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LETTER FROM THE EDITORS

Welcome to the *Journal of the International Academy for Case Studies*. The International Academy for Case Studies is an affiliate of the Allied Academies, Inc., a non profit association of scholars whose purpose is to encourage and support the advancement and exchange of knowledge, understanding and teaching throughout the world. The purpose of the IACS is to encourage the development and use of cases and the case method of teaching throughout higher education. The *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 must correspond directly with the author(s) of the case.

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

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

Inge Nickerson, Barry University
Charles Rarick, Barry University

CASES

SAVE-A-BUCK GROCERY: INCREASING ITS SALES THROUGH A RAFFLE

Robert J. Williams, Valdosta State University
Allan C. Reddy, Valdosta State University
Phyllis G. Holland, Valdosta State University

CASE DESCRIPTION

The primary subject matter of this case concerns a promotion, specifically a raffle, that can be used by any size business to increase its sales. Secondary issues examined include the specifics as to how a raffle might be conducted, and a demonstration of the proper statistical technique needed to assess the effectiveness of the raffle in increasing a firm's sales. The case has a difficulty level of three, appropriate for junior level students. The case is designed to be taught in two class hours, and is expected to require two to three hours of outside preparation by students.

CASE SYNOPSIS

Firms are constantly seeking ways to increase their sales. A raffle involving a cash prize may be an excellent technique for accomplishing this objective. A raffle might be a way to "pay" customers to buy more, and is usually appropriate for any size firm. This case shows how a simple raffle technique can be used to increase sales, and also demonstrates the type of data and the statistical technique needed to examine the effectiveness of a raffle. Students will learn the type of data needed to evaluate the raffle and how the data can be collected and tested. Further, students will be exposed to the types of questions they must ask themselves in order to properly conclude whether a raffle has been cost effective in stimulating firm sales and profits. This case is an excellent teaching tool that is appropriate for an introductory statistics course, an introductory marketing course, a promotions course, a course in marketing strategy, and business policy.

INSTRUCTORS' NOTES

CASE OVERVIEW

Save-a-Buck Grocery launched a promotional campaign to increase its sales. For each \$10 spent, customers were given a ticket for a cash drawing to be held at the end of the month. Analysis of the results showed that the contest did significantly increase minimum per basket sales, and

monthly sales in total. The owners are now considering further modifications to the promotion. Students are asked to use the data provided to determine what the next step should be.

LEARNING OBJECTIVES

The twin learning objectives of this case are:

1. Demonstrate ways to promote sales through a raffle method.

Students should question the appropriateness of using a raffle type contest, and explore other methods, such as coupons, to stimulate sales.

2. Demonstrate the use of ANOVA to make a marketing promotion decision.

Students should examine the results for themselves, and determine if the results support the authors' contention that the contest helped to increase the average basket.

If so, students should become familiar with the interpretation of the ANOVA results, and consider ways to alter the ANOVA technique to accommodate further increases in the cash prize.

QUESTIONS

1. **What are the benefits of a raffle over other types of promotion available to Save-A-Buck?**

After reviewing various types of promotion, students should conclude that the raffle is cost-effective, targeted, and exciting to customers.

2. **Assume that an estimated 1000 customers per month are eligible to participate in the contest and that 2/3 of the increase in the basket size is due to the contest. Also, assume Save-A-Buck's gross profit margin is 33% of sales. Is John right, has Save-A-Buck made money by giving away money?**

John estimates that 2/3 of the increase in the basket size is due to the contest. Thus, the basket has increased by about \$.80 by having the contest. Since the \$.80 increase is averaged over 1,000 customers per month, total sales have increased by \$800 per month. Given a 33% profit margin, gross profit has increased by approximately \$264. Overall, Save-A-Buck has increased its profit by \$164 after paying the contest winner the \$100 prize. Also, in the event the customer is unable to

locate the winning ticket, the prize money is not awarded. This was observed to have happened about one-fourth of the time.

- 3. What can you say the effect was on the basket size between offering a \$25 prize and offering no prize, i.e., is there statistical evidence that the \$25 prize actually increased the basket?**

There was no statistically significant evidence that a \$25 prize increased sales.

- 4. If John had increased the store's advertising during the contest period, what impact might this have had on interpretation of the results?**

An increase in advertising would have introduced an additional variable, not considered in the analysis, making it impossible to attribute the larger basket purchase to the contest alone.

- 5. Are there any other factors that are not controlled for in this experiment? Any alternate explanation for the increase? Does John take these into account?**

Seasonal changes in buying patterns would have an impact. Another possibility would be "sales" or special pricing that might encourage shoppers to buy extra at an attractive price. By using a "conservative" estimate of 2/3 of basket increase accounted for by the contest, John is acknowledging that there may be other factors at work.

- 6. In Table 1, what does the minimum basket number of \$10.17 during the \$100 prize period suggest about customer behavior?**

It suggests that the average customer is purchasing at least the \$10 minimum basket in order to obtain at least one ticket.

- 7. Did John use the correct statistical technique to test the effectiveness of the contest?**

In comparing three or more means--baskets or monthly sales, ANOVA is the appropriate technique.

- 8. In tables 3 and 4, what is meant by the expression "Comparisons between means are significant at the .05 level?"**

While there are mean differences present, such differences might be due to chance or sampling bias. Comparison of means is significant at the .05 level suggests that the chances that the means are

different due to chance or sampling bias is less than 5%. Thus, we can be fairly confident that some main effect (the raffle) is causing the means to vary across different levels of the contest.

9. At the end of the case, John is planning to give away more money. Mary and Myra object. Whom do you support and why?

This goes beyond statistical analysis to require judgment. Perhaps, two \$100 prizes might be preferable, since this gives two customers per month a chance to win the prize. This might serve to increase the excitement among customers about the contest, and help to spread the word about the contest. Students may share Mary and Myra's conservative bias and argue that the law of diminishing returns will kick in eventually.

Students may suggest various ways to improve judgment, but this is a good opportunity to recognize that there are limits to research's ability to answer questions in a cost effective manner.

EPILOGUE

After conducting the contest for 64 weeks with a prize of \$100, John is convinced that the raffle has increased sales. Mary Mason, though still uncertain, does concede that customers do seem to be buying more in order to win the cash prize. John wants to study the data further, but is leaning toward offering two \$100 prizes in order to give more customers an opportunity to win. John realizes that this action will be costly, but the data can be easily obtained to see if offering the second prize of \$100 has the desired effect of further stimulating sales. Nevertheless, John has not made a final decision at this time.

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CAN WORK REALLY BE THIS MUCH FUN?

Joseph Kavanaugh, Sam Houston State University

Kathy Gilcrease, Sam Houston State University

CASE DESCRIPTION

The primary subject matter of this case concerns the differences between the characteristics of teams and high performance work groups. Secondary issues examined include distinguishing between the two forms of group organization and the appropriate use of each; the necessary components that contribute to a group's success; and learning how to successfully cope with a change in a group's membership. The case has a difficulty level of three. It is designed to be taught in one hour and is expected to require two or three hours of outside preparation by students.

CASE SYNOPSIS

The case involves a highly performing work group, which displays many characteristics of a high performance team, in the setting of a small office on a university campus. Through displays of their strong interpersonal relationship, one can see why the group is so successful, but the continuing success of the group is in jeopardy when one member announces her retirement. The group is left to ponder the question of how to sustain their team, or were they a team anyway?

RECOMMENDATIONS FOR TEACHING APPROACHES

Clearly, the teaching note relies heavily on the work of Katzenbach and Smith, *The Wisdom of Teams* (1999). Therefore, it would be advisable to make this book a text for the course, where appropriate. It clearly draws the distinction between high performing work groups and teams, and discusses the conditions under which each is the preferred operating choice. If not a course reading, the instructor may wish to become familiar with this work and outline it for students.

Prior to introducing the case, class discussion can be helpful to tease out the differences between work groups and teams. The table in response to question 2 can be helpful in this regard, as well as material contained in most textbooks on organizational behavior or team work. Help students understand and appreciate that "getting to team" is not necessarily the required organizational response. In many circumstances, work groups that perform well are quite satisfactory, indeed preferred, and require far less personal and institutional commitment than teams.

While sports analogies are often not appreciated, they are apt here. Students are quite conversant with such, and are generally able to identify the differences in personal performance

required by athletes when compared to, say, most decision-making groups in their lives or student organizations. “Only the team wins;” “Everyone has to pull on the rope together;” “Do something sacrificial for the team;” reflect a different orientation than a committee environment that may be dominated more by personal agendas, power issues, low commitment, and compromise as a decision mechanism.

DISCUSSION QUESTIONS AND ANSWERS

1. Is Beatrice correct when she calls the group a team?

Yes and no. The group displays characteristics of both a high performance work group and a team. The intermingling of the appropriate characteristics of a work group and team leads to the group’s success. Overall, the group meets the definition of a high performance work group, which is “a group that can achieve its performance challenge entirely through the combination of individual performances” (Katzenbach, 1999).

Work groups are not mutual accountable for their work and usually have a single leader. They interact primarily to share information and to help other work group members perform better in their individual roles (Katzenbach, 1999). This is exactly the environment that is displayed at the office in the case study. The performance goals of the office of Academic Affairs are handled through the combined individual efforts of each staff member which has assigned responsibilities with the Vice President being the single leader of the office.

Works groups tend to have a leader that controls the group and assigns work. The work group goals are determined by the organization with emphasis on individual performances and communication flowing down from the leader (Pell, 1999). This is the behavior displayed by the group in the case study with the work group goals determined by the university and flowing down from the Vice President to the other office members.

In contrast, teams tend to have a leader that is a facilitator with goals and work assignments determined by team members. Team communication tends to flow up and down with decisions being made by the entire team (Pell, 1999). Table 1 illustrates the differences between work groups and teams. The group in the case study displays the characteristics of work groups listed in the table. The group has a clearly focused leader, the Vice President, which delegates the work with the office members being individually accountable for their work. The group’s work does not have direct performance measures, and its purpose is to achieve the broad university mission.

Table 1*: Comparisons -- Work Groups vs. Teams		
Variable	Work Groups	Teams
Leadership	Strong, clearly focused leader	Shared leadership roles
Accountability	Individual accountability	Individual and mutual accountability

Table 1*: Comparisons -- Work Groups vs. Teams		
Variable	Work Groups	Teams
Purpose	same as organization mission	Specific purpose that the team delivers
Work Products	Individual work-products	Collective work-products
Meeting Style	Runs efficient meetings	Open discussion and active problem-solving
Performance Measured	Indirectly by influence on others	Directly by assessing team work-products
Leader Style	Discusses, decides, and delegates	Discusses, decides, and does real work
*Katzenbach, J. R. & D. K. Smith (1999). <i>The Wisdom of Teams</i> . New York: HarperCollins Publishers.		

2. What team characteristics does the group display?

The group displays many team characteristics even though, overall, they would be considered a high performance work group. A team is described as “a small number of people with complementary skills who are committed to a common purpose, performance goals, and approach for which they hold themselves mutually accountable” (Katzenbach, 1999).

The ideal size of a team is between four and approximately twelve members. As the size of the team grows, the team structure will begin to deteriorate, and the team will begin to break into smaller teams or subgroups (Katzenbach, 1999). This group does meet the qualification of a small number by having six members, who are Dr. Gaines, Dr. Richards, Dyan, Beatrice, Jamie, and Ruth.

The next characteristic of a team is to have complementary skills. These skills fall into three categories: technical expertise, problem solving, and interpersonal (Katzenbach, 1999).

The group does have complementary technical skills. Each group member has a field in which he or she specializes. Dr. Gaines and Dr. Richards make all the pertinent decisions and focus their attention on coordinating the division of academic affairs. Dyan and Jamie specialize in budget, curriculum, and faculty issues. Beatrice concentrates on any issues that concern the four colleges within the Division of Academic Affairs, and Ruth handles any matters concerning academic services. When these categories are combined, together they are able to handle the wide variety of tasks that are required of the office.

The group in the case study does not display the complementary skill of problem solving because the group leader makes the significant decisions. On the other hand, the case study group does display numerous examples of their interpersonal skills. Some examples of interpersonal skills are communication, trust, constructively handling conflict, support, and recognizing the achievements of others (Katzenbach, 1999).

The category of interpersonal skills is probably the strongest team characteristic displayed by the group in the case study and attributes significantly to their success. Effective communication and trust are displayed on several occasions, but probably the most significant example is the group’s Friday lunch sessions. During this time, the ladies openly share with each other their

frustrations regarding office matters as well as personal affairs with the assurance of complete trust and confidentiality. Another important interpersonal skill, handling conflict, is displayed when Beatrice becomes upset with Dyan regarding the copier. Instead of brooding or pouting about the situation, Beatrice vents her anger by over dramatizing what she wants to do to resolve the situation by asking the Vice President for permission to slap Dyan. The Vice President in turn handles the circumstance with humor by making light of the situation when he responds “ok, but no hair pulling”. Humor serves as a catalyst to change the situation from a potentially tense setting to a relaxed atmosphere.

Support is another interpersonal skill the group exhibits when they sacrifice their work time to help Beatrice meet her deadline. They give her the benefit of the doubt that she has worked diligently, but was not able to complete the task on time without the help of the other members. They also show support to Dyan when they agree to sacrifice their time after work to help fix her dress for the awards program. The group recognizes the interest and achievement of others as they share in Dyan’s success when she wins the Staff Evaluation Award.

Another team characteristic is to be committed to a common purpose and performance goal. This group is committed to the broad common purpose and performance goals of the office of Academic Affairs; however, to fit the team definition, they would need to transform these goals into specific and measurable performance goals (Katzenbach, 1999).

The last two team characteristics of a common approach and mutual accountability are not displayed by the case study group. The members of the group approach their work assignments by methods each feels is best, and are individually accountable to the vice president for their performance.

3. In this job setting, would a work group or team approach be recommended?

A leader needs first to evaluate the circumstances and determine which approach is best suited for the situation. Work groups are suited for settings in which performance goals can be met through individual efforts (Katzenbach, 1999). Since planning for work groups is done by the supervisors and decisions are implemented through individual assignments, work groups need little time to plan. Work groups are usually considered less risky, less time consuming, and less disruptive than teams (Pell, 1999).

Teams can be valuable in settings when a project requires individuals with diverse backgrounds, the culture of the organization is participative, and the managers are committed to implementing a team concept (Pell, 1999). Teams will typically outperform a work group by being more flexible, responsive to change, and allowing the group to draw upon the talents of all the members to create synergy, which is defined as the whole being greater than the individual parts (Robbins, 2000). If an organization is pursuing a creative tactic, developing employees’ potentials, and is synergistic, it should use a team approach (Pell, 1999).

The setting for the case study group is more suitable to a work group approach since the performance goals can be met through individual contributions. An office environment lends itself to having predetermined goals, while a team approach is more suited for project type situations. Furthermore, for the sake of time, the case study setting is more conducive to having a single leader, the Vice President, making the decisions for the office instead of each decision being hashed out by the group. Also, there are many decisions in the office that only the Vice President can handle.

Teams are frequently found in large organizations with multiple departments, multiple divisions, and numerous employees. Teams are used in this setting to help with problem solving, special projects, and to unite a widely dispersed group of employees (Devine, 1999). Teams are used in the university setting drawing members from various departments and divisions to work on special projects that concern the university as a whole. The work group in the case study does have the advantage of being ready to come together as a team for special projects required of the office since they already have the foundation of a team within the work group. As demonstrated by this case study, one does not have to have a work group or team in its purest form. Characteristics of each can be combined in the appropriate setting to accommodate unique work environments.

4. What makes this group so successful?

As stated in the answer to a previous question, one reason the group is so successful is the members have incorporated appropriate team characteristics of communication, trust, constructively handling conflict, support, and recognizing the achievements of others into a work group setting to enhance their relationship. When a group has a strong interpersonal relationship, it will lead to higher levels of productivity. If a group is cohesive, members have a stronger desire to attain the goals of the group (Robbins, 2000). These individuals take great pride in their work and know they can depend on each other to produce quality work. Each attempts to do her best on each assignment to assure she will not let down the other group members. Each feels she is a part of a group and, even though they might not be mutually accountable for their work, they feel a sense of responsibility to perform at the high standards that have been set by the office.

In the case study, it is noted that the ladies are known on campus as a group. This feeling of being a part of the group fulfills the basic need of belonging for the group members. It provides security, status, self-esteem, affiliation, and power, which gives the members the necessary attributes to be successful at their jobs (Robbins, 2000). The ladies obviously work at enhancing their relationship by spending time together. As mentioned in the case study, they took a trip together which helped the ladies bond by providing the group with time outside the office. Groups tend to be more cohesive if they spend a significant amount of time together (Robbins, 2000).

Another reason the group is successful is they enjoy the environment in which they work. Ruth enjoys it so much that she has had trouble making the decision to retire. One reason the group members are attracted to the group is because they share similar work habits and personal traits. As

stated in the case study, they are all hard workers and go above and beyond the call of duty. If the group felt that one member was not doing her share of the work, this would lead to animosity among the other members and interfere with the group's cohesion. Their work styles may be different to a certain extent, but their broad work traits are the same. The two members of the group that work together, Dyan and Jamie, have similar work styles as well as broad work traits which contribute to their successful partnership. Also, the group shares common personal traits. Even though this might not play as significant a role as the work traits, common personal traits add additional common ground to bring the group members closer. The fact that three of the four members of the office group have strong roots in the community seems to be an added bonus that provides them with close ties drawing them together. This situation has apparently not caused problems for the fourth member of the group because it appears the other three group members include Ruth in their conversations regarding the community, and Ruth has not allowed the situation to alienate her from the group.

Another reason for their success is the manner in which they handle conflict. It is apparently customary for the office members to express their dislikes or disagreement openly, but with humor in order to buffer the situation. It is important they let the other members know when they are having a problem instead of letting the problem escalate, but the manner in which they handle the situation is the key to their success.

5. What can they do to make sure the group will continue to be successful after Ruth's retirement?

The answer to Beatrice's question at the end of the case study, "Do you think our team will ever be the same?" is "no". The group will never be the same because there will not be the same members, but this does not mean the new group cannot continue to be successful (Katzenbach, 1999). Initiating a new group member will frequently impede the group's progress, but there are some tactics that will help make the transition as smooth as possible. The existing group members need to be involved as much as possible in the selection of the new member. Furthermore, they need to assign a person to be responsible for orienting the new member and providing the new member with all relevant background information regarding office procedures (Harrington-Mackin, 1996). The group is on the right track at the end of the case study when they start listing the qualities of the new group member they wish to fill the open position. One reason for their success is their common work and personal traits. They need to find an individual that shares these common traits to fit into the group.

First, the group needs to make sure the new group member will possess the abilities to perform the technical aspects required of the job. This can be achieved by making sure the candidate meets the educational and experience requirements outlined in the job description and qualifications form utilized by many human resources departments. The more difficult task will be

to find an individual that possesses similar work and personal traits desired of the existing group. The existing group members need to make a list of the traits they wish for the new group member to possess and formulate interview questions so that the answers will reveal the existence of these traits. They also need to make clear to the new member the standards of the office so the new group member will have a complete understanding of what is expected.

After the selection of the new group member is made, the existing group members need to welcome the new member into the group and help the new member feel a part of the group (Katzenbach, 1999). They need to nurture the relationship and realize it will take time to build a strong interpersonal relationship of trust, communication, and support with the new member. The existing group members need to realize the group will never be as it was in the past, and it will be important not to compare the new member with the old member. They need to look at the new member as an opportunity to bring new insight to the group, and be open minded regarding ideas from the new member (Katzenbach, 1999).

The new member also has a role to play to fit into the group by realizing he/she will need to earn a place on the team (Katzenbach, 1999). The new member needs to try to fit into the group culture that already exists, but not be afraid to bring his/her ideas to the group. A new team member can be a threat or an opportunity to the group (Katzenbach, 1999). When a new member joins a group, two situations can occur. The new member can become a part the group, and the newly formed group has the opportunity to grow with the insight of a new member. On the other hand, the new member can remain an outsider that will cause disruption in the group that could prove detrimental to the group's success (Katzenbach, 1999). When a group that works so closely together is faced with adding a new member, a great deal of effort needs to be put forth to assure the new member is a good match with the existing group members. Furthermore, the new relationship needs to be nurtured and given time to grow. This may seem like a great deal of work but, as evidenced in the case study, the results will be worth the effort.

Every organization needs to learn to deal with changing group members, which in today's transit society will occur on a regular basis. Even though a group does everything possible to assure the group's continuing success when selecting a new member, success is not guaranteed. When dealing with the complex human factor, no one knows exactly the right combination of skills and personal traits that will provide the right chemistry. Although, a group that has been successful in the past, as the one in the case study, has the advantage of assessing the factors that have contributed to its success, and try to emulate these factors for future success.

EPILOGUE

Several months have passed since this case study was written. To everyone's surprise, these months have brought about tremendous change to this normally stable office. Jamie received notification from the President of the university that she had been selected to replace his assistant

who was retiring. Consequently, she will be leaving the office of academic affairs to assume her new position next month.

With the announcement of Jamie's promotion, Ruth has once again decided to delay her retirement. The office has already selected the replacement for Jamie. During the selection process, the applicants were first screened to make certain they evidenced the skills and abilities for the position, which narrowed the field of candidates. Then, probably the most important part of the selection process for the office came when each member of the office, including Jamie, visited with each applicant. Afterward, the office met as a group, and each group member cited his or her top two choices and stated the reasons for the choice. Surprisingly (or not), each group member had selected the same individuals. After some discussion, the group came to a consensus regarding the new employee. The office did the best they could when they selected the replacement for Jamie to make certain the new employee will be a good "fit" with the group. However, the question still remains, will the group ever be the same?

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IS IT TIME TO UNLEASH A SOCIAL ENTERPRISE INTERNET BUSINESS ON THE GLOBAL MULTIBILLION DOLLAR WEDDING INDUSTRY? A CASE STUDY

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CASE DESCRIPTION

The primary subject matter is the potential entry of a business with a social enterprise strategy into a highly competitive industry. It can be used to introduce business social enterprise, triple bottom line, and sustainability strategies and practices. Secondary issues include the use of business plan competitions for testing out an idea, securing initial funding, and developing vital networks. The case has a difficulty level of three to five and works well in the undergraduate policy or strategy capstone class or first-year MBA. It is designed to be taught in one to two class hours.

CASE SYNOPSIS

This case revisits a business plan that won first place in 1999 in its university's business plan competition. Subsequent to winning the award, the team had concluded the opportunity, as they had explored it, was a "too-little-too-late" Internet startup, and the team members were not in a position to want to pursue an online wedding information site at the height of the dot-com boom. Six years later, Bill, the would-have-been CEO of Wedding Information Site, received an e-mail from his instructor urging him to revise the strategic position of Wedding Information Site and secure an MBA team to enter the business plan competition again. The instructor proposes that a social enterprise component be added to the business strategy that would result in a significant impact for good (i.e., the "triple bottom line" of people, profits, and environment) on the \$70 billion a year wedding industry in the United States alone. The key issue is how to position Wedding Information Site's social enterprise strategy and practices to become a competitive force, to secure initial financing, and ultimately to become a desirable buyout from an established competitor or to become a significant competitive force in the multibillion dollar industry. Venture capitalists are not traditionally known for looking first at social return, then financial return. However, this is potentially a very compelling investment opportunity for the right investor.

