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LETTER FROM THE EDITORS

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 *JIACS* 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. The Instructor's Note for each case in this volume will be published in a separate issue of the *JIACS.*

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.

Inge Nickerson, Barry University
Charles Rarick, Barry University

CASES

SURVEY RESEARCH: QUESTION WORDING AND DESIGN

Charlotte A. Allen., Stephen F. Austin State University

CASE DESCRIPTION

The primary subject matter of this case concerns survey research. Secondary issues include questionnaire design, research objectives, bias, and ethical considerations in marketing research. This case has a difficulty level of three (appropriate for junior level) to four (appropriate for senior level). This case is designed to be taught in one class hour and is expected to require no outside preparation by students.

CASE SYNOPSIS

Do you need a case on marketing research, but do not need anything to do with statistics? Do you want an interactive case that will generate a lot of discussion? Survey Research: Question Wording and Design is the case for you. It is designed to be used in a marketing research section of a Principles of Marketing class or in a Marketing Research class itself. This case follows the career of Ann Horton, the new Director of Marketing Research at a large metropolitan hospital. Ms. Horton is presented with a finished customer satisfaction survey by William Whedon, who is in charge of Public Relations. He has to have her approval to administer the survey and is impatient to find out the results of the survey to include in a new marketing brochure for the hospital. Should Ms. Horton approve the survey or not? This case deals with bias in survey research that can occur when questionnaires are designed. How does one find the bias in how surveys are worded or presented? This case will allow students to critique the proposed survey and try to spot any biases that may occur in the survey or how the survey is administered. There is also an interesting ethical question of what should Ms. Horton's actions be in this situation.

SURVEY RESEARCH: QUESTION WORDING AND DESIGN

Ann Horton was recently hired as Director of Marketing Research for a large, metropolitan hospital. The hospital is under new management and is interested in re-positioning itself in the market as having the best medical care in the area (there are four other hospitals in the area that are in direct competition with Ms. Horton's hospital). She is excited about the new job since this is her first opportunity to be in charge of a research unit- she has worked in survey research and focus groups, mostly in the medical and services areas. Therefore, this new job is certainly a large leap for her career wise. As a new hire, she has been meeting with all of the other directors and the employees in her research unit. During her first week, she is introduced to William Whedon, the Director of Public Relations for the hospital. He welcomes her to the hospital and makes an appointment to come back and talk to her later in the week about some research he needs to have done.

Fast-forward to a week later and Ms. Horton has met with Mr. Whedon. She is looking over the survey he presented her at the beginning of the meeting (See Table 1 for actual survey). It is a customer satisfaction survey to be handed out in the hospital to patients. Everyone receiving care at the hospital would receive a paper copy of the survey. The survey time period would run one full week and Mr. Whedon is anxious to administer the survey and collect data: "We could then use the results in our new marketing brochure- it would be good pr for us". Mr. Whedon spent quite a bit of time discussing the printing deadline for the brochure and before he left he told Ms. Horton that Mr. Paris, her predecessor, had "unofficially approved" the existing survey. Mr. Paris had left the organization to go to work in another city, but had left detailed notes and examples of previous research done at the hospital. Most of the previous research was conducted with in-depth interviews and focus groups. The results of focus groups and interviews were generally positive with specific criticisms that were addressed by changes in rules or instructions to staff. However, the sample sizes used in previous research were too small and not representative enough to generalize to the whole consumer base. This survey would not only be the first organization-wide survey of their customers, but it would be used as a benchmark for future studies. Ms. Horton must approve any marketing research that is done at the hospital and, with this authority and responsibility in mind, begins to analyze the survey.

ASSIGNMENT FOR STUDENTS

Put yourself in Ms. Horton's position. Answer the following questions concerning the case: (1) Is the survey a good survey? (2) Are there any ethical considerations in the survey design?, and (3) Should Ms. Horton use the existing survey?

Table 1: Hospital Survey				
Please fill in unit name:				
Please rate your satisfaction with:				
	Very Satisfied	Somewhat Satisfied	Not Satisfied	Not Applicable
Overall quality of care				
Your nurses				
Your doctors				
Admission process				
Cleanliness of room				
Food delivered to room				
Interaction with staff				
Billing/Financial services				
What did you like most about your stay?				
What could we have done to improve your stay?				
Are there any staff members you would like to recognize for outstanding car or service?				
Thank you for filling out survey. Please return it to the person who gave it to you.				

THE UTAH SUMMER GAMES MARKETING RESEARCH PROJECT

Wayne A. Roberts, Jr., Southern Utah University
Emmett Steed, Southern Utah University

CASE DESCRIPTION

The primary subject matter of this case concerns the development, implementation, and analysis of a real market research project. Secondary issues examined include the link between research objectives and questionnaire development, sampling and non-sampling error, and practical problems and issues that affect marketing research projects. The case has a difficulty level of four. The case is designed to be taught in one to two class hours, and is expected to require 2 to 3 hours of outside preparation by students.

CASE SYNOPSIS

In 2004 the new director of the Utah Summer Games, an athletic event modeled after the Olympics that draws almost 7500 athletes, is concerned about the lack of any data other than anecdotes and annual registrations. No one was sure how satisfied athletes and their families are with the athletic events, the opening and closing ceremonies, and the products, services and environment of Cedar City. They also do not know how people learn about the events. The case depicts the planning, implementation, and some results of a marketing research project developed to measure satisfaction levels regarding the community and the opening ceremonies, and to assess what other activities participants do in conjunction with the games. Manageable in scope, the case illustrates marketing research steps, has some shortcomings for students to identify, and has enough results to permit them to reach some tentative conclusions. The case is simple enough to be used in a marketing principles course. Its value is probably greatest in a marketing research course, where it can also be used as an illustrative project in the beginning, and referred to throughout the course as sampling and non-sampling error, questionnaire development, and data analysis topics arise. It could also be used as a model for semester-long student projects.

INTRODUCTION

Every year thousands of people participate in athletic events sponsored by members of the National Congress of State Games. Forty states conduct summer games, and 14 conduct winter games. Started in 1978 in New York, more than 90 sporting events, ranging from basketball to arm wrestling to bass fishing, are offered across the country during the summer games, which are modeled after the Olympics.

In Utah, the Utah Summer Games (USG) were started in 1986 by Gerald Sherratt, then president of Southern Utah University (SUU) in Cedar City. Sherratt's belief was that if young athletes and their parents visited the campus and the surrounding area they would be more inclined to consider attending the university. The USG office is maintained on SUU's campus, and the university supports the games financially. The office has a small staff, which is supplemented by roughly 1000 volunteers.

In January of 2004 Kyle Case, a recent MBA graduate, was hired as the director of the Utah Summer Games. He has a strong interest in athletics, and has also participated as an athlete in the USG. Case has a strong interest in seeing the summer games expand and develop.

The total budget for the Utah Summer Games is roughly $375,000. Approximately $165,000 comes from athlete registration fees, and sponsorships account for another $135,000. The rest comes from city, county and state contributions. In addition to donating office space and most utilities, Southern Utah University allows the summer games to use their facilities for free. The total value of SUU's contribution is roughly equivalent to $25,000.

THE 2004 GAMES

For the 2004 USG there were 44 different competitive events. Soccer, as usual, was expected to be the most popular by far, with roughly 2600 participants. Basketball, the second most popular event, was expected to have around 400 to 500 participants. In total almost 7500 athletes were expected to participate. An abbreviated event schedule is provided in Table 1. Most events were to be held in the Cedar City area, but a few were to be held elsewhere. For example, sculling was to be held near Salt Lake City, and bass fishing was scheduled at a reservoir 30 miles south of Cedar City.

The cost for participation varied by event, but for most ran about $25 per person. People could register by mail or electronically via the Internet. Internet registrations, initiated in 2000, had increased from roughly 20% to an expected 45% to 60% in 2004.

The USG has an elaborate opening ceremony each year, complete with the community's best fireworks display, a parade of athletes, a band, and other events. The opening ceremonies are held in the Eccles Coliseum, Southern Utah University's football stadium. Athletes are admitted free, and the price of admittance for others varies depending on seating location. Ticket prices for 2004 varied from $7 to $12. Opening ceremonies account for approximately $45,000 of the USG's total budget. Historically, revenues from ticket sales have fallen short of the cost of the event.

After finals for each event awards ceremonies are held in the Eccles Coliseum, where ribbons and trophies are presented to the top three teams or participants. The award ceremonies occur as each event wraps up.

Table 1
Schedule of Events for the Utah Summer Games, 2004

	Day of the Week & Date in June																	
Sport	TH 3	F 4	Sa 5	SU 6	M 7	T 8	W 9	TH 10	F 11	SA 12	SU 13	M 14	T 15	W 16	T H 17	F 18	SA 19	SU 20
Archery																X	X	X
Baseball														X	X	X	X	
Basketball												X	X	X	X	X	X	
Bass fishing										X								
Cycling															X	X	X	
Equestrian															X	X	X	X
Fencing									X	X								
Golf												X	X					
Gymnastics									X	X								
Racquetball	X	X	X															
Shooting															X	X	X	
Soccer							X	X	X	X								
Softball												X	X	X		X	X	
Volleyball																X	X	

THE DESIRE FOR INFORMATION

A major concern of Kyle Case's was the lack of hard information:

"We know how many athletes participate each year, in which sports, where they live, and we have lots of anecdotal information that suggests we are doing okay. But we don't know how satisfied the athletes are and, if they are kids, how satisfied their parents are with the games and their Cedar City experience. We advertise and get lots of publicity, but we don't know how they hear about us. Are there other potential athletes out there we aren't reaching? We don't know."

"And there is more we don't know. We don't know how much of an economic impact the games have on the community. We don't know the impact on our sponsors, and we don't know how satisfied sponsors are with us. We want the city and local businesses to continue to support us, and we want to do a good job for our sponsors. However, it sometimes is hard to talk to these and other folks without having any good, specific data."

In addition to discussions with the staff of the USG, one of the researchers also consulted with the mayor of Cedar City, who happens to be the former president of SUU and founder of the Utah Summer Games, Gerald Sherratt. He agreed with the notion of discovering participants' perception of Cedar City resident friendliness.

In discussing the possibility of collecting information to help the USG decision-makers during May 2004, the staff at the USG made it clear that their resources were stretched to the limit for the current season. The many volunteers were all assigned to various needed duties.

In late May Kyle Case and Steve Ahlgreen, the Utah Summer Games Marketing Director, met with two researchers to discuss the possibility of conducting a marketing research project.

RESEARCH PURPOSE AND OBJECTIVES

Given the time and resource restraints it was decided that the objectives of the research would be as follows:

1. Determine how satisfied attendees are with various aspects of the opening ceremonies.
2. Determine if attendees would prefer that the opening ceremonies be changed, with the price of admittance being changed accordingly. Should prices and the quality of the opening ceremonies be raised? Should they be kept about the same, or should the admittance price and the quality of the show be lowered?
3. Determine satisfaction levels of USG participants with their Cedar City experience.
4. Determine what other activities visitors participated in while at the USG.

The first two objectives were of particular interest to the director and the marketing director. The third objective was believed to be of interest to everyone concerned with the summer games, in particular the mayor and local service and merchandise providers. The last objective was intended to provide at least a rough indication of who was impacted by the large influx of visitors. The purpose of all these objectives was to aid in planning future summer games, and in garnering local support for the games.

DESIGNING THE RESEARCH

It was clear that there was little time for any real exploratory research. While it would have been appropriate to talk to individuals and groups, particularly participants, about their experiences associated with the Utah Summer Games, two major hurdles prevented this. First, there was a lack of researcher time to conduct many interviews. Second, given the desire to assess the opening ceremonies, such exploratory research would either have to rely on recall among the previous year's attendees, or would mean that collecting information about 2004's opening ceremonies would have to rely on post-event telephone interviews, email, or mail surveys.

With regard to the objectives regarding opening ceremonies, the interest was in measuring opinions and satisfaction levels of all who attended. Many people from around the area, it is believed, attend open ceremonies – not just USG participants and their families. At the opening ceremonies Delta Airlines was going to give away two first-class round trip tickets, and in order to enter people needed to fill out a form, complete with their telephone numbers and addresses, and drop it into a box. This data, it was believed, could be used to generate a mailing list, or a telephone list, for a subsequent survey.

There were some other things to consider. First, if a questionnaire was to be generated that was meant to provide information regarding all the research objectives, it would have to be designed to be easily filled out by both USG participants and non-participants. Second, it was against university policy to allow surveys of people under 18 years of age unless parental permission was granted. Third, during the event everyone's attention would be glued to the show. After the show, around 11:00 p.m., it seemed questionable whether anyone would be willing to participate in a survey. Lighting would also be a problem. Finally, there was a concern that asking people too long after the event was over might result in some non-sampling error. Non-response would likely be a problem, and depending on how long after the event the data was collected, there might be recall errors.

While not free from all concerns, it was decided to employ a drop-off and pick-up approach among parents of soccer players as well as other event fans in the days following the opening ceremonies. Since over 2600 soccer players would have been in Cedar City two full days prior to the ceremonies, many with their parents, it was believed that during the day following opening ceremonies they would be able to provide responses appropriate to all the objectives. Further, since players were supposed to arrive early to their competitive events in order to get organized and warm up, it was felt that parents and friends on the sidelines would not be reluctant to fill out questionnaires while waiting for the game to begin. The plan was to randomly choose fields and games, and to make two trips around each playing field. On the first trip questionnaires and pencils would be handed out, and on the second trip the completed questionnaires and the pencils would be picked up.

Regarding the target number of respondents, it was decided, based on experience more than anything else, that 250-300 respondents would suffice.

With the data collection approach chosen, the questionnaire was developed. After several iterations the questionnaire, presented in exhibit 1, was finalized. The questionnaire was developed by the two researchers, without input from people from the Utah Summer Games or from anyone else. However, the final questionnaire was approved by Kyle Case and Steve Ahlgreen.

COLLECTING THE DATA

Opening ceremonies were held the evening of June 10. On the morning of June 11 one of the researchers showed up at a field where 3 soccer games started out simultaneously, donned a Utah Summer Games volunteer shirt, and tested out the procedure. It worked out well, except that 3 fields tended to take too much time if data collection was to occur between the time when the players showed up and the game began. Nevertheless, all respondents were very accommodating.

The researcher had arranged for 3 soccer players to help in data collection for several hours after their first game. Unfortunately, the soccer players decided at the last moment against the job based on the advice of their coach. Hence, the plan to randomly choose games for data collection went out the window. Instead, the lone researcher scrambled from location to location in an effort to garner as many completed questionnaires as possible. In choosing among the many soccer fields used in the area, he chose those fields where he could get a mix of players of various ages. While not quite a quota sampling technique, it was the best that could be accomplished under the circumstances. A total of 176 completed questionnaires were obtained. Remarkably, only two folks refused to fill out the questionnaire. A few others failed to fill out the questionnaire due to getting involved watching the game.

The other researcher, between June 16 and June 19, distributed and collected questionnaires at basketball, swimming, track and equestrian events. He attended events in the SUU swimming pool complex, the Centrum basketball arena, the equestrian arena in Parowan, and the Eccles Coliseum for track events. Parents and coaches were handed surveys in a pass around the sports complex. The surveys were then retrieved in a second pass. Very few people refused to fill out a survey. An additional 89 questionnaires were completed, bringing the total to 265.

Exhibit 1. The Questionnaire

Southern Utah University June 2004

Thank you for helping us make the Utah Summer Games a better event. All information is confidential. Please have only ONE ADULT per family fill out this survey ONCE during the Summer Games. After finishing, please either return the questionnaire to a Utah Summer Games volunteer or deposit the questionnaire in the designated drop box.

1. Did you go to the Utah Summer Games opening ceremonies?
____ a. YES
____ b. NO (Go to question 3)

2. How much did you, personally, like each of the following events of the opening ceremonies? Please circle an appropriate number for each event.

	DISLIKED VERY MUCH	DISLIKED	NEUTRAL	LIKED	LIKED VERY MUCH	DID NOT ATTEND
BMX stunt team	1	2	3	4	5	6
Black Hawk Band	1	2	3	4	5	6
Utah Jazz Bear	1	2	3	4	5	6
Fireworks	1	2	3	4	5	6
Parade of athletes	1	2	3	4	5	6

3. Did a child of yours, or a minor under your care, attend the opening ceremonies?
____ a. YES
____ b. NO (Go to question 6)

4. Please rate how you feel the minor in your care enjoyed each of the following events.

	DISLIKED VERY MUCH	DISLIKED	NEUTRAL	LIKED	LIKED VERY MUCH	DID NOT ATTEND
BMX stunt team	1	2	3	4	5	6
Black Hawk Band	1	2	3	4	5	6
Utah Jazz Bear	1	2	3	4	5	6
Fireworks	1	2	3	4	5	6
Parade of athletes	1	2	3	4	5	6

5. Which of the following statements most appropriately represent your opinion about the opening ceremonies?
____a. RAISE THE ENTRANCE PRICE BY $5 OR MORE, AND RAISE THE SHOW QUALITY.
____b. RAISE THE ENTRANCE PRICE BY $1 TO $4, AND RAISE THE SHOW QUALITY.
____c. MAINTAIN TODAY'S ENTRANCE PRICE; MAINTAIN THE SAME SHOW QUALITY.
____d. DECREASE THE ENTRANCE PRICE BY $1-$4, AND REDUCE THE SHOW QUALITY.
____e. DECREASE THE ENTRANCE PRICE BY $5 OR MORE, AND REDUCE THE SHOW QUALITY.
____f. NOT SURE/NO OPINION.

6. While at the Utah Summer Games, please indicate what other activities you have participated in or will participate in (circle all that apply).
a. VISITS TO NATIONAL PARKS
b. VISITS TO STATE AND LOCAL HISTORICAL SITES
c. TOURS OF SOUTHERN UTAH UNIVERSITY CAMPUS
d. SHOPPING FOR CLOTHING, GIFTS & SOUVENIRS, OR JEWELRY & ACCESSORIES
e. VISITS TO FAMILY OR FRIENDS IN LOCAL AREA
f. OTHER: PLEASE EXPLAIN______________________________
g. NONE OF THE ABOVE

7. Please indicate how satisfied you are with the following aspects of Cedar City and the Utah Summer Games.

	VERY DIS-SATISFIED	DIS-SATISFIED	NEITHER SATISFIED NOR DIS-SATISFIED	SATISFIED	VERY SATISFIED	DON'T KNOW/ DOESN'T APPLY
Lodging options	1	2	3	4	5	6
Lodging prices	1	2	3	4	5	6
Eating options	1	2	3	4	5	6
Eating prices	1	2	3	4	5	6
Activities between events	1	2	3	4	5	6
Friendliness of Cedar City residents	1	2	3	4	5	6
Overall, the Utah Summer Games	1	2	3	4	5	6

8. Please circle all of the letters that apply.
   Sex: a. Male b. Female
   Role: a. Coach; b. Parent of athlete; c. Athlete; d. Team or organization representative
   Funding: a. We conducted fund raisers to pay for the trip;
   b. The school or organization paid for the entire cost of the trip;
   c. The school or organization paid for a portion of the trip
   Lodging:
   a. I am staying in a hotel/motel;
   b. I am staying in a Bed & Breakfast:
   c. I am staying in a campground;
   d. I am staying with a family or friend;
   e. I am staying at home
   Income:
   a. Our household income is less than $35,000
   b. Our household income is between $35,001 and $70,000
   c. Our household income is over $70,000
   Age: a. I am under 18 years old;
   b. I am between 18 and 25 years old;
   c. I am between 26 and 35 years old;
   d. I am between 36 and 55 years old;
   e. I am over 55 years old
9. My zip code: _______________
10. My suggestions for improving the Utah Summer Games experience:

DATA PREPARATION AND ANALYSIS

Each questionnaire was numbered, and the results input into SPSS.

With regard to the opening ceremonies, 49.8% of the respondents attended the event, and 55.6% had a minor in their care attend. Predictably, attendance varied by sport, with 68% of soccer field respondents attending, and 75.6% of the soccer field respondents indicating a minor in their care attended. This was to be expected given the timing of the soccer and opening ceremony events.

Tables 2 through 6 show the results from question 2, regarding the satisfaction levels of adults with the opening ceremony. Tables 7 through 11 show the results from question 4 regarding satisfaction levels among youths and children.

Table 2. BMX Stunt Team-Adult Perception

	Frequency	Valid Percent
Disliked very much	1	.8
Disliked	7	5.4
Neutral	30	23.3
Liked	43	33.3
Liked Very Much	48	37.2
Total	129	100.0

Table 3. Black Hawk Band -Adult Perception

	Frequency	Valid Percent
Disliked very much	2	1.5
Disliked	11	8.5
Neutral	22	16.9
Liked	44	33.8
Liked Very Much	51	39.2
Total	130	100.0

Table 4. Utah Jazz Bear--Adult Perception

	Frequency	Valid Percent
Disliked very much	2	1.5
Disliked	2	1.5
Neutral	23	17.7
Liked	38	29.2
Liked Very Much	65	50.0
Total	130	100.0

Table 5. Fireworks--Adult Perception

	Frequency	Valid Percent
Disliked very much	1	.8
Disliked	2	1.6
Neutral	6	4.8
Liked	25	19.8
Liked Very Much	92	73.0
Total	126	100.0

Table 6. Parade of Athletes--Adult Perception		
	Frequency	Valid Percent
Disliked very much	3	2.3
Disliked	1	.8
Neutral	6	4.7
Liked	34	26.6
Liked Very Much	84	65.6
Total	128	100.0

Table 7. BMX Stunt Team--Child Perception		
	Frequency	Valid Percent
Disliked very much	0	0
Disliked	2	1.4
Neutral	23	16.3
Liked	48	34.0
Liked Very Much	68	48.2
Total	141	100.0

Table 8. Black Hawk Band--Child Perception		
	Frequency	Valid Percent
Disliked very much	5	3.5
Disliked	20	14.1
Neutral	38	26.8
Liked	36	25.4
Liked Very Much	43	30.3
Total	142	100.0

Table 9. Utah Jazz Bear--Child Perception		
	Frequency	Valid Percent
Disliked very much	0	0
Disliked	2	1.4
Neutral	27	18.4
Liked	38	25.9
Liked Very Much	80	54.4
Total	147	100.0

Table 10. Fireworks--Child Perception		
	Frequency	Valid Percent
Disliked very much	0	0
Disliked	0	0
Neutral	6	4.1
Liked	24	16.6
Liked Very Much	115	79.3
Total	145	100.0

Table 11. Parade of Athletes -Child Perception		
	Frequency	Valid Percent
Disliked very much	2	1.4
Disliked	3	2.1
Neutral	13	9.0
Liked	34	23.6
Liked Very Much	92	63.9
Total	144	100.0

With regard to assessing whether respondents wanted to see the price and quality raised, maintained, or lowered, the results from question 5, ignoring those who were not sure or had no opinion, are shown in table 12.

Table 12. Pricing and quality recommendation

	Frequency	Valid Percent
Raise price $5 or more, raise quality	10	6.8
Raise price $1-$4, raise quality	36	24.3
Maintain price & quality	89	60.1
Decrease price $1-4, reduce quality	9	6.1
Decrease price $5 or more, reduce quality	4	2.7
Total	148	100.0

Tables 13 through 19 depict results to question 7, regarding participant satisfaction levels with various aspects of their Cedar City and Utah Summer Games experience.

Table 13. Satisfaction with lodging options

	Frequency	Valid Percent
Very Dissatisfied	17	9.8
Dissatisfied	17	9.8
Neither Satisfied nor dissatisfied	27	15.5
Satisfied	80	46.0
Very Satisfied	33	19.0
Total	174	100.0

Table 14. Satisfaction with lodging prices

	Frequency	Valid Percent
Very Dissatisfied	9	5.2
Dissatisfied	26	15.0
Neither Satisfied nor dissatisfied	45	26.0
Satisfied	71	41.0
Very Satisfied	22	12.7
Total	173	100.0

Table 15. Satisfaction with eating options		
	Frequency	Valid Percent
Very Dissatisfied	5	2.3
Dissatisfied	6	2.7
Neither Satisfied nor dissatisfied	29	13.2
Satisfied	111	50.5
Very Satisfied	69	31.4
Total	220	100.0

Table 16. Satisfaction with eating prices		
	Frequency	Valid Percent
Very Dissatisfied	3	1.4
Dissatisfied	5	2.3
Neither Satisfied nor dissatisfied	34	15.7
Satisfied	121	56.0
Very Satisfied	53	24.5
Total	216	100.0

Table 17. Satisfaction with activities etween events		
	Frequency	Percent
Very Dissatisfied	4	2.3
Dissatisfied	15	8.8
Neither Satisfied nor dissatisfied	77	45.0
Satisfied	62	36.3
Very Satisfied	13	7.6
Total	171	100.0

Table 18. Satisfaction with friendliness of Cedar City residents		
	Frequency	Percent
Very Dissatisfied	6	2.8
Dissatisfied	2	.9
Neither Satisfied nor dissatisfied	27	12.6
Satisfied	83	38.6
Very Satisfied	97	45.1
Total	215	100.0

Table 19. Overall satisfaction with the Utah Summer Games		
	Frequency	Percent
Very Dissatisfied	6	2.6
Dissatisfied	2	.9
Neither Satisfied nor dissatisfied	10	4.3
Satisfied	109	47.4
Very Satisfied	103	44.8
Total	230	100.0

An interesting question is whether satisfaction levels with the Utah Summer Games, and with activities between events, is a function of where people stay. If people stay at home or with relatives, they may not need as many activities between events to keep them occupied. Also, people who have to travel longer distances and therefore incur more expenses may be less satisfied with the USG overall. To examine these possibilities, cross tabulations and chi-square tests were performed to test the hypotheses that satisfaction overall, and satisfaction with regard to activities between events, are independent of where people stay. In order to get cell numbers up towards satisfactory numbers collapsing of the data was necessary. The results are shown in tables 20 and 21.

Table 20. Satisfaction with activities between events by lodging arrangement					
		Satisfaction with activities between events			
Rooming Arrangements		Dissatisfied	Neither Satisfied nor dissatisfied	Satisfied	Total
Rent Room or Camping	Frequency Row percent	11 9.9%	55 49.5%	45 40.5%	111 100%
Stay at Home or with Others	Frequency Row percent	7 13.2%	19 35.8%	27 50.9%	53 100%
Total	Frequency Row percent	18 11.0%	74 45.1%	72 43.9%	164 100%
Pearson Chi-Square = 2.732, with 2 degrees of freedom. Significance level = .255					

Table 21. Overall satisfaction with the Utah Summer Games by lodging arrangement					
		Overall satisfaction with Utah Summer Games			
Rooming Arrangements		Dissatisfied	Neither Satisfied nor dissatisfied	Satisfied	Total
Rent Room or Camping	Frequency Row percent	2 1.5%	6 4.5%	124 93.9%	132 100%
Stay at Home or with Others	Frequency Row percent	6 7.1%	3 3.6%	75 89.3%	84 100%
Total	Frequency Row percent	8 3.7%	9 4.2%	199 92.1%	216 100%
Pearson Chi-Square=4.627, with 2 degrees of freedom. Significance level=.099					

Finally, with regard to determining what other activities people participate in while at the Utah Summer Games, table 22 provides the results from question 6.

Table 22. Participation frequency in other activities	
Activity	**Number indicating participation**
Visit national parks	36
Visit state and local historical sites	26
Tour SUU campus	25
Shop	129
Visit family or friends	67
Other	46
None of the above	61

INTERPRETING THE RESULTS

At this point the two researchers were ready to interpret the marketing research results. To help they constructed table 23. What should they report and recommend to the director and marketing director of the Utah Summer Games?

Question	Sample size (n)	Mean	Standard Deviation	Standard Error of the Mean
2. Opening Ceremonies – Adult				
BMX stunt team	129	4.01	.948	.083
Black Hawk Band	130	4.01	1.023	.090
Utah Jazz Bear	130	4.25	.907	.080
Fireworks	126	4.63	.724	.064
Parade of Athletes	128	4.52	.823	.073
4. Opening Ceremonies – Young Athletes				
BMX Stunt Team	141	4.29	.789	.066
Black Hawk Band	142	3.65	1.156	.097
Utah Jazz Bear	147	4.33	.822	.068
Fireworks	145	4.75	.521	.043
Parade of Athletes	144	4.47	.852	.071
7. Satisfaction with Cedar City and the Utah Summer Games				
Lodging options	174	3.55	1.190	.090
Lodging prices	173	3.41	1.056	.080
Eating options	220	4.06	.871	.059
Eating prices	216	4	.789	.054
Activities between events	171	3.38	.841	.064
Friendliness of Cedar City residents	215	4.22	.905	.062
Overall the Utah Summer Games	230	4.31	.818	.054

Table 23. Sample means, standard deviations, and standard errors.

SUGGESTED QUESTIONS

1. What other specific research objectives could have been pursued? Why do you think they weren't chosen?
2. The researchers did not do any real exploratory, or qualitative, research prior to designing their research or their questionnaire. What might they have missed by NOT conducting in-depth interviews and focus groups? What are the dangers of skipping this step?
3. The chosen method for collecting data was to drop off and pick up the questionnaires at competitive events following opening ceremonies. What other methods could have been used, and what are the pros and cons of each? Was the sampling method appropriate for achieving the objectives of the study?

4. Critique the questionnaire. The researchers did not do a pretest. What are the risks of skipping this crucial step, and how might it have helped in this particular case?
5. What additional analyses of the data would you recommend?
6. Evaluate the cross-tabulations and the associated chi-square tests. What do the significance level numbers mean?
7. Construct the 95% confidence interval for the overall satisfaction level with the Utah Summer Games. Interpret this number. Is there any non-sampling source of error with which you would be concerned?
8. What conclusions can be reached, and what recommendations would you make?

THE ORANGE PEEL SOCIAL AID AND PLEASURE CLUB

Dennis Patenotte, Western Carolina University
George W. Mechling, Western Carolina University

CASE DESCRIPTION

This case primarily targets students enrolled in management science/quantitative business methods courses. Its intent is two-fold: 1) provide students the opportunity to decide how a real-world entertainment club should assign its bartenders to work stations at its wet bar in order to realize the bar's revenue potential and 2) require students to construct a business context in which to make such a decision.

The bar has six work stations and the expected revenue each of the club's eight bartenders generates varies from work station to work station. Doubling up bartenders at selected work stations does occur. The complexity of this case's assignment requirements and restrictions go beyond what the "assignment" algorithms found in most student software packages can accommodate. Linear programming is not so limited and thus, is this case's methodology of choice.

This case is valuable to students for several reasons. Constructing the business context in which they are to make their decisions, students add a transcendent layer of analysis to their task that can give them valuable first-hand practice at defining problems and developing an appreciation for the relevance of the methods they can employ solving such problems. Furthermore, this case's assignment restrictions and requirements reflect the club's operational reality and are therefore, quite realistic, practical, and worth knowing how to program. Programming many of these assignment restrictions and requirements will also challenge students well beyond what they customarily encounter in most linear programming problems. It will also require them to use their intuition in at least one assignment situation the club faces that should lead them to conclude that the application of a decision-support methodology such as linear programming is not particularly necessary. Finally, students can transfer lessons learned from this case to real-world business settings they will eventually face.

The authors designed this case for use by MBA and upper class undergraduate students to be taught in 2 class hours, with 3-4 hours of student preparation time. The instructor can modify this case for more complexity per suggestions found in the "Instructor's Note."

CASE SYNOPSIS

The Orange Peel Social Aid and Pleasure Club is located in downtown Asheville, NC and is the premiere music venue in Western North Carolina. It books music groups from all over the United States and the world and has the reputation of having the best beer selection in town. Patrons travel to the Orange Peel from all over the southeast region of the United States to enjoy their favorite musicians live. The club opened in fall 2002 and has become the most popular night *spot in Asheville since that time. The Orange Peel's goal is to provide its customers the best convivial social atmosphere and "pop" music in a 100 mile radius of Asheville.*

The club's wet bar is an important revenue center. Opportunities occur for the bar to generate the most revenue on nights when the club has sold-out shows. The club manager has eight bartenders (six of whom are part-time) she can assign to six work stations for such occasions. The revenue performances of each bartender vary from one work station to the next and vary among bartenders for a given work station. Therefore, making assignments that will realize the bar's revenue potential is somewhat complex and therefore, will require some thought by the club manager.

