors offer a 72 Hour Rush service, for a premium, while others are even slower.

TARGET MARKET

QuickTrophy's target market was the person who typically purchases the team trophies: The coach of the team. More specifically, the coach who is extremely busy and time pressured and values speed, simplicity, and a minimum of decisions when purchasing their trophies. Also, the target market was someone linked to the internet on a regular basis. The growing use of the internet to post practice sessions and game schedules offers QuickTrophy the opportunity to target these coached directly.

In addition, because the coaches are so busy, they often don't order the trophies until the last minute. QuickTrophy's fast turn around time fills this need perfectly. Here are some quotes from recent customers:

"Thanks for the great trophies. I was amazed that the order was processed and the product was fabricated only hours after being ordered. I will recommend your company to others who are looking for a good product at competitive prices with excellent service." - William S.

"I received our volleyball trophies today and they look great. I am very pleased with my experience with your company. The ease of ordering, speed of delivery, and prices will keep us returning for future orders." - Kathleen K.

"I just received my order this afternoon and wanted to express my appreciation for the EXTREMELY FAST service and wonderful craftsmanship. Trophies ordered and at my door in 5 days! Faster than any trophy shop in SE Michigan - AND awesome prices! THANKS!" - Julie W.

QuickTrophy's customers rate their speed, products, and service very high according to results of a recent survey. In addition, 89% of those surveyed planned to use QuickTrophy again and 94% said they would recommend QuickTrophy to a friend.

The challenge with marketing to coaches directly represents classic consumer behavior issues; namely, how to find and contact coaches. Typically, the only record of team coach contact information is kept at the local league level. Some e-mail or other contact information is available on league web sites or local team web sites, but this requires significant searching.

Another challenge with team coaches is the short "life span" of volunteer coaches. Many volunteers only coach teams for one or two seasons before they get burned out and quit. Some of the long-timers will coach for 5-6 years before they quit. In addition, they only need trophies or awards once or twice each year. So a "frequent buyer" will only be looking to purchase annually or semi-annually.

Finally, coaches tend to be very busy and don't have a lot of time to shop around. So when they need trophies, they will either go where they went last time or ask another coach what they did for trophies. In smaller towns this works to the advantage of the local trophy retailer where local brand recognition and loyalty are important. The challenge for QuickTrophy is to reach the coach just before they need to order trophies.

MARKET NEEDS

The need for relatively inexpensive trophies currently exists as shown earlier. The need to purchase these trophies in a fast, easy to use environment, with a minimum of frustration is a growing need among the target market segment and will continue to grow. Because of this, QuickTrophy has focused on simplicity, ease of use, order placement in a minimum of time, quick fulfillment, and accurate production of the trophies to meet the demands of the target market.

Presently it is estimated that the vast majority of the sports trophy market is being supplied by local retailers. There are currently an estimated 10,000 local retail trophy shops in the United States (ARA membership dealer records). With the large number of local retailers, it is obvious that the market is quite substantial.

The internet is a large and rapidly growing marketplace. Consumer sales on the internet is growing at a rapid pace. ComScore Networks says that consumer spending on the internet in the first 6 months of 2002 grew 29% to \$19.8 billion. BizRate.com calculated the sales during the same time period were \$23.5 billion. Meanwhile Nielsen/NetRatings calculated that 120.2 million people use the internet either at home or at work, an increase of 6.5% over the previous year. And those users spent an average of over 19 hours on the internet during the month. Including QuickTrophy, there are only a handful of on-line trophy retail companies with a serious presence on the internet.

With the advent of QuickTrophy.com and several key competitors (summarized in the next section), a strategic window exists for other competitors to enter this market. It seems questionable

that any new web-based competitors will emerge from traditional local retailers as the business model for the two businesses is so different. Additionally, it appears that some consolidation in the local retail business is taking place through franchises, mainly by Crown Awards. They are headquartered in New York and have roughly 100 franchised stores throughout the United States.

COMPETITION

As stated earlier, there are already several trophy retailers on the internet. Most are simply advertising pages for a local retail shop and they offer no on-line ordering, just a local phone number to call to place your order. There are currently 6 internet major web sites which do offer on-line ordering similar to that offered by QuickTrophy.

The existence of other internet retailers puts pressure on QuickTrophy to provide preferable service in the form of speed, ease of use, and accuracy. In addition, more pressure is placed on marketing and sales as the existence of a web site is no longer unique.

A thorough review of the competing internet sites found that all competitors had some aspect which made them desirable. However, they all required many decisions to be made and required a considerable number of "clicks" to place the order. All had confusing or cumbersome engraving instructions. Additionally, all competitors offer many (often too many) choices for their customers. In light of all these shortcomings and the QuickTrophy chosen market niche, the QuickTrophy.com web site is faster and easier to use than any of the current competitors.

The chart below details the strengths and weaknesses of each of the current internet competitors. The links should be live to their site if you want to view them personally.

MARKETING STRATEGIES

Product

QuickTrophy's product line focuses on relatively inexpensive (\$5 - \$30) sports trophies and medals. The trophies are attractive, made with quality parts, and built to order. The name plates are engraved to customer specifications. Three lines of engraving are allowed on each name plate. The high level of automation at QuickTrophy ensures that what the customer requested for engraving is exactly what gets engraved. Customers are given several chances to review and correct any misspelled words or names before the name plates are produced. The streamlined product selection and automated engraving allows QuickTrophy to make and ship orders by the next business day for most customers.

Competitor	Advantages	Disadvantages
Awards.com www.awards.com	Nice drag & drop feature	Cartoon-like pictures
	Free Engraving	Cumbersome engraving process
	Extensive product line	Slow to load
	Reasonable prices	7 days + shipping
CrownAwards.com www.crownawards.com	Many choices	Many layers of pages
	Reasonable prices	Need to specify engraving for each trophy separately
	3-5 days + shipping	10¢/letter after 40
NetTrophy.com www.nettrophy.com	Can customize each part	Adds to trophy price
	Free Engraving	Cumbersome engraving process
	Extensive product line	Many pages of choices
	Reasonable prices	Priced ala carte items
	Free shipping > \$50 order	5-10 days + shipping
MrTrophy.com www.mrtrophy.com	Limited choices	Cumbersome process
	Easier engraving instr	\$1 per trophy <10 order
	Avg 3 days + shipping	Up to 14 days + shipping if out of stock
	Lowest prices	\$12.50 ship orders <\$100
DinnTrophy.com www.dinntrophy.com	Extensive selection	Confusing selection process
	Low prices	Difficult engraving process
	Avg 3 days + shipping	5¢/letter after 40
	Free shipping > \$100 order	Confusing procedure
Trophies2Go.com www.trophies2go.com	Fast loading page	Too much stuff on page
	Free engraving	Cannot find where to engrave
	Large selection	Many pages to view
	Free shipping	3-7 days + shipping

The QuickTrophy web site is clean, tastefully designed, and easy to navigate. Customers can place an order in 6 pages (3 to specify the trophies and engraving, 3 to specify shipping and credit card information). The entire order process can be completed in 10 minutes for a team of 12 players.

Communication and customer service is extremely important at QuickTrophy so the customer knows what to expect and when to expect it. After placing their order, they are automatically sent an e-mail from the credit card processor informing them that their credit card was charged and the amount it was charged. Then they are sent an e-mail from QuickTrophy listing the details of their order along with a request to review it for accuracy and call or e-mail in any corrections. When the order is completed and shipped, they are sent an e-mail from UPS with the package tracking number and a link to the UPS web site to track their order to their door. If there are any questions about their order, a QuickTrophy representative will call and/or e-mail the customer for confirmation or clarification.

Price

QuickTrophy prices its products comparable to other internet retailers. Retail prices of other internet retailers are periodically checked and compared to QuickTrophy's prices for any changes. Periodic price testing of trophies between product lines (e.g., for example raising the price of all golf trophies and lowering the prices on all bowling trophies) has demonstrated that a great deal of price elasticity exists in this market. Although the internet invites easy comparative price shopping, it appears price is not a primary concern among QuickTrophy customers.

Engraving is included in the price for all trophies. Engraving on medals is optional and costs \$0.99 per medal (3 lines are allowed). Shipping costs are based on the UPS shipping model using weight, distance, and speed to calculate the costs. Most orders cost about \$7 to ship via UPS Ground.

Promotion

Because QuickTrophy is an internet company and sells all their products through their web site, their marketing efforts have focused on directing people to their web site.

Their primary marketing strategy has been to achieve key placement on internet search engines. This has been pursued in a variety of ways. The fastest and easiest method to get top placement on a search engine listing is to buy it. This is done via pay-per-click vendors such as Overture, Ah-ha, 7Search, and Yahoo! Pay-per-click vendors let retailers bid on key words (such as "trophy" or "trophies") or keyword phrases (such as "baseball trophies"). When an internet user types the keyword in a search engine (such as MSN, AOL, Looksmart, Ask Jeeves, etc.) the highest bidders appear at the top of the page and the rest of the matches appear below them in an order determined by the search engine. When a customer clicks on the listing, it takes them to the company's home page, and automatically charges the company their bid price. This free-market approach works reasonably well except that usually only the top 3 bidders get to appear at the top of the search engine list, so a company like QuickTrophy.com needs to be a top bidder in order to

make the cut. Quite often the most popular key words get bid way beyond the point where they make any economic sense, particularly for smaller firms.

QuickTrophy's second method to get high placement on the search engines is to optimize the web pages to fit the criteria each search engine uses to rank their pages. These are the pages that appear below the paid listings. Each search engine uses different criteria and changes those criteria periodically. You can purchase software to help you optimize your web pages, but everyone uses the same software, so it doesn't help much. Another option is to contract out the optimization to a company that specializes in this service. Of course, they also charge on a click-through basis.

QuickTrophy's secondary marketing effort has focused on direct e-mail. Their database of e-mail addresses has been obtained primarily by direct on-line searches of league web sites, sports portal sites (eteamz, ysusa, etc.), and individual team web sites. Their e-mails point out the key selling points of a simple, easy to use web site, fast production of custom made trophies, and accurate engraving. QuickTrophy sends out e-mails at the beginning of each sport season and includes pictures of our products. They also send out follow up e-mails 2 to 3 weeks later.

Place / Distribution

The primary distribution method for QuickTrophy products is via the QuickTrophy web site: www.QuickTrophy.com. Details of this are covered in the above section.

An alternative distribution strategy QuickTrophy employs is to supply finished trophies for other retailers. QuickTrophy currently supplies selected trophies to an internet retail site and labels them with the retailers name tag and drop ships directly to the customer. Although this does not help their brand recognition, it does provide production volume to the factory and revenue to the income stream.

Another distribution strategy is to employ sales representatives on a commission basis. QuickTrophy has set them up with their own web page (for example see Mark Johnson's Home page at markj.QuickTrophy.com). Results of sales reps has been limited.

CURRENT PERFORMANCE CHALLENGES

Since the time that Stephen had such an excruciating experience with his local trophy shop and tried to order trophies on the web but could find no companies to help him, QuickTrophy has emerged to fill that void. However, in the meantime, other competitors have also entered the arena. Now the strategic picture has changed and the challenges have likewise changed.

1. How can QuickTrophy achieve brand recognition in a rapidly congested internet marketplace? How can a national brand be built on a local marketing budget? When a volunteer coach needs to get trophies, what can be done to make sure he or she thinks of

QuickTrophy? What methods of brand-building can be employed that are effective and yet inexpensive?

2. Search engine placement is rapidly increasing in price to ridiculous levels. How can more traffic be driven to the web site on a cost-effective basis? What will it take to double the number of web site visitors? Quadruple? Increase the visitors by an order of magnitude? What methods are available and what will each method cost - in total and on a per customer basis? In other words, what are the customer acquisition costs per method?
3. People only coach for a few years, and only purchase trophies once or twice a year. How can QuckTrophy.com get to the decision-maker at the right time? How many new customers need to be added each month to replace "lost" coaches and still achieve a significant level of growth? How can "new" customers be identified and cultivated by QuickTrophy.com ?
4. Are there other market channels that should be exploited? Other product lines that should be added? How can QuickTrophy build sales to \$1 to \$2 million in 2 years? How can sales be increased to \$10 million in 5 years?