This case is a teaching tool to explore how to use social enterprise and the triple bottom line strategies and practices from the startup as a viable market entry strategy. This model can

potentially change an industry and have a significant impact on people, profits, and environment while meeting the needs of various stakeholders, including shareholders. It is arguably the predominate model of the 21st century for doing business.

INSTRUCTORS' NOTES

Case Overview

The WeddingInfoSite.com won the University's grand prize business plan award in 1999, the first annual business plan competition. The team's members, however, were at career spots that did not lend themselves to engaging in any startup at that time. Also, at this time TheKnot.com was emerging as a serious force in that space, and it went public later that year. The Knot became profitable in 2003, seven years into its business, and has been in a strong growth mode ever since. The Knot has stayed the course with a clearly profitable "bottom line" approach focused on giving the best source of information for those getting married. The wedding related market is an estimated \$70 to \$150 billion market in the United States alone. China and Europe are also seeing a real surge in this market. In the emerging social enterprise/sustainable era of post 9/11, post dot-com, post Enron, post Martha Stewart, post Hurricane Katrina, it is conceivable that strategies not previously considered as being viable will be impacting entire industries and businesses from small to large. Indications are that there is increasing demand for value-oriented wedding/marriage starts. The average cost of a wedding at \$26,000 means large segments of the population are spending increasingly large amounts of money for weddings. It also means large segments of the population are not able to participate, at least not in the way the wedding industry is now serving the market. Is there an opportunity now that was not there before? The WeddingInfoSite.com is revisited six years later by the original designated CEO, who is now ready for a career change but maybe not another business plan competition with an updated Wedding Information Site. Bill reviews an e-mail challenge from his instructor for Wedding Information Site to become a Ben & Jerry's of the wedding industry--a Ben & Jerry's social enterprise with a triple bottom line strategy. Wedding Information Site's tag line theme could be: "Quality weddings to meet your price and quality of life and planet concerns."

The detailed Instructor's Notes provide an opportunity for the instructor to get background materials on the areas of social enterprises, triple bottom line, and social responsibility to be able to incorporate into courses. It also includes a suggested student consulting assignment to the CEO of The Wedding Information Site which has been used successfully at the undergraduate and graduate levels, including classes with culturally and ethnically diverse student populations. A potential debate assignment is proposed to explore the pros and cons of business plan competitions. The international diversity of students and the age range of senior undergraduates to older MBA's, many who are considering marriage, allows for discussion of the potential global wedding market. Usually several students have used a service such as TheKnot.com or have been involved with

someone else who was registered on one of the sites such as The Knot. Also included are social enterprise definitions and Web links for instructors to see how companies actually applied the concepts. It is timely to address values, ethics, and social responsibility. Hurricane Katrina is only the latest concern to cause people to question “abusive consumerism.”

This works well for introducing concepts of triple bottom line, social enterprise, sustainability, social responsibility, values, social justice, and maximizing stakeholder returns. It is useful in entrepreneurship, strategy, and management courses. This case is about entering the U.S. market. Would this be applicable in any country? What role do business plan competitions play in introducing new ideas into the marketplace? Suggested case discussion questions and student exercises are included, followed by social enterprise background material, links for the instructor, and mini lectures.

DISCUSSION QUESTIONS AND STUDENT LEARNING ACTIVITIES

1. **Are “social enterprises,” “triple bottom lines,” “sustainable businesses,” and “social return on investment” just academic discussions in the competitive world of bottom-line focused U.S. businesses? Didn’t the social responsibility and ethics era cover it all? Note to students, for definitions, the “Social Enterprise Lexicon” is useful: http://se-alliance.org/resources_lexicon.cfm.**

Social Enterprise Lexicon: http://se-alliance.org/resources_lexicon.cfm

For a quick primer on the triple bottom line in action, go to <http://www.rolltronics.com/ppl/tbl.html>. There is a definitive article “The ‘Triple Bottom Line’: A Boardroom Guide” (Sauvante, 2001) plus a “Sustainability Whitepaper” (n.d.).

For additional background notes on social responsibility, triple bottom line, social enterprise, and sustainability, refer to J. Andriof and C. Marsden OBE (n.d.) “Corporate Citizenship: What It Is and How to Assess It?”

We have included a mini lecture based on Andriof and Marsden’s article with some updates on trends and forces that are making a case for this being a required strategy for businesses to be competitive in the 21st century. It is necessary to consider impact on social, economic, and environmental stakeholders:

Mini Lecture--Background Notes on Corporate Social Citizenship, Social Responsibility, Triple Bottom Line, Social Enterprise, Sustainability. Corporate social citizenship is not a new idea. Its importance in the workplace has increased significantly in the last ten years in the United States and globally. We have gone from bottom line talk to including double and triple bottom lines in the for-profit and not-for-profit sectors. It is increasingly clear to the great majority of businesses in industrialized nations that for a business to truly succeed, it must prosper in the areas of profits, people, and planet. This is still a less clear recognition for nonprofits, who are

moving into double bottom line areas with social entrepreneurship and efforts to generate income from business activity. The way a business chooses to conduct itself can have tremendous global impact. Negative examples of this are the Nestle Baby Food debacle of 1970; Nike Corporation's use of child labor, which came to be a public issue in 1996; and the Anderson/Enron debacle of 2002. The way a nonprofit chooses to conduct itself can have a tremendous global impact.

Good corporate citizenship can be defined as understanding and managing an organization's wider influences on society for the benefit of the organization, its constituents or stakeholders, and society as a whole (Andriof & Marsden, n.d.). Furthermore, organizational citizenship embraces an understanding that everything an organization does has some flow or effect either inside or outside the organization, from customers, volunteers, and employees to communities and the natural environment. Corporate social responsibility (CSR) encompasses the environment, the workplace, the community, and the marketplace which refer to triple bottom line concerns of economic prosperity, environmental quality, and social justice (Elkington, 1998). Within these four areas, companies are able to make a difference by conducting specific programs and actively becoming involved in monitoring and changing the effects of their operations (Andriof & Marsden, n.d.).

Aspects of responsible management include:

- Employees/volunteers are most productive when they do meaningful jobs at fair wages/relevant compensation, in a healthy environment, are empowered to have a say, are respected for their contributions, and have a good balance between work and family life.
- Organizations function best over the long run when the community they are in is healthy and has a below average crime rate, adequate education and health care, available skilled labor, and robust economic activity.
- Companies that treat the environment with respect in all aspects of their operations have reduced waste output, higher quality products and services, high resource efficiency, reduced costs of regulatory compliance, experience low incidence of litigation, and enjoy a high degree of loyalty from customers, business clients, staff, volunteers, and funding sources.
- Organizations must take a long-term view of their operations and make decisions, which consider a more holistic view of the constituents and world. Sometimes this means forgoing short-term profits in favor of long-term benefits.
- An organization's brand and reputation are becoming more and more important as consumers, investors [grantors, donors, funding agencies] [often] consider reputation and performance, contribution to social/human good, and care for the environment as important as price in making purchasing decisions (Andriof & Marsden, n.d.).

The Forces of Change Towards a Triple Bottom Line. What are the factors that make an organization want to change? Why in the last ten years have the pressures and business factors for change been more prominent than ever?

- (1) 9/11--In a global CSR study by APCO Worldwide opinions of 419 elite panelists from ten countries in North America, Europe, and Asia-Pacific in 2004, it found the greatest forces perceived to drive change in social responsibilities of companies tend to be external media,

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- government regulations, and lawsuits. Internal company stakeholders--employees, business partners, executives, and shareholders--were viewed as very important also.
- (2) Deregulation, Globalization, and Internet--which has provided business and nonprofits with many opportunities previously denied to it. Among these opportunities has been the ability to compete in most of the world's markets; the ability to raise funds from numerous different and competing sources; and the opportunity to buy supplies from anywhere in the world and sell goods to anywhere in the world. The effects of these changes have included more competitive local markets and the squeezing out of the small business. For example, Wal-Mart has been blamed for the demise of countless local retailers. Other effects include cross-cultural business investments and transactions. Many factories are located so as to make use of cheap foreign labor. However, Article 29 of the Universal Declaration of Human Rights (1948) provides that "Everyone has duties to the community ..." and that is a global community. Business for Social Responsibility (2005) is a global partner for responsible business leaders with more than 1,400 members and affiliated companies worldwide. "BSR helps businesses achieve commercial success in ways that respect ethical values, people, communities and the environment" (<http://www.BSR.org>).
 - (3) Rapid Advances in Communication Technology--which has allowed information to be relayed around the globe almost instantaneously and with minimal costs. There are few areas of our global community that have not been affected by the changes that have occurred in communication technology and those that are still developing--e.g., the Internet and wireless technologies.
 - (4) The Rise in the Power of the Consumer--the combination of the forces described above has resulted in what many have termed 'the information age.' With access to instant, free information from a variety of sources; a multitude of service and product providers; a multitude of global investment opportunities; and, the unopposed spread of capitalism as the dominant economic structure; the rise in the power of the consumer has been unrestrained (Andriof & Marsden, n.d.).
 - (5) Availability of socially conscious investment funds--e.g., Domini funds. Sources of funds--investment options--social investors--need to consider revenue generating opportunities, especially if they further the mission of the organization.
 - (6) Evidence that "good marketing/management" pays off.
 - (7) Curriculum in business schools, beyond the grey pinstripes, business plan competitions that include a social enterprise, sustainable, or triple bottom line awards. Programs MBAs are engaging in such as the University of Washington's Challenge for Charity Auction partnering with Special Olympics, over four years volunteered over 5,200 hours and donated over \$275,000 to Special Olympics.

- (8) Other topics and headlines indicate a “movement” has begun from hybrid energy cars driven by higher gas prices and a carrot approach of government to allow credits of tax up to \$2,000 for purchasing a car/truck that uses alternative energy sources.
- (9) Growing awareness that working on a triple bottom line increases probability of an even better profit bottom line. The financial industry is watching. For example, in *Who Cares Wins: Connecting Financial Markets to a Changing World: Recommendations by the financial industry to better integrate environmental, social, and governance issues in analysis, asset management, and securities brokerage* (United Nations Global Compact & Swiss Federal Department of Foreign Affairs, 2004), institutions endorsing the report believe that

Companies that perform better with regard to these issues can increase stakeholder value by, for example, properly managing risks, anticipating regulatory action, or accessing new markets while at the same time contributing to the sustainable development of the societies in which they operate. Moreover, the issues can have a strong impact on reputation and brands, an increasingly important part of company value.

The report further clarifies roles of different market actors: companies, regulators, stock exchanges, investors, asset managers, brokers, analysts, accountants, financial advisors, and consultants.

- (10) Natural disasters and future hypothetical disasters:
 - a. The December 26, 2004, India Ocean earthquake, Sumatra-Andaman earthquake generated a tsunami that killed more than 150,000 people.
 - b. Hurricane Katrina, August 25, 2005, thousands dead, New Orleans decimated, hundreds of thousands displaced in Gulf area.
 - c. Hypothetical future disasters (*List of disasters*, 2005):
 - i. Overpopulation
 - ii. Supervolcano
 - iii. Asteroid impact event
 - iv. Mega-tsunami such as recurrence of Cascadia Earthquake of Juan de Fuca Plate in Pacific Ocean (originally January 26, 1700)
 - v. Global warming
 - vi. Hypernova
- (11) John Elkington’s seven revolutions driving the triple bottom line challenge.
 1. **Markets** will be driven by competition, largely through markets. As a result, business will shift from using competition as an excuse not to address the triple bottom line agenda to a new approach, using the triple bottom line as part of the business case for action and investment.
 2. **Values**--the worldwide shift in human and societal values. The transition from ‘hard’ commercial values to ‘softer’ triple bottom line values.
 3. **Transparency** already under way, is being fueled by growing international transparency and will accelerate. As a result, business will find its thinking, priorities, commitments, and activities under increasingly intense scrutiny worldwide.

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4. **Life-cycle Technology**--‘X-ray environment,’ in which their value chains and product life-cycles will be exposed (often in excruciating detail) to wider scrutiny. New forms of ‘X-ray environment’ can switch on without warning, illuminating activities, processes, and companies way back down a value chain.
 5. **Partnerships**--will dramatically accelerate the rate at which new forms of partnerships spring up between companies and between companies and other organizations.
 6. **Time**, driven by the sustainability agenda, will promote a profound shift in the way we understand and manage time. By contrast, the sustainability agenda is pushing us in the other direction, towards ‘long’ time. Bubble environments which--as illustrated by the history of spectacular economic crashes around the world--can delude and destroy even the deepest-rooted businesses. Unless companies can balance the short-termism of most ‘wide time’ markets with a real sense of ‘long time,’ they are extremely unlikely to survive the sustainability transition.
 7. **Corporate Governance**--ultimately the triple bottom line agenda is the responsibility of the corporate board.
- (12) Corporate citizenship is a powerful influencer of consumer behavior--40% of respondents to survey of 3,500 Americans said that good corporate citizenship makes them more willing to do business with a company (GolinHarris, 2005).

The Top 12 Corporate Citizenship Drivers that are viewed as being important in building a company’s reputation as being a good corporate citizen:

1. Values and treats its employees well and fairly
 2. Executives and business practices are ethical, honest, responsible, and accountable
 3. Goes beyond what is required to provide safe and reliable products and services
 4. Responsibly markets and advertises its products and services
 5. Committed to social responsibility, economic opportunity, environmental protection, etc.
 6. Committed to diversity (gender, race, etc.) in the workplace and its business practices
 7. Listens to community or customer input before making business decisions
 8. Is active and involved in the communities where it does business
 9. Company’s products and services enhance peoples’ lives
 10. Corporate values and business practices are consistent with my own beliefs
 11. Donates or invests its fair share of profits, goods, or services to benefit others
 12. Supports a cause or issue that has led to improvement and positive change
- (13) Examples of corporate brands/companies which embrace corporate citizenship and “have also succeeded in making corporate citizenship an essential and vital part of their business strategy, value proposition and stakeholder relationships” (GolinHarris, 2005).

Johnson & Johnson
 Ben & Jerry’s
 Disney
 Whole Foods
 SC Johnson
 Kraft
 3M
 McDonald’s
 Procter & Gamble
 Southwest Airlines

(Note to instructor: This may be a real weakness for Wedding Information Site's CEO/founder. This is a totally integrated concept and maybe too "foreign" to CEO to implement successfully. There was no indication of awareness in 1999 business plan social responsibility.)

- (14) Need to make management education responsive and actively engaged in solving challenges business currently faces like:

A general public--including investors and consumers--that has become cynical about the integrity and the motivations of business;

Challenges like public outrage at executive compensation; and

Calls for reform of the SEC, the audit system, the way market analysts work and are compensated; and most important,

The growing public expectation that corporations accept responsibility for what has previously been presented as economic "externalities:" the environment, public health, impacts on families and communities and employees of boom and bust cycles driven by share price (Gentile & Samuelson, 2003).

- (15) Social Impact Management (not ethics or corporate social responsibility) is a way of thinking about business activities. It explicitly considers and evaluates 3 aspects of a business:

First, **Purpose:** What is the purpose--in both societal and business terms--of a business or a business activity?

Second, **Social Context:** Are the legitimate rights and responsibilities of multiple stakeholders considered? Employees, pensioners, local populations, natural resources.

And Third, **Metrics:** How is performance and profitability measured? What is being counted, and more importantly, what is *not* being counted? Are impacts and results measured across both short and long term time frames? How do we compute the impacts of what we tend to call 'externalities' but that increasingly rebound directly to the business environment, to intangibles like reputation and the ability to attract talent, and the franchise to operate around the globe?

Social Impact Management is about how to manage a complex interdependency--an interdependency that is unavoidable in today's business world (Gentile & Samuelson, 2003).

- (16) Emergence of international reporting standards such as the Global Reporting Initiative (GRI; 2000, revised 2002), performance standards such as Organization for Economic Cooperation and Development (OECD), Guidelines of Corporate Responsibility (2001), the UN Global Compact (1999), and socially responsible investment ratings of stakeholder performance--INNOVEST, Core-Ratings, Sustainable Asset Management (SAM)--this vague notion of planetary ethics is becoming measured, tracked, and publicized. Planetary ethics is entering the global marketplace, not because business has suddenly adopted a conscience--it has always had one--but because there is a growing demand for values and principles of sustainability (Laszlo, 2003, pp. 21-22).

2. **Bill's instructor says to follow the Starbucks model of stating triple-bottom-line concepts in the mission statement. What values are reflected in Starbucks mission statement? How do they translate these values into specific business practices? On Starbucks' website, the *Corporate Social Responsibility 2004 Annual Report* "describes**

our social, environmental and economic impacts on the communities in which we do business.”

Starbucks Mission Statement (See also the answer to Question 3.)

Establish Starbucks as the premier purveyor of the finest coffee in the world while maintaining our uncompromising principles while we grow.

The following six guiding principles will help us measure the appropriateness of our decisions:

- Provide a great work environment and treat each other with respect and dignity.
- Embrace diversity as an essential component in the way we do business.
- Apply the highest standards of excellence to the purchasing, roasting and fresh delivery of our coffee.
- Develop enthusiastically satisfied customers all of the time.
- Contribute positively to our communities and our environment.
- Recognize that profitability is essential to our future success.

This is a benchmarking triple bottom line mission that clearly delineates the importance of people, planet (community), and the environment.

- 3. An effective assignment has been to request the students to write a report to the CEO of The Wedding Information Site. He has hired you to develop a new Wedding Information Site mission statement. Use the Starbucks’ model as a guide and keep in mind the criteria for University’s business plan competition (<http://www.seattleu.edu/asbe/ec/newventure/Executive%20Summary%20Screening%20Round.pdf>). He has also asked you to give examples of programs, practices, policies, and services that would reflect the triple bottom line mission and strategic positioning. This is a particularly useful assignment to help clarify that individual students understand and can operationalize the concept. This assignment can be for individuals or teams. We prefer it as an individual assignment even though the class is teamed.**

Or

Assign this as in-class assignment. Allow one hour to work on assignment. Work is to be done by teams with a report given at the end of class.

Or

Assign mission statement for homework. Each student brings five copies of mission statement to class. Break out in class into teams. Each team picks one mission statement. Teams then brainstorm practices, policies, services ... identify 10. Then conduct a round robin with whole class, getting one suggestion from each team until all suggestions have been put up on blackboard or transparency or PowerPoint. This has been run successfully several times at graduate- and undergraduate- level. It clarifies if students understand what it is and how it can be operationalized.

Try to get students to capture the competitive edge/value proposition in the mission statement and to spell out the importance of backing people, planet/environment, and profit issues. Ask students to self- or team critique to see if the spirit of the eight triple bottom line criteria are reflected in mission statement.

The judging criteria for the business plan competition which were added since the 1999 competition are noted here. The entire form can be accessed online: <http://www.seattleu.edu/asbe/ec/newventure/Executive%20Summary%20Screening%20Round.pdf>

Triple Bottom Line/Sustainability/Social Enterprise Aspects of Plan

2	4	6	8	10	12	14	16	18	20

Old mission statement: The mission of Wedding Information Web Site is to provide continual improvements in services to our online users. This is the formula for business success at Wedding Information and prosperity for our employees and investors.

Example of possible new mission statement: In its quest to provide highest quality diverse priced earth- and human-friendly wedding resources, services, and products for all those at both ends of income spectrum, Wedding Information Site and its employee-owners shall commit to:

- Constantly working to improve the customer experience in terms of information provided, services performed, and products offered on The Wedding Information Site.
- Constantly work to improve the product, service, and advertiser/sponsor experience to make this the site on which to profitably showcase one's business.
- To provide a working environment that inspires creativity, passion, and commitment to the customer and company.
- Embrace diversity in the workplace, customer experience, and community.
- Commit to finding environmentally and socially responsible good buy products and services that will leave the world and those who produce, pay for, give, and consume the goods and services ... better off.
- Conduct business in a fair and accountable way to foster customer, shareholder, employee, the investment community, and service partners confidence and trust in the Wedding Information Site.
- Commit to making the wedding experience accessible to the bottom of the financial pyramid as well as the top.
- Commit to providing quality benchmarking shoestring wedding alternatives at prices that leave more time and money to buy the shoes and leave a planet to walk on.
- Commit to providing a source for the underserved and under represented in the wedding market in the whole financial range--open the doors to enabling a high quality socially responsible experience to build one's future for oneself, one's family to come, one's community to live in, and one's planet for the future.

Stay forward looking while not forgetting the importance of profitability to our shareholders, stakeholders, investors, employees, and team. The more profit we make the better we should be able to carry out our other commitments.

The following are several practical examples of programs and policies that would support a triple-bottom-line corporate mission and potentially increase revenue:

Wedding Gown Donations and Exchange: Provide a place where people can donate or sell their “slightly used” wedding gowns and bridesmaid dresses. The donations will provide a valuable resource to less fortunate brides-to-be and provide a way for newlyweds to generate some additional money for starting their lives together. Wedding Information Site can charge a nominal rental fee or possibly a transactional fee for the exchange service.

“Wedding on a Shoe String” Editorial: Truly challenge your editorial staff to provide compelling editorial for the large percentage of people that cannot afford \$22,000 (industry average) on their wedding. This initiative could increase site traffic and advertising revenues significantly.

Offer or promote environmentally friendly wedding products (i.e., no toxic dyes, natural or organic foods, etc.) and/or vendors that provide “living wages” (no sweatshops). Besides appealing to environmentally conscious consumers, this opens up new advertising and e-commerce from suppliers dealing in natural fibers/products and whole food bakeries/caterers. Additionally, this may raise the social consciousness of all vendors to Wedding Information Site and create a new industry segment.

Wedding Information Site Deserving Fund--Donate a small portion of proceeds to train unemployed people on different facets of the wedding industry. From catering to wedding coordination, by educating and training people to work in the wedding industry, Wedding Information Site is also potentially expanding its supplier and revenue base while improving society. Hire from this pool where appropriate.

Employee Volunteer Program: Provide your employees the option of taking up to five hours a month of paid volunteer time. This will promote employee participation in socially and environmentally beneficial volunteer opportunities while leading to happy, loyal employees.

Where can recycled products be used by Wedding Information Site?

Make energy use green. Encourage less energy usage by employees. Pay “bonus” for alternative energy source vehicles.

Encourage energy saving policies/practices at suppliers.

The instructor might find it useful to raise the following observations/suggestions to the class. Look for practices and policies in people, planet, and profit arena. How to make weddings/bridal activity accessible to those at poverty level? How to make wedding more friendly to handicapped, mobility impaired. How to target the senior market, youth, disabled.... How to create win-win situations.

Who could Wedding Information Site partner with who has these bits of expertise? Can Wedding Information Site make a market for goods in developing countries or partner with someone who does?

4. What would be a SWOT for the new Wedding Site?

Strengths

- Not viewed as competitive--low profile--time to enter market.
- From startup--build in--easier than trying to change strategy/brand. It's a long process to change existing relationships for established ones.
- "Personalize" feedback from users to rate local vendors.
- Viral marketing still works--model should get "airtime/PR" as well as viral.
- Building base for long-term relationships based on meaningful, long-term impact experiences.
- Giving/charity model is increasingly popular.
- Should be easier to attract committed top talent with cause.
- Tap into global need.
- Provide outlet for those who want to "give"--be a part of something doubly cool.

