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LETTER FROM THE EDITORS

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

The Instructors' Notes contained in this volume have been double blind refereed with their corresponding cases. Each case for which there is an Instructors' Note contained herein has been previously published in an issue of the *Journal of the International Academy for Case Studies*. Each case was required to have a complete teaching note before consideration. The acceptance rate for manuscripts in this issue, 25%, conforms to our editorial policies. This publication also conforms to the AACSB requirements to publish case notes which are considered by that body to be of more academic value than the case itself.

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 should 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

CASE NOTES

THE MILTON HEALTH AND REHABILITATION CENTER

Robert C. Schwab, Andrews University

CASE DESCRIPTION

This short case focuses on the problems of mixing religious values with a secular work environment. Fairness issues dealing with freedom of expression and prayer in the workplace, religious intimidation, discrimination and harassment are raised. The case has a difficulty level of four, and is best-suited for use in junior, senior, or graduate-level courses in human resource management or organizational behavior. This case can be presented and discussed in about one and a half hours, and is expected to require two to three hours of outside preparation by students.

CASE SYNOPSIS

This case is set in a private mid-western rehabilitation center. The new owner has implemented an operating philosophy based on Biblical principles, and the born-again assistant administrator now begins all staff meetings with prayer. The situation is exacerbated when the assistant administrator persists in inviting staff to attend evangelistic meetings at his church. A few workers are concerned about this new imposition of religion in the workplace, and become more alarmed when they discover that the highest raises have been given to workers who attended some of the evangelistic meetings and who regularly volunteer to pray at the staff meetings. After an employee quits and files a complaint with the Michigan Department of Civil Rights, an investigation discovers that a couple of workers have felt somewhat annoyed, while the majority at the center feel the working environment has never been better. Are the new owner's religious values appropriately expressed and displayed at work, or has the work environment become one of religious discrimination, harassment and intimidation?

INSTRUCTORS' NOTES

This case raises issues of religious expression, fairness, discrimination, intimidation and harassment in the workplace. Ask your students to read the case carefully and prepare answers to the discussion questions, or assign them into small groups and ask them to make specific recommendations to Mr. Southington. As you discuss the case, try to keep the class focused on both the legal and practical issues that must be resolved at the Milton Health and Rehabilitation Center. Expect lively class debates and differences of opinion.

DISCUSSION QUESTIONS

- 1. Is it acceptable or inappropriate for Mr. Southington to impose his conservative values and religion-based business philosophy on the operations of the Milton Health and Rehabilitation Center?**

When corporate ownership changes, new policies, procedures and work rules can be expected, unless there is a union contract in place. There will be a variety of opinions expressed by the class, but it appears that Mr. Southington did nothing inappropriate when he held his initial meeting with the staff. He offered to retain all workers if they felt comfortable with his new management expectations at the center, and if they were not, they were free to leave the organization and seek employment elsewhere. He revealed his intention to apply Bible-based values and the Golden Rule as guiding business principles at the rehabilitation center. Mr. Southington's new business principles are general enough that most people would not see this as an imposition of religion in the workplace. He didn't tell the staff they had to pray or to start going to church. His values (the Golden Rule) imply that the staff should go out of their way to treat everyone with respect, and to deal with others as we would wish to be dealt with if we were in their position. This principle is not unique to Christianity, and even atheists and post-modern secularists would say this is a courteous practice to follow. Swearing, crude remarks, and smoking are impositions which frequently make others uncomfortable, so banning these actions should enhance the work atmosphere and make the patients and staff feel more comfortable. Drunkenness and smoking are dangerous activities which jeopardize the safety and health of patients and coworkers. Many secular organizations ban these practices on their premises and discipline those who do not comply. Finally, worker appearance and demeanor are often formalized by dress and behavior requirements spelled out in the corporate handbook or employee manual. This is often necessary in order to maintain a consistent image of corporate professionalism. Mr. Southington wanted his staff to appear and behave conservatively while on the job. He did not ask them to practice religion but to simply follow the new job requirements and expectations.

He still needs to formalize these job expectations by listing them in the company handbook and making appropriate references to these expectations in performance appraisals and job descriptions. These job expectations must be clearly revealed to all new employees and prospective applicants, perhaps through some training sessions or orientation meetings or videos.

- 2. Is Mr. Bush's conduct acceptable or inappropriate in this work setting? Has he created a climate of religious intimidation and harassment at the center? Explain.**

Once again, the class will have a lively debate over whether Mr. Bush has gone too far in his zeal to implement “Bible-based values” at the rehabilitation center. It seems appropriate to urge the staff to treat the patients with respect, or to do what you can to make them feel comfortable; but it’s something else to require the staff to pray with the patients or to pray in staff meetings. Is the new practice of prayer at the beginning of staff meetings an inappropriate religious practice at the center?

Mr. Bush frequently offers the opening prayer himself or asks whether others are willing to volunteer, but he has never forced anyone to offer prayer. A few employees feel uncomfortable with the idea of a formal prayer at the beginning of each staff meeting, even if someone else does the praying. Mr. Bush is well-meaning and zealous to promote his belief in and worship of God, but he is using his position in the organization to impose a form of religion or worship on others that appears to be a violation of the Civil Rights Act of 1964. Corporate prayer cannot be mandated in a work setting unless the organization itself is inherently religious. If the rehabilitation center was owned and operated by the Catholic church, corporate prayer could be held for all workers without question because being Catholic and following appropriate religious rituals could be a “business necessity” for all workers in the facility. However, the freedom of a religious organization to practice its religion in the workplace does not extend to privately-owned nursing homes. In a recent federal court case, nursing home workers received “hostile work environment” damage awards because they were subjected to deliberate and repeated acts of religious intimidation and harassment (see *EEOC v Preferred Management Corp*, 2002). The harassment and intimidation included required attendance at meetings where religious matters were discussed, and the imposition of disciplinary actions for failure to attend and participate in religiously-focused activities (including prayers) which were required by the zealous Christian owner. We can also learn something about required public prayers from rulings which have impacted the public schools. In general, prayer may still be allowed at events like football games, but school officials are not permitted to lead out in such activities. Coaches and teachers can be present, but they cannot organize or participate in prayer sessions...it must be initiated and conducted by the students on a voluntary/spontaneous basis.

More possible evidence of unintentional intimidation or harassment can be found when Mr. Brown solicited the workers to attend the evangelistic meetings at his church. He did not appear to be resentful or obnoxious when no one wanted to attend the evangelistic meetings, but he did remind everyone of what a blessing they were missing. He obviously enjoyed the meetings and probably felt it was his moral duty to try to convince the others to attend. He was very kind and sincere in all his requests, but he was also persistent. This persistence was what seemed to bother Sarah and the other two anonymous individuals interviewed by the MDCR. As one said, “When I say no thanks, I don’t want to be bothered

about it again. So why doesn't Mr. Bush get the hint...no means NO!" Once a worker indicates s/he isn't interested in attending the religious meetings, Mr. Bush should stop. If he doesn't, he is probably guilty of religious harassment. This is the same standard that is applied to cases of sexual harassment. When the victim says no, and the aggressor stops immediately, no harm is done; but if s/he persists or continues, a pattern of harassment has been established. Trying to convert others to your religious way of thinking is called proselytizing, and religious people often persist because they feel someone's eternal soul is at stake. Unfortunately, this persistence creates an intimidating environment, and the courts have not viewed this activity in a favorable light (see *Venters v City of Delphi*, 1997).

Religious harassment isn't only a quid-pro-quo pattern (if you go to church with me, I'll stop bothering you, or I'll do something nice for you), there is also the possibility that the work environment itself is intimidating. One might not even be the object of the pressure, yet this ominous environment can cause mental anxiety and harm to others. This form of harassment (a hostile work environment) was probably perceived by Sarah even though Mr. Bush didn't intend to pressure her further. His exuberant pronouncements to her and others that "...last night's meeting was a real blessing," implies that you should go tonight and get what I think you need to turn your life around. Most experts would say that a hostile work environment is not necessarily what an objective, third-party would see by examining the situation, but rather what the "victim" perceives in his/her mind. This "environmental intimidation" form of harassment is much more difficult to find and eradicate in the workplace.

The courts are not suggesting that religious conversations be banned in the workplace, but simply that both parties must agree to hold such a conversation. This was clearly the case between Mr. Bush and Sylvia Smith. There is no harassment or intimidation unless one party wishes to stop while the other person persists. In fairness to Mr. Bush, one of the anonymous complainers indicated that they said..."No thanks, I don't want to talk about religious things today." This seems to imply that maybe tomorrow they would be willing to resume the conversation with Mr. Bush. It is important that a very clear "stop" needs to be communicated to Mr. Bush. If he persists after that, he would clearly be guilty of religious harassment.

One final point should be made; Mr. Bush does have the right to express his religious views privately to others in the workplace as long as the conversations are mutually agreed to. He has obvious religious beliefs and under the Civil Rights Act of 1964, the organization may be obligated to accommodate his religious views and practices within reason, provided the cost of doing so is minimal (see *Trans World Airlines v Hardison*, 1977). In another federal case, an employer tried to dismiss a born-again Christian because they claimed his religious activities and public expressions of Christian "good wishes" were offensive to the other workers. The courts did not find that others took offense with his private behaviors

and furthermore felt the organization had not attempted to find ways in which his Christian zeal could be legitimately accommodated in the workplace. He won his case and was reinstated (see *Brown v. Polk County, Iowa*, 1995).

In summary, while most of the workers at the rehabilitation center have no problem with Mr Bush's religious conversations and prayers, the fact that a few people are feeling intimidated should not be brushed aside. There is no evidence that Mr. Bush deliberately discriminated against those who do not share his religious philosophy, but others might still perceive the work environment as intimidating. If these persons can prove that they have been injured or harmed in some way because of their resistance to the religious practices at the center, they may be able to collect damages under the Civil Rights Act of 1964.

3. What do you think the Michigan Department of Civil Rights will conclude? Is Sarah Roberts entitled to any damages or relief? Defend your position.

In order to establish a prima facie case of religious discrimination, one of the things that must be shown is that the employee was harmed or injured because of refusal to comply with some employment requirement that conflicts with one's religious views. We also know that religious harassment can be argued if one party persists in forcing religion onto another, contrary to their will. According to Sarah, she feels she has been harassed because Mr. Bush has not stopped asking her to pray, nor has he ceased to invite her and others to his church. She apparently told him NO on at least one occasion, but she keeps hearing him talk about how wonderful the meetings are and how everyone should really try to go so they can "...find the love of Christ that can transform your life." Furthermore, she feels he is looking in her direction when he asks for volunteers to pray at the staff meetings. While Mr. Bush's subsequent comments and actions may not have been aimed at Sarah, the fact that he continued to express these religious ideas publicly, within her earshot, may be contributing to her perception of an intimidating or hostile work environment. A harassing or hostile environment is determined not so much by what other people think is going on, but by what the employee perceives. While some may say Sarah is simply paranoid or is suffering from a guilty conscience, if she really has developed a nervous condition due to the stress she feels at work, she could possibly be entitled to compensatory damages.

If as Mr. Southington implied, there is no evidence of religious discrimination against Sarah on her performance appraisals, and no proof that Mr. Bush judges people on anything other than their performance and qualifications, it will be difficult for Sarah to win compensatory damages because there is no proof that she was harmed or injured because of her religious beliefs (or lack of them). Unless she has a doctor's testimony that she has suffered mentally and physically as a result of the stress caused by Mr. Bush's occasional requests for prayer or offers to attend religious meetings, she has not suffered any damages.

The Michigan Department of Civil Rights will likely warn the rehabilitation center that some of Mr. Bush's practices are over the line, but there is no evidence of malicious intent to harm Sarah or anyone else, and they will probably be content if the objectionable behavior just ceases in the future.

4. What specific advice would you give to Mr. Southington if he wishes to avoid or minimize future claims of religious discrimination or harassment at the Milton Center?

Mr. Southington has not provided Mr. Bush with a clear list of "do's and don'ts" in his role as an assistant administrator. He needs to counsel with Mr. Bush and explain to him that his well-meaning behavior on the job is putting the center in legal jeopardy. Prayer can be encouraged among the staff, but it should probably be the private, discretionary kind. Staff meetings need to omit the public prayer, and Mr. Bush should stop using his staff meetings to make appeals to attend his church or evangelistic meetings. He can continue to talk with employees privately about religious matters and his "...walk with the Lord," but he also needs to be quick to back off if the person indicates that they would prefer that the conversation not continue. Mr. Bush should be commended for his objectivity and fairness in the selection and evaluation process, but reminded that some staff may suspect his religious views may cause bias, so he must continue to demonstrate fairness and transparency in all employee-related decisions.

REFERENCES

Brown v. Polk County, Iowa, 61 F.3d 650; (1995). U.S. App LEXIS 20184.

EEOC v. Preferred Management Corp, 216 F. Supp.2d 963; (2002). U.S. Dist LEXIS 3495.

Trans World Airlines v. Hardison, 432 U.S. 63, 97 S.Ct 2264; (1977).

Venters v. City of Delphi & Larry Ives, 123 F 3d 956; (1997). U.S. App LEXIS 20184.

INNOVATION IN EMPLOYER HEALTH COVERAGE: THE CONSUMER DRIVEN HEALTH PLAN (CDHP) AT LOGAN ALUMINUM

Robert D. Hatfield, Western Kentucky University

CASE DESCRIPTION

The primary subject matter of this case concerns a particular emerging innovation in employee health care coverage called Consumer Driven Health Plans (CDHP). Secondary issues examined include issues related to healthcare costs increases in the U.S. and other developed nations. The reactions to these healthcare costs increases are categorized, defined, and illustrated. It becomes clear from the case that they may be no easy answer to rising healthcare costs. Further, issues related to employee involvement and the strategic fit between CDHP and involved employees is explored.

The case has a difficulty level of three, appropriate for junior level or above. The case is designed to be taught in one class hour after at least one hour has been spent surveying existing approaches being used by employers to provide health care insurance coverage such as HMOs, PPOs, and POS plans. The case is expected to require one hour of preparation by students.

CASE SYNOPSIS

Healthcare costs are soaring in the U.S. and in other developed nations. The model used in the U.S. is that the government provides healthcare insurance for the poor and for senior citizens, while employers traditionally provide healthcare coverage for employees. Employers and government have tried approaches to containing the costs of healthcare insurance while still providing coverage. The government created the "health maintenance organizations" (HMOs) and the marketplace created "point-of-service" (POS) and "preferred provider organization" (PPO) plan designs. Managed care approaches were introduced into virtually all plans in an attempt to control runaway costs in recent years. Some feel that the a "free ride" approach causes consumers of healthcare to have no financial stake in the costs of health services which, in turn, makes such costs hard to control.

Consumer driven health plans (CDHPs) have emerged as plans designed to get the consumer to take a normal consumer interest in the cost and quality of healthcare service. CDHPs must have two elements: some type of medical spending account and high deductible healthcare coverage insurance. Logan Aluminum manufacturing company provides a graphic illustration of the positive elements of a CDHP with lots of additional plan elements, such a wellness, financial incentives, and

free health services. Since Logan has implemented the CDHP healthcare costs have not seen the huge increases seen in the U.S. The fact that Logan uses participative management and team approaches in other areas of its operation is seen as helping to get participation and teamwork on solving the healthcare cost problems.

INSTRUCTORS' NOTES

RECOMMENDATIONS FOR TEACHING APPROACHES

The special aspect of this case is that it presents a novel approach to a well-known problem involving healthcare costs. It also brings realistic details to help the student understand the abstract concepts and acronyms associated with these issues.

The primary goal is for the student to understand what is considered a consumer driven healthcare plan (CDHP). The secondary goal is for the student to be able to place this innovation within the mix of other standard healthcare plans. Further, it is useful for the student to see the broader policy, social, and political implications. The fit between being consumer driven and being an empowered employee is also an interesting relationship that is illustrated by the Logan case.

The standard case approach will accomplish these goals. Assign the case as homework, and then have the student teams answer the questions. Open class discussion based upon the answers of the teams. Finally, update the case with the information on results found in the epilogue found here in the instructors' notes.

If the course includes a unit on types of healthcare plans (e.g. POS, HMO, and PPO) then this case would be a good way to demonstrate how innovation can modify these "standard" approaches. If the course only approaches the topic of healthcare plans offered by employers in a broad way, then this case will provide just enough information about the plan types to allow learning and discussion.

There are a number of short videos provided by publishers and/or available commercially. I recently used a 10 minute clip titled "Crisis in Healthcare" that would provide a good set-up for this case. Spring boarding off of a video on healthcare is a good way to bring in students of varying learning styles.

There are a number of topics in this case that would be worthy of a short (or long) research paper. The articles in the References section provide an example of the amount of academic and other information available. While students may not be able to write a long research paper on CDHP they certainly can write a multitude of topics surrounding healthcare issues in the U.S. and around the world.

In a course stressing international dimensions of organizations students could choose countries or regions of the world and research how healthcare insurance and/or coverage is handled in the chosen countries or regions.

I have brought guest speakers into class to discuss these issues. I have used guest speakers from the universities own HRM department and from the private sector.

This case will allow you to spend as little as an hour or as much time as a unit might take in your course. It will work for junior level students on up through graduate classes. It has traction in business, sociology, political science, psychology, medical fields, public sector, and other content and industry domains.

QUESTIONS FOR TEACHING THE CASE

1. Why are healthcare costs increasing faster than inflation in the U.S. and other developed nations?

The case points out that prescription drug costs are rising sharply in the U.S., Canada, and in European nations such as Italy. Advances in the effectiveness of pharmacology, competition between pharmaceutical companies leading to heavy advertising, and research and development costs are all part of the high costs of drugs. Students may think of other reasons.

However, healthcare costs also include the costs associated with doctors, hospitals, medical hardware and other diagnostic tools, improvement in technologies, legal and insurance coverages for healthcare professionals, billing and records, and complying with regulations. Patients in developed nations continue to demand and expect higher and higher levels of healthcare.

2. What are the types of healthcare insurance approaches used currently in the U.S. and how are they different?

This is sometimes referred to as the “alphabet soup” of healthcare insurance plans. Students need to understand the playing field to recognize the innovation revealed in this case of CDHP.

The oldest active plan is the point-of-service plan (POS). This is much like the comprehensive coverage students may have in their car insurance plan. The out-of-pocket expenses to the patient are a deductible, a co-payment (often 20%). POS plans allow the covered person to use any provider or doctor as long as the fee is “reasonable and customary” (which means some of those who charge the most for their services are a problem for the patient since the insurance will not pay abnormally high prices) and is an

approved medical procedure (which can be a problem when a therapy or procedure is “experimental”). An attractive aspect of POS plans is that they allow the patient to pick his/her own “point of service” – that is, they can pick whatever doctor or provider they wish.

This is in contrast to the health maintenance organization (HMO). HMOs have come under attack in the past few years because of publicized cases where managed care professionals at the HMO failed to “authorize” or pay for certain procedures. However, it is sometimes enlightening for the student to realize that this “bad-boy” insurance approach is the only one that is directly from the government. The HMO act of 1972 set this plan up to manage the high costs of healthcare. HMOs must encourage preventative and diagnostic care (like “well baby” and annual check-ups) that POS plans used to refuse to cover. It is notable that it will not pay a provider who is outside a predefined list of “in-network” providers. The rare exception is that it may pay for a specialist when no such specialist is provided within the network.

The preferred provider organizations (PPO) really developed as a reaction to a) the HMOs inability to pay “out-of-network” providers and b) the mergers among large healthcare providers and insurance companies. The main distinction of a PPO is that it only “prefers” its own “in-network” providers by paying more to them (often 80%). It still will pay, unlike an HMO, to providers “out-of-network”. Since it doesn’t “prefer” them, it generally pays less (perhaps 50%). Since PPOs and POSs aren’t under specific insurance regulation the plan details of these two types of plans can vary. For instance, many POS plans now pay for “well baby” visits where the baby has not symptoms of illness.

3. Whose responsibility is it to provide healthcare?

This is a question that is hotly debated in political and other circles. The U.S. model is that the federal government provides coverage to those 65 and above in age (Medicare) and states provide coverage to those below a certain line of poverty (Medicaid). Some estimate that the government’s share of coverage amounts to about one-third of all Americans once you combine Medicare, Medicaid, and the insurance that U.S. governments provide to their employees.

The rest of the nation relies primarily upon private employers for their group healthcare coverage. Small percentages buy individual coverage or join a group or association to facilitate group coverage (thereby spreading the risk).

There are different explanation reasons offered to explain why the U.S. ended up with the employer model rather than the governmental model. One reason is an aversion to “socialistic” solutions. The historical underpinnings of the U.S. suggest a distrust of large central governments and associated totalitarian measures. “Socialized medicine” has served as a pejorative slur used to limit the entrance of the government into healthcare. Employer

healthcare programs precede the movement to more socialistic or governmental approaches. This means that employers were using healthcare coverage as a recruiting and retention tool before the nation had an appetite for federal social welfare programs (like those in the “Great Society” in the 1960’s). The free-market approach in the U.S. may also explain the employer model. Innovations (like the one in this case) and adjustments occur faster and more often in the free market. If one employer has superior insurance coverage a competing employer may copy or “up the ante” by offering a better compensation package.

Students should be able to argue that spreading the risk across the whole nation and exercising pricing pressure might work in the U.S. This case mentions the case of Canada where things are not as rosy as they once were in that government-model program. There are problems in Europe as well. At least in abstract, spreading the risk and exercising controls at the level of the nation seems appealing if the goal is simply that everyone should be covered.

Lively debate can be prompted here – Canadian model vs. U.S. model. Listing the pros and cons of each would be an interesting approach to take.

4. What is a consumer driven health plan (CDHP) and why does it include the word “consumer”?

The case states that a CDHP needs only two features: a) a medical spending account of some type, and b) a high-deductible insurance plan. In the Logan case, each family is allotted \$800 worth of healthcare expenses. This means that the employee can spend up to \$800 on healthcare without being out-of-pocket. Students should realize that this was not originally cash, but rather an “account” from which Logan paid directly to healthcare providers. Employers using CDHPs will normally handle and fund these medical spending accounts themselves. The CDHP employer will contact a medical insurance company to write a policy only for the high-deductible plan aspect. For instance, Logan uses a company to insure its employees for healthcare after a \$2,000 deductible is satisfied (or Logan might self-insure this aspect).

Employers can create whatever gap they wish between what the medical spending account will pay and what the high-deductible plan will pay. In the Logan example the gap for family coverage is between the \$800 in the spending account and the \$2,000 deductible insurance. Therefore the gap is \$1,200 for Logan families. Sometimes these are called “bridge” plans because the employee has to bridge the difference between the two coverages. Plans can have small or large gaps and still be considered CDHPs.

It would be interesting to discover whether any student is currently under any type of plan that might be considered a CDHP.

“Consumer” refers to the type of behavior that the employer wants employees to engage in when dealing with healthcare. Consumers shop, are aware of prices, are aware of quality requirements, gather information, and then make the best decision they can make. In governmental models and in the POS, HMO, and PPO models, the only entity with a consumer interest seems to be the insurance companies. The patient seems to have no stake in the cost. The consumer-driven approach would re-attach the patient and employee to the decisions surrounding the cost and quality of healthcare. The idea is that if the consumer cared what things cost, and could compare the cost and quality of alternatives, then better decisions would be made. The hope is also that the real consumer, the patient, would put pressure on the healthcare providers to offer high quality but reasonably priced medical choices.

5. **Students are left with a question at the end of the case. “Observers wonder if the benefits in the first year can be repeated in the second year, or whether the first year may have merely squeezed out some efficiencies that caused a temporary effect.” What do you believe happened in the second year – did the savings continue or was the effect just a short-term effect? Why did the benefits continue or not continue at Logan in the second year?**

The epilogue provides additional information that updates the case. It provides the details of the savings in the first year (which is mentioned briefly twice near the end of the case). Here’s what the update in the epilogue reveals.

There was almost a 5% decrease in costs in year one (2003) at a time when the rest of the nation was experiencing at least a 13% increase.

Costs in year two were either stable or up only 1%. This is remarkable since the beginning of the case points out that increases in healthcare costs have been in double-digits for each of the past four years. This means that an increase in a give year of something like 5% would actually be a “savings”. However, Logan actually reduced spending in year one and held it even in year two. This is a real savings of over 23+%.