INTRODUCTION

The Orange Peel Social Aid and Pleasure Club is located in downtown Asheville, NC and is the premiere music venue in Western North Carolina. It books music groups from all over the United States and the world and has the reputation of having the best beer selection in town. Patrons travel to the Orange Peel from all over the southeast region of the United States to enjoy their favorite musicians live. The club opened in fall 2002 and has become the most popular night spot in Asheville since that time.

THE CONCERN

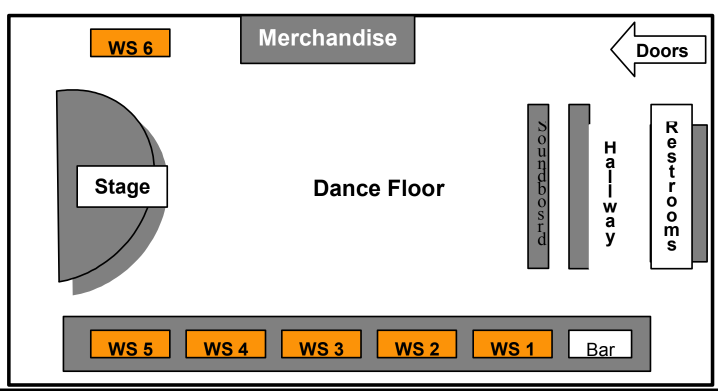
The Orange Peel's goal is to provide its customers the best convivial social atmosphere and live "pop" music within a 100 mile radius of Asheville, NC by offering them the widest selection of beverages in town at its wet bar and booking top-name "pop" music groups for its shows. It would appear that the club has so far been successful pursing this goal. Its shows frequently sell out with close to 950 attendees at those shows who patronize the club's wet bar it staffs with eight bartenders (six of whom are part-time) at six work stations. The wet bar is one of the club's important attractions and revenue centers but the newly-hired club manager has noted that bar receipts on nights of sold-out shows are sometimes well below what one would otherwise expect. This concerns her. It is easy for a going-concern to overlook or ignore problems in its operations function when business is good and the club manager does not want this to be true for the "Peel." She doubts that the club is managing its bar as effectively as it could and this could be the reason for the bar's inconsistent revenue performance. Ineffectively managing the bar's operations could hurt the club by impairing critically needed cash flow when business activity slows as it will from time to time in this sort of business. She also knows that if the club can effectively manage its bar in a well-organized and rigorous fashion for sold-out shows, it will also then have insight into effectively managing its bar when its shows are less than sellouts.

The club manager decides to share with the club's owners her concern about the bar's inconsistent revenue performance and her plan to critique the bar's operations. She intends to review the revenues each of the club's eight bartenders generated at the different stations of the bar they have worked and observe bar operations during its shows. The owners too, have had some concern about the bar's sporadic revenue performances. Therefore, they not only clear the club manager to begin her assessment of the bar's performance but charge her with the task of submitting to them a report of that assessment, her recommendations for improving the bar's revenue performance and performance consistency, and provide a methodology for implementing those recommendations as well.

PROBLEM SPECIFICS

The layout of the wet bar is displayed in Figure 1. There are five work stations (WS1 through WS5) at the main bar and one work station (work station six--WS6) at the satellite bar. The main bar is 20 yards in length with the work stations and a cash register for each work station evenly spaced along it. Due to the layout of the bar some work stations have more traffic than others. When customers first enter the club they see WS1 and WS2 first. Therefore, the bartenders at these work stations are usually the busiest. Bartenders might work the entire bar length of 20 yards regardless of their work station assignments. However, inasmuch as most customers go to the closest cash registers, the bartenders at WS3, WS4, and WS5 tend to work the bar's length more taking customer orders than if they were at WS1 and WS2. Also, many of the ingredients for mixing beverages have special placements behind the bar and that requires bartenders to move back and forth behind the bar to get to them. The satellite bar, W6, has its own cash register and is on the other side of the bar at a room corner.

Figure 1 Layout of the Orange Peel



THE ASSESSMENT

The club manager does her assessment over several weeks of sold-out shows reviewing cash register receipts while randomly assigning her eight bartenders to different work stations and observing their performances. As a result of her assessment, the club manager observes that the skill and efficiency with which each bartender mixes and serves drinks varies. The ingredients for mixing beverages also have special placements behind the bar. Therefore, some bartenders must move back and forth greater distances behind the bar than others to get to the mixing ingredients because of their work station/cash register assignments. Also, the satellite bar, compared to the main bar, has a restricted selection of products due to its small size and distance from the main bar. Consequently, revenue at the satellite bar (WS6) is on average lower than at any of the work stations at the main bar.

The club manager thus concludes that revenue varies among bartenders and for any one bartender varies from work station to work station. Cash register receipts at the six work stations for the eight bartenders support this conclusion. Table One summarizes this variation in USD although one could substitute other forms of currency in its place.

Table One
Average Sales (USD) per Soldout Shows for Each Employee at Each Work Station/Cash Register

	WS 1	WS 2	WS 3	WS 4	WS 5	WS 6
Andrew	1,527	1,589	1,487	1,362	1,253	489
Lori	1,350	1,387	1,268	1,124	1,069	396
Sterling	1,685	1,654	1,592	1,473	1,365	542
Gavra	1,106	1,068	1,058	965	952	628
Chad	1,298	1,368	1,365	1,254	1,123	485
Mike	1,459	1,387	1,369	1,152	1,158	486
Jessica	1,268	1,158	1,087	1,154	1,041	368
Leslie	1,468	1,475	1,368	1,198	1,024	472

As the result of reviewing past bar receipts, the club manager also discovers to her dismay that the bartenders have been participating in an informal work station assignment rotation system of their own devising in lieu of management directly designating such assignments. The two bar managers, Andrew and Lori, for the most part, trade off working at WS1 and WS2. The remaining bartenders are part-time and the club calls them in to work as needed. They rotate through the six work stations each in turn doubling up with Andrew and Lori at WS1 and WS2. Furthermore, the club manager also observes that the bar's operations often appear to slow down drastically when the bartenders change out empty beer kegs on tap with full ones. The club has its kegs on tap located at WS5 because of its proximity to the keg cooler. The bartender at WS5, as a matter of practice, has the responsibility to do the change out.

Having completed her assessment, the club manager must now prepare a report that she will submit to the club's owners that will contain her findings, recommendations for improving the bar's revenue performance and performance consistency to submit to the club's owners, and a methodology for implementing those recommendations.

FITNESS PRO: MANAGING A GROWING BUSINESS

Lee Tompkins, Jr., Fitness Pro
Russell Kent, Georgia Southern University
Michael McDonald, Georgia Southern University

CASE DESCRIPTION

The primary subject matter of this case concerns entrepreneurship. Secondary issues examined include operations, finances, marketing, distribution, warehousing, policies, procedures, and information systems. The case has a difficulty level of four. The case is designed to be taught in one and one-halfr hours and is expected to require two hours of outside preparation by students.

CASE SYNOPSIS

The case examines how a physical therapist started an exercise equipment and personal fitness business: Fitness Pro. Eventually, the son takes over the business and moves it to the Hilton Head Island, South Carolina, and Savannah, Georgia, areas of the Southeast United States. As the business begins to grow, the founder's son looks for growth opportunities that fit his business model. He finds it in a similar business located in Tallahassee, Florida: Fitness Master. As these two businesses merge into one named Fitness Pro, they later start a new business in Jacksonville, Florida.

Within a few years, the business has three retail stores in Savannah, Tallahasee, and Jacksonville, and several outside sales staff who focus strictly on commercial accounts. With growth, however, comes growing pains. Major problems facing the two owners are what to do about rising shipping costs, warehousing, inventories, and financial control. The partners decide to bring in a more experienced partner to help them negotiate with their suppliers. Also, the new partner is trying to help the business develop accounting and financial information systems.

The case ends with the three partners attempting to develop a strategic plan for the future of the business.

INTRODUCTION

Fitness Pro, Inc., is a small company that specializes in selling and servicing high quality health and exercise equipment to residential and commercial customers. Fitness Pro operates out of three retail locations, Savannah, Georgia, Jacksonville, Florida, and Tallahassee, Florida, with the long-term goal of opening additional satellite stores.

COMPANY HISTORY

The original Fitness Pro was started in the 1970's in Lexington, Kentucky, by the father of one of the current owners, Paul Drake. The father, a physical therapist by occupation and training, saw a need for his clients and others to buy professional exercise equipment from knowledgeable people. Paul opened his first Fitness Pro store in 1990 in Charleston, West Virginia; however, Paul disliked living in Charleston, and so he closed the store and started looking for opportunities in other markets. He found the Savannah/Hilton Head area to be a good potential market and opened Savannah's Fitness Pro store in 1993, moving it to its current location in 1996.

By the late 1990's, Paul was looking to expand his business into other markets. He looked at a possible location in Tallahassee, Florida. At that time a fitness store, Fitness Master, was operating in Tallahassee. The owner of Fitness Master, Pat Sullivan, contacted Paul about his interest in joining up to open a store in North Florida. The two met and, from this meeting, a partnership formed, and a new store opened in Jacksonville, Florida. All stores took the name of Fitness Pro, with the corporate headquarters remaining in Savannah, Georgia.

In 2003, a third partner joined the organization, Lee Tompkins, Jr. Lee took over the financial and operational side of the business as chief financial officer. Lee joined as a partner to add additional capital, to bring business and financial management skills to the company, and to allow the other partners to focus on selling.

INDUSTRY TRENDS: SOCIO-CULTURAL FACTORS

The fitness industry will likely continue to benefit from health favorable socio-cultural trends as well as good demographic and economic conditions that are expected to maintain a steady level of growth in fitness equipment. This trend of healthier lifestyles creates a need for convenient methods of exercise, which, in turn, creates an increased demand for home fitness equipment as well as health and fitness clubs. Much of the health movement is fueled by factors such as heightened media attention; increasing healthcare costs; and widespread health problems like obesity. According to the U.S. Center for Disease Control and Prevention, the rate of obesity among U.S. adults between 1991 and 2002 increased by 74 percent. In addition, the Surgeon General's report on physical activity and health issued in 1996 stated:

> *The fitness movement is being transformed by Americans aged 45 and older. ... [and] The prevalence of physical inactivity was greater among persons with lower levels of education and income.* (Center for Disease Control and Prevention, 2005).

INDUSTRY TRENDS: ECONOMIC FACTORS

According to Paul Drake, many new custom homes are now being designed with the idea of a fitness room in the floor plans. Fitness Pro benefitted from being in growing markets that have shown sustained growth in population, housing starts, disposable income, and economic success. The company's current primary markets include the MSAs of Jacksonville, Savannah, and

Tallahassee. All three markets should continue to grow and will rely on key factors. These factors include population growth, disposable income, education levels, and a diversified industrial base.

Population in the Jacksonville MSA grew by approximately 7 percent from 2000 through 2003, and it increased by 21 percent from 1990-2000 (U.S. Census, 2005). By 2009, the Jacksonville Chamber of Commerce projects the total MSA population to equal 1,330,938. The Jacksonville Chamber of Commerce also estimates a median average household income of $46,271 and an average household income of $60,070 (Jacksonville Chamber of Commerce, 2005).

The Tallahassee MSA population grew by approximately 1.3 percent from 2000 through 2003, and it experienced a 24.4 percent increase from 1990 to 2000 (U.S. Census, 2005). The Tallahassee Chamber of Commerce estimates that the MSA population will reach 248,039 by 2010. Median household income was $37,517 in 1999, and the number of households in 2000 was 96,521 (Tallahassee Chamber of Commerce, 2005).

The Savannah MSA population (304,325) grew by approximately 3.78 percent from 2000 to 2003, and it experienced a 13.57 percent increase from 1990 to 2000 (U.S. Census, 2005). Median household income was $35,608, and the number of households was 116,000.

> *The number of jobs in the coastal [Georgia] MSA is growing twice as fast as that of the state and the nation as a whole, and employment is projected to rise by 3.1 percent in 2005, which is the largest percentage gain predicted for any of the state's metropolitan areas* (Savannah Chamber of Commerce, 2005).

Other general economic conditions that could affect Fitness Pro's business include the expansion of the new housing market, volatility of interest rate fluctuations, inflation, and increased gas prices.

> *As mortgage rates climb, there will be less new residential construction. The 2005 housing forecast calls for permits authorizing 9.7 percent fewer homes. The slide in multi-unit residential construction is much steeper: 36 percent fewer units will be authorized in 2005* (Savannah Chamber of Commerce, 2005).

Inflation and price changes pose a risk to the company's performance. A significant increase in inflation could decrease discretionary income among consumers and also commercial clients. Shipping costs are a major cost for Fitness Pro, and, thus, gas prices play an important role in the cost of receiving, distributing, and delivering products.

INDUSTRY TRENDS: LEGAL/POLITICAL

Many companies within the fitness industry are looking internationally to find cheaper alternative methods to manufacture their products.

The fitness industry has not experienced a wide range of legal problems to date, however, as with any business, it is cautious in what it does. A legal issue facing the fitness industry is any problem experienced while using the equipment. Consumers have sued manufacturers and retailers due to injuries occurring when using the equipment. Many times, these injuries have been due to the customers' misuse of the equipment or not being physically fit enough to use the equipment. Companies help to protect themselves against these lawsuits by putting warnings on equipment suggesting proper use and advising users to consult with their doctors before use. In the early stages of growth, the industry faced some problems due to patent infringements.

Currently, most products in the industry are easily duplicated and are no longer protected by patents.

INDUSTRY TRENDS: TECHNOLOGICAL FACTORS

The fitness equipment industry has grown over the years with many new products emerging in the market. Equipment types range from endurance and strength training machines to those products which aide in stretching. Slight differences exist in appearance or operation, but the equipment generally provides the same results.

The industry is saturated and, therefore, it is hard to keep new technology out of competitor hands. Occasionally there are advances in equipment operations or production processes, so the manufacturer can secure a patent to help protect the design. Without patent protection almost every aspect of the equipment would be fully replicated by the competition and reproduced; however, generally, new technology is easily duplicated.

The market is fiercely competitive. Cost or quality is how a company competes. There are similar products offered in the low cost, medium cost, and/or high cost areas. The major differences among these different brands are the durability, materials used in production, and accessories. Technological advances are geared toward new features added to current products. Equipment is not only expected to increase in sophistication; it is also expected to increase the level of interaction between the machine and the consumer. Many manufacturers focus their efforts on the addition of TV, radio, and Internet access to their equipment. New equipment is expected to be user friendly and aesthetically pleasing.

INDUSTRY/COMPETITIVE CONDITIONS

Fitness Pro is a distributor with retail and commercial clients. Smaller distributors like Fitness Pro rely on fitness equipment manufacturers to supply them with the products they sell. Fitness equipment manufacturers create exclusive agreements with distributors such as Fitness Pro; however, those agreements can change at any time. The fitness equipment industry has revenues of more than $4 billion. The exercise equipment industry segment can be broken into two distinct segments, the manufacturing segment and specialty retailers/distributors segment (PSN Retailing Today, 2005).

Within the manufacturing segment are two other segments, the mid to high-end manufacturer and the low-end manufacturer. Fitness Pro only distributes high-end equipment. The mid to high-end fitness equipment manufacturing segment is primarily controlled by a handful of producers. These producers sell their products through specialty distributors to fitness gyms, spas, resorts and residential customers. This has been a stable segment of the industry, and it appears growth will come from equipment sold for residential use. The major players of this segment are Precor, Cybex, True Fitness, and Life Fitness. See Table 4 for size comparison information on Precor, Cybex and Life Fitness.

The mid-to-high-end manufacturing industry as a whole is expected to continue to grow. True Fitness has recently had good years due to its expanded offerings. Even struggling names such as Cybex, are emerging from hard times. Analysts expected growth of this segment in 2003 to exceed 5 percent following a 10 percent growth in 2002 (DSN Retailing Today, 2003).

Specialty retailers and distributors, such as Fitness Pro, make up only 2.2 percent of industry sales. These firms tend to be local or regional with few able to reach national status. One of the leaders is Gym Source, which claims to be the largest supplier of mid- to high-end fitness equipment (www.gymsource.com). Competition in smaller markets tends to come from locally owned shops. In Savannah, for instance, the major competition for Fitness Pro is a new store, Just for Fitness. Barriers to entry are relatively low. Capital requirements to open a store in Savannah, for instance, are approximately $150,000. The most significant barrier in any given market is the number of competitors. Smaller markets like Savannah could probably not support more than three or four stores of this type. In addition, suppliers are plentiful but their exclusive arrangements with distributors can mean the supplier controls traffic generating brands. Overcoming these barriers is the burden of the distributors, and they know their stores' environments and service offerings are directly affected by the growth or decline of the fitness equipment industry.

Friendly and highly knowledgeable sales staff characterizes specialty fitness equipment stores. These success factors are recognized as the key to providing competitive advantage. In addition, the quality of the products sold sets these businesses apart from mass retailers. Finally, superior customer service including after the sale warranty service is a major competitive advantage.

THE STRATEGY OF FITNESS PRO

Existing Strategy

The strategy of Fitness Pro, includes implementing an operations plan that all three retail locations will follow. The goals are to establish common practices for merchandising, marketing and financial reporting that will clear the way for successful growth. Part of this strategy includes developing a computer system that links all the stores to a central location in order to simplify capturing inventory and sales information. Another component of the strategy is to build a partnership relationship with True Fitness which would lead to assistance in opening new stores, marketing and improving cash flow. Another long-term strategic goal is to explore new market opportunities throughout Georgia, North Carolina, South Carolina, and Florida. The final and ultimate long-term goal for Fitness Pro is to make itself an attractive target for purchase by a larger company.

Marketing

Fitness Pro targets high-end customers from both the commercial and residential sectors located within a reasonable driving distance from retail stores in Jacksonville and Tallahassee, Florida, and Savannah, Georgia. The company markets its products by focusing on quality, customer service, competitive pricing, direct selling and limited advertisement. Fitness Pro has historically operated on a marketing budget of approximately two to four percent of sales. The company has also launched a website that has technical and pricing information for commercial, residential and used products. It is also able to offer a lease option for commercial customers, and it is able to provide competitive consumer financing for the purchase of residential equipment.

Commercial clients include businesses such as corporations, hospitals, health clubs, hotels/resorts, apartment complexes, YMCAs and golf club/residential communities. Fitness Pro markets to commercial clients through the direct personal sales efforts of five commercial sales representatives. Much of this marketing is dependent on personal relationships and knowledge of upcoming business opportunities. Due to the selling techniques used in the commercial division, the market area for commercial products is much larger than the residential division. The five commercial territories are

1. Florida Panhandle (Tallahassee West to Pensacola);
2. North Florida {Jacksonville Metro West to Tallahassee);
3. S.E. Georgia & S.E. South Carolina;
4. West to Columbus, GA, North to Macon, Northeast to Charleston, S.C.; and
5. Central Florida -Daytona, Gainesville, Ocala, Orlando Southeast Alabama -Dothan, AL, Enterprise, AL.

In addition, each retail store displays commercial equipment on the floor and is staffed by sales associates capable of selling the equipment and in facilitating the design of fitness rooms.

The majority of Fitness Pro's retail customers are individuals who purchase products for their homes. These residential clients are typically educated, 40-55 years old, and have a household income of more than $100,000. According to Paul Drake, clients who are middle aged or older constitute a significant portion of this sector. Marketing and advertising strategies to residential clients vary from store to store. The Savannah and Tallahassee stores rely primarily on store location, signage and word of mouth, while the Jacksonville location also utilizes media such as radio, targeted mailings and booth participation in events such as the Home and Garden Show. In addition, the company sponsors a booth at the Heritage Golf Tournament on Hilton Head. All retail stores are strategically located in established retail areas having high traffic counts.

Fitness Pro is proactive in sizing up its competition. It regularly surveys its local and non-local competition to ensure its pricing structure remains competitive. In the Savannah market, its primary competitor is Just For Fitness. Both rely heavily on their retail locations for a significant portion of market exposure. Because Just For Fitness is smaller than Fitness Pro, it is likely Just for Fitness operates under similar budgetary constraints in terms of advertising and marketing capabilities.

In the Jacksonville and Tallahassee markets, Busy Body Gyms To Go, with fifteen locations over Georgia and Florida, is Fitness Pro's most significant competition. Busy Body Gyms primarily markets itself through personal commercial selling, its website, a monthly newsletter/magazine featuring new product information, promotions, health news and through involvement with local Chambers of Commerce.

In all three markets, Fitness Pro indirectly competes with Sears, which has an estimated 80 percent market share on all treadmills sold. Sears is considered indirect competition because its product line and service level is considered to be of lesser quality than that offered by Fitness Pro. Sears has been able to capture a larger portion of overall market share largely due to lower price points, a wide retail presence, a large advertising budget, and a robust marketing program.

In addition to competition from firms with physical stores, Fitness Pro competes with online companies such as Trendmillbynet.com, which sells comparable products at lower prices over the Internet. These companies often market themselves as selling high quality equipment at much lower prices than stores such as Fitness Pro. Fitness Pro is unable to promote itself in a similar way because its business model includes a service component that is not well suited to selling products outside of its market areas. The online companies may have an advantage via price, but they are typically unable to provide a comparable level of service.

Financial

Fitness Pro experienced consistent sales growth from 2000 to 2003. Its sales grew from $3.4 million in 2000 to $4.7 million in 2003. The largest part of this increase was experienced in 2001. The percentage growth from 2000 to 2001 was 20 percent. During this period of growth, Fitness Pro's gross margin increased slightly from 37.2 percent to 38.3 percent. The growth in 2002 was 11.6 percent, but the gross margin increased to 39.2 percent. By 2003, the growth over 2002 was 2.2 percent and the gross margin fell back to 38.2 percent. The first four months of 2004 show a gross margin at 40.2 percent. Fitness Pro has been able to maintain its gross margin percentage around 40 percent for the past four years.

Increased sales of Fitness Pro have also brought increased operating expenses. The operating expenses grew from approximately $1.3 million in 2000 to more than $1.8 million in 2003. In 2002, sales grew by 11.6 percent, while expenses increased by 7.4 percent. Fitness Pro's net income varied up and down from 2000 to 2003. While the firm experienced an increase in sales, its increased expenses decreased net income, particularly in 2003. Fitness Pro's net income for the year ended December 31, 2002, was $98,429, while the following year the firm showed a net loss of $32,966. In 2003, sales increased by 2.2 percent, while overall operating expenses grew by 7.7 percent. A drop in gross margin of 1 percent and an increase of almost 48 percent in salaries-officers contributed to the net loss.

Fitness Pro, Inc. Consolidated Balance Sheet

Assets	2004 Amount	2003 Amount	2002 Amount	2001 Amount	2000 Amount
Current Assets					
Cash	$ 451.99	$ 371.99	$ 271.99	$ 300.00	
Bank-First Chatham Bank	$ 225.66	$ 51,960.00			
BB&T Payroll Acct	$ 4,122.40	$ 5,132.63	$ (820.29)	$ 522.94	
BB&T General Acct	$ 22,564.67	$ 58,608.17	$ 5,800.74	$ 80,782.08	
Century South-P/R Account					$ (14,556.11)
Century South-Gen Acct					$ 11,357.53
Amsouth (Tallahassee)	$ 72,307.19	$ 2,239.62	$ 23,467.97	$ 29,595.78	$ 22,251.24
Suntrust (Jacksonville)	$ 10,672.44	$ 104.15	$ 14,371.11	$ 6,553.72	$ 15,933.38
Ameribank Premium Investment					$ 31,538.39
BB&T Prem Investment Acct	$ 96,270.50	$ 40,584.69	$ 7,347.42	$ 61,891.16	
Perishing IMS Invest Acct			$ 50,000.00		
A/R Commercial			$ 134,586.55		
A/R Orange Park			$ 2,837.74	$ 11,674.45	
A/R Savannah	$ 53,083.83	$ 63,671.31	$ 88,741.74	$ 74,715.48	$ 99,047.05
A/R Tallahassee	$ 43,822.72	$ 149,823.26	$ 96,254.24	$ 44,386.03	
A/R Jacksonville	$ 20,700.00	$ 97,773.81	$ 24,042.75	$ 102,132.60	$ 49,385.58
A/R Officer			$ 12,900.53	$ 8,100.53	
Fed Income Tax Receibavle (Redcell Inc)					$ 7,469.00
Employee Advance	$ 7,056.65	$ 820.05	$ 2,198.10	$ 455.78	$ (420.00)
N/R Pattrick Sullivan			$ 21,688.00	$ 21,688.00	$ 21,688.00
Inventory-Savannah	$ 769,828.50	$ 138,233.67	$ 81,965.89	$ 67,137.44	$ 54,629.18
Inventory-Tallahassee		$ 53,138.73	$ 53,279.46	$ 53,952.56	$ 133,770.74
Inventory-Jacksonville		$ 174,123.65	$ 63,000.51	$ 49,337.58	$ 118,957.59
Inventory-Orange Park			$ 28,725.55	$ 25,746.29	
Total Current Assets	$ 1,101,106.55	$ 836,585.73	$ 710,660.00	$ 638,972.42	$ 551,051.57
Property and Equipment					
Autos & Trucks	$ 111,398.39	$ 103,296.99	$ 67,236.99	$ 40,029.40	$ 33,575.00
Equipment	$ 34,584.37	$ 30,784.27	$ 27,153.48	$ 21,062.68	$ 10,504.76
Furniture & Fixtures	$ 69,308.12	$ 64,726.51	$ 61,439.70	$ 60,817.70	$ 55,925.06
Leasehold Improvements	$ 12,202.40	$ 9,102.40	$ 9,102.40	$ 9,102.40	$ 6,803.00
Accumulated Depreciation	$ (184,236.02)	$ (137,079.02)	$ (107,129.02)	$ (86,040.22)	$ (68,813.00)
Total Property & Equipment	$ 43,257.26	$ 70,831.15	$ 57,803.55	$ 44,971.96	$ 37,994.82
Other Assets					
N/R Fit Holdings LLC	$ 64,556.41				
Deposits	$ 9,404.80	$ 8,754.80	$ 8,754.80	$ 8,754.80	$ 8,754.80
Closing Cost	$ 9,580.00	$ 9,580.00	$ 9,580.00	$ 9,580.00	$ 9,580.00
Goodwill	$ 4,981.00	$ 4,981.00	$ 4,981.00	$ 4,981.00	$ 4,981.00
Accumulated Amortization	$ (9,938.64)	$ (6,803.64)	$ (6,803.64)	$ (3,402.00)	$ (1,701.00)
Total Other Assets	$ 78,583.57	$ 16,512.16	$ 16,512.16	$ 19,913.80	$ 21,614.80
Total Assets	$ 1,222,947.38	$ 923,929.04	$ 784,975.71	$ 703,858.18	$ 610,661.19
Liabilities & Capital					
Current Liabilities					
Accounts Payable	$ 623,960.97	$ 518,522.02	$ 421,766.12	$ 421,878.58	$ 285,932.73
Tax Deposit in Transit		$ 17,989.36			
SWH Payable	$ 1,082.29	$ 2,476.03	$ 1,168.61	$ 902.09	$ 689.06
FUTA	$ 208.47				
SUTA	$ 818.90				
GA Sales Tax Payable	$ 3,840.42	$ 10,424.84	$ 4,638.38	$ 8,583.24	$ 7,562.15
Florida Sales Tax Payable	$ 11,648.30	$ 9,282.87	$ 19,122.55	$ 18,503.91	$ 10,082.85
S.C. Sales Tax Payable	$ 4,134.65			$ 2,664.01	$ 3,703.56
Total Current Liabilities	$ 645,694.00	$ 558,695.12	$ 446,695.66	$ 452,531.83	$ 307,970.35
Long Term Liabilities					
N/P Ameribank					$ 114,872.67
N/P BB&T	$ 41,103.50	$ 61,881.22	$ 81,366.40	$ 99,522.20	
N/P FCB LOC	$ 1,074.53	$ 52,981.00			
N/P AMEX Card		$ 20,785.58	$ 4,487.38		
N/P Citizens Finance	$ (498.82)				
N/P Pat Sullivan	$ 46,873.26	$ 6,015.26	$ 25,000.00		
N/P Paul Drake	$ (1,694.99)	$ 635.20	$ 10,000.00		

Fitness Pro, Inc. Consolidated Statement of Income

	2004		2003		2002		2001		2000
Revenue	**Amount**	**Percent**							
Sales	$4,356,126.73	100.0%	$4,720,213.02	100.0%	$4,597,235.23	100.0%	$4,138,009.67	100.0%	$3,447,869.90
Total Revenue	$4,356,126.73	100.0%	$4,720,213.02	100.0%	$4,597,235.23	100.0%	$4,138,009.67	100.0%	$3,447,869.90
Cost of Goods Sold									
Purchases	$2,385,862.25	54.8%	$2,920,476.07	61.9%	$2,808,357.02	61.1%	$2,554,711.89	61.7%	$2,165,861.95
Cost of			$417.50	0.0%					
Discounts			($2,073.45)	0.0%					($111.32)
Cost of Contract Labor	$23,498.12	0.5%							
Total Cost of Goods Sold	$2,409,360.37	55.3%	$2,918,820.12	61.8%	$2,808,357.02	61.1%	$2,554,711.89	61.7%	$2,165,750.63
		0.0%							
Gross Margin	$1,946,766.36	44.7%	$1,801,392.90	38.2%	$1,788,878.21	38.9%	$1,583,297.78	38.3%	$1,282,119.27
Expenses									
Advertising	$127,603.47	2.9%	$115,445.12	2.4%	$121,337.63	2.6%	$154,167.20	3.7%	$125,328.08
Amortization Expense	$3,135.00	0.1%			$3,401.64	0.1%	$1,701.00	0.0%	$1,701.00
Auto & Truck	$59,289.42	1.4%	$46,122.28	1.0%	$31,589.44	0.7%	$26,852.10	0.6%	$23,391.59
Auto Repairs	$15,238.84	0.3%	$18,584.03	0.4%	$16,242.33	0.4%	$12,070.81	0.3%	$4,297.46
Cleaning	$3,277.90	0.1%	$4,212.79	0.1%	$3,299.52	0.1%	$2,864.05	0.1%	$2,308.78
Casual Labor	$7,345.60	0.2%	$15,711.62	0.3%	$8,751.82	0.2%	$9,327.64	0.2%	$4,550.55
Consultants	$3,025.20	0.1%	$378.75	0.0%	$692.50	0.0%	$752.00	0.0%	
Dues & Subscriptions	$2,237.01	0.1%	$2,608.08	0.1%	$2,386.55	0.1%	$3,651.38	0.1%	$1,599.61
Depreciation	$47,157.00	1.1%	$29,950.00	0.6%	$21,088.80	0.5%	$17,227.22	0.4%	$17,059.00
Donations	$338.00	0.0%	$1,793.93	0.0%	$1,640.00	0.0%	$1,091.00	0.0%	$2,380.00
Travel	$20,742.40	0.5%	$14,403.61	0.3%	$18,543.67	0.4%	$7,647.37	0.2%	$8,498.55
Meals & Entertainment	$9,258.33	0.2%	$10,868.06	0.2%	$10,685.60	0.2%	$22,109.41	0.5%	$6,283.68
Moving Expenses	$2,357.17	0.1%							$5,141.54
Trade Show Expense			$1,080.00	0.0%	$2,505.00	0.1%	$538.90	0.0%	$3,706.99
Equipment Rental	$4,621.17	0.1%	$8,489.43	0.2%	$12,065.22	0.3%	$8,913.83	0.2%	$6,501.15
Non-deductible Citations	$282.04	0.0%	$110.00	0.0%	$10.00	0.0%	$106.00	0.0%	$59.00
Freight	$154,669.32	3.6%	$123,090.56	2.6%	$170,693.62	3.7%	$177,762.05	4.3%	$178,580.85
Insurance-Officers Life	$1,030.04	0.0%	$3,958.82	0.1%	($464.95)	0.0%			$1,874.12
Insurance	$75,861.48	1.7%	$53,833.12	1.1%	$42,791.40	0.9%	$58,272.18	1.4%	$41,950.23
Interest	$18,716.60	0.4%	$8,882.79	0.2%	$13,827.42	0.3%	$12,710.41	0.3%	$16,203.46
Bank Charges	$7,895.26	0.2%	$6,978.28	0.1%	$6,127.44	0.1%	$1,885.54	0.0%	$2,367.85
Credit Card Fees	$25,445.07	0.6%	$29,961.96	0.6%	$34,125.65	0.7%	$25,786.64	0.6%	$17,544.46
Inventory Fee		0.0%							$9.86
Legal & Accounting	$18,978.06	0.4%	$19,206.15	0.4%	$16,552.31	0.4%	$20,090.60	0.5%	$13,186.22
Professional Fees							$1,625.00	0.0%	
Office Supplies	$7,204.74	0.2%	$6,570.54	0.1%	$9,207.11	0.2%	$6,776.67	0.2%	$8,079.09
Postage	$2,219.68	0.1%	$1,910.09	0.0%	$3,080.04	0.1%	$3,288.63	0.1%	$2,518.94
Rent	$165,627.57	3.8%	$195,146.35	4.1%	$191,664.74	4.2%	$174,762.08	4.2%	$141,552.43
Repairs-Building	$1,357.56	0.0%	$1,463.03	0.0%	$919.01	0.0%	$939.08	0.0%	$436.29
Repairs-Equipment	$30,242.09	0.7%	$27,957.99	0.6%	$4,826.11	0.1%	$3,157.76	0.1%	$10,880.97
Salaries-Officers	$197,298.92	4.5%	$248,229.64	5.3%	$166,280.00	3.6%	$178,754.14	4.3%	$126,437.17
Salaries	$663,461.47	15.2%	$692,819.99	14.7%	$679,249.07	14.8%	$566,708.09	13.7%	$425,658.81
Employee Benefits		0.0%							$1,240.00
Security	$486.82	0.0%	$567.96	0.0%	$1,026.22	0.0%	$1,353.23	0.0%	$416.65
Storage	$805.95	0.0%	$467.80	0.0%	$410.88	0.0%	$729.95	0.0%	$1,798.41
Supplies	$2,134.74	0.0%	$7,424.40	0.2%	$3,674.14	0.1%	$2,324.84	0.1%	$4,538.69
Taxes-Business	$12,470.47	0.3%	$13,903.44	0.3%	$9,890.21	0.2%	$3,471.60	0.1%	$4,849.84
Taxes-Payroll	$70,001.38	1.6%	$68,753.34	1.5%	$67,332.85	1.5%	$59,798.53	1.4%	$49,446.16
Telephone	$36,051.10	0.8%	$34,502.25	0.7%	$47,024.68	1.0%	$33,738.91	0.8%	$26,913.56
Temporary Labor					$659.12	0.0%			
Temporary Labor					$2,400.00	0.1%			
Uniforms	$393.45	0.0%	$471.93	0.0%					
Utilities	$20,787.46	0.5%	$20,363.83	0.4%	$19,872.12	0.4%	$19,949.29	0.5%	$17,994.53
Penalties	$3,740.16	0.1%	$661.67	0.0%	$360.00	0.0%			$53.24
Total Expenses	$1,822,787.94	41.8%	$1,836,883.63	38.9%	$1,745,768.91	38.0%	$1,622,905.13	39.2%	$1,307,338.81
								0.0%	
Income from Operations	$123,978.42	2.8%	($35,490.73)	-0.8%	$43,109.30	0.9%	($39,607.35)	-1.0%	($25,219.54)
Other Income									
Vendors Compensation	$1,933.49	0.0%	$1,929.07	0.0%	$2,131.79	0.0%	$1,829.15	0.0%	$1,562.73
Interest Income	$23.65	0.0%	$595.73	0.0%	$381.03	0.0%	$1,764.18	0.0%	$2,406.49
Personal Training Fees									$6,000.00
Total Other Income	$1,957.14	0.0%	$2,524.80	0.1%	$2,512.82	0.1%	$3,593.33	0.1%	$9,969.22

Fitness Pro's operating cash flow from 2000 to 2003 varied considerably, but was always positive, even during the years of overall net losses. The operating cash flow of Fitness Pro indicates they are able to cover their everyday operating expenses based on the cash they earn from business operations.