Weaknesses

- CEO not knowledgeable about current wedding industry.
- Team is not evident.
- The need may be being met by a new competitor.
- May not be able to communicate/reach market.
- Not access to bridal registry--some exclusives.
- No recognized brand.
- Financial model is not evident/compelling.
- CEO would need a lot of coaching on social enterprise strategy and how to operationalize.

Opportunities

- Extend reach of weddings truly to mass market.
- Venture capitalists looking for opportunity to have big social impact--like Greater Good Hunger Site. Investing could impact environment globally. Good PR and returns.
- Provide people starting life together opportunity to help new start for someone else--wedding service 10 percent of item.
- PR to advertise.
- Rising gas prices--less disposable income--even more need for ways to save money.
- Build to sell to The Knot to get money to expand--have impact on industry like Ben & Jerry's on Unilever.
- PR--good image for the wedding industry in this post 9-11, post Enron, Katrina Hurricane era. Legitimizes spending \$26,000 on wedding. Help save money and make environment and community better off as a result of you having a wedding.
- Partner with providers--capture sponsor who might like/get exclusive with green line values.
- Jumpstart market exposure through business plan competitions--Social Enterprise Berkeley exposure--get visibility--may be a partnering opportunity rather than competing opportunity from the beginning.
- Triple bottom line--quality--ratings--feedback from customers. Give more information to customers and gift giver.
- Increase disposable Y or target from one-shot blowout to responsible building for future.
- Increase ability to get top quality employees due to value orientation.
- Opportunity to impact working conditions and quality of life through giving preference to "Fair Trade" products--make the world healthier than if you had not done business.

Threats

- Hard to get top quality employees.
- Patent infringement
- Can't get venture capital funding.

- The Knot will become triple bottom line (not now part of branding) on its own--no need for it to buy out Wedding Information Site.
- Software or necessary database information may be patented/copyrighted.
- Not enough money in bottom third or ways to reach it.
- Another competitor may be meeting this need now. Have not done adequate due diligence.

5. Debate: Assign half of class to one side of argument and the other half to other side of argument. Bill should enter the University business plan competition again and the Global Social Venture Competition.

Global Social Venture Competition Judging Criteria: <http://www.socialvc.net/index.cfm?fuseaction=Page.viewPage&pageId=113&parentID=110&grandparentID=58&nodeID=1>

Pros

- Exposure to VC's--social enterprise/triple bottom line/sustainable is better return possibly than--13% now running at
- Possible to secure other team members from student or outside population participants, class members
- Force me to get going on plan
- Inexpensive way to get feel for validity of idea.
- Would have to sink/invest a lot to get VC ears in non-business plan channels.
- Feedback on whether business proposed meets potential success criteria and how well. Many eyes input. Find gaps/shortcomings/strengths before commit to cause.
- May be able to secure advisors and possibly board of directors through process
- Greatly enhanced network
- Process is valuable for development of CEO/founder--capacity building
- Requires rigorous
- Dry run excellent

Cons

- Takes too much time
 - o Trade show
 - o Incubator pitch
 - o Final round presentation
- Lot of weight on one-page executive summary
 - o Can't get why should
- Students not changed
- Doesn't give real feel--"just collegiate"
- CEO/founder not in best position to
- Time long--window of opportunity could be shut before the competition date/process
- Precludes stealth entry into industry
- Too much diverse "undereducated" (possibly not informed) feedback can cause loss of focus.

6. The Global Social Venture Competition Judging Criteria (<http://www.socialvc.net/index.cfm?fuseaction=Page.viewPage&pageId=113&parentID=110&grandparentID=58&nodeID=1>) require a social impact assessment and

calculating an SROI--social return on investment. What would be some of the venture's potential social impacts both quantitative and qualitative?

Refer to mission statements and policies and practices that the students have generated. What impacts do the values statements say they will have? What are they committed to? Refer to Answer in Question 3.

What are the measured benefits to society, and what are the data that are going to be used to represent those benefits? The field is still quite new with guides though existent for the Global Social Venture Competition Social Impact Assessment Guides 1, 2, 3 being helpful (<http://www.socialvc.net/index.cfm?fuseaction=Page.viewPage&pageID=96&parentID=58&nodeID=1>). SROI is a concept developed to account for both traditional financial value created by an enterprise and the social value. There are 5 main steps to calculating SROI:

Defining the Outputs--determining which outputs are you considering most important. Amount of CO2 reduced from wedding guests shopping online for gift? Number of dollars donated to charities? Numbers of trees saved from promoting green products? Numbers of lives extended from encouraging healthy lifestyles? Numbers of jobs created in developing countries from fair trade policies?

Monetize: translate outputs into a dollar value where possible. Reduction in CO2 and use of fossil fuels reduces pollution by certain amount which reduces deaths/illnesses by how much. (Research on each required.)

Develop social cash flow "pro formas." Calculate social benefits and costs as in projected discounted cash flow analysis.

Where outcome is purely qualitative discuss what it is and how you will know it's happening. E.g., wedding guests feeling better as a result of contributing to social good will potentially treat each other better. It will potentially affect other expenditures and increasing awareness of people and planet issues thus increasing consumers awareness of need for socially responsible proactive behavior.

Cite sources and articulate assumptions clearly. There is lots of room for creative thinking. Brainstorm and research. And for more information go to Research and Resources at <http://www.socialvc.net>.

The competition now stresses an assessment of the business' "Blended Value" which stresses high economic and social returns.

EPILOGUE

After investing a great deal of time and effort into our idea to develop a wedding website with feature strengths in gift registry (the mega-database) and localized links, we came to the conclusion that we could not go forward with this approach.

We came to this realization near the end of the quarter after we received feedback about our plan from our peers and mentors. We thought we could entice many large retailers to use our mega-database that would seamlessly link their database with ours for this website. The feedback we received indicated that this was unlikely, as retailers would have no incentive to do so. They could keep their own database and not pay to have someone else manage it. They would not leave

themselves open to competitive pricing and risk their same giftware being purchased elsewhere, and they would not provide this proprietary customer base to another company.

This left us with only one major competitive advantage--localization. We wanted to be a portal site that would instantly localize information for the user. To see if this advantage was still strong, in March we revisited our competitors' websites to see if anything had changed. Not only were our competitors stronger, but we looked at these sites with clearer eyes and dug much deeper.

We found that the weddingchannel.com had vastly increased and improved its local hyperlinks to wedding vendors. We also found a new competitor, ultimatewedding.com, whose strategy mirrored our localization portal-site strategy. Not only did we see our plan eroding, we saw the lead our competitors had on us.

A more thorough investigation of TheKnot.com revealed many things we overlooked when we thought we had a grand e-commerce scheme. What we discovered was this: The Knot had added maps to its local vendors as well as credit ratings and business profiles that could be purchased. It still did not have extensive hyperlinks, however. But what did amaze us was the strong brand that this site was building. It was doing this because it had deep pockets and great visibility. The Knot had received seed money to start its site from AOL. It had an exclusive wedding site on AOL where it was receiving 6 million page views per month. In addition, it had established agreements with Intuit, and its wedding planning site was tied in with Quicken's pages. It was able to make these moves because of the venture capital provided by Hummer Winblad Venture Partners. The Knot was also building its brand offline. It was publishing wedding planning books through Bantam Doubleday Dell and developing a wedding planning series with a PBS affiliate. It also had numerous alliances with other large retailers and commercial entities.

We realized we had no competitive advantages that we could pursue in the short time left in the quarter. We do believe, however, there is opportunity in this marketplace. If we had to do it again, we would seek a niche market within this arena. A site could be developed and marketed to all wedding websites. Some ideas could be:

- A rating service similar to AAA that would provide couples an expectation of the services provided by a vendor.

- A wedding insurance clearinghouse. This site could pull together various policies from national insurance companies that relate in any way to putting on a wedding or function.

- A localized wedding planner. Make the plans, arrange contracts with vendors, and offer cookie-cutter packages to couples for set prices.

Bill was rather intrigued. He had wanted a career change, and he wanted to do something that would make a difference. He had not previously considered that a triple bottom line Wedding Information Site might be an answer.

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MONOCHROMATIC PERSONNEL SCANNING AT TECHMARK

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CASE DESCRIPTION

The primary subject matter of this case concerns sexual discrimination. Secondary issues examined include appraising employees and management ineffectiveness. The case has a difficulty level of four, appropriate for senior level courses. The case is designed to be taught in two class hours and is expected to require two hours of outside preparation by students.

CASE SYNOPSIS

This field-based case provides a powerful example of how changing market forces and changes at the top of an organization can uncover core operational problems, which corporate growth and profitability have been allowed to fester. It is also a cautionary tale. A company may espouse equality, empowerment and management, but failure to train, execute and enforce these policies may have substantial repercussions.

This is a case with misdirection and a twist ending; a grievance based upon racial discrimination. It is not evident from the case what the ethnic origins of the people involved are in the case although perhaps the students might hazard a guess as to Katherine's national origin given the mention of Mexico and Latin America.

Moreover, the case seems to focus more on Pat's maintaining her "old girls network" and indoctrinating new employees into that network. Katherine seems to be a maverick, someone always bucking the system, and therefore is not allowed to join Pat's "tea party." Katherine is ostracized by most of the workers in her unit and even Gloria, the top performer in the group, does not go out of her way to challenge the way Pat manages the group. The group dynamics of the participants in the case seem to hold the students' attention therefore creating the "smoke and mirrors" for the astonishing finale.

INSTRUCTORS' NOTES

Intended Instructional Audience & Placement in Course Instruction

This case was primarily developed for upper level undergraduates taking an introductory course in human resource management since the focus of the case requires students to make a determination as to whether racial discrimination occurred in the workplace. Specifically, the students would need to analyze Techmark's employee's recent promotions relative to the Civil Rights Act of 1991. The case may also be employed in an introductory undergraduate management course (perhaps after the section on staffing), and a management strategy course (after the section on strategy implementation and tactical plans) although it lacks critical information (financial statements, description of personnel, personnel practices, etc...) about the firm that would allow for a balanced SWOT analysis.

The case should be introduced after students have read the chapters on understanding the legal environment of business, appraising employees, and complying with workplace justice laws (Kleiman, 2004, Chapters 2, 8, 11; Byars and Rue, 2006, Chapters 2, 3, 11). Since the case covers numerous chapters in each text, and has many confounding elements, it is recommended that the case be employed as a sectional or comprehensive case rather than an end-of-chapter case. In its secondary uses, the case could serve as an end of chapter case dealing with HRM issues in an introductory management course (Jones and George, 2006, Chapter 12; DuBrin, 2006, Chapter 10) or could serve as a introductory or end of chapter case dealing with tactical and operational issues (Thompson, Gamble, and Strickland, 2004, Chapter 8; Pearce and Robinson, 2005, Chapter 9).

LEARNING OBJECTIVES

The overall purpose of this case is to introduce students to the nuances associated with discrimination and affirmative action laws as they apply to employee evaluation and promotion. Students obtain a "real-world" feel of the situation through character dialogue and tacitly experience some of the difficulties that Katherine encountered when trying to contribute to the firm. Specific learning objectives are as follows:

1. For students to obtain a basic understanding of the antidiscrimination laws as they apply to the work environment.
2. For students to understand the idiosyncratic nature of managing and being managed in a fast-growth firm.
3. For students to discern the real problem in this case given the complicating factors and disguised nature of the problem.

4. For students to make a judgment (based upon the facts case and the presiding laws on discrimination) whether or not Katherine has a prima facie case.
5. For students to decide, assuming Katherine does have a prima facie case, whether or not Katherine should win her case and what would be an acceptable remedy.

TEACHING STRATEGIES

Preparing the Student Prior to Case Analysis

There are several approaches, none of which are mutually exclusive, that an instructor may employ in terms of utilizing this case. It is strongly recommended that, regardless of which course this case is to be employed with, students should have some exposure to antidiscrimination law. Some background information can be gleaned from such websites as <http://www.eeoc.gov/types/race.html> (EEOC's definition of race discrimination), <http://www.eeoc.gov/facts/qanda.html> (discriminatory practices), <http://www.usdoj.gov/crt/emp/faq.html> (the justice department's site on frequently asked questions) and <http://www.lawzilla.com/content/fed-emp-300.shtml> (facts about EEOC mediation).

Secondly, it is also recommended that students have some grounding in employee compensation and evaluation (<http://trmep.tamu.edu/cg/overheads/oh8-5.html>; http://www.accel-team.com/job_interviews/job_selct_interviews_01.html). The above information may be delivered prior to assigning the case by using at least one (1) of the follow methods:

1. a short lecture, student presentation, discussion session, and/or reading assignments on aforementioned topics.
2. a guest lecturer from a human resource manager and/or EEOC compliance officer.

Case Method

Although most of the students in a marketing or management strategy course may have had some exposure to the case method, it behooves the instructor to provide the students with a review to the case method of analysis. In the traditional case method, the student assumes the role of a manager or consultant and therein takes a generalist approach to analyzing and solving the problems of an organization. This approach requires students to utilize all of their prior learning in other subject areas although the focus should be on the current course content. It is strongly suggested that students prepare for the case prior to class discussion, using the following recommendations:

1. allow adequate time in preparing the case
2. read the case at least twice
3. focus on the key issues

4. adopt the appropriate time frame
5. draw on all your knowledge of business. (Pearce and Robinson, 2005)

The instructor's role in case analysis is one of a facilitator. The instructor helps to keep the class focused on the key issues; creates a classroom environment that encourages classroom discussion and creativity; bridges "theory to practice" by referring back to key concepts learned in this or prior courses; and challenges students' analyses in order to stimulate further learning and discussion. There are several variations of the aforementioned approach including: written assignments, oral presentations, team assignments, structured case competitions, and supplemental field work. (Nicastro and Jones, 1994)

Regardless of the variation employed, it is recommended that the students' work be evaluated and graded as partial fulfillment of the course's requirements. However, if this case is not employed as a comprehensive case, it is not recommended that this case (and its related assignments) have a large weight or impact on students' overall course standing.

Using Case Questions

Whether or not the instructor assigns questions for students to analyze with the case is usually a matter of educational philosophy and student readiness. Naumes and Naumes (1999), for example, thought that if the questions were handed out with the case "students will tend to focus only on the issues specifically raised by the questions ..." (p.86). Lynn (1999), on the other hand, noted that the use of assignment questions provided students with more concrete guidance in case preparation and analysis; specifically directing them to consider the decision to be reached.

In deciding whether or not to assign questions, the instructor should first answer the following questions:

1. What is the level of course instruction?
2. What type of case is being taught? (Iceberg, incident, illustrative, head, dialogue, application, data, issue, or prediction – see Lundberg et. al., 2001 for full descriptions.)
3. What is the instructor's preliminary assessment of the students' ability to be self-directed learners?
4. What are the students' previous experience with case instruction?
5. If the students have already been exposed to the case method, what types of cases have they been exposed to? Case incidents (1-2 page cases with questions)? Short cases (3-8 page cases with and/or without case questions)? Comprehensive cases (greater than 8-15 pages) Harvard-style cases (greater than 15 pages)? (David, 2003)

6. What is the instructors preferred method for case instruction? (For example, “sage on the stage”, “guide on the side”, “student as teacher” (student-lead discussions), “observer and final commentator” (open class discussion with faculty summation), etc....

As per objective #3, this case requires that students maintain their focus when analyzing this case and not get caught up in the various side issues embedded in the case.

The authors believe that this case would work far better if the instructor were not to hand the question in advance since the case has numerous complicating factors that tend to obfuscate the problem. It is very easy for a student to stray from the immediate problem (the discrimination grievance) and to become mired in the numerous facts in the case. We believe that the real test for students will be in their ability to wade through the case, recognize the real problem, and address the inequities caused by the improper evaluation and compensation systems of the firm.

Role-Playing (85 minutes)

Role-playing enacts a case and allows the students to explore the human, social, and political dynamics of a case situation. This case lends itself quite well to a role playing exercise since the filing of discrimination charges can be enacted through a confrontational venue; a mock court.

Prior to role-playing the case part, students should be asked to not only read the case part but to answer the following questions:

1. Who are the key participants in the case? Why?
2. What is the “role” of each of these participants in the organization?
3. What is their motivation or rationale for their behavior?
4. What is the “charge” in this case and is there prima facie evidence to support such charges?

The instructor may either go through these questions prior to case enactment or wait for the role playing exercise to be completed in order to use this material to debrief the class.

Step 1: Assignment of Roles & Instructions (10 minutes)

The class as a whole should be employed for this exercise. Given the class, the instructor can determine how many jurists will be needed, whether a student will play the role of the judge (although this role is suggested for the instructor), and how many witnesses will be available to testify in court. At least the top three key

characters of the case (Katherine Anderson, Mike Arend and Pat Hagen) will need to be role played as well as their respective attorneys (assume that Katherine will be suing Pat and Mike who are represented by the firm's attorney) and there should be a student assigned for each witness called in to testify on behalf of Katherine and the Pat. Appendix A has a brief description of the three key characters including a description of possible witnesses that may be called by either party.

Step2: Enactment (50 minutes)

The instructor or the student playing the role of the judge should start the court hearing by summarizing the situation and then asking each attorney to make an opening statement. The instructions to the students playing the attorneys is that they need to "win at all cost" and therefore: a) a settlement is out of the question; b) they will conduct a very aggressive cross examination. The instructions to the students playing Mike and Pat is to absolutely deny that Katherine's race, age, or gender impacted their treatment of Katherine in general and certainly did not play any role in the most recent promotion decisions.

Step 3: Debriefing (20 minutes)

The instructor might want to ask the following questions:

1. Did the jury reach a verdict? If in favor of the Plaintiff, what was the settlement?
2. Did you agree with the jury's verdict? Why or Why not?
3. Evaluate each attorney – did they do a good job in making their case?
4. Evaluate the Plaintiff and the Defendants – were they believable?
5. Evaluate the witnesses - were they believable?

The instructor should then have the class as a whole comment on the results of the role-play and determine with the class their overall analysis of the situation. Students should also be given the opportunity to comment on the role-playing exercise as a learning instrument. The instructor might ask the class the following questions:

1. Did this exercise animate the case? Did students get a "feel" for the issues surrounding the discrimination suit?
2. What were the strengths and weaknesses of the exercise? What changes would they make to the exercise given their experiences with it?

The debriefing session should produce closure for students by connecting HRM practices and EEOC laws with case specifics and the results of the role-playing exercise.

PRELIMINARY CASE ANALYSIS

Discussion of Embedded, Underlying Problems and Complicating Factors

There are several concerns that run throughout this case that students may note in their analyses but that are not directly attributed to the problem at hand, the discrimination suit. The following represents a short discussion of these topics.

- 1) *Laissez-faire manager.* Mike Arend, as Senior Director, was faced with an insurmountable workload. Managing relationships with three key distributors, with responsibility for nearly a quarter billion dollars in annual revenue would be a sizeable enough task for even the most capable corporate officer. The position was essential from both a strategic and tactical standpoint. It also required frequent travel and had him reporting to the highest echelons of executive management. How then could he expect to be fully aware of the individual strengths and weaknesses, talents and shortcomings of this Telesales group that was also his charter? How attuned could he be to the daily workings of his team?
- 2) *Lack of professional supervision.* Had the Telesales group been comprised of seasoned, senior sales people, this might have been less of an issue. Unfortunately, as it was comprised largely of impressionable college graduates and older former line workers for whom TechMark was their first professional experience, this lack of oversight was clearly a problem in the organization.

Of course, Mike had not been aware that there was any lack of oversight and professional mentoring. He had assumed that Pat Hagen was actively managing the team. After all, Pat had worked with him over the course of a decade and in many ways helped support his rise through the corporate ranks. She had always proven herself capable and extremely loyal. How could he possibly question her leadership abilities or dedication to the job?

- 3) *Profits over Process.* Although the corporation was prospering, signs indicated poor administration of the unit - failure to do timely performance reviews, inability to answer key questions about the group's activity during audits, ignoring Katherine's apprehensions, etc. – Mike chose not to acknowledge them.

Though Pat may have been a hands-on manager and a highly motivated and capable lieutenant at some point in her career, Pat had clearly grown complacent. Her

unwillingness to perform even the most routine managerial tasks (regular team meetings, setting up training and education for her people, annual performance reviews, mitigating personal conflicts among group members) was the clearest indication of this. Was she incompetent, lazy or simply bored? All three? In either case this was a liability, especially for a manager of a young group, positioned as future leaders of the corporation.

- 4) *Favoritism.* Perhaps most divisive was Pat's open willingness to select favorites and allow -even perpetuate - unequal treatment. This led to the complete politicization of the group and had a profoundly negative effect on morale and motivation. Decisions seemed to be made on whim rather than empirical evidence and sound business judgment. Holding closed-door meetings with Kerri and Tara without inviting or sharing the agenda with other team members, allowed for feelings of exclusion and powerlessness.

The absence of regular or honest feedback also allowed insecurity and miscommunication to flourish. Katherine had no way of knowing how the quality of her work and on-the-job behavior was being perceived.

Of course, due to the esteem in which she was held, Pat was able to influence Mike's thinking and thus directly shape the future direction of the team. When it finally came time to select associates for promotions, as Telesales became "Inside Sales," he simply took her recommendations at face value. No other counsel was solicited – or desired.

- 5) *Poor Performance Indicators.* There were also several elements of the job that might have made "management-by-fact" somewhat difficult even in the hands of the most proactive and engaged supervisor. First and foremost, sales dollars were recorded on leads that were sent to a partner and successfully "closed." Unfortunately, a lucky sales rep might pick up the phone and get a prospect who knew what he wanted, had a budget and was ready to purchase. In this case all that might need to be done was a simple referral by giving a prospect a partner's telephone number and prepare to take credit for the deal.

Furthermore, a demanding Fortune 500 prospect that required exhaustive pre-sales technical information would put TechMark up against several competitors who competed as low cost providers. A talented sales rep would marshal TechMark's resources, put the company in a favorable position and still lose the deal due to budget cuts, a change in corporate structure, or an especially price aggressive competitor. She may have worked extremely hard on the deal and, as no revenue was immediately accrued, had nothing to show for it. In short, as partners made the actual sales - and the quality of the prospects was often quite random - revenue figures bore little relation to a Telesales rep's skill or effort.

Moreover, revenue was counted by region. It was not uncommon for a rep to fully qualify and support a prospect in a territory outside her own, only to see the deal closed in another team leader's region. As we have seen, this happened to Katherine on multiple occasions.

A Summary of the Factors and Events Underlying the Formal Complaint

Before students analyze the case, the better students will review the critical facts and events that lead to the law suit. The following constitutes a synopsis of those events.