The “why” question is complex. Advocates for consumer-driven programs focus upon the consumer. An engaged consumer exercising discretion and informed choice should be expected to make wiser choices. The most common illustration is switching to generic drugs rather than paying the higher prices of “brand” drugs. There are also different kinds of MRIs. The more pleasant ones (“open” machinery rather than closed “closed” tube style) cost more. Both do the job equally well. The informed choice would be selecting the alternative that a) meets the quality requirements necessary and b) provides the best price.

Another “consumer” or free market outcome can be that the market may adapt to meet this “informed choice” demand by a) making it easier to discover the quality of its services and b) making the price easier to obtain.

Opponents of CDHP say that employees are simply neglecting their health to keep from paying the “bridge” amount. Information in the epilogue indicates that there was no statistically significant change in visiting the doctor in year one (2003). Employees went to the doctor about the same amount. However, employees went to the emergency room less. Managed care and other cost control approaches have frequently focused upon the emergency room since it seems to be the most misused medical service. People routinely go to the emergency room, where costs are very high, when they could have simply visited their own doctor. If you have no stake in the costs, what do you care if the emergency room costs three times the cost of an average doctor’s visit? At Logan, the numbers seem to indicate a more informed and wiser choice in relation to the use of the emergency room.

The whole area of wellness and the preventative care benefits at Logan surely have an impact. Logan partners/employees are focused upon their health, the costs associated with healthcare, and are being counseled on how to improve their health. Since the average age of Logan partners/employees is 43 we cannot assume that only the young and healthy work at Logan. However, some would argue that the big savings are really found in the wellness and the improving fitness of Logan partners/employees.

ASSIGNMENTS AND TEACHING METHODOLOGIES

1. The standard approach of reading the case, discussing the questions in a student group, and then sharing the analyses of the various groups will work very well. I have used this case in class and it can stimulate some interesting discussions.
2. DEBATES:

An alternative is to have the students read the case, then divide the class into a “pro-CDHP” team and an “anti-CDHP” team and have a debate. This is a good way to get the pros and cons out into class discussion. Introducing the epilogue information would be a good way to take the debate up “another notch”.

A variation on the pros-cons debate is to assign a team to sell and defend the four different types of healthcare plans in the U.S.: POS, HMO, PPO, and CDHP. Teams could start by saying “The plan detail that makes this the best overall approach is...” For instance the most attractive plan detail for POS is unlimited choice of healthcare providers; for HMO is the emphasis on preventative care often not found in other plans; for PPO is that it will pay out-of-network providers; for CDHP it seems to create savings and emphasizes choice.

A major debate is whether the U.S. should move from an employer-based healthcare insurance model to more of a government-based model. Require the teams to explain why the opposing model has flaws – why it does not work well (e.g. why are the government-based approaches having trouble or why is there a crisis, if there is, with the current employer-based approach?).

This could be turned on its ear if students had additional information about either the Canadian or European models that feature the government-based approach. Then the debate between models could be whether Canada or a European country should return to an employer-based model.

3. Homework assignments could include asking students to find out what healthcare they are under (if they are working) or what healthcare plan a family member might be under. As the student to categorize the plan within the “alphabet soup” of plan types: POS, HMO, PPO, and CDHP. Make sure the categorization is correct. It is worth noting that some plans are really a mix since only the HMO has legally required elements.

Another homework assignment is to have students find a copy of a healthcare insurance plan on the Internet, at their workplace, or from a family member. Reading all of the provisions gives the student insight on how complex any insurance plan can be.

4. Initiate the case by spring boarding off of a video or news snippet found online concerning healthcare costs.
5. Have students bring in news items over several class periods concerning problems relating to healthcare costs and insurance. Have each student give the news worthy aspect of the news item and relate that item to the case.

EPILOGUE

Year One: In 2003, the first year Logan used the CDHP model, company costs actually declined compared to 2002. There was a net cost reduction of 4.6 percent compared to 2002. These numbers are particularly impressive since it reverses the national trend of 13-14 percent of expected healthcare cost increases for 2003. These 2003 costs were about a million dollars less than expected had Logan not changed plan designs and continued the wellness focus.

In addition, prescription drug costs have been impacted by this plan that promotes "employee consumerism". In 2002, Logan had changed its prescription drug plan design to the extent it encouraged employees to choose either generic drugs or preferred brand drugs. Drug costs declined by nearly 6 percent in 2002 and by another 5 percent in 2003, the first year of the CDHP. Prescription drug savings amount to more than a half million dollars in 2002 and 2003, when

inflation is considered. Logan attributes the savings to employees being wise consumers and talking more about prescriptions and therapies to their doctor. Anecdotal evidence from area doctors reveals that Logan employees and dependents are asking more questions about treatment options and drug alternatives than ever before. This is the consumer behavior hoped for in CDHPs.

Year Two: In 2004 overall costs were up slightly, but by less than one percent. Medical and drug costs were nearly flat in 2004 compared to 2003. This amounted to another significant savings for Logan, since the increases nationally for healthcare was in the double digits for most plan designs.

One objection that is frequently voiced by opponents of the consumer directed healthcare model is that people will avoid medical care and fail to get needed medical attention in an effort to conserve their health care spending account dollars. The 2003 results at Logan do not seem to support that argument. While doctor's office visits and emergency room visits were down slightly in 2003 compared to 2002, the change was not statistically significant. Hospital days of care stayed about the same in 2003 as 2002, but the average length of stay declined in 2003 compared to 2002. On the other hand, there was a significant change in the number of out patient surgeries. Out patient surgeries fell by a double-digit percentage. There was also a positive trend of not going to the emergency room for non-emergencies and visiting urgent care clinics or their family doctors. This behavior is more appropriate as well as a wise consumer financial decision.

Another result of the changes that made at Logan is the national attention it is receiving. In February, 2004, Logan testified before the Joint Economic Committee of the U.S. Congress. Logan has also been featured in several major newspapers, including USA Today and the Chicago Tribune. Several magazine articles and radio shows have discussed the innovations at Logan Aluminum. The attention has generated a lot of calls from employers who are considering changes to their plan design.

Are employers ready to attempt to design an integrated approach to containing healthcare costs using the CDHP model? When asked about the likelihood of offering a high-deductible plan with a savings arrangement within the next two years, firms employing 13 percent of the covered workforce indicated that the firm is "very likely" to offer an HRA-type plan in the next two years; firms employing 26 percent of covered workers reported that they are "somewhat likely" to do so (Gabel, 2004). This level of interest, particularly among the largest firms, suggests that these arrangements could grow considerably in the near future. The case of Logan Aluminum may provide some excellent insight into CDHP design and integration with wellness and incentives as well as aspects of HR and general management.

IS THIS A BONA FIDE OCCUPATIONAL QUALIFICATION?

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CASE DESCRIPTION

The primary subject matter of this case concerns human resource management, particularly the issues of discrimination, and the Bona Fide Occupational Qualification (BFOQ) exception to Title VII of the civil rights act and the Age Discrimination in employment act. This case has a difficulty level of three to four, and is appropriate for an upper division, undergraduate level. This case is designed to be taught in one class hour, and is expected to require two to three hours of outside preparation by students.

CASE SYNOPSIS

This case examines the Bona Fide Occupational Qualification (BFOQ) exception in discrimination cases. Title VII of the Civil Rights Act of 1964 prohibits discrimination based on race, color, religion, sex or national origin. The Age Discrimination in Employment Act expands this protection to cover age discrimination against people over 40. However, there is an exception, the BFOQ. Under certain circumstances, an employer can discriminate, if age, gender or national origin can be shown to be a legitimate requirement, in order to perform the job. In this case, the BFOQ is defined, the criteria for a BFOQ are listed, and the limits to BFOQ are discussed. Several real examples are given of cases in which a company has alleged a BFOQ exists. Students are asked to examine each example, and determine which, if any are legitimate BFOQs. The main focus of this case is to teach students to apply the criteria from Title VII of the civil rights act BFOQ exemption, to real situations.

INSTRUCTORS' NOTES

RECOMMENDATION FOR TEACHING APPROACHES

I have often found that students do not clearly understand the concept of Bona Fide Occupational Qualifications, without seeing specific examples of BFOQs. This case was designed to help clarify this particular issue, in a manner that allows insightful discussion of the topic.

Generally, the approach I take with this is to divide the class up into small groups, and assign them each one or more of the cases to discuss. Then each group will present their determinations to

the class, and we will discuss, as a whole, whether the analysis picked up the important facets of the case. Each of these cases is based on a specific real situation, and all but one have been decided in a court of law. The specifics of each case follow:

CASE 1 - ROLE MODEL

This is based on two specific cases. The first is Robinson vs. Kenosha Youth foundation. In this case the Wisconsin Labor and Industry Review Commission determined that it was a legitimate BFOQ, to require male counselors for positions in which they were to provide same-sex role models for pre-delinquent male children. Similarly, in Stonecipher vs. DILHR, a The Dane County (WI) Circuit court upheld sex as a BFOQ for child care workers in a juvenile detention center, based on the need to provide same-sex role models. To answer the specific questions the students are to reply to:

- 1) Is this practice discriminatory?

Yes, this practice discriminates based on sex of the applicant.

- 2) Is the BFOQ defense legitimate?

Yes. Providing a same-sex role model for children, particularly delinquent, or pre-delinquent children, has been upheld as a BFOQ.

- 3) Why, or why not?

Psychologists can show compelling evidence of a relationship between same-sex role models, and the success of programs designed to avoid delinquency, or rehabilitate delinquents.

CASE 2 - FAA REGULATIONS

This case is the case of Western Air Lines Inc. Vs. Criswell 472 U.S. 400 (1985). This particular case was decided by a U.S. District court, and appealed to the U.S. Supreme Court. The Supreme Court upheld the district court decision, which found that age was not a BFOQ.

- 1) Is this practice discriminatory?

Yes, age is being used as the determining factor in hiring.

-
- 2) Is the BFOQ defense legitimate?

According to the U.S. District court, and upheld by the U.S. Supreme court, no.

- 3) Why, or why not?

In order for a qualification to be a legitimate BFOQ, all or nearly all of the excluded group must be incapable of performing the work. While the airline was able to establish that more people over 60 were incapable of performing the duties, they could not convincingly show that the whole class of workers was unable. In fact, the airline used individual testing to determine fitness of its under 60 employees, and there was no reason that they could not continue to assess the fitness of the employees on an individual basis, once they hit 60. The plaintiffs in this case also used the practices of other airlines, who allowed flight engineers over 60, and had not had problems from doing so, to rebut the airline's claim.

CASE 3 - SEX SELLS

This case is loosely based on several suits filed against Hooters. Most notably, a class action suit was filed against the chain by 7 males who applied for wait staff positions, and were rejected based on their sex. Hooters settled the case in 1997 for \$ 3.75 million, avoiding a legal decision in the case. The lack of a court decision is an important item to note, as they avoided a legal condemnation of their business as unacceptable. This leaves the actual BFOQ question unanswered. The specifics of the settlement raise more questions than they answer.

- 1) Is this practice discriminatory?

Yes, men are not considered for wait staff "hooters girl" positions.

- 2) Is the BFOQ defense legitimate?

There is not clear unambiguous legal precedent. On the side arguing no, there is the fact that Hooters was forced to pay \$3.75 to settle a class action suit, thereby supporting the idea that they were doing something wrong. However, on the side arguing BFOQ, they point to the fact that the settlement allows Hooters to continue their operations, with an all female wait staff. However, they were required to make some other positions (eq. bartender and host) gender neutral.

3) Why, or why not?

One issue to discuss here, is the centrality of “vicarious sexual recreation,” to their business model. Hooters says the “Hooters girl” experience is a central part of their business model. Opponents say that Hooters operates as a restaurant, not a sex show, and therefore the sex of the wait staff is not an important facet of the business model.

It should be pointed out at this point, that business operating sex shows (strip clubs) have successfully defended sex discrimination as a BFOQ. The sex of the stripper is crucial in the delivery of the desired service to the customer. On the opposite side, it should be pointed out that customer preference is not an acceptable BFOQ. Whether the majority of customers in a truck stop prefer that a female waitress serve their eggs and toast, is irrelevant. If a male waiter can do the job, then the fact that the customer would prefer a female is irrelevant. It might also be pointed out that customer preference was one of the arguments that many businesses attempted to use to defend race discrimination, during the 1960s.

CASE 4 - THE NURSE

This is based on the case Slivka vs. Camden Clarke Memorial Hospital (2004). The details of the case are exactly as described in the main portion of this paper.

1) Is this practice discriminatory?

Yes, sex is used as a criterion for hiring

2) Is the BFOQ defense legitimate?

According to the West Virginia Supreme Court, Yes.

3) Why, or why not?

. In determining the BFOQ in this case, the court focused on the privacy of the patient. Due to the highly personal nature of obstetrics, and the necessity for the patient to have their private parts exposed during examinations, requiring same sex nurses was determined to be an allowable BFOQ. This was in spite of evidence that other hospitals successfully used male obstetric nurses. In fact, the plaintiff in this case, Mr. Slivka, had served previously as an obstetrics nurse at Marietta Memorial Hospital.

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VALUATION OF A DREAM: RIVERSIDE COUNTRY CLUB FOR SALE

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CASE DESCRIPTION

The primary subject matter of this case concerns the business valuation process. Secondary issues examined include the challenges of valuing small, privately held businesses and determination of an appropriate discount rate. The case requires students to have an introductory knowledge of accounting, finance and general business issues, thus the case has a difficulty level of three (junior level) or higher. The case is designed to be taught in one or two class sessions of approximately 1.25 hours (depending on the level of detail covered) and is expected to require 3-4 hours of preparation time from the students.

CASE SYNOPSIS

This case describes the challenges faced by Chris Johnson, who for years has nurtured a dream of owning a golf course. As a successful insurance agency owner and accomplished golfer, Mr. Johnson hopes to one day make his dream a reality. Opportunity arises when Golf Corp LLC, a leading national golf course owner and operator in the U.S., decides to sell Riverside Country Club, an entry-level semi-private course located near Mr. Johnson's residence, in an effort to refocus its corporate strategy toward operating higher-end properties. Mr. Johnson now has an opportunity to realize his dream, but is uncertain as to the fair value of acquiring Riverside.

INSTRUCTORS' NOTES

CASE OVERVIEW

Chris Johnson, a successful insurance agent with a dream of one day owning a golf course, has an opportunity to purchase Riverside Country Club, an entry level semi-private course located near his residence. Golf Corp LLC, a leading national golf course owner and operator in the U.S., has decided to liquidate Riverside in order to pursue a more profitable venture elsewhere. Golf Corp LLC is asking \$3.5 million for Riverside and Johnson is unsure whether this figure represents a fair market value.

One of Johnson's concerns is the fact that some, but not all, golf courses built during the explosion of golf course construction in the 1990's have recently sold for less than their construction costs. This concern is confirmed by the database of similar golf course sales over the last 5 years. For example, Lost Oaks located in Palm Harbor, Florida, sold for \$5.9 million in 1998, but recently sold for only \$2.3 million in 2003.

The primary subject of this case is small business valuation methods. Within this context, a secondary subject concerns the appropriate discount rate for a privately held business. The case requires students to have an introductory knowledge of accounting, finance and general business issues thus the case has a difficulty level of three (junior level) or higher. The case is designed to be taught in one or two class sessions of approximately 1.25 hours (depending on the level of detail examined) and is expected to require 3-4 hours of preparation time from the students.

DISCUSSION QUESTIONS

1. Discuss each valuation method. Describe the strengths and weaknesses of each.

- a. *Asset Based Methods*: In general, asset based methods assume a business is equal to the market value of its assets. The two methods listed in the case approach asset valuation differently, but the basic valuation process is the same.
 - i. *Accounting Book Value*: This value can be obtained from a review of the firm's balance sheet. It has the advantage of being easy to obtain, but since accounting values are historical values this approach has little value. Current assets (cash, accounts receivables, and inventory) may reflect a market value, but fixed assets which are recorded at cost and depreciated over time are most likely to be an inaccurate estimate of fair market value. This method is rarely the basis of a sales transaction.
 - ii. *Adjusted Tangible Book Value*: This value recognizes the weaknesses of accounting balance sheet numbers and inserts market values for historical values. Market values for large dollar fixed assets (land, buildings, vehicles and other equipment) are obtained from appraisals. Current assets are also reviewed. Receivables are adjusted by removing accounts that are more than 60 or 90 days past due (the age of acceptable receivables would vary from company to company). Inventory items are reviewed to determine proper value. Some items may be considered to have no value and are discarded. After adjustments are made, this method is relatively easy to calculate but still views the value of a business as the sum of its assets.
- b. *Market Comparisons*: In general, market comparison methods assume a business can be valued by examining similar transactions and using selected relationships. The

three methods listed in the case require an appropriate “comparable” before the methods can be applied. Examples of market comparison methods include the following:

- i. *Direct market comparison* is defined as a general way of determining a value indication using a method that compares the subject to similar investments that have been sold. It is a market-oriented concept based on the Principle of Substitution. This principle assumes that the value tends to be determined by the cost of acquiring an equally desirable substitute. Past transactions can provide objective, empirical data for developing value measures.
- ii. *Rules of thumb* may provide insight on the value of a business; however, value indications derived from the use of rules of thumb should not be given substantial weight unless supported by other valuation methods. At best, rules of thumb are based on averages and do not account for a business being below or above average.

The major difficulty with using market comparison methods is finding guideline companies similar to the business being appraised. Public company data is often not directly comparable with small privately held companies and data from transactions in private firms is not publicly available. True comparables are hard to find and usually require the services of an investment banking firm or a business broker.

- c. *Free Cash Flow (also called Discounted Cash Flow)*: This method follows the traditional finance valuation approach by establishing a firm’s value based on the present value of future cash flows. The advantage of this approach is that it is based on future cash flows rather than a “comparable ratio” or asset values. The disadvantage of this method is that it requires future cash flows to be forecasted and the development of an appropriate discount rate. The value of a firm is the present value of future cash flows plus the value of non-operating assets.

2. Develop values for Riverside Country Club using methods discussed in Question 1.

- a. *Asset Based Methods*
 - i. *Accounting Book Value*: The Book Value of the Assets is \$2.009 million
 - ii. *Adjusted Tangible Book Value*: Substituting Market Value of the Fixed assets for the Book Value of the Fixed Assets (\$2.5 million for \$1.605 million) gives an estimated value of \$2.904 million

b. *Market Comparisons*

- i. *Direct Market Comparisons (Weighted Average)*: When multiple selling prices are given, only the most recent information is used. For example, Eagle Watch sold in 1998 for \$6.4 million, but was later sold in 2002 for only \$5.9 million. The only relevant information for a direct market comparison is the 2002 selling price.

Direct Market Comparison					
Weighted Average Price Per Hole					
<i>Name of Course</i>	<i>Yr Sold</i>	<i>Price (\$Thou)</i>	<i># of Holes</i>	<i>Price/Hole (\$ Thous)</i>	<i>Weight</i>
Black Bear	1998	4,100	18	227.8	0.05
Club of the Country	1998	2,600	18	144.4	0.05
Cooks Creek	1999	6,100	18	338.9	0.05
Cypress Creek	1999	4,200	18	233.3	0.05
Meta-Mora	2000	5,900	18	327.8	0.075
Eagle Watch	2002	5,900	18	327.8	0.125
Palm Desert	2002	4,100	27	151.9	0.125
Sweetwater	2002	3,300	36	91.7	0.125
Lost Oaks	2003	2,300	18	127.8	0.175
Mystic Creek	2003	3,500	27	129.6	0.175
				Weighted Average	
				Price/Hole (\$Thous)	
				188.3	

Valuation for Riverside using a weighted average price per hole:

$$\$188.3 * 18 \text{ holes} = \$3.389 \text{ million}$$

- ii. *Multiples of Revenue*: The case suggests that using the following rules of thumb will give an average valuation: 130% of Golf Revenues, 65% of Food and Beverage Revenues, plus the market value of Real Estate. The market value of Real Estate was suggested to be worth \$10,000 per acre and Riverside Country Club is 151 acres.

	Revenue in (\$Thous)	
Year	Golf	Food & Bev
2000	1,012	124
2001	1,104	116
2002	995	110
2003	1,191	119
Average	1,076	117
Multiple	130%	65%
Valuation	1,399	76
Market Value of Real Estate		
Price/Acre (\$Thous)	Number of Acres	Total (\$Thous)
10	151	1,510
	Valuation (\$Thous)	
Golf	1,391	
Food and Beverage	76	
Market value of Real Estate	1,510	
Total	2,977	

The Total Valuation for Riverside is \$2.977 million using the multiple of revenue approach.

- iii. *Multiples of Income*: The case recommends using 8 times NOPAT plus the market value of real estate for the multiple of income approach.

	2000	2001	2002	2003
	(\$ Thousands)	(\$ Thousands)	(\$ Thousands)	(\$ Thousands)
Golf Revenue	1,012	1,104	995	1,191
Food and Beverage Revenue	124	116	110	119
<i>Total Operating Revenue</i>	1,136	1,220	1,105	1,310
<i>Total Operating Expenses</i>	879	915	862	935
<i>Gross Margin</i>	257	305	243	375
<i>Depreciation</i>	150	155	155	175
EBIT	107	150	88	200
<i>Tax rate</i>	0.30	0.30	0.30	0.30
NOPAT = EBIT*(1-tax rate)	75	105	62	140

Year	NOI (\$Thous)			
1999	75			
2000	105			
2001	62			
2002	140			
Average	96			
Multiple	8			
Valuation	768			
Market Value of Real Estate				
Price/Acre (\$Thous)	Number of Acres	Total (\$Thous)		
10	151	1,510		
	(\$Thous)			
Multiple of NOPAT	768			
Market Value of Real Estate	1,510			
Total Valuation	2,278			

The total valuation for Riverside using the multiple of income approach is \$2.278 million.

c. *Free Cash Flow Approach:*

Assumptions and Calculations Needed:

- i. Scott and Johnson thought forecasting for six years would be appropriate.
- ii. Revenues were forecast to grow at 4.0% per year for 2004 and 2005, 5% per year for 2006 and 2007, and 6% for 2008 and 2009.
- iii. Scott suggested a forecast for operating expenses at 60% of sales.
- iv. Capital expenditures for the first two years would be approximately \$150,000 for the first two years and \$100,000 per year thereafter.
- v. Annual depreciation expense was \$175,000 last year, but additional capital expenditures are planned. Scott suggested using \$200,000 for annual depreciation expense in year one (2004) and reduce the amount by \$10,000 each successive year.
- vi. An income tax rate of 30% was projected.
- vii. Current assets and current liabilities were projected at 35% and 10% of sales respectively.
- viii. The cost of capital for Riverside Country Club needs to be estimated based on the WACC.

$$\text{WACC} = \% \text{debt} * (\text{after-tax cost of debt}) + \% \text{equity} * \text{cost of equity}$$

- (1) The amount of debt used for financing is 60%. The cost of debt was assumed to be 8.5%. The after-tax cost of debt is equal to the before tax cost of debt * (1-tax rate). After-tax cost of debt = $8.5\% * (1-.30) = 5.95\%$
- (2) The amount of equity used for financing is 40%. The equity beta is found using an unlevered beta for the golf industry of 1.3, and then relevered to incorporate Riverside's proposed capital structure. The beta of debt is assumed equal to 0.2.

Debt Beta = 0.2 (60% debt)

Unlevered Beta = 1.3

Equity Beta = ? (40% equity)

$$1.3 = .60*0.2 + .40 * \text{Equity Beta}$$

$$\text{Equity Beta} = (1.3 - (0.6*0.2)) / .4 = 2.95$$

- (3) CAPM used to estimate the cost of equity (assumptions include: risk free rate = 3% and market risk premium = 7%)

$$\begin{aligned} \text{Cost of Equity} &= \text{Risk Free Rate} + \text{Equity Beta} * \text{Market Risk Premium} \\ \text{Cost of Equity} &= 3\% + (2.95 * 7\%) = 23.65\% \end{aligned}$$

After-tax Cost of Debt = 5.95% (60% debt)

Asset WACC = 13.03%

Cost of Equity = 23.65% (40% equity)

$$\text{Weighted Ave. Cost of Capital} = 60\% * 5.95\% + 40\% * 23.65\% = 13.03\%$$

- ix. Scott suggested using the constant growth model to estimate residual or horizon value. Scott suggested assuming a 5% constant growth rate (g) for FCF after 2009

$$\begin{aligned} \text{Horizon Value} &= 2009 \text{ Free Cash Flow} (1+.05) / (.1303-.05) \\ &= \$260 * (1.05) / (.1303-.05) \\ &= \$3,400 \text{ Thousand} \end{aligned}$$

Free Cash Flow Valuation: (See Table Five for Completed FCF Table)

Year	FCF (\$Thous)	PV of FCF@13.03%
2004	58	51
2005	100	78
2006	173	120
2007	199	122
2008	228	124
2009	260	125
	(\$Thous)	PV of HV @13.03%
Horizon Value	3,400	1,630
		(\$Thous)
Present Value of Cash Flows		2,250

The Valuation of Riverside using FCF method is \$2.250 million.