Operations

Fitness Pro's current strategic concerns in operations are logistics/distribution and inventory control. The equipment sold by Fitness Pro is shipped directly to its warehouses from product suppliers like True Fitness. All equipment comes with a product warranty. Any service or warranty related issues are coordinated by the Fitness Pro location where the product was purchased. Inventory is tracked by three separate systems, one for each warehouse location. Fitness Pro's warehouses are located as part of its retail locations in Savannah, Jacksonville, and Tallahassee.

Fitness Pro's shipments from its suppliers are done in bulk and shipped to only one of the three warehouse locations, rather than all three, for cost savings. Company trucks and delivery drivers then distribute equipment needs to the other locations. Because of the major expense this represents, the logistics involved in getting products to the retail locations is a significant cost issue for the company. Currently, the company is considering options for improving its warehousing and delivery. The goals are to decrease shipping costs, decrease inventories, and improve customer satisfaction.

One area Fitness Pro is looking into is to establish a better system of inventory control. A point of sale system would track the inventory from the point of sale and send information to the central warehouse for replenishment as needed. This information system could help track receipts, sales and transfers of inventory. This would help Fitness Pro to more effectively manage inventory and potentially increase inventory turnover. This system should also help with financial reporting problems that Fitness Pro has experienced in the past with inaccurate reporting.

Management Capabilities, Organizational Structure, and Organizational Culture

Fitness Pro is led by four key individuals who have been in the industry for several years and are very knowledgeable. Paul Drake is president and part-owner of the company. He took over after his father left the company. Paul gained all of his knowledge about the company and the industry from his father. Another key manager and part-owner is Patrick Sullivan. Patrick is vice president. The most recent partner is Lee Tompkins, Jr., who was brought in to help with the business. Lee's role with the company is chief financial officer. Lee also aids in any other management needs for the individual stores. David Egan is general manager and also leads all operational concerns. Finally, each store has its own manager, each of whom has either several years of management experience or has been a personal trainer in the past. This knowledge of personal fitness leads to exceptional knowledge about the industry and the products they are selling and competing against.

Fitness Pro operates each separate store with only a few staff, totaling about 19 employees working for all three stores. Each store hires new employees as needed, but these new hires must be cleared through one of the top managers beforehand. All three stores operate individually, and somewhat independently, from one another.

The culture at Fitness Pro is very casual yet knowledgeable about fitness and health. Individuals who work for the company have a very thorough knowledge about their products. They also have detailed knowledge about the competition's product. Each employee is also a certified fitness professional. This ensures that customers can have their questions answered, thus, making their shopping experiences more enjoyable. When customers enter one of the stores, they are not hassled or pushed to purchase anything. Rather, employees encourage participation on the customer's part. Customers are encouraged to workout for however long they wish on a piece of equipment to see if they like it. Should the customer not be satisfied with the equipment, the employees will assist in finding a better fit. Fitness Pro does whatever is required to make the customer comfortable and satisfied with the product.

Currently, Fitness Pro's organizational structure allows the flexibility to operate as needed. As more stores are added, and as distribution and marketing efforts are increased by the firm, the owners think that it will be essential for the structure to formalize. Stores will need to have closer communication and an understanding of each location's needs if Fitness Pro hopes to improve its logistics and distribution efforts. The owners have each operated as somewhat independent entrepreneurs; however, they wonder if more routine policies and procedures are needed to standardize the way they do things.

STRATEGIC POSITIONING

At their most recent executive meeting, the three owners (Paul Drake, Pat Sullivan, and Lee Tompkins) each had opinions and ideas about what the company needed to do to improve its competitive position. Paul thought that the company should have one warehouse to which all suppliers would ship in bulk, hence saving Fitness Pro much in transportation and shipping charges; however, the question was where should it be located—in the Savannah, Jacksonville, or Tallahassee area? How would product be shipped from that warehouse to the individual stores?

Pat wanted each store to operate independently from each other. He argued that what works in Tallahassee might not work in the Savannah market. He wanted Jacksonville to be able to do what it wanted to do without having to get approval from Paul or Lee. For example, recently, the Jacksonville store had spent much more on advertising (as a percentage of sales) than either Savannah or Tallahassee.

Lee was pushing his two new partners to implement the point of sale system and use the data it could provide to then make a more informed decision about warehouse location. Lee also wanted to persuade his two partners to focus more effort on commercial sales. Recently, it seemed that the commercial sales reps were generating high levels of sales, and it appeared that their markets were growing.

All in all, Fitness Pro seems to be doing well; however, like any growing small firm, it has challenges. How to grow in a profitable manner? How to control its costs and expenses without stifling initiative? How to market and promote itself in its three somewhat different markets? What to do, if anything, with consolidating its warehousing? How to establish some level of standard operating procedures and policies without losing the flexibility that helps the firm satisfy its customers? How to attract and retain highly motivated store-level staff and commercial sales reps? Those and other issues were all raised at this day-long meeting!

Table 1: Savannah Demographics
Savannah MSA Demographic Analysis[1]

Land Area: 1,362 square miles
Population Density: 215 persons per square mile
Median Household Income: $35,608.00
Unemployment Rate: 3.5%
# of Households: 116,000

Population Trends*					
Metro County	2003 Estimate	2000 Population	1990 Population	% Change 90-00	% Change 00-03
Chatham	235,270	232,048	216,867	7.00	1.39
Effingham	42,715	37,335	25,691	46.10	13.80
Bryan	26,340	23,417	15,436	51.70	12.48
Total	**304,325**	**293,000**	**257,995**	**13.57**	**3.87**
Age*					
Metro County	18 and Under	18-64	65 and over	Total	
Chatham	73,559	128,787	29,702	232,048	
Effingham	14,076	20,457	3,003	37,535	
Bryan	9,086	12,622	1,709	23,417	
Total	**96,721**	**161,865**	**34,414**	**293,000**	
% of Total,	**33.01**	**55.24**	**11.75**		
Education (25 years and Older)*					
Metro County	High School Graduate		Bachelor Degree or Higher		Total People
Chatham	186,102		58,012		232,048
Effingham	29,615		5,105		37,535
Bryan	18,499		4,519		23,417
Total	**234,217**		**67,636**		**293,000**
% of Total	**79.94**		**23.08**		

[1]Source: U.S. Census and Savannah Chamber of Commerce
*Source: U.S. Census (2000)

Table 2: Jacksonville Demographics Jacksonville MSA Demographic Analysis[1]					
Land Area: 2,634 Square Miles Population Density: 426 persons per square mile Median Household Income: $46,271.00 # of Households: 432,627					
Population Trends*					
Metro County	2003 Estimate	2000 Population	1990 Population	% Change 90-00	% Change 00-03
Baker	23,424	22,259	18,488	20.40	5.23
Clay	157,502	140,814	105,955	32.90	11.85
Duval	817,480	778,879	673,188	15.70	4.96
St. Johns	142,869	123,135	83,822	46.90	16.03
Nassau	61,625	57,662	43,950	31.20	6.87
Total	**1,202,900**	**1,122,750**	**925,404**	**21.33**	**7.14**
Age*					
Metro County	18 and Under	18-64	65 and over	Total	
Baker	7,679	12,532	2,048	22,259	
Clay	48,722	78,293	13,800	140,814	
Duval	260,924	436,172	87,782	778,879	
St. Johns	35,093	48,463	19,578	123,135	
Nassau	17,991	32,407	7,266	57,663	
Total	**370,410**	**627,866**	**124,474**	**1,122,750**	
% of Total	**32.99**	**55.92**	**11.09**		
Education (25 years and Older)*					
Metro County	High School Graduate		Bachelor Degree or Higher		Total People
Baker	16,004		1,825		22,259
Clay	121,663		28,304		140,814
Duval	644,133		170,575		778,879
St. Johns	107,374		40,758		123,135
Nassau	46,707		10,898		57,663
Total	**935,881**		**252,359**		**1,122,750**
% of Total	**83.36**		**22.48**		

[1]Source: U.S. Census and Jacksonville Chamber of Commerce
*Source: U.S. Census (2000)

Table 3: Tallahassee Demographics Tallahassee MSA Demographic Analysis[1]					
Land Area: 2,634 Square Miles Population Density: 426 persons per square mile Median Household Income: $46,271.00 Unemployment Rate: 3.2% # of Households: 96,521					
Population Trends*					
Metro County	2003 Estimate	2000 Population	1990 Population	% Change 90-00	% Change 00-03
Leon	242,577	239,452	192,486	24.40	1.31
Total	**242,577**	**239,452**	**192,486**	**24.40**	**1.31**
Age*					
Metro County	18 and Under	18-64	65 and over	Total	
Leon	64,652	154,925	19,875	239,452	
Total	**64,652**	**154,925**	**19,875**	**239,452**	
% of Total	**27.00**	**64.70**	**8.3**		
Education (25 years and Older)*					
Metro County	High School Graduate		Bachelor Degree or Higher		Total People
Leon	21,352		99,851		239,452
Total	**21,352**		**99,851**		**239,452**
% of Total	**89.10**		**41.70**		
[1]Source: U.S. Census and Tallahassee Chamber of Commerce * Source: U.S. Census (2000)					

Table 4: Fitness Industry Company Comparison[1]		
Company Name	**Sales (millions)**	**Employees**
Precor	222.3 (2003)	471
Life Fitness	156.1 (2003)	1,500
Cybex	90.2	486
[1]Source: Hoover's online (March 8, 2005)		

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INTERNATIONAL PRODUCTS LTD*

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CASE DESCRIPTION

The primary subject matter of this case concerns marketing.. It has a difficulty level of five (appropriate for senior level). The case is designed to be taught in one class hour and is expected to require two hours of outside preparation by the students.

CASE SYNOPSIS

This case deals with a Thailand producer and marketer of clothing products that is locked in a struggle to produce quality products efficiently and sell them in sufficient quantity, both domestically and abroad. One individual, the president of the company, is responsible for developing corporate strategy. He is aided in this process by the advice of a consultant whom he has retained. The firm has been in business for a considerable time period and has enjoyed some degree of success. However, management is currently involved in decisions regarding whether or not to employ a company (rather than a private) brand, how to control the channel of distribution, how to generate products which meet consumer desires, and possible additions to the product line. These decisions are complicated by somewhat unstable economic, social, supplier, competitive, and legal/political environments which confront the clothing industry in both Thailand and in other countries where the products are sold.

* The name of the company and the name of its president have been disguised.

INTRODUCTION

Mr. David Pongsan, President of International Products Ltd., is a business manager from a developing country (Thailand) who has been successful in creating a profitable firm largely through his own efforts. Further, he has been able to maintain his achievements during periods of national economic turmoil. However, the problem that he must now address is how to survive and prosper in an increasingly competitive global market.

One late evening, while relaxing after work in his luxurious home, Mr. Pongsan sat at his desk and reflected on the past. He began to mentally compile his business history, focusing on how he had built up the company through continual planning and determination. Most of the major difficulties, which had arisen in previous years, seemed to be under control. However, expected future competition brought about by globalization trends would require considerable deliberation on his part. He decided to confer with his business consultant.

During the first week of March, 2002, Mr. Pongsan invited the consultant to his home to share a pot of coffee and to exchange ideas about how they could prepare company strategy for survival in an increasingly uncertain market.

At the time, Mr. Pongsan seemed to be very eager to chat about his past and present efforts. The highlights can be summed up as follows:

PAST HISTORY

This man formed the enterprise at the age of thirty, while holding only a high school education. (Since that time he has continued his studies by enrolling in a marketing bachelor's degree program based in the Philippines). Previously, he had accumulated valuable experience in the textile business as a result of working for his father for more than 20 years.

During childhood years, Mr. Pongsan had assisted his father in operating a textile manufacturing firm. In the process, he had acquired numerous skills, such as, the ability to carefully purchase a variety of needed raw material cloth products in the Sampeng Market, which is located in Bangkok, the capital and largest city in Thailand. This involvement was invaluable in developing an understanding of the functioning of a firm in this industry. Part of this experience involved making the acquaintance of export agents, who ordered childrens' clothing, nightgowns, and undergarments–the main products of his father's organization. At this time, his responsibilities included marketing, contacting exporting agents, and acquiring insights and intelligence on exporting.

In 1972, this aspiring businessman formed a company which sold finished clothing products, mainly undergarments, to his father's business for resale. He purchased 50 machines with several hundred thousand baht from a wig sewing factory in Bangkok which had gone bankrupt. (A baht traded for approximately 2.3 cents in 2002). Some of the machines were in good condition, while others were in severe need of maintenance. He was not familiar with the mechanical aspects of the machines but recognized the importance of this operation, so he began to study machine mechanics under the guidance of a business associate.

Thailand witnessed a major political revolution in 1976. This event created unprecedented difficulties for businesses, both large and small. Government regulations dictated that David's machinists must always arrive at work between 9:00-10:00 p.m. and would have to leave before an 11:00 p.m. curfew. When a machine was no longer working properly and it was impossible to obtain a machinist to repair it on time, David had to fix it himself. At times he labored on the machines between 8:00 p.m. and 5:00 a.m. in order to continue the operation of the factory.

Prices were calculated so that the company earned ten percent of the selling price to the father's business. This percentage was customary in the industry. However, a major change was necessitated when an elder brother, who was taking over the management of the father's company, announced that, from that point on, David would have to seek new customers because the father's company would no longer purchase products from him. Further, he would not be permitted to manufacture products which competed with those of the father's company . He was somewhat shaken but not overly discouraged at this chain of events, because he was aware of means of locating export target markets and had accumulated numerous machines and equipment and a reserve of over 20 million baht.

The reserve, plus funds from a sister's loan, was dedicated to the purchase of additional machines, paving the way for penetrating larger markets. His first large order came through a Thai export agent, who sold womens' and childrens' clothing to a Kuwait wholesaler, who in turn, sold to a Saudi Arabian customer. Following this, other Kuwaitee firms placed orders.

The company was named "International Products Ltd." in 1986. During that year, the firm earned 6 million baht. Over the next year, earnings rose to 40 million, well above the 20 million target that was expected. Operating profits permitted David to move his production facility from Bangkok to the Sankampaeng District in Chiang Mai–a large city in northern Thailand. The facility in Chiang Mai was formerly a silk factory.

The Sankampaeng District has distinct characteristics. It is the original and traditional garment industry area for the country. Historically, the residents were not attracted to agriculture, which is a large industry in the country. Rather, they preferred handicraft work. This helped to ensure a large and skilled source of labor. At the time, there were over 200 handicraft workers in the area, as many as were in Bangkok.

After operating his firm from the Sankampaeng district for several years, David decided to open a factory in the nearby Sanpatong District, the hometown of his wife. Initially, he installed a "training house" to train local workers in embroidery and sewing. Word of mouth among the villagers spread the message that this training would place local persons in a position to gain good jobs. The firm still utilizes the factory there, while the headquarters is situated in Bangkok.

During the time period 1989 to 1991, the company had expanded its market to Belgium, Germany, and Australia. In turn, the product line at this time was composed primarily of nightgowns but also included limited production of school track uniforms and casual clothing. At this time, the net selling volume to the Middle East decreased to about half of the company total. David came to the conclusion that this was not a stable market for his products and decided to focus on exporting quality merchandise to the European market, which was less competitive. Today, company products are sold by leading importers of nightgowns in Europe, such as, the British Home Store, Littlewoods, Mothercare, and Debenhams in England.

COMPANY OBJECTIVES AND OPERATIONS

The current objective of the company is stated as "the manufacturing and selling of quality nightgowns for women and children." Quality control standards are high, as the firm strives to produce products that are superior to those of domestic and foreign rivals and to provide reliable and fast delivery. The workforce has received extensive training and is subjected to close supervision. In turn, the firm is in compliance with Thai government quality and environmental policies, which promote efficiency in manufacturing, preservation of the natural environment, safety in the workplace, and low production costs.

ENVIRONMENTAL CLIMATE

In 2001, Thailand's economy was not prosperous. The recession in the United States, Europe, and Asia had a dampening effect on world economics and this carried over to Thailand, which witnessed a decrease in exports and an increase in Gross Domestic Product of only 1.4 percent. Consumption and investment in the country declined and competition in most industries advanced during this year. Other countries erected trade barriers which created obstacles for Thai products.

World economic predictions for 2002 were uncertain. The levels depended upon the efficiency of economic recovery measures to increase consumption and investment in dominant countries, such as the United States, Japan, and Britain. Further, the entrance of China into the World Trade Organization was expected to increase price competition in many industries, since China enjoys an advantage over many nations in manufacturing costs.

THE LEGAL ENVIRONMENT

Certain developments in the legal environment are of concern to the company. The Thailand Ministry of Commerce has adjusted textile quota regulations in order to promote and support access to free trade in the textile market. In the past, the government solicited orders from foreign importers and then allocated the orders to the various textile producers. Each producer was assigned a quota, which was the maximum amount of the government- solicited business that it could obtain. Now, however, individual firms are allowed to solicit their own orders. This policy favors companies such as International Products Limited, which has skills in finding markets and competing strategically. Other manufacturers and international textile exporters are not confident that entering free trade in the world market by cancelling the quota system will be successful for them, since they lack marketing skill.

Further, the Ministry of Commerce has appointed a committee, composed of members of the Thai Garment Industry Association, to study and develop measures for success in free market textile trade. For example, plans for personnel development, manufacturing information systems, and raw material acquisitions will be prepared and disseminated among the companies which compose the industry..

Given the importance of Western Europe to the company, changes in the political climate in that region are of major significance. The European Union (EU) is a group of countries regarded as having the highest standards in the world for the physical environment and product safety. These standards and the laws underlying them require high levels of product quality. Some of these measures have created concerns among foreign managers who export textiles to the region. Companies desiring to do this must pass manufacturing process inspections which look for violations of product safety standards. In turn, this is viewed by some exporters as a trade barrier.

Further, distributors who have difficulty meeting the standards of the European Union will be confronted with higher operating costs and higher risks of failing to meet the challenge of competitors.

REACHING TARGET CONSUMERS

The major market of the company is the European Union, and approximately seventy percent of the firm's output will go to England. In turn, International Products Ltd. will sell its products to European firms, who own the brands and are responsible for distributing the products. These firms usually develop the specifications for the products.

However. Mr. Pongsan realizes that selling company products under another firm's brand poses obstacles to growth. If the European enterprises are not successful in marketing the products, revenues may not be satisfactory. Further, the European companies may seek other sources of supply, if these sources can offer lower prices. Currently, David is considering a study of the potential benefits and obstacles associated with selling its products in Europe under its own brand name and drawing up its own product specifications.

As to the internal market, Thai consumers tend to emulate foreign culture in many elements of clothing and life styles. The greatest opportunity for success appears to be offering nightgowns which are popular in Europe for the Thai market. The firm is able to do this and has numerous patterns which are suitable for women of every age. Currently, competition in the internal market is not severe.

TECHNOLOGY

The textile industry is highly dependent upon manufacturing technology in order to generate a variety of products which meet consumer needs in an efficient manner. However, buying high technology machines requires substantial capital, ranging from five to ten million baht per machine.

International Products Ltd. has become a member of the "Thai Garment Industry Association", a trade association which has developed policies to advance the competitive capabilities of the Thai garment industry in order to fully access free trade markets by 2005. In turn, the association has developed time and motion and other study suggestions which can be employed by members to increase their manufacturing efficiency.

The Thai Garment E-Market Project of Thailand.com is a project that the association has created as a portal site. Its purpose is to facilitate the export of textiles through the provision of information on markets to Thai firms. Companies that are members of the association can be reached through this portal site. The project was initiated in 2001.

COMPETITIVE SITUATION

The worldwide economic downturn which commenced in late 2001 had a dampening effect on the Thai garment export industry. Revenues declined while the number of manufacturers remained the same. This set off considerable competition in the industry, which is expected to remain intensive. Most firms have experienced increases in labor cost, because the high demand for labor has increased wages and the combined effect of this and the increased competition has been lower profits for all producers.

Information from the Thai Garment Industry Association indicates that Thai garment exportation in the first three quarters of the year was $2,392 million in U.S. dollars, which has decreased 7.5% from the previous year. The largest declines were from the European Union countries (a reduction of 12.7%) and Japan (a reduction of 6.5%).

The major competitors for International Products Ltd. are new clothing manufacturing companies located in neighboring countries, mainly Vietnam, Indonesia, Bangladesh, and especially China, which is regarded as the most important new competitor. Firms in these countries have power stemming from joint ventures with other firms which have marketing knowledge and manufacturing technology. Some of these companies, such as those in Hong Kong, South Korea, and Taiwan, have switched their production to neighboring countries in order to take advantage of lower labor costs. In turn, these costs are relatively high in Thailand, when compared with those in Vietnam, Laos, and China. However, some Thai firms are able to remain competitive because of their advanced technological standards.

While firms in other countries have lower wages than those in Thailand, this is not expected to be an insurmountable competitive advantage. Brand image, experience, skills, quality control, technology, and marketing expertise are also important. The major competitors of the future are expected to be those which have these assets, and do not rely solely on low wage rates. Fortunately for the firm, International Products Ltd. is financially stable and is well endowed with production and marketing skills, and can be expected to remain as a contender in the marketplace. The advantages which the firm enjoys have led to considerable customer loyalty. However, there are firms in neighboring countries that also have these strengths, so the going will not be easy.

There are five Thai companies manufacturing the same type of nightgowns as International Products Ltd. However, these firms concentrate their efforts on other types of garments. Overall, nightgowns make up only about five per cent of their total sales, which amounts to 2.25 million nightgowns a year. This compares with International Products Ltd. total production of four to five million nightgowns a typical year.

PRODUCT STRATEGIES

Virtually all of the product line is made up of nightgowns for women and children. In turn, nightgowns can be divided into three classes, all of which are produced and sold by the firm. All three are available in 100% woven cotton, 100% cotton single, lyra, and satin.

1. Night dress: A long loose garment with no sleeves..
2. Night shirt: A long knee-length shirt with long sleeves.
3. Kimono: A long loose garment, knee-length, long and wide sleeves, worn with a belt.

For products sold in Thailand, International Products Ltd. has licences for Disney characters, Garfield, and Pooh Bear. These characters are portrayed on the nightgowns sold by the company. The brand name which the firm is employing to build the market in Thailand is "Bed Time Story".

PRICING STRATEGIES

The company sets competitive prices, just below industry averages, thereby accepting slightly lower than average margins. This policy enables the firm to operate on a low-margin, high-turnover basis, and to benefit from economies of scale brought about by large sales volumes. The production facilities are efficient, because of advanced machinery technology and machine operator skill, allowing the firm to keep manufacturing costs at reasonably low levels and prices that are competitive with some rivals with low labor production costs.

DISTRIBUTION STRATEGIES

International Products Ltd. produces for marketers of quality garments in England and other members of the European Union, such as France and Ireland. Some of the British marketers of company products have well-known brand names, such as the British Home Store, Littlewoods, Mothercare, Debemhams, and Dunnes Store. The British wholesale distributor is a large and well-known company "Halle Model". Recently, a few marketers have considered bypassing this distributor and placing their orders directly with International Products Ltd.

In the past, the major reason for utilizing the distributor in England was that the International Products Ltd. brand name was not known in the country. However, it is believed by company management that the firm may now enjoy sufficient recognition among potential buyers to merit a break from the distributor. Further, many customers have come to the conclusion that purchasing through a distributor is no longer a necessity–direct purchase may be preferable. Hence, the company has moved in this direction and now has a sales office in England.

The transportation system has been developed and refined over a period of time. A racking system in the factory arranges the products for movements into containers, which are suitable for shipment by truck. When a truck arrives at the warehouse, the workers will make up the shipment and move them from the rack into the container, where they are assembled and the container is filled and loaded onto the truck. From this point, the shipment moves directly to the customers' warehouse receiving dock.

VISION

Management is considering the use of a company brand name on all of its offerings, both within Thailand and abroad. It has utilized the "Bed Time Story" brand in Thailand, beginning in 2001. The firm will export products to increasing numbers of countries, attempt to sell more products in Thailand, and continue to offer high product quality that meets both domestic and international standards.

MARKETING OBJECTIVES

The firm has developed marketing objectives for the foreseeable future. These are as follows:

1. To maintain and increase foreign sales volume.
2. To achieve domestic sales of not less than 50 million baht.
3. To increase domestic sales by ten percent each year.
4. To increase the gross profit margin ten percent each year.
5. To increase domestic market share ten percent each year.
6. To design at least six new nightgown patterns per year.
7. To improve the transportation system by adopting the Just in Time system in three years.

COSTS, EXPENDITURES, AND FINANCIAL STATUS

Direct labor accounts for twenty to thirty percent of the total manufacturing cost. This makes it difficult to compete with Vietnam, Laos, Bangladesh, and Pakistan companies for the low-end market. Raw materials make up approximately sixty to sixty five percent of the manufacturing cost. The remainder is manufacturing overhead. The gross profit is approximately fifteen percent of total costs and the net profit about nine percent of total costs. Selling and administrative expenses are fifteen percent of total sales. The company pays a corporate income tax of thirty percent of the net profit. In 2001 company sales were 500 million baht, ten percent above the figure for 2000.

The total assets of the company are 180 million baht. Current assets make up about sixty percent of the total and fixed assets approximately forty percent. Current liabilities are about seventy five percent of total assets and long-term liabilities about ten percent.

OPPORTUNITIES AND OBSTACLES FOR THAI PRODUCERS

Mr. Pongsan has stated an opinion that the textile industry in Thailand has been successful in the past and should continue to operate in this manner. Basically, Thai workers are generally well trained and adequately skilled and firms in the country will benefit from this resource. However, new technologies at home and abroad could lead to new product patterns, product standards, and methods of production. This being the case, producers in this country must pay strict attention to technology, in order to remain competitive in the future.

Brand loyalty for most Thai company offerings appears to be reasonably good. Mr. Pongsan believes that most customers do not have a strong desire to change their suppliers, unless such a change would be clearly needed. It appears that many Thai firms enjoy a relatively secure customer base.

An ever-present obstacle is competition from manufacturers in Vietnam, Indonesia, Bangladesh, and China, all of whom have low labor costs. Further, some of these companies gain technological advantages by joint venturing with firms from Hong Kong, Korea, and Taiwan. Thai manufacturers must remain alert to changes in the competitive strategies and tactics of these companies.

The producers in Thailand have numerous supporting industries, such as their suppliers–companies which produce various kinds of cloth, thread, decorations for clothing, and other items-- which serve their firms. Companies that generate raw materials, for instance, receive virtually all of their orders from Thai enterprises. However, the raw materials producers have been reluctant to make investments in production and in marketing. This is because they perceive the Thai garment industry as occupying the maturity stage of the market, with intensive competition and pressure on profits. Over the past few years, Thai producers have seen their share of the world market slip from first to third place.

CURRENT COMPANY PROBLEMS

Mr. Pongsan and his consultant deliberated on the strategies which would be in the best interests of the firm. They agreed that the major problems of the company were as follows:

1. The company does not use its own brand name for exports at the consumer level. Distributors are the major customers of the company, so in the absence of a brand name for International Products, Ltd., they exercise considerable control over prices, terms of sale, and other marketing variables.

2. The company has very limited control over its channel of distribution. It produces nightgowns only when distributors send in an order, making production less efficient than if it engaged in continuous production.

3. The firm lacks information on target consumer behavior and major trends in the target market.

4. Major customers are interested only in purchasing nightgowns, although the company capable of producing other textile products.

5. The manufacturing process wastes more than 1.5 percent (the standard level of the industry) of the raw material inventory.

6. Manufacturing efficiency is less than that of producers in Europe and the United States, due to lesser technological development in Thailand.

MAJOR CONCERNS FOR THE PRESIDENT

There are several matters which particularly worry Mr. Ponsan and his consultant. These are as follows:

The company must acquire raw materials from many domestic suppliers. However, these suppliers do not devote a great deal of attention to product standards. Management has conducted meetings with suppliers in order to stress the importance of quality standards and to make suggestions to the suppliers on this issue, but very limited progress has been achieved. The suppliers are unwilling to undertake major investments for quality improvement, due to the low profit margins and high wage costs in the industry. Until the suppliers raise their standards, the company will not be able to effectively penetrate some foreign markets, such as that in the United States.