It is apparent that it was the sting of being passed over for a promotion that immediately prompted Katherine to file a formal complaint. In fact, it was both the way it happened - and the rapid unfolding of events in the weeks that followed - that finally drove her to action. Consider the following:

- A) She received no advanced notice whatsoever. Katherine returned from a trip to Brazil to find herself frozen in her current position. Planning for this eventuality had clearly been ongoing for several months and instead of learning of it from Mike, a man whom she still respected and trusted, she came into the office to find a new organizational chart pinned to the wall.
- B) Three of her associates received significant promotions. Not only did they have new titles, they were moved up two zones in pay, were now directly reporting to Arend and had teams working under them. To make matters worse, none of the new "Inside Sales Team Leaders" was any more qualified or skilled than she was. In fact, Katherine consistently worked longer hours, shouldered more responsibilities and had empirically better performance statistics than the others.
- C) She was slotted under Pat Hagen, a woman with whom she clearly did not get along. Still, Pat continually came to Katherine with routine and basic questions about partners, TechMark's products and the lead tracking and assignment system.
- D) No explanation was forthcoming and no avenue of recourse was presented. A reply of "life is not fair" was the only answer she received.
- E) New hires were brought in at Katherine's pay grade. Katherine, who had devoted three years to the company, was expected to assist in training of the recruits.
- F) As a senior member of the group, Katherine might have expected the exclusionary practices to diminish. In actuality, they intensified. Team leaders now spent lengthy periods behind closed doors with Arend, where decisions were made on how the Inside Sales team should function. New protocols were then handed down without further consideration. Moreover, an email thread was formed, to which only Team Leaders could subscribe. Katherine felt more excluded than ever before.

Preliminary Assessment and Comments

Most students will then continue their written analysis of the case by presenting an initial appraisal of the situation. The following comprises that assessment.

In assessing this case we must examine Katherine's racial background. It is indeed a fact that each person who received a promotion was fair skinned and blonde haired. Moreover, not a single new hire was African-American. Given a record of excellent performance, we cannot simply dismiss racial discrimination as not playing a role in this case.

Assuming for the sake of argument that color was not a principal factor in this case, what other elements of Katherine's behavior account for her treatment in Telesales?

Clearly, Katherine had stepped into an organization that had always been run informally, under the aegis of a single personality – Pat's. Young, ambitious and intelligent, Katherine strived for an element of professionalism and effectiveness that had never been part of the group's charter. From the start, her questioning of how things were done, her immediate suggestions for improvement and change were viewed as an upset to the status quo.

Though Mike Arend indicated that these were qualities he looked for and sought to cultivate, in actuality the group was run by Pat. While veterans of the group, and Pat's "favorites," patronized and placated their supervisor, Katherine continued to advocate change. This was immediately perceived as a threat to a heretofore comfortable status quo. Even a simple act as working late could be judged as an attempt to outshine other group members and their supervisor, who were packed up and ready to leave at 4:45pm every evening.

Exacerbating the problem was Katherine's repeated attempts to directly reach Arend or his superiors. Clearly, in an organization that seemed to value consensus and looked to maintain a low profile, this was a major liability.

Given the repeated slights, both real and perceived, that she experienced, it is no wonder that Katherine had increasing difficulty in concealing her disdain for her job, the group and her supervisor. Did word get back to Mike and Pat that Katherine was actively trying to find a position in a different part of the company? Perhaps. Was it clear that Katherine seemed to be growing unhappier as the months wore on? Absolutely.

When choosing leaders for the new group, might not cheerfulness, deference to authority and ability to follow instruction as given be placed at a premium? It certainly seemed so.

Alternative Scenarios and Possible Solutions

Going back to 2000, the students should have identified multiple problems that lead up to Katherine's lodging of a formal complaint. Once the students have analyzed the case, the better students will provide several options as solutions to the case problem. The following material is presented as possible students' solution strategies.

It is apparent from prior analysis of the case that Mike Arend was given too great a charter and should have had Telesales as his sole focus. Pat should have been forced by Mike into retirement, demotion, or fired for her failure to adhere to the management practices of the firm. Those practices included failure to: perform performance reviews, exhibit management by example, develop knowledge of the business, and adhere to actual performance metrics. Objective standards might have been put into place to force an accurate assessment of each associate's contribution.

Unfortunately, it is far too late in the case to make these adjustments; hindsight is 20:20. There is a discrimination complaint at hand that could severely impact Mike Arend's career and potentially expose TechMark to significant liability. Moreover, as Katherine is the only associate at present with the experience and language skills to develop the Mexican and Latin American territories, her leaving the Inside Sales group could have a significant impact on the business. So, what to do?

First, Katherine needs to immediately feel that she is a recognized and valued member of both TechMark and the Inside Sales organization. Mike Arend needs to schedule a private session, with Jim Taylor in attendance, to listen to Katherine's concerns and give her solid and honest feedback on her performance. Rationale for the decision on promotions needs to be made. A balanced assessment of her contributions to the company should be undertaken with her active involvement.

Pat needs to answer for her actions, first to Mike and then to Katherine.

Given her record of outstanding performance and the fact that she single-handedly ran the Latin American territory from an Inside Sales perspective, Katherine should have two options presented to her. She could be made a "Team of One" and directly report to Arend on the Latin American business. Unfortunately, if her feelings regarding the group have deteriorated to the point where she does not feel that she could stay, a similar position should be opened under Tony Sassone. TechMark accrues the same benefits while Katherine may feel happier coming to work each day. It goes without saying that an increased salary or variable compensation tied to performance be granted her immediately. Though considerably less expensive than a legal settlement might be, this is not a bribe but a justly deserved reward for three years of committed and effective service to TechMark and needs to be presented as such.

SUGGESTED CASE QUESTIONS

Objective #3, discerning the real problem in the case, could serve as an introductory question (i.e. discuss the problem posed in the case), however, this question should be separated from the other case-specific questions dealing with race discrimination since it is evident that the latter questions would bias the answer to the first question. We suggest that, at most, students be given only the question dealing with discussing the case problem as a take home assignment and that the remainder of the questions be employed as in-class discussion questions. Possible mitigating factors, analysis, and answers to discerning the real problem have been presented in the prior section entitled “Preliminary Case Analysis.”

1. **What are the antidiscrimination laws concerning the workplace that apply to this case?**

This question requires that students recognize that the focus of the case is on the race discrimination claim against Pat and Mike by do some reading and research on race discrimination.

The below average student will answer this question by referring to discrimination in general rather than to race discrimination as discussed in the case. This student might cite Title VII of the Civil Rights Act of 1964 which “prohibits discrimination based on the protected classifications of race, color, religion, national origin, and sex.” (Kleiman, 2004, p. 29)

The average student will probably cite the more recent Civil Rights Act of 1991 noting that this act was passed in order to make it easier for employees to substantiate their claims and by addressing mixed-motive cases (those cases where other performance-related factors also motivated the employment practice). (Kleiman, 2004)

The above average student will also note that “in *Wards Cove Packing Co. v. Atonio* (1989), a five-member Court majority implicitly overturned its earlier interpretation of Title VII of the 1964 Civil Rights Act in *Griggs v. Duke Power Co.* (1971) and held that the burden of proving that a defendant company's employment practice discriminates against a protected group always remains with the plaintiff and does not shift to the defendant. In this act [P.L. 102-166], Congress rejects the Court's holding in *Wards Cove* and places the burden of proving that its employment practices do not discriminate squarely on the defendant.” <http://www.unl.edu/ashavers/cra1991.htm>, April 21, 2005.

The exceptional student will further denote that “in the most important affirmative action decision since the 1978 *Bakke* case, the Supreme Court (5–4) upheld the University of Michigan Law School's policy, ruling that race can be one of many factors considered by colleges when selecting their students because it furthers ‘a compelling interest in obtaining the educational benefits that flow from a diverse student body.’”

<http://www.infoplease.com/spot/civilrightstimeline1.html>, April 21, 2005. This student might also indicate that states also have their own civil rights laws. For example, New York's Executive Law Article 15 Section 296 (Unlawful discriminatory practices) states that "It shall be an unlawful discriminatory practice: (a) For an employer or licensing agency, because of the age, race, creed, color, national origin, sexual orientation, military status, sex, disability, genetic predisposition or carrier status, or marital status of any individual, to refuse to hire or employ or to bar or to discharge from employment such individual or to discriminate against such individual in compensation or in terms, conditions or privileges of employment." <http://www.nysdhr.com/hrlaw.html#296>, April 21, 2005.

2. In your opinion, does Katherine have a prima facie case for race discrimination?

This question has two purposes; one, to determine if students understand the concept of making a prima facie case; two, to see if students can apply the requirements for a prima facie case to this case.

The below average student will answer this question without referring to the law regarding prima facie cases and discrimination. This student will then offer a personal opinion based upon the facts of the case (without reference to said laws).

The average student will most probably answer this question by first defining what a prima facie case is. "A prima-facie case is a lawsuit that alleges facts adequate to prove the underlying conduct supporting the cause of action and thereby prevail. ...

A plaintiff can establish a prima facie case of race discrimination under Title VII by establishing that (1) he or she belongs to a racial minority; (2) he or she applied and was qualified for a job for which the employer was seeking applicants; (3) he or she was rejected for the position despite his or her qualifications; and (4) the position remained open after his or her rejection and the employer continued to seek applications from other people with similar qualifications to the plaintiff. *McDonnell Douglas v. Green*, 411 U.S. 792, 802 (1973). In *Texas Dept. of Community Affairs v. Burdine*, 450 U.S. 248, 253 (1981), the Supreme Court stated that "[t]he burden of establishing a prima facie case of disparate treatment is not onerous." <http://www.lectlaw.com/def2/p078.htm>, April 21, 2005.

This student would then indicate that the plaintiff (Katherine) was in fact a member of a minority group, was eligible for promotion, did not receive a promotion although her colleagues did, and her performance seemed to equal in fact if not surpass her colleagues who in fact received promotions (employing the McDonnell-Douglas Test). (Kleiman, 2004)

The above average student would continue by noting that there are two types of discrimination, intentional and unintentional. Intentional discrimination is when employees are treated unfairly or receive disparate treatment while unintentional discrimination is when

employment practices that is not job related results in a disparate impact. (Kleiman, 2004) A prima facie case can be made for intentional discrimination if there are restrictive company policies, discriminatory remarks, or by applying the McDonnell-Douglas test. An unintentional discrimination case can be made by applying the four-fifths rule (the hiring rate of new employees for a minority group may not be lower than 80% of the majority group).

This student would note that by employing the four-fifths rule for promotional purposes, it is clear that the other three employees promoted were members of an advantaged group.

The exceptional student would probably continue to cite some of the legal issues surrounding prima facie cases as it affects the defendants. “After the plaintiff has established a prima facie case, the burden of production shifts to the employer to articulate a legitimate, non-discriminatory reason for the plaintiff’s rejection. *Id.* If the employer sustains the burden, the plaintiff then has the opportunity to present evidence showing that the employer’s stated reason for the rejection was merely pretextual. *Id.*; see also McDonnell Douglas, 411 U.S. at 807; Lindahl, 930 F.2d at 1437 (“The defendant’s articulation of a legitimate nondiscriminatory reason serves . . . to shift the burden back to the plaintiff to raise a genuine factual question as to whether the proffered reason is pretextual.”) (quoting Lowe, 775 F.2d at 1008).

... Under McDonnell Douglas, to establish his prima facie case, the plaintiff need not prove that discrimination was the motivating factor in his dismissal. All he must do is raise an inference that such misconduct occurred.

A plaintiff can also establish a prima facie case by “offering evidence adequate to create an inference that an employment decision was based on a discriminatory criteria illegal under [Title VII].” *Mitchell v. Office of the Los Angeles County Superintendent of Schools*, 805 F.2d 844, 846 (9th Cir. 1986) (quoting *Teamsters v. United States*, 431 U.S. 324, 358 (1977)); see *Lowe v. City of Monrovia*, 775 F.2d 998, 1006 (9th Cir. 1985) (plaintiff can establish prima facie case of disparate treatment without satisfying McDonnell Douglas test if he or she provides evidence suggesting rejection was based on discriminatory criteria), amended, 784 F.2d 1407 (1986). ...

Although ‘the mere existence of a prima facie case, based on the minimum evidence necessary to raise a McDonnell Douglas presumption, ... the plaintiff [who has established a prima facie case] need produce very little evidence of discriminatory motive to raise a genuine issue of fact’ as to pretext. Lindahl, 930 F.2d at 1437. In fact, any indication of discriminatory motive . . . may suffice to raise a question that can only be resolved by a factfinder.” <http://www.lectlaw.com/def2/p078.htm>, April 21, 2005.

This student might then note that in order for the defendant to rebut a prima facie case, intentional or unintentional, he or she may employ the bon fide occupational qualification defense (BFOQ defense) (1. that all or nearly all members of this group are

incapable of performing the job in question; 2. to be “authentic”, the employer must limit its employees to a specific group; 3. that it would be socially and morally improper to hire a specific gender for the job; and 4. employment of an older worker would place people in jeopardy), indicate that any perceived discriminatory remarks made were not really of a derogatory nature, that hiring and/or promotional standards employed were legitimate, and that the decision made was of a business necessity (the criteria must directly relate to the employee’s ability to perform the job effectively). (Kleiman, 2004)

This student would denote that Katherine’s log of preferential treatment and perceived discriminatory behavior would be difficult to disprove since the BFOQ defense does not seem to apply. There is also no information in the case that would indicate that Katherine’s performance was lower than her colleagues, what exactly the promotional standards were, and what selection criteria were employed for promotion. This student would probably conclude that a prima facie case could be made by Katherine.

3. Assuming you were the judge in the case and you had already allowed this case to go forward based upon the prima facie evidence, what would be your verdict and what would be an acceptable remedy to the complaint?

The purpose of this question is to allow students to express their opinion about this case and to propose a solution strategy for rectifying the problem based upon the main provisions of the Civil Rights Act of 1991.

The below average student, regardless of their ruling for or against the defendants, would not reference the Civil Rights Act of 1991 in terms of either burden of proof or awarding of damages. This student’s final judgment and award will therefore be unbound by legal limitations and be totally based upon personal interpretation of the facts of the case.

The average student would note that damages in cases of intentional discrimination include compensatory damages and punitive damages. “Compensatory damages are awarded for [current and] future financial losses, emotional pain, suffering, inconvenience, mental anguish, and loss of enjoyment of life” (Kleiman, 2004, p. 32) while punitive damages could be awarded if the jury perceived there was malice or reckless indifference exhibited by the defendants. The limitations on the totals damages would be \$300,000 (500+ employees). (Kleiman, 2004) If this student indicates that there was in fact discrimination in the practices of the firm might suggest that Katherine be reimbursed punitive damages and Katherine be placed in a position of equivalent authority, responsibility, and compensation as her former co-workers who did receive promotions.

The above average student, when describing his or her final judgment, would indicate if they found for the plaintiff whether or not their finding was of intentional or unintentional discrimination. In either case, they would also explain how the jury came to

that conclusion given the facts of the case (i.e. since burden of proof is more difficult in disparate impact cases, this student would indicate how the company might fail to prove that their employment practices “is job related and consistent with business necessity”). (Kleiman, 2004, p. 33)

The exceptional student might deem this case far more complex in that perhaps mixed-motives were in play. For example, it is quite possible that Pat and Mike would argue that they in no way intentionally discriminated against Katherine re: working behavior and promotion in that they would have treated Katherine the exact same way, regardless of her race, given Katherine’s performance and the needs of the firm. They could certainly point to the need to have Katherine continue to service the South and Latin American clients although they realize now that Katherine should also be promoted and report directly to Mike. If this defense held up, the award could be merely a promotion for Katherine (and any related back pay) and the reimbursement of attorney fees and court costs. (Kleiman, 2004)

EPILOGUE

As of 2005, the case is pending, and Katherine is temporarily working in a different office while the facts are under review. She has not yet left TechMark and indicates that she is hopeful that a resolution may be found. Nearing 70, Pat is still coming to work everyday, though there are rumors that she is looking to retire this year. Mike has been in several closed-door meetings with the Director of Human Resources and as of now, his position seems secure. In fact, he just received authorization to add two new department heads this week; one speaks Spanish.....

APPENDIX A: Case Character Descriptions

Note: All descriptions below are of 2000. As the case takes place over three years, ages, roles and job functions will all change.

Katherine Anderson

The key person in this case. Twenty Three years old. Immaculately groomed, soft-spoken, amiable and ambitious African-American female. Graduated with Honors in Economics and Spanish and is fully bilingual. In her job interview she stated: “I am looking for a career, not just a job.” She was brought on as Team Leader for Canada and the Western sales territories.

After a year Katherine had been given Mexico and Latin America to manage and turned over her other territories to be redistributed among the rest of the group. To make sure her language skills were up to task, she attended a Berlitz program at night, in addition to the in-house MBA classes she was enrolled in.

Mike Arend

Senior Director, in charge of the Telesales group as well as Distribution Business Development. In his mid-forties, this former music major had experienced success in his tenure at TechMark; his career path seemed to follow the trajectory of the channel – namely upward with largely unimpeded growth. The events of late 2000 and on would mark his first real challenges at the company.

Tall, broad-shouldered and possessing a deep, resonant voice, Mike certainly had excellent room presence. Despite imposing physical stature, Mike was every bit the “company man,” often rushing to do the bidding of his superiors and never crossing into open disagreement, even when he believed them wrong.

An optimist by nature, Mike generally had a smile for all of his reports and had an open door policy. If there were ever problems in the group, Mike either did not know about them – or refused to acknowledge their existence. By 2000, due to the increasingly large scope of his job responsibilities, Mike left the day-to-day affairs of Telesales in the hands of Pat.

Pat Hagen

Pat never revealed her age but anyone guessing mid-60s could not be too far off the mark. A teacher by profession, Pat joined TechMark in 1991 and worked for Mike Arend for most of her tenure. Like Mike, her career grew with the expansion of the Channels group, particularly the growth of the Telesales group she managed. By the time the “College New-Hire” program was initiated, Pat was a fixture at TechMark.

While jocular outside the office, in meetings she never uttered a word other than to reiterate the remarks of Mike or another Director. Her management style seemed to be as casual as her mode of dress; her reports quickly learned to handle questions and disputes among themselves. Pat never openly involved herself in conflict. The sign in her cubicle read: “It’s all about me.”

Kerri Masters

The first of the “new blood” to join the group, Kerri actually came over from Human Resources where she worked in recruitment. With blonde hair and blue-eyed, this vivacious 25 year old was well-known around the company. Though by no means slender, she was quite buxom and always presented herself well. With a ready laugh and sunny disposition, she was quite popular with other groups at TechMark.

Though she presented well at meetings and events, Kerri’s approach to her job on a daily basis could be described as “breezy” at best. Nevertheless, as Team Leader for the Central region, she never missed her quota and tended to have good relationships with her business partners. During

the duration of the case, she completed an in-house MBA program, the first of the Telesales reps to have done so.

Tara Cohen

Tara was 23 when she joined Telesales in mid-2000. A decent student, Tara had worked as an intern over summers at TechMark, so she had an inside track on the job. Like Kerri, Tara was an attractive blonde. Unlike Kerri, Tara was more reserved and business-like in nature. As “Team Leader” for the Mid-Atlantic and New England region, she regularly met her quotas and was considered by her peers to be willing to share the burden when the workload got heavy.

Cathy Lawrence

Cathy was the one Team-Leader (Southeast) who was a member of the original Telesales group. In her early 30s, Cathy had worked as an administrator before Mike and Pat hired her to work for them in 1997. Though she only had a high-school diploma, Cathy was an extremely hard worker, her face rarely seen during the workday, as she was constantly on the telephone with prospects and partners. Pat would often assign extra calls and projects to Cathy, who completed them without comment. A highly effective organizer, Cathy knew her territory quite well and took pride in meeting her quotas every quarter. In meetings Cathy was usually silent – perhaps self-conscious about her education – but generally feeling that Pat was more apt to listen to Kerri and Tara while dismissing her own input.

Rhonda Howard

Though hired as part of the “New College Hire Program” Rhonda was 32 when she joined TechMark. A late starter, she had worked her way through Carnegie Mellon University and thus had the most prestigious educational background on the team. Her ethnic background (African American) was her only similarity to Katherine. Those who did not know her – and even those who did – might be apt to find her somewhat rude and abrupt. Rhonda never paid it any mind.

Given the technical aspects of her educational background, Rhonda was often working both in and outside the group on IT related issues and was thus never a core part of the group’s sales function.

Robert Simon

A graduate of a local college, Robert, 22, joined TechMark when he was not accepted to the Suffolk County Police Academy. Initially quiet and soft-spoken, Robert soon grew more

comfortable in his position and was looked upon as a solid member of the group. He took an active interest in learning more about TechMark's products and technologies than was typical for the group. Pat would often go to Rob when questions arose for which she had no answer.

Gloria Vernon

Standing about 4'11 and weighing in at about 200 pounds, Gloria was the anchor of the Telesales group. At 63, this grandmother of four was part of Telesales since its inception, having been hired off the manufacturing floor. The first to pick up an incoming phone call, Gloria's affinity for the job was matched only by her penchant for complaining about it. Most of the new hires learned quickly to go to Gloria rather than Pat for questions about product or about the job, for which Pat was exceedingly grateful.

Gloria was a volunteer for TechMark's mentoring program, in which new hires were assigned an experienced TechMark Associate to help them acclimate to the company. For 6 months, Katherine was her "mentee." As the business climate soured, Gloria was to be the only original member of the Telesales group to keep her job. All others were laid off.

Jim Taylor

Human Resources, charged with ensuring that TechMark's hiring and promotional policies were in accordance with Federal Equal Opportunity Employment guidelines. Jeff was an African-American male in his late 30s. Although soft spoken and reserved, Jeff could be quite deliberate in thought and action.

Tony Sassone

Pensive and soft-spoken, Tony was in charge of Channel Business Development for Mexico and Latin America. He and Mike were peers, reporting to the same Vice President. Tony interfaced with Katherine on a regular basis, as they established plans for growing the Latin American sales channel.

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DILEMMA IN THE DELTA

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CASE DESCRIPTION

The primary subject matter of this case concerns a capital budgeting decision for a small business. The case is couched in a family farm operation, but the dilemma could easily relate to any small business. It involves a decision to invest in a major piece of equipment – a decision that each and every owner or manager of a small business is likely to face. The case involves management, economic and accounting issues. It has a difficulty level of three, appropriate for junior level courses. The case is designed to be taught in one class hour and is expected to require two hours of outside preparation by students.

CASE SYNOPSIS

In only five years and counting the days, John Jones will retire from a life-long career of farming. His combine, the largest and most expensive piece of equipment he owns, has reached the point of high maintenance costs or replacement. John and his wife are contemplating four options: 1) keep the current combine, 2) rent a combine when needed, 3) hire a custom cutter to harvest the crops, or 4) buy a new combine.

Each option includes several factors to consider. Comparisons must be made between old and new equipment repair and maintenance costs, tax benefits of depreciation, resale values, and crop quantity and quality yields. Renting or hiring custom work will require consideration of associated costs and timeliness of availability.

The cost effectiveness and efficiency of the four options over the next five years presents the “Dilemma in the Delta.”

INSTRUCTORS’ NOTES

The following pages explain and provide details about the suggested answer to each question. Analysis of the case should emphasize to students that farming is a business and that the decision to be made in this case is just a tiny grain in a whole field of business decisions to be made on a farm.