3. Recommend a fair market value for Riverside Country Club:

There is not a single correct value. The valuation methods give answers ranging from a low of \$2.009 million using the accounting book value method to a high of \$3.375 million using a direct market comparison method. A summary of the valuation methods used includes:

Method of Valuation		Valuation (\$Thous)
Asset Based	Accounting Book Value	2,009
	Adjusted Tangible Book Value	2,904
Market Comparison	Direct Market Comparison	3,389
	Multiples of Revenue	2,977
	Multiples of Operating Income	2,278
Free Cash Flow	Free Cash Flow	2,250

Of particular note is that the multiples of operating income and free cash flow valuations support a price of about \$2.3 million, while the direct market comparison and multiples of revenue approach support a price of about \$3 million to \$3.4 million. This suggests the revenues for Riverside are consistent with other clubs, yet the operating expenses for Riverside may be too high. Unless Johnson can incorporate additional cost

savings beyond what he originally projected and reduce his operating expenses to below 60% of revenues, the asking price of Riverside at \$3.5 million is too high to justify an appropriate return on investment.

	2003 Actual (000s/\$)	2004 Projected (000s/\$)	2005 Projected (000s/\$)	2006 Projected (000s/\$)	2007 Projected (000s/\$)	2008 Projected (000s/\$)	2009 Projected (000s/\$)
Total Operating Revenue	1,310	1,362	1,416	1,487	1,561	1,655	1,754
Total Operating Expenses	935	817	850	892	937	993	1,052
Depreciation	175	200	190	180	170	160	150
EBIT	200	345	376	415	454	502	552
Income Tax (30%)	60	104	113	125	136	151	166
NOPAT	140	241	263	290	318	351	386
Operating Current Assets	404	477	496	520	546	579	614
Operating Current Liabilities	96	136	142	149	156	166	175
Required Net Operating Working Capital	308	341	354	371	390	413	439
Capital Expenditures		150	150	100	100	100	100
Required Net Plant and Equipment	1,605	1,755	1,905	2,005	2,105	2,205	2,305
Required Net Operating Capital	1,913	2,096	2,259	2,376	2,495	2,618	2,744
Net Investment in Total Operating Capital		183	163	117	119	123	126
Free Cash Flow		58	100	173	199	228	260
(NOPAT-Net Investment in Total Operating Capital)							
Horizon Value							3400
PV of Free Cash Flow	620						
PV of Horizon Value	1,630						
PV of Future Cash Flows	2,250						

FREEZING DAD: TAXING POTENTIAL HUMAN CAPITAL

**Valrie Chambers, Texas A & M University-Corpus Christi
Barry Armandi, SUNY-Old Westbury**

CASE DESCRIPTION

The primary purpose of this case is to encourage students to derive a plausible, well-supported answer to a novel tax situation (in which virtually no direction currently exists) using critical thinking skills. This case is important because practitioners inevitably face situations without finite, predetermined answers. The secondary purposes of this case are to utilize broad-based research skills and familiarize the student with Reg. Sec. 1.6694-2(b) of the Internal Revenue Code of 1986, as amended) which states that to protect the preparer from penalties, a tax solution must have a better than 1 in 3 chance of being sustained on its own merits. The level of case difficulty is a 5/6 (graduate level), and is designed to be taught in 3 class hours with 6 hours of outside student preparation, or alternatively assigned as an out-of-class report with a 1-hour in-class discussion.

CASE SYNOPSIS

“Joan, we can be very wealthy in a few years, as long as the technology keeps advancing,” said Jim Andrews to his sister. “I don’t know, Jim, it sounds kind of eerie and science fiction-ish. And even if the technology is there and we make millions, how much is the government going to grab?” replied Joan. “Good point!” answered Jim. “Let’s talk to our accountant.”

Most business cases presented to students have a fixed answer either as the result of past investigation in a formal (e.g. legislation or litigation) or informal (academically studied and expert-recommended) environment. However, many problems in life contain novel elements for which no existing answer has been published. Thus it is critical that students be able to think independently of a known, existing answer, while simultaneously relying on similar existing research or tenets. The need for critical thought required to analyze such a situation and derive a tentative solution is as timeless as changes in business environment that precede legislation and litigation. Previous examples of where practitioners have faced novel situations include: the time period where equipment became increasingly more computerized (should the estimated useful life of hybrid equipment be that of the computer elements, or that of the other underlying asset?) and the estimated useful life of software (where tax software, for example was essentially good for a year, but other applications had longer operational lives but faced acute obsolescence before they actually stopped

functioning). This case, which is based on the death and subsequent litigation on the disposal of the remains of Ted Williams, has no definitive answer, and requires tax speculation supported by general logic and broad-based research.

INSTRUCTORS' NOTES

Most business cases presented to students have a fixed answer either as the result of past investigation in a formal (e.g. legislation or litigation) or informal (academically studied and expert-recommended) environment. However, many problems in life contain novel elements for which no existing answer has been published. Thus it is critical that students be able to think independently of a known, existing answer, while simultaneously relying on similar existing research or tenets. The need for critical thought required to analyze such a situation and derive a tentative solution is as timeless as changes in business environment that precede legislation and litigation. Previous examples of where practitioners have faced novel situations include: the time period where equipment became increasingly more computerized (should the estimated useful life of hybrid equipment be that of the computer elements, or that of the other underlying asset?) and the estimated useful life of software (where tax software, for example was essentially good for a year, but other applications had longer operational lives but faced acute obsolescence before they actually stopped functioning). This case is important because practitioners inevitably face situations without finite, predetermined answers. This case had no definitive answer, and required quite a bit of tax speculation.

When faced with a novel situation, practitioners must use a variety of sources to fashion a plausible, supported solution. To protect the preparer from penalties, that solution must have a better than 1 in 3 chance of being sustained on its own merits. (Reg. Sec. 1.6694-2(b) of the Internal Revenue Code of 1986, as amended.)

INSTRUCTIONAL AUDIENCE

Because solutions for this situation would fall primarily to practitioners, this case was presented to a master's level tax research and planning class. Students of this class had already had basic federal income tax, and often had a second course in income tax and for a class in estate tax planning. The prerequisites to this class provided basic exposure to the CCH database, and students had some general web-based skills. This case in this context would be inappropriate for students unexposed to basic tax concepts and those lacking basic web skills. A version of this case was presented on an extra-credit basis to two undergraduate Federal Income Tax I classes who were also presented with a brief structured format in class lecture for addressing the issues. While a few results showed promise, in general, undergraduate results were unimpressive.

LEARNING OBJECTIVES

The learning objectives for this case are:

- ◆ Identify estate tax issues
- ◆ Identify federal income tax issues
- ◆ Provide proposed estate tax treatment
- ◆ Provide proposed federal income tax treatment
- ◆ Understand the interplay between these two types of taxes
- ◆ Demonstrate broad, general research skills
- ◆ Demonstrate critical thinking skills

LITERATURE REVIEW

Angelini et al. (1999) show that in a tax context, teaching with the use of cases leads to a greater learning experience over lecturing alone. This case stresses student development of a plausible, supported solution in an environment where a solution has yet to be adopted. In a dynamic world with emerging technological innovations, new and novel accounting applications of established theories is probable. Those wishing to become leaders in the accounting field must be able to supply plausible applications using critical thinking skills. Albrecht (2002) values different stages of accounting: Stage 1 (bookkeeping) worth no more than \$10 per hour, Stage 2 (summarizing transactions) worth no more than \$30 per hour, Stage 3 (manipulating data into useful information) worth no more than \$100 per hour, Stage 4 (converting information into knowledge helpful to decision making) worth no more than \$300 per hour, and Stage 5 (making value-added decisions using Stage 4 knowledge), worth \$1,000 per hour.

Dewey (1933) asserts that reflective and critical thinking involves multiple steps, including problem recognition in an environment of uncertainty/doubt, search for potential solutions, evaluation of alternative solutions, judgment of best decision, and reformulation of the solution as necessary. Piaget (1974) notes that learning to think critically is achieved in developmental stages. Bloom's (1956) taxonomy lists several stages of critical thinking. Fischer (1980) asserts that these stages begin as concrete knowing (knowing of facts), and progress to systems of facts, abstracts of those systems of facts, and how the multiple abstracted systems of facts relate to one another. King and Kitchener (1994) assert seven developmental stages of critical thinking, also beginning with concrete knowing based on personal observation. This stage is followed by: concrete knowing based on authoritative decree, then introducing stages of uncertainty and content-specific justification, followed by a comparison of issue aspects across contexts, followed by knowledge that is the product of reasonable inquiry and is consistent across domains.

Wolcott and Lynch (2002) also approach critical thinking, applying critical thinking skill development directly to business situations using an Issues-Theory-Analysis-Conclusions (ITAC) model. Assuming an implicit foundation of concrete knowledge and skills, Wolcott and Lynch simplify critical thinking into four additional steps: 1) identify problems, relevant information, and uncertainties, 2) explore interpretations and connections, 3) prioritize alternatives and implement a solution, and 4) envision and direct strategic innovation. This structure provides a directly relevant structure for formulating a solution for this case.

CASE DEVELOPMENT

In the summer of 2002, a media and court dispute arose pertaining to the disposition of the remains of the famous baseball player, Ted Williams. His daughter pursued a burial, while his son pursued freezing the remains, allegedly allowing for the possibility of selling his DNA. This case raised many ethical issues, but to a tax instructor it also raised many estate and income tax issues that have not been previously legislated or litigated. Because this case garnered high media attention, the students could identify with the possibility that they might have to answer tax questions in a novel situation as opposed to only finding a previously determined solution buried in the authoritative literature. Thus, this issue produced fertile ground for a short tax research case which required not only a look at the authoritative literature, but also a broad search for relevant historical and scientific context in which to interpret that (lack of) authoritative literature.

RECOMMENDATIONS FOR TEACHING APPROACHES

This type of venture is new and attributable in part to emerging technology. There is no pre-determined answer to these questions, rather the student is being asked to come up with answers where no definitive answers (in Code, regulations, or case law) exist, but at least preliminary accounting treatment is needed.

Background

Shown in movies featuring the character Austin Powers, cryogenics is a method of preservation whereby tissues are generally treated then placed in liquid nitrogen and stored at temperatures well below zero degrees Fahrenheit. The hope is that the DNA, body, or tissue, when unfrozen unharmed at a later date will be as useful as the DNA, body or tissue was prior to death and/or freezing.

Cloning is the reproduction of a set of cells using the DNA of one cell. Cloning can be divided into three types: recombinant DNA technology (DNA cloning), reproductive cloning, and therapeutic cloning (Human Genome Project, 2003). Reproductive cloning most commonly results

from “somatic cell nuclear transfer,” where genetic material from a donor cell is inserted into an egg cell where the original DNA has been removed. The altered egg cell is then inserted into the uterus of the mother for the duration of a “normal” pregnancy. While scientists have celebrated successful cloning of mammals, the stripping of the nucleus from the egg cell is risky, expensive, and inefficient. More than 90% of the attempts fail, and of the viable clones, many have compromised immune functions.

Even where cloning is successful, the specific talents one wishes to purchase in selecting a DNA donor might not be realized due to environmental (including chemical) factors. For example, Jose Conseco has a distinguished career in major league baseball, hitting an impressive number of home runs. His identical twin brother, Ozzie, (who would be similar to a natural clone) had a very short major league baseball career, hitting no home runs.

Alternative Presentation Formats

This case was designed for students to provide a short (1-2) page memo answering the case questions, with research sources attached to the back of the memo. Alternatively, this case could require that the students format their answers in the form of a recommended revenue ruling, present hypothetical courtroom arguments for a particular point of view (e.g. depreciating v. currently expensing cryogenic expenses, or capital v. ordinary income), or as an in-class discussion.

Additional Thought Questions for In-Class Discussion

What are some non-tax issues that can affect this plan? For example:

- 1. Sale of organ donations is illegal in the United States; sale of sperm or eggs is not. Currently, what is the legality of cloning human beings in the United States? How are the sale of sperm, the sale of eggs, and the donations of organs currently handled under the tax code?**

Currently, bills have been introduced to ban the cloning individuals in the United States. (See for example, “Human Cloning Ban and Stem Cell Research Protection Act of 2003,” Senate bill 303, 108th Congress, 1st Session, and “The Human Cloning Prohibition Act of 2003,” House Report 234, 108th Congress, 1st Session.) If found guilty, criminal penalties would include imprisonment for up to ten years and fines of up to the greater of \$1,000,000 or three times the gross pecuniary gain from the violation. Australia and the United Kingdom, however, have allowed (limited) cloning. Therefore, serious consideration should be given to having a portion of this business overseas. Geographical diversification might significantly limit the clients’ business risk.

In 1984, the National Organ Transplant Act prohibited the sale of human organs in the U.S. Illegal black markets for organs exist, and it is conceivable that one would spring up for DNA also. For example, Congress has investigated human rights violations in China pertaining to the removal and sale of prisoners' organs before execution (Parmly, 2001). Still, certain forms of quid pro quo arise even in the U.S. BBC News (2001) reports that an "American hospital is encouraging people to donate their kidneys to strangers by promising early operations for their relatives as a reward." Similarly, the organs4life website (2003) answers the question of whether one can sell his organs to another person by saying, no; **but** "IT IS ENTIRELY POSSIBLE to ask for and receive money and/or other things of value, in return for the HARSHIPS ASSOCIATED WITH giving up and Organ! (sic)"

Also, selling DNA from the deceased could arguably violate state "abuse of corpse" rules. For example, the Texas Penal Code Sec. 42.08 says, "a person commits an offense if, not authorized by law, he intentionally... dissects, in whole or in part. . .or treats in a seriously offensive manner a human corpse. . .[or] sells or buys a human corpse or in any way traffics in a human corpse." If the donor is indeed a willing donor, it seems markedly simpler to obtain a DNA sample from the living donor and forego the posthumous cryogenics.

Selling of tissues or fluids that are regenerated by the body (e.g. blood and semen) have been treated by the courts as legal sale of property held for sale to customers in the ordinary course of business (*M.C. Green v. Commr.*, 74 TC 1229, Dec. 37,229 (1980)). The distinction between blood and organs rests on the ability of the donor to regenerate the removed part. Sale of blood, sperm, and eggs are currently allowed under U.S. law. Often, payments for these materials are labeled as donor stipends or incentive fees, and channeled through non-profit organizations that are overseen by the National Institute of Health.

2. If one child is reproduced from the DNA, and that child's DNA is subsequently sold (at a lower price) to others wishing to have children with celebrity DNA, how are your client's rights protected?

The answer to this rests in the form a legal protection that DNA can have. U.S. common law only recognizes limited tangible property rights for the human body. For instance, the next-of-kin has the right to control the disposition of a human body. Also, the Uniform Anatomical Gift Act controls the treatment of human organs as property for the purpose of facilitating their donation to others.

DNA would likely be protected by a patent. A patent grants the inventor the right to exclude others from using the inventor's discovery for a limited period of time (generally 17 years from the date of patent application; see U.S. Constitution, Article I, Section 8). Currently, DNA for individuals is not patented. However, genes, cell lines, and genetically

modified single-cell organisms are patentable per *Diamond v. Chakrabary* (S Ct. 1980), because that material did not naturally occur in nature. Per Cohen (2001), the DNA Copyright Institute is trying to persuade famous people to copyright their DNA to protect it against DNA theft, misappropriation, cloning, and other unauthorized activities. DNA becomes patentable when it is isolated, purified, or modified to produce a new form (Human Genome Project, 2003). In *Moore v. Regents of the University of California*, 202 Cal. App. Sd. 12S0, 249 Cal. Rptr. 494 (1988), the California Court of Appeals ruled on property rights of human body parts where physicians removed the spleen of Moore, and then found that the cells of Moore's spleen possessed commercially exploitable characteristics. Without Moore's knowledge, the physicians developed, patented and sold a cell line utilizing the tissue from his spleen.

Patents would likely have limitations similar to those found in animal husbandry law. A royalty or "stud" fee is paid to have the animal bred, but no payments are due from the breeding of the subsequent offspring. Even if a patent violation could be proven however, it is unlikely that all resultant DNA could be successfully recovered.

3. Would the treatment markedly differ if DNA were taken from live donors, frozen, and sold for reproduction purposes? If so, how?

If DNA were taken from living donors, advantages exist beyond reproduction. Tissue samples can be used to identify individuals, establish evidence in court cases, and in testing for genetic disease.

Also, the donor would clearly have no basis in the DNA, and no need for estate planning due to posthumous DNA collection. Remittances for donations would be taxed as earned income (subject to self-employment taxes) in the year(s) received. (Whereas, it would be a daunting task to argue that a deceased person was self-employed when his/her DNA was sold.)

Group Versus Individual Effort

Because novel business situations are often solved after extensive public and private debate, students were actively encouraged to talk with one another about the issues, research findings, applications of those findings, and conclusions. In addition to short class discussions, students had access to one another's email address and to an electronic chat room and discussion board. The final, written solution however had to be uniquely his or hers. Evidence of talking before class, and during break was evident, but each written exercise was unique, and demonstrated varying levels and quality of critical thinking skills.

In lieu of individual problems, this case is conducive to group projects using either instructor-assigned groups or student-formed groups. The instructor could assign group grades using one project grade for everyone in the group. Alternatively, the instructor could assign the project a grade, and ask each participant to allocate that grade among group members. Each student would then receive the average of the allocated group grades. For example, if the group contained three members, and the project grade were a ninety, each group member would have $(3 * 90 =)$ 270 points to allocate among the three group members. Group members who contributed more than average would receive more points (and possibly more than 100 points), with the compensating points coming from the grades of group members who were perceived to be slackers (See Masselli et al, 2001:15 for an example of this grading.) In either case, it is important to clearly outline the grading procedures at the assignment of the case.

INSTRUCTOR ANSWERS WITH STUDENT COMMENTS

As indicated above, the CPA partner suggested several tax issues following the case. The written issues suggested with the case are in italics. Following are the case responses expected by the instructor. This case was tested in a graduate tax course for accounting and tax majors. Therefore, after the instructor's suggested answers student responses follow that enhanced the instructor's response or surprised the instructor.

Under Either Plan (Effect to the Estate):

1. What is the value to the estate of a celebrity's DNA?

Definition of Gross Estate is found in IRC Sec. 2031. (All remaining cited code sections are for the Internal Revenue Code of 1986, as amended, except as specifically noted otherwise.) In general, the value of the gross estate is determined to be the fair market value at the time of death of "all property, real or personal, tangible or intangible, wherever situated." Currently, gross estates of less than 1.5 million dollars (2005; 2 million dollars for 2006-2008) are not subject to estate tax.

DeCode Genetics paid the government of Iceland \$14 billion for the population's DNA, or about \$50,000/person (Santosuosso, 2000). Both Iceland and Tonga have sold the commercial rights to the DNA information of their citizenry to for-profit companies, and Bear (2001) assesses the profitability of the information gained at about \$100,000/person. Dividing the profits equally between donor and researcher, the rights to DNA are valued at \$50,000 for the donor.

In the United States, there is no established value for the DNA of a cadaver (celebrity or otherwise) used for reproduction purposes. While organs are sometimes donated at death,

Public Law 98-507, Title III Sec. 301 says, "it shall be unlawful for any human to knowingly acquire, receive, or otherwise transfer any human organ for valuable consideration." DNA might eventually be subject to the "no sale" rule. However, medical schools have bartered for cadavers and additional tuition fees for courses with cadaver dissection range from \$30 to \$1,200, depending on transportation, embalming, registration, cremation, and burial costs (AACA, 1998).

Arguably, the body has zero value because all costs expended on the body to-date were personal expenses to at best increase the quality or quantity of life, not value at death. However, the processing, freezing, and maintenance costs could constitute "improvements" that establish a basis in the remains. Alternatively, these "improvements" could be considered burial expenses (to be deducted from the estate on the estate tax return) instead of allocated against the income that the DNA generates. Using any of these approaches, the remains alone are insufficient to trigger estate tax.

If a market for DNA eventually emerges, the value would likely vary as influenced by such economic factors as supply, demand, and ease of substitution. One could then also approach the valuation by discounting the expected future cash flows of the project.

Student comments (paraphrased): The fair market value of a "non-operating" human body is \$0. At one point this famous athlete was worth millions of dollars at the prime performance of his body, however when his contract with the athletic organization was completed they did not renew his contract because they recognized that the decedent's body (property) was no longer as valuable as when he signed the last contract. After he had reached his prime condition, his body began to depreciate in value until his death, at which point a non-operating body was worth nothing to the decedent. The client therefore "inherited" property that has a fair market value of \$0.

2. Is the value of the remains of a celebrity sufficient enough to prompt estate tax?

Assuming the student concluded the FMV of the remains was zero, or relatively low, the remains alone would be too low to trigger estate tax. However, if a high value was assigned, or Bob were considered wealthy enough to pay estate tax anyway, estate tax on the remains might arguably be imposed. In 2005, estate tax rates on taxable transfers are 47% above the \$2 million (IRC Secs. 2001, 2501). Generally, where the value of the remains is indeterminable, it would be better to use the low end (e.g. zero) as a basis for estate tax purposes. While this will result in a higher income tax rate if DNA is ultimately sold for a profit, the highest income tax rate is substantially lower than the highest estate tax rate, and the income tax liability would likely be deferred to future years, garnering the advantage of the time value of money.

3. Are the costs of cryogenics deductible by the estate? Currently (or must the costs be depreciated, depleted, or amortized)?

Alcor, the firm that froze Ted Williams, offers head-only cryogenics for \$50,000, and full-body cryogenics for \$120,000. The Cryonics Institute will freeze smaller pieces of tissue (hair, skin, inner cheek, saliva, or blood) for \$1,250 plus \$98 for a DNA sample kit and preparation procedures. Freezing of animal tissue, which is relatively common, tends to be less expensive. For example, Lazaron BioTechnologies will freeze pet tissue for \$500 plus a monthly storage fee (Lazaron, 2003).

Per Reg. Sec. 20.2053-2, reasonable amounts paid for funeral expenses are allowed to the extent that they are: allowable by local law, and must be paid out of the decedent's estate, as reduced by social security and veterans administration death benefits. Examples of allowable expenses are: tombstone, monument, mausoleum, burial lot, mortuary care, embalming, cremation, casket, hearse, limousine, florists, and a reasonable amount for any kind of future care of the remains. Cryogenics are not specifically mentioned, nor are they specifically excluded. Therefore, to the extent that it is the executor's (executrix') choice for post-mortem care, both the initial cost of cryogenics and the ongoing maintenance costs would likely be deductible from the gross estate for estate tax purposes. (Note: In community property states, deductibility depends on whether the funeral expenses are deemed to be community expenses or expenses of the decedent's estate. In the first case, only one-half of the amounts expended are deductible.)

To the extent that these costs can be planned for, it is preferable that the estate, if subject to estate taxes, deducts these costs as funeral expenses because the maximum marginal estate tax rate is currently 48%, whereas the maximum corporate and individual tax rates on the highest-income taxpayers are 35%.

4. What is the estimated useful life of dad's remains?

The estimated useful life to the estate is largely irrelevant, because any sale of DNA will occur under plans 1 and 2, discussed below. Neither plan will likely result in sales immediately (before the settlement of the estate), correspondingly, it is the heirs, not the estate that must determine estimated useful life.

5. Would this plan, if profitable, produce ordinary income, capital gains, or other income (type - e.g. passive)?

To the extent that the DNA (property) is held for the primary use of sale to customers, any income would be ordinary, not capital or portfolio income. But again, it is not the estate that

will hold the DNA for resale, but the heirs or their assigns, so this question is not pertinent to the estate, but rather it is pertinent to the heirs.

Under Plan 1 (Effect If Jim & Joan Absorb Costs and Sell DNA):

1. What is the heirs' basis in the celebrity's DNA?

Sec. 1014(a) (1) of the Internal Revenue Code of 1986, as amended, states that the basis of any property, real or personal, acquired by an heir from a decedent is its fair market value of the date of the decedent's death. Fair market value can be defined as the price for which a willing seller would agree to sell and a willing buyer would agree to buy. The heirs' basis in the DNA is likely equal to fair market value as of the date of death, because no current market exists and future value is speculative at best. Further, if no value were allocated to the estate, then the basis would be zero.