BOVINE PREGNANCY TESTING, INC.

Joseph J. Geiger, University of Idaho

Scott Metlen, University of Idaho

Douglas Haines, University of Idaho

CASE DESCRIPTION

BPT is a business start up case, based upon field research, requiring students to examine initial financing, marketing issues involving changing customer attitudes, and determining appropriate core customer groups. Additional issues include developing an appropriate organizational structure and developing business process arrangements with domestic and foreign customers. The difficulty level is five, with sufficient information provided in the instructor notes to use the case in both senior and graduate level strategy, policy, and entrepreneurship courses. The case is designed to be taught in two class sessions following reading of the case and instructor handouts provided in the case notes (two hours). A formal case write-up and presentation by a student or case team should take approximately 10 hours.

CASE SYNOPSIS

Bovine Pregnancy Testing, Inc., (BPT), is a bio-tech start up firm whose main product, ELISA, is designed to provide dairy farmers with early and accurate pregnancy testing capabilities not requiring manual examinations which can injure and/or abort the fetus. Because the productivity of dairy cows is related to frequency and timing of pregnancies, incremental improvements in pregnancy testing can significantly improve profits. The firm's product cannot be patented but is protected by trade secrets and technical know-how.

BPT is two years old with a small customer base. Growth has been hampered by a lack of capital, resistance to change by dairy farmers, and poor marketing. The current product, which requires blood samples to be sent to regional veterinary laboratories for over night testing, is competitive with traditional manual examinations performed by veterinarians. An upgraded test that can be administered by the dairy operator (i.e., "cow-side") is in the development stage. With 9 million dairy cows in the United States, the product has a multi-million dollar per year sales potential. Interest in the product has also been achieved in at least two foreign countries.

BPT has many challenges: (1) overcoming the resistance of veterinarians who earn fees from the traditional manual testing, (2) creating a compelling argument for angel/venture venture capital financing, (3) determining the core customer group (large or small herds and/or domestic or foreign markets), and (4) managing and operating a start-up business. The case is based upon field research

involving BPT leadership, operators of dairy herds, and owner-operators of veterinary clinics and laboratories. Information provided in the case and the instructors' notes provides students with opportunities to explore angel/venture capital financing, marketing high technology products, product positioning, developing financial and marketing elements of a business plan, and exploring many practical aspects of launching a new business.

BOVINE PREGNANCY TESTING, INC.

Garrett and Amy Johnson had great expectations when they decided two years ago to scale up their tiny pregnancy testing business into a larger firm. Prior to the decision, they had taken the results of Garrett's research to perform small-scale pregnancy testing on request from owners/managers of certain wild game animal farms. When the bovine blood test was perfected, they enlisted Garrett's network of fellow researchers, veterinarians, and family members to seek initial customers. The initial plan was to target large dairy herd managers and to work through the large veterinary clinics that typically served the larger operations. BPT believed the product would be an instant success because of two crucial advantages: (1) the test provided earlier detection than the traditional manual examinations performed by veterinarians, and (2) there was no danger of aborting the fetus as a result of performing the manual test. In addition, the cost, while greater than a manual examination, proved to be very competitive when the incidence of fetus loss and earlier detection were taken into consideration (see Table 1). The manual examination, or rectal palpation, required the examining veterinarian to insert her/his gloved hand through the cow's anus until the fetus was reached and manually examined.

Table 1 Cost Savings Using Elisa Test (Source: Bpt Website)		
Cost Item	BPT Test Cost (per cow)	Manual Test Cost (per cow)
Labor, Blood, or Palpate	\$0.33	\$1.67
Supplies and Shipping	\$0.50	\$0.10
Veterinarian Travel Fee	\$0.00	\$0.00 (1)
Embryo Death	\$0.00	\$1.44 (2)
Test Inaccuracy Cost	\$0.00	\$2.00 (3)
Lab Analysis	\$1.70	\$0.00 (4)
Record Keeping	\$0.10	\$0.16
Total per 100 cows	\$254	\$537

Notes:

- (1) No cost for ELISA because the test is shipped to vet; Manual test travel cost is included in basic site visit costs by vet for manual test
- (2) Cost of lost milk and new cow production - ELISA does not endanger embryo
- (3) ELISA is 98% accurate, cost difference reflects net difference between manual and ELISA - A false negative results in hormone treatment prior to next impregnation which aborts an existing embryo and results in lost milk and calf production
- (4) Based upon average sized or small herds; some savings in ELISA per test costs for large herds.

Garrett and Amy had analyzed the distribution of dairy herds in the United States (Table 2) and concluded that a profitable firm was possible by contracting with several well-chosen regional veterinary clinics. The owners were equally excited about the potential development of a 'cow side' pregnancy exam that would not require the direct involvement of a veterinarian. They knew the 'cow side' test would be competitive with both the manual tests and the ELISA lab test provided by the veterinary clinics, but thought the problem of market penetration could be managed by targeting only the small herds that were less attractive to veterinarians who relied on providing manual tests for a major portion of their income.

Table 2 Number of Operations by Size and Percent of Herd Inventory for 2002

(Source: USDA web site)

Total United States Herd Inventory							9,151,700
Total Operations in the United States							91,990
Herd Size	# Operations	% Operations	Cumulative %	% Inventory	Cumulative %	# Inventory	
1-29	25680	27.9	27.9	2.3	2.3	210,489	
30-49	18525	20.1	48.1	7.5	9.8	686,378	
50-99	27865	30.3	78.3	20.1	29.9	1,839,492	
100-199	11860	12.9	91.2	16.7	46.6	1,528,334	
200-499	5155	5.6	96.8	16.1	62.7	1,473,424	
500-999	1750	1.9	98.7	12.5	75.2	1,143,963	
1000-1900	775	0.8	99.6	11.5	86.7	1,052,446	
2000+	380	0.4	100.0	13.3	100	1,217,176	

Table 3 Number of Operations, Herd Inventory, Avg. Herd Size by Region in Usa

(Source: USDA web site)

Region	# Operations	% Operations	% Inventory	# Inventory	Average Herd Size
North West	7,150	7.77	12.25	1,121,000	157
South West	7,600	8.26	28.15	2,576,000	339
Central	47,600	51.75	34.39	3,147,000	66
North East	20,670	22.47	17.33	1,586,400	76
South East	8,970	9.75	7.88	721,300	80

Table 4 Inventory by International Region (2001)

(Source: USDA website)

Region	% Inventory	# Inventory
North America	8.17	10,206,000
Central America	5.45	6,800,000
South America	16.26	20,300,000
Europe	20.16	25,174,000
Russia & Ukraine	13.98	17,458,000
Asia	7.23	9,029,000
India	28.75	35,900,000
Total	100	124,867,000

At a recent meeting of the owners with their primary (and first) regional veterinary clinic, it had become apparent that while interest in using the test was shared by two of the partners, both vets and herd owners were concerned because of the threat to their income, concern over the limited data on the reliability of the test when used in high volumes, and general resistance to change by dairy owners. Inquiries at several other large regional clinics by Garrett and friends of BPT produced similar concerns but a willingness to listen and perhaps try out the product. Individuals interested in being 'field representatives' have explored opportunities in the rocky mountain and Idaho regions and have found significant interest. These individuals have suggested that they would

work for a 'finder's fee' plus commission. Nevertheless, the BPT owners were becoming discouraged and, as they related to a friend who had performed initial financial analyses for BPT, "We don't have sufficient funds to hire a full time sales force, we don't know anything about an incentive/commission based field representative work force, the cost of developing the cow side test is estimated at \$200,000 and will take two years to develop. Family members are not trained or very good at marketing, and we can't seem to rapidly grow a large customer base." When asked about the potential for a foreign market, Garrett's spirit rose: "We have found a veterinary in Europe who wants to license the product and I have a scientist friend in Korea who is also interested. Garrett had also identified individuals in nine foreign countries who might be induced into working with us. Perhaps we should focus on the foreign markets," he asked? "In any event", replied Amy, "we need a break"! "What should we do", she asked?

GENERAL OPERATING CHARACTERISTICS OF DAIRY INDUSTRY

Current dairy management exhibits many characteristics similar to modern manufacturing. Each cow is viewed as a production unit manufacturing milk, butterfat, and cream. Each cow has an identification number used to collect health, production, life cycle, and reproductive schedule and history. Creating and maintaining a productive herd of milk cows requires skillful use of data to ensure timely impregnation of a cow so that optimal milk production can be maintained for the duration of a milk cow's life. It is crucial to determine as soon as possible if a cow has been impregnated once a cow has been bred. If the cow is not pregnant, steps are taken to ensure impregnation during the next menstrual cycle. Delays in pregnancy have significant financial implications including the cost of re-impregnating the cow. More importantly, delayed pregnancy results in below optimum milk production over a cow's lifecycle. BPT's product is designed for early and accurate determination of pregnancy and thus addresses most of these problems.

BPT's PRODUCT-PROCESS MODEL

Small blood samples are collected by the lead herds person, documented, and sent to the local vet lab. BPT provides a glass plate containing dozens of small, shallow indentations (wells). Each well is coated with a substance based on an "enzyme-linked immuno assay" or 'ELISA' which is the product of BPT's scientific research. The firm's trade secrets are based on the ingredients in the ELISA coating, the biological/ chemical formulae, preparation, and the manner in which the 'wells' are coated (shelf life of the plates is several months). Blood serum from a specific, identified cow is placed in the well and treated over a short period of time. Each participating veterinary laboratory must be trained and certified in the use of the plates. The results of the reaction between the ELISA

coating on the well and the blood serum are analyzed and pregnancy confirmed. The results are accurate 95% (98 % accurate against a false positive) of the time at 28 days after onset - meeting or exceeding all other testing procedures. The results are provided to the dairy owner within 36 hours from the time the blood sample was taken.

BPT's BUSINESS MODEL

The business model is based upon BPT manufacturing and supplying the ELISA plates to participating veterinarians who then use them for determining individual pregnancies for the dairy herds. The cost of production per plate (well) test is approximately \$.23 per test. The BPT owners believe break even is achieved with approximately 50,000 tests per year (no salary for owners). The gross revenue is \$1.00 per test in the US, and is \$1.80 per test for potential foreign operations. Additional shipping costs for foreign customers are approximately \$0.20 per test.

LAUNCHING THE FIRM

Despite the problems associated with financing, marketing, and organizational structure the Johnson's decided to establish an appropriate management and marketing structure and pursue start up funds. Based upon the essential merits of the ELISA product and the potentially enormous domestic and global markets, they believed a compelling case could be made to investors. They returned to their financial advisor who estimated that start-up funds on the order of \$200,000 were needed to finance the firm from 2003 through 2005 with additional 'phase 2' financing needed as the firm grew to \$1,000,000 in net sales (see Table 5).

The advisor based his pro forma income statement, balance sheet and external funds needed on a set of assumptions derived from conversations with the owners and an analysis of the industry (see Table 6). The Johnson's also believed that they could produce 1,000,000 tests with their current facility and incremental increases in hourly staff. They agreed that they should hire a part-time (20%) field representative (\$40,000/ representative full-time). The development and use of the 'cow side' test was viewed by the Johnsons as vital to achieving their initial sales goal of \$1,000,000 sales per year.