The local culture, as it affects the work force, poses certain problems. Employees are not as productive as management would like them to be. Work force absenteeism and tardiness at the plant are deemed excessive by management and productivity has not reached desired standards, despite the efforts of the company to train its employees.

A final concern of management is that the firm's products are not sold to export consumers under its own brand name. This has limited progress toward the establishment of consumer oriented marketing programs and the movement of company products into countries which are currently not served.

PHILOSOPHY OF MANAGEMENT

Mr. Pongsan holds the belief that a good administrator must manage in such a manner that he creates a maximum of advantages and a minimum of damages for the firm. When negative happenings occur, the reasons for their existence should be discovered and eliminated or minimized. He feels that a good administrator should be able to solve problems quickly, make decisions without undue hesitation, and not avoid responsibility. He is of the opinion that confidence, diligence, and wisdom are needed in order to accomplish company goals. The overall objective of the firm is profit maximization in his view.

WHERE TO GO FROM HERE?

Mr. Pongsan and the consultant are in the process of deliberating what they should do next. They have discussed the possible avenues which could be explored, but have not yet settled upon any specifics. They feel that changes in marketing are necessary, but what ones? Their choices will have a major impact upon the profitability of this company in the future.

ABOCA S.S.: PERFECTING A 700 YEAR TRADITION OF BOTANICAL REMEDIES

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CASE DESCRIPTION

This case was developed for an MBA marketing strategy course and as an international marketing elective, ideally suited for non-US MBA programs. As an MBA marketing strategy course it encompasses analysis and decision making from broad strategies concerning growth management, industry structure attractiveness and competitive advantage. Due to the market data in this case these broad strategic decisions can be augmented with marketing decisions for branding, product positioning, product line policies, channel selection, price policies and marketing communication policies. The international aspect of US market entry from an Italy based company and the corresponding logistical, economic, regulatory and cultural contrasts allow students to practice international marketing concepts. This case can be taught in one class session with three to four hours of student preparation.

CASE SYNOPSIS

Aboca is a family owned herbal supplement manufacturer located in Tuscany Italy. It has experienced remarkable success in Italy with exceptional growth (25% CAGR) and has achieved market dominance in herbal supplements in its Italy market. It now faces a classic growth dilemma as it approaches saturation in its core supplement business. The case presents the array of product-market growth challenges to the firm with the associated risk and potential returns. Within this matrix of opportunities the firm's successor to the president (founder's son) must evaluate a potential US market launch. US industry data, consumer buyer behavior, competitor positions, channel options and regulatory constraints are presented for analysis and students are expected to assume the successor's role in choosing an entry strategy with a detailed action plan.

The case discussion is most effective if students have read marketing concepts for growth strategies (e.g. David Aaker, Strategic Market Management*, 5e., Wiley, chapter 12)and have mastered concepts of product positioning and marketing mix decisions. The discussion is best organized by beginning with growth strategy decisions and then progressing to the US market launch decision. At a minimum the US launch decisions should include a product positioning statement and policy decisions for branding, breadth of product line, communication and pricing. There is sufficient data for students to specify operational decisions for brand names, product stock* *keeping units, advertising copy, sales promotion tactics and price points. However it is recommended to postpone such specific marketing mix decisions to a second class session.*

ABOCA CASE STUDY

Massimo Mercanti, the son of the founder of Aboca S.S., returned to his hotel after celebrating an exciting victory by his favorite soccer team, Juventus, over its major rival, Milano. It is 12:30 AM, October 20, 2001 and Massimo must prepare to present his growth strategy for Aboca's herbal business in two days. His United States consultant has just sent his US market recommendations. In reviewing the draft Massimo is concerned that this is the third strategy revision within the past 18 months and as yet no decision has been made. After two years of analysis he wonders if Aboca's herbs will ever reach the 275 million Americans. The export market has changed and he wonders if the US market is Aboca's best avenue for growth. In the past year new opportunities have developed in Italy, and other international markets have begun to develop.

Massimo knows his father, Valentino, wants him to decide and take responsibility for a major division within the firm, and certainly the US offers a great opportunity although not without substantial risk. As Massimo reflects on these challenges he feels envy for the simple strategic decisions of his beloved Juventus. If only the world of business could be so straightforward.

Aboca's History

The company, Aboca S.s., derives its name from a beautiful Tuscan village in the Valtiberina. A valley noted for its sculptured farmlands. The firm manufactures herbs from its organic farms and follows a tradition dating from the 1200s when Franciscan monks cultivated herbs for their own medicinal remedies and harvested the best woad, a herb used in dying wool. Aboca S.s. was founded by Valentino Mercati in 1978 and the family business has grown to become the leading herbal company in Italy. Both in-house technologies and those developed in collaboration with numerous Italian and foreign universities enabled Aboca S.s. to develop a vertically integrated agro-pharmaceutical product line.

Today Aboca cultivates over 1700 acres. All farming processes are organic, seed selection, planting, fertilization, pest control, harvesting and cleaning. Aboca grows 70% of all raw materials used in manufacturing and grows over 65 species of medicinal plants. Air ventilated dryers extract the medicinal substance from harvested plants followed by automated separation, shredding and micronization of plants, then freeze drying and blending. Liquid extracts are obtained through a custom process for each herb. By using water, alcohol, and low-temperature vacuum evaporation Aboca is able to achieve the optimum level of active principles (the herbal component that induces the therapeutic effect) in its products. It employs over 20 chemists in its manufacturing and quality control laboratories.

Aboca extends its control to marketing activities with its own marketing design department and direct sales force. Its attractive packaging, advertising and in-store displays make Aboca a favored supplier to pharmacies and herbal shops. Aboca supplies over 7000 retailers in Italy with promotional support through its marketing and sales force.

Aboca maintains its quality leadership with an investment of 10% of its revenue into research and development. Such investment has led to many patented inventions in new products and manufacturing processes.

Aboca's Business Vision:

Aboca is committed to improving people's lifestyle with all natural products. This mission originates from the President, Valentino Mercati, and is visible in all aspects of Aboca's business. Clear indications of Aboca's values are its commitment to the organic or all-natural concept, and its investment in customer education. This attention to company values has distinguished Aboca from other herbal supplement manufacturers.

Aboca's position on genetic engineering is a clear example of its dedication to an "all natural" or "organic" product. When asked if Aboca is conducting any research related to genetic engineering, Mr. Mercati's response was that he believed that genetic engineering is not a natural process and would contaminate the purity of his products. Even though Aboca could reap huge benefits from developing herbs with desirable genetic characteristics, such as resistance to disease and pests, or higher yielding, faster growing plants, and still promote an "all natural product", Aboca has not chosen to develop such technology.

Aboca refuses to use preservatives in spite of the limited shelf life of its products. Using preservatives would increase the shelf life of many of Aboca's products, but given its commitment to a real 'all natural' or 'organic' products, it has chosen not to contaminate the product's purity to save costs. Instead it relies on freeze-drying and vacuum packing. Both processes increase the shelf life of the products while maintaining product purity and quality. Aboca's freeze-drying and vacuum packing processes are unique in supplement industry and Aboca has acquired patent protection for its processes.

Aboca has a robust quality control process. Every crop for every product is stringently tested for purity. If there are contaminants in the batch that the sample came from the entire batch is pulled from the manufacturing process. This presents a significant problem for the imported herbs Aboca receives from suppliers, especially ginseng, which can be grown only in far eastern countries. Because of Aboca's high standards, suppliers are resistant to reshipping rejected herbs. Mauro Mercati, the director of operations for Aboca, stated that Aboca has incurred losses because of its supplier policy. The supplier, generally a small farm, will send herbs that usually appear to be of good quality. However the level of "active principle" (the extract needed for remedies) can be determined only in the quality control laboratory. If the shipment is rejected, the supplier may refuse to refund the purchase. Since Aboca must prepay for the delivery, it occasionally must absorb the cost of an unsatisfactory shipment. To minimize this risk Mauro, often orders herbs with known quality variability from wholesalers. Wholesalers bill Aboca for shipments at the end of the month, and rejected batches can be subtracted from their invoices. However wholesale prices exceed the price of direct shippers by 40%.

Another indication of Aboca's clarity of vision is its commitment to educating customers about its products. Eighty of its 200 employees are sales representatives who spend most of their time teaching doctors, pharmacists, herbalists and customers about Aboca's products. Typical instruction includes when to use, how to use, and why to use the products. Aboca's herbal products are designed to treat multiple therapeutic areas such as geriatric, coronary, and emotional ailments (see exhibit #2 for a list of therapeutic areas and associated herbal treatment.) Aboca also provides training programs for doctors and pharmacists in the use of herbal remedies. During the year 2000, Aboca provided in-residence training to over 1000 Italian health care practitioners.

Aboca purposely selects print media as its preferred method of advertising. Due to the need to inform trade clients and consumers of the benefits of herbal remedies and to educate consumers of the strict standards it adheres in its manufacturing processes, detailed description and analysis must be presented.

Vertical Integration

Another characteristic of Aboca's business that separates it from most competitors is its level of vertical integration. Aboca controls every step from seed development to consumer purchase and imposes its vision of a purely natural product on every aspect of the operation.

Vertical integration can create organizational problems for a company. The nature of vertical integration forces a company to be involved in many different types of activities. The diverse set of activities does not allow the company to specialize and focus on a single aspect of its business. Since Aboca performs all farming, manufacturing, logistical, marketing, customer service and administrative functions, it is challenged to control costs in order to compete against more operationally focused and scale efficient competitors. Most well known herbal brands in the US, for example, Centrum Herbals owned by American Home Products, are specialized in marketing and distribution and get their product from independent suppliers.

Valentino Mercati feels Aboca's scale disadvantage is offset by its ability to respond to customer's needs (particularly the need for education), product purity, and product effectiveness. Product purity and quality depend on the execution of each link in Aboca's value activities. Given the strategic focus on purity and quality coupled with customer service and education, it is in Aboca's best interest to control as much of the value chain as possible. By controlling the value process from seed development to marketing, product purity and quality are guaranteed to meet the company's rigid standards. Aboca believes the cost savings from improving operational efficiency are less important than the value created by a consistently high-quality product.

ABOCA'S ORGANIZATION

In the rapid growth from the days when Valentino Mercati sold homemade herbal remedies to friends, his firm has struggled to build an administration structure to serve its expansion. Valentino recently chose a three level management structure. The first level of management is responsible for the long term strategy and today comprises Valentino as president and chief executive officer who consults with his board of directors in deciding corporate strategy. The second level of management represents the division managers who are responsible for the operational functions. The third level is the product and technical support managers. The organization structure was recently developed with the help of a consultant to define responsibilities during its period of rapid growth, to provide a succession path for executive development, and to inspire departmental leadership. As of 2000, all international operations were centrally controlled. For instance, sales to China, Japan and Spain were made through independent sales representatives and wholesalers with terms of sale negotiated by Aboca's corporate sales office.

FINANCING ACTIVITIES

Aboca finances most of its operations internally. This financing behavior has advantages and disadvantages. Using its own revenues to support internal investing creates a very conservative atmosphere. In Italy the cost of capital is much higher than in America (30% compared to 15% typically). The high cost of capital motivates internal financing to avoid the high interest payments. Cash must be saved until it reaches a level equal to or higher than the cost of investment. Typically, Aboca has large quantities of cash on hand and very little debt. The risk of bankruptcy is minimal. The downside of such financing behavior is the constraint on growth. Aboca must wait until they generate enough cash to make an investment. In today's fast paced global economy, waiting can result in missed market opportunities.

To access lower cost capital Valentino Mercati is contemplating issuing stock on Milan's borsa. However this would change Aboca's corporate status to a public company and substantially alter Aboca's favored tax rate as a farm entity. Furthermore, additional financial reporting requirements for public disclosure would add a burden to his administrative staff.

Aboca's Financial Performance:

For the first 9 months of 2001 Aboca has shown remarkable sales performance. It expects to achieve revenue growth of over 25% in 2001. Revenues should exceed $62 million for the year. Its revenue has been matched by exceptional profitability. In 2000 its gross profit margin from production was 61% and net profit after taxes and interest was 5.5% (exhibit #3).

MARKETING EFFORTS

Aboca Brand

Aboca's has positioned two product lines to serve two distinct herbal retail channels in Italy, pharmacies and herbalists. The Aboca brand is the product line for its pharmacies market and currently comprises 60% of Aboca S.s. revenue and profits. The products are positioned as technologically sophisticated with all natural ingredients. It is the premier product line for Aboca and is characterized by herbal formulas specially designed to treat defined health ailments. The line also includes single herb "mono-concentrates" and a few natural cosmetic products. The product line consists of approximately 400 stock keeping units (sku).

To serve the pharmacies Aboca has a direct sales force of 50 agents who currently sell to 5000 pharmacies in Italy. The agent's role is to develop a continuous relationship with pharmacists and secure a commitment with a one year contract. The contract defines the services to be provided, the merchandising obligations for the pharmacy, and the discount structure for the purchases. Aboca has recently refined its collaboration to allow pharmacies to restock without managing excessive inventories and to calculate purchase discounts on the cumulative annual purchases. Pharmacies commit to a set retail price, to stock new product introductions, and to display Aboca products in a recommended fashion. The retail price to consumers allow pharmacies a 37% margin with the opportunity to increase to 52% with the maximum volume discount.

To help pharmacists serve their clients with herbal remedies Aboca offers free training seminars at its corporate headquarters. Aboca also provides advertising and merchandising support to its products through magazine advertisements and point of sale promotions.

Planta Medica Brand

The planta medica product line (approximately 200 skus) is positioned to serve the herbalist retail channel. This product line emphasizes the traditional qualities of herbal remedies that are compatible with the herbalist concept of treatment. However, the herbal products are remarkably similar to the Aboca brand; the minor differences include some products with preservatives and chemical additives, which are absent in the Aboca brand line. The Planta Medica brand was acquired from a competitor in 1992 and its quality has been upgraded to be comparable with the Aboca line. At acquisition it was decided to sell this brand only to herbalists to avoid confusing pharmacy consumers loyal to the Aboca brand name.

The Planta Medica products are serviced by 30 sales agents who manage 2000 herbalist retailers. The price policies and promotions are consistent with Aboca brand policies. Planta Medica contributes 40% of Aboca S.s. revenue.

ITALY'S HERBAL MARKET

Industry

The total natural supplement market in Italy was estimated to be $600,000,000 in 1999. Aboca is the market leader and in 1999 led the product category with 9% market share. Aboca derives its revenue from two channels, herbalists and pharmacies. Aboca dominates the herbal products sold through pharmacies with a 38% market share while its herbalist stores are more competitive with a 19% share performance.

In response to findings of contaminants and lack of labeled ingredients in supplements, the Italian ministry of health has decided to investigate the herbal supplement industry to determine if more stringent manufacturing regulations should be applied. Such regulatory oversight would be welcomed by Aboca because its manufacturing and quality assurance practices are comparable to pharmaceutical manufacturers.

Competition

Despite Aboca's favorable position in the Italian herbal market, competitors have begun to take actions that could slow Aboca's growth. In the herbalist retail channel Bottega Verde, a large natural health and beauty retail chain, has begun to secure retail outlets in major Italian cities. Though it primarily features upscale natural beauty products, Bottega Verde, offers a modest selection of herbal health care products. And though its store personnel are not as knowledgeable of herbal health remedies as traditional herbalists, its innovative store format and beauty product selection is attracting customers from traditional herbalists. Also, the growth in mass market food retailers, a channel Aboca does not serve, has increased the retail shelf category for supplements and has attracted lower price competitors to Aboca's brand.

POTENTIAL GROWTH STRATEGIES: INTERNATIONAL EXPANSION

Since 1999 Aboca has tested international markets with a limited product export strategy. It sold its products through independent distributors who agreed to promote and sell Aboca's leading herbal mixtures to their respective markets. These distributors approached Aboca and offered their services for the right to have exclusive geographic distribution to their national markets. Aboca offered no marketing or promotional support and the distributors paid wholesale prices for their inventory. Aboca did not actively solicit international distributors but was open to discussion from distributors interested in its products.

Aboca learned that distributors' initial enthusiasm waned after the first year and though early sales appeared attractive it was difficult to sustain in subsequent years. Exhibit #5 shows the recent sales trends in its nine international markets. From this limited experience Aboca's executive committee has decided to forego independent international sales representatives in future international ventures. The sales representatives appear to lack sufficient incentive to build sustainable brand equity in their respective markets.

However in 2001 Aboca has instituted an "international markets" department and is planning to install international sales offices in Spain, Taiwan, Japan and the United States to launch the Aboca brand. With company resources and control Aboca hopes to build its international brand equity and sustain growth.

UNITED STATES HERBAL MARKET

The Nutritional Business Journal estimated the herbal supplement market to reach $4.18 billion in 2001 which is predicted to be 24% of all health supplement sales. The market had grew

35% from 1996 to 2000 and the conditions that stimulated such growth (such as, deregulation, scientific evidence of herbal efficacy, consumer confidence in alternative medicine) should continue to spur exceptional growth in the sector. The retail channels for herbal sales and respective distribution share of herbal sales in 1999 were: natural foods health stores (33%), multi-level personal sales (27%), mass market national chains (19%), health practitioner dispensaries (9%), mail order (9%) and health and fitness specialty shops (3%). The mass market had a 100% increase from 1996 and continues exceptional growth. Such growth in the mass market indicates wide acceptance of herbal remedies. This growth has resulted from large increases in advertising with total category advertising exceeding $204 million in 1998, a 100% increase from 1997. In 1999 there were 12 US herbal companies that were publicly owned, and many of the world's largest pharmaceutical firms competed in the herbal market with extensive herbal product lines.

DOMESTIC GROWTH OPPORTUNITIES

As Massimo Mercati considers his consultant's recommendations he wonders if a postponement of the US investment would be judicious. His efforts in building Aboca's brands in Italy's herbal sector are finally showing success. He will have his first "Herbe Salute" retail store opened in two weeks (Aboca's first herbal retail store.) Also the new "corner franchises" (a "store within a store" concept in which Aboca manages the herbal supplement category for major pharmacists) may begin to expand rapidly. Both efforts to expand Aboca's Italian market share will face rigorous challenges from competitors and require substantial financial investments and human resources. Massimo assumes the Herbe Salute venture will take three years to "break even" with annual revenue of $350,000 and, if successful, other retail stores openings will require his time and Aboca's capital. The "corner franchises" show the best potential and Massimo expects to open 200 corners within the next two years. Now he must define the structure of the franchise agreements and document Aboca's operating procedures. Massimo, as a lawyer, realizes the legal issues of franchises are complex and he must attend to the details to insure the long-term viability of these ventures.

Aboca's new research in all natural cosmetics, its anticipated "Nativa" product line, presents an opportunity to expand beyond its current herbal market channels. The "natural cosmetics" market could far exceed its herbal supplement markets and may offer the best access to global mass markets. Massimo is involved in a legal challenge to its Nativa brand name, which has been contested by a major Italian cosmetic manufacturer, Ciccarelli di Cupra. The next month could require depositions and Massimo's legal expertise in court proceedings.

If the US venture begins as planned, Aboca will need to invest at least $750,000 in the first year and will need annual revenue of at least $500,000 before it will see any returns. To make a proposal to Aboca's board of directors Massimo must review the data sent from his consultant to assess the opportunities and threats in expanding to the US.

US HERBAL SUPPLEMENT MARKET

Aboca was first attracted to the US market in 1996. At that time health supplements enjoyed exceptional growth and retailers were offering shelf space and attractive price margins to distributors, and manufactures. However as Massimo reviews exhibit #6 he sees the trends have stalled and the supplement categories and usage conditions vary in consumer acceptance.

A research report accessed from HealthWire cites conditions that contributed to this downturn. The report states the herbal and botanical market is "the most fragmented and competitive" of the supplement product categories. Consumer skepticism of product effectiveness and the lack of manufacturing standards are reducing market acceptance. Frost and Sullivan industry analyst Bradley Watkins wrote "the lack of stringent efficacy testing for natural dietary supplements relative to synthetic drugs causes many people to question their validity and thus restricts the market. The impact of this should lessen, however, as more clinical research is done."

US CONSUMER BEHAVIORS

The demographic trends favor US supplement manufactures. The prime consumers of supplements are aging baby boomers, about 76 million and increasing. Currently 20% of US population age 55 or older consume supplements, and this percent will grow to 33% by 2030. Baby boomers desire wellness, self care, disease prevention and active lifestyles. They show a greater awareness of the interrelationship of health and environment and are the leading customers of supplements (exhibit #7). They are looking for natural solutions to aging and environmental sustainability and find organic foods and health supplements one way to meet these desires.

Health supplement sales reached $17 billion in 2000 but are minimal when compared to traditional medicines, which exceed $170 billion. A study by the Nutritional Business Journal (NBJ) found that 4.5% of US adults were "heavy" users of supplements, spending $40 per month, 35% were "regular" users at $10 month and 32% were "occasional or rare" users spending less than $4 per month. NBJ attributed the large disparity between usage groups to consumer confusion and ignorance of botanicals and nutrients. From focus group studies it discovered that most consumers desired to know more about supplement consumption but lacked a basic understanding of general nutrition.

One difference between the US health supplement consumer and Massimo's Italian customers is the prominence of nutriceuticals in health supplement formulations (e.g. vitamin, mineral, amino acid). In Italy, consumers tend to associate health supplements with botanicals, nearly 50% of supplements had only botanical ingredients. In the US only 24% of supplements are botanicals.

DIRECT COMPETITORS

Exhibit 8 identifies the major competitors in the US supplement market in both the retail and health care practitioner channels. Unlike Aboca's dominance in the Italian herbal market none of the listed competitors reach significant market share in their respective product categories in the US. Most competitors sell a broad product line of botanical and nutraceutical supplements and rarely are they integrated from supply source to branded retail products as Aboca. Massimo was able to identify three herbal companies that incorporated all of Aboca's value activities. The characteristics of each company are as follow.

Gaia Herbs

Gaia Herbs was founded by Richard Scalzo in 1987 and provides therapeutic organic herbs and liquid botanical extracts from the Blue Ridge Mountains. It claims to be the leading U.S. manufacturer of liquid herbal extracts of guaranteed quality, and certified organic purity

Like Aboca, Gaia is highly vertically integrated as more than 50 herbs are cultivated in their 100 acre lands. They commit to sell only organic products to high end consumers. A clear focus has been laid on strict quality control as every batch is analyzed and they consider themselves as leader in the herbal products analysis.

In terms of distribution, Gaia sells through grocery stores, professionals, health food stores, drugstores and independent pharmacies. They have no on-line stores, however, it is possible to buy their products through specialized on-line stores.

Revenue in 2000 has been $9m and the company had 70 employees. Some sources say that Gaia had 100 employees in 1998, which would imply that the company is in decline.

Herb Pharm

Herb Pharm was founded in 1979 by Ed Smith and Sara Katz, both herbalists.

The company, similar to Gaia, is specialized in liquid herbal extracts and claims to by the leader in that field ("We are the best selling liquid herbal extract line in America's natural product stores", www.herb-pharm.com). It currently produces 240 SKUs including single liquid extracts, liquid extracts compounds , alcohol free glycerites, oils, tablets and capsules.

Like Aboca, it is vertically integrated and grows 110 herbs in its 85 acre land and 2 green houses, which represent 50% of the herbs needed for its production. It also uses wild herbs and produces only organic herbs.

In terms of production, it seems to focus on full spectrum liquid herbal extracts.

Its sells its products through health food stores, herbalists, naturopathic physicians and doctors, as well as through on line stores (no own online store). Some sources say the company has 3000 accounts. It claims to have the best selling children's extracts for cold and flu season (Echinacea) and best selling Kava in the US.

Currently, the company has 75 employees and its revenue in 2000 is reported as $7 million.

Eclectic Institute

Founded in 1984 by Dr Edward Alstat, a naturopathic physician, it is still privately owned by him. The company intends to be 100% integrated, but it only produces 30% of the herbs needed today in its organic farm of 90 acre, representing 40 herbs.

The company produces organic alcohol extracts and alcohol free glycerins and freeze dried herbs. It promotes the fact that the herbs are processed while fresh.

The company seems to be strong in terms of products development as it developed flavored glycerin alcohol free extracts and organol, an organic grape alcohol used in liquid extracts.

Some sources say that the company gains 70% of it revenue from its manufactured products and wholesales other products for 30%. It also has a publication business, the Eclectic medical publications.

In October 2001, the company suffered a product recall for one of its dietary supplement due to salmonella contamination. This may have damaged the brand.

Their products seems to be distributed nation wide through naturopathic physicians and health food stores. The company also runs its own on-line store. It also sells its products outside the US as 30% of its turnover is made outside the country.

No financial information is disclosed, but the company had 87 employees in 2002, which implies that its revenue could be around $5-10m.

Another focused herbal supplement company, from Australia, Mediherb, Inc. (www.mediherb.com) has recently partnered with Standard Processes (fourth largest supplier to health practitioners, exh. #8) to sell its herbal supplements to US health practitioners. Aboca is a major raw herb supplier to Mediherb, which does not grow its botanical ingredients. Massimo is also aware of a number of raw herb suppliers and private label manufacturing companies who are considering branded herbal supplements for the US market.

SUPPLEMENT CHANNEL OPPORTUNITIES

In Italy, Aboca concentrates its marketing channel through independent pharmacies. Italian pharmacists are generally family businesses that often serve as the first personal contact for health consultation for consumers. As noted in the previous discussion of Aboca's marketing efforts, Aboca has achieved premier status with pharmacies and training to pharmacists to consult with consumers in managing their health. Health supplement channels in the US are more varied and less personal. The US channels are shown in exhibit 9 with their respective sales volumes. Each channel has distinct competitors. It is rare for competitors to serve multiple channels and supplement brands are channel specific.

PRODUCT LINE AND PRICING COMPARISONS

In Italy Aboca sells over 600 herbal supplements products (sku) within its branded Aboca and Planta Medica lines. These products comprise over 200 distinct herb or herbal formulations in multiple delivery forms, such as capsules, tablets, tinctures and teas. Massimo requested a price comparison of Aboca's more popular formulations from exhibit #2 with relevant US competitors found in retail, internet and health practitioner channels (e.g. naturopaths, chiropractors, acupuncturist, massage therapist, etc.). The practitioner channel was of interest because the customer needs, supply chain and sales force requirements in this channel were most similar to Aboca's experience with pharmacists in Italy. Furthermore, it has shown exceptional growth, increasing from $350 million to $1.1 billion in five years.

For product comparison Aboca selected its introductory package, a convenient "blister" pack with one month supplement supply. Aboca calculated its wholesale price to practitioners based on its standard 40% mark-up on selling price on landed cost in the US (this includes shipping and tariff of 6.25%). See exhibit #10 for its price comparison analysis.

Massimo realized that the consumer price of supplements will be more difficult to control in the US, where Aboca cannot enforce retail price, a legal practice in Italy.

MARKETING COMMUNICATION DECISIONS

Aboca prides itself on its effective and creative advertising in Italy. In the past January edition of Panorama, the leading life style magazine in Italy, Aboca sponsored the complete publication as the sole advertiser. This had never been done by an advertiser in Italy and proved a success. Aboca negotiated a highly favorable sponsor rate because January is historically the lowest media cost and used its sponsor dominance to introduce its herbal diet product line, Fitomagra. The Fitomagra line is expected to be the Italy market leader in diet supplements by 2003.

However Massimo is well aware of the challenge to gain brand awareness in the US with a population five times the size of Italy and with herbal advertising exceeding $300 million yearly. Aboca could not afford the media dominance it achieved with the Fitomagra launch. Furthermore, as Massimo reads the latest the latest regulations from the FDA, he realizes Aboca's benefit claims will be restricted.

Under DSHEA (Dietary Supplement Health and Education Act of 1994), dietary supplements may bear "structure/function" claims – claims that the products affect the structure or function of the body -- without prior FDA review. They may not, without prior FDA review, bear a claim that they can prevent, treat, cure, mitigate or diagnose disease (a disease claim).

This final rule describes how FDA will distinguish disease claims from structure/function claims. While this rule should not affect the availability of dietary supplement products or consumer access to them, it may affect whether certain claims can be made under DSHEA. The final rule precludes express disease claims ("prevent osteoporosis") and implied disease claims ("prevents bone fragility in post-menopausal women") without prior FDA review. The final rule clarifies that such express and implied disease claims can be made through the name of a product ("Carpaltum," "CircuCure"), through a statement about the formulation of a product (contains aspirin), or through the use of pictures, vignettes, or symbols (electrocardiogram tracings). The rule permits claims that do not relate to disease. These include health maintenance claims ("maintains a healthy circulatory system"), other non-disease claims ("for muscle enhancement," "helps you relax,"), and claims for common, minor symptoms associated with life stages ("for common symptoms of PMS," "for hot flashes").

Under DSHEA and existing regulations, dietary supplement manufacturers are already required to have, in their files, substantiation of any structure/function claims they make. They must also include a disclaimer on their labels that the dietary supplements are not drugs and receive no FDA pre-market approval. Finally, they must notify FDA of the claims they are making within 30 days of marketing a given dietary supplement.

No matter how lucrative the US herbal market, Massimo knows he cannot jeopardize Aboca's stellar reputation with regulators and consumers in Italy by incurring an FDA compliance violation. Massimo sees three key requirements for his communication strategy for the US.

1. He must choose a brand/product position that will distinguish Aboca from its US competitors.
2. He must determine a branding policy and brand names that will communicate this position.
3. He must target the right customers and deliver sufficient message contact to achieve adequate brand awareness.

IMPENDING DECISIONS

While folding his favorite soccer jersey ("Zidane") for his trip to Seattle Massimo rereads his last e-mail from his US consultant.

MAX, URGENT OPPORTUNITIES TO CONSIDER!

I have discovered the following opportunities to promote Aboca and these should be discussed as soon as a "general manager" has been selected:

Aboca is on the waiting list for an exhibit table at the North West Naturopathic Physicians Convention for this May 11-13 in Tacoma Washington.

The president of the Acupuncturist Athletic Association has invited Aboca to participate in its convention this October.

An executive from Aboca has been asked to apply for a position on Bastyr Universities Board of Trustees. This could be valuable for Aboca's relation with this prestigious naturopathic university. The University expects its trustees to contribute $1000 for this position.

There is an opportunity to present Aboca's products at conventions and trade shows by a consultant with extensive experience in representing natural food products at such venues. She is knowledgeable of the alternative medicine industry and is favorably impressed with Aboca's products.

One of the founders of Bastyr University has expressed interest in learning about Aboca and possibly serving as a medical consultant. He has published a text on the "Naturopathic Applications of Botanical Remedies" and is current writing a book on the use of herbs in the "biblical" era. He would be extremely interested in learning about Valentino's (Massimo's father) collection of ancient herbal texts.

I have met a potential sales representative who is currently employed as a sales representative for a text book publisher. He is very skilled, his wife is a naturopath and he is very interested in a sales position with Aboca. Of course the general manager of Aboca USA should decide the person for this position.

The Group Health Association, the largest "health maintenance organization" (HMO), in the Northwest is choosing herbal brands to provide to its clients. Aboca might have an opportunity to present its products to Group Healths medical staff for adoption.

Max, I think it is time to begin operations in the US. I think the products will be successful if Aboca can communicate its quality to US customers. I suggest you hire a general manager quickly and decide on how to enter this market, either through medical practitioners or retail outlets.

Ci vediamo (we'll meet) in Los Angeles?

Massimo has dealt previously with aggressive consultants from the US but it is still annoying. He likes the more leisurely pace and less risky manner of Italy business culture. However he knows he will be pressed to make a decision to not only enter the US market but also to select a marketing strategy that will allow Aboca to succeed. Then he must return to Aboca's board of directors and defend his decision.