2. Is the heirs' basis in the celebrity's DNA deductible against any proceeds received from DNA sales?

If the cryogenic expenses were deducted as funeral expenses, then they could not also be deducted against the sales of DNA. If, however, the heirs incurred and paid the fees, the heirs could likely allocate the cost of cryogenics against the revenue it generates (Code Sec. 162).

3. Are the costs of cryogenics deductible? Currently or must they be depreciated, depleted, or amortized?

To the extent DNA sales are legal, the ordinary and necessary expenses incurred to produce revenue from cloning would be deductible under IRC Sec. 162. Costs used up currently are generally deducted currently. If the cost is expended for a long-term exhaustible resource, it should be pro-rated, either through depreciation (Sec. 167, generally pertaining to fixed assets), depletion (Sec. 611, generally pertaining to renewable natural resources), or amortization (Sec. 197 et al., generally pertaining to intangible assets). Non-exhaustible resources (e.g. land) on the other hand generally cannot be deducted per Sec. 263.

The largest cost of preserving DNA might be overhead, in which case the client must carefully avoid triggering IRC Sec. 263A uniform capitalization rules. Stringent overhead rules apply to all manufacturers and to retailers and wholesalers whose annual gross receipts for the last three years exceed \$10 million. Because of the potential for exceptionally long DNA "inventory" life, the IRS might assert under Sec. 263A that overhead be capitalized

into inventory – essentially suspending the costs of cryogenics indefinitely while taxing the revenues immediately. Further, many of the expenses incurred might be deemed personal (that is, not entered into for a profit) and therefore non-deductible.

Note that cloning is illegal in some states (e.g. Iowa Code, Chapter 707B) and might become illegal nationwide. Still, the income is taxable and expenses related to a (an illegal) business are deductible (see *Max Cohen v. Comm.*, 49-3 USTC 9358, 176F.2d 394 (CA-10, 1949), and *Neil Sullivan v. Comm.*, 58-1 USTC 9368, AFTR2d 1158, 356 U.S. 27 (78 S.Ct 512, 1958)) unless the expense itself constitutes an illegal payment (such as a kickback, or bribe), or is a court assessed fine for an illegal activity (e.g. speeding ticket), (IRC Secs. 162 (c) and (f)). Although DNA is not yet classified as a “controlled substance,” a law change could eventually invoke a statute similar to IRC Sec. 280E, which prohibits the deduction of any expenses related to the trafficking in controlled substances, other than cost of goods sold (*W.H. Sundel v. Commr.*, 75 TCM 1853, Dec. 52,589(M), TC Memo. 1998-78, *aff’d per curiam*, CA-1 (unpublished opinion), 99-2 USTC Par. 50,635).

Student comments: Sec. 1.263(a)—1(b) denies deductions for expenditures that would substantially prolong the property’s useful life, adapt the property to a new or different use, or materially adding to the value of the property. The client is promoting to do all three; therefore, cryogenic expenses for preserving the asset for income generating purposes are not deductible.

In *Green vs. Commissioner*, 74 T. C. 1229 (1980), the court ruled that taxpayer’s bodies are not among the natural deposits considered by Congress as eligible for depletion. In this case, the petitioner’s main source of income was the sale of her blood, for which she claimed a depletion deduction for the loss of her blood’s mineral content and ability to regenerate. The court did not allow depletion in this case.

Sec. 482 defines an intangible asset as an asset that comprises of any of the following items: patents, inventions, formulae, processes, designs, patterns and know-how. DNA has some of these characteristics, so it may be an intangible asset. Sec. 197 allows amortization of intangibles, generally over a 15-year period. In this case, the father or the parents of the father would be considered the inventor, not the client. With the piecemeal sale of the asset, perhaps the client should sell licenses for the use of DNA.

4. What is the estimated useful life of a celebrity’s remains?

For cloning, the estimated useful life is uncertain, and depends on how the remains are ultimately classified. If the remains were held for resale, then useful life would be irrelevant because the DNA would in essence be “inventory.”

Some applicants have received patents for DNA, indicating that DNA might be an intangible asset as opposed to tangible, personal property. If the DNA is patented, patent

costs would be amortized over the estimated useful life (generally the legal life) of the patent. Sale of patents does receive long-term capital gain treatment under IRC Sec. 1235. Currently, the long-term capital gains tax rate is 15%, making the sale of a patent an attractive option.

If costs are to be depreciated, only a portion of the costs offset the revenue in any given year. IRC Sec. 168 governs depreciation and assigns the estimated useful life for tax depreciation. Currently, cadavers are not directly assigned an estimated useful life. However, if the remains were to be depreciated, Sec. 168(e)(3)(c) states that property that does not have an assigned class life would receive a default class life of 7 years.

If it is argued that the remains are a natural, depletable resource, then IRC Sec. 611 would apply. However, these sections were passed to promote exploration and development of primarily geological (mines, wells, and timberland) resources. DNA might not qualify.

To the extent the DNA will be sold piecemeal, the estimated useful life might best be expressed in terms of number of original DNA samples. An expert in the DNA field, taking into account past experience, present conditions, and probable future developments, best determines this total number.

Student comments: More than 100 individuals have been frozen since the first suspension in 1967. The assumption is they can still be revived when a technology permits. Based on that information, the useful life of dad's remains of the client is at least 35 years.

Scientists have successfully collected DNA samples from a thousands-year old Egyptian mummy (CNN, 2000). The tax life however is the lesser of the real life (which is unlimited) or 40 years (the longest time for a tangible to be depreciated).

5. Would this plan, if profitable, produce ordinary income, capital gains, or other income (type - e.g. passive)?

IRC Sec. 64 defines ordinary income as any gain from sale of property that is not a capital asset. The definition of a capital asset (IRC Sec. 1221) specifically excludes property held primarily for sale to customers in the ordinary course of a trade or business. No laws, regulations, or case laws exist to specifically determine the nature of income received from cloning. However, case law exists regarding the sale of one's own blood. Per *M.C. Green v. Commr.*, 74 TC 1229, Dec. 17,229 (1980), the income from the sale of blood is ordinary and subject to self-employment tax; the basis in one's own blood is zero. Likely, DNA would fall under the broad provisions of IRC Sec. 64 and *Green v. Commr.* above.

An aggressive taxpayer might try to claim IRC Sec. 1231 capital gains treatment for depreciable property used in a trade or business. However, if DNA is inventoried (and thus not depreciated), it would not qualify for Sec. 1231 treatment.

IRC Sec. 469, passive activities, restricts losses to individual passive investors. Your client, by forming a corporation, would not be affected. The heirs may be subject to passive activity loss limitations for any trade or business in which the taxpayer does not materially participate. The limitations state that all passive activity losses in excess of passive activity gains are suspended until the year that the passive activity loss property is completely disposed of.

Alternatively, the client might be able to place at least some of the proceeds received from the estate into a cemetery perpetual care fund trust. This approach would be, if sustained, beneficial for tax purposes; because per Revenue Ruling 58-190, a cemetery company can currently exclude the portion of the sales price received that is required to be placed in trust for the perpetual care of the grave site.

Under Plan 2:

- 1. Assuming the celebrity is interred in your facilities for further reproductive opportunities, have you purchased an asset? 2. If so, what kind of asset is it (how do you classify it)? If not, against what do you charge expenses (e.g. cost to transport the body in, etc.)? 3. What is your basis in the celebrity's DNA? 4. Is your client's basis in the celebrity's DNA deductible against any proceeds received from DNA sales? 5. Are the costs of cryogenics deductible by the clients? Currently (or must the costs be depreciated, depleted, or amortized)?**

The sale of a human body is generally illegal in the United States, so the remains would likely be held "on consignment," as opposed to purchased. IRC Sec. 162 expenses (and basis) would be deducted against consignment revenue similar to Plan 1 above. Restrictions on cloning are easing internationally, with one company in London being issued a license to clone human embryos for medical research (CNN 2005), so the implications of operating internationally should be explored.

Other Accounting Issues

- 1. Would the cryogenics fall under start up costs?**

Under IRC Sec. 195, the costs of investigation of a new business are capitalized until business commences (often measured by when the first sale takes place), and then amortized over not less than 60 months. The exception to this rule says that when a taxpayer is in the same or similar business as the new, beginning business, the costs of investigation and start-up are wholly deductible in the year paid or incurred, regardless of whether the taxpayer

undertakes the business (Sec. 195(c)(1)(B)). Arguably, if DNA is yet another fertility method, the costs could be currently deductible.

2. Would the recipient of the fertilized DNA be able to deduct the procedure as a medical expense?

Currently, artificial insemination, in vitro fertilization, and medical expenses for the donor sperm/egg are deductible as medical expenses. Other payments to the donor and payments to a surrogate mother are not (Reid and Main, 2000.)

STUDENT REACTIONS

Initially, several students did not like being assigned an exercise without a known, finite answer. Others found the case intriguing and/or challenging. Some mentioned that attempting to answer a tax question without a known or nearly known answer was nearly impossible. Their source of discomfort seemed to be that they did not know where to "find" an answer if it could not be looked up on the web or in the authoritative literature. That is, they were uncomfortable having to find an answer from logic and general knowledge (including general tax knowledge) alone. When the assignment was not altered to accommodate the discomfort of the students, nearly all produced a reasonably strong case. Students were allowed to discuss ideas and issues amongst one another out of class (similar to bouncing ideas off colleagues in a practitioner setting), but their final answer had to be their own. Scores ranged from a low of 81 to a high of 100. While instructor prepared answers were expected from students, alternate answers were also counted for full credit if well supported. In this sense, the grading for this case differed from those cases that had a finite answer.

TABLE 1: RELATIVE STUDENT EVALUATIONS OF THIS EXERCISE

Compared to 8 other cases given..?	# Students Chose This Case	%	Rank Order
Easiest (n = 7)	0	0	9 (last)
Hardest (n = 7)	1	14	3-way tie: 2 nd
Learned the Most (n = 8)	3	37	1
Most Fun (n = 9)	2	22	2

Students were given a total of nine cases throughout the semester. Three came from the PricewaterhouseCoopers (2002) series, three came from their Scholes et al. (2002) textbook, and three were instructor-developed cases. A short, relative student evaluation of these cases was made during the last week of class. Subsequent evaluations comparing this case to the other eight cases presented throughout the semester are shown in Table 1.

On the final, departmentally administered teacher evaluations, there is no specific evidence to indicate that this case hurt instructor evaluations, and instructor evaluations in general were quite high for this course.

CONCLUSIONS

The point of this case is to get students to be able to create a reasonable solution to a new accounting problem using general research skills where no such solution currently exists. This case provides a colorful, futuristic scenario where such critical thinking and research skills would be needed. The case is both significantly difficult and significantly engaging to prompt learning and entertaining class discussion.

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SHOE WAREHOUSE CASE: APPLICATION OF STRATEGIC INFORMATION PRINCIPLES

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CASE DESCRIPTION

The primary subject matter of this case concerns identification of technology issues for a small business and the design of a new system. Secondary issues to be examined include implementation of a new system and data conversion issues. The case has a difficulty level of five. The case is designed to be taught in two class hours and is expected to take approximately ten hours of outside student preparation.

CASE SYNOPSIS

Students are presented with a business scenario in which they need to get a new information system installed for a small company where they have just started working. Students are asked to review the scenario, summarize the information in more organized fashion, describe the benefits of the new system and some possible solutions, then prepare a proposal for the new system they feel the company should pursue.

INSTRUCTORS' NOTES

This case has been used to reinforce the concept of a structured approach to information system development/acquisition for a graduate course taken by Master of Business Administration (MBA) students. While all MBA students are exposed to problem solving, this case is designed to have them apply their problem solving skills to getting a new information system for the company. This case forces the student to follow some of the System Development Life Cycle (SDLC) concepts to solve their problem.

A general instruction approach should include a review of the SDLC and general problem solving skills. This discussion should take approximately 2 in-class hours. Give examples of the SDLC steps and general problem solving skills. A description of the SDLC can be found in *Essentials of System Analysis & Design* (Valacich, George, and Hoffer, 2004).

Projects are graded primarily for content. Successful students present well-written documents that show the student understands there is a relationship between the organization of the company, its desired system outcomes and the requirements for the system. The successful student includes components that address today's IT issues, such as networking, security, virus protection, etc.

Consideration should be given to the following items when presenting the case to the class:

- ◆ Using separate servers for both the e-mail server and the ERP system server to enhance performance and reduce maintenance issues.
- ◆ Using at least a T1 internet connection to properly support the B2B activities.
- ◆ Using at least cat 5E for network infrastructure cabling to allow for future expansion into such bandwidth intensive items as VOIP.

This case may be expanded to include a budgeting component by requesting the student also develop a budget for ongoing upgrade and maintenance needs for future years, including any additional personnel needs as a result of these changes.

Item 5 is an optional item, with usage depending upon the technical sophistication of the students. A proposed solution to item 5 has not been included in the following sample solution.

A sample solution follows.

Item 1 — an executive summary describing the system that you would propose to the company president.

To: James Deen

From: Joe Smith

Re: System Specification Assignment for Comfort Shoe, Inc.

Date: November 27, 2001

As per your request, the following is a copy of my proposal to our President for your review. I have included some of the more important aspects that will be required in order to accomplish this technology make-over. After your review, I would like to discuss any comments or suggestions that you might have. Your tenure and experience in our company could provide some insights to help us succeed in the conversion plan that I have described below. I can meet at your convenience.

Thank you for your time.

Summary

After conducting several benchmarking interviews with other small wholesalers and distributors that have similar business functions as our own Comfort Shoe® line, and conducting internal discussions regarding needs and wants with each of our VPs and staff, a hardware, software

and conversion plan was developed. At least three vendors each of hardware and software solutions submitted a bid from my request for proposal. With this information in hand, I was able to construct the system specifications and receive separate and direct pricing quotes, thus decreasing the overall capital investment figures. This recommendation meets the current overall company objectives and mission while integrating across every department in the company. It also allows for growth and scalability in all aspects of our business. Most importantly, it positively and immediately impacts each department's performance to the bottom line profit.

The technology make-over will consist of replacing our existing computers with new state of the art desktop PCs and providing leading edge laptops to our sales force, all networked together and tied to a new company software infrastructure that consists of a company intranet, a website and an ERP solution that allows for integrating all of our home office and warehouse functions. On-line reporting and tracking of sales, payables, receivables and profit/loss statements will be made available on a secure intranet as well as on hard copy reporting as done today. The conversion to this new system is estimated to occur over a period of 10 weeks. This includes hardware and network replacement, legacy system data conversion and training.

The overall budgeted cost is as follows:

Hardware – Main server, network hardware/connectivity/Desktops/Laptops	\$25,899
Software Desktop - MSOffice/email	\$8,500
Software – ERP/Intranet/Salesforce	<u>\$13,500</u>
Grand Total	\$47,899

A detailed budget is included as an appendix item.

In addition, a full set of key factors of success have been identified in each department that spell out what the criteria of success and sign-off requirements are on the new system. Company involvement and ownership has been included throughout this plan.

Technology Features

The office suite of software will consist of Microsoft Office XP, Corporate edition, which includes Frontpage web creation and hosting.

The ERP software solution is made by CeeCom Inc. which creates B2B solutions for both the traditional bricks/mortar companies and the new e-commerce companies. It will provide an integrated suite specifically designed for wholesalers/distributors that have a corporate office and a sales force. The ERP solution also provides an intranet module that allows secure web access by sales force, material suppliers, vendors and the small retailers. The solution will provide information of purchases, payments, order tracking, order placement, returns, materials on-hand, inventory and many other financial and necessary information points that will allow us to enhance our business.

The system includes a special module that allows for catalog creation, tracking and features. It also has an intranet feature that allows for e-commerce to occur between our B2B (business to business) partnerships.

The supply chain module allows all warehouse/distribution functionality, and finance features such as A/R, G/L and A/P.

The strategic plan calls for initial use to match what is actually being performed from our existing systems. The scalability and modularity of the ERP software allows for us to strategically turn on/off, (at our leisure) the features described above.

A news brief highlighting the ERP software is attached as an appendix item for your review.

Use of an existing direct tie line to the internet will provide an existing 153kb fractional T-1 that to the Home Office Facility. Surplus funds from the original budget will be used if an upgrade needs to be made to increase bandwidth for improved access.

Note: This assignment was created in a scenario format in order to depict what I would include in the real world.

Appendix Item

Ceecom Inc. releases Ceecom e-Business Suite 7.1, a Fully Integrated B2B Solution for Small to Mid-Size Enterprises

June 19 , 2001, Singapore, CommunicAsia2001 . . . Ceecom Inc. today announced the release of the latest version of their fully integrated suite of B2B e-Business software line. The newly introduced Ceecom e-Business Suite 7.1 software package seamlessly integrates front-end and back-office applications, enabling SMEs (Small to Medium size Enterprises) to compete with a total, end-to-end, e-business solution which is deployable in only a matter of weeks. Ceecom's collaborative enterprise e-business solution focuses on the global shift to customer-centric businesses, enabling highly dynamic and interactive relationships with both customers and suppliers.

Ceecom's suite of e-Business products targets mid-size manufacturers, distributors and wholesalers desiring to leverage the efficiencies and cost-savings associated with today's e-business model, without spending the large amounts of time and money typically associated with fully-fictional web-enabled ERP applications.

Ceecom *e-Business Suite Version 7.1* is totally web-enabled and provides users with a complete *e-Order fulfillment* module, enabling customers to browse product catalogs, enter orders, and obtain order and shipping status updates. An *e-Customer Order* module enables customers to request information, inquire about product and account status, and update their own user profiles. The *e-Procurement* module allows for the tracking of quotations, POs, as well as account information. The forth module, *e-Customer Support*, allows for the easy management of warranty information, requests for support and product returns.

All Ceecom *e-business Suite 7.1* functionality is tightly integrated with all of Ceecom's ERP and Supply Chain back-office software products, allowing for a total, end-to-end e-commerce solution. Ceecom ERP and Supply Chain solutions can be tailored to an organization's specific environment. Each industry sector has unique processes and practices and Ceecom provides a comprehensive set of software solution components that address the exacting needs of each specific market sector.

Full integration and flexibility across the entire Ceecom systems ensure a seamless flow of information and transactions while providing the ability to adapt to changing business requirements in the years to come.

"Ceecom's e-Business Suite Version 7.1 will help small and mid-size companies who want to compete with the larger players but don't have the time or financial resources to invest in typical Enterprise-wide solutions. Our customers are looking for a web-enabled ERP system they can customize to their exact business requirements and have up-and-running in matter of weeks or months -- not years," said Ray Talwar, President of Ceecom Inc. SMEs can quickly benefit from Ceecom e-Business Suite Version 7.1 as complete system payback can often be realized in less than one year.

Ceccom *e-Business Suite Version 7.1* is built on a multi-tier, object oriented architecture that includes HTML support, Web Server and Application Server, Java Components and EJB (Enterprise Java Beans). Version 7.1 supports the high performance Microsoft SQL Server 7.0 and Sybase Adaptive Server Enterprise as Database Servers on Windows 2000, Solaris and UNIX. Industry standard Crystal Reports enhances the system's report capabilities and makes web publishing available. Ceecom's open architecture provides for easy integration with Trade Exchanges, Portals and Wireless Devices.

Ceccom customers include: The Ontario Provincial Police (OPP), Novartis, Weston Bakeries, Dow Jones and Ion Systems.

Item 2 — an implementation plan for the new system; be sure you adequately cover the conversion of the data from the old system to the new system, as well as the necessary time line for the entire conversion process. Address whether there are any special software needs for the management of the implementation itself.

Implementation Plan

The implementation begins with 2 weeks of rewiring the home office and warehouse with CAT5 high speed Ethernet cable and installing new desktop computers, distributing the laptops and configuring the main server. Simultaneous data conversion to the new software will also occur over the first 2 weeks.

Next, while each department is getting accustomed to the new desktop (or laptop) hardware with full access to e-mail and the Internet, a conference room pilot will occur for 2 weeks with the new system producing the minimum of what the existing system produces, while highlighting all the additional features and benefits. This will require each department to sign-off on each module to assure accuracy and matching with existing reporting and tracking. Weekly, monthly, quarterly and annual financial closings will be simulated both on the old and new systems to verify accuracy. Each department will be required to sign-off on all figures and reporting.

Next, there will be 1 week of class room training coordinated with each department during the 5 day work days. Each department head will be asked to participate in order to assure the objectives of the change-over are met. Separate area training and coordinated group training will occur to ensure all integrated functions are highlighted and tested. During this week the field sales force will be required to travel to the home office. Meeting a flexible schedule will be essential during this week in order not to disrupt existing operations.

Next, there will be a 2 week live pilot, where both the new system and the existing system will be utilized in a live environment. All normal activity will be required to be performed on both systems to ensure accuracy. An additional 1 week allotment is placed in the schedule to allow for issues that may come up during the live pilot. If the 1 week is not needed, then the schedule will complete in 9 weeks versus the stated 10 weeks.

Once the live pilot is signed-off on by each department, and the established criteria for success factors have been checked off, the system will be officially put into production and the old system will be archived and stored. The next 2 weeks are considered follow up weeks to assure each department is comfortable and utilizing the system as best as possible.

Normal maintenance, updates and upkeep of the hardware and software will be required on an on-going basis. A 12 month and 18 month strategic plan has been created and will be distributed to each department in order to ensure we realize optimal utilization and benefits from this technology make-over.

Items 3 and 4 — a hardware budget that includes a general description of the hardware items to be purchased with estimated costs, and a software budget that identifies the specific software packages with estimated costs.

<i>ItemType/Department/Users</i>	<i>Description</i>	<i>Cost</i>
Desktops	Athlon XP performance, 512MB DDR RAM, 80GB HD, PenIV 3 VPs 5 Finance Associates 2 Ops Associates 3 Warehouse (various locations for tracking performance) 2 Expansion Units	\$9500

Laptops	Toshiba Satellite 1805, 128MB Ram, 20Gb HD, Pen IV, DVD, network cards included	\$8600
	10 Sales force	
	2 Expansion Units/Homeoffice Use for Travel	
Other Required Hardware and Software		
	1 Main Business Server	
	AMD Athlon XP, 512 MB RAM, 300GB HD, Raid5, PenIV	\$2499
	1 Backup Business / Primary email Exchange Server	
	Same as above	
		\$2499
	1 Router with firewall	
	D-Link DSL/Modem/Cable router w/firewall	
		\$1849
	1 Workgroup Switch	
	Xircom Premium Workgroup Switch	
		\$892
	2 16-port 10/100 thick ethernet hubs	
	PortGear Hubs	\$759
	Cat5 High Speed Ethernet Cable	
	2500' bundle w/rj45 punch downs	\$1800
	MS Office XP Corporate Suite with up to 40 seat licenses and 2 server licenses	\$8500
	CeeCom Supply Chain and B2B Software Suites	
	2 server licenses and 40 seat licenses	<u>\$13,500</u>
	Total	\$47,899

Note: The direct tie line to the internet will be an existing 153kb fractional T-1 that was existing in the Home Office Facility. Surplus funds from the original budget will be used if an upgrade needs to be made to increase bandwidth for improved access.

THE PROPOSED MERGER OF AMERICA WEST AND US AIRWAYS: WILL IT FLY?

Richard Cobb, Jacksonville State University
Carl W. Gooding, Jacksonville State University
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CASE DESCRIPTION

This case discusses a proposed merger between two major airlines - America West and US Airways. The primary objective of this case is to address the critical issues required either to support or reject a merger strategy. The case would be appropriate for the senior or first year graduate level Strategic Management course, and the case should work well as a team project. The case is designed to be taught in 1 class hour and is expected to require 3 hours of outside preparation by students.

CASE SYNOPSIS

In April 2005, America West and US Airways made a public announcement concerning a proposed merger between the two carriers. The information needed to support or reject this proposal is available from company, industry, and governmental sources and generally indicates that although the proposed merger partners operate in the same industry, they have very different operating characteristics. This case challenges students to analyze the critical strategic issues which the proposed merger partners must address to consummate successfully a merger.

INSTRUCTORS' NOTES

Case Objective

Students will search available information and identify and analyze the critical merger issues of this case.