Table 5 Bpt Financial Statements					
Income	2002	% Sales	Balance Sheet	% Sales	2002
ELISA preg testing	\$ 58,252		Assets		
Elk preg testing	\$ 2,412		Cash	12%	\$ 7,200
Returns, Allowances	\$ (973)	2%	Mkt Securities	32%	\$ 18,225
Discounts	\$ 2,000	4%	Acct. Receivable	21%	\$ 12,154
Total Net Sales	\$ 57,691		Inventory	24%	\$ 14,000
Expenses			Fixed Assets, Net	48%	\$ 27,500
Advertising	\$ 11,000	19%	Total Assets		\$ 79,079
Bookkeeping	\$ 2,000	3%			
Contract Labor	\$ 8,000	14%			
Insurance	\$ 2,600	5%	Liabilities		
Misc. Exp.	\$ 3,600	6%	Acct Payable	13%	\$ 1,850
Lab. Supplies	\$ 4,300	7%	Payroll Liabilities	15%	\$ 725
Legal Fees	\$ 1,000	2%	Long Term Debt		\$ -
Payroll	\$ 5,000	9%	Total Liabilities		\$ 2,575
Other Contract Svcs	\$ 3,500	6%	Equity		
Building Rent/Taxes	\$ 7,500	13%	Owners Equity		\$ 100,000
Shipping	\$ 900	2%	Retained Earnings		\$ (23,496)
Travel	\$ 2,000	3%	Total Equity		\$ 76,504
Utilities	\$ 5,000	9%	Total Liab and Equity		\$ 79,079
Total Expenses	\$ 56,400				
Net Income	\$ 1,291				

Table 6 Assumptions Used by Bpt for 2003-2005 Financial Forecast			
Income	Assumptions for 2003-5 And a \$1,000,000 Sales Est.	Balance Sheet	Assumptions for 2003-5 & \$1,000,000 Sales Target
ELISA preg testing	50% Growth for three years, no increase in \$1.0/unit sales	Assets	
Elk preg testing	Flat sales	Cash	12% or 44 days of expenses; 8.33% or 30 days
Returns, Allowances	2% of Sales	Mkt Securities	10% for 3 years, 2.5 % thereafter
Discounts	4%,3%,2%	Acct. Receivable	27%,25%,25% or 90 days; 40 days
Total Sales		Inventory	20% or 73 days;30 days
		Fixed Assets, Net	Estimate of new equipment needs
Expenses		Total Assets	
Advertising	21%;25%;20%,10%		
Acct/ Bookkeeping	3%,2%,2%	Liabilities	
Contract Labor	14%,14%,12%;	Acct Payable	13% of Inventory
Contract Marketing	Cost of Field Representatives	Payroll Liabilities	2%of payroll
Insurance	4%,3%,3%,3%	Long Term Debt	See "Plug"
Misc. Exp.	5%,4%,3%,3%	Total Liabilities	
Lab. Supplies	8%,7%,6%,6%		
Legal Fees	2%; assume no litigation	"Plug" To Balance	New Debt Need (Not needed)
Payroll	9%,10%,11%,11%		
Other Contract Svcs	Constant 6% of sales	Equity	
Building Rent/Taxes	Plugged - slight increases	Owners Equity	
Shipping	Constant @ 2%	Retained Earnings	
Travel	5%,5%,4%,2% thereafter	Total Equity	
Utilities	7%,6%,5%,4%		
Total Expenses	Total Liab and Equity		
Net Income	Assume No Dividends	Total Liab/Equity w/New Debt:	
Net Income % of Sales			

TELECOMMUTING TROUBLES

Kellyann Berube Kowalski, University of Massachusetts - Dartmouth
Jennifer A. Swanson, Stonehill College

CASE DESCRIPTION

The primary subject matter of this case concerns telecommuting. Secondary issues examined include decision-making, motivation, leadership style, and empowerment. The case has a difficulty level appropriate for the junior level and above. The case is designed to be taught in one class hour and is expected to require one hour of outside preparation by students.

CASE SYNOPSIS

The world is undergoing a transformation from the industrial age to the information age and we are seeing many changes to the world of work and management. One of the ways that information technology is changing work is telecommuting. Telecommuting is becoming more prevalent as an alternative working arrangement. The International Telework Association and Council (ITAC) estimates that nearly 25 million Americans regularly work from home one or two days a week. Furthermore, ITAC forecasts that the number of telecommuters will reach 30 million by 2004. As the number of telecommuters continues to increase, it is important for business students to have an understanding of the issues involved in managing telecommuters.

Telecommuting Troubles is a case detailing a telecommuting work arrangement of one member of a product development team. Difficulties arise as the telecommuter no longer feels an integral part of the team. Analysis of the case allows students to see from the perspective of the telecommuter, the manager, and the coworkers how telecommuting is changing how, where and when we work. The case is designed to allow students to apply and evaluate organizational behavior concepts such as decision-making, motivation, leadership style, and empowerment to an alternative work arrangement.

CASE PART A

Subject: Product Line
Date: Monday, June 27 2003 08:24:22 EST
From: Susan Jefferson <sjefferson@abcbaby.com>
To: Christine Henley <chenley@abcbaby.com>
X-Mailer: Internet Mail Service

Hey Christine!

I just wanted to let you know that the team decided not to go with your recommended product line after all. Gotta run, I'm swamped. You have no idea how lucky you are to be able to work from home - we're all so envious! See you at our Wednesday meeting. Don't watch too many talk shows!

Talk to you later, Susan

Susan Jefferson
Advertising Executive
ABC Baby, Inc.
Phone: (508) 111-1314
Fax: (508) 111-2424

Christine cannot believe the e-mail she has just read and wonders how this can be possible! Last week it was unanimously decided that the product development team would go ahead with the no-spill toddler cup product line that Christine had firmly recommended. Christine wonders what could have happened in the last few days to bring about such a change. In her position as Market Research Analyst, Christine had spent months researching the viability of the no-spill toddler cup line. All research results indicated that the toddler cup line would be enormously successful. As a member of the product development team, it was Christine's responsibility to present the team with research results and make recommendations based on them. The team had always supported her recommendations in the past. Last Wednesday, everyone had seemed so enthusiastic about the proposed product line. Christine kept thinking, "When did the team meet again and why did they meet without me? What did Susan mean that 'the team' had decided against the no-spill toddler cup line? Wasn't I a part of that team?" Christine finally decided to see if she could get answers to her questions.

Christine picks up the telephone to call Scott, her boss and the Marketing Director and head of the product development team.

Christine: "Hi Scott, this is Christine."

Scott: "Hi, it's nice to hear from you. What can I do for you today?"

Christine: "Well, I just got a disturbing e-mail message from Susan informing me about the product line change. When did all this happen? I thought we made a final decision at last week's meeting."

Scott: "Oh, don't worry about it! The team went out last Friday after work for happy hour and the topic of the toddler cup product line came up in conversation. It seems some team members had concerns about its success. We talked about it for awhile and decided that there is really no need for a new cup line because we already have one."

Christine: "Yes, but as we discussed last week, the cup line I proposed is entirely different. The cups are impossible to spill! All my research subjects indicated that parents wanted this type of product and would definitely purchase no-spill toddler cups if they were on the market."

Scott: "Christine, I don't know what to tell you. Some of the team members had reservations about the product line. I wish I could discuss this with you further but I am already late for a meeting. We'll talk about this when you actually come into work on Wednesday."

Christine hangs up the phone, even more upset than before. She thinks to herself, "How could things at work have gotten so bad?" Christine thinks back to Wednesday's team meeting in Scott's office. She had presented her research findings during the first part of the meeting. Discussion had followed and it seemed as if the team members liked the proposed product line. Christine wonders, "Maybe they don't trust my research like they used to." There had been the usual snide comments about her telecommuting work situation during the meeting. Though she was getting weary of hearing such comments from her coworkers, she had always taken them lightly. Perhaps the comments have not been so innocent after all. Perhaps no one trusts her judgment any more because they don't really believe she is working diligently from her home.

In fact, even Scott seems to be checking up on her more often since she began telecommuting. When Christine worked strictly from the office, Scott was a very hands-off manager. He gave her lots of freedom and flexibility in how she carried out her duties. Now he calls her often and seems to be checking up on her to make sure she is at home working. Scott used to delegate certain responsibilities to her from time to time - this has been less common since she started telecommuting. Was he sending her a subtle message?

When Christine first started telecommuting three months ago, it seemed like the ideal situation. Christine had grown so tired of her daily two-hour commute from her home to the office.

She loved her job as a Market Research Analyst but hated the long drive. Since most of her work could be done from home and the company had already furnished her with a state-of-the-art laptop computer to use for the extra work she took home, she thought that telecommuting would be the ideal solution. When she approached Scott about working from home, he agreed to let her be the company's first telecommuter. Christine was one of the top employees at the company and she knew that Scott did not want to lose her to a company that was closer to her home. It was decided that Christine would work from home four days a week and come in to the office on Wednesdays. Christine was very happy with the arrangement and hoped to be able to spend more time with her husband who worked as a software engineer in their town.

Christine is a member of the Marketing Department at ABC Baby, Inc. ABC is a mid-sized company that designs, produces and sells products for babies and toddlers. Christine has worked for the company for five years, having been promoted several times into her current position. As the only Market Analyst, her primary responsibilities are to collect and analyze research on existing products and possible new products. In doing so, Christine is responsible for organizing focus groups with parents and children, collecting data at shopping malls and retail stores, conducting telephone and e-mail surveys, mailing out questionnaires, and placing observers at various locations to see what people were using. Christine is also responsible for a group of parents whom she uses as a sounding board for proposed new products and product lines. As a member of the product development team, her task is to collect data on what people are looking for in new products and analyze the data in order to develop new products. She then recommends new products or product lines to be considered by the product development team. The team consists of Christine, Scott (Marketing Director), Susan (Advertising Executive), John (Sales and Marketing), and Andrea (Public Relations), all in the Marketing Department. The team also works with the production and finance departments when needed.

Since Christine started telecommuting, she has been working more hours than before, even without the two-hour per day commute. She thinks it is unfair that her coworkers might be wondering if she is not working as hard as they are because she is working from home. The philosophy around here seems to be that in order to be 'working' a person has to be on site. Yet, there are quite a few people in the marketing department who go in to work everyday only to spend a large portion of their time playing computer games and searching the web. It feels as though just because she works from home her ideas are no longer as valuable to the team.

This latest incident is not an isolated case. Christine has been feeling left out of the 'loop' for quite some time now. She thought coming in one full day a week would keep her in the loop. The team had been willing to schedule all meetings on Wednesdays so Christine could attend. However, she has noticed that many of the most important decisions get made at informal times, like the most recent decision made Friday night over happy hour. In addition, whenever Christine needs to find out any task-relevant information from Scott or the rest of the team, she needs to take the

initiative. They just don't keep her abreast of what is going on...unless it is to tell her they shot down her idea of course.

Christine sits back wondering if she is blowing everything out of proportion. She really loves what she does and is committed to the company. The department overall is also doing quite well and the team has been developing new products. She cannot decide what to do next. She thinks about the conversation with Scott, last Wednesday's meeting, and the telecommuting experience. She has to decide how to handle this latest incident.

PART A QUESTIONS

1. What would you do if you were Christine? Apply the decision-making framework to your answer.
2. What are the implications of your decision?

CASE PART B

Christine goes into the office on Wednesday and goes directly to Scott's office.

Christine: "You can't expect me to feel a part of the product development team if decisions are going to be made without me."

Scott: "Christine, what are you talking about?"

Christine: "I am talking about the fact that I thought the decision made last Wednesday regarding the product line was our final decision. I didn't expect it to be changed without my input and knowledge at a dinner I was not a part of nor invited to. Scott, this is not the first time something like this has happened. I really do not feel appreciated or an integral part of this team or department anymore."

Scott: "Christine, I am surprised you are so upset. If you feel so strongly, why don't you come back to work full-time?"

Christine: "Scott, this is exactly my point! I do work full-time. As a matter of fact, I put in more hours since I started telecommuting than before. Things are just not working out."

Christine stomps out of Scott's office, leaving him alone to worry about the situation at hand. Scott knows that Christine is one of his best employees and that he cannot afford to lose her. Christine is intelligent, highly skilled, and he thought she loved her job until now. Scott wonders if he has been insensitive to Christine's needs. This was the first telecommuter he had ever managed and he thought things were going fine. He didn't realize that Christine was at all unhappy. Scott can't help wondering what the problem is. The department is doing well, Christine recently received a wonderful performance evaluation complete with a raise, and the team is successfully developing new products. Scott did have to admit to himself that he did seem to call Christine at home to 'check up' on her and he delegated less tasks to her now that she was working primarily out of the office.