1. **In the production comparison of the old versus the new combine (Table 2), how many more bushels of rice should be realized in one season with the new combine under similar weather and crop conditions? By how much would rice income increase each year?**

4170 bushels; \$15,846 rice income increase

Students should use Table 2 from the case to formulate an answer to this question. Table 2 shows that, using the old combine, 2,000 bushels of rice can be harvested in an eight-hour day. This equates to 250 bushels per hour (2,000 bushels / 8 hours). Six acres can be harvested per hour, which equates to 41.7 bushels per acre (250 bushels / 6 acres).

With the new combine, 5,000 bushels of rice can be harvested in a ten-hour day. This equates to 500 bushels per hour (5,000 bushels / 10 hours). Nine acres can be harvested per hour, which results in 55.6 bushels per acre (500 bushels / 9 acres).

Comparison of the two machines shows that the new combine will increase field productivity by 13.9 bushels per acre (55.6 bushels per acre v. 41.7 bushels per acre). Since John farms 300 acres of rice, the more effective and efficient harvesting technique of the new combine would increase his yield by 4,170 bushels of rice (13.9 bushel increase per acre times 300 acres). With a \$3.80 per bushel price for rice, the new combine would increase income by \$15,846 per year (4,170 bushels times \$3.80).

Note that the increase in income from the rice harvest is based on the average commodity price. No adjustment in price has been made for the increased quality of the harvested grain. As stated in the case, the farmer doesn't really know how much the price difference due to quality will be. Therefore, the same price (\$3.80 per bushel) is used for rice harvested with the old and the new combine.

The above results are summarized in the following table:

Yield and Income Increase – New Combine v. Old Combine	
Old Combine:	2,000 bushels / 8 hours = 250 bushels per hour
	250 bushels per hour / 6 acres per hour = 41.7 bushels per acre
New Combine	5,000 bushels / 10 hours = 500 bushels per hour
	500 bushels per hour / 9 acres per hour = 55.6 bushels per acre
Yield Increase Per Acre:	55.6 bushels per acre – 41.7 bushels per acre = 13.9 bushels per acre
Yield Increase Per Season:	13.9 bushels x 300 acres per season = 4,170 bushels per season
Income Increase Per Season:	4,170 bushels x \$3.80 per bushel = \$15,846

This case focused on differences in productivity for the rice crop only. It should be noted that the quality and quantity of the soybean and wheat crop will increase as well.

.2. What is the net out-of-pocket cost that should be incurred over the next five years for each of the four options?

Suggested answers for each of the four options are shown in the following table:

Option One:	\$30,409
Option Two:	\$208,204
Option Three:	\$92,566
Option Four:	\$59,075

Option One: Keep Current Combine (Suggested Answer, \$30,409)

The following table shows the computation of the net out-of-pocket costs of using the current combine over the next five years until John's retirement. The computation should include costs of annual check ups, maintenance, and repairs and one major overhaul. In addition, the resale value of the combine at the end of five years use and the tax savings from repairs and depreciation must be considered.

Net Out-of-Pocket Costs of Current Combine		
Annual Out of Pocket Costs:		
Annual Check-up	\$2,500	
Repairs	5,000	
Total Annual Out-of-Pocket Costs		\$7,500
Total Annual Out-of-Pocket Costs over Five Years		\$37,500
One-Time Cost of Major Overhaul		10,000
Total Out-of-Pocket Costs over Five Years		\$47,500
Less:		
Resale Value at End of Five Years' Use	\$10,000	
Tax Savings – Check-ups, Repairs, & Overhaul ($\$47,500 \times 12.2\%$)	5,795	
Tax Savings – Depreciation ($\$10,620 \times 12.2\%$)	1,296	(17,091)
Net Out-of-Pocket Costs over Five Years		\$30,409

The text of the case stated that John will need to budget for annual check-ups at a cost of \$2,500 to \$3,500 each. The above solution uses an annual cost of \$2,500, but students may use \$3,500 or an average of \$3,000. The case also stated that John should budget annual repairs of

\$5,000 and a major overhaul costing about \$10,000. The resale value of the current combine after John uses it for five more years will be about \$10,000.

Before computing the tax savings from repairs and depreciation, John's tax rate must be computed. Taxes shown in Table 1 of the case are \$12,500. Since net farm operating income is \$90,000, John's income before taxes would be \$102,500 (\$90,000 plus \$12,500). Therefore, John's tax rate is about 12.2 percent (\$12,500 divided by \$102,500).

Tax savings over five years for check-ups, repairs, and overhaul will total \$5,795 (\$47,500 x 12.2%). As indicated in the case, two years' depreciation totaling \$10,620 remain on the old combine. Therefore, tax savings on the depreciation is \$1,296 (\$10,620 x 12.2%). Deducting the resale value of the old combine after five years and the tax savings from check-ups, repairs, overhaul, and depreciation leaves net out-of-pocket costs of \$30,409.

Option Two: Rent Equipment (Suggested Answer, \$208,204)

The following table shows the out-of-pocket cost of renting equipment. Costs to consider include rental costs net of tax savings. The case states that an average rental should require 300 hours to harvest the soybean and rice crops. If John chooses to rent equipment, he will need to keep the old combine to harvest his wheat. Therefore, the net out-of-pocket costs from Option One increase the net out-of-pocket costs of Option Two.

Net Out-of-Pocket Costs of Renting Equipment	
Rental Cost (300 hours per year x \$135 per hour x 5 years)	\$202,500
Tax Savings (\$202,500 x 12.2%)	(24,705)
Out-of-Pocket Costs over Five Years of Renting Equipment	\$177,795
Out-of-Pocket Costs of Current Combine Over Five Years (Option One)	30,409
Net Out-of-Pocket Cost of Renting Equipment	\$208,204

As stated in the case, John would need to rent equipment for approximately 300 hours per year at a cost of \$135 per hour. Over five years, rental would total \$202,500, and tax savings would total \$24,705 (or 12.2 percent). After adding the cost of keeping the current combine (Option One), out-of-pocket cost of renting equipment totals \$208,204.

Option Three: Use Custom Harvesters (Suggested Answer, \$92,566)

If John uses custom harvesters, he must consider the cost of using them to harvest all three crops (rice, soybeans, and wheat). Costs to consider include per acre charges, the tax savings from the custom harvester expense, and resale value of the old combine. The net value is shown below:

Net Out-of-Pocket Cost of Using Custom Harvesters		
Annual Out-of-Pocket Costs:		
Soybeans (600 acres times \$20 per acre)	\$12,000	
Rice (300 acres times \$40 per acre)	12,000	
Wheat (180 acres times \$30 per acre)	5,400	
Total Annual Out-of-Pocket Costs		\$ 29,400
Total Out-of-Pocket Costs over Five Years (\$29,400 x 5 years)		\$147,000
Less:		
Current Resale Value of Combine	\$36,500	
Tax Savings (\$147,000 x 12.2%)	17,934	(54,434)
Net Out-of-Pocket Cost over Five Years		\$ 92,566

The case background states that John farms 900 acres, two-thirds of which are soybeans and one-third rice. He also farms 180 acres of wheat in the off-season. The per-acre harvesting charges are \$20 for soybeans, \$40 for rice, and \$30 for wheat. Therefore, out-of-pocket costs for one year total \$29,400. For five years that cost would be \$147,000. The current combine could be sold at its current resale value of \$36,500. In addition, since the cost of custom harvesters can be deducted as a business expense, the tax savings of \$17,934 (\$147,000 x 12.2 percent) are deducted as well. As shown, the net out-of-pocket cost of using custom harvesters totals \$92,566.

Option Four: Buy New Combine (Suggested Answer, \$59,075)

The table below shows the net out-of-pocket cost of purchasing the new combine. Costs to consider under this option include the list price less trade in, interest paid on the note, repairs over the five years John will use the combine, the trade-value of the new combine, and tax savings from repairs, maintenance, and depreciation.

Net Out-of-Pocket Cost of Purchasing New Combine		
Purchase Costs:		
List Price of New Combine	\$150,000	
Trade-in of Old Combine	(36,500)	
Purchase Price	\$113,500	
Interest Paid Over Term of Note (\$134,358 – \$113,500)	20,858	
Total Cost to Purchase Combine		\$134,358

Repair Expense over Five Years:		
First 370 hours of Use (500 – 130 hours)	\$ 0	
Next 630 hours of Use [(1000 – 370 hours) x \$500 / 100 hours]	3,150	3,150
Total Out-of-Pocket Cost over Five Years		\$137,508
Less:		
Resale Value of New Combine at the End of Five Years	\$ 65,000	
Tax Savings – Depreciation (see explanation below)	10,504	
Tax Savings – Repairs (\$3,150 x 12.2%)	384	
Tax Savings – Interest (\$20,858 x 12.2%)	2,545	(78,433)
Net Out-of-Pocket Cost over Five Years		\$59,075

The list price of the new combine is \$150,000, and a trade-in allowance of \$36,500 will be given on the old one. The purchase price, therefore, is \$113,500. Since the case states that the total paid out for the loan over five years is \$134,358, the amount of interest is \$20,858 (\$134,358 minus \$113,500).

The case states that the first 500 hours of a new combine's use requires no repair or maintenance cost. Since the new combine John is considering has 130 hours on it, only 370 hours remain of the first 500 hours (500 - 130). After the first 500 hours, the next 1,000 hours should cost \$500 for every 100 hours. John estimates he will use the combine for a total of 1,000 hours. Since the first 370 hours should be cost-free, John will incur maintenance and repair costs for the remaining 630 hours (1,000 - 370 hours). Estimated repair costs, therefore, total \$3,150 (630 hours / 100 hours x \$500 per hour). Total out-of-pocket costs of the new combine total \$137,508.

From the total out-of-pocket costs, the resale value of the new combine at the end of five years and the tax savings from depreciation, repairs, and interest should be deducted. The case states that the new combine should have a resale value of \$65,000 at the end of five years.

Depreciation would be based on \$124,120 (the list price of \$150,000 less the trade-in allowance of \$36,500 plus the unrecovered depreciation on the old combine of \$10,620). Since John will own the combine for only five years, he will depreciate a total of 69.37 percent (found by adding years one through five of the MACRS Depreciation shown in Table 3 of the case) or \$86,102 (\$124,120 x 69.37%). Tax savings on depreciation would be estimated by multiplying \$86,102 times the approximate tax rate of 12.2 percent, which equals \$10,504. Tax savings on repairs and interest would be estimated by multiplying those costs times 12.2 percent. Consideration of all these factors results in net out-of-pocket costs of \$59,075 for purchasing the new combine.

Even though this question focuses on costs only, students may point out that increased productivity will more than cover the net out-of-pocket costs of the combine. Analysis of Question 1 showed that the increase in productivity in the rice crop alone would result in increased income of \$15,846 per season. Five seasons would see a total estimated increased income of \$79,230

(\$15,846 x 5 years). That one crop alone, therefore, more than offsets the net out-of-pocket costs of the new combine (\$79,230 > \$59,075). Even though no data is given to compute the increase in soybean and wheat production and income, those increases would only make the new combine option more attractive.

3. What factors other than direct costs must be considered in each of the four options?

The following paragraphs present factors other than direct costs that must be considered for each option.

Option One: Keep Current Combine

One of the benefits of keeping the current combine is that John owes no money against it, so no interest costs will be incurred under this option. In addition, John only intends to farm for another five years. These two factors make the option of keeping the current combine more attractive. A major disadvantage of this option, however, is the age of the machine. Since it has been used for a large number of hours, normal maintenance and repairs will be more expensive than for a new machine. In addition, even though John has maintained the combine well, it is much less reliable than a new one. One or more major repairs may very well be necessary over the next five years. If the combine broke down during harvesting while conditions were at their peak, harvesting would stop until repairs were made. This down time could cause the crop to be harvested after its peak resulting in lower quality and quantity yield and a lower price received for the grain. In addition, such a breakdown would cause an increase the estimated out-of-pocket costs of this option.

Option Two: Rent Equipment

As with Option One, a major advantage of renting equipment is that it requires no investment on John's part. This is important since John plans to retire in five years. Another advantage of this option is that he may be able to rent a more efficient combine than the one he owns to harvest his soybean and rice crops. One of the biggest disadvantages is that equipment is rented on a first-come first-serve basis. A quality machine may not be available when he needs it. Therefore, the yield and the quality of the grain harvested could be adversely affected. If so, a lower price may be received for the grain. In addition, renting equipment does not eliminate the need for keeping and maintaining the current combine, although it does decrease John's dependency on it.

Option Three: Use Custom Harvesters

As with the previous two options, a major advantage of using custom harvesters is that John will not have to make any additional investment during his last five years of farming. Hiring custom harvesters has an advantage over Options One and Two in that John can sell his current combine since he will no longer need it. As with Option Two, however, John may not be able to schedule the harvesters when he needs them. If harvesters are busy in other fields when John needs them, his grain will be harvested when it is past its peak. Harvesting past the peak conditions could result in lower yield and a lower price received for the grain.

Option Four: Buy New Combine

Advantages of purchasing the new combine include greater dependability of the new machine and improved quality and quantity of harvest per acre. In addition, the new machine provides a greater probability that the harvest of the grain will be timely and of the highest quality possible. Finally, and significantly, John will spend less time in the field since the new combine requires fewer hours to harvest his crops than does the old one. John will have to borrow the purchase price, however, resulting in loan payments he would not have with the other options. This is an important factor to consider since John only wants to farm for another five years. Another important factor to consider under this option is whether John's current cash flow permits the purchase of a new combine. It was mentioned in the background that he has a strong financial standing. Therefore, students can assume that John will have no problem obtaining a loan or making payments.

4. Which option should John choose? Why?

Based on out-of-pocket costs and other considerations, Option Two (renting equipment) is definitely the least attractive of the four options. It's the most expensive option and gives John little, if any, control over harvesting crops when they are at their peak. Option Three (hiring custom harvesters) is not as expensive as Option Two but still has the disadvantage of John's not being able to control the timing of the harvest. Therefore, students should rule out Options Two and Three.

Some students may choose Option One (keep the current combine) on the basis that the estimated out-of-pocket costs are lower than any of the four other options. In choosing this option, however, it is important to consider the possibility of a major breakdown. In addition, considering only one of John's crops (his rice crop), Option Four results in higher yield quantity and quality that produces additional income greater the out-of-pocket costs of the new combine. Therefore, Option Four (purchase the new combine) appears to be the most advantageous option. Students may still choose Option One over Option Four, however, since the case repeatedly emphasizes that John plans

to retire in five years. Option One requires no additional investment in equipment or borrowing. Even so, John can sell the new combine when he is ready to retire.

EPILOGUE

What did John do? He chose Option Four and purchased the new combine. Although crop conditions vary considerably from year to year, John has noticed a higher quality yield due to better grain handling by the equipment. He also spends less time in the field with shorter and fewer days harvesting. In the three years since John purchased the new combine, he has used it only 600 hours and has spent less than \$100 in repairs and maintenance. Because of all these benefits, John is quite pleased with his decision.

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TO INVEST OR NOT TO INVEST: THAT IS THE QUESTION!

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CASE DESCRIPTION

This case describes a real estate rental startup venture with a twist; renters select their house to rent and then enter into a three-year contract and earn a \$100/month credit to buy the house at the end of the contract period. The problem for the characters in the case is whether or not they should enter into this venture and how they should then proceed given their decision. Several factors complicate this business startup decision, including: their lack of business experience, one of the character's prior negative experiences with being a landlord, the need for further information in order to calculate costs (and therein profits), and the need to examine the potential risks associated with the venture. The case has a difficulty level appropriate for junior level or above. The case is designed to be taught in one class period (may vary from fifty to eighty minutes depending upon instructional approach employed, see instructor's note) and is expected to require between two to four hours of outside preparation by students (again, depending upon instructor's choice of class preparation method).

CASE SYNOPSIS

Derived from observation and field interviews, the case describes how two English professors, Stephen Hodgetts and Richard Davis, are lamenting their losses in the stock market and how these losses have negatively affected their retirement funds. Davis's solution to working past retirement age (or praying for a miracle turnaround market) is to take control of his investment funds by becoming a landlord and developing a rental scheme which caters to lower income households and/or families with bad credit. Hodgetts has a visceral negative reaction to the plan, given his politics and prior experiences as a landlord, but intently listens as Davis describes in detail how a \$10,000 investment per home will yield over \$20,000 of profit within three years. Hodgetts is incredulous and wonders why more knowledgeable business people have not constructed a similar business. The case ends with both professors quoting from Shakespeare to support their positions. Hodgetts is willing to get involved in the venture if Davis can provide him with some assurances as to predictability of the success of the business venture.

INSTRUCTORS' NOTES

Overview

To quote Vesper (1990, p. 128) "sometimes the idea for a particular venture comes 'out of the blue' in the form of a proposal by someone else who has seen an opportunity and wants to collaborate in exploiting it." This statement aptly describes the situation that our two protagonists find themselves in; both individuals are English professors who have collaborated on books and articles and find that they both have suffered economically from a downturn in the stock market. Both want to take control of their investments and Davis proposes a plan in which they become specialty landlords who cater to families who can are looking to buy starter homes but do not have the down payment and/or credit rating that will allow them to obtain an affordable mortgage.

Several factors complicate this business startup decision, including: the lack of knowledge and business experience of the individuals involved in the business, one of the individual's prior negative experiences with being a landlord, the need for further information in order to calculate costs (and therein profits), and the need to examine potential risks associated with the venture. In this case, students are asked to analyze the proposed venture and to decide whether the offer "is a good deal." Students must also determine what additional information is needed in order to make a viable decision about this business venture, the risks associated with this business, and the legal form of organization the business should take.

Intended Instructional Audience & Placement in Course Instruction

This case was primarily developed for undergraduates taking an Entrepreneurship and/or Small Business Management course, focusing on the areas of business startups and ownership. Secondly, this case could also be utilized in a personal finance course (the locus of the case). The case should be introduced after the students have read the chapters on business start-ups, and legal forms of organization (Chapters 4, 5 and in Hodgetts and Kuratoko, 1998; Chapters 1, 6 and in Hisrich and Peters, 1998; Chapter 2 [Section 2], and 5 in Coulter, 2001). For personal finance courses, the case may be employed in conjunction with investment planning strategies and risk tolerance (Mittra, Kirkman, and Seifert, 2002, Chapter 14; Strong, 2004, Chapter 2).

Secondly, it is also strongly recommended that students prior to reading the case be exposed to material dealing with rental properties and the duties and obligations of landlords. Managing rental properties is far more than collecting rents and includes tenant and property selection, avoiding vacancies, property repair, landlord – tenant laws, and how to create a psychological bond between the tenant and the property (Perry, 2000). Material is provided later on in the teaching note on real estate investment, valuation and return on investment, tax considerations, and residential

property management that may be supplied to students to support their analyses of this investment decision.

This case may be employed as a chapter or sectional summary case, especially in the areas of business startups and business formation – it may not be sufficiently complex for graduate students or broad enough to be used as a comprehensive end-of-semester case.

LEARNING OBJECTIVES

The overall purpose of this case is to introduce students to the nuances associated with a small business startup related to the real estate market. Students obtain a “real-world” feel of the situation given the low capital investment (less than \$5,000 per person), the manner in which the opportunity arises (drop in the stock market), and the lack of information that the decision-makers have about their investment decision. This case is of particular value to students since many of them may be presented with similar deals from co-workers, family members, and friends. Specific learning objectives are as follows:

- For students to determine what information is needed (and whether Davis and Hodgetts have that information) in order to make a cogent decision on whether or not to start this business.
- For students to develop preliminary recommendations on whether Davis and Hodgetts should move forward with the new business.
- For students to recommend what legal form of organization this new venture should employ.

TEACHING STRATEGIES

Preparing the Student Prior to Case Analysis

There are several approaches, none of which are mutually exclusive, that an instructor may employ in terms of utilizing this case. It is strongly recommended that regardless of the specific methodology employed, that students prior to reading this case be exposed to some material on business startups, legal forms of organization, and the real estate market. (Greene, 2001) See Overview and Discussion Concerning Related Literature for details – may be used as class handouts. This conceptual framework may be delivered prior to assigning the case by using at least one (1) of the follow methods:

- a short lecture and/or discussion session on aforementioned topics.
- a reading assignment prior to reading the case on the pros and cons of starting your own business (Vinturella, 1999).
- a short student presentation on each topic.
- a guest lecturer from a local real estate agent or property management corporation on how and why a person would invest in real estate.

Case Method

In the traditional case method, the student assumes the role of a manager or consultant and therein takes a generalist approach to analyzing and solving the problems of an organization. This approach requires students to utilize all of their prior learning in other subject areas as well as the field of management. This case in particular will also require students to draw upon their knowledge of business startups and small business management. It is strongly suggested that students prepare for the case prior to class discussion, using the following recommendations:

- allow adequate time in preparing the case
- read the case at least twice
- focus on the key issues
- adopt the appropriate time frame
- draw on all your knowledge of business. (Pearce and Robinson, 2000)

The instructor's role in case analysis is one of a facilitator. The instructor helps to keep the class focused on the key issues; creates a classroom environment that encourages classroom discussion and creativity; bridges "theory to practice" by referring back to key concepts learned in this or prior courses; and challenges students' analyses in order to stimulate further learning and discussion. There are several variations of the aforementioned approach including: written assignments, oral presentations, team assignments, structured case competitions, and supplemental field work. (Nicastro and Jones, 1994)

Regardless of the variation employed, it is recommended that the students' work be evaluated and graded as partial fulfillment of the course's requirements. However, if this case is not employed as a comprehensive case, it is not recommended that this case (and its related assignments) have a large weight or impact on students' overall course standing.

OVERVIEW AND DISCUSSION CONCERNING RELATED LITERATURE

The following sections are short summaries of some of the literature pertaining to legal forms of organization, real estate investment, and residential rental property management. More detailed material can be found in the cited references and the discussion section of the teaching note. It is strongly suggested that students be given access to this information prior to reading the case since knowledge of this material is pertinent to analyzing the case.

Legal Forms of Organization

One of the most critical decisions in a business startup is determining the legal form of the business organization. Each form has differing set-up costs, tax treatments, liabilities to the

owner(s), advantages and disadvantages and therefore the pros and cons of each form should be considered by the entrepreneur. The forms are as follows:

- *Sole Proprietorship* - one owner, profits and losses of the business are taxed at the personal rate of the owner and are filed on his or her personal income tax. Advantages include low startup costs, freedom from most government regulations, direct control by owner, and easy exit from business. Disadvantages include unlimited personal liability, assume all risk, excluded from business tax deductions, may be difficult to raise capital.
- *General Partnership* - Two or more owners, profits/losses taxed at personal rate with flexibility in profit-loss allocation to partners, and personal assets of all partners are at risk. Advantages include ease of formation, pooled resources and talent, somewhat easier financing than sole proprietorship, and some tax benefits. Disadvantages include unlimited personal liability, divided authority and decisions, potential for conflict, and lack of continuity of transfer of ownership.
- *Limited Liability Partnership (LLP)* - Similar to a partnership except only one partner retains unlimited liability (others are limited). An advantage to the LLP is that it is a good way to acquire funds from limited partners. Disadvantages include the cost and complexity is high and the limited partners are excluded from the management of the business.
- *C Corporation* - Unlimited number of owners (no limits to type of stock or voting arrangements). Dividends are taxed twice (corporate and personal) while the corporation handles the taxes from profits and losses. Advantages include limited liability, transferable ownership, continuous existence, and easier access to resources. Disadvantages include expensive to establish, closely regulated, double taxation, extensive record keeping, and charter restrictions.
- *S Corporation* - Up to 75 shareholders (no limits to type of stock or voting arrangements). Profits/losses taxed at personal rate with flexibility in profit-loss allocation to partners. Advantages include easy to set up, enjoy limited liability and tax benefits of partnerships, can have a tax-exempt entity as a shareholder. Disadvantages include must meet certain requirements and may limit future financing options.
- *Limited Liability Company (LLC)* - - Unlimited number of members (no limits to type of stock or voting arrangements). Profits/losses taxed at personal rate with flexibility in profit-loss allocation to partners. Advantages include greater flexibility, not constrained by regulations on C and S corporations, and taxed as a partnership. Disadvantages include the switching cost from one legal form to a LLC can be high and you need legal and financial advice in forming the operating agreement. (Coulter, 2001, 136-7)

Ridley (1999) noted that certain business forms may be appropriate during the start-up, pre-capital phase but become less attractive from a venture capital funds perspective (i.e. S Corporations, partnerships, LLP's, and LLC's). These firms would not be able to obtain preferred stock or convertible debt, their preferred choices of security, from certain legal forms of business.