Teaching Methodology

An abundance of information may be found in the Investors Relations section of www.americawest.com and www.usair.com, particularly within their respective SEC filings. Governmental sources such as the Federal Aviation Administration (FAA) and the Bureau of

Transportation Statistics (BTS) offer current statistical data. Also, proprietary sites such as Standard and Poors NetAdvantage provide quality information.

QUESTIONS AND ANSWERS

1. Evaluate the internal and external environment and analyze major obstacles to making this merger successful.

To answer satisfactorily this question, students must prepare, at a minimum, the weaknesses (internal) and threats (external) parts of a SWOT analysis. Students, based on their educational and professional background, may create many obstacles, but the major strategic issues are outlined below:

Internal Obstacles

a) *Culture* – Started in 1983, *America West Airlines* (AWA) is a much newer airline and is the only post-deregulation startup to survive. It is known as a lower fare, full-service airline that has achieved profitability as recently as 1Q and 2Q of FY05.

In contrast, *US Airways* (USA) is larger and a legacy carrier and has been in existence since 1939. It has not been profitable, on a fiscal year basis, since 1999. The company has been in bankruptcy twice since 2002.

In evaluating each company's history and its current standing within the industry, a clash of employee cultures must be considered. The merged airline will be headed by existing AWA senior management. However, a smaller, younger, more fluid, and profitable carrier merging with a larger, unprofitable, legacy carrier has the potential for two organizational problems. First, the merged company has elected to utilize the US Airways name, a perceived stronger brand image than AWA, and this decision could cause disgruntlement with the employees of AWA, stakeholders in the more profitable company. Second, because AWA is a younger company, some employees may have lower seniority than their USA counterparts.

b) *Seniority* – USA has managed to obtain major wage concessions from its employees during its two Chapter 11 bankruptcies, and its wage rates are generally comparable to that of AWA. While wage issues seem to be a minor area of concern, the issue of seniority looms large. AWA employees, who helped to build a profitable airline and therefore helped create the opportunity for this merger to happen, now could find themselves at a disadvantage in the merged company's union seniority lists. This situation provides the potential impetus for poor morale or other work-related problems as management attempts to integrate the very different workforces.

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- c) *Costs* – According to the Bureau of Transportation Statistics (BTS), AWA has one of the lowest cost structures versus U.S. based major airlines. In fact, in 2004, its cost per available seat mile (CASM) was the lowest of any U.S. hub and spoke airline. However, its costs are still higher than *Southwest*.
- d) *Branding* – As mentioned earlier, the combined companies have elected to use the *US Airways* brand for its perceived brand equity, even though the unprofitable legacy carrier has had two bankruptcies since 2002. Management is gambling that USA's current consumer perception, based on today's industry environment, can be repositioned as a vibrant, progressive low-cost airline. Should the merged airline have considered using the possibly geographically limiting yet profitable *America West* brand? Should the merged airline attempt to create a new brand in the manner used by *ValuJet*? In May 1996, *ValuJet* suffered a brand destroying crash in the Florida Everglades. In October 1997, *ValuJet* management merged the carrier successfully with Atlanta based *AirTran*, adopted its name, and has experienced profitability in every fiscal year since 1999.
- e) *Duplication* – The merger brings obstacles, such as duplication of efforts in management, staff, personnel, facilities, and competitive routes. AWA management has stated in public merger-related documents that it expects \$600 million in synergy savings. Of the \$600M, route restructuring will save \$150-\$200M; reductions in IT, facilities, and administrative overhead are to equal \$250-\$300M; and increased revenue synergies of \$150-\$200M are projected. Are these savings estimates realistic based on the industry's history relative to other mergers and acquisitions?

External Obstacles

- a) *Fuel* – Raising fuel costs have hit not only consumers, but airlines as well. AWA management has stated its business model for the merged airline is profitable at \$50/barrel. As of late August, oil had hit \$66/barrel, a 32% increase. Its model for the merged airline is now unprofitable.
- b) *Government*
Regulation – The U.S. government has the right to regulate mergers and acquisitions to help prevent any business from achieving an overwhelmingly dominant position. In fact, in 2000, *United Airlines* considered merging with *US Airways*. The financial instability of both airlines combined with regulatory concerns thwarted that deal. The current merger proposal passed its review by the U.S. Justice Department on June 23, 2005. It faces further regulatory review from the U.S. Department of Transportation, the Air Transportation Stabilization Board, the Security and Exchange Commission, and U.S. Bankruptcy Courts.

c) *Capacity/
Competition*

– AWA management has openly expressed its desire for industry consolidation and restraint in order to reduce airline capacity. Will competitors react in agreement or create an even more aggressive fare war to gain market share in anticipation of the proposed merger.

In an effort to provide the instructor and students with all available information needed to help make meaningful decisions, one of the case authors had a personal interview with W. Douglas Parker, current CEO and Chairman of AWA and future CEO and Chairman of the merged U.S. Airways. Mr. Parker was asked to comment on the issues contained in the questions. His comments are summarized as follows:

He began his commentary by stating, “I do wish to point out there are many strengths and opportunities to our merger that we hope to exploit.”

Mr. Parker agreed that organizational culture and the system of union seniority are the major threats to the merger plan. Having expressed his concern however, he felt that through communication, employees would gain an understanding that their long-term survival depends on the success of this merger and that they can “manage through these issues.”

On the topic of branding, Mr. Parker noted that “*US Airways* is a recognized global brand.” He felt that any current negative consumer perception towards the brand can be changed by quality service and performance. He cited Continental’s poor image in the 1990s, recalling that it has done a good job of changing its brand image. Also, by keeping the *US Airways* name, the new company will not incur any brand building costs needed with a new name.

Regarding fuel, Mr. Parker commented that he feels “seats will continue to disappear,” which “will relieve pricing pressure.”

Regarding government regulation, Mr. Parker stated he is confident the merger will pass all governmental tests.

In commenting on competitive actions, Mr. Parker stated that “so far, there has been no major action by competitors” regarding the merger. He added, most in the industry “recognize that this is what has to be done.”

- 2. An increase in \$1/barrel increases the merged airline’s costs by \$36M. The merger model was based on \$50/barrel. At \$66/barrel, how much does this increase the merged company’s fuel costs? What options does it have to offset this cost increase?**

$\$66/\text{barrel} - \$50/\text{barrel} = \$16/\text{barrel increase}$

$\$36\text{M} \times \$16/\text{barrel} = \$576,000,000$

Generally, to offset an increased expense, one must increase revenues or decrease other expenses. One way the industry attempts to offset rising fuel costs is by utilizing fuel hedging. However, because of USA's poor financial standing, it is unable to purchase fuel hedging contracts. Currently, hedging is a limited option.

During the August 2005 interview with AWA CEO Douglas Parker, he stated, "In the past six months, the industry has shown the ability to raise prices to cover the increasing fuel costs." He added, "Although AWA's fuel costs will have increased about \$200M year over year, the company's overall profit and loss situation will not be materially different than in FY04."

- 3. As stated in the case, the existing top level of management at AWA will become the top level of management for the merged company. Does the data presented in the case indicate any areas wherein the merged management team may be able to improve overall operating results? The team would accomplish these improvements by applying differing managerial practices to the larger portion of the merged company which was US Airways?**

If students do comparative plots of some of the data in Tables 3 and 4, they should be able to discern if AWA has over time outperformed US Airways on critical productivity measures such as Average Aircraft Utilization/Day and Yield (Column H/I).. Students should look at data from competitors of each merger partner to see if these results are systemic or a product of better management practices.

DID NAPOLEON WIN THE BATTLE OF WATERLOO?

Martine Duchatelet, Barry University

CASE DESCRIPTION

The primary subject matter of this case concerns the value of information. A secondary issue raises the question of the effect of technical progress in the dissemination of information on the organization of markets. The case has a difficulty level of 3 to 4, it was designed for an audience of juniors and seniors with elementary knowledge of statistics, economics, and finance to illustrate the concept of value of information for the private citizen and for society at large. The class discussion easily fits within a 50 minutes class and is expected to require no longer than 60 minutes of outside preparation by students. The unfamiliar historical setting for the case and the well-known personalities featured typically captivate student interest.

CASE SYNOPSIS

This case evokes the financial uncertainty on the London stock market on the eve of the Battle of Waterloo in 1815. The lack of accurate information offered opportunities for tremendous profit for economist David Ricardo and banker Nathan Rothschild. The case illustrates numerically the rates of returns that could be achieved in such circumstances and makes us appreciate the value of instantaneous, accurate information in today's global markets.

INSTRUCTORS' NOTES

Suggestion for Further Class Discussion

A case reviewer suggested that this somewhat atypical case would lend itself to drawing students out into thinking about other issues than those called for by the Case Discussion Questions reviewed below. Each instructor has many such issues in mind and may wish to lead the discussion outside the narrow disciplinary training of the class for which this case was designed.

It is mentioned in the case that Nathan Rothschild was a "young" banker in 1815. In truth, he was 38 years old. His four brothers ranged from 23 to 42 years old at the time. The five Rothschild brothers controlled the finances of the Western World of their time, financing all armies and governments on both sides of the conflict. These facts could lead to a discussion of nepotism. They could also lead to a discussion of opportunities afforded young, gifted, highly trained

individuals as opposed to today's world when any kind of power is rarely in the hands of professionals under fifty.

It is mentioned in the case that Nathan Rothschild went to Lord Castlereagh, the Foreign Secretary, with the news as soon as he received it only to be rebuffed for reasons having to do with class consciousness or racial prejudices. This fact can lead to a discussion of the failures of a government, blinded by shortsightedness. Current examples abound that can be evoked if the instructor doesn't fear controversy in the classroom.

The discussion could turn to ethics and insider trading. Should Nathan Rothschild have trumpeted his news to the large public rather than simply tried to communicate it to the authorities and then trading to his advantage.

The discussion could raise the question of how the instantaneous spread of news today is only useful if the public can truly appreciate the drift of the news as in the result of a battle or the devastation of a hurricane. If the news is widely and instantly disseminated but its purport is ill understood, there remains a huge insider's advantage to those who can distill the tenor of the information. We can think of the scientific reports on avian flu dangers and global warming threats that are so crucially difficult for the public to assess.

SUGGESTED ANSWERS TO DISCUSSION QUESTIONS

- 1. Compare the uncertainties associated with the Battle of Waterloo to the uncertainties associated with a recent battle, say during the American invasion of Iraq. Could any one citizen, however influential, have a temporary monopoly on crucial, accurate information about today?**

Wars always offer uncertainties. It is still true now as it was then that before battle, no one knows what the outcome will be. What is altogether different today from the situation at the time of the battle of Waterloo is that as soon as an event has unfolded, news about its outcome is virtually instantaneous, no matter where in the world, what time of day, what the climactic situation, etc. Furthermore, the information is widely accessible and accurate, or at least easily verifiable. Such are the advantages of cellular, satellite, and internet technology.

There might today still be a person, or a group of persons, private or public, who comes by a bit of knowledge first, thereby garnering a monopoly of sort. But the length of the information monopoly is doomed to be extremely brief thanks to widespread access to radio, television, cell phones, satellite communications and the World Wide Web. This is true in economically developed countries as well as in emerging and developing countries. The length of the information monopoly has become nil for news whose informational

content and impact is readily understood by all, as is the case for the outcome of a battle or an election, or the happenstance of a natural disaster. The length of the information monopoly for a piece of knowledge that requires considerable technical sophistication to process and understand can last a bit longer.

2. **David Ricardo, the economist celebrated for developing the theory of International Trade based on comparative advantages, is reported to have held on his holdings of consols in spite of rumors and panics (Skousen, 2000). We know that consols closed at 69 & 1/16 pounds on Friday, June 16th, and stayed at that price until the 20th when Nathan Rothschild started buying. The price was up to 70 pounds even on Wednesday the 21st before the victory became official news, and closed at 71 & 1/2 on Friday the 23rd (Cowles, 1973). What annualized return would Ricardo have realized on his consols holdings over the week of June 16th to June 23rd, 1815?**

For each consol he held, Ricardo realized a value appreciation of [71.5000 – 69.0625] British Pounds on an initial investment of 69.0625 British pounds. This amounts to a rate of return of 2.4375/69.0625 or approximately 3.53% for one week. With 52 weeks to a year, this amounts to a yearly rate of return of approximately 183.53%.

3. **Consider the following (fictitious) numbers and compute the expected value of accurate information for Nathan Rothschild. Make the following assumptions:**
- ◆ **The French and the Allied Forces had a 50-50% chance of winning the decisive battle.**
 - ◆ **Rothschild had 200,000 British pounds in cash available for speculation.**
 - ◆ **Rothschild assumed that on the news of an imminent battle, uncertainty and panic selling would bring the price of a consol as low as 50 British pounds, and that the price would sink and stabilize at 20 pounds in the case of a British defeat or would rise and stabilize at 73 pounds in the case of a British victory.**
 - ◆ **Rothschild was confident that his sources would tell him the results of the engagement a full 24 hours before the official confirmation would arrive.**
 - ◆ **On the news of a victory, Rothschild would not attempt to aggravate the panic by selling first to bring prices even lower and buy later at the new bottom price.**
 - ◆ **Rothschild would not engage in hedging operations. He would enter the market only upon news of a confirmed victory.**

On the news of a defeat, he would keep his speculative stash in cash and refrain from entering the market. On the news of a victory, he would enter the market and purchase as many consols as possible. With 200,000 British pounds, Rothschild could purchase 10,000

consols at the price of 20 British pounds. After 24-hours or so, the official news of a victory would cause the consol price to rally to 73 British pounds. Rothschild's consols holding would now be worth 730,000 British pounds. This would increase Rothschild's wealth by 530,000 British pounds, a considerable amount for the time. The expected value of accurate news of the outcome of the battle would therefore be: $\{(0.5) [0] + (0.5) [570,000]\}$ British pounds or 290,000 British pounds (or 29 million US dollars of today, approximately.) Clearly the reward to the courier and the costs of his trip to and from Belgium were well worth the trouble.

- 4) **Does this little historical example illustrate to you an aspect of the role of technology in economic markets that doesn't come immediately to mind? Does this example suggest that, through the ages, we have come closer or further from what economists define as "perfect competition?" Explain.**

Most of the public understands readily the advantages of technology to society in terms of facilitating the discovery of new products and services and in terms of finding new processes that reduce the costs of production. What is special about information technology is that not only does it reduce the costs of production by bringing about faster, more accurate communications, but it also brings markets closer to "perfection." Perfect competition is defined as a situation where no one buyer nor seller has any degree of market control and where all economic decision makers are therefore free of making their most advantageous decision to the greater benefit of all. In Adam Smith's famed words, the "invisible hand" brings about efficiency in production, distribution, and consumption. Modern information technology insures that every participant in a market is able to access the goods visually and by their precise descriptions, track them through the vicissitudes of transportation, and compare their prices to the prices for similar goods, all this at very low cost and with great trust in the quality of the information. Information technology does not remove the cost advantage of large production scale, but it does remove the disadvantage small firms used to be experiencing in making their products widely available and widely comparable on the world market. Perfect competition is the condition of markets most beneficial to Society. Deadweight losses (losses in consumer and/or producer surplus) do not occur in Perfect Competition. Prices are as low as can be to cover unit costs. Consumer sovereignty and production efficiency prevail.

Modern information technology brings us closer to perfect competition.

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DISASTER RECOVERY FOLLOWING THE EVENTS OF SEPTEMBER 11, 2001

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CASE DESCRIPTION

This case analysis examines the process of developing and implementing a disaster recovery plan. The case (1) discusses some of the inherent problems that large organizations face in developing an effective disaster recovery plan, and (2) highlights the challenges of implementing a disaster recovery plan in the face of real world events that vary from the plan's initial assumptions. This material is appropriate for undergraduate and graduate courses in risk management, information systems, and business continuity planning. The case is designed to supplement a general discussion of disaster recovery planning, and disaster risk management.

CASE SYNOPSIS

Developing a disaster recovery plan is a challenging process for most organizations, requiring plan developers to strike an appropriate balance between breadth and detail. In 2001, the Chief Financial Office organization began a disaster recovery process that was completed in the early part of September 2001. This case reviews the process used by Merrill Lynch's CFO organization to develop a disaster recovery plan, and the challenges faced in implementing this plan following the events of September 11, 2001.

INSTRUCTORS' NOTES

The case can be used in a variety of settings, ranging from a brief introduction to the concept of disaster recovery planning, to advanced courses in risk management. It provides opportunities for discussing the key aspects of disaster recovery, business continuity planning, and the challenges faced when a company is forced to put a plan into action. Several aspects of disaster recovery planning and implementation can be addressed with this case, including (1) resource allocation during the planning phase, (2) resource allocation during the implementation phase, (3) planning horizon, and (4) the role that disaster context has on plan implementation.

The case was based on the second author's experiences during an internship with Merrill Lynch during the summer of 2001, where she was extensively involved in the development of the

CFO unit's disaster recovery plan. This manuscript has also benefited extensively from interviews with Nicole Degnan, Merrill Lynch Director, and John Fosina, Merrill Lynch Controller.

SUGGESTED ASSIGNMENT QUESTIONS

The following questions may be assigned to foster class discussion.

1. What aspects of the CFO unit's business continuity plan would you consider critical to an effective disaster recovery plan?
2. What aspects of the CFO unit's business continuity plan would you consider weak and detracting from the plan's overall effectiveness?
3. What elements of the CFO unit's implementation would you consider as critical to the plan's ultimate effectiveness?
4. What elements of the CFO unit's implementation would you consider to have detracted from the plan's ultimate effectiveness?

SUGGESTIONS FOR CLASSROOM USE

One way to incorporate this case into classroom discussion is to ask students to evaluate the CFO unit's disaster recovery process along three dimensions: (1) plan development, (2) plan implementation, and (3) the entire disaster recovery process (i.e. plan development and plan implementation combined). Specifically, I ask students to score each dimension on a 10-point scale. For the plan development dimension a "1" represents extremely poor (almost non-existent) planning, "5" indicates an adequate level of planning, and a "10" indicates as perfect of a disaster plan as could be conceived. For plan implementation a "1" indicates horrible implementation where the company was largely unable to implement the designed plan, "5" indicates an adequate implementation, and a "10" represents perfect implementation. Finally, an overall grade is given to the entire disaster recovery process reflecting how well the company's plan development and implementation handled the events of September 11.

I usually have students work in teams of 3 to 5, and give them about 10 minutes in class to discuss these and come to a consensus on a numerical rating. Giving students this time for deliberation is particularly beneficial because it gives them a chance to compare their detailed analysis (see suggested assignment question), and link their analysis with a single metric of performance. I also try to encourage students to avoid giving "5s" and make more definitive assessments of these dimensions. This often requires me to emphasize that there are no "correct"

answers, and that their grades will not be affected by their ratings, but rather by their class discussion.

After students have deliberated, I ask each group to share their ratings with the class. I then ask students who have provided ratings on each end of the spectrum (i.e. low and high) to explain what specific factors led them to make their ratings. I'll keep a list on the board of the specific items that students mention.

After discussion of the final dimension, I ask students what is the single most important factor in the disaster planning and implementation process. Several different factors are usually mentioned, including:

1. Understanding the company's business model and strategy
2. Understanding the industry's structure
3. Prioritization of business unit activities
4. Prioritization of service unit activities
5. Process of allocating resources among units
6. Process of allocating resources between business and service units
7. Technology issues

The goal here is not to identify a single factor, but to force students to think about prioritizing the myriad of issues that a company must face in the disaster recovery process. I then use this discussion to transition into a discussion of how to prioritize these demands. I try to leave students with an acceptance of the uncertainty associated with disaster recovery planning and implementation, and that there is no "correct" answer. I also try to emphasize that disaster recovery planning and implementation is highly contextual. Different things such as company specific issues, industry issues, and economic conditions could all impact the prioritization of individual disaster recovery elements. Additionally, the specific disaster that occurs will provide further context that will shape the priorities in implementing a disaster plan. For example, the events of September 11 will have a completely different implementation and prioritization than a hurricane or a fire.

APPLYING DISASTER RECOVERY PLANNING IN A UNIVERSITY SETTING

In more advanced risk management classes, I extend this exercise by asking students to outline a disaster recovery plan for an organization they are familiar with. I often ask students to focus on a university setting. I emphasize that students should take the perspective of the CEO of the university, and focus on the activities that are critical to the operation of the institution and not them personally. To make the exercise more manageable, I often have students:

Identify the top 5 to 10 activities that should be tier one priorities. I further ask students to explain why they have assigned these specific tasks to tier one.

Identify the 5 to 10 activities that should be tier two priorities. I again ask students to explain why they have assigned these specific tasks to tier two.

Identify the 5 to 10 activities that should be tier three priorities. Again, I ask students to explain why they have assigned these specific tasks to tier three.

Discuss any activities of the university that should not fall under the disaster recovery plan at all.

I emphasize that students should take the perspective of the CEO of the university, and focus on the activities that are critical to the operation of the institution and not to them personally. Again, there are no "correct" answers. This discussion is intended to give students a chance to work through the decisions in building a disaster recovery plan rather than coming up with specific solutions.

INSHALLAH: AN EXPATIRATE CHALLENGE

Phillip L. Hunsaker, University of San Diego

CASE DESCRIPTION

The primary subject matter of this case concerns how lack of understanding and appreciation of cultural differences can undermine potentially beneficial joint ventures. Secondary issues examined include awareness of cultural differences, the role they play in crafting international alliances, the consequences of violating cultural norms, and the steps expatriates should follow to form successful interpersonal relations with foreign counterparts. Students also become more aware of their own readiness for assignments in foreign cultures through assessments of their empathy, flexibility, and analytical skills as they identify with the American expatriate and assess what actions he should take. The case has a difficulty level of five, appropriate for first year graduate level. The case is designed to be taught in one hour and is expected to require one hour of outside preparation by students.

CASE SYNOPSIS

Bladeco is a United States company that has recently undertaken an international joint venture with a Saudi Arabian company in the precision steel products market. The newly appointed Middle Eastern Manager is eager to apply his international relations skills to enhance the sales of Bladeco products in Saudi Arabia. He enthusiastically accepts the overseas assignment as an opportunity for gaining international experience and advance his career with Bladeco. But as an American expatriate, he immediately meets intense cross-cultural obstacles. What the Middle East Manager must determine is how to effectively communicate with his Saudi counterparts in order to convince them to honor their commitments to aggressively market Bladeco products in order to reverse declining sales.

INSTRUCTORS' NOTES

Teaching Objectives

The purpose of this case is to demonstrate how the lack of understanding and appreciation of cultural differences can undermine potentially beneficial joint ventures. Discussion of this case enhances awareness of cultural differences, the role they play in crafting international alliances, the consequences of violating cultural norms, and the steps expatriates should follow to form successful interpersonal relations with foreign counterparts. Students also become more aware of their own

readiness for assignments in foreign cultures through assessments of their empathy, flexibility, and analytical skills as they identify with the American expatriate and assess what actions he should take.

Intended Courses

This case has been successfully utilized in business schools at both undergraduate and graduate levels to help students examine how to assess cultural differences and successfully adapt to them. It has also been the focus of discussion in management development seminars dealing with cross-cultural relations. The case can provide an example for learning how to deal with cross-cultural dilemmas in courses relating to international business, global marketing, international management, international strategy, and diversity.

Examples of successful utilization in specific graduate courses have included an advanced course in International Comparative Management where the case was used to explore business opportunities and threats in the Middle East, examine advantages of joint ventures, discuss cultural variables in mergers and joint ventures, and learn how cultural differences influence the crafting international alliances. After the discussion, teams generated strategies for avoiding this type of dilemma in this specific case and other joint ventures. The case has also been used for several semesters in the introductory course in Organization and Management in an International MBA program to increase student awareness the importance of cultural awareness in international situations.

The case has been used at the advanced undergraduate level in international strategy classes to discuss cultural variables in mergers and joint ventures, explore business opportunities and threats in the Middle East, examine advantages of joint ventures, and learn how cultural differences influence the crafting international alliances. It has also been a successful vehicle for teaching advanced undergraduates in an international interpersonal relations course about the importance of cultural awareness in international relationships.

DISCUSSION QUESTIONS

1. Why is Jack having so much difficulty achieving his objectives?

This question gets right to the heart of the problem of different perceptions, values, norms, and expectations, based on different cultural backgrounds. Jack has no understanding of the Saudi culture. This deficit causes him to make a number of blunders and considerable confusion about his Saudi counterparts' intentions and way of doing business. Unfortunately, management at Bladeco headquarters in the United States is equally as naïve

about Saudi culture and applies unrealistic pressure without being capable of coaching Jack on how to understand and adapt to Saudi expectations.