Scott decides to discuss Christine's unhappiness with the other team members. Susan, John, and Andrea seem surprised that Christine is upset. They can't believe that she has the audacity of complaining when she obviously has the best deal in the department working from home.

PART B QUESTIONS

1. Analyze Christine's motivation and her coworkers' motivation using a needs-based model and a process-based model of motivation.
2. How could Scott have better empowered Christine so that the telecommuting experience was more successful?
3. Analyze the relationship between Scott and Christine using the Hersey and Blanchard's Situational Leadership Model.
4. If you were Scott, what would you do next?

SUPERIOR FOODS: A CASE STUDY IN COSO RISK ASSESSMENT

Marla Kraut, University of Idaho
Hugh D. Pforsich, California State University, Sacramento

CASE DESCRIPTION

This case addresses the risk assessment process in the internal audit function. The level of difficulty is four. The case should require about three hours of classroom time for coverage and students should expect to spend another three to four hours in preparation time outside class. This case is designed to be used in an accounting information systems or auditing course, graduate or undergraduate. In order for students to learn how to audit a client's risk assessment process, they must first gain a detailed understanding of that process. This case has been developed to provide exposure to an actual company's risk assessment process and thereby provide guidance for this understanding.

CASE SYNOPSIS

This case describes the development, implementation, and results of a Fortune 500 company's risk assessment process. Some information about the company has been altered due to the company's request for anonymity. However, the detailed descriptions of the risk assessment process and the risks identified by management are factual.

The newly hired Director of Internal Audit Services in this case already had seven years of experience managing external audits for a major international public accounting firm. The company had been one of his audit clients, so he was very familiar with their internal controls and financial reporting procedures. He was hired to develop a comprehensive internal control program to comply with the COSO Report (1992). His first step was to develop a process of risk assessment. This case describes the design and implementation of that risk assessment process.

"I've done over fifty audits...evaluation of internal control systems, tests of controls, substantive tests, etc... now COSO requires management to have a risk assessment process. How do we design, implement, and then audit this new 'process?'"

*-- Greg Johnson, CPA
Director of Internal Audit
Superior Foods, Inc.*

INTRODUCTION: COMPANY HISTORY

Superior Foods is a household name throughout the Southeast. When James Superior and his wife, Janie, opened the doors of his first grocery store in 1949, they were more focused on quality than quantity. Their motto from the beginning, that soon thereafter became their reputation, was "the customer is superior." Shoppers in the area learned that the best place to buy quality food in a clean store at a fair price was Superior Foods. Within two years of opening, the store's sales volume began to take off. After numerous additions and renovations, that first store had no room to grow. Superior decided to branch out, not with just one new store, but three. James Superior's special talent for training management and new employees allowed him to reproduce the renowned customer service developed in the first store. James established an extensive training program over the next ten years to give all his stores an almost uniform persona that people in the South really came to love and appreciate. By 1958, the company had grown to fifteen stores.

By 1980, Superior Foods was a regional chain of 200 supermarkets. The average store size had doubled to 20,000 square feet and sales had swelled to over \$400 million, an increase of 100 percent in just the last four years. The company went public in 1985. By 1990, the company grew to be one of the top 40 merchandisers in the country with 1,200 stores across seven states, 15 distribution centers, 105,000 employees, and over 7,000 shareholders. During this time, Superior Foods implemented electronic scanning and expanded their basic grocery service to include delicatessens, bakeries, pharmacies, coffee shops, and in some locations, full department stores. Superior Foods was truly "superior" in the Southeast food services industry. Sales had reached \$25 billion, net earnings approached \$750 million, and the company was poised for its next major expansion program, westward as far as Colorado and northeastward to New England.

THE COSO REPORT

The history of internal controls at Superior Foods was not unlike that of most of its peers. Prior to 1994, the company did not have an internal audit department, but did have a sophisticated set of internal controls to safeguard assets and to assure reliable financial reporting. In 1993, the Board of Directors became aware of an important study on the development of an integrated internal control program. The study was conducted by the Treadway Commission¹ through a group of several leading accounting organizations² called the Committee of Sponsoring Organizations of the Treadway Commission (*COSO*). In 1992, the report on this study, known as the *COSO* Report (*COSO* 1992), was published. According to the report's new definition, internal control is a "process" that is the responsibility of an entity's Board of Directors, management, and other personnel. In October of 1993, Superior Foods' Board of Directors took its first step to address this responsibility by hiring Greg Johnson, their former external auditor, as the new Director of Internal Audit Services. Johnson was instructed to establish a comprehensive internal control program.

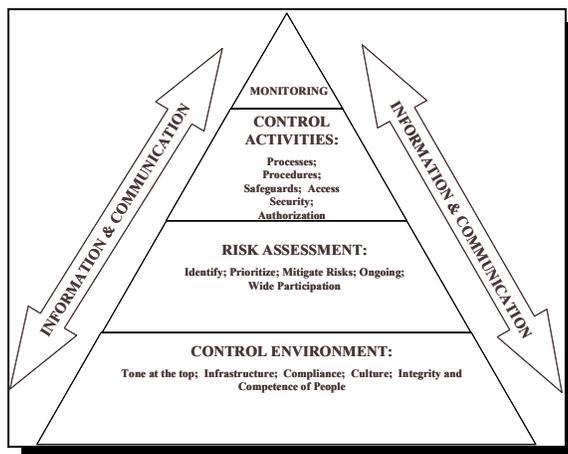
The *COSO* Report gave Superior Foods' Board of Directors, management, and specifically, Johnson, a formal framework to aid them in implementing an effective internal control program. Since the *COSO* Report had just been recently published, Johnson, like most accountants and business professionals, needed to become familiar with the details of the new framework.³ Johnson thought that the following information from the *COSO* Report was important in order to understand this new internal control framework.

The *COSO* Report emphasizes the need for an ongoing process of internal control that would provide management with reasonable assurance regarding the achievement of the company's objectives in three categories:

1. Effectiveness and efficiency of operations,
2. Reliability of financial reporting,
3. Compliance with applicable laws and regulations.

The first category of objectives regarding operations is related to the achievement of a company's basic mission. These objectives pertain to effectiveness and efficiency of the operations, including performance and financial goals and safeguarding resources against loss (i.e., theft of assets). The financial reporting objectives pertain to the preparation of reliable financial statements, including the prevention of fraudulent financial reporting. They are driven primarily by external requirements (GAAP or SEC requirements, etc.) but must satisfy management's need for adequate financial and operating information. Compliance objectives pertain to laws and regulations such as IRS regulations, OSHA requirements, and EPA regulations.

The *COSO* Report states that five critical components are necessary for an internal control program to assure management that a company's business objectives will be accomplished. These internal control components are depicted in the following pyramid⁴ and further defined in the subsequent table:



INTERNAL CONTROL COMPONENTS PER THE <i>COSO</i> REPORT	
<i>Control Environment</i>	Sets the tone of an organization and influences the control consciousness of its employees.
<i>Risk Assessment</i>	A process of identifying, analyzing, and managing the relevant risks associated with the organization's ability to achieve its objectives. It forms the basis for determining what risks need to be controlled and the establishment of controls that will mitigate those risks.
<i>Control Activities</i>	The policies and procedures that help ensure that management directives are carried out.
<i>Information & Communication</i>	Systems necessary to enable the organization's personnel to capture and exchange information needed to conduct, manage and control its operations.
<i>Monitoring</i>	The process of assessing the quality of internal control performance over time to determine whether controls are operating as intended. It also includes the modification of controls as appropriate for changes in conditions.

In studying the report, Johnson noted that the components of control activities, information & communication, and monitoring are dependent on the risk assessment process, and therefore he realized that the development of the risk assessment process was his first step in establishing an internal control program.

THE RISK ASSESSMENT PROCESS AT SUPERIOR FOODS

From his years of auditing Superior Foods from the outside, Johnson was aware that, although a standard structure of internal control procedures was in place, the company did not have a comprehensive risk assessment process to the extent described in the *COSO* Report. As discussed in the report, many of the potential risks to Superior Food's business objectives had not been formally identified, assessed, or linked to controls.

Based on *COSO's* definition of risk assessment, it was clear that Johnson needed to broaden his understanding of the term "risk." As an external auditor in public accounting, he had always viewed risk as any threat to the fair reporting of financial information under audit. He had been trained and experienced in the implementation of internal controls to assure such fair financial reporting, but Johnson had less experience with risks related to the effectiveness and efficiency of operations or the risks related to compliance with laws and regulations. Now he had to consider a broad array of business risks related to the achievement of the company's entire set of business objectives. Johnson knew that once Superior Foods' specific risk factors were identified, they would have to be linked to specific business processes and controls.

MANAGEMENT'S RESPONSIBILITIES

Johnson's first step in developing a formal risk assessment plan was to receive approval at the executive level from the Board of Directors and the corporate management team (CEO, CFO, VP of Tax, VP of Operations, and VP of Human Resources). Initially, the executive team expressed a particular interest in increasing Superior Foods' system controls. Johnson explained to them that he would need to design not just a set of internal controls, but a comprehensive, ongoing, iterative risk assessment process (see Table 1).

Table 1: Risk Assessment Process
1. Identify the risks to the organization.
2. Determine any potential effects of the risks to the organization.
3. Determine the likelihood of a loss actually occurring.
4. Determine how much potential monetary loss is present (i.e. impact).
5. Estimate the potential monetary loss from the risk (combining steps 3 and 4).
6. Rank the risks (individually or by activity).
7. Determine if controls exist to mitigate the above risks.
8. Design or formulate additional controls if necessary.
9. Implement controls.
10. Test operational compliance of controls.
11. Evaluate controls.
12. Periodically reevaluate the risk assessment plan.

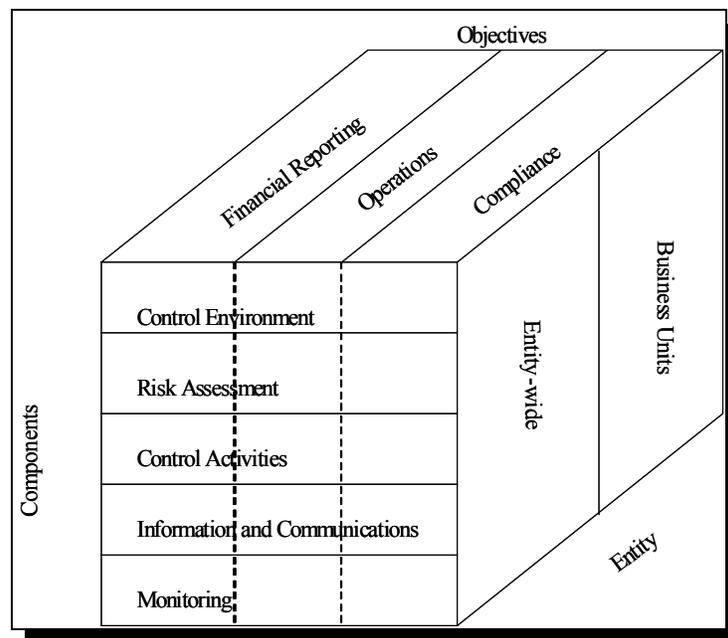
In discussing this process, he explained that management would need to define the company's objectives. Management informed Johnson that the company's objectives were already defined as part of the company's strategic plan developed several years before. Johnson then told the executives that the risks associated with the company's objectives would have to be identified. Next, the risks would have to be assessed, meaning that their likelihood of occurrence and monetary impact would have to be estimated. He also reminded them that, as management, they were ultimately responsible for the process of risk assessment and management, and therefore would have to decide whether to *accept*, *transfer*, *mitigate*, or *avoid* each risk identified. If a risk had a low likelihood of occurrence and low potential financial impact, it could simply be *accepted*. If the likelihood of occurrence was low but the potential impact was catastrophic, the risk could possibly be *transferred* by purchasing insurance. However, if the risk had both a high likelihood of

occurrence and a high potential impact, a set of controls was needed to *mitigate* it by reducing either its likelihood or impact, or both. If appropriate controls and/or insurance were not feasible, then the risk may have to be *avoided* by discontinuing that portion of the business most vulnerable to such a risk or by raising sales prices to garner a sufficient return to offset the risk.