EXHIBIT 2: ABOCA'S THERAPEUTIC FORMULATIONS	
Herbs for Aging Well:	Branded Formulations: GinkgoPlus – memory enhancement GinkgoVasal – improve circulation Cholest-oil – control cholesterol levels Triglic-oil – maintain triglyceride levels Cholesterbe – control cholesterol and liver support Menovamp – support for menopause Prostenil – maintain a healthy prostrate
Herbs for Gastro-Intestenal Aid	Branded Formulations: Sollievo – relieve constipation Finocarbo – relieve indigestion FiberDolpholis – aid digestion
Herbs for Energy Restoration	Branded Formulations: Natura mix – relieve stress and fatigue Royal Jelly – nutrient to restore strength Energo – energy stimulant
Herbs for Mood Enhancement	Branded Formulations: Armovita – reduce emotional distress Sedivitax – relieve sleeplessness
Herbs for Weight Reduction	Branded Formulations: Phytoslim Reduce – calorie blocker Phytoslim Active – metabolism enhancement Phytoslim Purifier – fluid reduction
Herbs for Immune System:	Branded Formulations: Propol Pure – flu and cold prevention Grindtus – respiratory aid Grindoral – throat relieve
Herbs for Pain Relief:	Branded Formulations: Phytoreuma – reduce joint pain Ruscoven – improve leg circulation Calendula – reduce muscle pain
Mono-concentrates:	40 plus single herb supplements designed for varied therapeutic needs.

Exhibit 3: ABOCA HERBS AND HEALTH INCOME STATEMENT 12/31/00	
Net Sales	57,239,020
Operating Costs and Expenses	
Cost of Goods Sold	22,090,958
Selling Expense	6,882,835
Advertising and Promotion	9,369,239
General and Administrative	13,874,049
Total Operating Expense	52,217,081
Total Operating Income	5,021,948
Nonoperating (Income) and Expense	
Interest and Investment Income	(755,328)
Interest Expense	1,638,873
Total Nonoperating Expense	883,545
Income Before Taxes	4,138,403
Corporate Taxes	968,934
Net Income	3,169,469
ABOCA HERBS AND HEALTH BALANCE SHEET 12/31/00	
Inventories, accounts receivable, and other current assets	37,517,575
Marketable securities, cash, and cash equivalents	2,603,776
Total Current Assets	40,121,351
Tangible fixed Assets	39,005,312
Other long-term Assets	2,750,778
Total long-term assets	41,756,090
TOTAL ASSETS	81,877,441
Trade accounts payable and other short term liabilities	28,719,897
Deferred revenue and taxes	3,392,787
Total Current Liabilities	32,112,684
Notes payable	16,323,788
Total Liabilities	48,436,472
Share capital	20,000,000
Retained Earnings	13,440,969
EQUITY AND LIABILITIES	81,877,441

Exhibit 5: International Sales and Country Economic Data (http://www.exportinfo.org/worldfactbook/index.html)						
	INTERNATIONAL SALES			ECONOMIC DATA 1999		
Country	1999 Sales	2000 Sales	2001 Sales	Per Capita Income	GDP	GDP Growth
Bosnia	$26,000	$15,000	$5,000	$1,770	$6.2 billion	0.015
Ireland	0	$40,500	$34,300	$20,300	$73.7 billion	0.084
Switzerland	0	$47,000	$48,500	$27,100	$197 billion	0.014
Germany	$8,000	$7,000	$7,500	$22,700	$1.86 trillion	0.015
Austria	$47,000	$41,000	$30,000	$23,400	$190.6 billion	0.02
Sweden	$17,000	$6,000	$8,000	$20,700	$184 billion	0.038
Greece	$48,000	$18,000	$29,000	$13,900	$149.2 billion	0.03
Taiwan	$30,000	$25,000	$40,000	$16,100	$357 billion	0.055
Romania	$6,000	$24,000	$18,000	$3,900	87.4 billion	-0.048
TOTAL	$182,000	$223,500	$220,300			

Exhibit 6: U.S Nutrition Industry by Product, 1996-2005
($mil, consumer sales)

Products	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Vitamins	4,720	5,330	5,730	5,900	5,970	6,020	6,080	6,150	6,240	6,330
Herbs/ Botanicals	2,990	3,520	3,960	4,070	4,120	4,180	4,230	4,280	4,330	4,370
Sports Nutrition	1,060	1,190	1,340	1,450	1,590	1,730	1,860	1,990	2,120	2,250
Minerals	890	1,020	1,140	1,290	1,350	1,390	1,430	1,470	1,520	1,570
Meal Supplements	1,600	1,670	1,780	1,910	2,070	2,310	2,520	2,740	2,950	3,150
Specialty/ Other	930	1,140	1,400	1,730	1,940	2,130	2,330	2,520	2,730	2,930
Supplements Total	12,190	13,870	15,350	16,350	17,040	17,760	18,450	19,160	19,880	20,600
Natural/ Organic Food	7,810	8,530	9,520	10,480	11,490	12,560				
Functional Foods	12,980	13,690	14,790	16,080	17,250	18,500				
Natural Personal Care	2,790	3,050	3,290	3,590	3,820	4,120				
Nutrition Industry	35,770	39,140	42,950	46,500	49,600	52,940				
Annual Growth	10.0%	10.0%	9.7%	8.3%	6.6%	6.7%				

U.S Condition Specific Supplement Markets

Supplements	2001 ($M)	% of total
General Health	4,503	25%
Cold/ Flu-Immune	742	4%
Sports/Energy/Weight-Loss	5,123	29%
Brain Mental	302	2%
Insomnia	124	1%
Mood	285	2%
Menopause	248	1%
Heart health	724	4%
Joint health	1,025	6%
Sexual Health	153	1%
Bone health	804	5%
Gastrointestinal health	315	2%
Diabetes	432	2%
Anti-cancer	550	3%
Sum of top 14 Conditions	15,329	86%
Others	2,431	14%
Total Supplements	17,760	100%

Exhibit 7: Supplement Usage and Age Group Growth Rates

Age Group	% who use supplements	Projected Growth Rates of age groups (1999-2010)
18-34	21.0%	7.8%
35-49	22.0%	-5.1%
50-64	30.0%	42.6%
65+	30.0%	11.3%

Supplement Product Segments for 1999

Category	Dollar Sales	Sales Growth (98-99)
Functional Foods	$16 billion	8.7%
Natural Personal Care	$3.6 billion	9.1%
Natural Foods	$9.5 billion	9.4%
Dietary Supplements	$15.4 billion	6.0%

Channel Sales of $44.5 billion US Nutritional and Functional Foods Industry (1999)

Channel	Dollar Sales	Sales Growth	Growth est 2000	Next 2 years
Mail Order	$1 billion	-2.0%	2.0%	0-2%
Health Food Stores	$13.6 billion	8.3%	7.0%	7-9%
Internet	$170 million	180.0%	75.0%	50-80%
Medical Practitioners	$1.01 billion	16.0%	11.5%	10-15%
Multi-Level Mktg.	$4.9 billion	2.0%	2.0%	0-2%
Mass Market Retail	$23.9 billion	8.5%	7.5%	6-10%

Market Shares of Distribution Channels in % of Total Dietary Supplement Retail Market

Channel	1997	1998	1999	2000	2001	2002
Mass Market	25.4%	28.3%	27.9%	32.0%	33.2%	34.4%
Health Food	33.8%	35.4%	34.8%	32.0%	30.3%	28.6%
Multi-Level	25.4%	21.3%	20.9%	19.2%	19.4%	19.0%
Mail Order/Internet	7.2%	6.8%	7.0%	6.4%	6.9%	7.4%
Medical Practitioner	5.2%	5.2%	6.1%	7.0%	6.9%	7.4%
Other	3.1%	3.0%	3.3%	3.4%	3.4%	3.2%

Source: Nutritional Business Journal, San Diego, CA.

Exhibit 8: TOP U.S. Supplement Manufacturing Companies - 1999 (mass market channel)*				
	Manufacturer/Marketer	Headquarters		SALES
1	American Home Products	Madison	NJ	620
2	Leiner Health Products	Carson	CA	533
3	Rexall Sundown (acq by Numico)	Boca Raton	FL	519
4	Pharmavite	San Fernando	CA	450
5	General Nutrition Products Inc. (acq by Numico)	Pittsburgh	PA	383
6	Weider Nutrition Group	Salt Lake City	UT	362
7	NBTY	Bohemia	NY	281
8	TwinLab Corporation	Ronkonkoma	NY	260
9	Global Health Sciences	Anaheim	CA	247
10	Abbott Laboratories/Ross Products Division	Evansville	IN	192
11	Experimental & Applied Sciences (EAS)	Golden	CO	165
12	Murdock Madaus Schwabe (Natures Way/B&T)	Springville	UT	135
13	Perrigo*	Allegan	MI	134
14	Nutraceutical International	Park City	UT	107
15	MET-Rx USA (acq by Rexall)	Irvine	CA	105
16	Country Life	Hauppauge	NY	100
17	IVC Industries	Portland	OR	98
18	Bristol Myers Squibb /Mead Johnson	Columbus	OH	86
19	Enzymatic Therapy	Green Bay	WI	85
20	Bayer Corporation	Pittsburgh	PA	82
21	Natrol	Chatsworth	CA	82

Exhibit 9			
	Company	1999 Practitioner Channel Supplement Sales	Headquarters
1	Douglas Laboratories	45-50	Pittsburgh, PA
2	Integrative Therapeutics	30-35	Wilsonville, OR
3	Metagenics	25-30	San Clemente, CA
4	Standard Process	20-25	Palmyra, WI
5	Allergy Research	15-20	Hayward, CA
6	Bronson Pharmaceutical	15-20	Hauppauge, NY
7	Pure Encapsulations	10-15	Sudbury, MA
8	Thorne Research	10-15	Dover, ID
9	Amrion (Physiologics)	10-15	Austin, TX
	Size Category	**Companies**	**Pract. Sales**
	Greater than $20 million	5	160
	Less than 20 million	61	375
Nutritional Business Journal 2000			

Exhibit 10: Product Launch Price Comparison							
Mental Health		q.	Form	Retail price	Internet price	prof price	cps/day
GinkgoMemo	**Aboca**	**40**	**Op**			**9.25**	**4**
Ginkoba	Pharmaton	36	Tabs	17.99	10.66		3
Ginkoba	Pharmaton	72	Tabs	28.79	17.08		3
Memory&Concentration	One-A-Day	30	Caps		7.99		2
Energy Ginkgo Power	Nature's Herbs	60	Tabs	29.99	17.81		2
Ginkgo Power	Nature's Herbs	50	Tabs	18.99	11.28		3
Brain Support	American Nutrition	60	Caps		24.19		2
Ginkogin	Thompson Medical Products	30	Caps		9.99		1
Ginkgo Biloba	NNC	60	Caps		11.95		3
Ginkgo Biloba leaf extract	Solgar	60	Caps		11.99		2
Ginkgo Biloba extract	Virtuvites	120	Caps	16.95	7.95		3
Ginkgo-RoseOx	Metagenics	60	Tabs			11.48	3
Blood Lipids		q.	Form	Retail price	Internet price	prof price	cps/day
Colest-oil	**Aboca**	**60**	**Caps**			**10.55**	**4**
Natural Epa Fish Oil	Nature's Bounty	100	Tabs	9.99	7.99		3

Exhibit 10: Product Launch Price Comparison							
PRO EPA Fish oil	Nature Made	90	Tabs		9.79		6
Omega-3	Natrol	60	Tabs		5.69		
Cholesterol Health	One-A-Day	30	Tabs		7.99		2
Cholo-Syn	Douglas Lab	120	Caps		10.13		
Arctic Omega	Nordic Naturals	60	Caps		12.49	11.97	3
Borage&Flax Oil Softgel	NF Formulas	90	Caps		13.5		
Cholesterol Power		60	Caps	18.99	14.99		4
ArteClear	Pacific Biologic	100	Caps		30.38		
Prostate		q.	Form	Retail price	Internet price	prof price	cps/day
Prostenil	**Aboca**	**60**	**Caps**			**12.3**	**4**
Prostatonin	Pharmaton	56	Caps		17.29		2
Prostate Power	Nature's Herbs	60	Caps	20.99	12.46		2
Prostate	Nature's Way	60	Caps	15.99	7.92		4
Prostactive Saw Palmetto	Nature's Way	50	Caps	20.49	12.17		
Prostate Health	One-A-Day	30	Tabs		7.99		2
Saw Palmetto extract	Virtuvites	60	Caps		12.5		2
Saw Palmetto	Gaia Herbs	29	Ml		8.41		
Con Ultra Prostagen	Metagenics	30	Tabs			9.98	2
Menopause		q.	Form	Retail price	Internet price	prof price	cps/day
Menovamp	**Aboca**	**60**	**Caps**			**14.5**	**2**
Menopause formula	Natrol	60	Caps		5.99		2
Black Cohosh	atrol	60	Caps		6.89		
Menopause Health	One-A-Day	30	Tabs		7.99		2
Black Cohosh	Nature's Way	60	Caps	9.99	4.95		2
Menopausal Formula	Nature's Herbs	135	Caps	21.99	13.06		9
Black Cohosh-Power	Nature's Herbs	60	Caps	18.29	10.86		4
FEM Support	American Nutrition	60	Caps		14.65		2
Soy Isoflavones	Virtuvites	120	Tabs		12.95		3
Fem ExtroPlex	Metagenics	90				18.98	2
Mood Support		q.	Form	Retail price	Internet price	prof price	cps/day
Armovita	**Aboca**	**60**	**Caps**			**10.55**	**3**
Tension & Mood	One-A-Day	30	Caps		7.99		2
St. John's Wort extract	Solgar	60			6.99		3
Mood Aid	Nature's Way	60		13.99	6.93		3
St. John's Power	Nature's Herbs	60		9.99	5.93		3

Exhibit 10: Product Launch Price Comparison							
St. John's Power	Nature's Herbs	180		25.29	15.02		3
Mood Support	American Nutrition	60	Caps		13.49		
St. John's Wort Extract	NNC	60	Caps	12.95	8.97		
St. John's/plus	Metagenics	30	Caps			10.17	2
Sedative		q.	Form	Retail price	Internet price	prof price	cps/day
Sedivitax	**Aboca**	**30**	**Caps**			**7.45**	**2**
Bedtime&Rest	One-A-Day	30	Tabs		7.99		2
Good-Nite	Nature's Herbs	60		12.99	7.71		3
5-HTP	Nature's Way	50		16.99	8.42		2
5-HTP	American Health	60		24.99	14.84		2
Sound Sleep	Gaia	60	Caps			10	2
Digestive		q.	Form	Retail price	Internet price	prof price	cps/day
Sollievo	**Aboca**	**30**	**Tabs**			**3.75**	**2**
Finocarbo Plus	Aboca	30	Caps			5.75	3
Colon Care	NNC	100	Cps		5.95		3
Senna extract	Nature's Herbs	100	Cps	9.39	4.64		2
Herbal Laxative	Thorne	90	Cps			5.75	3
Energy		q.	Form	Retail price	Internet price	prof price	cps/day
Natura Mix Adult	**Aboca**	**30**	**Caps**			**10.55**	**1**
Ginsana	Pharmaton	60	Cps	28.79	17.08		2
Ginsana	Pharmaton	30	Cps	17.99	10.66		2
Daily Fatigue	Nature's Herbs	60	Cps	20.99	12.46		6
Energy Formula	One-A-Day	30	Cps		7.99		1
Phytisone	Thorne	60	Cps			4.95	2

RODNEY STRONG WINERY: THE GREAT CORK DEBATE

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CASE DESCRIPTION

The primary subject matter of this case concerned an intriguing product development dilemma encountered at Rodney Strong Vineyards, whether to use natural corks or metal screw caps on their wines. Secondary issues examined include Total Cost Analysis, Cost of Quality, House of Quality, and the voice of the customer. The case has a difficulty level of three and is very appropriate for advanced undergraduate and MBA level classes. The case is designed to be taught in one hour of class time with one hour of outside preparation by students.

CASE SYNOPSIS

John Leyden, the Vice President of Packaging and Distribution at Rodney Strong Vineyards, wrestled with the issue of cork taint - a widespread quality problem that ruins a significant percentage of wine. Cork taint causes moldy, musty aromas that affect perhaps up to 10% of wine produced worldwide. Contamination can lead to customer alienation and ultimately lost sales. Cork taint is a defect that can be eliminated by using alternative closures, such as screw caps or plastic corks, instead of natural cork. From a quality viewpoint, the best solution is a screw cap, which offers the advantages of a durable, long-lasting seal, which can be resealed after the bottle has been opened. However, this solution has been rejected in the marketplace because cork is perceived as a high quality closure while screw caps are associated with cheap jug wines.

Product development decisions require marketing, production, quality control, and purchasing to work together to find a solution. Suppliers should also be included to provide technical information and suggest solutions. The issue boils down to a choice between the technical superiority of one closure or consumer preference for a popular but inferior closure. John Leyden gathered critical information from suppliers and colleagues to help him make the decision. Possible courses of action included changing suppliers, increasing quality control efforts, using an alternate closure, or doing nothing. As the case closed, John was faced with the dilemma of whether to select a high-performance closure, which customers may not accept, or the inferior customer-preferred natural cork.

Students are asked to complete a Total Cost Analysis model. They are also asked to analyze the consumer acceptance aspects of the decision. A complete House of Quality example is fully developed to assess Cost of Quality issues.

INTRODUCTION

> *'"Pop!" It's a sound every wine lover knows - that of a cork being pulled from a bottle of wine. But more than that, it is the music of wine itself, an echo that evokes a world of history and culture and a pleasure that touches all our senses. Some may argue that twist-offs help to demystify wine, but wine is not a commodity in the manner of mineral water or milk. Wine represents civilization; reducing it to the level of mundane, everyday beverages and condiments with twist-offs erodes its core, its very essence."*

Thus spoke senior editor James Suckling of Wine Spectator in the March 31, 2005 issue devoted to the "Great Cork Debate". In Suckling's statement one finds the passion that forms consumer resistance to switch from natural cork, a flawed historical solution to the preservation of wine, to a modern reliable solution, the twist-off screw cap. While the screw cap solves a costly quality problem, it is vehemently resisted by legions of wine aficionados.

The rational side of the debate is well represented by another senior editor at Wine Spectator, James Laub:

> *"For wine drinkers, faulty corks lead to frustration and annoyance far too often. A bad cork is more than just a spoiled wine. It is hard-earned money down the drain."*

> *"At the California Wine Experience this past November, hundreds of bottles of rare and expensive wines from many of the world's greatest producers were poured. The percentage of corky wines ranged from 4% to 12%. According to the sommeliers, one winery had a nightmarish incidence: Thirteen of its 72 bottles, or 18 percent, were off because of rank corks."*

The question boils down to: Does the importance of symbolism and tradition embodied in the cork closure supersede the economic reality that valuable wine is literally poured down the drain because of cork taint? On the surface the choice of a modern reliable closure seems like a "no brainer" . . . until you remember the passion felt by perhaps millions of wine drinkers aligned with James Suckling, as opposed to the competitive realities of using a technologically advanced closure that large numbers of consumers may refuse to buy.

Tom Klein, Chairman and CEO of Rodney Strong Vineyards, was as passionate about wine as any wine lover. He was well aware of the possibility of mass resistance to any closure that didn't resemble cork. He also disliked the thought of customers having a distasteful experience, not to mention the economic loss due to spoiled product. Clearly Tom was at a crossroads and felt a decision had to be made on the cork question. What should he do? He was determined to rationally examine all alternatives before making his decision.

Klein got the ball rolling by calling on John Leyden, Vice President of Packaging and Distribution, to conduct a full review of the closures to be used on all future bottling of Rodney Strong Wines. In doing so, Klein knew that the solution to the cork taint problem was not clear-cut. On the one hand, natural cork closures had, over the centuries, achieved tremendous popularity with wine aficionados and had been used for all Rodney Strong wines since its founding. On the other hand, screw caps and synthetic closures possessed performance and cost advantages over natural cork. Klein said to Leyden, "John, we have to protect our wines as best we can." How best to do so was not immediately clear.

John Leyden was a key player on the product review committee. The other members included the winemaker as well as representatives from the departments of Marketing, Production, and Quality Control. John and the others knew the facts all too well. Industry estimates of the percentage of cork tainted wine ranged from 2% to 10% of all bottles sold (Chehalem, 2004). The main culprit was a compound known as 2,4,6 - Trichloranisole, or TCA, which can be found in natural cork. Leyden knew that screw caps and synthetic cork closures would reduce the cork taint problem. The winery would probably even save money as well as better protect the quality of the wine with these types of closures.

The problem with changing to more effective closures was that many wine consumers loved natural corks. Consumer surveys showed that the customers strongly preferred natural corks, even at the risk of some unpleasant experiences. Customers have reported that screw caps cheapen the image of the wine. John summed it up this way as he began to gather his information: "It is a perception situation. People associate the natural cork with quality. Plus, I don't see much romance in the screw cap."

THE RODNEY STRONG EXPERIENCE

Rodney Strong Vineyards was the 24th largest wine company in the United States in 2004. With its headquarters and winery in Sonoma County, California, sales at Rodney Strong were about 550,000 cases per year with revenues approaching $58 million. The winery was originally built by Rodney Strong in 1969 and was technologically a state-of-the art facility at the time it was constructed. Tom Klein purchased the winery in 1989, when sales were $3 million per year. He has been the Chairman and CEO since 1989. He established a lofty goal for the company. "I would like to be perceived as the finest super-premium winery in Sonoma County," he informed the Wine Spectator (Marcus, 2001). "We have the land, the people, the focus, and the commitment."

Rodney Strong wines competed at a variety of price points. Its Sonoma County brand varietals sold for $12 to $18 per bottle, while vineyard designated wines such as Alexander's Crown and Alden Vineyards were priced in the $26 to $28 range. Their high-end wine, Symmetry, sold for $50 a bottle.

THE CORK TAINT PROBLEM

Trichloroanisole 2-4-6 or TCA as it is commonly called, is one of the strongest aromatic substances in the world. High levels cause wine to smell like moldy old newspapers. Lower levels, with only a few parts of TCA per million parts of wine, can strip a wine of its fruitiness and flavor. These off flavors associated with the use of cork alter the character of the wine from what the winemaker had originally intended.

Cork taint is a serious economic problem for wine makers because it ruins a substantial percentage of wine. Estimates of the extent of contamination range between 2% and 10% of the supply of wine. "Current consensus, through extensive interviews with wine wholesalers and retailers, places the incidence of cork taint at least above 5%" according to recent research (Murray and Lockshin, 1997). So prevalent is the problem of faulty corks that some commentators believe that cork problems cost the global wine industry as much as $10 billion per year (Fuller 1995). "It is Russian Roulette," John said, referring to the odds of buying tainted corks.

How does the cork get contaminated? The original contamination probably occurs in the forest when freshly cut slabs of cork bark are cured on the ground. Batches of cork planks are then boiled in large tanks at processing plants to prepare them for grading and punching. This boiling may actually spread the contamination from batch to batch if the water is not changed. If the cork has been contaminated in the forest or during production, it can ruin the wine that it comes into contact with. Natural cork isn't the only source of taint, however. TCA has been found in winery equipment, oak barrels, building materials, and even winery air conditioning systems.

REDUCING TCA CONTAMINATION

Reducing the incidence of TCA contamination had been a long and expensive process. For John Leyden, the effort started many years ago: "I have been going to Portugal since 1992. Conditions were deplorable then compared to now. I am not sure they ever changed the water during the boiling process. I went back to Portugal in 1996 and was told they change the water once per week. We asked what day they changed the water." "Monday", they replied. "Give us corks boiled on Monday," John requested.

Since then, some cork producers have made heavy investments to improve the quality of the corks they sell in the U.S. The main supplier at Rodney Strong, M. A. Silva, opened a new production plant in 2004 in order to implement new processes that reduce the level of TCA in cork. The new plant cost about $3.5 million and featured major new technology to reduce taint.

At the new facility, cork planks are stacked on a concrete slab for drying instead of being piled on the ground. Traditionally, the cork planks were stacked to dry on bare earth in the open air for about 6 months, which allowed them to be contaminated by fungi in the dirt. The use of concrete slabs prevents contact with the soil. Cork planks are then carried into the plant on stainless steel pallets.

The centerpiece of the plant was a new type of boiling system. The cork planks were pressure boiled for about one hour in a closed tank and the water was continuously cleaned to remove contaminants. This eliminated the possibility of one load of cork planks contaminating another load. Stainless steel pallets were again used to move and store the planks after boiling, also reducing the chance of contamination. The results of tests performed by M. A. Silva indicate that the new boiling process has markedly reduced the incidence of TCA. Has it eliminated TCA completely? It is too soon to tell, but initial sensory results showed that the amount of TCA present had been almost cut in half. "We are very hopeful," says Jose Oliveira, the general manager of M.A. Silva.

NATURAL CORK AND ALTERNATIVES

The purpose of any wine closure is to prevent oxidation and leakage of the wine. Oxidation is one of the main causes of spoilage of wine and closures prevent oxidation by providing a seal that allows a minimal amount of air into the bottle. In Roman times, a layer of olive oil was floated on top of the wine to protect it. Natural cork has been the closure of choice for wine since the 1600's, when Dom Perignon, a French monk, began putting cork stoppers into sparkling wine bottles. The first cork factory was opened around 1750 in Spain.

"Worldwide cork production is estimated to be slightly less than 13 billion wine stoppers per year. The domestic (US) market shows steady growth, with estimated usage of natural corks exceeding 900 million this year. Growth in the market is estimated at 7% annually" (Cork Quality Council, 2004). The most common types of closures are:

Natural Cork - Natural cork, which is harvested from the bark of the cork oak, is the most popular closure for wine bottles. Natural cork, including technical cork closures, represented about 90% of all wine closure sales in 2003 (McKenna, 2003).

Technical Cork - Technical corks are made from natural cork materials that have been reworked in some way. One popular type is the twin top. The body of the closure is made from ground up pieces left over from the making of natural corks. The top and bottom of the closure consists of natural cork discs to provide a high quality barrier.

Synthetic Corks - Synthetic closures accounted for about 9% of sales. Synthetic corks are made from food grade thermoplastic elastomeric materials. These plastic corks function in a fashion similar to natural corks and are available in a variety of colors.

Screw Caps - The remaining 1% of wine bottles are sealed with screw caps made from aluminum with a liner specifically designed for wine. The screw cap is removed by twisting it counter clockwise. Screw caps have been used most often on lower priced wines, while the closure of choice for expensive wines has typically been natural cork.

THE CORK INDUSTRY

Portugal is the leading cork producer in the world and the cork industry forms a key element of the Portuguese manufacturing sector. The cork industry has a long and colorful history during which a fairly complex supply chain has evolved. Each stage of the production process tended to be managed by independent operators and brokers so the supply chain was difficult to coordinate and quality was difficult to monitor. The source of cork contamination was also difficult to identify.

The natural cork stopper is traditionally made out of a solid piece of cork. The raw material comes from the bark of the cork tree, which is found mainly in Portugal, Spain, and North Africa. It takes over 25 years after planting until the cork can be harvested for the first time. Thereafter, it can be harvested about every 9 years (Corkmasters, 2002). Material suitable for wine closures is not available until the 3rd harvest, or some 50 years after planting.

Once the cork tree is ready for harvest, the loggers cut off the cork bark from the tree in large planks. The planks are then left in the open air to rest and "age" for 6 to 24 months. This allows for the natural release of moisture and chemical compounds. Afterward, the cork planks are boiled and washed to eliminate spores, mildew, bacteria, and volatile aromatic substances found naturally in the cork. The cork bark is cut into strips according to the size of the desired stopper and the stopper is then directly punched out of the strip. After additional shaping and polishing, the stoppers are sorted and graded according to quality control criteria. Depending on the cork supplier, special treatments may be included in the process to clean the lenticels (small pores or lines) of the cork stopper, removing the substances responsible for TCA taint. Corks are then packed into thermo-sealed bags and shipped to warehouses in the U.S.

QUALITY CONTROL

Cork manufacturers have been working on the taint problem for years and have made progress, but they still have not completely solved the problem (Leske, 1996). In 2002, the Cork Quality Council claimed that the number of high-risk batches rejected due to TCA content had been reduced by 70% since 2000 (Cork Quality Council, 2002). However, researchers past warnings that "sole reliance on cork supplier's QC has been largely unsuccessful, and a passive acceptance of the status quo will not solve the continuing problem of cork taint in wine" still seem timely (Butzke and Suprenant, 1997).

John knew that the TCA problem had not been solved completely. Obviously, each winery had to protect itself by instituting some sort of inbound inspection and quality assurance program.

"The more you can control right from the beginning, the better it will be at the end," John said.

"Here is how quality testing works at Rodney Strong. For each lot of 500,000 corks, we ask for a pre-purchase sample of 250. We visually inspect 100 of them. We also soak 150 of

them individually in small jars containing a small amount of neutral white wine. They soak for 24 hours and we then perform a blind tasting with staff members. The supplier is also invited to participate, but not to vote. If less than 2% show signs of taint, the lot is accepted. If the taint level is above 2%, the lot is not considered for purchase. A similar testing process takes place when the shipment actually arrives. This has worked pretty well and constitutes a big improvement over the old days when the taint level was from 4% to 8%."

Of course there is a cost for these efforts. Simpson and Veitch (1993) estimated the cost of sensory appraisal of 1,000,000 corks to be $1,600 to $3,200 (or 2-3 cents per case). Alternatively, a local laboratory can perform the sensory evaluation for $35.00 per lot. It is typical to pull a sample from every lot of 10,000 corks so this amounts to about 4 cents per case.

COST ANALYSIS

There are several grades of natural cork based primarily on appearance and the prices vary according to the grade level (Cork Quality Council, 2004).

"A" corks have a surface with only very small holes or pores.
"B" corks have larger holes and pores and some small cracks.
"C" corks have cracks and channels not to exceed 50% of length of the cork.

Rather than sift through each suppliers version of A, B, and C grade corks, John preferred to handle things a bit differently. "Here is what we are willing to pay," John told the suppliers. "Show me what you've got."

He could then make a choice based upon actual samples rather than the subjective criteria of cork grades that can vary from supplier to supplier. Additionally, he could add requirements about the degree of contamination and any special treatments required. John expected to pay about $.30 each for an acceptable natural cork, although lower cost corks are available.

In order to save money, many wineries have turned to technical corks. A technical cork is essentially a cylinder of ground up cork with a disk of natural cork at each end. It is the least expensive option but it has the same taint problem of natural cork. An acceptable technical cork costs about $.09. These have a very consistent shape and few surface defects. Furthermore, technical corks also allow the cork makers to use material that may have been thrown away previously.

Synthetic corks are basically made out of plastic. One type has an inner core that is manufactured from Low Density Polyethylene (LDPE) foam designed to offer the elasticity of a natural cork and a long-term seal. There is rarely any taint with synthetic corks but sometimes they give a bit of a plastic taste. They have been known to be a somewhat difficult to pull out of the bottle. They will not break, however, and they are guaranteed not to crumble, as sometimes happens with natural cork (Wilson and Lockshin, 2003). These corks are available in bright colors and the brand name can be printed on them.

"We started looking into synthetics about 10 years ago," John said. "They were cleaner initially and did a great job, but after 12-14 months they started to show some signs of oxidation. There was also some leakage and a lot of negative feedback from customers back then. Quality, however, has improved considerably since then."

Suitable synthetic closures can be obtained for about $.10 each. Several suppliers exist so there is plenty of competition. Suppliers now assert that consumers are accustomed to synthetic closures and that customer reaction is now one of indifference, many do not even seem to notice (Pitcher, 1999). Synthetics work well for wines consumed within 12 months of bottling. "But how do you know that the wine will get sold and consumed within 12 months?" John asked.

An alternative that has recently received greater attention is the screw cap. It is constructed of aluminum and it has an inside liner where the closure contacts the bottle rim. Testing has been very positive. The Aussies have accomplished some long-term testing that shows the screw cap preserves the quality of the wine better than either synthetic or natural cork. The Australian Wine Research Institute (AWRI) results show that, after three years in the bottle, screw caps provide the best protection against oxidation and there is no TCA taint. The next best performer was the synthetic cork (Godden, 2002). Still, John felt that "The jury is still out on wine requiring several years of bottle aging."