Real Estate Investment

According to Tyson (1997), real estate investing is attractive for the following reasons:

Land is a limited and fixed resource. Demand for housing and land continues to grow while supplies are dwindling. Basic economics would then suggest that prices should rise over time increasing the value of the property.

Land can be leveraged. Real estate, unlike other investments, require a small percentage (10 to 20 percent) of the value of the investment as collateral for a loan. Investment dollars hence can purchase more property, increasing the value of property holdings.

Get both growth and income. Like a stock that pays a dividend, rental properties earn an income and appreciate in value. The value appreciation is tax-deferred so that taxes are only due on the sale of the property. Unlike stocks, however, “rolling over” property (using the proceeds from the sale of one property to buy another of similar value) avoids capital gains taxes.

Diversification. Real estate does not necessarily move in conjunction with the stock market and is far more tied to lending rates, and the local economy. For example, even though the economy has slowed since 1999, Las Vegas led all cities in building growth with a Private Construction Intensity index rating of 40.94, putting it well ahead of second-ranked Atlanta (30.35). http://www.reviewjournal.com/lvrj_home/2002/Jun-26-Wed-2002/business/19054359.html

Ability to add value. Properties can be purchased below fair market value (i.e. handy-man specials) or can have additional work done in order to increase the value of the property and/or rental fee (i.e. finishing a basement).

Ego gratification. Real estate is a tangible asset, easy to display and show off – it is visible wealth.

Real estate is less emotionally loaded than other investments. Financial investments such as stocks and bonds vary on a constant basis and therefore it is easier for investors to get caught up in the rollercoaster ride of the stock market. The inability of investors in real estate to get an immediate read on the value of their properties actually allows them time to think through their long-term investment strategies.

Tyson (1997) also noted that certain individuals would be poor candidates for real estate investing if:

Lacked free time. Property purchasing and management are “time sinks” (p. 239) – evaluating properties and potential tenants is time consuming (or costly, if you hire a property manager) and requires proper due diligence.

Low tolerance for stress. Since tenants in general do not care for properties as well as property owners do, they tend to abuse or overlook property damage (i.e. stained rugs) that might send homeowners up a wall. Property owners who are going to agonize over damage to their property might want to avoid this investment.

Not funding retirement accounts. Retirement accounts have immediate tax advantages and profits accrued in these accounts are either tax-deferred or tax free. Real estate operating profits are taxable while being earned (although capital gains can be sheltered).

Real estate or being a landlord isn't appealing. Some people just do not want to be a landlord, with stocks providing comparable returns in the long run.

Deciding where and what to buy is critical to the investment decision. Tyson (1997) indicated that single-family residences are easiest to deal with since you need to find and deal with only one renter. Factors influencing the buying decision include local economic issues, the real estate market (building permits, vacancy rates, property listing and number of sales, and rents), and financial return considerations.

Valuation and Return on Investment (ROI)

Muto (2002) indicated that one quick way to value a potential residential rental property is through its price/earnings (P/E) ratio. The higher the P/E, the more earnings growth is implied. To determine the P/E ratio for a house, divide the price of the house by the estimated annual rent the house could generate. For instance, if a \$500,000 home could rent for \$25,000 a year after maintenance and management expenses, the P/E ratio is 20. This methodology, also known as the rent multiplier, provides a clean-cut approach that allows potential investors to compare real estate investments with stock and bond performance. A second method for calculating property valuation is the capitalization rate. (Pond, 1998) Here the net operating income (revenues – operating expenses excluding cost of debt) is divided by the total property cost where the property cost includes both the down payment and the amount financed. This method accounts for operating expenses but does not factor in debt service and tax savings.

Pond (1998) offers an alternative method for calculating residential property values and return on investment. This method computes the net cash flow of the property in order to determine ROI where cash flow ROI =

$$\frac{(\text{Rental Income} + \text{Tax Savings}) - (\text{Operating Expenses} + \text{Reserves} + \text{Mortgage Debt Service})}{\text{Equity Investment}}$$

This method, however, does not account for the impact of inflation on the investment, risk, or opportunity costs.

Sherman and Rowley (in press) indicated that another method for determining whether a property should be purchased is through the net present value (NPV) rule. This rule states that a project should be undertaken if its net present value is positive and should be rejected if its net present value is negative. In order to calculate the net present value of any project, we must first

subtract the cost of financing the proposal (called the discount rate) over the time it will take to implement the project. This discount rate could refer to either opportunity costs (the return the investor could receive from putting the funds into a guaranteed investment i.e. a bank certificate of deposit) or borrowing costs (the interest rate, dividend, or bond rate the investor would pay in order to purchase the property). The net present value can be calculated as follows:

$$\text{NPV} = \frac{\text{Net Cash Flow Per Year}}{(1 + \text{Annual Discount Rate})} \text{ for each year of investment} - \text{Initial Investment}$$

The internal rate of return (IRR) rule is a second method for determining whether or not a residence should be purchased. This rule states that a property should be purchased if its internal rate of return is higher than its cost of capital. The minimum internal rate of return, also known as the hurdle rate, is the discount rate that makes the net present value of a project equal to zero. The internal rate of return is then adjusted for the time value of money (the length of time the project will take). The equation is as follows:

$$\text{Initial Investment} = \frac{\text{Net Cash Flow Per Year}}{(1 + \text{Internal Rate of Return})} \text{ for each year of investment}$$

Yet a third method of making an appropriate decision is to analyze the pay back period (based on the breakeven point) – the time it takes for any project to recoup its initial investment. Most firms employ a two to three year pay back period as their cutoff period; projects above the cutoff period are rejected, those in a shorter time span are funded. Many businesses adjust the measure of years using net present value, that is, they discount their cash flow by their cost of capital. The breakeven point is calculated as follows:

$$\text{Breakeven Point (In Years)} = \frac{\text{Down Payment}}{\text{Net Cash Flow Per Year}}$$

Using net present value allows comparisons between projects and internal rate of return does not. The payback method ignores time value of money and all cash flows the moment payback occurs.

Tax Considerations

According to Pond (1998), tax reforms in the 1980's has had a significant negative impact on real estate investing hence real estate investments must be based predominately on economic considerations. Several tax laws effect real estate investments.

- *Passive Tax Shelter and Losses and Credits* – a taxpayer’s deduction for net losses from rental properties are only allowed to offset net income from other passive activities such as stock dividends and bond interest. They may not be used to offset active income such as wages or other active business income. Real estate income is considered passive if the taxpayer works less than 50% in the real estate business.
- *At-Risk Rules* – a taxpayer’s deductible loss on a real estate property is the limited to the amount that the taxpayer invested in that property, specifically the amount of money paid into the property, the adjusted basis of any property contributed, and any amounts borrowed where the taxpayer is held personally liable.
- *Rehabilitation Tax Credit* – a 10% tax credit is available for rehabilitating residential buildings built prior to 1936 while a 20% credit is available for certified historic structures.
- *Low-Income Housing Credit* – eligibility for this program requires that at least 20% of the units of a housing development or project be set aside for families with incomes no higher than 50% of the area median income or at least 40% of the units earmarked for families at or below 60% of the are median income. Rents for these units cannot exceed 30% of the qualifying income limit.
- *Modified Accelerated Cost Recovery System* – residential property is depreciated over a 27.5 year period.

Residential Rental Property Management

Residential housing, compared to commercial properties, is easier to understand since personal home ownership has already introduced most novice investors to issues dealing with house location, purchasing, and upkeep. Managing property entails developing rental collection processes and procedures, property maintenance and repair, delinquency procedures (dealing with late payments, and returned checks), increasing the lease renewal ratio, reducing turnover rates, increasing rent rates, decreasing the load factor (none income-producing space), preparing the rental space, tenant move-in and evictions, marketing and showing the property, rent and other income, and addressing tenant problems. (<http://www.atlastitle.net/literature/CreativeInvestment08c1-PMB-RI-RentalIncome.htm>)

The cornerstone of any rental arrangement is the lease. Characteristics of a lease include:

- *Requirements of all contracts* – offer and acceptance, consideration, competent parties, legal purpose
- *As a type of real estate contract*, a lease should contain a precise description of the leased property

- *The term should be specified*, with all significant dates (e.g., start and end) noted
- *Must be in writing if for longer than 1 year*; but putting things in writing is a good idea even for a shorter term
- *Signature of the lessor* (just like a grantor must sign a deed while a grantee need not); but it is good for the lessee to sign also, to show that the lease features are understood and acceptable. (<http://www2.cob.ilstu.edu/jwtrefz/FIL260/F260Ch9.doc>)

In a residential lease, rent is generally a fixed monthly amount. Rents are determined by:

- Age, location, and other features of the property, relative to those of competing properties
- The benchmark usually is per room or per bedroom.

Operating expenses.

Negotiating strength - Manager may remodel premises, give prizes (free trips), or give “free” rent to attract tenants in a competitive market, or Tenants may have to agree to longer-term leases, and to escalation clauses, when renting in low supply markets. <http://www2.cob.ilstu.edu/jwtrefz/FIL260/F260Ch9.doc>

A recent issue that property managers have had to deal with is the growth of home-based businesses, according to Sleeper and Walker (2002). The success of residential property managers in limiting nuisance-creating home businesses depends on whether those uses are usually associated with family residences and whether they are favored in particular city and state laws and policies. Property managers do have direct legal authority over parties who have signed contracts and the courts will back their rights to that extent. Calling the police remains the best response, but eviction requires proof that residents themselves have committed contract violations. Recommendations for protecting residential real estate from home business nuisances are: background checks and testing, contract drafting, public authority enforcement, and political efforts.

Bell (2002) has noted that there has been a structural shift in the residential property management industry. “It's definitely a tougher market today, one that has made dear the need to differentiate from competitors with better service. The overall goal is tenant retention.” (p. 25) Bell suggested that the property manager become more proactive with tenants – “the property manager's altered role is one of insuring the existing tenant base is satisfied. It means spending more personal time with tenants and connecting with them on a face-to-face basis. Managers need the skills that will create positive experiences for tenants. The building is not just a place where you house somebody.” (p.26)

Smith (2002) indicated that the decision as to whether to pay a third-party manager to run the property, (leaving all the fixing of leaky roofs, faulty faucets and clogged sinks, plus rent collection and leasing the property to someone else) boiled down to two main considerations: cost and tolerance of middle-of-the-night calls from tenants. In terms of costs, owners should expect to pay 5% to 10% of the gross income from the property. The more services a property manager has to perform, the higher the cost. While considering cost, a lot depends on an owner's proximity to the properties and the number of properties owned. Property managers themselves say hiring a third party to manage 20 units or less that are within reasonable distance may not be necessary. Unless, of course, one hates to deal with daily landlord/tenant matters.

SUGGESTED CASE QUESTIONS

1. Do Davis and Hodgetts have enough information in order to decide whether or not to go into this business? If not, what more information would you want before starting this business?

In answering this question, we must first inventory the information that Davis has already collected about the real estate business. We have the following information:

- rent on a three bedroom two bath house is between \$1,100 to \$1,400 a month.
- three bedroom homes sell new for around \$175,000, with real estate taxes of around \$1,000/year
- on a \$175,000 home, a 5%, 30 year mortgage would cost be about \$900/month.
- renters earn a \$100/month credit towards the purchase of their home by paying their rent on time.
- goal is to make at least \$200/month per rental, not counting administrative costs associated with managing our operation.
- homes in our area are appreciating in value about 5% every year - a \$ 174,000 home today will be worth slight over \$200,000 at the end of a three year lease.
- would make over \$20,000 dollars in three years with an investment of less than \$10,000 by: selling the home back to the homeowner yielding a \$26,000 profit rental fees over the first three years are \$7200 dollars, lose \$3600 for rental credit towards home purchase.
- Furthermore, we also know that Hodgetts has a very negative attitude towards becoming a landlord, given his prior rental experience.

The below average student would make a determination that Hodgetts and Davis have enough information as to whether they should go into this business venture. They would argue that Davis has perhaps not worked out all of the details (as per Hodgett's comments) but that there certainly is enough information in which to make a decision, one way or another, given the revenue streams and costs projected by Davis.

Most of the other students may note that more specific information is needed and/or needs to be verified. For example, Pond (1998) recommended that the following information is needed just to forecast rental real estate income and expenses: occupancy rate, level of rent increases,

inflation rate, nonrecurring repairs and maintenance, advertising, travel, bank charges, cleaning and regular maintenance, commissions, depreciation, insurance, interest, legal and professional fees, salary and wages, supplies, taxes, telephone, and utilities.

Further, most students will also note Hodgetts and Davis's general lack of knowledge of residential rental property management. They may also point out that once Hodgetts and Davis have researched the industry from an operational standpoint, that Davis and Hodgetts may determine that they are unwilling and/or unable to perform the functions of a rental manager.

The average student would may argue that a business plan is needed in order to demonstrate the profitability and manageability of the new venture. The plan would provide an explanation of the business concept and delineate the market channel for the rental/home purchase service, set specific goals for Hodgetts and Davis and the business, describe the strategies employed to achieve those goals, and describe the background and experience of the people involved in the business start-up. The plan would highlight capital requirements and capital formation, the organization's legal structure, and include a SWOT analysis demonstrating the viability of the project.

The above average student would note that before putting allot of time and effort into developing a full-blown business plan that a feasibility study is needed in order to determine whether the business is worth pursuing. This study would include a brief description of the venture, industry and economic background; competitive analysis; accounting, management, marketing, finance, legal and tax considerations. The feasibility study should also highlight the areas of distinctive competence and the competitive advantage of the proposed business model as well as include estimated start-up costs, an operating budget, and a simple break-even analysis.

The exceptional student would note that the most critical information lacking is the personal, financial, and managerial background of both Hodgetts and Davis. All that we know from the case is that both Hodgetts and Davis lost money in their retirement accounts and their personal stock portfolios and that both were college professors on a fixed income, with at most 3% annual raises, and that Davis was married and liked to travel to Europe. We do not have even the most basic information concerning their personal financial means including their net worth, liquidity, and credit rating. Leimberg et. al. (2002) indicated that before any investment is contemplated that a basic financial portfolio be developed that includes:

- *Current financial information* – balance sheet, cash flow analysis, asset liquidity analysis. Includes age, marital status, dependents, and life style.
- *Retirement plans* – including income at death/disability and financial security of heirs.
- *Investment tactics* – tax implications, risk management, and wealth transfer.

Although the initial investment in this business would seem quite small, (assuming only one house, \$5000 per person), we cannot ascertain at this time whether Davis and/or Hodgetts would

qualify for a 30 year mortgage or have the assets to leverage or liquidate for the initial down payment. Furthermore, although Hodgetts has some experience in being a landlord (although not positive), it is not clear from the case what skills or expertise either Hodgetts or Davis bring to the venture or how the business venture will be managed (will they self-manage or look for a property manager?). This would seem to be a critical issue since some student may be skeptical as to Hodgetts and Davis's ability to deal with troublesome tenants (will they have the heart to evict bad tenants?) and in general manage a business. Davis has started to create a network of experts (mortgage lender, real estate agent) but has yet to bring in someone with either real estate or rental insurance experience.

Given the financial information in the case and the general economic trends in August, 2002, conduct a preliminary financial feasibility study of renting a \$ 175,000 home for \$1200/month.

There are several methods that could be employed to analyze this investment. The simplest method would be to conduct a price/earning (P/E) analysis. With a price of \$175,000 and an annual income of \$ 14,400 the P/E ratio is approximately 12.15. Comparing this ratio with the S&P 500 of nearly 30 at about the same time period, this would seem to be a very conservative investment. Lower than average students will conduct this simple assessment and may have a positive recommendation.

The average student would conduct a second analysis. The second method might be to calculate the return on invest as indicated by the equation:

$$\frac{(\text{Rental Income} + \text{Tax Savings}) - (\text{Operating Expenses} + \text{Reserves} + \text{Mortgage Debt Service})}{\text{Equity Investment}}$$

Students would need to generate several pieces of information to complete this equation. Assuming that they purchase new construction and that there are no tax savings per se (given the form of ownership, there may be tax deductions as a second mortgage), the first calculation would have to be mortgage debt service. Assuming 5% down on a \$175,000 mortgage, Hodgetts and Davis would have to obtain a loan for \$166,250. The 30 year mortgage rate in early September of 2002 was below 6% (http://www.usatoday.com/money/perfi/housing/2002-10-10-mortgage-rates_x.htm) so students might assume a mortgage rate in August 2002 of 6%. The monthly mortgage would be \$996.75, annualized at \$11,961.

Better students will note that this information does not correlate to the information in the case (Davis is told that the cost of this mortgage is \$900/month) and may either work with the new mortgage figures or recalculate the borrowing amount (for a 30 year loan at 6% interest, \$900/month will finance a \$150,000 loan – 14.2% down on a \$175,000 home). Assuming students work with the calculated mortgage figures, we would then have to calculate maintenance costs and taxes. Taxes are stated in the case as \$1000/year. Maintenance expenses for a new home would seem to be minimal (repairs at least in the first year would be covered by the builder's warranty, appliances

warranties, or by the renter), however, students may set aside 10% of the rent as a reserve or as a management fee (\$1,440). These assumptions would yield the following:

$$\frac{\$14,400 - (\$11,961 + \$1,000 + \$1,440)}{\$8,750}$$

$$= -1 = 0$$

$$0$$

Since this yields a negative cash flow of \$1/year and a '0' ROI, some students may recalibrate the ROI by adding back the reserve/management fee (or a percentage thereof). This would yield an ROI of 16.4% (\$1439/\$8750) and a positive recommendation.

Better students might also calculate Net Present value, producing the following assuming a three year time horizon and a 6% discount rate:

$$\text{NPV} = \$1439 \times 3 \text{ (a 3 yr. investment)} = \$4072.64 - \$8,750 \text{ (Initial investment)} = (\$4677.36) (1 + .06)$$

It would take a little over 6 years for this investment to produce a positive NPV or breakeven. Under these circumstances, one would not invest in this project.

Better students will perform several analyses and conclude that the investment may have relatively low risk (given the low P.E. ratio), but has discouraging returns (if one deducts the reserves from the cash flow), a negative NPV, and a high breakeven point. They may also note that this lack of cash flow does not provide any salary for either of the owners (unless they manage the property on their own and use the reserves to pay themselves) and may reject the business proposal.

On the other hand, exceptional students will note that none of the calculations include the appreciated value of the property, that is, that the property may rise in value although the cash flow from that property may be neutral. They may note that given the near break-even cash flow of the situation, that any accrual to the property beyond the opportunity costs associated with the initial down payment (\$8,750) would be considered a profit. This will be minimal given the very low interest rates of CD's and/or government bonds in August of 2002. They may also observe, however, that property is not as liquid as stock or bonds and therefore Hodgetts and Davis may not be able to sell the home in a timely manner. This may lead to a vacant property and negative cash flow given the need to still pay the monthly mortgage and taxes.

Given the misinformation provided by their mortgage lender, these advanced students may also question the price growth rate information provided by the real estate agent. The Federal Reserve reported that in August 2002 prices for new homes rose 5.25 percent, and the repeat-sales price index for existing homes was up 6.25 percent. (www.federalreserve.gov/pubs/bulletin/2002/0802lead.pdf) This would verify the real estate agent's assessment of the property.

Assuming that the property breaks-even in terms of cash flow, the capital appreciation of the property would then be calculated by compounding the value of the home, \$175,000 by 5.25% over a three year period; equaling \$204,034.85. Students may try to adjust the revenue by accounting for sales commission, at the standard 6% rate, producing a net revenue of \$ 191,792.75, or they may assume that the renter has purchased the property and discount the sale price by \$3,600, making the total revenue \$200,434.85. Assuming the worst case scenario, commissioned sales, the net profit of \$ 16,792.75 would then be divided by the original financial invest (\$ 8,750) and then divided by 3 (the years of investing), yielding nearly a 64% return on investment. Property appreciation clearly makes the project a viable one.

2. Assuming that Davis and Hodgetts do opt to go into business, what legal form of organization would you recommend?

The issues related to the legal form of organization in this case include personal liability (Davis and Hodgett's personal assets), tax implications, and entity ownership. In terms of personal liability, it is probable that, Davis and Hodgetts would require a legal form of organization that would limit their liability to solely their investment in the business. None of the participants would want their personal assets at risk.

Secondly, the student's choice of ownership may partially be determined by his or her projected cash flow for the business; if the business will show a loss that loss should be passed on to the owners to deduct from their personal income taxes. Gains, on the other hand, should be paid by the business if the business tax rate would be lower than the corresponding personal tax rate.

Third, ownership arrangements should reflect each participant's invest equity, whether the equity is in-kind services (sweat equity/labor) or assets. It is not clear who will be managing the property (Davis, Hodgetts, both, or a property manager) but one would expect an equal ownership arrangement would be the most acceptable.

Given the neutral cash flow, and the desire to protect personal assets, and the need to have ownership reflected as the percentage of equity investment, it would seem that a limited liability corporation would meet be appropriate for the situation.

3. Discuss the risks of this venture and the associated liabilities. Given your answer to question 2, are the rewards worth the risk?

The below average student will discuss risks and liabilities from a theoretical perspective or argue that there are no real risks associated with this venture since all the information presented leads to a very profitable venture. From their perspective, the rewards are evident and are risk-free.

The average student might start by assuming that Hodgetts and Davis form a LLC in which to run the business and then deed the property over to the LLC. In this situation they would note

that the financial risk associated with this business venture would then be limited to those funds invested in the business in order to purchase the residential property (the down payment of \$ 8750) and the costs associated with owning a vacant rental property (mortgage, taxes, insurance, and any maintenance expenses i.e. electricity, heating and lawn care, estimated at \$5000/year). These students might see the risks as minimal, and given the potential upside (a positive rental cash flow and property appreciation) would argue that the risk is worth the reward.