Following this discussion, Johnson received the management team's approval to design and implement a risk assessment program. He informed them that he would be consulting with them regularly throughout the process.

RISK ASSESSMENT ON TWO LEVELS

Based on the guidance of the *COSO* Report and management approval, Johnson decided to design the risk assessment process at two levels: the entity-wide assessment level and the business-unit assessment level. The following cube diagram puts the *COSO* framework's five components and three objectives, along with Superior Food's two entity levels, in perspective:⁵



The *COSO* Report stresses the need for a continuous assessment process of identifying, analyzing, and managing the comprehensive entity-wide risks related to a firm's sale of goods and services, information sharing, internal personnel, and external business-partner relationships. For

the "entity-wide assessment," the following eight external and internal factors from which risks might arise were considered:

1.	Supply sources
2.	Information and technology
3.	Financial
4.	Products and services
5.	Customers and markets
6.	Legal and regulatory mandates
7.	Natural events
8.	Human resources.

Johnson worked with his new internal auditing staff to organize the entity-wide risks into three broad categories: general risks, technical risks, and natural risks. General risks include labor strikes, disruption of supply, theft of cash, and noncompliance with income tax regulations, etc. Technical risks include risks such as accounting system software failure and failure of cash registers. Natural risks may include damage from hurricanes and fire, etc. The three types of risks would have to be identified for the corporate office, division offices, distribution centers, and retail operations. According to the *COSO* Report, risks should also be identified at the activity level. Dealing with risks at this level helps focus risk management on major business units for functions such as sales, production, marketing, technology development, research and development. After numerous discussions with management, Johnson decided that the "business-unit assessment" should be organized for each of the following business units and processes:

Business Unit	Business Processes
Corporate office	Payroll, purchasing, and financial reporting
Division offices	Pricing and marketing
Distribution centers	Procurement and shipping
Retail stores	Sales and receiving

Johnson's next step was to identify the specific risks of the various business processes and then evaluate the existing internal controls.

THE SCOPE OF INVOLVEMENT IN THE RISK ASSESSMENT PROCESS

According to the *COSO* framework, Superior Foods' risk assessment program should span internally from the senior executive level all the way down to operations. Furthermore, external risks must be considered, particularly pertaining to compliance with applicable laws and regulations. Given the scope of such a risk assessment program, Johnson knew that he would need to involve Superior Foods' personnel on every level.

Johnson began at the top by holding discussions with the CEO, the CFO, and the Controller. Next, he spent several months interviewing the managers of all the various business units (corporate office, division offices, distribution centers, and retail operations), and individual employees who worked in these business units. It was at these levels of middle management and operations that most of the specific threats and risks were identified.

Finally, Johnson went outside the firm to seek the perspective of the external auditors, attorneys, stock analysts, industry analysts, and economists who audited, represented, and/or monitored Superior Foods. These discussions focused on the identification of two risk types: 1) the firm's compliance with relevant laws and regulations, and 2) a comprehensive analysis of industry and economic trends pertaining to Superior Foods.

RISK LIKELIHOOD AND IMPACT

After conducting a first round of interviews to gain a thorough understanding of Superior Foods' risk portfolio, Johnson and his staff conducted a second round of interviews focused on estimating the likelihood of occurrence and the potential monetary impact of each identified risk. In addition, the strength of contingency plans and existing controls for each identified risk was assessed. If a particular risk was not covered by a control, then one or more controls for that risk were developed. In some circumstances it was apparent that a control was either not applicable or not cost effective. In such a situation, was the firm's insurance plan sufficient to cover the potential loss?

Senior management was most influential in determining the ranking of the risks. The entire risk assessment process took about one year. Understanding that risks change over time, Johnson decided that the risk assessment plan needed to be reassessed and evaluated every three years. Tables 2 and 3 display the forms used by Johnson to document the specific risks identified by the entity-wide and business-unit risk analyses.

Table 2: Entity-Wide Risk Analysis Form

Risks (General)	Potential Affects of Risks	Superior's Ranking Codes				Contingency Plans and Controls	Control Rating 1=Effective 2=Limited 3=Deficient
		P	T	I	Wt		
Labor Strikes	Disruption of operations. Loss of sales. Negative publicity.					Contracts and disputes are monitored. Dispersion of contract dates. Contingency plans.	
Disruption of Supply	Inability to meet consumer demands. Loss of sales.					Alternative vendors in place. Back up plans to distribute goods.	

CODES

P = Probability (low = 1, medium = 2, high = 3)

T = Threat (low = 1, medium = 2, high = 3, where,

Speed of onset: slow = 0, fast = 1

Forewarning: forewarning = 0, no forewarning = 1

Duration: short = 0, long = 1)

I = Impact (Low, Medium, High)

Wt = Weight (relative weight = P x T x I)

Table 3: Business-Unit Process Risk Analysis Form		
Retail Stores -- Receiving		
Control Objectives	Risks	Controls
Correct quantity is received.	Theft. Pay for goods not received.	All product must be electronically received by item. Both vendor and receiver must sign for product.
Only authorized products are received.	Receipt of goods that were not ordered.	Approved purchase order must be on file in Receiving Dept. before goods are accepted.
All deliveries are recorded correctly.	Error in recording goods received.	Receiving reports are matched to purchase orders.
Product arrives at maximum freshness.	Spoiled product.	Products are inspected at point of receipt.
Products are safeguarded/secured.	Unauthorized access to products.	Lock warehouse.
Pay only for merchandise received.	Pay for goods not received.	Vendor's invoice is matched to receiving report.
Pay on a timely basis.	Lost discounts.	Disbursement listing by due date.
Partial deliveries are subsequently monitored.	Pay for goods not received. Never receive goods ordered.	List of partial shipments periodically reviewed.
Refund or credit is received for rejected goods.	Lost payment for returned goods.	Documentation of returned goods, including shipping documents, is sent to Accounts Payable.

LOOKING FORWARD

Johnson walked past his secretary into his office with a slight spring in his step. He sat down, loosened his tie, and put his feet up on his desk in the crossed position. What a relief! It had been a long first year as Director of Internal Audit at Superior Foods. He had met and worked with nearly every manager in the company, plus many other employees. Stage One was finished and he had signatures from all the directors, the members of the audit committee, and the corporate managers to prove it. Management seemed quite pleased with the risk assessment program he had put into motion. Now, he was just looking forward to a much-earned vacation.

Johnson knew, however, that when he returned in two weeks, he needed to address the last two components of the *COSO* model: Information & communication, and monitoring. He

remembered reading in the *COSO* Report something to the effect that: *All personnel must receive a clear message from top management that control responsibilities must be taken seriously.* He decided to jot down a few points while these matters were still fresh in his mind. The following outline⁶ summarizes his notes:

A. Information & communication

Information

1. Information system consists of the methods and records used to record, maintain, and report the events of an entity, as well as to maintain accountability for the related assets, liabilities, and equity.
2. In order to provide accurate and complete information, the information system should:
 - (a) Identify and record all business events on a timely basis.
 - (b) Describe each event in sufficient detail.
 - (c) Measure the proper monetary value of each event.
 - (d) Determine the time period in which events occurred.
 - (e) Present properly the events and related disclosures in the financial statements.

Communication

1. Provide an understanding of individual roles and responsibilities pertaining to internal controls.
2. People understand how their activities relate to the work of others and how exceptions should be reported to higher levels of management.

B. Monitoring

1. Monitoring is the process of assessing the quality (in design and operation) of internal control performance over time.
2. Monitoring should be done on a timely basis and corrective actions should be taken as needed.
3. Continual and/or periodic evaluations help to ensure that internal controls are monitored, their effectiveness is evaluated, their results are reported, and recommendations are provided.

He opened the top drawer of his desk, slid in his yellow notepad, and headed out the door, thinking of the beachfront condo he and his wife had rented for the next two weeks.

QUESTIONS

1. List additional "general" risks that would pertain to a company that owns and operates grocery stores.
2. List additional "technical" risks that would pertain to a company that owns and operates grocery stores. The locations of such risks would include corporate office, division offices, distribution centers, and retail operations.
3. List additional "natural" risks that would pertain to a company that owns and operates grocery stores. The locations of such risks would include corporate office, division offices, distribution centers, and retail operations.
4. List control objectives, risks, and controls in the "purchasing activity" that would pertain to a company that owns and operates grocery stores.
5. How is the "monitoring" component related to the "risk assessment" component?
6. List "monitoring" activities that could be implemented by Superior Foods.
7. List "information & communication" activities that could be implemented by Superior Foods.
8. SAS 78 (AICPA 1995) now requires external auditors to understand all the components of internal controls of the auditee. What audit procedures should be performed to understand and evaluate a company's "risk assessment" process?
9. What audit procedures should be performed to understand and evaluate a company's "monitoring" component of internal control?
10. What audit procedures should be performed to understand and evaluate a company's "information & communication" component of internal control?

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- COSO (1992). *Internal Control - Integrated Framework*, (New York: Committee of Sponsoring Organizations of the Treadway Commission), 1992.
- Hollander, A., E. Denna & J. Cherrington. (2000). *Accounting, Information, Technology, and Business Solutions*, Irwin McGraw-Hill.

ENDNOTES

- 1 The Treadway Commission is the National Commission on Fraudulent Financial Reporting named after its first chairman, James C. Treadway, Jr., former Executive Vice President and General Counsel of Paine Webber Incorporated and a former Commissioner of the U.S. Securities and Exchange Commission.
- 2 The five sponsoring organizations of *COSO* included the American Institute of Certified Public Accountants (AICPA), the American Accounting Association (AAA), Financial Executives International (FEI), the Institute of Internal Auditors (IIA), and the Institute of Management Accountants (IMA).
- 3 Note that the AICPA revised their definition of internal control in SAS No. 78 to conform with the *COSO* Report in 1995, the year after Johnson left public accounting.
- 4 *COSO* pyramid illustration of internal control system: Copyright © 1992 by the Committee of Sponsoring Organizations of the Treadway Commission.
- 5 The original *COSO* cube illustration of components, objectives, and entities (Copyright © 1992 by the Committee of Sponsoring Organizations of the Treadway Commission) was revised here to reflect the two entity levels to which King Foods applied the *COSO* risk assessment process.
- 6 Adapted from Hollander, A., E. Denna, and J. Cherrington (2000). *Accounting, Information, Technology, and Business Solutions*, Irwin McGraw-Hill, pp. 198-199.

KSB ARGENTINA

D. K. “Skip” Smith, Southeast Missouri State University
Carlos Aimar, University of Palermo and University of San Isidro
Andres Kessen, KSB Argentina

CASE OVERVIEW

Andres Kessen, General Manager of the Argentine subsidiary of the German pump manufacturer KSB AG, is requesting permission from KSB AG headquarters in Germany to allow him to begin manufacturing pumps in Argentina for export to markets elsewhere in the world, primarily Less Developed Countries (LDCs) such as Egypt, Uzbekistan, Venezuela, etc. The pumps produced in Argentina would compete with pumps already produced by KSB manufacturing plants elsewhere in the world. Advantages of the KSB Argentina-produced products would include shorter delivery times (60 days vs. 120/150 days). In addition, use of KSB Argentina’s obsolete technologies (not available elsewhere in KSB’s system) offer lower manufacturing costs and higher margins. Kessen must decide what arguments he will offer to KSB AG’s Board of Directors, in support of his proposal that KSB Argentina be allowed to expand its operations in this way. Kessen believes deeply in the merits of this proposal. However, he knows already that KSB AG’s Director in charge of operations in the Americas (that is, the Director to whom he reports) is against the idea, because it would challenge and disrupt KSB AG’s existing Global Manufacturing Network, which KSB Argentina (a small subsidiary using obsolete technologies) has not been invited to join.

The case is based on discussions conducted by the authors in Argentina. The case is appropriate for senior-level undergraduates as well as students in MBA and Executive Development programs. It is designed to be taught in a class session of 1.5 hours, and is likely to require a couple of hours of preparation by students.