The unit price for screw caps is about $.12, so they cost less than natural cork but more than synthetics and technical corks. There are some additional production costs, however. The Production Department estimated that it would cost about $100,000 to purchase the capital equipment needed to utilize screw caps on the filling line. That capital expenditure could be avoided by using a contract packer or the mobile bottling line for screw caps. The bottling fee at a contract packer was about $.20 per bottle or $2.40 per case. There was no additional expense for screw cap compatible bottles and they are readily available. The leading screw cap product is the Stelvin cap, manufactured by Pechiney Corporation of France, with cap manufacturing facilities in nearby Napa County. While not widely employed in the U. S., screw caps are very popular in Britain and Switzerland. Consumer resistance to the screw cap has been strong in the United States for wines priced over $10.00. "The biggest thing against the screw cap is consumer perception," John said. John used the following spreadsheet to perform a Total Cost Analysis evaluation (Exhibit 1).

MARKETING CONSIDERATIONS

The wine industry is unique. People who work in the industry frequently speak of their passion for wine making. The word romance is likely heard more often in this industry than any other. Consumers are caught up in the mystique of wine. The customers have a great fondness for the ambience and sensuality provided by the cork. The cork is a major essence of the wine experience. The ritual of opening the bottle and hearing the cork pop is very dear to customers. John Leyden summarized it this way, "It's like the Japanese tea service, people just love the ceremony."

Exhibit 1: Total Cost Analysis Model					
Suppliers:	Supplier A	Supplier B	Supplier C	Supplier D	Supplier E
	Natural Cork	Natural Cork	Technical Cork	Synthetic Cork	Screw Cap
Price per 1000					
Other Costs (per 1000)					
Transportation/Receiving					
Inspection/QA					
Accounts Payable					
Capital Equipment Investment					
Total per 1000 (Price + Other Costs)					

Wine Business Monthly found that a majority of wineries were using natural corks, even though industry insiders gave natural corks less than favorable ratings on price and risk of cork taint. Natural cork scored extremely well on consumer acceptance and proper aging of the wine. Ratings of synthetic closures and screw caps received low marks on consumer acceptance (Wine Business Monthly, 2003). The tension between closure performance and consumer acceptance was shown by the fact that screw caps received the highest marks when it came to wine protection attributes, but natural cork was far and away the leader in consumer acceptance.

The impact that consumer acceptance has on winery decisions was confirmed by research of Atkin and Garcia (2004). When wineries were asked to rank the issues that prevented them from using screw caps, the most frequent answer was consumer reluctance to accept screw caps. Wineries listed uncertainty about product quality and cost of equipment as the secondary reasons for not using screw caps.

Others in the wine industry echoed Leyden's opinion about the romance of the cork. Here is what John Souter, Sales and Marketing Manager at Casella Estate Wines had to say:

> *"Screw caps for wines resold quickly would be ideal: however, in my opinion, the consumer still enjoys the experience of opening a bottle of wine with a corkscrew in the traditional way. I think the investment in the education process to convince consumers their wines are far better in screw caps would be more than my budget could afford."*

Similarly, according to John Stallcup, formerly of Winevision (an industry strategic planning group), "Wine is a very tactile experience and the cork is almost what defines the wine" (Stallcup, 2003). On the other hand, Randall Graham of Bonny Doon expressed a different viewpoint: " The biggest surprise about screw caps is that it is really a big non-issue for our customers" (Emert, 2003).

Historically, technological superiority is often not enough for a product to be successful - the new product must be perceived to be superior by the potential adopter. Even though it has been around since the 1970's, the screw cap hasn't caught on with customers because it is incompatible with the values, customs, and past experiences of the mainstream wine consumer. (Mortensen and Marks, 2003). In other words, consumers think the screw cap is cheap. It could be a tough "sell" to break that association in the customers mind. John decided to start building a "House of Quality" in order to reflect the voice of the customer as well as technological considerations in the decision process (Exhibit 2).

COMPETITIVE ASSESSMENT

For the time being, most wineries have elected to stay with natural cork. An industry poll by Wine Business Monthly in 2004 found that the vast majority of wineries (78 percent) utilized natural cork. As stated earlier, natural cork accounted for 90% of all closures employed. The popularity of technical corks has been declining steadily with only 21 percent of wineries applying technical corks, while the popularity of synthetic closures is on the rise with 31 percent of wineries capping with these closures. Only 5 percent of respondents have turned to screw caps (the numbers add up to more than 100 percent because many wineries use more than one type of closure).

Bonny Doon and Plumpjack are two wineries that have bottled some excellent wines under screw caps. Other wineries preferring screw caps are Fetzer, which used them on wines exported to Europe, Sonoma-Cutrer on top-of-the-line Chardonnay, and Murphy-Goode on the line of wines called Tin Roof (Prial, 2003). Clos du Bois announced a change over to synthetic closures in 2001 on the bulk of their Sonoma County Classic wines. They have not switched to 100% synthetics, however.

On the international scene, Tesco, the biggest wine retailer in the U.K., has had almost no customer resistance to the introduction of large numbers of screw caps to its shelves. The chain has been selling up to a million bottles of high quality screw cap wines per week (Joseph, 2003).

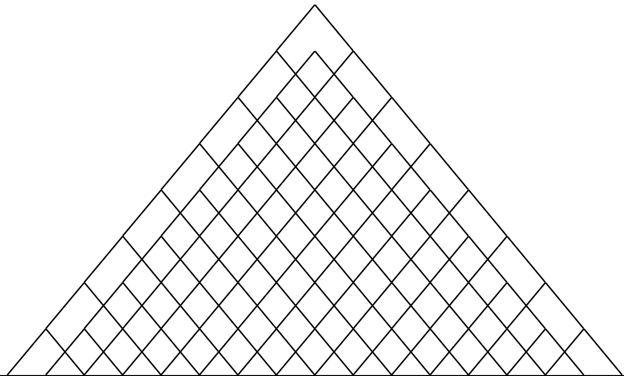
CONCLUSION

John Leyden pondered the decision at hand. It was another beautiful April day and the growing season was in full swing. It was time to make this critical recommendation for the new vintage. Much of the information pointed in different directions, however. How could he reconcile the technical advantages of screw caps and synthetic closures with the popularity of natural cork? "When the cork is clean, it is our number 1 choice," John stated emphatically. "Unfortunately, sometimes it is tainted. Bottom line, our number one concern is to protect the wine and to deliver it to the consumer as the winemaker intended."

Should Rodney Strong Vineyards switch all of its production to alternate closures? Some? None? These are Sixty-four thousand dollar questions facing John.

Exhibit 2: QFD Worksheet
House of Quality

Tradeoff Matrix



	Design Factors	Importanc	Grape																Competitive Assessment				
	Customer Requirements																		1	2	3	4	5
Flavo																							
Packag																							
Othe																							
	Measurement Units																						
	Target																						
	Design Changes																						

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JEA LABORATORY

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CASE DESCRIPTION

The primary subject matter of this case concerns cost/managerial accounting – more specifically, activity-based costing. Secondary issues examined include analyses of marketing and operations. The case has a difficulty level appropriate for junior level courses. 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

This case involves designing an activity-based costing system for a service-oriented organization – a testing laboratory. Because of this service setting, the case complements activity-based costing material in cost/managerial accounting textbooks, virtually all of which focus heavily on manufacturing settings. The objective of the case is to enable students to understand the issues and procedures for designing a two-stage activity-based costing system as well as how to use the resulting cost information. The case also entails an analysis of marketing and operations based on this costing system.

INTRODUCTION

JEA Laboratory was formed in 1999 by Julie Rachelson, Evan Henrick, and Amy Devorak. These three individuals had worked together for an aerospace firm for several years until drastic reductions in defense contracts caused a massive downsizing of the firm. Julie Rachelson, having a degree in electrical engineering and eight years of experience in testing electronic components, convinced Evan Henrick and Amy Devorak to join her in a new venture that would involve conducting tests for custom integrated circuits. They would set up a laboratory where various electrical characteristics of integrated circuits would be measured and compared to the manufacturer's specifications. After months of planning and raising capital, they established a testing laboratory in northern California, where they would be located near many high-tech manufacturing companies.

ORGANIZATIONAL STRUCTURE AND STRATEGY

Julie Rachelson became CEO of this new enterprise, JEA Laboratory. She does not draw a salary from the company. Evan Henrick had also previously been a testing engineer and now became Vice President of Operations for the new firm. His responsibilities include supervising the design and implementation of testing processes. Amy Devorak became Vice President of Accounting and Finance, since she had twelve years of experience in these areas. Her responsibilities include job order-taking, bookkeeping, payables, receivables, billing, cash management, and preparing financial statements.

JEA focused on a strategy of providing quicker turnaround times than currently offered by manufacturers' labs or other outside labs. The strategy was successful and had been marketed well by Marcy Noonan, a marketing manager hired by Rachelson in early 2000. Within four years, JEA had annual revenues of approximately $1.7 million. Profit and cash flow had also been very good and had allowed JEA to totally self-fund all expansion.

NEW VENTURE

At a meeting in 2004, Noonan suggested that there was a large demand for testing of magnetic components such as transformers. She was convinced that many of JEA's current customers would turn to them for these types of tests. Julie Rachelson immediately set up a task force to study this idea. After a few weeks of experimentation, Evan Henrick reported that testing transformers would be feasible and soon thereafter the task force recommended implementation of this new service. So JEA began offering transformer testing in late 2004. By spring of the following year, transformer testing was so successful that the lab was now running on three full shifts.

Company employment had grown to 36 people, as shown in Table 1. Amy Devorak hired three additional people in Accounting and Finance. The vast majority of this group's time was spent on taking job orders and billing because of the large number of small clients served by JEA. Three people were hired for a Maintenance group. Their responsibility was to maintain the testing equipment and keep the testing areas clean. In addition to using three shift supervisors (one of whom is Evan Henrick), Operations now had two test engineers and 20 direct workers. A marketing group employed two other representatives besides Marcy Noonan to call on existing accounts and to establish new ones. The marketing employees are the only individuals in the company that travel. A time study of their efforts during a five month period found that 25 percent of their time was spent on marketing integrated circuit tests while 75 percent was spent on marketing transformer tests. Information about space occupied and utilities consumed by the various functional areas appears in Table 2.

JEA was soon able to raise its price for transformer testing. In addition, JEA was finding that this service was being performed for a much broader clientele than was integrated circuit testing. Not only were component manufacturers utilizing JEA, but research institutions such as universities were also sending transformers to be tested at JEA. Information about number of jobs, number of items tested, and number of setups for the two types of tests conducted during a recent time period appear in Table 3. During this period, 8,000 hours were available for testing and setup. Setup time for testing a batch of either integrated circuits or transformers is about 15 minutes, on average. The costs incurred during this same time period are shown in Table 4.

FUTURE STRATEGY

In the midst of all this success, Julie Rachelson is now faced with a dilemma. Amy Devorak has come to her and argued that testing transformers is much more profitable than testing integrated circuits and that JEA should concentrate more of its resources on marketing and performing transformer testing. To support her argument, she has compiled costs and profit margins for each service (see Table 5). The $2.13 labor and overhead cost was obtained by dividing $1,147,700 (all costs shown in Table 4, except the materials costs) by 540,000 (the total number of items tested, from Table 3). Rachelson's reaction to this analysis was:

> *"I can hardly believe that testing transformers is over twice as profitable as testing the integrated circuits. I wonder if we're using a proper costing method. Something bothers me about the way we're assigning costs. I think we have to look into this some more."*

The next day, Rachelson decided to hire a consultant from a CPA firm. The consultant recommended using an activity-based costing system, where at first, labor and overhead costs would be assigned to three cost pools: Operations and Maintenance, Accounting and Finance, and Marketing. Then, the Operations and Maintenance costs would be assigned to two activities based on hours taken up by these activities: Testing-Processing and Testing-Setup. Finally, all costs would be assigned to the two types of tests.

Table 1: Company Employment

Position	Personnel
Chief Executive Officer	1
Accounting and Finance	4
Maintenance	3
Operations:	
Supervisors	3
Engineers	2
Testing	20
Marketing	3

Table 2: Resource Utilization by Functional Areas		
	Square Footage	Utilities Usage
Accounting & Finance	350	7%
Maintenance	375	9%
Operations-Supervision	450	10%
Operations-Engineering	400	5%
Operations-Testing	26,800	58%
Marketing	670	11%
TOTAL	29,045	100%

Table 3: Operational Data by Test Type			
	No. of Setups	No. of Items Tested	No. of Jobs
Integrated Circuits	425	335,000	370
Transformers	1,890	205,000	1,640
TOTAL	2,315	540,000	2,010

Table 4: Cost Data	
	Costs
Salaries-Operations	696,500
Salaries-Maintenance	59,600
Salaries-Acctg. & Finance	141,000
Salaries-Marketing	115,000
Depreciation-Building	66,000
Depreciation-Operations	31,000
Utilities	19,900
Travel	18,700
Materials-Integ. Circuits	83,750
Materials-Transformers	92,250
TOTAL	1,323

Table 5: Profit Margins by Test Type		
	Integrated Circuits	Transformers
Revenue per Test	$2.90	$3.70
Materials Cost per Test	$0.25	$0.45
Labor & Overhead per Test	$2.13	$2.13
Profit per Test	$0.52	$1.12

STORMY KROMER

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CASE DESCRIPTION

This case primarily focuses on the rescue of a brand which has been around for nearly a century, and how strategic marketing can be effectively used to rebuild and reinvigorate a relatively old brand and product. Secondary issues include brand positioning and brand equity issues, channel conflict, and e-commerce. This case has a difficulty level of 2-3, and would be appropriate for sophomore – to – junior level students. The case is designed to be taught in 2-3 class hours and is expected to require 3-5 hours of outside preparation by students. It might be helpful for students to further examine other "nostalgic" brands for the purposes of comparison.

CASE SYNOPSIS

This case centers around an entrepreneur (Bob Jacquart) who unexpectedly finds out that a product his family has worn for generations (the "Stormy Kromer" cap) has fallen upon hard times and is nearly being discontinued. After making some inquiries, Bob purchases the rights to produce the product / brand, and begins to realize the power held by the brand itself. Sales for the Stormy Kromer hat increase dramatically over a short period of time, and Bob is challenged to find ways to successfully grow the brand equity associated with the Stormy Kromer name through suitable additions to the product line, expansion and diversification of the channel strategy (including e-commerce: go to StormyKromer.com) and possible international expansion.

INTRODUCTION

It was a normal workday in September of 2001 when Bob Jacquart headed to a local Ironwood, Michigan coffee shop, to grab a quick lunch and to catch up on the day's news. As in most small northwoods communities, many of the patrons were local business persons and retirees who gather daily to talk about everything from local politics to the weather. On this particular day, the owner of Hobby Wheel, a general merchandise retail store that carried the Stormy Kromer, announced that the hat's manufacturer, Kromer Cap Company of Milwaukee, Wisconsin, was no longer making the legendary cap. The Stormy Kromer has been part of most northwoods mens' wardrobes for almost a century, and Bob's immediate reaction was "get me the phone number"…

Later that day, sitting on Bob's desk was a slip of paper from the Hobby Wheel with a phone number on it. So Bob decided to make some inquiries with Richard Grossman, owner of the Kromer

Cap Company, to see if he would be interested in selling the rights to produce the Stormy Kromer. As fate would have it, Bob's decision to call was a momentous one.

HISTORY OF THE STORMY KROMER

Nearly 100 years ago, George "Stormy" Kromer invented the now famous hat which is known for its ability to keep one's head warm and stay on one's head in windy conditions. Stormy, a native of Kaukauna, Wisconsin was an avid baseball player and at the age of 17 joined a semi-professional team in Sterling, Illinois. He probably would have continued to pursue a career in baseball had he not fallen in love and married Ida Homan. At Ida's father's insistence, they established their new home in Wisconsin and in 1897 Stormy went to work for the Chicago and Northwestern Railroad.

There is some confusion has to how the idea for the hat came to George. One version of the legend has it that the idea came to him because his baseball cap would always blow off his head as the stiff wind blew through the cab of the locomotive. Another version is that he got the idea watching the brakeman's hat blow off time and time again. Still, another version is that to prevent headaches from wearing a cap with a stiff visor, Stormy would push the cap back on his head and the wind would catch the visor and blow the cap off. Regardless of how the idea surfaced, Stormy, with the help of Ida, who was an excellent seamstress, invented the Stormy Kromer.

Stormy began to wear his new cap to work on the railroad. Co-workers took notice and before long, Stormy and Ida were in the hat business. When his wife could no longer keep up with the demand, they hired some employees. The business continued to grow. Stormy quit the railroad and in 1918 moved the business to Milwaukee. The hat continued to gain popularity and larger production facilities were acquired in 1930 and again in 1945. In the mid '60s, Stormy's health began to deteriorate and the family sold the business to Richard Grossman. Grossman continues to run the Kromer Cap Co. Today, the firm's main product is cotton visor caps for welders. In 2001, the firm decided to discontinue the production and sale of the original Stormy Kromer wool "blizzard" model hat when sales declined to about 3,800 units a year.

A NEW BEGINNING FOR THE STORMY KROMER

As Jacquart sat and ate his lunch on that day in September of 2001 he did not believe the news he was hearing about the demise of the Stormy, after all he had worn them all of his adult life. Jacquart thought to himself, he could make the caps at Jacquart Fabric Products. The seasonality of hat sales would complement the seasonality of other products the firm sews.

Bob had grown up in Ironwood and after attending a nearby university, in 1971 he came home to join the family's small contract sewing business. In the last thirty-plus years, he has grown the business from a small shop with just one non-family employee into a very successful small business employing more than 160 workers making a variety of products including dog beds and cat scratching posts for a large direct pet supply company, boat covers and truck tarps. The firm has gained national recognition for its ability to rapidly adapt its manufacturing capabilities to changes in product demand and mix.

One thing led to another and Grossman agreed to sell Jacquart the rights and pattern of the patented hat, but not the name. He feared that Jacquart's use of the Kromer brand name would cause confusion in the market and potentially could harm the Kromer name, since the Kromer Cap Company (www.kromercap.com) was still marketing Kromer welding hats.

It took no time for Jacquart to begin analyzing the most efficient way to sew the 13 component parts together to produce the Stormy Kromer cap. To complicate matters, the hat was available in 8 sizes and Jacquart believed he needed to add 3 more. Furthermore, unlike most contract sewers, Jacquart pays its employees by the hour, above the minimum wage. The hat is fairly expensive to make and distribute and Jacquart estimates his fully loaded cost including his profit margin at about US$ 15 per unit. The hat had been retailed at $17.00.

As part of Jacquart's original agreement with Grossman, he was also given the names of the small sporting goods and men's apparel stores across the upper Midwest who had retailed the hat for Grossman. Almost all of the retailers agreed to continue selling Stormies. Although Jacquart had no consumer branding or marketing experience, he was convinced that with his energy and a little strategic market planning, he could grow sales of the hat.

THE STORMY KROMER MERCANTILE IS ESTABLISHED

News broke in the northwoods that Jacquart had acquired the rights to manufacture the Stormy Kromer. During a stop at Jonny's Bar in Mercer, Wisconsin, the owner told Jacquart "It's the finest hat to wear on a Harley in the fall." It didn't take to long before Jacquart dreamed of a co-branding and distribution arrangement with Harley Davidison. For advice on how to approach the licensing giant, he turned to his cousin, Ron Jacquart, a successful attorney in Milwaukee. His advice was to seek the assistance of a professional marketing firm.

Jacquart interviewed a few Milwaukee-based firms his cousin had recommended before settling on Hanson Dodge. Although his original objective in hiring an agency was to gain access to the lucrative Harley Davidson license, he was soon convinced that developing a branding strategy of his own for the return of the Stormy Kromer Cap should be his first priority. The agency' principle's first question to Jacquart was, "How could you successfully market a hat famous enough to have been the subject of "Mr. Puffer Bill," a Little Golden Book published in 1965 without having the rights to use its name?" Again, Jacquart contacted Grossman and came to an agreement on right to use the name "Stormy Kromer."

A "retro nostalgia" marketing communications strategy was initially used, featuring real life Stormy Kromer stories developed to re-establish and expand awareness of brand. In addition to the paid advertising, stories about Jacquart saving the Stormy were pitched to various news organizations in the region. A Milwaukee Journal-Sentinel reporter call to interview Jacquart about saving the Stormy and ended up convincing her editor to drive all the way up to Ironwood and spend three days researching and writing an article which ended up being syndicated throughout the Midwest. Additionally, a Wisconsin television station produced a segment for a statewide magazine news show. Most recently, the Travel Channel show "Made in America", hosted by John Ratzenberger ("Cliff" the postal employee from "Cheers") filmed an episode about the Stormy Kromer.

Over time, with a limited advertising and promotional budget of about $150,000 per year and the publicity the hat received the more hats he sold and the more Kromer stories and photographs he received. Sales in the first year (2002) grew to 14,000 units despite the fact that he had raised the manufacturer's suggested retail price to $29.99; the approximate wholesale price for the Stormy Kromer cap is $15.00, allowing retailers to "keystone" the price. Distribution of the Stormy Kromer cap was limited to the company's own Website (www.stormykromer.com), and small-to-medium sized retailers (mostly independents in the Midwest).

Jacquart was concerned about the ability of the initial branding strategy and advertising campaign to carry the brand to the next level and sought out Madison, Wisconsin-based Campbell-LaCoste, a marketing communications agency which specializes in outdoor products. An updated branding strategy was developed which continued to focus on both the emotional and functional appeal of the hat with the clever use of humor in its execution. Because of limited resources, a decision was also made to primarily target the "hunt and fish" crowd. In the Western states, ranchers are also targeted.

Concurrently with Jacquart's efforts to revitalize the brand and properly position and target the hat, he hired a sales manager to develop an expanded distribution strategy. A decision was made to use independent reps to peddle the hat. The United States was divided up into five geographic territories (east coast, east central, west central, mountain states and west coast) and salespersons that represented complementary lines like Carhartt apparel and Red Wing Shoes were sought. Additionally, Stormy Kromer Mercantile began exhibiting at the Shooting, Outdoor and Hunting (SHOT) and the Outdoor Retailer trade shows. A major boost to sales was the landing of the hunt and fish catalogue and superstore Cabela's account which accounted for about 15% of unit sales in 2004.

SUCCESSFUL COMEBACK OF THE STORMY KROMER . . . AND THE FUTURE

The early marketing efforts for the Stormy Kromer began to bear fruit in 2003 and 2004, as sales for the hat increased significantly over that time period:

Year	Unit Sales	Percent through Website
2002	14000	10 %
2003	48000	23
2004	78000	28%

One thing that frustrated Bob is that he had some difficulties in finding out how big the potential market might be. Since sales figures for hats are lumped in with other accessories like belts and wallets (for example, see www.hoovers.com) it was difficult for Bob to have an idea as to the actual size of the hat market. And, even if hat sales were segregated, the Stormy Kromer is such a specialty type hat appealing to a small segment of the total men's hat market that it would still be difficult to estimate market potential.

After a couple of years of successful growth, Bob wondered about the future of the Stormy Kromer brand. What, if anything, should be done over the next five years, in order to ensure a successful future for the brand? During early 2005 Bob was sitting at his desk, contemplating the future or next phase for the Storm Kromer brand. On a legal-sized pad, he made a list of the following notes / questions:

1. Should the Stormy Kromer brand name be extended to related products or lines, such as clothing (i.e., coats, jeans)? If so, how would these products be priced? Promoted? Distributed? A brimless version of the Stormy Kromer had recently been introduced, with some success, but who was buying this version of the Stormy Kromer and why?

2. How should the brand name and brand image of the Stormy Kromer be managed over the next 5 years? The brand seems to be off to a "good start", but Bob continually worries about the future of the brand. How would, or should, the promotional strategy for the Stormy Kromer brand change or evolve over time? Who buys the Stormy Kromer cap, and why? How, or might the customer, or target market for the Stormy Kromer change over time? How should the brand be positioned in the future?

3. Should the Stormy Kromer brand be launched in the international market? Bob has wondered about potential markets, such as Canada, and parts of Northern Europe and Scandinavia (i.e., Finland, Sweden, and Norway). What would it take to achieve a successful launch in one or more foreign markets? What business model should be used?

4. What about competition? Bob worried about foreign competitors marketing cheaper versions of the Stormy Kromer cap in the U.S.; would these competitors enhance their marketing efforts once word leaked out about the success of the Stormy Kromer? Would other competitors, such as Columbia, Carhartt, Filson, Woolrich, and Pendleton launch similar products?

5. How (if at all) should the distribution strategy for Stormy Kromer be changed? Should the company hire more of their own sales representatives? Should more of an emphasis be placed on the Web-based sales (see www.stormykromer.com)? Should company-owned "Stormy Kromer" retail stores be opened in selected locations in the Midwest, West and Northeastern U.S.? Should more of a merchandising presence be established with "big name" retailers? Might any channel conflict result from changes in distribution?

6. Jacquart’s first attempt to expand the product line was the introduction of the “Lil’ Kromer.” It was recalled for some safety concerns, which have since been corrected and the hat was recently re-introduced to the product line. How should the children’s market be approached? How lucrative would the children’s market be to Stormy Kromer?

Bob had some other notes scribbled on the legal-sized sheet, related to sponsorship of certain outdoor events (such as ski races), maybe sponsoring a “Kromer fest” in the Ironwood area, etc. With so many ideas, Bob wondered about first prioritizing what needed to be done in 2005 (based upon his list of issues and ideas), and then secondly, developing strategy and plans based upon the top 2-3 priority issues. His goal was to have these two items completed by the end of November 2004.

PIXELON: A STRATEGIC EXAMINATION OF CORPORATE GOVERNANCE AND ETHICS

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CASE DESCRIPTION

The primary subject matter of this case concerns corporate governance and ethics. Secondary issues include technical managerial, financial, and marketing knowledge, communication skills, critical thinking skills, and coping with uncertainty and unstructured problem-solving. The case has a difficulty level of four, appropriate for senior level. The case is designed to be taught in two class hours and is expected to require ten hours of outside preparation by students.

CASE SYNOPSIS

Organizations with an interest in improving business education continue to increase awareness of the broad range of skills that businesspeople must have to be successful. In addition to technical managerial, financial, and marketing knowledge, communication skills, critical thinking skills, and coping with uncertainty and unstructured problem-solving are often listed as critical skills that students should be developing.

Pixelon was a real online broadcasting and online content startup that initiated its existence with the most expensive launch party ever – iBash '99. In this series of four critical incidents, students are presented with a brief history of Pixelon and several significant decision points for the company's executives and board of directors.

One of the main objectives of this case is to provide an opportunity for students to practice their written and oral communication skills. The case is assigned as a writing assignment which is then followed up with class discussion about the case when the paper is turned in. Since the case builds in facts and detail, the case provides a relatively deep learning environment over time.

Another objective of the case is to allow students to demonstrate their technical business knowledge via discussion of management, finance, and marketing strategies. Since new facts are introduced in each of the four critical incidents, the students must deal with uncertainty in answering the case questions in the first three critical incidents, which fulfills the objective of giving students a chance to participate in problem-solving in an unstructured setting.

Pixelon Case Part I: Do Not Go Gently Into that Pixelon Night (December 1999)

Robert Carsia frowned as he looked over the business plan of Pixelon, a 3-year-old online broadcasting and online content provider startup that had just offered him the position of Chief Executive Officer. It wasn't that Carsia was new to the burgeoning Internet industry. He had recently resigned as acting CEO at the company that owned the A2Zshopping.com site because he felt the firm was not ready to go public. In addition, he had experience in the upper management of Network Event Theater, a website targeted at college students. Ten years managing Six Flags and another ten years in a graphics consulting business rounded out his experience in the entertainment industry.

Carsia thought back to October 29, 1999, when Pixelon.com had hosted a huge startup extravaganza at the MGM Grand Hotel and Casino in Las Vegas. The iBash event included performances from the Who, the Dixie Chicks, Kiss, LeAnn Rimes, Brian Setzer, and Tony Bennett, and was estimated to cost $12 million. Tens of thousands of Internet executives, media, and tourists attended the launch of the online broadcast and online content firm at a time when many Internet industry experts were emphasizing the correlation between publicity and market valuation.

Pixelon had raised $20 million from venture capitalists before the launch party, and it was estimated to have spent more than half of its available funds on iBash. However, Michael Fenne, the company's founder and chairman at the time, said that to be successful in online broadcasting firms had to be "…fast and big, or [they're] dead." Although there were many large and well-funded competitors (Viacom/CBS and Disney/ABC) striving for leadership in online broadcasting, there were no clear industry leaders. The opportunity still excited Carsia. "Pixelon could still be the top firm in online broadcasting, the company just needs to be more focused," he thought to himself. On the content side, the environment did not look as promising. Pixelon had already had to remove some of the video clips from the party after complaints from the performers. "The senior management needs to figure out what they want to be when they grow up," Carsia sighed.

Also, Carsia was aware of the need for improvements in Pixelon's online broadcast technology. The Web simulcast of iBash was marred by strange error messages and links that went nowhere. Most of those people that did see the performances viewed them using Microsoft's streaming software, not Pixelon software. Pixelon had since admitted that its current software was not able to squeeze data into files compressed enough to support live broadcasts.

However, iBash had helped Pixelon build brand identity, Carsia conceded. Top players in the Internet and entertainment industries were now aware of Pixelon. Other companies had successfully gone to such extremes to build their brand identities. In January 1999, the employment website HotJobs spent half of its yearly revenues on television advertisements during the Super Bowl, and was now a well-recognized employment search site. Many dotcoms were regularly spending $100 million on ad campaigns, so even one event at $12 million did not necessarily seem excessive to Internet industry boosters.

However, not all of Pixelon's investors agreed with the iBash marketing strategy, and that criticism combined with the technology issues led to the ouster of Michael Fenne as chairman and Chief Technical Officer. Carsia thought about all of the opportunities and risks inherent in becoming Pixelon's Chief Executive. Finally, he said to himself, "I know how businesses work and I have a template for how that should be executed. I'm accepting the offer."

Required:

1. What immediate management actions would you expect Carsia to take after becoming CEO of Pixelon? Why?
2. What were the advantages and disadvantages of the marketing strategies implemented around Pixelon's launch? What are the characteristics of marketing strategies for firms in emerging industries?
3. Prepare a SWOT analysis for Pixelon.
4. How do venture capitalists judge the viability of technology being developed by a startup?
5. How do potential investors assess management skill within a new company?
6. If you were the head of Pixelon's venture capital firm, would you recommend another round of funding for the company in the near future? Why?

Pixelon Case Part II: Secrets of the Golden-Tongued Salesman (April 2000)

"It's just absolutely shocking to everybody here," said Stephanie Kitzes, corporate counsel for Pixelon. "We'll be conducting an investigation into exactly who this person is."

Kitzes had just found out that Michael Fenne, founder of Pixelon, was actually David Stanley, an embezzler who was on the run from the state of Virginia, where he had on the most-wanted list since 1998. David Stanley had engineered "iBash '99", Pixelon's launch party at the MGM Grand Hotel and Casino in Las Vegas, featuring numerous musical performances and costing $16.2 million of the initial $20 million raised by Pixelon. While the party generated a high degree of buzz, investors were furious at what they felt was excessive spending. Stanley had been ousted from Pixelon in November, but he was under contract to act as a consultant for two years. However, he became aware that the Virginia State Police were closing in on his California home, and had turned himself in at the county jail in his hometown of Wise, Virginia.

Back in 1989, Stanley had pled guilty to 55 counts of fraud-related charges. Some of his victims attended the church in Wise where Stanley's father preached. Others were elderly people living in Virginia and Tennessee, and the total amount swindled was estimated to be $1,250,000. The judge called Stanley "the golden-tongued salesman" and gave him a suspended sentence to give him time to pay back the money he had taken before he was sent to prison for eight years. Stanley had repaid most of the amount owed at the time he disappeared from his home in Tennessee in 1996 just before a court hearing related to the fraud conviction. Virginia law enforcement officials sent out alerts warning that Stanley (also known as David Rivers) would most likely change his identity and appearance and be involved with possibly a church, music (he had once been a professional piano player), computers, or some combination of these.

At Pixelon, Stanley/Fenne was very secretive despite the carnival atmosphere he generated. Even as he was attempting to recruit reporters for iBash, he avoided questions about his past and turned away photographers. Few questioned his self-description of a 31-year-old roadie who taught himself computer programming.

Wise County Circuit Court Judge J. Robert Stump had the 39-year-old Stanley held without bail, but Stanley was provided with an Internet connection, phone, and a fax machine so he could liquidate his assets and start repaying his victims.