The above average student would note that the reality is that since the new LLC will have minimal assets and no operating history, the mortgage that will need to be obtained for the home will have to be personally signed for by Hodgetts and/or Davis. They would therefore each be incurring an additional \$166,250 debt per person if they both sign for the mortgage. The risk associated with this property and its mortgage, besides the mortgage payment, would be the associated loss, if any, incurred through the liquidation of the property in the case of a non-rental situation or break-up of the LLC. They might also note that Hodgetts and Davis, as owners of the firm, also have potential liability as homeowners (i.e. tenant is injured on the property) which presumably will be covered through homeowners' and business insurances. Here, risk and reward are a muddier issue and students might argue either way in terms of the investment.

The exceptional student might assume a near worst case scenario for Davis and Hodgetts (that the property will yield a break-even cash flow from rental revenues, that the home will be sold through a real estate agent, that the property will accrue in value at 3% per annum, and that the home will take six months to sell), in order to try to quantify the risks involved. Using the above scenario produces a net revenue of \$ 2253.58, or a 8.6% annual return on initial cash investment ($[\$2253.58/3 \text{ years}]/\8750) as calculated below:

$$\begin{aligned} & \$175,000 \text{ compounded by } 3\% \text{ for three years} = \$191,227.22 - 6\% \text{ commission} = \\ & \$ 179753.58 - \$2,500 \text{ (estimated cost of empty property for six months)} = \\ & \$177,253.58 - \$175,000 \text{ (initial home price)} \end{aligned}$$

They might go further and compare the return on no risk or low risk investments (CD's, T-bills, Corporate Bonds) to this investment perhaps using the following August 2002 data: (www.federalreserve.gov/pubs/bulletin/2002/0802lead.pdf)

$$\begin{aligned} & 3 \text{ Month T-Bill} = 2\% \quad \text{Corp. Bonds (AA 7-10 yrs.)} = 6\% \\ & 2 \text{ Yr. T-Bill} = 3\% \quad 3 \text{ year CD's} = 3.5\% \\ & 10 \text{ Yr. T-Bill} = 5\% \end{aligned}$$

These students may conclude that the real estate nearly worst case real estate scenario return on initial cash investment produces a higher rate of return than even longer term T-Bills and AA

corporate bonds, and would therefore seem to warrant the additional risk associated with the debt burden.

Many of the students may also point out that from a non-financial perspective, Davis and Hodgetts might feel more empowered and in control of this investment versus their other passive investments and hence might derive a psychological income from managing at least a part of their money.

4. Assuming that Davis and Hodgetts decide to go into this venture, what might be some of their short-term and long-term goals and objectives?

The purpose of this question is to test students' ability to see beyond the immediate initial property investment and to use their creativity in developing longer term goals and objectives. Shorter term goals and objectives should generally deal with the initial investment property. This would include establishing the corporation, locating a property and a suitable renter, obtaining a mortgage, going to closing on the property, signing a lease agreement with the renter, and deciding whether to self-manage the property or contract out services.

Longer term goals should deal with developing a vision and mission for the firm (what should the company look like in five years) including the personal plans of Davis and Hodgetts, instituting growth and profit goals, formalizing a sustainable competitive advantage, and developing a network of contacts in the property rental industry. Very specific questions can be addressed by the students, including:

5. How many rental properties do Hodgetts and Davis envision owning in 1 year, 3 years, five years ...? What is their goal for the size of the business? Does either Hodgetts or Davis envision retiring or leaving academics to run the business full-time? If so, in how many years? Are there related businesses that Hodgetts and Davis should contemplate entering? (I.E. real estate rentals and sales, commercial renting, mortgage lending, and home construction.) Are there family members (spouses, children, sibling, parents, etc. ...) who may have an interest in entering this business? If so, in what capacity and when? When would Davis and Hodgetts like to retire from the business? Is there a succession plan for the firm?

Given the very open ended nature of this question, it is expected that students will develop a myriad of goals and objectives that may go beyond the scope of the answers given in this instructor's manual.

CASE EPILOGUE

Davis and Hodgetts decided to go into the business and formed D & H Reality, LLC with an initial investment of \$40,000 each. They decided that they would start the business with at least two homes at around \$165,000 each, putting 10% down, with each of them buying a home (and therein obtaining the mortgage) and deeding it over to the company. Davis brought in his wife to manage the rental properties while Hodgetts played banker and loaned the firm additional capital in order to expand the number of managed properties. Within a year's time, the firm had accumulated ten properties, worth approximately \$ 1.8 million dollars, had debt of around 1.6 million, and was generating a positive rental cash flow of about \$2,000/month.

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THE FALL OF THE LAST ANGLO-SAXON KING: A CASE OF LEADERSHIP FAILURE DURING A CRISIS

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CASE DESCRIPTION

The process of Crisis Management can be broken out into three distinct phases: pre-crisis preparation, dealing with the crisis itself, and learning from the ordeal after the crisis is over. While the study of all phases is important, this case examines the most crucial phase, the actual crisis itself. The case describes the Battle of Hastings, placing emphasis on the decisions made by Harold Godwinson, the last Anglo-Saxon King of England. First the events leading up to the battle are presented to provide the context and show the preparations undertaken by Harold. Next the Battle itself is explored.

The most important skills that a leader can have in dealing with a crisis are the ability to reasonably and objectively evaluate real-time feedback, and the ability to adapt to your surroundings and change course, quickly and decisively, as the situation evolves. The Battle of Hastings demonstrates the failures that can occur when a leader does not have these skills. Crisis management and leadership are the primary topic areas covered. In the questions following the case, students are asked to research and examine three specific well-known crisis situations - the New Coke fiasco, the Tylenol scare and the Apollo 13 accident. Information on these cases is widely available on the internet. Instructors can adjust the questions to fit other crisis situations that the students might be more familiar with. The case is designed for senior level undergraduates or entry MBA level students (difficulty 4/5). It is designed to take two hours of class time with two hours of outside preparation if the Coke/Tylenol/Apollo13 questions are addressed, and one hour of class time with one hour of outside preparation for the Battle of Hastings alone.

CASE SYNOPSIS

In the spring of 1066AD, Harold Godwinson was celebrating his third month as the Anglo-Saxon King of England. This new king acquired two fairly powerful enemies almost immediately - William, the Duke of Normandy, and Harald Hardrada, King of Norway, both of whom were preparing to invade. So the king called out to the entire kingdom for men to mobilize, had defensive positions built along the southern coast at strategic locations, and had many staging areas set up on good ground where he could rally troops and defend the land against invasion.

Hardrada was the first to make a major attack, finally landing near York in the central eastern part of the island. The well-trained English reached them in a few days and used tactics that had proved successful in earlier uprisings. They were able to repel the Norwegian invaders in one day.

Meanwhile, William's army had landed and proceeded to the town of Hastings. Harold arrived in London ahead of his main force and moved toward Hastings with a new army of relatively untrained men. The forced march that worked with his seasoned troops did not work with the new soldiers. It is estimated that no more than a third of the English army, was on the field when William, long since ready to attack, approached. Unlike previous adversaries, the Norman army had knights and archers who rendered Harold's previously successful tactics ineffective. Harold was unable to adjust during the battle. Despite careful planning and proven successful tactics, the short-lived career of the last Anglo-Saxon King was over.

INSTRUCTORS' NOTES

The case is an interesting one, as it is not related to the business world or even to the modern world. It is nearly 1000 years old. But, its lesson is timeless, a lesson that shows how badly things will turn out if you cannot think on your feet and are not flexible enough to change a plan that has served you well in the past when the feedback is screaming at you to do just that.

Crisis management and leadership are the primary topic areas covered. The case is designed for senior level undergraduates or entry MBA level students (difficulty 4/5). It is designed to take one hour of class time with one hour of outside preparation. The case should be handed out at least one week before covering it in class. The students should be instructed to read the case and be prepared to answer the questions. If it fits into the class structure, the students can be asked to provide written answers. Given a week or more to read the case and prepare answers gives the students ample time to do additional research on the Battle of Hastings, Harold Godwinson, and other case elements. MBA students should be required to do some additional research, such as locating maps of the battle, developing a profile of Harold, or finding analysis that supports their answers to the discussion questions.

In class, the case analysis can start with the short introductory lecture. This can be followed by a summary of the story elicited from the students, to get them talking about the case. Next the discussion questions should be addressed in order. The answers provided are fairly straightforward and the class discussion may drift a bit but the main points will most likely be made. The answers to the final question can be segued into a conclusion.

Each discussion question about Harold is augmented with parallel 'b' questions that refer to three specific well-known crisis situations - the New Coke fiasco, the Tylenol scare and the Apollo 13 accident. These three cases were chosen because (1) they deal with different types of real crises, (2) there is a great deal of information and analysis about them readily available on the

internet. The instructor can use just the ‘a’ questions, incorporate the ‘b’ questions for some link to more current situations or use other supplemental questions.

Introductory Lecture

The recognized truth is that some number of crises will happen to each and every one of us, eventually.

So, it is a good idea to plan for the likely crises that will harm you, because preparing for them will help you cope with and react appropriately when any one of them occurs.

But it is important to realize that your plan will be inadequate in some way, maybe in some very fundamental way, when the actual event occurs. Somehow, it will fail to fully meet the needs of the crisis. For each crisis is unique, at least in the particulars. Things are apt to move, evolve, and change during the event. “Crises do not stand still. They evolve...situations change...new data emerges that contradicts earlier information.” (Barton, 2001b). Moreover, no one can prepare for every eventuality. No one has the resources to do that.

The ability to think on your feet during a crisis is vital if you are to get through it. And, that ability is of paramount importance for the crisis management team leader. This is the person most people will look to when a crisis occurs, and if this person cannot think, act, and change things on his/her feet, not only will his/her followers defect, but the crisis will overwhelm the organization s/he hopes to protect.

If you are that team leader, you must be able to:

Continuously sift through, sort out, and reasonably evaluate the real-time feedback you are receiving during the crisis (this, of course requires that you set up a mechanism for that feedback), and

Then act quickly and decisively to integrate some of and to adapt or change the rest of your pre-crisis planning, as appropriate and based on that feedback.

In a word, you must be flexible.

And, you must cultivate this skill long before you try to lead the way out of a crisis. Moreover, you must guard against ego and arrogance, so as not to view the feedback you’re getting through a clouded lens or worse ignore it altogether.

DISCUSSION QUESTIONS

1. (a) What is a crisis? Is War a crisis?

Few people would argue that war is not a crisis that must be managed very carefully. Barton (2001b) describes a crisis as being “unexpected, overwhelming and negative.” It is

certainly negative - people die. It is self-evidently overwhelming in nature. And, while sometimes expected, no one can truly grasp its nature until s/he is in the thick of it. Moreover, the battles in war and the war itself meet Pearson and Clair's definition of a situation that presents a "dilemma in need of a decision or judgment that will result in a change for the better or worse."

(b) What business situations are crises?

Student answers to this question will vary from general categories such as natural disasters, product failures and terrorism to specific cases. A wide variety of answers should be actively solicited in order to make the point that there are many types of crisis situations that can arise in business settings. Near the end of the discussion the instructor can refer to Barton's description of a crisis as being "unexpected, overwhelming and negative." (Barton, 2001b). This description will most likely cut across and summarize the answers given by students.

- 2 (a) Clearly Harold was in a crisis, and clearly he did not manage it well - as he lost. The first stage in crisis management is pre-crisis preparation. Was Harold's failure a lack of preparation?**

Preparation Is Not Enough

It could not have been for lack of preparation. Harold was clearly prepared for both invasions. He had a good spy network and, for his time, incredible communications network. He prepared several sites for troop deployment. And, he raised a strong, well-equipped and well-trained army, at least the first time.

Yet, all of this preparation did not help him win the day. True, he did not take into account the inferiority of his forces at Hastings, both in training and in type. But, he undoubtedly expected to drive the enemy from the field long before that would be a factor.

No, Harold was very prepared. It's just that preparation is not enough.

Harold failed, because: 1) He could not properly evaluate the feedback that was out there; neither before arriving or during the course of the battle. And, he failed, because 2) He could not adapt his simple, but previously successful, way of doing things in the face of the changing situation he encountered at Hastings.

Harold needed to be able to handle the crisis itself.

(b) Consider three famous recent crises - the New Coke fiasco, the Tylenol scare and the Apollo 13 accident. (information on these crises is widely available on the internet) Were these crises caused or exacerbated by a lack of preparation?

Like Harold's situation, none of these crises were caused by a lack of preparation.

The Tylenol scare was an unanticipated act that took place outside of Johnson & Johnson's control. Once it happened, changes in packaging and other preventive measures were put into place to minimize the chances of recurrence.

The Apollo program went to great lengths to anticipate and train for handling all manner of problems. The notion of handling a crisis in real time as it occurs was a key component of NASA mission preparation. They knew that if and when a problem occurs in a mission it might be something unanticipated, therefore the training and procedures focused on diagnosis, analysis and problem solving, not just problem recognition and implementation of existing solutions.

Only the New Coke failure could have been reasonably been prevented, but not by crisis prevention methods.

3 (a) Why did Harold fail to properly evaluate the feedback before moving on Hastings?

Harold The Blind

Surely, he was not a stupid man. He had seized the throne, after all. And, he had managed to hold it against the rightful heir and other local lords who all wanted it. He had made all of the preparation for war previously mentioned. And, he had won at Stamford Bridge not three weeks before his downfall.

No, he was not stupid. He simply did not set up any kind of organized feedback mechanism with which to be able to properly evaluate anything of the situation before he moved on Hastings. Most notably, he did not set up a defensive screen on his approach. That feedback mechanism would have given him real-time data on the current state and subsequent evolution of the situation. Reports of the opposing army's size, location, intent, and disposition would have streamed into his camp.

This was not only a basic tactic of the time, but it was a crucial one – for all armies. And, it is highly unlikely that he did not know this, especially since he had exhibited the ability to do something like this sort of preparation in setting up his spy network and his communication network.

Yet, because he did not do this fairly simple thing. He was supremely disadvantaged, as evidenced by his surprise on arrival at the battle and the fact that he had to take a

defensive position when he got there with an ill-trained and exhausted army that was not prepared to do so.

(b) Why did Coca-Cola misinterpret their market research? Could any feedback have prevented the Tylenol or Apollo 13 situations?

Coca-Cola used both survey and focus group techniques before and during the development of New Coke. The different data gathering techniques provided seemingly contradictory findings. The surveys and taste tests were very positive and New Coke tested very well compared to old Coke and Pepsi. Focus groups revealed that there would be resistance and resentment to changes in Coke. Using the taste test data to support a change depended on the assumption that a difference in the taste of the soda would increase sales. The focus groups definitively undercut this assumption and indicated that taste was not the prime attraction of Coke. Unfortunately, Coca-Cola discounted the focus group findings. There are several explanations for this. The two most widely accepted explanations are that the taste test verified what they were planning to do anyway and that product tasting was a method that dominated consumer products marketing with focus groups being less accepted in this situation.

Johnson & Johnson and NASA did not have such feedback. J&J had feedback mechanisms in place to prevent or detect many product problems; however there was no monitoring once the product was distributed. They were able to track production runs through the distribution channel and identify inventory, but this was only useful after the fact.

NASA had a great number of sensors and redundancy; however the problem that occurred went un-noticed. Without getting into technical details, the relevant feedback device was inadequate. It did not accurately show the temperature within the oxygen tank that exploded. In fact, it was not until well after the crew was safely home that the cause of the explosion was identified and the inadequacy in feedback was recognized.

4 (a) He was effectively blind in the days leading up to the Battle of Hastings. Why did he march to it anyway?

Harold The Arrogant

Hubris – born of initial success and fostered by repeated victories of the highest levels.

Harold was clearly a man of action. He reacted very quickly and aggressively to the crises and opportunities he encountered. And, this had made him a winner, over and over

again. Moreover, this extremely positive reinforcement caused him to feel that simple, aggressive action was the right thing to do, always. And, as shown in the case, he never varied from that course.

This is clearly an example of man filled with hubris. It is basically one of the founding tenets of it - this sticking to a simple plan that had worked well in the past - in this case quick, aggressive action - without regard to why it had worked at all. (Knoll, 2000)

Moreover, his hubris is evident in other areas throughout this case. He shows it in his dealing with Hardrada at Stamford Bridge, where he could have made peace and taken hostages. But, instead Harold offered the King of Norway only a grave large enough in which to bury himself. Undoubtedly, many men died needlessly because of this arrogant stance.

And, it is evident in how he handled himself at London before marching on to Hastings to meet William. He stayed there for only five days. He should have spent much more time than that, preparing the levies who had been waiting for him and allowing the rest of his army at York to catch up.

(b) NASA was blind regarding Apollo 13's accident, why did they act so quickly?

Despite having many feedback devices and considerable information regarding the spacecraft, they did not know what happened and did not necessarily have the information that they needed. They did know that resources were depleted and the capabilities of the spacecraft severely compromised. It was necessary to take immediate action because the astronauts and spacecraft continued to consume resources such as air, water and electricity. Knowledge of the cause of the problem or the exact damage was not possible, but it wasn't necessary to know either. What were available were estimates and measurements of the current resources and capabilities of the men and ship, and they were able to use knowledge to formulate different solutions and test them on the ground when possible.

5 (a) Did Harold have to attack William as quickly as he did?

It is true that William was causing trouble in the south. But, to any level-headed observer, it was an obvious ploy to draw Harold down as quickly as possible. William was in no position to wage a long war in hostile, unfamiliar territory, especially as winter would soon arrive. Nor did he have the forces necessary to invade London with Harold sitting there. So, William needed Harold to come to him, and quickly

In addition, with such a quick and decisive victory over the Norwegians, the overall situation had changed for Harold. He no longer had two dangerous enemies - just one. Moreover, he was fortunate enough to know that one remaining foe, a man he had fought

beside on the continent two years earlier when he had promised to back that man's move for the English throne. He knew the man's tactics, and he knew the capabilities of the Norman forces William commanded.

Also, William had his back to the sea. And, his small force could do some, but not a lot of damage.

Moreover, there was every likelihood that a great many of his troops would succumb to disease, given enough time. Disease was so common in armies until the 20th century that a certain number of losses were calculated due it alone in the planning of any campaign.

(b) Did Coca-Cola have to introduce New Coke when they did?

No, there was no pressing need for it. It is true that the competitive landscape was changing and that competition in the soft-drink industry was increasing, however there was not sufficient cause to justify such a large change. Even if the problems were big enough to warrant significant changes, New Coke was probably not the 'solution' to any problem that they were having.

6 (a) Why should Harold not have pressed so hard to get to Hastings?

The Clouded Lens

Clearly, Harold was in the better position, and he could make war on his own terms.

For the first time that year, there was no need for Harold to act quickly. Time was actually on his side. And, Harold should have known this, should have acted differently based on this. But, he played right into William's hands. As usual, he wanted to take the fight to his enemy.

So, he foolishly pressed south as soon as possible, hoping to seize the initiative, just as he had done so many times before when he felt like he was experiencing time pressure (Tetlow, pg. 128). But, as we have seen, he had no time pressure; he was simply acting out of habit.

And worse still: 1) his approach was observed by William, 2) when he got to the field, more than half of his army was not there for the start of the battle, and 3) those that were there, were exhausted.

These three things are exactly **not** what he wanted. There was no hope of his 'shock' plan being implemented let alone working.

But, the king did not absorb this dire feedback he was getting live at the battlefield. And, as we shall see in the next section, he did not even act properly and decisively in the face of impending defeat.

He had come too far, too fast, too arrogantly. And, to make matters worse, he did not understand what he was seeing when he got there.

So, because of this character flaw, this hubris within him, he was viewing the feedback, if he was seeing it at all, both before and during the battle, through a clouded lens. He could not possibly have evaluated it properly.

(b) Why should Coca-Cola have not committed so fully to New Coke?

This is a good question for a class discussion there are a number of good answers. Among the potential answers – it wasn't worth the risk, the contradictory market research should have stopped them, there were other ways to introduce New Coke besides replacing Coca-Cola, and it could have been introduced in only certain markets, and so on. The different answers all reveal different sets of faulty assumptions or flawed reasoning on the part of Coca-Cola.

7 (a) - The battle did not go as planned. Why didn't the English make adjustments?

Harold The Inflexible

So, the battle began in a manner Harold did not want – he was surprised, he was forced to defend, and his men were physically exhausted. But, he did nothing about this.

Moreover, at one point he was actually winning. His exhausted men had held their ground against several attacks. And, the failed charges of the Norman knights were having a terrible effect on their army's morale. Many units began to retreat; some of the less disciplined ones even routed. But again, he still did nothing.

Eventually, his men took matters into their own hands, charging after the fleeing Normans three times. And, even though each time they were slaughtered, he still did nothing to adapt to the steadily worsening situation.

Harold was clearly inflexible during the Hastings crisis. His inaction is practically the very definition of inflexibility

And, failure, sometimes catastrophic failure, will occur when a leader cannot think on his feet and adjust his previously successful tactics and strategies in the face of negative, real-time feedback. Harold showed us that. In fact, he experienced the worst of all possible outcomes. He was killed. Though, perhaps worse still, the English who relied on his leadership were devastated, their lives changed forever.

Strangely, Harold seems to have shown an ability to think sensibly outside or just after a crisis. For example, he did not allow his men to take booty from the dead at York. And, he granted them only a brief celebration the evening that he won at Stamford Bridge.

For, it seems that he knew that he would have to mop up what remained of the Norwegian forces the next morning and then head south again, to London, in order to prepare for William.

But, as soon as he heard of William's landing, that sensibility went out the window. He marched off again quickly to do battle with his enemy.

Maybe it was ego. Maybe his previous successes in these types of life and death matters had created a powerful habit within him of quick, aggressive action. One can almost see Harold chomping at the bit during those five days he spent in London before the Battle at Hastings.

But, whatever its root cause, Harold's inflexibility and steadfast hold on previously successful tactics in the face of the negative realities he was experiencing was a fatal flaw.

(b) The Apollo 13 mission did not go as planned. What adjustments did NASA make or fail to make?

They had to make a great many changes, from rescheduling operational personnel on the ground to physically fabricating parts in the spacecraft. The answers that the students give will show how they frame the 'problem'. Subsequent discussion can bring out the notion that the adjustments needed to be made by an organization are not just those necessary for implementing the solution, but those involved in identifying the problems and formulating the solutions as well.

8 (a) What should Harold have done once the battle was joined? Why would that have worked?

Had Harold been hearing the feedback, he would not have stuck to his simple plan, now clearly a failing course of action. In fact, even with his initial improper evaluation, he could have been successful had he simply been flexible on the field.

There were two courses he could have navigated in order to take advantage of the situation.

He could have taken stern control of his men and stood-fast, giving them a much-needed rest. Then, he could have left the field, mostly intact, to fight another day. He still had the advantage of time over William.

Or alternatively, he could have charged the Normans with whatever portion of his army had made it to the field at the point of the Norman confusion and smashed into them. Then, he could have pursued the routed enemy at his leisure.

Either course correction in mid-crisis would have won him the day, or at the very least put him in a very strong position to do so later.

But, the king stood transfixed, because things had changed beyond what his simple plan could deal with. And, his inflexibility cost him and the English people everything.

(b) What did NASA and Johnson & Johnson do once the crisis was recognized? Did these actions work?