CASE SYNOPSIS

Andres Kessen is General Manager of the Argentine subsidiary of the German pump manufacturing company KSB AG. The business involves designing, manufacturing, marketing, selling, and servicing pumps and related equipment. The markets served include water, sewage, industrial applications, energy, movement of water and/or waste water in buildings, oil and mining. Historically, KSB Argentina has manufactured a very limited range of pumps for the local market, and has imported a wide range of pumps produced elsewhere for applications not covered by its

local manufacturing efforts. To date, KSB Argentina has not been involved in manufacturing pumps in Argentina for export. However, given the current economic situation in Argentina (unemployment is high, pressures for increases in wages are low, etc.) plus the fact that, over the last two years, the peso has depreciated 70% against the U.S. dollar, Kessen believes that substantially increasing his production would make it possible for him to produce (at very reasonable prices) enough pumps not only to cover local needs but also to provide a substantial number of pumps for export to developing world markets such as Egypt, Uzbekistan, and Venezuela. However, before producing pumps for export, he needs to receive permission to do so from world headquarters in Germany.

Data in the case include:

1. Description of the challenge faced by the company
2. For Argentina: Historical overview, plus a sample of recent statistics from the World Bank and (for benchmarking purposes) comparable statistics for the United States.
3. On KSB AG: Historical overview and current performance.
4. On KSB in Argentina: Historical overview and current performance.
5. On the opportunity Kessen sees for KSB Argentina: Information on the strategy currently being used (markets targeted, products offered, prices of those products, the route to market used, (that is, characteristics of the channels of distribution), promotional initiatives, and so on. Also, characteristics of the competitive situation in the pump industry in Argentina.

THE SITUATION

Several weeks ago, Andres Kessen, General Manager of the Argentine subsidiary of the German pump manufacturer KSB AG, requested permission from KSB AG headquarters in Germany to allow him to begin manufacturing pumps in Argentina for export to markets elsewhere in the world, primarily Less Developed Countries (LDCs) such as Egypt, Uzbekistan, Venezuela, etc. The pumps produced in Argentina would compete with pumps already produced by KSB manufacturing plants elsewhere in the world. Advantages of the KSB Argentina-produced products would include shorter delivery times (60 days vs. 120/150 days), a benefit which is important to many customers. In addition, use of KSB Argentina's obsolete technologies (not available elsewhere in KSB's system) would offer lower manufacturing costs and higher margins than KSB AG currently experiences. Kessen believes deeply in the merits of this proposal. However, he knows already that KSB AG's Director in charge of operations in the Americas (that is, the Director to whom he reports) is against the idea, because it would challenge and disrupt KSB AG's existing Global Manufacturing Network, which KSB Argentina (a small subsidiary using obsolete technologies) has not been invited to join.

Earlier this week, Kessen received an invitation to come to Germany and present his proposal plus supporting arguments to KSB AG's Board of Directors. Now, Kessen must decide what arguments he will offer to KSB AG's Board of Directors, in support of his proposal that KSB Argentina be allowed to expand its operations in this way.

THE COUNTRY

At 2.78 million square kilometers (larger than India, approximately 1/3 as large as Brazil), Argentina is South America's second largest country. The country is 3,500 kilometers long (2,170 miles), and 1,400 kilometers (868 miles) wide at its widest point. While the climate ranges from tropical in the north to sub-antarctic in the far south, most of Argentina lies in the temperate zone. Similarly, while the landscapes range from jungles to glaciers, a significant portion Argentina consists of fertile alluvial plains covered in grasses and known as "pampas." In the west (that is, in the rain-shadow created by the Andes Mountains, these grasslands are quite dry. In eastern Argentina, however, the pampa receives adequate rainfall, is one of the best agricultural areas in the world, and is intensively farmed (wheat and other grains) and ranched. Other parts of the country support a wide variety of additional agricultural activities, including the growing of fruits (including grapes for wine), tobacco, sugar cane, and vegetables. Patagonia (the southern quarter of the country) has a cool, wet climate, and supports some agriculture plus a large sheep-raising industry. Given all the above, it is no surprise that the production and processing of agricultural commodities accounts for a substantial portion of total economic activity in Argentina.

Institutionally, Argentina is composed of 23 provinces and the Buenos Aires Federal District. For a map, see Appendix 1. Since 1995, the president and vice-president are elected for 4-year terms and can be re-elected once. The bicameral national congress has 72 senators (three from each of the above areas) serving 6 year terms. The lower house has 257 deputies, proportionately elected and serving 4 year terms. Because greater Buenos Aires makes up more than 40% of Argentina's total population, the city's influence on the lower house is very large. There is a federal judiciary system, and a nine-person supreme court.

In addition to the federal institutions, there are provincial institutions. In Argentina, each province has a governor, a legislature, and a judicial system. Across the country, the major political parties are the Justicialist Party (Peronists), the Radical Civic Union, the ARI Party, and the Frepaso Party. For additional background information on Argentina, see Appendix 2.

THE PEOPLE

Prior to the arrival of the first Europeans, the area which has become Argentina was lightly populated. Starting in 1506 and continuing for the next 300 years, most of the immigrants coming to Argentina were Spanish. While African slaves were brought to Argentina in the 17th and 18th

centuries, they were very susceptible to a variety of problems which disproportionately impacted the poor (wars, yellow fever and other epidemics, terrible living conditions for the poorest members of society, etc.), and relatively few of them survived. Beginning in the late 19th century and continuing on through the first third of the 20th, 3.5 million new immigrants arrived in Argentina, mostly from Spain and Italy. However, many other nationalities are represented in Argentina's millennium population of just over 37 million people, including the Welsh (primarily in Patagonia), the British, the French, the German, the Swiss, various Eastern Europeans, and Chileans. Indian peoples make up about 15% of the population. 93% of the population is Catholic, 2% is Jewish, and 2% protestant, yet, at 1%, Argentina has one of South America's lowest population growth rates. A few additional statistical characteristics of Argentine and its people, together with (for benchmarking purposes) comparable figures for the United States) can be mentioned:

	ARGENTINA	U.S.
Fertility rate (births per woman):	3.0	2.1
Illiteracy rates (adult males and females):	3%	--
Life expectancy at birth (years):	74	77
Infant mortality rate (per 000 live births):	17	7
Primary school enrollment:	100%+	--
Secondary School enrollment:	74%	--
% of population living in urban areas:	89%	77%
% of population who are internet users:	7%	34%
% of population, access to improved water	79%	100%
% of roads paved:	29%	59%
% of urban population, access to sanitation:	89%	100%
energy consumption per capita (kwh)	1938	11904

THE ECONOMY (1)

With a Gross Domestic Product (GDP) of 91 billion dollars and its population of only 37 million, Argentina has a GDP per capita of approximately U.S.\$2500. Historically, a very substantial portion of this economic activity has been based on agriculture and/or ranching plus related (for example, food and/or meat processing) activities. By the year 2000, however, 67% of Argentina's GNP was services-related, 28% was industry-related (food processing [including meatpacking, flour milling, and canning] is the largest industry), and only 5% was directly accounted for by agriculture. International trade in goods accounts for 18% of GDP; this figure is approximately evenly split

between imports and exports. Major exports include wheat, corn, flax, oats, beef, mutton, hides, and wool. Principal imports include machinery, metals, and other manufactured goods. The chief trading partners are the United States, Brazil, Italy, and other European countries.

One might think that a country so richly endowed in natural and human resources would be extremely prosperous. However, in 2002, Argentina was unable to meet its debt obligations. Readers interested in learning a bit of the background on this default can find additional information in Appendix 2. In any case, debt and debt service levels for Argentina in 2000 were as indicated below:

Present value of total debt:	U.S.\$154.9 billion
Short term debt:	U.S. \$28.3 billion
Debt service as a % of exports:	142%

Because Argentina was unable to pay its debts, the country is technically bankrupt. Levels of unemployment are high, approximately 20%. Furthermore, many people in Argentina lost large amounts of money when the government decided that depositors who had U.S. dollars on deposit in banks in Argentina would be paid back their money in pesos, not dollars. Thus, if a depositor had U.S.\$15,000 on deposit, and the value of the peso used to be one dollar but is now three pesos, the 15,000 pesos the depositor will receive back from his bank are worth only U.S.\$5000. Because of this development, and because the government is meddling with the banks and banking policies, people no longer trust the banks and no longer deposit their money there. This means that the banks are unable to make loans, and that money is very hard to come by. Very few investors are willing to risk investing money in such an uncertain and problematic environment.

While the macro-environment in Argentina looks bad, some sectors of the economy (including farmers producing for export) are not only doing well but have good prospects for the future as well. Companies and/or individuals selling for dollars but incurring a substantial portion of their costs in local currency (that is, pesos) not only are making good money now but also (now and for the foreseeable future) can be competitive with competitors anywhere in the world. In short, while the overall business environment in Argentina is problematic, the situation faced by organizations and/or individuals producing for export can be much more positive.

THE ECONOMY (2)

As indicated below, it has been tough times for the Argentine economy. Each year from 2000-2002, Gross Domestic Product (GDP) fell. In 2002 the inflation rate increased massively, the peso lost 2/3 of its value, and unemployment increased to approximately 20%. As indicated below, however, it is also true that over this period, Argentina's trade surplus increased massively.

	2000	2001	2002
Real GDP %	-00.8	-.044	-.109
Exchange Rate (pesos/dollars)	1/1	1/1	3.4/1
Annual Inflation Rate	-.007	-.016	+.41
Trade Balance (TMUUS\$)	1.2	6.4	16.4
Unemployment %	15.1	17.35	19.65

It turns out that the pattern of inflationary pressures and changes in the value of the peso has not been consistently bad. As indicated below, while the monthly increase in the wholesale price index was double-digit from February through May 2002, it was at or even below zero from October 2002 through May 2003. As for the consumer price index, after the 10% increase in April 2002, it was 2% per month or lower over the period August 2002 through May 2003. After November 2002, the exchange rate held steady and/or strengthened each month. By mid-2003, the exchange rate had recovered to 2.8 pesos per dollar.

MONTHLY CHANGES: WHOLESALE AND CONSUMER PRICE INDICES PLUS EXCHANGE RATE			
	Wholesale price index	Consumer price index	Dollar Exchange rate
JAN, 2002	7%	3%	1.4
FEB	13%	4%	2.3
MARCH	15%	4%	3.1
APRIL	20%	10%	3.1
MAY	12%	4%	3.6
JUNE	8%	4%	3.8
JULY	5%	3%	3.7
AUG	5%	2%	3.6
SEPT	2%	1%	3.7
OCT	0	0	3.5
NOV	-2%	0	3.6
DEC	0	0	3.3
JAN, 2003	0	2%	3.2
FEB	0	1%	3.2
MAR	-1%	1%	3.0
APRIL	-2%	0	2.8
MAY	-1%	0	2.8

For businesses in Argentina, there are several important implications of the above developments. As indicated earlier, these include:

1. Companies and/or individuals producing for the local consumer market are likely to be experiencing serious financial problems. Many consumers are unemployed, and many consumers have lost substantial amounts of money due to the huge decrease in the value of the peso.
2. Companies and/or individuals producing for export may be doing very well financially, especially if a substantial portion of their costs can be paid in pesos, that is, local currency. In cases where companies and/or individuals are incurring peso costs but are generating revenues in U.S. dollars and/or other overseas currencies, they may be doing very well indeed.

THE GLOBAL COMPANY

KSB AG was founded in Frankenthal, Germany in the year 1871. In that year, three individuals named Klein, Schaezlin, and Becker (hence, KSB) started manufacturing and selling pumps. Over the years, the company grew far beyond its beginnings as a local company in Germany. Today, annual sales exceeding 1 billion euros are generated through sales in the following markets:

Water: The product line ranges from small pumps for individuals to huge and extremely powerful pumps. The types of pumps sold to this segment include submersible (KRT) pumps, submersible mixer (Amamix and Amaprop) pumps, and wet-pit (Amacan P and Amacan S) pumps, deep well pumps (B), submersible deep well pumps (U), and vertical mixed flow pumps for wet fit (SNZ, SNW, SEZ).