It helps students understand Jack's dilemma if they are briefed in the primary dimensions contributing to cultural differences. One conceptual framework, containing seven primary dimensions of culture is provided in Exhibit 1 (Hunsaker, 2001).

Exhibit 1: Dimensions of Cultural Differences	
1.	<i>Innovation and risk taking</i> : The degree to which people are encouraged to be innovative and take risks.
2.	<i>Attention to detail</i> : The degree to which people are expected to exhibit precision, analysis, and attention to detail.
3.	<i>Outcome orientation</i> : The degree to which management focuses on results rather than on the process used to produce those results.
4.	<i>People orientation</i> : The degree to which management decisions take into account how people within the organization will be affected by decisions.
5.	<i>Team orientation</i> : The degree to which work is organized around teams rather than individuals.
6.	<i>Aggressiveness</i> : The degree to which people are aggressive and competitive rather than easy-going
7.	<i>Adaptability</i> : The degree to which organizational activities emphasize growth as opposed to maintaining the status quo.
Source: Phillip L. Hunsaker (2001). <i>Management: A Skills Approach</i> , 2nd ed (p.320). Prentice-Hall.	

The more members accept these core values and the greater their commitment to them, the stronger the culture is. Strong cultures have great influence on their members' behavior. This makes appreciating and adapting to the needs of different cultures more difficult and causes interaction problems such as those Jack and the Al Amin family are experiencing.

Above average answers to this question should address the core problem, i.e., lack of understanding of different cultural backgrounds. These cause different perceptions, values, norms, and expectations and Jack's lack of awareness and understanding of what is happening creates most of the problems in the case. Above average answers would also discern that both the Bladeco home office and Jack himself share responsibility for these problems. Finally, this level answer would provide some of the primary dimensions contributing to cultural differences.

Average answers would indicate that lack of understanding of different cultural backgrounds contributes to most problems in the case and would hold Jack, and maybe his home company, responsible. Below average answers would miss the core problem and address specific conflicts without understanding why they have originated.

2. How does Jack show his lack of cultural sensitivity?

This question should generate a multitude of examples from the story. A good way to apply this situation with other domains of the world is to get students to disclose their own personal encounters with cultural diversity and insensitivity.

Not only does Jack Adams lack information about business practices in Saudi, but he also is unaware of the culture in which he operates. The underlying source for many of Adams's problems, and those of many executives abroad, is that of cultural differences, including differences in things like attitudes, values, and life goals (Harris & Moran, 1991). Cultural forces influence the conclusions people draw from the facts they have, the assumptions they make when they do not have facts, and, ultimately, the way they behave. The most significant problems between foreign executives and their local counterparts appear to be those in which culturally based characteristics create conflict (Carroll & Gannon, 1997).

This is the case for Jack Adams, who has taken a position which is contrary to the fundamental codes by which Mustafa Al Amin lives. In this example, Adams has violated two primary Saudi values. First is the importance of family name--something not to be lightly exposed in pursuit of materialistic rewards. Second is the importance of living a life marked by gradual and well-considered advancement. Mustafa Al Amin perceives risks to both his name and his long-run goals if he were to implement Adams's aggressive advertising scheme. In addition, Mr. Al Amin perceives no merit for such an advertising strategy in the Saudi business environment.

Lacking understanding of the true character of their disagreement, Adams believes he can reach his objectives by confronting Al Amin with logic, persistence, and forcefulness to argue his case. From his American business perspective, he cannot understand why these are ineffectual. One way to outline the differences between the two nation's cultures is presented in Figure 2.

Figure 2: Differences Between United States and Saudi Arabian Business Cultures		
	Saudi Arabia	United States
Decision analysis	Slow, deliberate where the importance of the decision lies in the amount of time allotted	Efficiency is one of the foremost desired outcomes
Type of economy	Fatalist: no responsibility for the outcome, as God decrees every organization's fate	Capitalist: free will: entrepreneurial, individual spirit
Negotiating culture	Particularists: relationships are more durable than contracts, detailed contracts are a sign that they are not trusted	Universalistic: rely on extensive and specific contracts to document the "rules" of doing business

Figure 2: Differences Between United States and Saudi Arabian Business Cultures		
	Saudi Arabia	United States
Work environment	Teamwork (collectivist)	Independent (individualistic)
Orientation with respect to meetings	Public orientation: more people are present for important meeting (some are related some or not)	Private orientation: important meetings are held behind closed doors
Arrangement of organizational space	Public dimension, crowded and no division or partitions between bosses and employees	Private space: closed doors, separate private offices with minimal interruptions
Business orientation	Relationship oriented	Task, goal oriented

Source: Nancy J. Adler (2002). *International Dimensions of Organizational Behavior*, 4th Ed (pp. 74-75). South Western College Publishing.

Above average answers to this question would provide a multitude of examples from the story. They would also describe the writer's own personal encounters with cultural diversity and insensitivity. They would point out that the underlying source for many of Adams's problems is cultural differences in things like attitudes, values, and life goals. Answers would provide specific examples from the case to demonstrate how Jack Adams, has taken positions contrary to the basic values of Mustafa Al Amin. Finally, they would point out several relevant differences between United States and Saudi Arabian business cultures

Average answers should also provide several examples from the story and they should point out that the underlying source for many of Adams's problems is cultural differences, some of which they should describe. Below average answers would not recognize how Jack's behaviors and attitudes showed cultural insensitivity and might blame the Saudi's for not seeing things Jack's way.

3. What should Jack have done differently to prepare himself for negotiating in Saudi Arabia?

Even if Jack had no idea what to expect with respect to the specific rules for negotiating an agreement in Saudi Arabia, just being aware that cultural differences exist and that he would have to adapt to be successful would have eliminated many of the problems that developed. Jack should have prepared himself to at least understand the bases on which agreements are reached in Saudi Arabia. Three areas he should have studied at a minimum include:

The rules that are spelled out technically as laws or regulations.

The moral practices mutually agreed on and taught to the young as a set of principles.

The informal customs to which everyone conforms without being able to state the exact rules.

In order to understand the symbolic meaning of friendship, rules, time, space and material possessions, Jack should have increased his awareness and understanding of the Saudi Arabian culture. It is amazing how well informed any average Arab is regarding United States customs. The same is not true about Americans (Hall, 1960).

Jack also needed to overcome his ignorance of the social and legal rules that govern business agreements. This would be more difficult than learning about culture mores in general because of the complexity and variations legal and moral standards that vary from region to region. Much research is needed to understand even the culturally different concepts of what is an agreement. Expatriates also need to overcome the traditional American ethnocentricity and understand that each code is different from their own. The farther away from Western Europe Americans get the greater the differences they find (Hall, 1960).

Informal patterns and unstated agreements often lead to countless difficulty in cross-cultural situations. Middle Eastern businessmen generally look for family, connections and friendships when forming enterprise alliances. Management of business in Arabia still works on the traditional "family" system where the merchant patriarch of the family has almost total control over the decision-making (Fekrat 1989).

Above average answers to this question should mention that Jack should have been aware that cultural differences exist and that he would have to adapt to be successful. He should also have prepared to understand the bases on which agreements are reached in Saudi Arabia, including the rules that are spelled out technically as laws or regulations, the moral practices taught to the young as a set of principles, and the informal customs to which everyone conforms. They should give examples of things Jack should have appreciated, such as, that practice of Middle Eastern businessmen valuing family, connections and friendships when forming enterprise alliances.

Average answers would also state that Jack should have been aware of cultural differences, and that he should have prepared to adapt to them so that he could be successful. They may not touch on all of the specifics, but should list some of the cultural bases on which agreements are reached in Saudi Arabia. Below average answers would indicate traditional American ethnocentricity by not understanding that other cultures are different from their own, or recommending that Jack should have worked harder to get the Saudi's to adapt to American values and practices.

4. How did Jack underestimate the complications he would face?

Simply put, Jack didn't plan ahead before going to Saudi Arabia. He entered the situation with an overconfident attitude that his recent MBA and sales success in the United States were sufficient for achieving higher sales in the Saudi Arabia. Jack's underestimation of the differences and complexities he would encounter in the foreign system is not unusual for first time American expatriates. The majority of difficulties faced by American expatriates are due to poor knowledge and understanding of the foreign system. Also, when negotiating a business agreement, American business people often rely on past experiences from back-home situations and trust their intuition to reach inappropriate conclusions in foreign environments (Rhinesmith, 1996).

Frequently, representatives of the home office lack basic, factual information about the country they are dealing in. They are not aware of how the business system works, what the trends are, where they may innovate with good chance of success and where not. It is a difficult and time-consuming process to learn how the various phases of a foreign business system work and how they interact to form an effectively functioning whole. Understanding the legal framework, the distribution system, the communications media, the labor supply, etc. of each country in which a foreigner must function often seems impossible. Under pressure to accomplish a particular task, the expatriate acts before having full knowledge of the local system.

The tendency to compromise long-term goals in order to accomplish short-term assignments is frequently aggravated when operations are in a foreign environment. This problem is exacerbated by the practice of assigning expatriates to overseas posts for brief periods of time, thus allowing them to escape the long-term consequences of their actions.

In this case, Adam's ambiguous goals further aggravate his problems. Jack's assignment to Saudi Arabia seemed to be a quick and easy way to replace the former Bladeco representative. He was not provided with training or education about the Saudi culture or business practices before he was hastily shipped off. Neither was Jack presented with a clear vision and alternative strategies for achieving his goals from his boss. His unilateral approach to implement aggressive marketing to accomplish increased sales lacks the flexibility to enable adaptation to the Saudi system. This was the problem in the first place that caused the initiation of regulations and tariffs. Neither Jack nor higher management have learned much from Bladeco's six years of operations in Saudi Arabia. Because of this Jack is perusing the same dead end strategy and is not getting short-term results or establishing good relations with the Al Amins for the future.

Above average answers to this question should point out that Jack didn't plan ahead before going to Saudi Arabia and that he overestimated the value of recent MBA and sales success in the United States for achieving higher sales in the Saudi Arabia. Jack also lacked

basic information about the country he was working in and was not aware of how the Saudi business system worked. He also failed to recognize that the home office pressure for quick results was contrary to the Saudi's longer term perspective. Finally, Jack's unilateral approach to implement aggressive marketing to accomplish increased sales lacked the flexibility to enable adaptation to the Saudi system.

Average answers would also indicate that Jack didn't plan or prepare adequately for this joint venture. They should point out some specific examples of problem areas. Below average answers would fail to recognize how the home office pressure for quick results was contrary to the Saudi's longer term perspective, and that, Jack's unilateral approach to implement aggressive marketing to accomplish increased sales lacked the flexibility to enable adaptation to the Saudi system, again, expecting the Saudi's to accept the American demands.

5. How could Jack establish better communications with the Al Amins?

Although Jack has not achieved the immediate changes he desires, this does not mean that his voice has completely fallen on deaf ears. In fact the Al Amin family could be considering his suggestions. More important decisions warrant more time for consideration in Saudi Arabia. This could be why a decision is not as readily forthcoming as Jack desires. It is difficult for most Americans overseas to realize how deeply culture affects ways of communicating when conducting business. Their counterparts in the foreign country may dress similarly, speak the same business "jargon," operate in a world of computers and technology, and read the same business magazines they do. Despite these similarities, each person is a product of his or her own unique culture. Because foreign expatriates often have only a superficial understanding of the culture they are immersed in, they may easily be lulled into believing that counterparts are as westernized internally as they appear externally. One example of the damage these assumptions of similarity can cause occurred when an American manager who was sent to Malaysia to close a deal was introduced to someone he thought was called Roger, so he began to call him "Rog" throughout their negotiations. This client was a "rajah," a Malaysian title of high nobility. To the Malaysians, this showed grave disrespect and the deal ended in failure. The American cultural tendency to conduct business in a friendly, informal manner was the cause of this error (Ricks, 1993, pp. 2-3.).

This tendency of Americans to believe that their own value driven ways of communicating are accepted globally, has caused people like Jack Adams to behave in ways that are effective in the United States, but are unacceptable in a foreign environment. In this case Jack's communication style is perceived as offensive by the Al Amins and it contributes to lack of performance and damage to long-term relationship between Bladeco and the Al Amins family conglomerate.

One way for Jack to communicate better is to understand the difference in styles of persuasion between each country instead of using his own personal style. As can be derived from Figure 3, instead of using logic, Jack should try appealing to his counterparts with emotion.

Figure 3: Styles of Persuasion in North America and Saudi Arabia		
	North Americans	Saudi Arabians
Primary Negotiation Style and Process	Factual appeals made to logic	Affective appeals made to emotions
Conflict: Counterparts' Arguments Countered with...	Objective facts	Subjective feeling
Making Concessions	Small concessions made early to establish a relationship	Concessions made throughout as a part of the bargaining process
Response to Counterparts' Concession	Usually reciprocate counterparts' concessions	Almost always reciprocate counterparts' concessions
Relationship	Short term	Long term
Authority	Broad	Broad
Initial Position	Moderate	Extreme
Deadline	Very Important	Casual
Source: E.S. Glenn, D. Witmeyer, & K. A. Stevenson (Fall 1977). Cultural Styles of Persuasion, <i>International Journal of Intercultural Relations</i> , Vol.1, No. 3.		

Jack could also attempt communicating through the youngest Al Amin, Ahmed, who could understand him better, advise him, and act as a liaison through which Adams's ideas could be effectively conveyed to the senior Al Amin. However Jack's intentions must be pure, as Saudi Arabians place a great emphasis on the value and strength of friendships. Adams cannot expect to abuse the friendship by dumping all of his work problems on his friend. Jack must also be a good friend in return.

Above average answers to this question should point out how deeply culture affects ways of communicating when conducting business in different cultures. They should demonstrate understanding of the differences in styles of persuasion between each country and recommend specifically how Jack should adapt to his Saudi counterparts. They should also recommend several communication strategies with the different Saudi counterparts.

Average answers should also recognize that culture affects ways of communicating when conducting business in different cultures. They should recommend several communication strategies, although they may not be as culturally specific. Below average answers may not recognize that cultural communications differences when conducting

business in different cultures. Although they may recommend several communication strategies, they probably will not be as culturally specific.

6. How should Jack adapt culturally in order to achieve negotiating success?

Jack should first seek to understand the culture and then adapt his goals and behavior in ways that do not compromise his own company's ethics. Managers who have been exceptionally successful in working with foreign associates are people who meet those situations by modifying their expectations and actions to the extent which seems necessary in order to achieve results over both the long and short term (Business International, 1992). Successful expatriates accomplish this without impairing their effectiveness at headquarters because his home office allows and expects them to use considerable flexibility in foreign environments. Some expatriates seem instinctively to know how to form a bridge between home office and joint venture partner. More often it is the result of evolution and careful planning. Effective overseas representatives retain their own attitudes and values intact, and at the same time are able to adapt enough in relations with their counterparts locally that productive results are accomplished for the joint business.

Above average answers to this question recognize that Jack should seek to understand the Saudi culture and then adapt his goals and behavior in ways that do not compromise his own company's ethics. Jack should retain his own attitudes and values and at the same time adapt enough in relations with the Saudis that productive results are accomplished for the joint business.

Average answers recognize that Jack should seek to understand the Saudi culture and then adapt his goals and behavior. They may not recognize how important it is to not compromise his own company's ethics when doing so. Below average answers may recognize that Jack should seek to understand the Saudi culture but not think he should adapt his goals and behavior, rather if the Saudis want to do business with us, they should be the ones to adapt.

7. What are Jack's current alternatives?

Jack can learn from his mistakes but he can't change them. If it is not possible to repair the damage caused by the Saudi reaction to Bladeco's aggressive marketing practices and Jack's cultural insults to the Al Amin relationship, the question simply answered would be to exit Saudi Arabia. If there is no foreseeable solution for resolving these problems and increasing revenue, then continuing business in the joint venture is a losing proposition. On the other hand, Bladeco had obtained strong sales and profits prior to the government intervention and formation of the joint venture. This indicates that Saudi Arabia is still a noteworthy market

to pursue. Future profits are probable if a feasible way of doing business can be ascertained. If this is true, the question remains, "What should Jack do?"

Many students are inclined to take the easy way out and just give up on the venture. A good way to stimulate discussion is to have the students provide alternative solutions. Given their suggestions, small groups are formed with the intent of formulating specific goals, creating a strategic plan and summarizing future expectations.

Numerous alternatives can stem from this question such as:

- ◆ Forming a stronger liaison with the younger Amin, Ahmed, in an effort to persuade Mustafa through a member of his own family and also a means to form a stronger bond with the family.
- ◆ Realignment with a different Saudi counterpart (once again BladeCo expatriates will be faced with similar high context/ low context organizational cultural differences so this isn't always the best solution unless they learn to avoid the same mistakes).
- ◆ Jack enrolling in a crash course in Saudi Arabian culture and business practices.
- ◆ Hiring a Saudi Arabian consultant to serve as Jack's advisor and mediator for conducting business.
- ◆ Being patient and respecting Amin's decisions (listen to the older Al Amin's advice because he is a proven successful businessman).
- ◆ Sending a more appropriate person for the assignment, a representative that has more experience, fits the profile better and has the professional know-how within the contexts of Saudi Arabia markets.

Above average answers to this question should recognize that Jack can learn from his mistakes but he can't change them. They should mention several alternatives such as those summarized above. Average answers will have fewer alternatives with less credibility. Below average answers may only give one alternative with not much analysis or insight.

EPILOGUE

Two years after the joint venture agreement with Mid-East Steel Merchants, BladeCo pulled out of the partnership and exited the Saudi Arabian market. BladeCo executives' assumption that Jack Adams would be able to apply his demonstrated prowess as a sales representative in California to convince the Saudi Arabian partners to pursue BladeCo's previous aggressive marketing strategy to increase sales failed miserably. Jack Adams was terminated when the joint venture folded because of his failure to turn sales around, a failure which was only partly his fault. Had BladeCo learned

from their earlier five years how to do business in Saudi and provided Jack the necessary education and training to successfully interact in the Saudi culture, a different outcome may have occurred.

This case has been rewritten from the personal experiences of the involved parties with the sole purpose of encouraging student discussion. The names of the companies and people involved have been concealed.

Additional Teaching Pedagogies

This case lends itself to several additional teaching pedagogies. Three possibilities are role playing, debate, and mediation.

Role Play

Solicit volunteers to play the roles of Jack Adams, Mustafa Al Amin, Ahmed Al Amin, and Bladeco CEO Amy Johnson. The situation could be a conference call with all role players involved. Start off by having Jack to explain the situation from his point of view to his boss, Amy Johnson. Then have the Al Amins react and share their point of view. Role players stick to the case information but are free to ad lib as the conversation progresses. See how the situation unfolds. The rest of the class act as observers who note the things the role players do to help and hinder the resolution of the situation. Debrief the role play according to the information in the teaching note.

Debate

Divide the class into three groups. Group one represents the Al Amin family (Mustafa Al Amin and Ahmed Al Amin). Group two represents the Bladeco personnel (Jack Adams and Bladeco CEO Amy Johnson). Members of the third group are the judges. Have the first two groups debate what should be done to rectify the situation. When they are finished, the third judging group can ask questions and vote to decide who wins.

Mediation

This is similar to the debate except that members of the third group in this approach act as mediators, not judges. As the debate unfolds, the third group's job is to help clarify, explore additional alternatives, and negotiate a mutually satisfactory solution.

The mediation approach could also be applied in the role play, by having a mediator, or team of mediators, intervene with suggestions as the role play evolves.

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TRANSFORMATION AT BTR

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CASE DESCRIPTION

The primary subject matter of this case concerns the viability of the transformation being undertaken in a large, widely diversified company with a storied past. Secondary issues include assessing merger and/or acquisition partners and the ability to assess organizational "fit" with its environment, between its headquarters and businesses, and across the portfolio. The case has a difficulty of six (appropriate for the second-year graduate level). The case is designed to be taught in three class hours and is expected to require six hours of outside preparation by students.

CASE SYNOPSIS

The story of BTR spans exactly 200 years and includes some of the most prominent leaders in British industry. The decision to be made in the case is the direct result of a successful corporate strategy coming out of phase with the changes going on during the 1990's. New management attempts to refocus the firm, but the plan is not well formulated initially, requiring adjustment and a protracted period of implementation.

The case describes the recent history of BTR in two major phases. The short first section begins in 1965 and is marked by the application of a niche-oriented business acquisition policy. In using this policy, management scanned the environment for wayward businesses that would respond to BTR's methods. Heavy reliance was placed on sound financial reporting and oversight, after a period of transformation.

By the end of 1995—after exactly 30 years—BTR's performance had sharply deteriorated. Forces outside and inside the firm incited mammoth change in the company. Initially, BTR was to be an "international manufacturing and engineering company," a more focused firm, better able to exploit relationships between the businesses. The depth and pace of the changes required were underestimated, however, and corporate management was forced to re-develop BTR the following year into a "leading global engineering company". But, the difficulties of the changes, and the complicating factors of BTR's decreased dividend and an over-extended warrant program, suggest that time and patience may have run out on the firm. At the end of the case, management is left to decide whether to finish implementing the current strategy or to seek partners for merger.

INSTRUCTORS' NOTES

Recommendations for Teaching Approaches

This case offers students solid insight into the formerly successful strategy of a prominent company in Great Britain that now requires painful adjustment. The case is taught most comfortably in a module devoted to corporate strategy, but can also be easily included in a general offering in Strategic Management. As well, the case contains a variety of major sections demanding attention, such as the relationship of environment and strategy; the interrelationship of strategy, control and culture; the sometimes overwhelming interests (and power) of key stakeholders; and the inseparability of strategy formulation from implementation. Finally, the student is allowed an overview of the effects of organizational history, how past decisions and events impact the present and the ability of management to deal with the future.

After full analysis of the case, students should have knowledge of and/or the ability to: assess organizational "fit" between the firm and its environment and within the firm (both between HQ and the businesses and across the portfolio); explain how strategy aligns the activities and resources in an organization to take advantage of opportunities; detail the difficulties (the sources of inertia, resource availability, stakeholder management) that commonly impede strategic change; and analyze the pro's and con's associated with fully implementing a plan for change versus taking up a plan to merge with any of three prospective partners.

Suggested Readings

If the supporting instruction for the case makes use of a textbook, limited opportunities are usually available for secondary reading. However, if a single article can be added to the reading list, the following piece is recommended:

Porter, M. (1987, May-June). From Competitive Advantage to Corporate Strategy. *Harvard Business Review*, 43-59.

The article by Porter informs readers about the large number of value-destroying diversification efforts marking recent industrial history. As well, useful strategic directions are given to students: restructuring (with obvious repercussions for BTR's unrelated diversification), skills transfer and activities sharing are clearly explained as methods for creating value from the corporate level. The difficult tests for diversification described by Porter should also help guide the discussion:

1	The Attractiveness Test: Does the move provide adequate returns?
2	The Cost-of-entry Test: Does the price for getting established erode the potential profits?
3	The Better-off Test: Is the business more powerful within the diversified company than outside it?

Finally, the time-boundedness of some of the diversification efforts— again, restructuring is often affected by large, but one-time value additions— is another of the valuable insights offered in the article.

If more space in the reading list is available, the following articles are recommended:

Hamel, G. & C.K. Prahalad (1990, May-June). The Core Competence of the Corporation. *Harvard Business Review*, 79-91.

Collis, D. & C. Montgomery (1981, May-June). Creating Corporate Advantage. *Harvard Business Review*, 71-83.

The article by Hamel and Prahalad makes a major contribution to corporate strategy (and to a case discussion concerned with divestment) by explaining the logic that should cut across the corporate and business levels, fostering and guiding innovation and diversification. The piece will provide help in identifying worthy core competencies and in eliminating the organizational clutter and over-reach that characterizes many diversified firms. Moreover, the article makes clear the deep level of integration required within a portfolio truly leveraging core competencies, directly impacting the reorganization of BTR.

The Collis and Montgomery piece aids in understanding how competitive advantage, coordination and control are inter-related. During the case discussion, students should be able to explain how the markets, strategies and skills combined to put different demands on the firm. These were met in quite varied ways. Indeed, the decision point at the end of the case is tangled in related issues: Are BTR's strategy, structure and control systems best suited to the opportunities and challenges that it faces? The Collis and Montgomery work will go a good way in helping to identify and deal with the salient issues.