Pixelon's venture capital firm, Advanced Equities, refused to comment upon finding that they had funded a convicted embezzler with $20 million. Requests by Pixelon for a second funding had just failed due to disagreements between management and Advanced Equities, and Pixelon had just begun talks with potential new investors.

Pixelon's current CEO, Paul Ward, had no direct comment about the revelation. His predecessor, Robert Carsia, left after just one month as CEO.

Required:

1. What procedures should investment banks use to investigate the backgrounds of prospective clients?

2. Why might Advanced Equities have omitted a background check of 'Michael Fenne'?

3. What three components are necessary conditions for a fraud to take place? Describe how each of these components was present in the case of David Stanley and Pixelon.

4. Comment on the stability of Pixelon's upper management.

Pixelon Case Part III: The End of the Charade (May 2000)

Not much was left of Pixelon in mid-May 2000. Six executives remained after the company fired all of its 55 remaining employees and began preparing to declare bankruptcy. The managers were attempting to find new sources of funding, but the outlook was not promising. Many potential investors had ceased talks when the news broke that Pixelon's founder was a convicted felon. Creditors of Pixelon had also recently filed a petition to force Pixelon into involuntary bankruptcy. However, worse news followed, as Pixelon admitted that the company was not using a proprietary format of digital video, but instead was using an open-source format that was available to everyone over the Internet. Russell Reeder, Pixelon's VP of product development, said, "The [Pixelon] Player was an adaptation of Windows Media Player because it (the video) was streamed using Windows Media as a streaming format."

Reeder admitted that Pixelon had intentionally misled the public about its technology in isolated cases, and that he had resisted Stanley's overselling characteristics. However, the Pixelon Player was not used to broadcast the Iowa straw poll in August 1999 as claimed, and other press releases were also misleading. Even white papers implying that Pixelon was using a proprietory mathematical formula for encoding files were false. Pixelon founder Stanley had claimed to have written the code when he lived in the back seat of his car after fleeing Tennessee.

Reeder claimed that Pixelon had taken proprietory techniques to make the files smaller than is possible with other techniques on the market. However, the files were similar to those compressed using other technologies according to two digital video experts who examined them.

Three former employees said that misrepresentation was widespread during their time at the company. Gary Devore, head of video encoding from May to November 1999, said that he used only FutureTel video-encoding technology while at Pixelon. Philip Bruce, another former encoding employee, agrees, and both former employees say that the FutureTel device was stored in a special box. Stanley explained to employees that to prevent reengineering the box was booby-trapped with an "acid pill" that would explode if anyone else opened it. An anonymous third employee also confirmed that, "From the start I knew that we didn't have our own proprietory compression codec." A target ad technology was also contrived to appear to work during demonstrations to clients, according to Devore and the anonymous source.

Devore said that he remained with Pixelon as long as he did because, "[Stanley] would say in meetings that everybody in this company is going to be a millionaire in a short period of time." Stanley had promised an initial public offering in April 2000 that would be comparable to the largest of the internet IPOs.

Even Pixelon's venture capital firm was duped by the technology swindle. Keith Daubenspeck, principal of Advanced Equities, said, "We brought technical people … to look at the product. Not only did they confirm that they thought the product was excellent, but one of them invested $50,000 in the deal."

Meanwhile, the four creditors of Pixelon who filed the involuntary bankruptcy suit claimed that Pixelon had never paid them for more than $500,000 worth of products and services. The lawyer for the creditors, Michael Kinney, said that the payment troubles had started in January, 2000. "It just seemed there was no interest in getting them paid," said Kinney. The creditors included an electrical contractor, an office products supplier, a consulting firm, and a former employee. The consulting firm and the former employee had been promised stock, not cash, for their work. Kinney claims the stock was never delivered.

Required:

1. What legal liability issues result from Pixelon's past misleading press releases and white papers? How might this factor in to an audit of Pixelon?

2. Why weren't Pixelon's employees more skeptical about the technology in use at the company? Why did they remain employees of Pixelon if they knew the proprietary technology didn't exist?

3. Would Pixelon management prefer a Chapter 7 bankruptcy or a Chapter 11 bankruptcy? Who has priority in a bankruptcy case, creditors seeking cash payments, or shareholders?

4. Did the investment bank undertake the appropriate steps in analyzing Pixelon's technology?

Pixelon Case Part IV: The Real Story of the Ousting of 'Michael Fenne' (November 12, 1999; prior to Parts I, II, and III)

Lee Wiskowski, Pixelon director and chairman of Advanced Equities, knew that Michael Fenne was not the run-of-the-mill company founder and board chairman. Fenne was paid only out of the company's expense account and he had no Social Security card or driver's license. He preferred to sign his email messages the "Big Giant Head of Pixelon." However, Wiskowski never foresaw the level to which Fenne's eccentricities would rise.

Recently, there was the strange series of events surrounding Judy Smith, formerly a communications executive at MSNBC and the spokeswoman for Monica Lewinsky. Smith was hired to be Pixelon's public relations director, and for months Fenne had been talking up Smith for the CEO position. Advanced Equities, Pixelon's investment bank, had opposed the promotion, but just a few weeks earlier at a shareholders meeting, Fenne introduced Smith as Pixelon's new CEO. The investors had been surprised to hear the announcement, but they were now even more stunned to hear that she had already been fired. Fenne had also been doling out millions of shares to employees and partners, diluting the outside investors' ownership share. In addition, some employees were being required to work 36-hour shifts.

Finally, Advanced Equities had just discovered that Pixelon had spent $16.2 million on 'iBash', Pixelon's attention-grabbing launch party that included performances by LeAnn Rimes and the Who. Pixelon had received financing of $20 million only one month before the party, and Wiskowski was furious that more than three-quarters of the funding had already been 'burned.' He, principal Dwight Badger, and another colleague flew from Chicago to California for an emergency board meeting. San Juan Capistrano is an hour's drive southeast of Los Angeles, and the team pulled their rental car up to Pixelon headquarters on the morning of November 12, 1999.

Immediately after entering the building the Advanced Equities group heard Fenne yelling over the public address system, "George better respond to me immediately, and if he doesn't have all the answers I might have to take him out behind the barn for a whooping! Frank, report to the woodshed, your uncle is going to give you a whooping!" The messages were repeated, and seemed to be directed at random to various employees. The trio could sense the fear from the Pixelon employees.

A Pixelon executive that the three met with later in the morning told them that he had gone to a scheduled meeting with Fenne a few weeks earlier. When he entered Fenne's office, he found another executive on his hands and knees with his head bowed in front of Fenne, and Fenne was sitting in a chair with his hands on the back of the executive's head, like "…a cult leader."

The group finally met with Fenne about 10:30 that morning. Fenne, a formidable 350-pound man, walked right past Badger's outstretched hand, appearing out of breath and exhausted. Fenne then went into a tirade about how he would never give up control of the company, and seemed potentially violent.

The Advanced Equities trio had anticipated asking the interim CEO and director, Paul Ward, to resign. However, the group decided by the end of the morning that Fenne should be ousted, even though he had an employment agreement ensuring him seven years as chairman. The investment bankers then sent a consistent message as they talked to each executive, "It's not a negotiation. …

If we don't have an agreement by the time we leave, you will have a class-action lawsuit on your desk within 48 hours."

The venture capitalists discreetly slipped off to a parking lot down the road with Ward, a second Pixelon director, and several Pixelon officers to settle on a plan. Since Pixelon had seven board members, they needed at least one more director to vote to take Fenne out, and they frantically tried to reach two other board members. Ward called Michael Kelley, a director living in northern California, and told him to get on the next available flight. He also left messages for Bart Moore, another board member who was on a horseback riding daytrip. Everyone agreed on the need to be ready to call the sheriff's office. One person said, "This feels weird. This feels like someone could die tonight."

Throughout the afternoon, Wiskowski and the others were concerned about whether they had the required four votes. Both Fenne and Dave Snyder, a board member with a paid position at Pixelon, were sure to vote against any ousting motions, so the support of either Kelley or Moore was critical. The planners decided to get Fenne into the conference room and have Robert Feldman, a recent Pixelon hire, watch the room through a window. If they thought Fenne was about to become violent, one of them would make a thumbs down gesture to Feldman, indicating that he should call the police.

As the group walked toward Fenne's office, they saw two large bodyguards who appeared to be armed standing outside. Wiskowski and Badger walked past the men and into the office. Fenne seemed to want to negotiate. "Give me 90 days and I'll turn the company around," he said. Cam Fraser, a recently hired executive, approached the office door and asked the guards to leave. They refused. Wiskowski faked a yawn and stretched his arms, putting his hands together and turning them so that his thumbs were clearly pointing down. Within a half hour, several squad cars from the Orange County Sheriff's Department converged on Pixelon headquarters. The bodyguards were removed peacefully as director Kelley was arriving in a taxi. The driver was panicked by the sight of the police cars and refused to stop, and Kelley had to jump out of the cab while it was still moving.

That night the board meeting finally got underway. Six board members, Fenne, Wiskowski, Ward, Kelley, Snyder, and Curtis were present, and attempts were still being made to contact Moore. Fenne continued his con game at the beginning of the meeting by saying, "I've reached an interesting agreement with the gentlemen from Advanced Equities, but we'll leave that action for last in our meeting." His remark was disconcerting to some of the planners. One board member recalls thinking, "This 350-pound guy is going to squeeze through the crack!"

The meeting moved on to other subjects. At last, Wiskowski slapped the table and motioned that Fenne be suspended as chairman and CTO for 30 days. Fenne blurted, "You betrayed me." Before Wiskowski had a chance to respond, Ward seconded the motion. A shocked Fenne turned to him and continued, "Now I know who my Judas is."

Snyder angrily argued that the ousting was illegal considering the employment agreement. As the heated discussion continued, Bart Moore finally appeared in jeans and cowboy boots caked in dried mud. In the end, only Fenne and Snyder voted no to the motion. Fenne had been ousted from Pixelon, although he was eventually signed-on as a consultant for two years.

Required:

1. Discuss the responsibilities of the Board of Directors in a private company. Are these responsibilities any different if the company is public?

2. How would you describe Fenne's management style?

3. Why did executives and employees tolerate Fenne's erratic behavior? When should other executives and employees take action if an executive is behaving strangely?

4. What warning signs indicated that Fenne might not be what he appeared?

5. Why did the Board of Directors agree to have Fenne stay on as a consultant after they ousted him?

CRISIS MANAGEMENT AT THE NATIONAL INSTITUTES OF HEALTH

Katherine Campbell, University of North Dakota
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CASE DESCRIPTION

Scientists at the National Institutes of Health (NIH), while government employees earning around $200,000, were consulting and serving on private firms' scientific advisory boards. Although such practices were rare before the 1980s, they became increasingly common during the 1990s and into the twenty-first century. These practices raised concerns over perceived, and real, conflicts of interest, when the same firms received grants from (and did research with) the NIH. Defenders of the practice, however, suggested that the development of scientific knowledge was enhanced when research scientists had regular contact with private industry. Federal ethics guidelines did not prohibit federal employees from "moonlighting" in their free time, but did place strict guidelines on such practices. The primary issue in the case is to understand the nature of conflicts of interest, conditions under which "knowledge sharing" can be appropriate, and when such actions can be inappropriate and potentially illegal.

A second issue explores "crisis management," when the allegations of impropriety and conflict of interest are leveled at the NIH in December 2003. The director of the NIH has called for a review of all consulting arrangements and the establishment of a Blue Ribbon Panel, but there are concerns that this does not go far enough and that the NIH is trying to avoid seriously dealing with the situation.

The primary audience for this case is a junior/senior course in Business Government and Society, or a Business Ethics course. The case would also be applicable in Public Administration classes, particularly where administrative ethics are discussed. The case might also prove of interest in a class on knowledge management issues in a graduate program. While both of the above identified issues should be addressed in any discussion, the instructor has discretion regarding which one should serve as the primary focus in a class. This note takes the perspective that students need to explore the positive and negative aspects of government scientists' involvement with private industry, and potential exposure to real and perceived conflicts of interest. After this is understood, then appropriate responses to the concerns can be evaluated.

CASE SYNOPSIS

In December 2003, the Los Angeles Times reported that many senior scientists in the National Institutes of Health (NIH) had outside consulting and advisory relations with health science and pharmaceutical firms. The story suggested that these arrangements created both the reality and the *perception of a conflict of interest, and were in violation of federal ethics regulations. Dr. Elias Zerhouni, Director of the NIH, quickly defended the integrity of his agency and its scientists, and indicated that the health and safety of Americans had never been at risk. Nevertheless, he instituted a review of all consulting arrangements, and announced the formation of a Blue Ribbon Panel that would advise the NIH on ways of dealing with this matter in the future.*

Various members of Congress jumped on the story, and promised full inquiries into the matter. It was hard to feel sympathetic for the scientists, as many earned around $200,000 in governmental salaries – more than members of congress. Should these scientists be allowed to consult for private firms while government employees? Is the nation's interest best served by allowing (and encouraging) knowledge transfer between federal research labs and private firms via such consulting arrangements? At the NIH, there was a need to proactively deal with both the perceptions of conflict of interest, and the potential reality of conflicts of interest.

INTRODUCTION

"Our mission is too important to the public health of the nation to have it undermined by any real or perceived conflicts of interest. … [our] ongoing review of outside activity files shows no evidence that patients were harmed or that decisions were influenced." (Dr. Elias A. Zerhouni, quoted in Willman, 2003b)

"This is not just a matter of a revolving door, where at NIH people go from the federal agency to the private sector. This is a matter of a swivel chair, where they sit at one desk ad do both jobs. … I have great concern about institute directors having outside sources of income. It's like deputy secretaries of Defense working for Lockheed Martin." (Rep. James C. Greenwood, Chairman of the House Oversight and Investigations Subcommittee, quoted in Willman, 2003b)

December 2003 was a difficult month for Dr. Elias A. Zerhouni, Director of the National Institutes of Health (NIH). On December 7th, *The Los Angeles Times* published a series of articles reporting that a number of top NIH scientists, earning $180-$200,000 in government salaries, also had lucrative consulting and advisory relations with firms receiving grants from the NIH. The articles (Willman, 2003a) suggested that these relations created conflicts of interest, and that, as a consequence, government funds might not be going to the most worthy projects, but to those that could financially benefit NIH officials. Perhaps even more troubling, was the suggestion that some patients' lives had been placed at risk by decisions that allowed unsafe drugs (from companies with financial ties to NIH officials) to be administered. *The Los Angeles Times* investigation concluded that this was not simply a matter of a few government employees trying to cash in on their knowledge and connections. Rather, the policies and practices at the NIH had created a climate where outside consultation was encouraged, and regular safeguards regarding disclosure of outside consultation had been systematically dismantled.

Initial reactions to the articles were predicable: the story was picked up by wire services, National Public Radio, and numerous other media outlets, Dr. Zerhouni defensively protected his Institutes' reputation, *The Los Angeles Times*' editors stood behind the story, and politicians called for investigations and looked for a scandal that would put their names in the press. But, behind these opening salvos, a strategy for dealing with the situation had to be developed by the leadership of the NIH. After the initial excitement, perhaps this story would just go away. If this happened, the best move would be simply to lay low and let the media attention and political fury pass on to the next big scandal. On the other hand, proactively dealing with the situation might diffuse the matter, and take some of the "wind out of the sails" of reporters and politicians that might try to make a bigger deal out of this than was warranted. The Congressional holiday recess had provided some breathing room, but the issue could quickly return to the headlines in January. While the NIH leadership could not entirely predict or manage how this issue would play out in the new year, actions taken now could influence whether the next NIH-related stories and Congressional hearings dealt with wonderful new drugs, important research results, and new treatments for serious diseases, or with the "scandalous" financial ties between top scientists and the private sector.

THE NATIONAL INSTITUTES OF HEALTH

The NIH is a part of the U.S. Department of Health and Human Services, and calls itself "The Nation's Medical Research Agency." The agency began in 1887 as a one room 'laboratory of hygiene' within the Marine Hospital Service. An early priority of the laboratory was to prevent the spread of infectious diseases from traveling seamen to the general population of the United States. Over the years, the entity's name and scope of mission changed many times. Currently, the primary mission of the NIH is to fund research on all aspects of public health. In 2004, the NIH's budget exceeded $28 billion. Most of the funds (80%) are spent on competitive grants given to researchers at universities, medical schools, hospitals, research institutes, and private firms located in all 50 states. The NIH has approximately 17,000 employees, including approximately 6,000 research scientists operating in its own laboratories. (Information in this section is summarized from the web site of the NIH (www.nih.gov). Specific facts and data are largely from www.nih.gov/about/NIHoverview.html, www.nih.gov/about/index.html, and history.nih.gov/exhibits/history/index.html.)

The NIH is organized as 27 centers, each with its own focus and funding (e.g., National Cancer Institute, National Institute on Aging, National Human Genome Research Institute). The heads of centers and individual laboratories are typically renowned scientists with established research records. At some point in their careers, many worked as researchers in hospitals, universities, or private industry. As NIH directors and scientists, their role is to keep abreast of developments in their field, in private industry as well as publicly funded laboratories, and to see that research grants are awarded to projects with the greatest potential. Thus, while their primary role is to allocate money to promising medical research, to do this effectively they need open lines of communication between private firms, other governments, research institutes, universities, and their own NIH projects.

NIH directors and senior scientists are highly compensated. Typical salaries are $150-200,000, which higher than that of many members of Congress and Supreme Court justices. Most senior NIH scientists could, however, earn even more working in private industry or practicing medicine. By serving as consultants or members of firms' scientific advisory boards, NIH scientists can supplement their governmental salaries and make their total compensation more competitive with other opportunities. (The NIH is one of a very few agencies where outside income can be significantly higher than governmental salaries. Employees of the National Park Service or the Federal Aviation Adminstration, for example, generally do not have such lucrative opportunities for supplementing governmental salaries.)

Decisions made by senior NIH scientists regularly involve allocating millions of dollars of governmental funds. The impact of these funding decisions on private firms, however, can be even larger. If NIH-funded work helps identify the root causes of a disease, a pharmaceutical firm can earn billions of dollars in long term sales by developing an effective treatment. In the end, the nation's public health may be well served by the NIH when diseases are prevented, eliminated, or cured, regardless of who might realize a direct financial profit.

THE U.S. OFFICE OF GOVERNMENT ETHICS

The U.S. Office of Government Ethics (USOGE) was established following the Ethics in Government Act of 1978. The primary role of the USOGE is to coordinate ethics programs for agencies within the executive branch, and interpret legislation and regulations. The USOGE publishes numerous pamphlets and handbooks outlining responsibilities of government employees, and steps that need to be taken to assure that employees comply with federal laws. The USOGE works directly with ethics administrators in government agencies (including the NIH) who monitor ethics programs and ethics compliance within their agencies. (Information in this section is largely taken from the web site of the USOGE - www.usoge.gov).

The motivation behind the Ethics in Government Act of 1978 was to provide a unified set of policies and procedures that apply to all government employees. While many branches of government and individual agencies had policies addressing ethical concerns, these were not uniform. Legislators believed several key issues needed to be addressed in a consistent manner. One area of concern was "the revolving door," where individuals might alternate between positions in government and firms affected by governmental decisions. Another was conflicts of interest, where a governmental employee (or their family) might personally benefit from governmental decisions. Nepotism, or favoritism in hiring one's family members for government positions, had been common in some situations, but was difficult to prove. Disclosure of financial interests and sources of income was also an issue that troubled many legislators. While creation of the USOGE did not eliminate these problems, or ensure complete consistency in policies, the agency has reported significant progress over the years.

CONFLICT OF INTEREST GUIDELINES FOR GOVERNMENT EMPLOYEES

Conflicts of interest arise when a government employee's work might also personally benefit the employee, or benefit family, individuals, or organizations with which the employee has a relationship. When a conflict of interest exists, a government employee may be tempted to act out of self-interest, rather than in the best interest of the public. Conflict of interest guidelines are designed to address these circumstances. Employees are required to notify a superior whenever a conflict of interest exists, so that the work can be reviewed or assigned to another employee. Examples of obvious conflicts of interest include employees authorizing purchases from a firm owned by a family member or negotiating with an outside firm as a government official, while simultaneously personally negotiating an offer of employment from the firm. In cases such as these, the employee's objectivity could be questioned, even if decisions actually are made without bias.

It can be challenging to develop guidelines identifying which conflicts are incompatible with performance of a government employee's duties. Consider the case of regulators at the Securities and Exchange Commission (SEC). SEC employees investigate cases of potential insider trading and other types of security law violations. If an SEC investigator directly holds stock in a company under investigation, an obvious conflict of interest exists that is likely incompatible with the employee's duties as an investigator. Does such a conflict of interest arise, however, when an SEC investigator indirectly owns stock through a well diversified mutual fund that is part of the employee's federal retirement savings account? In order to avoid a conflict of interest, is it necessary to forbid SEC investigators from holding any stock in personal investment or retirement accounts? Could conflict of interest concerns be adequately addressed by requiring SEC investigators to make financial disclosures and prohibiting them from investigating matters related to firms in which they have a direct financial interest? Do holdings in diversified mutual funds warrant the same scrutiny as direct equity investments? Should stock transaction disclosures also be required to assure superiors (and the public) that investigators are not trading on "inside" information? (This example from the SEC is entirely hypothetical, and may not accurately represent current implementation of policies at the SEC.) The general spirit of the government conflict of interest guidelines accepts that some technical conflicts of interest could exist (e.g., a bank auditor might carry a balance on a credit card issued by the bank being audited), but these should not be material. Government employees should be unencumbered from conflicts of interests when performing governmental duties and exercising professional judgment. The public should feel confident that public employees are acting in the interest of the public, and not in their own self-interest. (Information on conflict of interest guidelines is largely drawn from USOGE, 2002a).

FINANCIAL DISCLOSURE REQUIREMENTS FOR GOVERNMENT EMPLOYEES

Government employees are not prohibited from also working outside the government, as long as the outside employment does not directly relate to, or interfere with, their governmental duties. An administrative assistant in the Department of Justice can work evenings or weekends at an ice cream shop, for instance, without raising any ethical concerns. Likewise, a scientist can teach a course a local college, a park ranger can work part time as an emergency medical technician, and a lawyer can earn royalties from writing novels. A lawyer can also earn income from representing private clients, as long as the work is not based on his/her governmental duties or expertise, and does not involve advising clients on negotiations with the government. However, some types of outside employment are prohibited. An employee cannot receive royalties from a book that describes information developed as a part of their government job. An Environmental Protection Agency administrator cannot earn outside income from advising private firms how to comply with (or avoid) pollution control regulations. Generally, employees are free do what they want in their free time, including earning additional income, as long as this income is not directly related to their governmental duties (USOGE, 2002b).

All federal employees are required to disclose outside income. In 2003, employees paid $102,168 or more were generally required to file Form 278 listing all outside income. This form was made publicly available. Employees earning less than this amount were required to file a different form, Form 450, which was kept confidential and did not require disclosure of specific amounts earned.

ALLEGATIONS OF IMPROPRIETY

On December 7, 2003, in a series of articles written by David Willman, *The Los Angeles Times* ran a report raising significant concerns about the outside activities of several senior NIH scientists (Willman, 2003a). The following examples are all drawn from that report:

Dr. Stephen Katz was Director of the National Institute of Arthritis and Musculoskeletal and Skin Diseases. Dr. Katz was paid $200,000 in government salary, and earned approximately another $500-600,000 (total) in company fees in 1993-2002, according disclosures. One firm for which he consulted, Advanced Tissue Sciences, paid him between $142,500 and $212,500 during 1997-2002. During this same period, Advanced Tissue Sciences received $1.7 million in grants from Katz's Institute. Katz had removed himself from all decisions involving Advanced Tissue Sciences, and made certain they were handled by a subordinate. However, NIH policies prevent a scientist not only from being involved in such decisions, but from supervising an individual making the decisions. Katz was also a consultant to Schering AG, for which the NIH was conducting an experimental kidney treatment. In both cases Katz's consulting relations with the private firms had been disclosed to the NIH, and approved by the agency.

Dr. John I. Gallin was Director of the NIH Clinical Center, and received $225,200 in government salary. He earned another $145,000-322,000 between 1997 and 2003 from consulting with private firms. One firm with which he consulted, Abgenix, was owned by Cell Genesys. Cell Genesys collaborated with Gallin's lab in developing gene transfer technology, and articles were published that described the contributions of Cell Genesys to the work of Gallin's lab. Gallin also owned stock in Cell Genesys. Gallin indicated that his consulting relationship with Abgenix did not affect his decisions regarding Cell Genesys, nor did his ownership of stock in Cell Genesys.

Dr. Ronald N. Germain was director of the Laboratory of Immunology, and received a government salary of $179,900. Between 1992 and 2003 he earned over $1.4 million in consulting fees, and received stock options worth another $865,000. Between 1992-2002, he received $322,749 from the Genetics Institute. In 2001 the Genetics Institute entered into a contractual agreement with Germain's lab, yet he was advised that it was not necessary for him to discontinue his consulting relationship, even though NIH policy does not allow an employee to receive private fees from a firm that is in a collaborative arrangement with their lab. He also stated that he was initially unaware that his lab had entered into an agreement with the Genetics Institute.

Dr. Jeffrey Schlom was director was director of the National Cancer Institute's Laboratory of Tumor Immunology and Biology. His government salary was $180,400, and he received another $331,500 in consulting fees from 1994-2003. Cytoclonal Pharmaceuticals, a firm working on Taxol production, paid him $127,000. In his work at the NIH, Schlom worked on medications that, when used in conjunction with Taxol, can provide effective cancer treatment for some. Thus, the net result of his research would lead to increased demand for Taxol, and prove good for Cytoclonal Pharmaceuticals.

These are just some of the situations highlighted in *The Los Angeles Times* report. *The Times* also reported that many NIH employees who should have been filing the public "278" form had switched to filing the non-public "450" form, even though their salaries exceeded the "450" form threshold. The NIH had received an advisory opinion stating that, in determining which form an employee needed to file, one could use the bottom of an employee's salary grade range rather than their actual salary. Thus, as long as the low end of their pay grade was below $102,168, the employee could file the less detailed non-public form. As a result of this ruling, the NIH shifted many of its higher paid employees into different pay grades in order to allow them to switch forms (Willman, 2003a).

DEALING WITH THE REALITIES AND THE PERCEPTIONS

In *The Los Angeles Times* report there was no direct evidence that scientists had used their influence at the NIH to get preferential deals for their clients, personally profited from their government work, or had compromised the lives of patients as a result of consulting relationships. Yet, the report pointed out that the arrangements created the appearance of conflicts of interest, as well as incentives and opportunities for actions at odds with the scientists' duties to the public. In addition, scientists and their managers at the NIH had taken steps to circumvent some regulations intended to prevent the possibility of conflicts of interest. Was more being hidden from public view that might make these initial allegations seem trivial?

Dr. Elias Zerhouni and the NIH responded swiftly to the allegations. In a press release (NIH, 2003) on December 10th, 2003 (three days after the report), the agency indicated it was "committed to do everything possible to avoid even the perception of a conflict of interest. … To the best of our knowledge, NIH and its employees have followed all the current government ethics rules. It is clear, however, that we will need to consider changes after a thoughtful analysis of the issue." Dr. Zerhouni called for a review of every consulting relationship entered into by employees in the past five years, and called for the establishment of a Blue Ribbon Panel to "review consulting practices" and "identify systemic solutions for improvement."

The press release indicated that "it is important that our scientists stay involved in the science and health community beyond NIH to share their broad knowledge in their respective fields." The general tone of many who defended the NIH was that these were professionals of the highest integrity, prominent scientists in their fields, and it would be beneath them to ever let their scientific judgment be affected by private monetary gain. Yet, even if they intended to act without bias, is it reasonable to assume that they could completely disassociate their governmental and private consulting roles? Did private firms feel they needed to have close relations with NIH scientists in order to get a fair shot at NIH grants or contracts?

While NIH management initially defended the integrity of its scientists, they also acknowledged that they might need to do a better job of dealing with perceptions. But, perhaps there were real underlying conflicts of interest that needed to be addressed and avoided in the future. By requiring a review of consulting arrangements, and establishing a Blue Ribbon Panel, there was an acknowledgement that some action was needed. Was this all that was needed, or was more decisive action required to keep "the story" from becoming an even bigger issue that would distract NIH scientists from making further medical progress on important diseases?

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ORGANIC FOODS: THE FINANCIAL REPORTING OF DISCONTINUED OPERATIONS

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CASE DESCRIPTION

The primary subject manner of this case concerns the proper financial reporting of gains or losses on discontinued operations per Generally Accepted Accounting Principles (GAAP). This case has a difficulty level of three, appropriate for junior level courses. The case is designed to be taught in a one class hour and is expected to require three to four hours of outside preparation by students. The case would be appropriate for an undergraduate intermediate accounting course or graduate courses in either financial accounting theory or applied financial accounting research. Students will need access to Statement of Financial Accounting Standard No. 144, "Accounting for the Impairment or Disposal of Long-Lived Asset" and APB #30. These standards can be downloaded from the Financial Accounting Standards Board (FASB) web site at www.fasb.org or can be found on the Financial Accounting Research System disk that may be packaged with Intermediate Accounting or other advanced financial accounting textbooks.

CASE SYNOPSIS

This case provides students the opportunity to apply a financial reporting standard to a real-world situation where there is uncertainty about the proper reporting of restructuring costs. Specifically, Organic Foods, a publicly owned organic food retailing chain, is restructuring parts of its business and management is hoping to report all the related costs in a discontinued operations section at the bottom of their Income Statement. Financial analysts often spend very little time evaluating the discontinued operations section since it is not considered part of income from operations and usually includes only non-recurring disposal costs. For this reason, company managements have been known to pressure their accountants to include inappropriate costs in discontinued operations rather than reporting them as operations related expenses.

The case requirements have been separated into two parts -- Part A and Part B. Instructors can choose to have students complete Part A only or both Part A and Part B. In Part A, students: 1) read and interpret FAS #144 to determine the GAAP requirements for discontinued operations, and 2) apply those requirements to Organic Food's restructuring costs. However, Part A does not require the actual completion of any financial statements. Instead, Part A focuses on understanding the appropriate accounting for Organic's restructuring costs without getting into the computational details of preparing Comparative Income Statements.

Part B provides financial information and requires students to complete Comparative Income Statements based on the decisions they made in Part A. In addition, Part B requires students to discuss the impact of the required financial reporting on management and shareholder decision *making. Overall, the case provides students the ability to develop skills they will need to understand and apply FASB based financial reporting standards to uncertain situations.*

BACKGROUND

Organic Foods was incorporated in 1998 for the primary propose of providing top quality organic foods through a chain of speciality food stores. The company serves primary the southwest with stores in California, Arizona, and Nevada. In California, the company has experienced tremendous growth in sales. However, in Arizona and Nevada the company has been financially struggling.

The company is organized into three reporting segments covering Southern California, Arizona, and Nevada, respectively. The Southern California segment has nine stores and three distribution warehouses. Southern California is by far the most profitable segment for the company and there are plans to open several new stores in that area. However, the other two segments are problematic and the company is seriously considering restructuring or discontinuing them to help reduce the company's costs and increase profitability.

Assume it is currently early 2009. Approximately six months ago you were promoted to the position of Assistant Controller. Overall, you have been working for Organic Foods for the last several years since you completed your accounting degree. Your promotion to Assistant Controller is quite a feather in your cap and you are determined to make the most of your new position.

RESTRUCTURING MEETING

On February 1, 2009 the company CEO (Jonny Mack) is meeting with his management team to discuss how the company might address its problem segments. The Controller of the company (Jan Faith) has asked you to attend the meeting with her so that you will be aware of any accounting issues that are discussed. As described below, the meeting begins with Ben Keyman, the chief operating officer (COO), providing a status report on the Arizona and Nevada operations.

Arizona Segment

The Arizona segment consists of five stores (all in the Phoenix area) and one distribution warehouse. These stores, as a group, have had net losses for the last several years and future operating losses are expected unless some type of restructuring is undertaken to reduced costs and attract new business.