Waste Water: The product line ranges from small pumps for house sewer systems to huge systems designed to transport large volumes of sewage and/or corrosive industrial wastes. As in the case of water, the types of pumps sold to the waste water segment include submersible (KRT) pumps, submersible mixer (Amamix and Amaprop) pumps, vertical wet-pit (Amacan P and Amacan S, SNZ, SNW, and SEZ pumps) as well as horizontal pumps.

Industrial Applications: The product line includes pumps capable of operating in extreme conditions of temperature, pressure, and/or corrosiveness. KSB pumps sold to this segment (this includes KSB's Meganorm, Megachem, Magabloc, Etanorm SYA and CPK product lines) all use a technology called "single stage overhung" and can be used to transport a wide range of acids, caustic solutions, and other liquids.

Oil: the line includes products for use in up and down stream installations as well as process applications, most of them in accordance to API standard (RPH)

Energy: The line includes products developed for use not only in fossil-fueled power stations but also in nuclear installations. KSB pump applications in the energy sector include circulation of

water for use in boilers, pumps for transporting condensates, and pumps for transporting cooling water. Some of these pumps (KSB's HG product line) use multistage ring-section technology. Others (KSB's WKT and WKTA product lines) use vertical single- or multi-stage technology; still others (KSB's SEZ, PHZ, and PNZ product lines) use vertical semi-axial and/or axial hydraulics technology. One of KSB AG's large water pumps used for cooling power stations could pump 3,000 cubic meters of water per hour over the summit of Mont Blanc, the tallest mountain in Europe.

In-building Applications: The product line includes pumps to supply potable water throughout high-rise buildings, pumps to provide water for heating and/or air conditioning systems, and pumps for transporting waste water out of buildings.

Mining Applications: The product line includes pumps to remove large amounts of water from mines, as well as pumps to move slurry solutions (that is, fluids composed of small solid particles mixed with water) out of the mine to shipping and/or refining locations.

System Engineering: This unit of KSB is involved in analyzing customers' needs for pumping equipment, designing systems to meet those needs, and then procuring and installing the needed equipment.

Service: This unit of KSB provides service and warranty work on KSB equipment worldwide.

Training: This unit of KSB provides both custom training and workshops for individual customers as well as basic seminars for individuals who will be operating and/or maintaining KSB equipment.

Research: The primary activities of this unit of KSB include research and development in the areas of automation, hydraulics, and materials engineering.

KSB is a global company not only in terms of markets served but also in terms of the locations at which products are manufactured. The company has manufacturing plants not only in Germany and Argentina, but also in Brazil, China, India, Italy, Mexico, Pakistan, and South Africa. However, not all of these manufacturing plants are allowed to sell the products they manufacture outside of their home market. Before a KSB subsidiary is allowed to export products, the plant must be approved by KSB's Directors as part of KSB's Global Manufacturing Network (GMN) or the products to be exported must receive MBK Certification (that is, "Made by KSB Certification"). MBK Certification, which means that the quality of the product in question is guaranteed by KSB to meet global standards, is not only difficult to achieve but also (because of the high costs associated with successfully completing the process) may not be appropriate in some markets. Of the 20 products produced in KSB's factories in Argentina, Italy, Mexico, and South Africa, none are MBK Certified. Of the more than 30 products produced by KSB plants in Brazil, China, and Pakistan, only 6 are MBK Certified. As for receiving GMN status, to date KSB's Directors have awarded this status only to factories which have installed modern, high-technology production equipment. Factories like KSB Argentina which use obsolete technologies have been told by KSB senior management that they should not bother to apply for GMN Status.

Over the years, KSB AG has been highly successful. Currently, however, there are a number of issues which greatly concern KSB AG's Board of Directors, including the following:

1. The value of the Euro has increased from a bit more the U.S.\$0.80 two years ago to approximately U.S.\$1.20 today. Because the costs of products produced in Germany (and other locations in Europe as well) are incurred in Euros, KSB AG needs to dramatically increase its prices to buyers elsewhere in the world who purchase KSB AG products in U.S. dollars and/or currencies linked with the dollar. For the same reason, competitors based in the United States and/or other countries whose currencies are linked with to the U.S. dollar can offer prices which are very attractive compared to those which KSB AG must charge.
2. Historically, the role of stock markets and the importance of movements in the price of a company's stock has been lower in Germany than in many other developed countries. One reason for this is that in Germany, extensive cross-shareholding between large companies have in the past been very common and have insulated companies from performance pressures from individual shareholders. A second reason for the less importance role of stock markets and changes in share price in Germany is that historically, banks in Germany (rather than individual investors) have provided a very large portion of the funds used to operate and/or grow companies. Third and finally, banks in Germany have historically voted (by proxy) the shares of many small stockholders; the impact, once again, has been to insulate firms from stock market pressures. However, all three of the factors mentioned above are now beginning to change, and the importance to large companies (including KSB AG) of the stock market and of changes in share prices is increasing.
3. Over the years, Germany has developed a very effective system to ensure the production of high quality products and the use of leading-edge technologies. The system is called "verbundforschung," which means "research networks." It includes not only the research and development efforts of individual firms, but also the efforts of research and/or technology transfer institutes in Germany. For this reason, historically, most research and development efforts by German companies have been conducted in Germany. Recently, however, large companies including KSB AG have experienced increasing pressures to customize their products to local and/or regional markets. In addition, KSB AG and other large multinational companies are experiencing pressure to increase the local content of products which they sell in overseas markets. One of the implications of these trends is that large German companies including KSB AG are re-examining the issue of whether research and development should continue to be centralized in the home country (that is, Germany) or whether a different strategy may now be necessary.
4. Since the end of the Second World War, the system of industrial relations operating in Germany has been characterized by high levels of social stability and industrial harmony. On the one hand, management is expected to provide workers with high levels of training,

pay, benefits, and employment security; on the other, workers are expected to provide high levels of productivity and very low levels of strikes and/or other industrial problems. Recently, however, due in part to the forces mentioned above (for example, exchange rate-related issues, the growing importance of the stock market and/or changes in share prices, pressures to localize products and/or increase local content, etc.), large companies including KSB AG find themselves wondering whether maintaining this system in which they must embrace relative high costs and relatively low levels of profits is still sustainable or even desirable.

THE COMPANY IN ARGENTINA

In 1941, a company called South American Pump Company was founded. The purpose of the company was to produce and market centrifugal pumps. In 1960, KSB AG made a major injection of capital into this company, and became the majority shareholder; at this time, the company was renamed KSB Company Sudamericana de Bombas S.A. (hence, KSB-CSB). This is the company now known as KSB Argentina. Currently, KSB Argentina uses low-cost manufacturing techniques viewed as obsolete at corporate headquarters to manufacture a line of centrifugal pumps and valves. The company sells these locally manufactured pumps plus other pumps (MBK pumps manufactured elsewhere in the world; that is, pumps produced by members of MSB's GMN) throughout Argentina. Recent results are as indicated below:

	April	May	June
Return on Sales(ROS)	3.7% (1)	4.9% (2)	5.1% (2)
Return on Investment (ROI)	1.5% (1)	2.5% (1)	3.2% (1)
Days of Accounts Receivables	39 (3)	36 (3)	46 (3)
Days of Inventory	177 (1)	180 (1)	163 (1)
Net Financial Position (000 euros)	433 (2)	403 (2)	438 (2)
1 = Unacceptable compared to KSB Global Benchmarks 2 = Acceptable 3 = Good			

COMPETITORS AND THEIR CHARACTERISTICS

As indicated above, KSB Argentina's performance against corporate benchmarks established by KSB AG are not totally acceptable. As indicated below, however, the harsh realities of recent

economic, political, and social developments in Argentina have impacted not only KSB Argentina but also the performance of its competitors:

	GRUNDFOS	FLOWSERVE	SALMSON	MOTORARG	ROTORPUMP
Return on Sales(ROS)	-63%	-0.40%	-1.70%	10% (2)	66% (3)
Return on Investment(ROI)	-32%	-0.80%	-1.20%	6.1% (2)	22.8% (3)
Days Receivables	143 (1)	103 (1)	172 (1)	120 (1)	175 (1)
Days Inventory	391 (1)	32 (2)	457 (1)	328 (1)	704 (1)
Net Financial Position(Euros)	195 (2)	5,449 (3)	122 (2)	76 (1)	902 (3)

Exhibit 1 (including elaborative comments) provides additional information including overall market shares for KSB Argentina competitors plus the strength of the various competitors in specific market segments.

EXHIBIT 1 PUMP APPLICATION SEGMENTS COMPANY							
	PROCESS	INDUSTRY/ENERGY	WATER	CONSTRUCTION	SEWAGE	VALVES	TOTAL
FLOWSERVE	30,630	2,980	4,597				38,207
KSB	1,638	4,831		288	2,347	1,100	10,204
ROTOR PUMP		884	3,960	4,042	588		9,474
MOTORARG			4,500	2,784			7,284
FLYGT ARGENTINA					2,342		2,342
SCHMIDT	2,136	634					2,770
GRUNDFOS			2,100	850			2,950
SILWAN			1,021				1,021
BARBUY TEAM				688			688
GOULD ARGENTINA	493						493
TYCO						3,700	3,700
FOGLIA						470	470
FABRISI						470	470
OTHERS	2806	8,963	3,380	7,191	723	7,380	30,443
TOTAL	37,703	18,292	19,558	15,843	6,000	13,120	110,516

1. Total PROCESS segment sales have increased 56% since 2000. However, in this segment, KSB Argentina's sales in 2002 were 40% less than in 2001. The primary reason for this decrease was KSB Argentina's lack of Fire Fighting (FF) pumps in 2002. Many buyers in this segment have the potential to export their products; those companies are likely to be "open to buy" in 2003.
2. Total INDUSTRY/ENERGY segment sales have fallen 32% since 2000. In 2000, Flowserve was the market leader but now, as indicated, KSB Argentina holds that position. Many buyers in this segment have the potential to export their products; those companies should be "open to buy" in 2003.
3. Total WATER segment sales have fallen 61% since 2000. In 2000, Rotor Pump was the market leader but now KSB Argentina holds that position. The contraction in the 4 inch and 6 inch markets(dominated by Motorarg and Rotor Pump) explains the increase in KSB Argentina's market share. If public projects reappear (financed either by local governments or international bodies such as the World Bank), there will be opportunities in this segment in Argentina for KSB Argentina. KSB Argentina should also be able to export these sorts of products.
4. Total CONSTRUCTION segment sales have fallen 55% since 2000. In this segment, KSB Argentina's revenues (and those of Barbuy Team) have fallen 75%. In this segment, KSB Argentina's decrease in sales and loss of market share is due primarily to the lack of FF pumps. While government wishes to stimulate construction (so as to lower the unemployment rate), the lack of both private and public funds is likely to limit the recovery of this segment. Small local competitors are especially strong and active in this segment.
5. Total SEWAGE segment sales have fallen 60% since 2000. In 2000, Flygt Argentina was the market leader, with approximately twice the revenues of KSB Argentina. As indicated, in 2002, KSB Argentina is the market leader. However, as public projects begin to reappear (financed either by local governments or international bodies such as the World Bank), Flygt is expected to make intense efforts to regain market share. Flygt has the ability to manufacture pumps up to CP3300 and 55kw locally.
6. Total VALVES segment sales have fallen 36% since 2000. In 2000, Tyco was the market share leader and, as indicated, this is still true in 2002. In Argentina, water services were privatized some time ago. Because government has refused water company requests to increase rates, water companies are not investing additional money in their systems. Unless rates increase, local companies will not invest additional funds. However, there may be opportunities to export water pumps.