A final piece can be distributed AFTER the class, to broaden and deepen the analysis of firms pursuing unrelated diversification:

Kerr, G. & J. Darroch (2005, July-August). Insights from the New Conglomerates. *Business Horizons*, 347-361.

But, a caution should be offered about the use of the article. Events after the decision point of the case are recounted. As well, other points are offered in the article that should come from

classroom analysis rather than directly from the reading. However, the article is useful in that it outlines the available ways in which headquarters can add value to the diverse businesses in its portfolio. As well, a contingency approach to corporate strategy is described that can help students further understand the manner by which organizations— even those widely diversified— link with their environments. Finally, the article can form a bridge with the study of Invensys, the company that emerged from the merger of BTR and Siebe. (A case analysis of Invensys is currently under development.)

DISCUSSION QUESTIONS AND SUGGESTIONS FOR CLASSROOM ANALYSIS

Two basic methods are available for developing the discussion. The first can begin with a bid for recommendations from the class. The operative question could be posed, “What should be done at BTR?” Categories of actions can be developed. “Hold the line” is one of the obvious options. Recommendations should also include a merger with broad-based engineering firms like Emerson Electric, Siebe, or Siemens. Votes should be tallied once the choices have been generated. The aforementioned route for developing the analysis has the appeal of an opening “attention grabber” which demands students take a stand and be ready through the ensuing discussion to explain and defend their positions, even as the evidence against them mounts.

However, the bid at the beginning for recommendations will probably keep the discussion firmly involved in the here-and-now and will make for greater difficulties in drawing together the insights that are available from the company’s history. The long period of success at BTR could easily be missed, and the possibility of losing out on a full analysis of the three-decade-long experience with restructuring is probably too great a chance to take.

Therefore, the following questions are recommended as signposts for steering the discussion:

1	What were the primary elements of the "new" strategy of 1965? Why did it lead to such a lengthy sustained success?
2	Why did the company falter in the early 1990's? Why did the firm's management use so much time in making changes to its strategy?
3	What is your assessment of the current strategy? What suggestions do you make for improvement?
4	Do other options exist for BTR? How and when should they be played out?

1. **What were the primary elements of the "new" strategy of 1965? Why did it lead to such a lengthy sustained success?**

Four “pastures” can be created in the discussion, each centered on a set of key, related issues. The first pasture (opened through the question "What were the primary

elements of the "new" strategy of 1965?" and then by "Why did it lead to such a lengthy sustained success?") must include a number of features, including:

Consideration must be made of the forces driving the adoption of the new strategy. In a word, the force is leadership. While the strategy was hardly unique (it had been prominently pursued in the United States) BTR's top management deftly carried out its implementation. The vision was also maintained through two changes in top management, a natural corollary of the fact that each of three leaders had close connection to the original formulation and implementation of the strategy.

Students should also be expected to see that the strategy was a sustained success for a number of reasons:

First, the niche positions held by most of the early acquisitions typically needed guidance, as do most entrepreneurial firms, in making the transition to "professional management," BTR's strong suit. Financial controls were expertly fitted to the low-to-medium technological intensity of the targets. (The Collis and Montgomery article can provide help analyzing the topic.) As well, the natural constrictions placed on businesses serving niches (the fact that niches are, by definition, severely reduced in size and opportunities for growth) were relaxed by BTR's expertise in serving international markets and, therefore, the same niches in multiple locations.

Second, a group of competitive competencies were developed at the corporate level for enabling the strategy. (See the Prahalad and Hamel article). As the case material makes clear, headquarters was instrumental in identifying, negotiating, acquiring and transforming the target. A strong system and supporting skills for each of the key areas had been developed.

Third, the competitive intensity of the era was much lower than the present. Furthermore, the acquire-and-restructure strategy that spawned many of the conglomerates of that time was only getting started. Thus, many viable targets, and directions for growth, were available to the company.

Indeed, the present case should allow a lively discussion to develop about unrelated diversification. The commonly held notions about diversification (related diversification is good strategy; unrelated diversification is bad strategy) can be held up and examined using the events of this case. The best students should be able to look at the restructuring strategy (to use Porter's term) and see that it can be broadly applied and result in a disparate portfolio of businesses. What is "related" is not the panoply of end products. Rather, the "relatedness" within the portfolio is less obvious: it is linked to BTR's ability to spot and rectify management failures within its acquisitions, regardless of industry.

The best students should also be able to see two, sometimes unfortunate, facts about the restructuring strategy. First, to sustain a long period of steady and sizeable growth, increasingly larger acquisition targets must be pursued, or larger numbers of similarly sized acquisitions must be undertaken. Either way, the pressure on the firm can grow exponentially. Second, the "time boundedness" of the value additions must be taken into consideration. The restructuring strategy at BTR created most of the value added in a revolutionary phase in the first year or two after the acquisition. However, as the case material plainly states, the company went through a long stretch in its history during which

divestments went largely ignored. Questions remain about which businesses should have been sold much earlier, and when.

2. Why did the company falter in the early 1990's? Why did the firm's management use so much time in making changes to its strategy?

This last issue opens the second pasture. It concerns the ways in which the organization became increasingly out of phase with the changes in its environment during the 1990's. The reasons are stated in the case:

They are attributable to metamorphosis in the macroeconomy (lowered rates of inflation; increased technological change and intensity), and in the ways key industries were being re-organized (increased international trade and competition; changes in supplier/manufacturer/customer relations; growing service requirements; new patterns in industry consolidation).

Inside the firm, the previous patterns of doing business (customer relations; investment regimens; price management) and the internal control and planning mechanisms (the planning process; divisional and business autonomy; financial performance measurement) were increasingly out of step with the changes just described.

The best students (perhaps with exasperation) will ask at some point in the discussion why the strategy was allowed to continue for so long without adjustment. The answer must reside, in large part, with the inertia that is attributable to the long period of success the company enjoyed, and to the over-confidence (perhaps arrogance) this sometimes breeds. As the case points out, the culture constructed by Nicolson, Green and Ireland was extremely strong and well entrenched. A strong-as-steel culture can sometimes form itself into handcuffs.

3. What is your assessment of the current strategy? What suggestions do you make for improvement?

The way to the third pasture is opened with the next obvious topic: the implementation of the restructuring plan(s). Perhaps the best way of opening this last major area is to ask students to recount and improve upon the strategy as it was formulated and rolled out over the past two or so years.

The class should realize that the restructuring itself also took far too long. In part, this delay is attributable to underestimating the resistance that was to be encountered throughout the firm. (The information that 19 of 50 top executives left BTR during the period can be interpreted as a sign of a pretty wide-scale resistance of the new plan.) In part, the plan did not reflect a well-conceived first attempt to create value among the remaining businesses. The point must be driven home that the restructuring regimen demanded a fundamental re-orientation within the firm. Yet, the case doesn't mention (in the first go-around in 1996) much in the way of the mechanisms that would facilitate the plan's implementation, or the ways in which the corporate level was going to add value.

The second place in the final pasture can be gotten to with a question about BTR's current performance: "How is the company doing?" Answering this question can actually be quite tricky. On paper, BTR appears to be doing pretty well—or perhaps can be better stated that the worst seems over. The strategy, as described in 1997, seems far more deeply conceptualized and implemented. The financial results, in accounting terms, seem to illustrate similar improvement. Operating profits are the highest since 1989. Numerous expense categories show brighter prospects. So, why has the stock price stayed at such dismal levels, showing no signs of improvement?

The question of performance is, of course, relative to BTR's past and to the expectations (and their supporting mechanisms) that have been built up in key stakeholders. Students must remember that BTR had been generating large profits and returns to the owners of its equity for years. The warrants issues and the high stock valuations reflected past success. As long as performance was maintained, management was given free rein. The size and audacity of some of BTR's acquisitions in later years support the point. But, once performance proved unsustainable, the dividends also became unsupportable at current rates, and the warrants became mere paper. Moreover, strategic reorientation demanded profound change, generating sizeable risk to the firm. The company is beholden to its creditors in both the equity and bond markets, and patience is clearly running thin. A broad body of equity has to be fed earnings; interest and principle payments have to be met. Student analysis must fully draw out the challenges and the central players, realizing that very little time remains to complete the reorganization if that is the recommendation.

4: Do other options exist for BTR? How and when should they be played out?

Of course, three other related alternatives exist. They are mergers with Emerson Electric, Siebe or Siemens. A combination of qualitative and quantitative issues can provide a solid start at choosing among the alternatives. The table below assesses the firms using the following criteria: leadership, the added value of the combined portfolios (through savings and complementarity), the extent of M&A activities, the probable cultural fit, the relative size of the two organizations (with the merger of equals likely more problematic), and financial position.

	Emerson Electric	Siebe	Siemens
Leadership	Solid management team, experienced with success and refocusing strategy	Long-established strength in top leadership; now led by a young and vigorous CEO	Established, vigorous leadership intent on introducing greater competitiveness in the company
Savings from Combined Businesses	Obvious overlap in controls; but, BTR's businesses are much broader than Emerson's current portfolio	Much depth in controls offers a number of potential opportunities to leverage/rationalize mktg., mftg. and R&D; however, BTR will considerably broaden Siebe's portfolio	Siemens is currently undertaking a large rationalization of its very diversified portfolio; savings are likely from the Industry division (namely Automation and Drives)

	Emerson Electric	Siebe	Siemens
Complementarity of the Combined Businesses	The current BTR portfolio would add much breadth to Emerson; however, the value to customers is uncertain	Potential value additions can come from the application of Siebe's intelligent automation to portions of BTR's portfolio; but, the breadth of the resulting portfolio may not create much value	The already heavily diversified portfolio would become even more diversified; what kinds of rationalization are necessary and how will it impact the existing goals?
Merger & Acquisition Skills	The company is an active acquirer of businesses; but, the targets are much smaller and more focused than BTR	The company is an active acquirer of businesses; but, the targets are much smaller and more focused than BTR	The company is deeply experienced with M&A activities and with strategic alliances
Cultural Fit	Emerson is a strong culture company, with established systems and mores supported by outcome-based compensation and a long history of success	Continuity of leadership and commitment to employees has created a strong, engineering-based culture-- a potential fit with the new direction of Siebe	Siemens is undergoing cultural change from a company that Jack Welch called an employment agency to one that is more hotly competitive and entrepreneurial; therefore, the timing of a large merger seems dubious
Relative Size of the Organizations	The two organizations are approximately equal in size (by revenues)	The company is approximately 40% the size of BTR (by revenues)	Siemens is approximately eight times larger than BTR (by revenues)
Financial Position	Emerson is financially strong in nearly every relevant category	Steady growth in all meaningful categories; debt has grown but appears manageable	The company is going through a very challenging year, attributable to both the restructuring and to the Asian currency crisis; however, sufficient resources are probably available-- but should just as likely be carefully used

Students are exposed through the analysis above to the high risks that are associated with a large merger. Even Siemens, by far the largest of the firms under consideration, would be pressed to marshal the resources (both financial and managerial) to undertake such a massive undertaking. Moreover, timing is an important consideration for Siemens because of the company's current restructuring. Pro's and con's can be drawn up for a merger with each of the three potential partners. In two of the cases (Emerson and Siebe), great amounts of breadth would be added to the existing portfolio, suggesting that asset sales or further acquisitions would soon have to be in the works. The overlap and/or complementarity in the portfolios appear to be fairly narrow. However, a plausible economic rationale could be spun out of the relationship between Siebe's businesses and a number of those currently at BTR. The situation at Siemens, by comparison, appears to be much less conducive to taking on the disruption of a large merger.

A spirited debate should ensue over whether a merger or staying with the existing plan should carry the day!

EPILOGUE

In fact, BTR did not last long enough to enter the new millennium. The precipitous drop in the firm's performance and key stakeholders were putting enormous pressure on leaders to rectify the trouble. This weakness was compounded by a restructuring plan that took years to implement. The first round clearly reflected an underestimation of the depth of the required changes and the level of resistance it was going to meet.

The result, in hindsight, seems inevitable. BTR entered into a merger with Siebe, a British engineering firm, early in 1999, cementing the union from the decidedly weaker position, and losing primary control of its former operations. In the following year, a new company, Invensys, was created from most of the assets of BTR and Siebe. But, the BTR name, of course, was gone, a fixture on the British industrial landscape for more than 60 years, with a history that ran back exactly 200 years.

An operative question remaining for students and analysts alike (and the central decision focus for the case) is whether what BTR offered its shareholders was a viable plan to create value, with the right people at the top to support it. In the end, though, the company simply ran out of time, in a few short years having burnt up the goodwill that had been built up over the previous decades.

CALL FROM PEERLESS BANK: A CASE CONSIDERATION OF TELEMARKETING AND ETHICS

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CASE DESCRIPTION

The primary subject matter of this case concerns marketing ethics and strategy. Secondary issues examined include the evaluation and selection of direct marketing tactics. The key words for the case indicate the major areas for student learning: marketing ethics, marketing strategy, direct marketing, telemarketing, consumer privacy, banking and credit cards. The case is most appropriate for the junior level or above, including the graduate level, so it has a difficulty level ranging from three to 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

Rebecca MacDonald receives a call concerning a “special opportunity” being offered to Peerless Bank’s Visa cardholders, a program called “Basics” which offers discounts at retailers and reimbursement for haircuts in exchange for an annual fee charged against her Visa card. Rebecca is interested but unable to obtain literature without consenting to enroll for a trial period. After deciding not to enroll, she wonders about the ethics of the bank’s marketing tactics and considers whether to put herself on a do-not-call list. Following a review of the regulatory environment pertaining to consumer privacy, telemarketing and banking, the case transitions to a discussion of these issues by Peerless’ management that could well be taking place in light of the times. Management questions the choice and execution of the telemarketing strategy and decides to re-evaluate the offering and its promotion in light of ethical, regulatory and competitive concerns. The Note on the Commercial Banking Industry, especially prepared for this case, places this episode in its larger and important context.

INSTRUCTORS’ NOTES

Case Sources

Rebecca MacDonald’s call from Peerless Bank reports on a call the first author of the paper received. Rebecca’s thinking mirrors the thinking and reflection this call prompted. Both authors

have received other similar telephone calls. The material in the case on the commercial banking industry indicates why calls to consumers of this nature were occurring. The information on privacy legislation and regulation reveals a changing legal context requiring many organizations to reevaluate their marketing strategy and tactics.

Case Objectives

1. To develop student facility in using ethical frameworks to evaluate marketing programs and practices
2. To increase student knowledge and understanding of telemarketing as a direct marketing strategy, including its advantages and effective, ethical implementation
3. To increase student knowledge of the specific and evolving legal constraints at the federal and state levels within which organizations must operate their direct marketing programs
4. To increase student awareness of the organizational consequences of product mix additions and related promotional decisions
5. To increase student sensitivity to the existence of multiple direct marketing alternatives in implementing a chosen strategy (e.g., telemarketing, targeted e-mails, in-bound telemarketing, personal selling)
6. To increase student understanding of an important and familiar industry – commercial banking – and how the business practices of a member of this industry are affected by changes in legislation, regulation and the actions of competitors.
7. To increase student understanding of how increasing concentration in an industry, as well as shareholder requirements for profit growth, can prompt an organization to use a direct marketing program to help it respond to these realities.

CASE QUESTIONS AND SUGGESTED ANSWERS

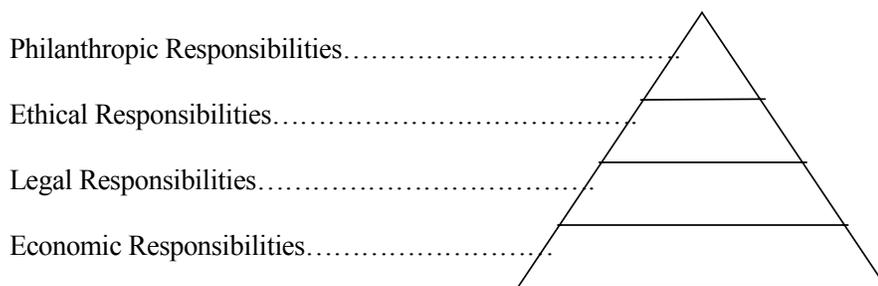
The following case questions cover a variety of topics, including ethics, legal factors, and marketing strategy and tactics. The breadth and depth of questions are intended to allow instructors flexibility in how they use the case to complement course material. For example, the first four questions focus on ethics and encompass several of the more popular ethical paradigms. Instructors can then decide which ethical approach(es) they are most comfortable with and then assign students the corresponding case question(s). Instructors are not expected to use all of the questions that follow when *Call from Peerless Bank* is used.

1. **How do the American Marketing Association's and the Direct Marketing Association's ethical guidelines/codes of conduct address telemarketing practices, both explicitly and implicitly (www.marketingpower.com and www.the-DMA.org)?**

Responses will vary depending on the depth of student exploration of these websites. Students can search for terms such as “ethics”, “telemarketing,” “do not call”, “consumer protection” and “privacy protection”. Searches such as these should lead students to find the organizations’ codes of ethics; reports, such as the DMA Ethics Case Report; and guidelines for correctly applying the organizations’ ethical guidelines (see, for example, the DMA site section entitled Corporate Responsibility in Action). In addition, a search for “ethics” on the AMA site will lead students to, among other resources, several articles that discuss current ethical issues in marketing.

2. Evaluate the case using each of the levels in the pyramid of corporate social responsibility (Carroll, 1991).

Figure 1



Note: By using this pyramid to evaluate Peerless Bank’s efforts, students are forced to consider the long-run best interests of both the company and consumers in their evaluation of the case.

The first level of consideration is economic. The bank must engage in activities that make a profit. Otherwise, they are not fulfilling their responsibilities to organizational stakeholders (e.g., employees, shareholders, current customers). In this case, one can assume that the program being offered will be profitable for the bank.

The second level of consideration is the legal responsibility of the bank. Based on the evidence presented in the case, the telemarketing strategy is being executed in a legal manner.

The third level of consideration is the ethical responsibility of the bank. In other words, is the bank behaving in a just, fair and right manner? On this point, views may vary considerably depending on the standards of justice and fairness applied and the ethical model employed (as discussed in responses to questions three and four in this section). One could argue that all consumers are being treated in the same manner by the bank. Also, the

benefits of the program are real and the “fine print” of the offer is clearly presented before the consumer is asked for a decision. Hence, the bank is meeting its ethical responsibilities. On the other hand, one could argue that the bank is not meeting its ethical responsibilities by raising various issues concerning possible deception and consumer confusion.

Students who determine that the bank is fulfilling its ethical responsibility would finally consider the apex of the pyramid, philanthropic responsibility. While the program does not appear to be contributing resources back to the community or improving quality of life, more careful consideration could lead to a different conclusion. One could argue that the program does improve the quality of life for consumers by offering them savings on products and services that they typically purchase. The savings are then available for alternative uses. Also, by featuring local merchants and services providers, the program encourages consumers to support the local economy. This in turn benefits not just the merchants but also the consumers through increased tax revenue for the municipality to use in support of roads, education, libraries, etc.

3. Evaluate the ethical issues in the case from the perspective of marketing managers at each the three different levels of moral development: preconventional morality, conventional morality, postconventional morality (Steven, 1979).

The preconventional perspective is very self-centered and childlike, and the primary concern of the person at this level of moral development is with punishment and reward. A manager at this level of moral development would assert:

There is nothing wrong with this approach to selling our product. For people who sign-up, it can make the company - and, therefore, me - a lot of money. As long as we are giving consumers the right to cancel, it is their responsibility to follow through. We are not doing anything illegal and we cannot be sued. If we can make money and behave lawfully, what is the problem?

The conventional perspective is highly concerned with societal/organizational norms and expectations. The primary concern of the person at this level of moral development is with legality and social acceptability. A manager at this level of moral development would claim:

This approach to selling and promoting our product is entirely legal. Furthermore, telemarketing is a very popular/common strategy for selling this type of product. Consumers know how this process works. If they don't want the service or product, they can hang up or cancel at any time. Not only is our strategy legal, but it is a common practice in the financial services industry.

The postconventional perspective is most concerned with self-respect and approval from others over the long term. A manager at this level of moral development would assert:

I know that this strategy is entirely legal, that we are not intentionally trying to deceive consumers, and that this endeavor is profitable for the company. However, is it really the right approach to take over the long run? We may be doing the company and our customers more harm than good by not sharing all the information before requiring a commitment. Some customers may not understand the offer and/or may easily forget to cancel an unwanted service. That is enough to make me see this as an unethical practice that needs to be modified.

4. **Evaluate the ethical issues in the case at hand from both the teleological and deontological perspectives. In particular, evaluate the ethics involved in requiring Rebecca to take action on the phone before reviewing information by mail (Churchill, 2001; Cooke, 1988; Ferrell & Gresham, 1985; Hunt & Vitell, 1986).**

The teleological perspective “focuses on the net consequences that an action may have” (aka the utilitarian model). If the net is positive, then the action is acceptable. If the net is negative, then the action is unacceptable (Churchill, p. 56).

Negative aspects:

- ◆ *some consumers find telemarketing calls annoying*
- ◆ *some consumers who try the program but are not interested may forget to cancel within the trial period and be charged for a service they will not use*

Benefits:

- ◆ *the program generates revenue for the bank, telemarketing firm, and the participating retailers*
- ◆ *the potential savings to the customers who subscribe to and use the program*

Using a teleological approach one’s conclusions will vary depending on the weight given to each of the above and to related factors.

The deontological perspective focuses on the impact on the individual (aka the rights or entitlements model), and considers the “means, intentions and features of an act itself” (Churchill, p. 56)

Conclusions from using the deontological approach will vary depending on the individual. For example, for individuals who are truly interested in the program and will

realize savings, the scenario may appear ethical. There is no harmful intent on the part of the bank or telemarketing firm. The telemarketer appears to be polite. The cancellation process appears to be legitimate. The intention of the offer is to provide a win-win-win situation for the bank, the consumer and the retailers.

For those individuals who are not interested in the program or who want to consider all the information before making any commitment, the scenario as presented may appear unethical. There is refusal to provide written information without a commitment (albeit an initially “free” commitment). An unsolicited phone call is an infringement on the consumer’s time. Despite these (and other) aspects of the scenario, the facts do not readily lend themselves to an argument that the intention of the bank or telemarketing firm was to be deceptive.

5. What is the current status of legislation and regulations concerning telemarketing and privacy protection (www.fcc.gov and www.ftc.gov)?

As the purpose of this question is to have students gather and analyze current information, a specific response to this question is not provided here. At a minimum, students should visit and explore at least the two websites listed above. Students can search for terms such as “telemarketing,” “do not call” and “privacy protection”. If they do so, they should be able to find listings of states with do-not-call lists which include links to state-specific sites. In addition, students should find recent court rulings, government agency statements, press releases and articles. Information for consumers and information for telemarketers can be accessed and compared, as well.

6. What options does the current legal and regulatory landscape offer Rebecca? Would being listed on a do-not-call (DNC) list prevent Rebecca from receiving telemarketing calls from Peerless Bank in the future? Explain.

Rebecca could sign up for the National Do-Not-Call Registry and she could sign up for a state-wide DNC list. However, this will not prevent her from receiving telemarketing calls from Peerless Bank or a telemarketing firm retained by the bank since Rebecca already has a relationship with them (Telephone Consumer Protection Act). Even if Rebecca “opted-out” through the bank’s privacy policy, she would only be preventing calls from third parties who are unaffiliated with Peerless Bank (Gramm-Leach-Bliley Financial Services Modernization Act). Her chief avenue for stopping these calls from Peerless Bank is to sever her relationship with the bank and take her banking services elsewhere. However, she may receive similar calls from her new bank. Should she not wish to stop banking with Peerless, Rebecca could become more creative in stopping the telemarketing calls. She

could secure an unlisted telephone number and not provide the bank with her phone number. She could block telemarketing calls using one of the products on the market for screening (or “zapping”) telephone calls made through the use of computer-generated dialing.

7. If, as a telemarketing organization, you wished to conduct business as you had prior to the changes in the legal and regulatory requirements in the United States, what options are available and what are the likely consequences of exercising these options?

The primary option available is to enlist the services of a telemarketing service located outside of the United States that would make calls from off-shore. Since these organizations are not bound by U.S. law, they are able to call *all* prospective customers, even those who had registered for a DNC list. (Note: This option nicely leads into another area ripe with ethical debate opportunities.)

8. In what ways do the legal and regulatory environments assist organizations with their marketing efforts? [For example: Telephone Consumer Protection Act (TCPA) of 1991, Fair Credit Reporting Act (FCRA) (as amended in 1996), Gramm-Leach-Bliley Financial Services Modernization Act (FSMA) of 1999, state and federal DNC registries – www.fcc.gov].