The COO indicates that his staff believes that the Arizona segment would become profitable if the company consolidated operations into two megastores (one for east Phoenix and one for west Phoenix) and closed the existing five smaller stores. The distribution warehouse would not be affected. Organic Foods owns the buildings that each of the existing five stores occupy and the company would need to sell them. However, the company feels confident they will be able to sell each of those buildings without incurring losses. Under the restructuring plan being proposed for the Arizona segment the megastores would be up and running in approximately eight months. Since the company does not want to lose market share, the existing five stores would need to remain in operation until the megastores are opened.

Nevada Segment

The Nevada segment consists of two stores and a distribution warehouse. All are located in the Las Vegas metro area. This has been a very difficult market for the company and the existing operations have had significant net losses over the last several years. The COO feels the company would be better served by closing the stores and warehouse in this segment. This would allow the company to put additional resources into the more profitable Southern California area. The company has operating leases on the Nevada stores and warehouse with all leases expiring on January 31, 2010. The COO believes the company would minimize its costs of discontinuing these stores by operating them until the end of their operating leases and then closing down all operations.

Southern California Warehouse

Finally, the COO indicates that one of the three distribution warehouses located in Southern California would only be operating at half capacity due to the restructuring that is being recommended for the Nevada segment. A final decision on how to handle this warehouse has not been made. The warehouse is owned by Organic and is located in an area of Southern California where the real estate market is down significantly. In fact, the COO believes this warehouse is impaired to a value significantly below its carrying value on Organic's books. Since the problems with this warehouse are directly related to the Nevada segment, the COO indicates that it would only seem fair to throw any impairment loss in with the restructuring/discontinued operations costs from the Nevada segment. The COO notes that this is the only company warehouse to have any impairment issues.

One member of the management team asks the COO whether it would be possible to close the impaired warehouse entirely and move operations to one of the other warehouses. The COO indicates that due to the warehouse location he does not feel that closing the warehouse would result in any cost savings. However, he again emphasizes that no final decision has been made about this warehouse. He did add that the company considers this warehouse to be part of its Southern California operating segment and that the company does not have specific cash flow related records for this warehouse. Finally, the COO indicates that he would have his staff monitor and evaluate the status of the warehouse closely and would report back at an appropriate time.

Meeting Discussion

The COO concludes by summarizing the various costs the company will incur in the restructuring he is proposing:

- Costs of opening the megastores in Phoenix,
- Operating losses of the existing stores in Phoenix until the megastores can be opened and the costs to close down the existing stores in Phoenix,
- Operating losses of the existing Nevada stores until their leases expire and the disposal costs of closing those stores and warehouse, and the
- Possible impairment loss on the Southern California warehouse.

Jonny Mack, the CEO, breaths a long sigh at the conclusion of the COO presentation and then acknowledges to the group that these issues have finally reached a point where the company must react. He indicates that he has decided to move forward with the restructuring plans presented by the COO.

Just before the meeting concludes the financial reporting of the restructuring costs is raised by another senior manager. The CEO indicates that based on his prior experience with restructuring costs and PPE impairments he believes that all the related costs and losses discussed at the meeting would be shown on the 2009 Comparative Income Statement as losses on discontinued operations. Since discontinued operations appear as a special section at the bottom of an Income Statement, net of tax, he indicates that the Board of Directors, shareholders, and financial analysts that follow the company will likely be more forgiving of the restructuring process than if the related costs were shown as part of income from operations.

PART A: THE FINANCIAL REPORTING RESEARCH ISSUE

After the meeting the Controller pulls you aside and indicates she is not sure all of those costs can be reported as requested by the CEO. In particular, she indicates that based on her prior experience she knows that FASB addressed the issue of discontinued operations in FAS #144 "Accounting for the Impairment or Disposal of Long-Lived Assets." However, she also indicates that she is not currently up to speed on FAS #144 although she does remember the requirements that were contained in the superseded APB #30.

Overall, the Controller asks you to perform research on the discontinued operations requirements in FAS #144. As she discusses her research expectations you can't help but feel some excitement about being included in the restructuring process. However, you also can't help but feel that determining the proper financial reporting of the restructuring and disposal costs is not going to be that straight-forward. Plus, based on your time with the company you know that the CEO, Jonny Mack, likes getting his way and the results of your research have the potential of causing some real stress in the accounting department given that the CEO seemed to have already made up his mind about the financial reporting of the restructuring costs.

In conclusion, the Controller asks to complete your research on FAS #144 and to provide her with a memo indicating the key requirements that must be met to classify a cost into the discontinued operations section of an Income Statement. She also asks you to provide an analysis indicating which of the company's restructuring cost(s) you believe can be shown as discontinued operations and which costs (if any) would have to be included in income from operations.

PART B
PREPARATION OF COMPARATIVE INCOME STATEMENTS AND ANALYSIS

Assume that the 2009 fiscal year is now concluding and the restructuring discussed at the February 1 meeting is almost complete. The Controller stops by your office and asks you to follow up on the memo you provided earlier in the year that indicated how you believed FAS #144 would require the company to report its restructuring costs.

Specifically, the Controller provides you with several pieces of financial information for 2009 (and 2008) and asks that you develop an initial draft of the Comparative Income Statements that will appear in the 2009 Annual Report. Your draft should incorporate the recommendations you made in Part A about the appropriate classification of the company's restructuring costs. She leaves you the following exhibits that you should use as a base to complete your task:

> Exhibit 1 contains the operating revenues and expenses for each segment for the 2009 and 2008 fiscal years, respectively. She notes that this exhibit contains only the day-to-day operating information for the segments, excluding any of the restructuring costs the company has been spending since the February 1 meeting.
>
> Exhibit 2 contains a summary of the restructuring costs the company has incurred during 2009 and other related financial information you will likely need to complete the Comparative Income Statements.
>
> Exhibit 3 is a format that she envisions the company's Comparative Income Statements will look like when they are placed in the 2009 Annual Report (assuming that at least some costs will be classified as discontinued operations). She requests you use this format to complete your task.

Finally, the Controller indicates that it is still unclear to her what the key difference are between the FAS #144 discontinued operations reporting requirements and those from APB #30. She reminds you that the CEO, Jonny Mack, will be asking a lot of questions about the Comparative

Income Statements and that we need to have complete explanations for him. Therefore, she asks that you also prepare a short memo to her indicating in bullet points the key differences between FAS #144 discontinued operations reporting requirements versus those that were required under the superseded APB #30.

She asks that you have your initial draft of the Comparative Income Statements and your memo completed in a few days when both of you can sit down and discuss them. As an aside, she indicates that she would like to have you think about how the financial reporting of the restructuring costs might be affecting management, shareholder, and financial analyst decision making. She hopes you will be able to discuss those potential impacts with her after you have completed the Comparative Income Statements.

Exhibit 1: Organic Foods Operations Related Financial Data for 2008 and 2009

A. 2009 Operations Related Data (excluding any restructuring charges): (in Thousands)

	Southern California Segment	Arizona Segment	Nevada Segment	Estimated Total
Revenue	$156,000	$30,000	$7,300	$193,300
- Cost of Goods Sold and Occupancy Costs	$(101,000)	$(20,000)	$(5,300)	$(126,300)
Gross Profit	$55,000	$10,000	$2,000	$67,000
- General and Administrative Expenses	$(48,000)	$(10,100)	$(2,500)	$(60,600)
Tentative Operations Related Income (Loss)	$7,000	($100)	($500)	$6,400

Note: Of the $100 loss to operate the Arizona segment, $60 occurred prior to the date the company made the restructuring decision and $40 occurred after that date. Of the $500 loss for the Nevada segment, $200 occurred prior to the date the company made the restructuring decision and $300 occurred after that date.

B. 2008 Operations Related Data (excluding any restructuring charges): (in Thousands)

	Southern California Segment	Arizona Segment	Nevada Segment	Total
Revenue	$120,000	$35,000	$10,000	$165,000
- Cost of Goods Sold and Occupancy Costs	$(76,000)	$(23,000)	$(7,300)	$(106,300)
Gross Profit	$44,000	$12,000	$2,700	$58,700
- General and Administrative Expenses	$(38,000)	$(12,400)	$(3,300)	$(53,700)
Operations Related Income (Loss)	$6,000	($400)	($600)	$5,000

Exhibit 2: Restructuring Costs and Related Financial Information

Summary of the restructuring costs Organic Foods has incurred during 2009
(all values are in thousands):

1. Significant progress has already been made toward shutting down the Nevada segment operations with actual disposal costs incurred in 2009 of $400. In addition, the company estimates an additional disposal loss of $10 will be incurred in 2010 on the remaining property, plant, and equipment in the Nevada segment. Note that the costs to operate the Nevada stores during 2009 are shown in Exhibit 1 and are not included in these amounts

   Organic Foods estimates that operational losses from January 1, 2010 until the stores are finally closed on January 31, 2010 (when the operating leases expire) is estimated to be approximately $20.

2. Restructuring costs to close the smaller Arizona stores and open the megastores of $240 have been incurred in 2009. Note that the costs to operate the Arizona stores are shown in Exhibit 1 and are not included in the $240. The Arizona restructuring has been completed and no future disposal costs will likely be incurred.

3. Organic Foods has completed an analysis of the potential impairment loss related to the Southern California warehouse discussed at the February 1 meeting and has concluded that there is a $60 impairment loss that should be recorded in 2009. The company has made the decision to retain the warehouse for future usage despite the impairment loss.

4. The company currently has a marginal income tax rate of 30% that will impact all items on the Comparative Income Statements.

Exhibit 3: Proposed Comparative Income Statements Format for the 2009 Annual Report

		2009			2008
Revenues		$XXX			$XXX
- Costs of Goods Sold and Occupancy Costs		- $XXX			- $XXX
Gross Profit		$XXX			$XXX
Other Operating Expenses:					
General and administrative expenses	$XXX			$XXX	
Other items classified as operations related expenses:	$XXX			$XXX	
(List those other items separately here)	$XXX			$XXX	
Total Operating Expenses		- $XXX			- $XXX
Income From Continuing Operations (Before Taxes)		$XXX			$XXX
- Income Tax Expense		- $XXX			- $XXX
Income From Continuing Operations		$XXX			$XXX
Discontinued Operations:					
Loss from operations of discontinued component(s),					
less applicable income taxes of $XXX for 2009; $XXX for 2008	$XXX			$XXX	
Loss from disposal of discontinued component(s),					
less applicable income taxes of $XXX for 2009; $XXX for 2008	$XXX			$XXX	
Total Net Losses on Discontinued Operations		- $XXX			- $XXX
Net Income		$XXX			$XXX

THE NATIONAL CANCER SOCIETY: CORPORATE GOVERNANCE IN A NONPROFIT ORGANIZATION

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CASE DESCRIPTION

The primary matter of this case concerns corporate governance in a nonprofit organization. Secondary issues examined include motivation of volunteer members in an organization and organization lifecycle. The case has a difficulty level of four, appropriate for senior level (it could also be used for first year graduate studies, level five). The case is designed to be taught in two class hours and is expected to require three hours of outside preparation by students.

CASE SYNOPSIS

NCS (National Cancer Society) was an organization founded and operated by volunteers. The organization received memorial contributions and distributed them as grants to applicants who meet the organization's criteria. The group also maintained a worship space (bay) in a local church and holds regular memorial services for the deceased.

At the time of the case, the organization had existed for about 18 years. The original enthusiasm of the founding members had waned and no one had come forward to replace them. Specifically, the president had not provided the leadership needed to maintain the organization's momentum. The board of directors was divided about how to deal with this problem so that rare meeting degenerate into arguments. A former president was still collecting mail and was still the authorized signatory for checks. The state had issued delinquency notices because the organization has failed to file required informational forms. These notices provide a point of departure for discussing the future of the organization. Students should consider the responsibilities of a board in such a situation and whether the organization is viable. More specifically, the details of revitalizing or discontinuing the organization must be addressed.

Accountants may find that volunteer organizations to which they belong call on their professional expertise to fill positions of financial responsibility. These organizations may operate informally and the accountant is in a difficult position as he or she attempts to impose standards that other members do not see as necessary. This case provides opportunity to discuss such a situation.

INTRODUCTION

"This is the last straw," exclaimed Carl Jenkins. He slammed the phone in disgust as Kathy Jones' answering machine invited him to leave a message. His previous messages, left on Kathy's home and office answering machines had not been returned.

As former president and current member of the board of directors for the National Cancer Society (NCS), Carl was aware of the challenges and difficulties in keeping a volunteer organization afloat. However, he could not understand the apparent lack of interest in the organization or lack of desire to improve performance shown by the current president, Kathy Jones.

The newest problem on the horizon had prompted him to call one more time. NCS had received a delinquency notice from the State of Minnesota for its failure to file annual reports for the years 1999-2000. Severe monetary penalties would be imposed on NCS if the returns were not filed within 30 days. Carl's name was still listed as the contact person on the state's records so he really needed to reach Kathy to discuss this matter. Carl was a successful and respected businessman. He didn't like receiving such notices and was too conscientious to ignore them.

As he looked at the phone, he wondered how things had gotten to this point. He took a moment to reflect on the organization and review the time line of events leading to the current situation.

THE NATIONAL CANCER SOCIETY

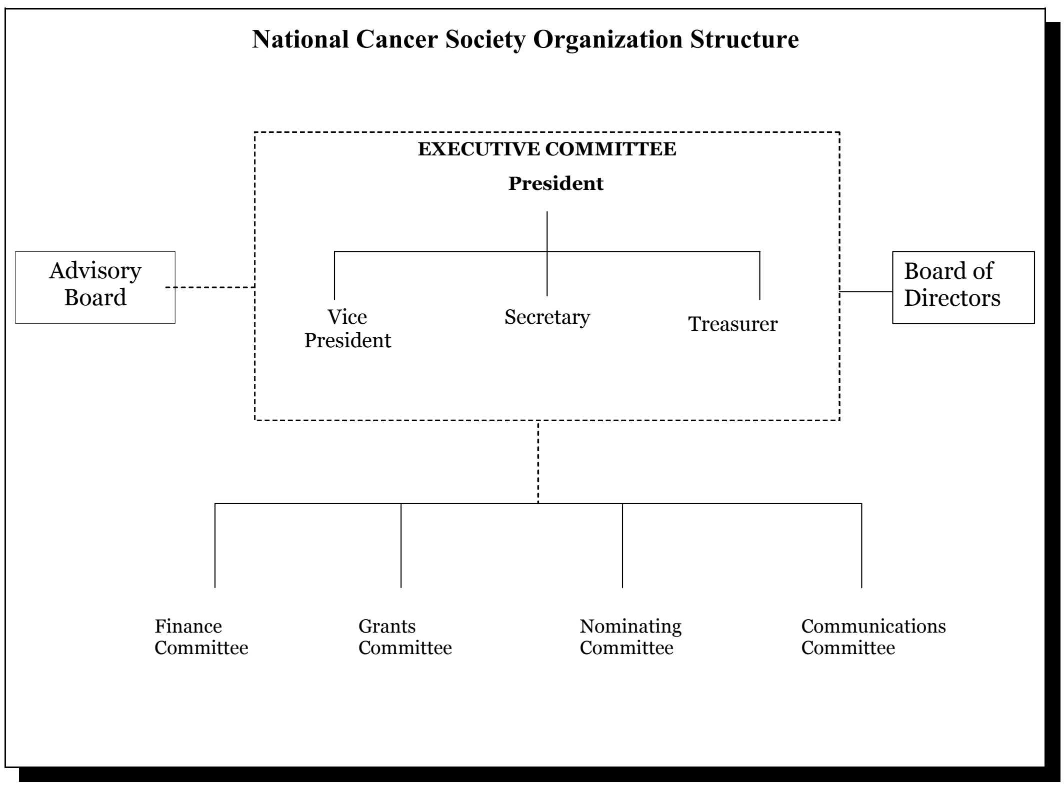
The National Cancer Society (NCS) was a non-profit organization founded in 1988 with a primary objective of supporting the fight against colon cancer and was loosely affiliated with a mainline Protestant church. NCS was incorporated in the State of Minnesota and was organized as a 501(c) (3) organization for tax purposes. NCS was a volunteer based organization; it did not have a formal place of business and instead used a post office box in Minneapolis to conduct its affairs (e.g., collect donations). NCS also had a prayer bay in a large local church that it used to provide a space for the families of both cancer patients and the deceased to gather and worship. These worship services were an integral part of NCS mission.

Mission

NCS had three main purposes. The first was to provide a book of remembrance with the names of those who had died from colon cancer. The second was to offer a monthly service in memory of these individuals who had died from the disease so that families and friends could attend and celebrate their lives. The reading of the names of selected deceased was an integral part of the service. The services were led by a member of the clergy and the ministerial committee was responsible for ensuring that a minister was available for the services. The third purpose was to provide grants to other organizations involved in providing ancillary services in the battle against colon cancer. Such grants are awarded on a one-time basis with a maximum grant of approximately $1,500. This was the limit imposed by the board of directors.

Organization

NCS adopted a formal charter that provided for a board of directors and an advisory board. The board of directors was supported by the finance, grants, ministerial and nomination committees. A copy of the organization chart is shown below.



The board of directors consisted of 12 members who were elected for three-year terms. Board members could be elected for additional terms and there was no limit on how long an individual might serve as a board member. To ensure continuity, the terms of the members were staggered so that no more than four positions were available each year. Board members had diverse skill sets (e.g., financial) to support the NCS mission. The NCS charter required that a board of directors' meeting be held on a monthly basis. Minutes were kept of each meeting to record all actions taken by the board of directors. See APPENDIX for general discussion of responsibilities of Boards of Directors of charities.

The advisory board had unlimited membership. Its members were former board members or members of the community, who wished to make a contribution to NCS, but could not or were unwilling to make the commitment necessary to be full board members. As the name suggests, the advisory board served an advisory role only and did not participate in the management of NCS.

The day-to-day business of NCS was governed by the executive committee (or officers) of the board of directors. The NCS charter provided that the executive committee included a President, a Vice President, a Secretary and a Treasurer. The President was responsible for managing NCS business affairs, supported by the Vice President. The Secretary maintained the organization records including its bylaws, resolutions and board minutes. The Treasurer was the chief financial officer for NCS and was responsible for maintaining accurate financial records, preparing periodic financial statements and regulatory reports, and for coordinating the annual budgeting process. The officers and all new board members were nominated by the nominating committee and elected at the annual meeting in March of each year. The officers were generally elected for a one-year renewable term.

The committees' roles were to review issues facing NCS and to recommend a course of action to the board of directors. Each committee was comprised of at least one board member along with other interested non-board members. Members were assigned to committees based on individual skills and the committees were not of equal size. For example, the finance committee had three members while the grants committee had six members.

Organization Activities

NCS relied on contributions received from the public for its funding. NCS did not advertise and so contributions were received on an ad-hoc basis. The donors generally donated funds on behalf of a loved one who had died of colon cancer. Funds were received through the post office box, an acknowledgment was sent to the donor by either the secretary or president, and the name was forwarded to the lithographer for inscription in the "book of remembrance." The funds were deposited in a NCS designated bank account which was maintained at a local bank. These funds were earmarked as NCS general fund and were used to complete its mission.

One of the many challenges NCS had faced was to obtain funds to complete the long delayed renovation of its prayer bay. Carl viewed this as his crowning achievements as President since he found creative ways to obtain the funds (classical concerts, fund raising dinner etc.). The funds were raised during the 1997-1998 time period. The income received from the events and the associated cost to renovate the bay was segregated from NCS general funds and maintained in a separate bank account. A copy of the NCS income statement for the years 1999 and 2000 (most recent years available) is included below. It should be noted that NCS currently has approximately $35,000 in its combined bank accounts.

NCS major expenses were the grants that it provided to other organizations involved in colon cancer care. Organizations requesting funding were provided with a standard grant application. Grant applications received were reviewed by the Grants Committee for completeness and consistency with the NCS mission. Funding recommendations (which identifies the organization and amount to be funded) were made to the Board of Directors for consideration at the next board meeting. The grant was then funded once board approval was received.

Disbursements were made from either the general account (regular expenses) or the special account (fund raising related expenses), and checks approved by any two members of the executive committee. NCS major non-grant expenses were the annual board retreat held in the summer and the annual holiday party in the winter. The most recent retreat cost approximately $500 which included the cost of a facilitator (to stimulate discussion between the board members) lunch, and refreshments.

As a non-profit organization, NCS was responsible for filing an information return with the Internal Revenue Service and an annual return with the State of Minnesota. The annual report ensured that the organization was fulfilling its fiduciary responsibilities. It categorized expenses between program and administrative to ensure that the funds received were used for their intended purpose, and was made available to the public on request.

VACANCIES TO FILL

In 1999, after more than a decade of working with the NCS and the push to fund the prayer bay, many founding members were simply exhausted and wanted to spend less time working with the organization. This meant that a number of vacancies were suddenly available on the board of directors, the advisory board and the various committees. The list of vacancies included a treasurer, secretary, finance committee member, grants committee members, and two board members. The most immediate need was to fill the open board vacancies especially the treasurer and secretary positions. The task of finding perspective members resided with the nominating committee.

Finding perspective members was a difficult task, especially since the individuals approached must also be willing to serve on the board. Two of the new board members were also expected to fill the treasurer and secretary positions as well, so they had to have the required skills. After a long search, perspective board members were identified and interviewed by at least two of the committee members. The goal was to ensure they had the proper qualifications, were willing to serve on the board and the executive committee, and were committed to the mission of the NCS. The field was narrowed to two candidates, one for each position. Resumes were provided to the other board members with a recommendation to accept the candidates for the open board and executive committee positions. These candidates were approved at the next board meeting.

Approximately six months later, the newly elected secretary resigned from the board because of other commitments. A new secretary was elected from the remaining board members and the board seat remained unfilled.

In the meantime, Carl was also getting restless. Carl was completing his third term as president of NCS and did not wish to seek re-election. Not only was Carl stepping down as president, he did not want to play an active role in the organization so he would not seek a board seat either. However, as a former board member and president, Carl could serve on the advisory board, and he agreed to do so. Carl was the person who generally obtained NCS mail from the post office and he agreed to continue to perform this role as well.

Carl's natural successor was his vice president, Kathy Jones. Kathy was one of the founding members of NCS and was actively involved in the organization for many years. Over the years, she served on a number of committees including nomination, grants and communication. In fact, she was currently the chair of the grants committee and an executive committee member.

Kathy's community involvement was far reaching. In fact, she was actively involved in a number of other organizations in addition to NCS and her time commitments were also increasing with a few of them. Some board members were therefore concerned about the amount of time that she could dedicate to the NCS and quietly expressed their reservations.

Before the next annual meeting of the NCS, the nominating committee prepared its slate of officers and new board members for consideration at the meeting. Among the nominees was Kathy Jones as president. At the annual meeting, additional board members expressed reservations on Kathy's ability to serve as president. Ralph the treasurer said "I am afraid for the future of NCS because Kathy is involved in too many organizations." Karen, a board member simply piped in "I agree." Sam, another board member was more direct: "Kathy is too busy to serve as NCS President and I will not vote for her." Vicki, a founding member of NCS said "Kathy has shown her dedication to NCS over many years and she deserves the chance to be president." After much discussion and prayer, the slate of candidates was accepted at the meeting and Kathy Jones became the new president of the NCS.

A NEW PRESIDENT

Kathy's first recommendation as president was to move the frequency of board meetings from its historical monthly basis to a quarterly basis. Since this would involve a change in the organization's bylaws, Kathy worked with the board's lawyer to affect the change. The rationale was to improve the efficiencies of meetings since the amount of new business that was brought to the board on a monthly basis was minimal. The recommendation was made to the board and accepted.

The NCS president's responsibilities include scheduling the board meetings and creating the agenda for such meetings. It did not take long before the quarterly meetings were not scheduled. Again, Kathy recommended that the formal meetings be changed to a semi-annual basis since the organization was in a maintenance mode, with very little new business. She suggested that ad hoc meetings would be held as necessary between the new meeting dates and e-mail and phone calls would be used to communicate important issues to the board. Reverend Smith, a board member, expressed the frustration of other members when he said "I know that we all have busy lives but I can't understand why it is so difficult for us to meet at least quarterly. I am afraid that the longer the gap is between meetings, the less likely we are to meet." In spite of this concern, the recommendation was made by Kathy and again accepted by the board.

A TIME FOR ACTION

In Kathy's first year as president, no board meetings or worship service were held and no grants were awarded. Fortunately, Carl continued to collect the mail from the post office, and the treasurer deposited funds received and balanced the books. NCS expenses incurred were paid by the treasurer with the checks signed by the former president (Carl) and the treasurer.

Carl's signature was not removed as an authorized signatory from NCS bank accounts upon the expiration of his term. This action was not taken because no request was ever made to the bank to change the authorized signatories on the account. The action should have been initiated by the president (Kathy Jones) with resolutions prepared by the secretary and approved by Kathy. The treasurer's term on the board had also expired and no election was made to elect a replacement. In fact, NCS checkbooks were still maintained by the treasurer who no longer lived in Minneapolis. However, the bank statements and invoices are received through the NCS post office box.

After approximately one year of inactivity, the president enthusiastically contacted the existing board members to gauge their interest in continuing to serve on the board. This was the first time some board members heard from the president in over a year. Her objective was to conduct a meeting in order to jump-start the organization and elect new officers and board members. Again, some of the board members had reservations about the wisdom of Kathy's presidency but decided to hold them until the actual meeting.

Carl hoped that the meeting would offer an opportunity to get NCS back on the right track. He was determined to use it to deal with the problem of un-filed annual reports and to get a change made in authorized signatories.

Call For Action

Assume that you are Carl or another concerned member of the board of directors:

♦ What expectations do you have for this meeting?
♦ What will you do to see that your expectations are met?
♦ What steps would you take to ensure the continuity of the organization? If these steps are not successful, should the organization be disbanded?
♦ What should be done with the remaining funds in NCS?
♦ How should the board respond to the delinquency notice from the State of Minnesota?

APPENDIX: A Guide for Board Members

From the Office of Minnesota Attorney General Mike Hatch

The Attorney General's Office has prepared this Guide for Board Members to help directors understand their responsibilities as stewards of their organizations. Under Minnesota law, directors of a Minnesota nonprofit corporation are responsible for the management of the business and affairs of the corporation. This does not mean that directors are required to manage the day to day activities of a corporation or to act in the role of an Executive Director. It does mean that directors must appoint officers and assign responsibilities to them so that the officers can effectively carry out the daily tasks of running the corporation. It also means that directors must supervise and direct the officers and govern the charity's efforts in carrying out its mission. In carrying out their responsibilities, the law imposes on directors the fiduciary duties of care, loyalty and obedience to the law. Minnesota courts have held that the law imposes the highest standard of integrity on the bearers of these duties.

This Guide is provided by the Minnesota Attorney General's Office to assist board members with the important responsibilities assumed when they volunteer their time. It is only a guide and is not meant to prescribe exactly how board members must act in all situations. Each organization possesses a distinct composition and experiences different circumstances and outcomes. This guide is merely provided as a reference tool and outline to assist directors in performing their duties..

Directors of Minnesota nonprofit corporations must discharge their duties in good faith, in a manner the director reasonably believes to be in the best interests of the corporation, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.

To Exercise the Proper Duty of Care:

1. *Active Participation*. A director must actively participate in the management of the organization including attending meetings of the board, evaluating reports, reading minutes, reviewing the performance and compensation of the Executive Director and so on. Persons who do not have the time to participate as required should not agree to be on the board.
2. *Committees.* Directors may establish committees having the authority of the board and may rely on information, opinions or reports of these committees. Committees operate subject to the direction and control of the board. As a result, directors are still responsible for the committees and should periodically scrutinize their work.
3. *Board Actions.* A director who is present at a meeting when an action is approved by the entire board is presumed to have agreed to the action unless the director objects to the meeting because it was not lawfully called or convened and doesn't participate in the meeting, or unless the director votes against the action or the director is prohibited from voting on the action because of a conflict of interest.
4. *Minutes of Meetings*. Written minutes should be taken at every board meeting. The minutes should accurately reflect board discussions as well as actions taken at meetings.
5. *Books and Records.* A director should have general knowledge of the books and records of the organization as well as its general operation. The organization's articles, bylaws, accounting records, voting agreements and minutes must be made available to members and directors who wish to inspect them for a proper purpose.
6. *Accurate Record Keeping*. A director should not only be familiar with the content of the books and records, but should also assure that the organization's records and accounts are accurate. This may mean the director must take steps to require regular audits by an independent certified public accountant. At the very least, the director should be aware of what the financial records disclose and take appropriate action to make sure there are proper internal controls.
7. *Trust Property*. A director has the duty to protect, preserve, invest and manage the corporation's property and to do so consistent with donor restrictions and legal requirements. Instituting proper internal controls will aid in the protection of assets.
8. *Resources*. A director must assist the organization in obtaining adequate resources to enable it to further its charitable mission.
9. *Charitable Trusts.* A trustee of a charitable trust has a higher standard of care than a director of a nonprofit corporation. A trustee has the duty to exercise the care an ordinary person would employ in dealing with that person's own property. A trustee with a greater level of skill must use that higher skill in carrying out the trustee's duties.
10. *Investigations.* A director has a duty to investigate warnings or reports of officer or employee theft or mismanagement. In some situations a director may have to report misconduct to the appropriate authorities, such as the police or the Attorney General. Where appropriate, a director should consult an attorney or other professional for assistance.

Traditionally, directors have an absolute duty of complete, undivided loyalty to the organization. This means that directors should avoid using their position or the organization's assets in a way which would result in pecuniary or monetary gain for them or for any member of their family. A director should put the good of the organization first and avoid engaging in transactions with the organization from which the director will benefit.

To Exercise the Duty of Loyalty:

1. *Conflicts of Interest*. Under certain circumstances, a contract or transaction between a nonprofit corporation and its director or an organization in which the director has a material financial interest is acceptable. However, if the transaction is challenged, the director will have the burden of establishing that the contract or transaction was fair and reasonable, that there was full disclosure of the conflict and that the contract or transaction was approved by members or other directors in good faith.
2. *Written Policy*. Boards should establish a written policy on avoiding conflicts of interest.
3. *Loans*. A nonprofit corporation may not lend money to a director or the director's family members unless the loan or guarantee may reasonably be expected, in the judgment of the entire board, to benefit the corporation.
4. *Charitable Trust*. In charitable trusts, transactions which otherwise might constitute a conflict of interest are permissible if the conflict was clearly contemplated and allowed by the original settlor of the trust.
5. *Corporate Opportunity*. Directors of business organizations are under a fiduciary obligation not to divert a corporate business opportunity for their personal gain. A director of a nonprofit corporation is also subject to this duty. This duty means that a director may not engage in or benefit from a business opportunity that is available to and suitable for the corporation unless the corporation decides not to engage in the business opportunity and conflicts of interest procedures are followed.
6. *Internal Revenue Code*. Other prohibitions relating to the duty of loyalty are specified in the rules of the Internal Revenue Code regarding self-dealing. These rules apply to private foundations.

Directors have a duty to follow the organization's governing documents (articles of incorporation and bylaws), to carry out the organization's mission and to assure that funds are used for lawful purposes. Also, directors must comply with state and federal laws that relate to the organization and the way in which it conducts its business.

To Exercise The Duty of Obedience:

1. *State and Federal Statutes.* Directors should be familiar with state and federal statutes and laws relating to nonprofit corporations, charitable solicitations, sales and use taxes, FICA and income tax withholding, and unemployment and workers' compensation obligations. They should also be familiar with the requirements of the Internal Revenue Service. Directors should see to it that their organization's status with state and federal agencies is protected.
2. *Filing Requirements.* Directors must comply with deadlines for tax and financial reporting, for registering with the Attorney General, for making social security payments, for income tax withholding, and so on. Additionally, if an organization is incorporated under the Minnesota Nonprofit Corporation Act, its directors have a duty to maintain its corporate status by submitting timely filings to the Secretary of State's Office.
3. *Governing Documents.* Directors should be familiar with their organization's governing documents and should follow the provisions of those documents. Directors should be sure proper notice is given for meetings, that regular meetings are held, that directors are properly appointed and that the organization's mission is being accomplished.
4. *Outside Help*. Where appropriate, directors should obtain opinions of legal counsel or accountants

Source: www.ag.state.mn.us/charities/charDuties.html