It turns out that KSB Argentina and nearly all its competitors in the pump industry in Argentina can be classified into one of three categories: (1) Companies with a broad line of products and activities (includes local manufacturing plus exporting and importing products); (2) Broad line

of products, all of which are imported; and (3) Limited line of products manufactured locally. For reasons shown below, KSB Argentina's most powerful competitors are, like KSB Argentina itself, Category #1 companies. Companies in each of the categories are as indicated below:

Category 1 Companies, their market shares, and additional comments		
Flowserve	34.9%	overall share leader
KSB Argentina	14.1%	overall, #2 in the market
Motorarg	8.3%	overall, #4 in the market
Flygt	4.1%	overall, #5 in the market
Category 2 Companies		
Rotor Pump	9.7%	overall, #3 in the market
Grundfos	3.6%	overall, #6 in the market
Goulds Argentina	3.6%	overall, #8 in the market
Salmson	1.7%	overall, #9 in the market
Category 3 Companies		
Schmidt	2.6%	overall, #7 in the market (also exports)
Silwan	1.3%	overall, #10 in the market
Others, including: Tromba Iruma EGIA Ernesto Kunz Eyl FAB		
Notes: 1. Category 1 companies tend to be very strong in terms of technical capabilities. The quality of their products and services is up to international standards. Because they are able to import products which they do not manufacture locally, they have deep and broad product assortments. 2. Because the peso has lost 2/3 of its value and because Category 2 companies import their products from elsewhere, many of them are in financial trouble. 3. Category 3 companies tend to be less strong technically than the Category 1 and Category 2 companies. Their products may or may not be up to international standards. Because they are not importing products from overseas, their product assortments tend to be less broad and deep than the assortments offered by Category 1 and Category 2 companies.		

There are several other characteristics of the pump industry not only in Argentina but also elsewhere in the world which can be mentioned:

1. Price has always been important but is becoming even more so. Assuming the Directors of KSB AG allow KSB Argentina to begin producing pumps for export, the obsolete technologies KSB Argentina uses will reduce manufacturing costs and increase margins.
2. Shorter delivery times have become more important to customers. At the moment, delivery times for customers ordering KSB pumps worldwide average 120 to 150 days. Assuming the Directors allow KSB Argentina to begin manufacturing certain pumps for export, delivery times for those pumps should fall to approximately 60 days.
3. As indicated above, there are a number of companies still competing in the pumps business in Argentina. However, the number of competitors is smaller now than it used to be.
4. Government has many projects it would like to undertake, but very limited financial resources. The public works projects most likely to go ahead are those funded by international bodies such as the World Bank.
5. Service is becoming more important, and repairing imported pumps is becoming a good business.
6. Managing and collecting accounts receivables is becoming a much more serious challenge.
7. Opportunities to export locally-produced pumps look particularly attractive.
8. Some buyers are becoming less concerned about technical specifications and more concerned about costs. This is especially true of buyers in Less Developed Countries (LDCs) such as Egypt, Uzbekistan, and Venezuela.

THE CHALLENGE

Assume you are Andres Kessen, General Manager of KSB Argentina. What arguments will you offer to KSB AG's Board of Directors, in support of his proposal that KSB Argentina be allowed to expand its operations by producing pumps not only for the local market in Argentina but also for export?

APPENDIX 1
MAP OF ARGENTINA



APPENDIX 2 BACKGROUND ON ARGENTINA

Little is known about the native inhabitants of the area we now call Argentina. Around the year 1502, the Italian Amerigo Vespucci became the first European to set foot in the region. In 1536, Pedro de Mendoza founded the settlement of Buenos Aires; however, attacks from the Indians forced him to abandon the town. In 1580, the city was re-founded by Juan de Garay. However, over the next two centuries, because the King of Spain decreed that all trade to and from the area must flow through Lima, Peru, most economic activity was centered in Peruvian border areas. During this period, the primary economic activity in Buenos Aires was smuggling. However, toward the end of this period, direct trade between Argentina and Spain was allowed and the King of Spain established a new administrative unit (specifically, a vice-royalty) covering what we now know as Uruguay, Paraguay, and parts of Peru and Argentina. This new vice-royalty was headquartered in Buenos Aires.

On 25 May 1810, with Spain occupied by Napoleon, an open town council (*cabildo abierto*) in Buenos Aires deposed the Spanish viceroy (the King's representative), and created a revolutionary council to govern the area. On 9 July 1816, the Argentine Congress made a formal declaration of independence from Spain, and by the end of 1818, Jose de San Martin had defeated Spanish forces in the area. However, due to struggles between powerful factions in the country (the Unitarians, desiring a strong central government in Buenos Aires; the Federalists, desiring a loose confederation of provinces), Argentina began a history (it continues till the present) of being unable to establish one vision around which all people would freely unite and an inability to fully recognize its economic potential. In any case, after independence, Argentina marked time both politically and economically, first under President Rivadavia and later, for more than 20 years, under the dictator Juan Manuel de Rosas.

In 1853, under President Justo Jose de Urquiza and then continuing under Presidents Bartolome Mitre, Domingo Faustino Sarmiento, and Nicholas Avellaneda, Argentina experienced a 30 year period of institution building. Railroads were built, and agriculture, ranching, and food processing flourished. Thanks to strong overseas markets (including factory workers in England), there was a steady demand for agricultural products from Argentina. By 1910, Argentina had become one of the richest nations in the world, and appeared to have finally escaped its long-standing inability to realize its potential.

Unfortunately, while Argentina had succeeded in becoming rich, it had not succeeded in establishing one vision around which all its citizens could rally and agree. At the start of the 20th century, large numbers of workers joined the Socialist Party, while many middle-class Argentineans joined the Radical Civil Union. In each case, the primary motivation was to press for a greater role in the political process for their own group. Hipolito Yrigoyen of the Radical Civil Union served as President for more than 10 years. At the onset of the Great Depression, a military coup removed Yrigoyen, but by 1937 Roberto Ortiz of the Radical Civil Union had returned to power. In 1943, another military coup removed President Ramon Castillo, Ortiz's successor. In presidential elections in 1946, one of the Grupo Obra de Unificacion military officers (Juan Domingo Peron) was elected President.

In 1955, several factors (students resenting the Peron government's heavy hand on universities, a Catholic church threatened by Peron's secular views on education, unrest in the military, and so on) led to another coup. Peron fled into exile, and was replaced by a series of Presidents including Arturo Frondizi, Arturo Illia, General Juan Carlos Ongania, and General Lanusse. None of these individuals was able to resolve the economic, political, and social problems bedeviling Argentina. In 1973, Hector Campora won the Presidency but then resigned so that Juan Domingo Peron could return from exile and re-occupy the Presidency. While Peron made some progress in dealing with Argentina's problems, his death on 1 July 1974 brought his third wife Isabel to the Presidency. Her term was viewed as corrupt and repressive, and she was removed by a military coup on 24 March 1976.

The generals proved unable to address the economic, political, and social problems bedeviling Argentina. The period of General Videla (1977-1983) is known as the "Proceso." The general attacked the problem of left-wing guerilla action with a campaign which came to be called the "dirty war." People suspected of left-wing sympathies simply

disappeared. Estimates on the number of “desaparecidos” (the disappeared) range from 10,000-40,000 people. Videla was replaced by General Viola, who was then replaced by General Leopoldo Fortunato Galtieri. During this period, Argentina’s foreign debt increased dramatically, unemployment increased, and the value of Argentina’s currency decreased dramatically.

In 1982, to distract Argentines from economic, political, and social ills, General Galtieri invaded the Malvinas (also known as the Falkland) Islands. After two months, the sinking of the cruiser General Belgrano, and the death of 600 of its soldiers, Argentina surrendered to Great Britain. The military government (now headed by retired general Reynaldo Bignone) collapsed, and Raul Alfonsín, the Radical Party candidate, was elected President on 10 December 1983.

Early in his term, President Alfonsín enjoyed some success in tackling Argentina economic, political, and social problems. A new currency (the austral) was introduced, and (for a time) inflation decreased dramatically. On the social front, trials were initiated against military officers believed to be responsible for the desaparecidos. Toward the end of the 1980s, however, inflation was running at 200% per month, food riots were taking place all across the country, and trials of former military officers ceased. In mid-1989, the candidate of the Peronist Party (a former truck driver and then governor of La Rioja Province, Carlos Menem) won his campaign for the presidency by promising wage increases.

Once in power, Menem and his Minister of Finance (Domingo Cavallo) replaced the austral with the peso and pegged the peso to the U.S. dollar. They also sold off (that is, privatized) a number of state-owned enterprises, and opened the Argentine market to imported foreign goods. A consequence of these steps was that thousands of both public sector employees (i.e., the state enterprises which were privatized) and private sector employees (companies which failed when low-cost imports flooded the country) lost their jobs. Notwithstanding the high incidence of unemployment, voters grateful for the end of hyperinflation re-elected Menem (1995) to a second term as president. In 1999, however, Fernando de la Rúa won the presidency over the Peronist candidate.

At the beginning of De la Rúa’s government, all economic indicators suggested that the recession was ending. However, the first measure that the Minister of Finance took to increase government revenues was not to reduce tax evasion (very high in Argentina), but rather to increase taxes for workers. This measure intensified the recession, bringing it to the highest level in the history of the country. Economic activity decreased to levels that would, a few months earlier, have been unimaginable.

At this point, De la Rúa called a friend to be the new Minister of Finance (Ricardo López Murphy). However, Murphy quit only 72 hours after being appointed. In desperation, De la Rúa then re-appointed the former Economy Minister during Menem’s government, Domingo Cavallo.

In a last-ditch effort to erase the fiscal deficit, Economy Minister Domingo Cavallo imposed draconian cuts in public sector salaries and pensions. Also, he persuaded the IMF to give Argentina \$8 billion in new money to supplement a \$40 billion emergency aid package delivered in December 2001. Publicly, big Argentine companies endorsed Cavallo’s moves. Privately, they began converting their pesos to dollars. Haunted by memories of 1990, when the government froze bank deposits, individual Argentines started to withdraw their savings from the banks. Faced with these actions, Cavallo restricted deposit withdrawals and started the “Corralito.” The immediate impact of these moves was inflation over 70%, an economic contraction that rivaled the U.S.’s Great Depression, and a currency depreciation of 356% against the U.S. dollar. As for the social situation, 54% of the population fell below the poverty line, up from 35% the prior year. The primary trigger for the deterioration in the above indicators was the fact that the depreciation of the peso was stronger than expected. In any case, the resulting wage cuts, layoffs, and bankruptcies severely aggravated tensions in the country. On 20 December 2001, President De la Rúa resigned.

De la Rúa’s resignation started a period of anarchy. In one week, the country had five presidents. One of these, Adolfo Rodríguez Saá, suspended payments on Argentina’s external debt. This period of anarchy ended in January 2002 when the congress named Eduardo Duhalde as interim president until December 2003. In actuality, however, a new presidential election was held prior to that date. On 25 May 2003, Néstor Kirchner became President of Argentina, having defeated former President Carlos Menem in that election.

With the election of Nestor Kirchner as President, the political situation in Argentina became more stable. The economic situation has also begun to improve. Economists believe that Gross Domestic Product (GDP) for Argentina will grow by 4% this year, and industrial production has increased 16.6% over the level for the previous year. Argentina's exchange rate has strengthened; as indicated earlier, one U.S. dollar is currently worth approximately 2.8 pesos. This strengthening of the peso is due primarily to the following two factors: (1) Inflation has fallen from 70% per annum to about 7% per year; and (2) In the first half of 2003, Argentina's trade balance hit an all-time high of U.S.\$5.283 billion dollars. This huge positive trade balance was caused by low levels of consumption in Argentina, the fact that a weak peso makes purchases for buyers outside of Argentina very cheap, and improvements in the prices of products (especially, the agricultural products which account for the largest percentage of exports) sold on international markets. The two primary destinations for exports from Argentina are (in order of importance): (1) Mercosur (that is, neighboring countries in South America); and (2) The European Union.

One of the key issues for both overseas and local businesspersons is the question of what sort of policies President Nestor Kirchner is likely to follow. Discussions with the President indicate that the following are likely:

1. The state will guarantee basic services, conduct direct transfers, and actively intervene in economic matters.
2. A prudent fiscal position will be achieved through a tax reform which will generate the resources needed for public investment and to increase social coverage.
3. There will be direct government involvement in the re-industrialization of the local economy.
4. To protect the local economy, a flexible exchange rate will be used.
5. Exports will be vigorously promoted.
6. Regional alliances, especially Mercosur, will be strengthened.

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