By eliminating calls to individuals who do not want them, calls are made to those who are more likely to receive them positively. This should result in improved efficiency, productivity and profitability for telemarketing efforts.

Marketers can use funds that had previously been allocated to outbound telemarketing to

- ◆ *improve their inbound telemarketing*
- ◆ *improve call centers*
- ◆ *provide more training to telephone representatives*
- ◆ *strengthen their customer relationship management (CRM) systems*

The DNC legislation “helps to disarm a political climate that might otherwise demand truly restrictive anti-marketing regulation” in the future (Donath, 2003).

9. How does a commercial bank generate revenue?

Banks generate revenue or income from three sources: customer deposits, interest from loans, and fees. Customer deposits are invested in various securities that generate

interest or dividends, or which appreciate in value. Banks make short, medium and long-term loans that create a stream of interest payments. Balances carried forward by customers on credit cards issued by the bank create interest income for the bank, as well. Various fees charged for particular bank services or associated with credit card use are a growing source of revenue for banks.

10. What are the different ways that credit cards issued by a bank contribute to bank revenues?

As was mentioned above, banks earn interest on credit card balances that are carried forward. Revenues are earned from late payment fees on credit card balances and an annual fee is often charged for credit card use. Fees paid by merchants are generated when bank-issued credit cards are used by customers for purchases. In addition, a bank obtains revenue when credit card customers can be induced to use their credit cards to sign up for various insurance, travel or consumer discount programs, like the “Basics” program.

11. What are developments in banking and financial services that could be troubling to a regional bank like Peerless?

All banks have been impacted by legislation that permits banks to expand their operations into other states, sometimes through merger and acquisition. One consequence is that regional banks, usually an area’s larger banks, may face new competitors whose strengths, strategies and tactics are not well known.

Legislation today also permits a bank’s competitors, through bank holding companies, to merge with or acquire firms offering a variety of financial services to individuals and businesses. These include services such as financial planning, insurance, mutual funds, mortgage and investment banking. A competitor, through the subsidiaries of its bank holding company, may be able to offer customers a comprehensive set of services tailored to each customer’s financial needs.

Through mergers and acquisitions banks reduce their risks and stabilize income through product and geographic diversification. Banks are also able to reduce their costs by combining and shrinking identical departments, volume purchasing and through other economies of scale. Income stability and cost savings permit newly combined organizations to aggressively compete with banks whose costs are higher.

Finally, legislative and regulatory changes permit customers today to look beyond regional banks like Peerless as they decide where to deposit their earnings and cash, borrow money, and obtain a credit card that is universally accepted.

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- 12. How is a program like the “Basics” program, marketed to the bank’s credit card holders, important to the bank strategically – that is, related to bank growth, success and survival?**

“Basics” and similar programs help Peerless generate revenue. This revenue funds operations and permits the bank to either initiate competitive tactics, such as free services and higher interest rates on savings, or respond to the tactics of other banks. Revenue contributes positively to the market value of a bank’s stock, which is important today as a bank’s stock is often used in the acquisition of other banks and financial services organizations.

- 13. Given Peerless Bank’s concern for profitability, was the telemarketing strategy appropriate? Explain.**

Outbound telemarketing allows the marketer to use customer databases to select prospects with characteristics and buying patterns that suggest they have a higher probability of subscribing to new offerings. Also, the rising costs of postage and the high cost of field sales representatives makes outbound telemarketing an attractive option for lowering promotional costs. Also, experience in the financial services industry indicates that these types of fee-based products/services, promoted and sold through telemarketing efforts, are profitable.

An instructor can support these assertions by citing the following statistics concerning the profitability and popularity of telemarketing, also referred to as teleservices by the Direct Marketing Association (<http://www.the-dma.org/government/teleservicefactsheet.shtml>; Lamb, Hair & McDaniel, 2005).

Sales made via telephone topped a whopping \$660 billion in 2001, which is almost 6 percent of Gross Domestic Product (GDP). Approximately 60 percent of these sales were business-to-business sales.

In 2001, nearly 185 million consumers spent nearly a record \$270 billion on purchases that originated with calls from marketers.

Telephone marketing is the number-one direct marketing sales medium, followed by direct mail, newspapers, television, magazines and the Web.

Telephone marketing accounts for more than 39 percent of all direct-marketing media expenditures and 36 percent of direct-marketing sales. Direct mail accounts for nearly 23

percent of all direct-marketing media expenditures and more than 31 percent of direct-marketing sales. These approaches together account for 62 percent of direct-marketing media expenditures and 67 percent of direct marketing sales.

Depending on the complexity of the product and customer, a telemarketer can make from 20 to 33 decision-maker contacts a day, compared to the average of 4 that an outside salesperson can make.

Whereas the average personal sales call costs about \$170, a routine industrial telemarketing call costs only about \$5 and a complex call \$20.

14. Given Peerless Bank's concern for its reputation, was the telemarketing strategy appropriate? Explain.

This choice does not seem to have been in Peerless Bank's best interest from the perspective of protecting and enhancing its reputation. Specifically, there are negative public perceptions concerning telemarketing, legal and regulatory efforts to restrict telemarketing practices, and abuses of the telemarketing strategy by less reputable marketers.

15. How could Peerless Bank improve its telemarketing of the "Basics" program and other fee-generating products and services it offers?

If Peerless wanted to continue calling all holders of its Visa card, it would have to make sure that the telemarketing service being used was affiliated with the Bank. Otherwise, it would need to purchase state and federal DNC lists and purge its database of any customer whose name was on one of these lists.

Second, Peerless could allow customers the option of reviewing material on the program before making an enrollment decision. The information either could be mailed to the customer and a follow-up call made, or the information could be viewed on the bank's website. If the website also permitted customers to enroll the need for a follow-up phone call would be eliminated.

16. What other strategies could Peerless Bank have implemented to promote its fee-based products and services and to realize its profitability objectives? What advantages and disadvantages do these alternate strategies offer?

Peerless Bank could have used:

Targeted e-mails – A major disadvantage is that the bank opens itself to similar complaints of privacy violation as it does with outbound telemarketing. Some advantages are:

- ◆ *the ability to target consumers who have been screened to meet certain criteria based on the nature of the fee-based product/service*
- ◆ *avoidance of “bothering” people with a phone call*
- ◆ *consumers who do reply are those who are most interested which increases the likelihood of a sale*
- ◆ *the low cost of message creation and distribution.*

In-bound telemarketing generated by direct mail promotion (postcards, flyers, newspaper inserts, etc.) – One disadvantage is that postage and printing costs can be high. Also, it is very easy for consumers to dismiss the mailing as “junk mail”, discarding the promotion without ever reading the invitation to call for more information. Some advantages are:

- ◆ *the ability to target consumers who have been screened to meet certain criteria based on the nature of the fee-based product/service*
- ◆ *avoidance of “bothering” people with a phone call*
- ◆ *consumers who do call are those who are most interested, which increases the likelihood of a sale.*

Personal selling by customer service representatives at branch locations – Some major disadvantages are the high cost of implementation, access to a limited number of consumers, and inability to accurately screen consumers. Some advantages are:

- ◆ *the ability of the salesperson to adapt the message based on the response(s) of the targeted customer*
- ◆ *ability to immediately respond to consumer concerns, questions or confusion*
- ◆ *two-way flow of communication*
- ◆ *low cost per sale compared to some forms of print advertising and broadcast media advertising.*

Newspaper/magazine or broadcast advertising – Some disadvantages are more limited ability to target consumers with specific characteristics than “database-driven” techniques, possibly higher costs, and inability to customize the message. Some advantages are delivery of message to a large audience of prospective consumers (not limited to those who already have a relationship with Peerless Bank) and avoidance of complaints concerning privacy violation.

TEACHING PLAN

Given the comprehensive and integrative nature of the Peerless case, instructors have a variety of options available in terms of how the case is used in a course. Three options are presented below, each taking a different perspective. While they are presented separately, these perspectives are by no means mutually exclusive, and instructors may wish to use the case to discuss multiple issues.

Ethical Focus

Pre-class assignment: read case and visit the American Marketing Association and Direct Marketing Association website to search for information concerning ethical codes and guidelines, particularly in the area of telemarketing practice.

In-class: present various ethical perspectives and the pyramid of corporate social responsibility, then have students, either in teams or as a class, discuss questions 1 through 4.

Legal/Regulatory Focus

Pre-class assignment: read case and visit the Federal Trade Commission and Federal Communication Commission websites to determine the current status of legislation and regulation concerning both telemarketing and privacy protection.

In-class: review findings from student exploration of FTC and FCC websites as a response to question 5. Then, have students, either in teams or as a class, respond to questions 6 through 8.

Marketing Strategy Focus

Pre-class assignment: read case and respond to questions 5 and 9 through 11 as a review of the key environmental and industry factors affecting the development of marketing strategy for a bank's fee-generating programs.

In-class: present (or review) direct marketing strategies and tactics as well as the answers to questions 5 and 9 through 11. Then, have students, either in teams or as a class, evaluate the bank's current strategy/tactics and propose alternative approaches at both the strategic and tactical levels. Questions 12 through 16 can be used to facilitate these activities.

ENDNOTES

¹ "Peerless" and "Basics" are pseudonyms for a real bank and program operating in the northeastern United States.

- ² Visa and MasterCard, both started in the mid-1960's, are non-profit competing organizations controlled by the banks that are members. The organizations are responsible for promoting the brand and for improving the infrastructure that processes consumer purchases. Organization membership requires banks to pay an application fee and quarterly service fees based on the volume of card transactions. For a bank, these costs are usually small in relation to the bank revenue generated by the cards.
- ³ A bank's telemarketers can handle in-bound calls, initiate out-bound calls, or can do both. In-bound calls are from customers responding to an ad or to a bank-sponsored mailing they have received. Out-bound calls are made to sell products or services. One outcome of do-not-call laws, which permit companies to call its current customers, may well be the establishment or acquisition of telemarketing organizations by banking and other organizations.

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RECRUITING AT ORGSERVICES CORPORATION*

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CASE DESCRIPTION

The case presents a good springboard for discussing the recruitment process in general and to illustrate the level of students' interest in less well-known organizations. The case also demonstrates the common practice of sending employees to their alma maters to recruit. The case presents a good opportunity to explore student's expectations regarding the job market in general and their specific desires regarding a suitable employer by evaluating the presentation of OrgServices. You may ask students to visit your own career center or one of the many websites providing salary information to obtain salary ranges for jobs of interest to each of the majors represented in your class. This may serve as a "reality check" for many of the students who have not been collecting this information. This case is intended for use in an Employee Selection class in a discussion of recruitment practices; therefore its difficulty level is a three (junior-level). The case is short enough to be easily covered in one class period or as a part of class period if using a recruitment lecture. Alternatively, the case can be used early in the Business Policy or General Management course to stimulate discussion of job-related topics. In either case the case should require less than 1 hour of outside preparation by students.

CASE SYNOPSIS

The case follows, Jason and Patrick, two service area managers for OrgServices Corporation as they return to their alma mater to recruit for the company's Management Training Program. A senior-level Business Policy class constitutes their audience for the presentation. OrgServices is the largest uniform provider in the United States with sales of over \$2 billion in 2001. Jason and Patrick briefly present a description of OrgServices and its outstanding achievements (e.g. over 20 consecutive years of growth in revenues and profits, making Fortune's list of Most Admired Companies, etc.). They project that the company will expand its workforce from its current level of 20,000 to 39,000 in 10 years. They also describe the 2-year Management Training Program open to all business majors where trainees rotate through all aspects of the business.

At the close of the presentation only 3 students pick up information on the company leaving Jason and Patrick to wonder what went wrong. Patrick and another alumnus of the University were scheduled to visit a junior-level class in one month. As the case closes the two are in a quandary over what if anything should be done differently for their next visit to campus.

**While based on real events the company and individual names have been disguised at the company's request.*

INSTRUCTORS' NOTES

Case Development and Teaching Approaches

This case was developed through one of the author's personal experience. The case material tracks very closely the actual presentation made by Jason and Patrick in the class. The name of the organization and individuals were disguised at the company's request.

This case is intended for use in an Employee Selection class in a discussion of recruitment practices. Alternatively, the case can be used early in the Business Policy course as "reality check" for those students nearing graduation. The case is short enough to be easily covered in one class period or as a part of class period if using a recruitment lecture. The case is not designed to encompass a review of the corporation's entire recruitment strategy, but to illustrate the students' level of interest in less well-known organizations.

The case can be used for a general discussion of the recruitment process and the role of campus visits in particular. Employee Recruitment is an area of study that has come into its own in the previous two decades. Until recently researchers have not attempted to measure a number of important process, intervening, and outcome variables. It has become clearer that recruitment is a pivotal step in the overall success of any employee selection initiative. For a current review of the recruitment literature see Breaugh and Starke (2000). You may then walk the students through the process as it explicitly or implicitly applies to OrgServices Corporation. Additionally, based on their own perceptions of what it would be like to work for OrgServices, students could describe what kind of information they would need before considering a job offer there or anywhere. Students could then describe the demographics and qualifications of the recruiter needed to convey this information. Finally, the students could describe the key components of the recruitment presentation that OrgServices should consider using.

The case also offers students the chance to role-play the parts of Jason and Patrick with the class. Alternatively, you may ask students to assume the roles of Patrick and Ann in order to design the presentation for their next visit. After hearing a brief presentation by the participants, you may have the class express whether they would pick up information on the company. Have each of the groups (interested vs. not interested) break into discussion groups to outline their rationale. Then have both groups place their rationale on the board to facilitate discussion with the entire class.

The case also presents a good opportunity to explore student's expectations regarding the job market in general and their specific desires regarding a suitable employer. You may ask students to visit your own career center or one of the many websites providing salary information to obtain salary ranges for jobs of interest to each of the majors represented in your class. This may serve as

“reality check” for many of the students who have not been collecting this information. It may also be instructive to have the students visit the U.S. Bureau of Labor Statistics website (listed below) to view industries and occupations with the largest job growth. Additionally a review of Fortune’s list of the “Fastest Growing Companies” may also be enlightening regarding job prospects.

QUESTIONS FOR CLASS DISCUSSION

1. Why were the students so uninterested in this opportunity? What are you looking for in a first job?

These open-ended questions elicit a number of responses from students and are a good way to kickoff the class discussion for this case. Our students offered the following comments in the next class meeting following the presentation. Many of the students expressed surprise that the presentation centered so much on the company, its products, and its future potential. Most students would have preferred more specific comments concerning pay, benefits, promotion, and location. The students specifically commented on how they related to the presenters being graduates of their institution. The typical comments were, "It made me feel that if they can do it, so can I", or "It made me feel confident that I could get a job with my degree".

Students specifically remarked on how the job opportunities at OrgServices did not meet their stereotype of an ideal job right out of college. One student remarked, "I really hadn't thought much about the kind of company I want to work for". Moreover, the students agreed that they were in their senior year and more than half of the class had not done any advanced preparation for a job. In this regard, the educational institution had failed the students by not specifically confronting their attitudes and perspectives concerning the job search.

Students didn't appear to be sure what they were looking for. Although they were not willing to admit it, it seemed as if they were willing to go to the "highest bidder" salary-wise. Absent more specific salary information, then "folding towels" right out of college didn't sound attractive. Students seemed unprepared to demonstrate how they would add value to a prospective employer. Rather, they felt that the value should be evident in the college degree.

2. What specific information do you look for when evaluating the attractiveness of a job opening? Did Patrick and Jason’s presentation provide this information?

These questions serve as a follow-up to the discussion generated by the questions above. It gives the professor a chance to tailor the case to their own institution’s students.

In terms of the actual recruitment message, the breadth of knowledge conveyed, specificity of information provided, and timing of communications are all-important variables that should be mentioned by students. During the job search process, external applicants are seeking specific job-related information on such issues as starting salary, benefits, raise determination, career advancement, and the success rate of new hires. Recruitment sources that do not meet applicant's expectations in these areas are seen as "lacking professionalism" and cause disinterest in the applicant. Even in cases where the recruiter tries to convey specific information, they may fall short in unsuspecting ways. For example, applicants desire more specific information than "competitive salary range", and the need for uncertainty avoidance may stimulate applicant disinterest. Furthermore, when the job or company is less well known the specificity and timing of information becomes critical. More well known companies may benefit from earlier recruitment and job offers than companies who are lesser known.

When answering this question information provided by students will vary, but regardless of the responses students should be pressed to provide the rationale for their answers. What are they looking for, a job or a career? How important are salary, benefits, training, advancement, etc. Their responses may be divided into job-related and company-specific information. Examples of company-specific information include the history, products/services offered, and growth prospects. Students may also point out that company success is important. Jason and Patrick pointed out that sales and profit growth over the past 220 years had been exceptional as has the stock performance. The company had also been recognized by Fortune magazine as one of the Most Admired Companies. Better students should point out that just because you may not have heard of the company does little to lessen its accomplishments. OrgServices may be less well known than other companies, thereby requiring a little more information on company-specific items. In this regard, the recruitment message needs to be informative enough to address the students need to overcome information ambiguity. When it comes to job-related information desired by students they will readily point out that salary, benefits, raise determination, career advancement, and the success rate of new hires would be appropriate. Students may be directed to search <http://salary.com> for salary information by field and desired work location. This helps give students some perspective on the salary range for management trainees mentioned in the case. Some students feel Jason and Patrick's comment that "selection into the program is competitive with salaries starting in the mid-30's" may have been a little too vague, but students should be pressed to consider the applicant's qualifications and its affect on starting salary. The content may have been better served if it had addressed more areas of student concern including benefits, and how raises are determined, but given the relative unfamiliarity with the company this was not practical. Better students will point out that

well-known companies have the luxury of dispensing with much of the company-specific information and concentrating on job-related items.

3. What recruitment objectives and strategies would be appropriate for a company like OrgServices?

The early stages of recruitment should speak to a number of key organizational variables that are critical to the success of human resource selection. These variables are specific to the organization's context and many should be considered consistent with overall corporate strategy. These variables include cost and speed of filling jobs, number of applicants, desired diversity of applicants, historical ratio of offers to acceptances, retention rate, and job performance variables. Specifically, the company would need to determine what variables are significantly related to successful employee performance, satisfaction, and overall retention. Recruitment objectives dictate the who, how, and when of recruitment procedures that follow, and are an indispensable first step. Once objectives have been identified, consistent recruitment strategies are developed. A typical organization views recruitment as a vehicle toward increasing the applicant pool at a minimal cost.

If you performed the lecture on recruitment, students will tend to answer this question by restating the variables including cost and speed of filling jobs, number of applicants, diversity of applicants, historical ratio of offers to acceptances, retention rate, and job performance variables. Given the growth prospects for OrgServices the sheer number of applicants possessing management potential is an important objective. Therefore, a source that promises to yield those applications would be highly desirable. College recruitment efforts would be part of a larger effort including newspapers, employee referrals, and direct applications. The objectives and strategies for the recruiting effort would be set by the corporate-level human resource department at OrgServices. Patrick and Jason were merely the instruments of the implementation of the company recruitment strategy. However, one can infer that given the growth projections, OrgServices would need a broad-based approach. Their willingness to consider all majors for the management training program is in keeping with this approach.

4. Were you surprised at the growth projections presented for OrgServices? What other industries do you think are projected to grow in employment?

Students are usually surprised by the growth of OrgServices? The U.S. Bureau of Labor Statistics tracks information related to job growth that you may want to share with students or have them retrieve on their own at <http://www.bls.gov/emp/home.htm#tables>. The Computer and data processing services industry is projected to grow at an average rate

of 6.4% between 2000-2010 followed by Residential care (5.0%), Health services (4.6%), Cable and pay television services (4.2%), Water and sanitation (3.8), and miscellaneous business services (3.7%). It is also sobering for college students to note the fastest growing occupations found at this website. Food preparation, customer service reps, registered nurses, retail salespersons, computer support specialists, cashiers, office clerks, security guards, software engineers, and waiter and waitresses are listed as the fastest growing occupations through 2010. Additionally, the website has a detailed list of employment changes by Standard Industrial Classification Code. This allows students to focus on specific industries of interest.

Fortune's list of "Fastest Growing Companies" provides an additional source of information that students may use to gauge their own aspirations with the opportunities in the marketplace <http://www.fortune.com>. This information combined with headlines of layoffs at America's largest companies may serve to educate students regarding the sources of new jobs. Additionally, a list of companies recruiting on your campus might be used during this discussion.

5. Were Patrick and Jason appropriate choices to be recruiters?

Research suggests that the recruiter has a strong influence on the outcome of the recruitment process. Unfortunately, research also indicates that companies devote little or no training to their recruiters (Rynes & Boudreau, 1986). Among those that do train, about thirty percent of the time is devoted to interpersonal skills training, whereas only about ten percent is given to developing actual recruitment content.

The role of the recruiter is especially important because candidates use the recruiter as signals of unknown organizational attributes. Information that is conveyed should come from a credible source, and be job positive. To be persuasive applicants need to perceive that the recruiter has considerable expertise and is trustworthy. Applicants who perceive recruiters as personable and informative also view the prospective employer as attractive. Typically recruiters are defined according to demographics and functional job held. With respect to demographics, applicants may develop more positive attitudes when the recruiter is similar to them demographically (gender, ethnicity, and age). However, as a caveat to demographics, research has concluded that experienced recruiters leave a more favorable impression among applicants. As for functional job held, recruiters who are job-incumbents appear more credible. Human resource specialists who recruit for all units are often seen as less trustworthy than actual job incumbents. Additionally, recruiters should convey realistic job information as first year retention rate among new hires may be related to a perception of employer honesty during the recruitment process.

When answering this question, the student's initial response to this question tends to focus on the recruiters' familiarity with the school and its student body and their ability to relate to the students. You may have to prompt the students to comment on Patrick and Jason's credibility, trustworthiness, and expertise. Research suggests that the functional job held, demographic match, and the realism of the presentation are important variables in stimulating applicant interest. Having successfully completed the management training program and currently working as service managers bolsters Patrick and Jason's credibility and trustworthiness. Their candor regarding "going to college to fold clothes" also enhanced the realism of the presentation. Although the demographics of the class were not included, students may reasonably fault OrgServices for sending two males to do the recruiting. Students should also point out that race and age would also influence the recruiter's credibility. Patrick and Jason's race and age were not explicitly identified in the case, although most students assume them to be young because they graduated four years earlier. Students who assume that Patrick and Jason were young may be reflecting a bias toward non-traditional students. Better students will point out that four years experience (two of which were in management training) may indicate limited experience in recruiting. It also may mean that students view the recruiters' short tenure as a lack of expertise thereby offsetting the credibility of the pair.

6. Why do companies send employees to their alma maters to recruit? Is this a sound practice?

Better students will also point out that this time-honored practice has some solid rationale behind it. Consistent with the comments presented in Question 1 earlier, recruiters from the students' alma mater get the attention of the students and provide a certain degree of credibility and trustworthiness to the recruitment presentation. Additionally, when setting recruitment strategies, many organizations have used source tracking techniques to help correlate recruitment sources with any number of "post-hire" outcomes. These include cost and speed of filling jobs, number of applicants, diversity of applicants, historical ratio of offers to acceptances, retention rate, and job performance variables. Based on the objectives set in these areas, it makes theoretical and economic sense for employers to return the source of its past successes in recruitment and selection.

7 What should Patrick do differently in his next visit?

Some students may argue that nothing needs to be changed until Patrick makes an additional visit to see if the next class has a similar response. Overall, Jason and Patrick appear to have done a good job of presenting OrgServices to the class. Their comments

regarding their reaction to “folding clothes” as a college graduate constituted a realistic job preview. Furthermore, students may point out that the addition of Ann from HR improves the demographic diversity and the recruitment expertise level.

Students advocating changes for the next visit will base their recommendations on their earlier responses to what they are looking for in their own job search. Students may argue that the presentation should cover more specific information such as vacation time, health benefits, a narrower salary range, and other specific perquisites. These students should be challenged to provide ideas on how to overcome the relative obscurity of OrgServices in order to “free up” the time for the additional information the student desires. Additionally, some students may perceive the presentation to be more professional if the recruiter has used a software presentation package rather than overhead transparencies.

EPILOGUE

Patrick and Ann visited the Professor’s class the following month and received much greater interest from the students. The same basic information was delivered with the assistance of PowerPoint slides. OrgServices continues to recruit on campus by providing class speakers and participating in Career Center activities.

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