This question is similar to several of the previous in as there are several correct answers and which ones are given reveals the biases of the students. Students tend to concentrate on the concrete actions taken – removing Tylenol from the shelves, moving the astronauts into the LEM. The actions taken by NASA and J&J worked, but it is important to recognize that the desired result was not to solve the poisoning or repair the exploded tank, but to stop panic and bring the astronauts home. It is important to emphasize the necessity of flexibility while reacting. The situations require correctly framing the problem and considering behavior outside of standard operating procedures. Obviously NASA had to change the mission from landing on the moon to returning the astronauts safely to Earth, but what was the driving force behind of Gene Krantz’s now famous declaration “Failure is not an option”? He provided psychological support to the Mission Control crew and gave them permission to explore all possible solutions.

The fact was that Tylenol capsules were being tampered with and people were being poisoned, but what were the problems that J&J’s was solving? If they accepted that the poisonings were few and very local and it was unlikely that others would be affected, they could have kept selling Tylenol as they had before the poisonings. What would have happened? Instead they reframed the problem as one of trust and emotions, which resulted in removing Tylenol from the shelves.

CONCLUSION

A crisis is an unstable time or state of affairs in which there is the strong possibility of an undesirable outcome (Darling, 1994). The Battle of Hastings was certainly that for the English. The failure of their leader to properly handle the crisis not only cost him his own life, but it literally changed the way of life of 5 million people, forever.

William would bring law and order, an iron hand, and feudalism to a people who had here-to-for been relatively independent and free. In fact, the change was so devastating for them that historical records show widespread English emigration into other countries in the late 1060’s and throughout the 1070’s. Those who could leave did leave. And, those who stayed behind were forced to become subtenants on what had been previously their own lands (Wood, 1987).

The Keys:

And, it all occurred, because Harold was unable to and/or did not

- 1) **set up an adequate feedback mechanism,**
- 2) **probe his environment,**
- 3) **keep his eyes clear and open,**
- 4) **evaluate the real-time feedback** he was receiving,
- 5) **act quickly and decisively based on the feed back to**
- 6) **adapt to what was happening** around him.

So, like Harold in the fall of 1066AD, you can be certain that crises will come to your doorstep, and that they will evolve during their course. Things won't go the way you expect or want. And, no amount of planning will help you get past that fact. So, when that happens to you, be sure you have the ability to read the feedback and adapt to the situation, as appropriate.

In a word, Harold was inflexible.

Don't be like Harold.

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ZEIT SAIC: THE ENTREPRENEURIAL HISTORY OF A FAMILY BUSINESS IN ARGENTINA

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CASE DESCRIPTION

The primary subject matter of this case concerns developing an action plan to attempt to save an old line Argentine manufacturing and service firm in the face of a collapsing economy in Argentina and significant technological change making their main product obsolete. The primary focus is that of general management and as such encompasses most of the business disciplines, but stresses primarily finance, marketing and corporate strategy issues. Secondary issues include the role of preparing and analyzing financial statements to aid management decisions and an appreciation of international issues. The case has a difficulty level of four, and is positioned for use in an undergraduate senior level cap stone strategy and policy course. The case is designed to be taught in ten class hours and is expected to require about five hours of outside preparation by students.

CASE SYNOPSIS

This case follows the career of George Brown, particularly in relation to Zeit, S.A.I.C., his family's business. After an on and off early association with Zeit, George, late in his career, joined the Company permanently in 1990 as V.P. In 1998, against the objections of his family, he purchased full control of the Company. That year was momentous since it began a steep decline in the business fortunes of Zeit precipitated by both changing technology and the Argentine financial collapse. The setting for student recommendations is in the middle 2003, near the bottom of the Argentine depression.

INSTRUCTORS' NOTES

Recommendations for Teaching Approaches

Suggested case questions follow. These questions have been tested with management students at Pontifical catholic University of Argentina during Spring 2005 and were found to be

useful and entertaining for students. We welcome your comments after application in your courses. Our answers to the suggested questions can be found following the questions.

SUGGESTED CASE QUESTIONS

- 1. The case mentions Avenida de Mayo in Bs.As. Most Argentines would have a good idea where it is located. Few non-Argentines would, but the smart ones would quickly be able to find out, at least those with an adequate international perspective. Use your skill and knowledge to decide what is the most notable man-made object reasonably near the intersection of 4th Avenue and 63rd Street in Brooklyn, New York, USA. How about the intersection of Tverskaya Ulitsa and Okhotny Ryad in Moscow, Russia?**

The internet is an excellent source for information such as this. Two good options for the “Brooklyn” question are YAHOO Map and Mapquest (both of which serve the USA and Canada.) In both cases the address (or intersection) is input and a map of the area results. The boundaries of the map can be expanded or contracted at will. Doing so with the Brooklyn address shows the location to be near “The Narrows,” the connection for Upper and Lower New York Harbor, which is spanned by the very impressive. Verrazano-Narrows Bridge, the suggested answer. The following link will take you there: www.mapquest.com

Similar interactive maps are unavailable for many countries, including Russia. But, maps particularly of major cities are generally available. Search engines such as Google are good choices to start. Inputting “Moscow, Russia map” gave many choices, including the following link: <http://www.euroave.com/maps/frame1.php?xcity=moscow>

Looking about carefully, it is obvious that the intersection is near the Kremlin—the suggested answer.

- 2. Exhibit 3 provides sufficient information for you to prepare a rudimentary financial accounting based income statement and a statement of cash flows for each quarter. For our purposes, assume that operating cash flow is defined as net earnings + depreciation – capital expenditures. Also assume the income tax rate is 35% and that all taxes other than income taxes are already included in expenses listed. Comment on your findings.**

The suggested income statements and operating cash flow statements based on case Exhibit 3 are reproduced below.

Income Statements			
Sales	\$908	\$997	\$1081
- Cost of Goods Sold	-465	-510	-548
Gross Profit	443	487	533
Depreciation	66	63	58
Other Indirect	182	189	215
Corporate O/H	42	45	50
Total Operating Expenses	290	297	323
Earnings Before Interest and Taxes	153	190	210
- Interest	- 0	-0	-0
Earnings Before Taxes	153	190	210
- Taxes (@35%)	- 54	-66	-74
Net Earnings	\$99	\$124	\$136
Net Earnings are declining quarter to quarter at an increasing rate.			
Operating Cash Flow Statements:			
Net Earnings	\$99	\$124	\$136
+ Depreciation	+66	+63	+58
- Capital Expenditures	-194	-87	-121
Operating Cash Flow	\$(29)	\$100	\$73
Operating cash flow (always below declared dividends in this time period) have gone cash flow negative in the most recent quarter.			

- 3. Exhibit 3 gives some detailed financial information for both the intercom and time recorder businesses. Use your knowledge of managerial accounting to present an analysis of the 3Q1998 pre-tax profitability of each business. What assumptions have you made? Comment on your findings.**

Using Exhibit 3 again, suggested statements of pretax profitability for each business follows based on those facts:

3Q-1998 Pre-Tax Profitability		
	Intercom	Time Recorder
Sales	\$438	\$470
- Cost of Goods Sold	-305	-160
Gross Profit	133	310
Depreciation	23	43
Other Indirect	102	80
Corporate O/H	20	22
Total Operating Expenses	145	145
Earnings Before Interest and Taxes	(12)	165
- Interest	- 0	-0
Earnings Before Taxes	(12)	165

We have assumed that corporate overheads are allocated based on sales revenue. Other methods are possible and perhaps more appropriate. A more reasonable way to allocate interest expense (had Zeit incurred any) might be based on investment in each business.

The time recorder business is much more profitable than intercoms. The gross profit margins (GP / Sales) are 30% vs. 66%. For time recorders a 35% operating profit margin (EBIT / Sales) is achieved vs. a loss for the intercom business.

4. George decided in 1998 that survival depends crucially on reducing expenses faster than revenue is likely to fall. What options are there to reduce expenses? Be exhaustive in your response.

An understanding of the income statement details and methods to manipulate the amounts is a necessary skill of all businessmen. A fairly exhaustive list of the kinds of expenses that most businesses incur follows, along with suggestions for reductions:

1. *Merchandise bought for resale or further processing*—Pressure can be put on suppliers to reduce costs, particularly if such requests can be combined with giving additional business by reducing the number of suppliers and convincing them that such necessary reductions are only temporary.
2. *Labor (wages paid hourly workers and salary paid to professionals and managers)*—During a crisis, each and every employee must help generate sufficient gross profit to cover his labor expense. Management must be ruthless in reducing

headcount by enforcing this discipline. Survival forces a short-term perspective. Also, in times of crisis, employees can often successfully be made willing to accept a reduction in their pay rate. Top management and all other highly paid workers should lead by accepting even larger reductions in pay.

3. *Employee benefits*—Any employee expenses not considered wages or salaries are employee benefits. Examples are pension contributions, medical insurance, vacations and holidays, etc. All can potentially be reduced in a crisis. Perhaps a reduction in vacation time, supporting further reductions in headcount, is given less consideration than it deserves?
4. *Utilities*—Most utilities are either variable costs that fall automatically as sales decline, or a fixed cost with little management control. The only exception is telephone service. Reducing the number of lines and tightly controlled billed service probably can help reduce costs.
5. *Depreciation*—This is an accounting based non-cash charge, so reducing it, say by lengthening the depreciation life of assets, will have no benefit. In fact, this adjustment might actually increase costs by raising taxes. The ultimate source of depreciation expense derives from the purchase of fixed assets, i.e., those with useful lives of more than a year. These purchases need to be strictly controlled in a crisis situation. We need to survive the week, the month and the year. If we do not, the long term does not exist.
6. *Rent*—Is very similar to merchandise discussed in (i) above. We can and should pressure landlords to reduce this expense to help us to survive. Further, in a crisis we can justify renting less space and less grand space.
7. *Taxes other than income*—These taxes are usually employment related or based on the value of product sold or assets owned. In that sense, the first two are variable costs that will decline as sales and employment falls. Property value is also likely to fall in a financial crisis; however, governments rarely reduce voluntarily the tax assessment. Reductions should be vigorously pursued if the value has truly declined and that decrease can be substantiated.
8. *Travel*—Again the need for business travel may fall as the number of customers and their business volume declines. Of course the other point may be that increased travel is necessary to “beat the brush” for additional business. The correct decision will be based on an incremental profit analysis.
9. *Advertising*—Almost exactly the same comments can be made for Advertising as for Travel, above. A short-term incremental profit analysis is the answer. We have included “short term” because some advertising is long term in nature. Due to the need for survival only advertising designed to increase sales in the short term should be allowed.

10. *Research*—Almost by definition research has long-term profit goals. Canceling research and dismantling a research department may be very harmful in the long run. A careful analysis of the need to save these costs to survive the crisis outweighs the long run harm if we do manage to survive.
 11. *Interest*—Everything is negotiable, even the interest rate and terms of repayment on our debts. In a national crisis (not just one related to our business) bankers may realize that allowing their best borrowers a chance to survive probably makes good business sense. It is probably best to suggest extending payment term rather than reducing the interest rate, which would directly impact the bank's income statement. To be judged a "best" customer, we should strive for a record on timely payments, quick response to any bank questions and (in the crisis) a well thought out written plan for survival and "catch-up" on bank interest and principal payments. Also, reduced sales may free up the need for working capital financed by bank loans. This money can be used to satisfy the banker or for other survival related purposes.
 12. *Income taxes*—During a crisis it is likely that companies will be incurring losses and therefore not owe any taxes based on income. In many countries, both Argentina and the U.S., the tax code allows for "loss carry backs" which will refund taxes paid in profitable years. If such carry backs are possible, they should be vigorously pursued. The extra cash recovered may be crucial to survival.
5. **The case says, "Within ten minutes George and Richard had agreed on a price of \$3.2 million, payable in cash by year-end. The price was exactly that proposed by Richard. The terms, however, differed. Richard suggested 20% of the purchase price each year for five years, interest free. George countered with an all cash offer, with a 5% cash discount price." George was very concerned with taking on debt in any form. Is it always wise to avoid debt? Use NPV to estimate what not accepting Richard's offer cost George, assuming the cost of capital was 9%.**

This question can be answered quantitatively by calculating each payment option's cash flows, then discounting to net present value to compare the cost of each. That analysis is shown below (all numbers in thousands of U.S. dollars):

Year	Discounted Price (DP)	Annual Payments (AP)	Delta CF (DP-AP)	9% PVIF	Discounted Delta CF
0	\$(3,040)	\$(640)	\$(2400)	1.000	\$(2400)
1	0	(640)	640	0.917	587
2	0	(640)	640	0.842	539
3	0	(640)	640	0.772	494
4	0	(640)	640	0.708	453
TOTAL	\$(3040)	\$(3200)	\$160		NPV=\$(327)

George's unwillingness to take on debt "cost" him \$327,000 in net present value terms. Following Ben Franklin's (and George's father's) advice, "Neither a borrower nor a lender be" was expensive, though for the risk adverse obviously worth the expense. We hope that Richard at least picked up the tab for the steak dinner?

More seriously, financial theory shows that, assuming assets earn a return higher than the cost of debt, increasing debt increases the expected profitability and return on equity. The negative aspect is that risk also increases, measured by variability of profit or return. As always in financial decisions, we are faced with a risk - return tradeoff. Those with high-risk aversion should minimize the use of debt, and accept lower profitability. The opposite advice is also valid.

6. **The case says, "Long ago George's father had impressed on him the need to avoid debt at all costs." From an accounting and finance standpoint, would you agree with the sentence: "Given George's abhorrence of debt the personal embarrassment of a Zeit bankruptcy was never a fear, even during the worst of the Argentine financial crisis."**

There are two kinds of "bankruptcy" that should be discussed from a personal embarrassment perspective—"Voluntary" (business liquidation) and "Forced" (court ordered liquidation to pay creditors.) A business can be voluntarily liquidated at any time for any reason, but the usual reason is that the future prospects are grim and that the business is worth more "dead" now than "alive" later. Further, no buyer can be found willing to pay a price for the going concern that is greater than the salvage value of the assets. Each reader will need to judge the personal embarrassment "quotient" of a business liquidation.

The court orders a forced bankruptcy when the company fails to pay its debts in a timely manner. By definition, if a company has no debt it has no creditors to force a bankruptcy. Therefore, on the surface, the quote seems to be true. However, if the business has substantial losses on its income statement and if those losses draw down cash, then when cash is exhausted, the business can be forced into bankruptcy as its suppliers and employees

go unpaid. The risk of embarrassment is reduced by an abhorrence of debt, but not eliminated, particularly during a financial crisis like the U.S. Great Depression of the 1930s or the Argentine collapse of the new millennium.

- 7. Look in the Internet for the 2001 2002 Argentine Crisis. Do you have any further information that permits a better description of the dimension of this social turmoil? In your opinion, what other index could be a good reference to visualize the real proportion of an international crisis?**

Through the Internet, visit www.google.com or www.yahoo.com and search for the paragraph: “argentine crisis 2001 2002”. You will find many articles and notes written about this issue. I recommend visiting the NYU web page and select (two or three at least): opinions, editorials or academic articles. <http://www.stern.nyu.edu/globalmacro/countries/argentina.html>

Another interesting web page would be the one belonging to Instituto Nacional de Estadística y Censos (INDEC). The INDEC is the Argentina official web page with many pieces of data about Argentina and its crisis. <http://www.indec.gov.ar> (choose English version)

On the other hand, the case selects representative index like Argentine GDP, domestic investment, inflation index, exchange rate, a social index like people below indigent and poverty standards and unemployment rates. Other interesting indices to study would be a five-years evolution of: GDP per capita, real (inflation free) and nominal salary index, interest rates, social structure and income distribution, automobile sales, cellular sales, retail sales, gas consumption, credit cards issues. Try to discuss in class the consideration of these indices and challenge the students to analyze new ones.

- 8. Assume that George’s son hired you to redefine a marketing plan for the extension of a new business unit: Security and Access Products and Supporting Software. Eduardo needed assistance in defining:**
- Marketing Segmentation,**
 - Targeting, Positioning,**
 - Value Proposal (Differentiation Strategy.)**

Every marketing strategy tries to match attractive opportunities to the Company’s goals and resources. In this case, Eduardo is searching for breakthrough opportunities for the Securities and Access Unit. Marketers have used segmentation, targeting and positioning as useful tools to detect profitable opportunities for a long time.

Segmentation: Market segmentation is a process by which marketing-oriented managers cluster people with similar needs or certain attitudes or characteristics into subgroups (segments). A market segment is a relatively homogeneous group of persons who would respond to a marketing mix offering in a similar way. Because none of the firms can satisfy everyone's needs, market segmentation is fundamental in the Marketing Strategy. As a marketing consultant to Zeit, you should work on a two-step process:

- a) Naming product markets,
- b) Dividing the product market based on segmentation criteria.

Firstly, the company should describe adequately a market. A complete market definition includes a four-part description:

Product type (describes the services and/or goods that customers want –access and visitor control business.)

Customer needs (refer to the needs the product type should satisfy for the customer. Product types usually provide functional benefits such as warming, transporting, etc –in this case; protecting. Although the basic needs definition, marketers should study the economics and emotional needs.)

Customer Type (refers to the final consumer or user of a product type-organization consumer.)

Geographic area (where the firm competes for customers. –Argentina and Uruguay.)

Secondly, marketers could divide the chosen market through two criteria

- 1) Possible segmenting dimensions for consumer markets:
 - Geographic: region, city size, metropolitan area, density, etc.
 - Demographic: gender, age, race, life stage, residence tenure, marital status, family size, ethnicity, etc.
 - Socioeconomic: income, education, occupation, social class, etc.
 - Psychographic: personality, values, lifestyle, etc
 - Needs: economic, functional, social, psychological, etc.
 - Thoughts: favorable or unfavorable attitudes, interests, opinions, beliefs.
 - Rate of use: heavy, medium, light, and nonusers.
 - Purchase relationship: positive and ongoing, intermittent, no relationship, bad relationship.
 - Brand Familiarity: insistence, preference, recognition, non-recognition, rejection
 - Kind of shipping: convenience, comparison-shopping, specialty, none.
 - Type of problem solving: routine response, limited, extensive.
 - Information required: low, medium, high.

- 2) Possible segmenting dimensions for business markets:
- Demographic: geographic location –region, country, and urban-, size –number of employees, sales volume- type of industry, etc.
 - Type of customer: manufacturer, service producer, government agency, military, nonprofit, retailer, etc
 - Kind of relationship: strong loyalty to vendor or weak loyalty, etc
 - Type of buying situation: decentralized, straight re-buy, etc
 - Purchasing methods –vendor analysis, sampling buying, long-term contract, negotiated contract.
 - How customer will use product –installations, components, accessories, raw materials, supplies, and professional services.
- Marketers should choose the most useful variables in order to define a proper and useful segmentation. Try to discuss in the lecture which criteria would be the most suitable segmentation for Zeit and work in groups with its market segmentation.

Targeting: Once you have a well-defined picture of markets segment, you should choose the most attractive targets among many possible target markets. There are three basic ways to develop market-oriented targeting:

The single target market approach: picking one of the homogeneous segments as the firm's target market.

The multiple target market approach: picking two or more homogeneous segments as the firm's target market and treating each as separated strategies.

The combined target market approach: combining two or more submarkets into one larger target market as a basis for one strategy.

The firm should choose their proper marketing targets considering the targets need, the Company's objective and resources as well as competitors. Ideally, good market segmentation should consider the following criteria:

Homogeneous: the customers in a market segment should be as similar as possible with respect to their response to the marketing mix variables.

Heterogeneous: the customers in different segments should be as different as possible with respect to their response to the marketing mix variables.

Substantial: the market segment should be big enough to be profitable.

Operational: the segmenting dimensions should be useful for identifying customers and deciding on marketing mix variables.

Positioning: Once the organization defines its targets, it is time to create a differentiation strategy and to position it in the customer's mind. A differentiation strategy means the marketing mix is distinct and better than what is available from a competitor in every chosen segment. Positioning refers to how customers think about proposed and/or present brands in market. A marketer needs a realistic view of how customers think about offerings in the market. Without that, it is hard to differentiate. Through the segmentation, targeting and positioning process, the company can fine-tune the whole marketing mix.

Value Proposal: Zeit could provide superior value to their target and achieve a competitive advantage through differentiation in three key factors:

Their background –more than 50 years in the industrial sector all over the country,

Quality of their products and state-of-the-art technology,

Excellent and responsible technical service based on responding precisely and on time technical question and commercial requests –off-line and on-line solutions- as well as offering post sale services through one year warranty from the day it was sold (any repair free of charge and provision of adequate technical service and supply of any spare pieces)

It is important to remember that a competitive advantage only succeeds if the firm provides a superior value and satisfies customers better than competitors.

9. **The case uses a number of American idiomatic expressions: “beat the brush” (on p. 6), “gravy” (on p. 7), “under his thumb” (on p. 8) and “antsy” (on p. 10). Do you agree with the following statement? “Using idiomatic expressions in international business is a good thing. It helps our foreign colleagues to understand the richness of our language.”**

We do not agree with the statement! The purpose of business communication is to allow the other party to unambiguously understand our position, questions or concerns, and for us to understand them. Anything that takes away from that goal is counter productive. Communicating with foreigners in international business is difficult enough. Avoid idiomatic expressions, slang and acronyms (like “IVA” (Impuesto al Valor Agregado) = VAT (Value Added Tax) and “IRS” (Internal Revenue Service = “AFIP” (Administracion Federal de Ingresos Publicos), the U.S. “tax man.

For information, the American idiomatic expressions can best be translated as follows: “beat the brush” = “search for”; “gravy” = “unexpected extra profits”; “under his thumb” = “under full control” and “antsy” = “extremely nervous.”

- 10. George’s friend Felix suggested that tax evasion might save Zeit from failure and could be rationalized as the lesser of two evils. Would you recommend that George take his advice?**

Business ethics is a subject that is viewed differently in different parts of the world. The company not only scrupulously following the law, but also doing what is “right” in all circumstances can best define the Western perspective. The two conflict only when the law is “unjust.” No rational person can consider the Argentine taxes of this period to be unjustly imposed on business. Therefore, ethics demands that they be paid both because it is / was the law and it is the right thing to do. Ethics forbids a decision taken because, “the ends justify the means.”

Sometimes the result of being ethical seems counterintuitive or counterproductive to business goals. That is a very good reason for ethical dilemmas to be discussed in business schools. The case study method is an excellent venue for that discussion.

- 11. Assume that George hired you in order to determine whether to sell Zeit or to keep it. What piece of advice would you give? Prepare a written business proposal to inform him.**

We suggest the following memo.

Mr. George Brown,
President of ZEIT SAIC

Dear Mr. Brown,

Thank you for choosing my professional services. As one of the leaders in the M&A advisory industry, I can assure you that my services will not disappoint you. I would like to approach you with this business proposal in order to assist you in the Zeit M&A decision process. For reasons I am sure you will understand, I ask that you keep this letter confidential and avoid it falling into the hands of third parties.

I would like to take this opportunity to briefly comment to you that selling a business is arguably one of the most important and difficult events in a business owner’s career. The business transfer process is often made more complex and arduous because the parties do not understand the

steps involved. I believe the attached checklist will lay the foundation necessary to guide you through the business transfer process.

Recommended Business Transfer Process Check List:

- 1) Identify the reasons why you are selling your business. The most common are the following:
 - Gaining personal liquidity.
 - Planning your retirement.
 - The business requires capital to grow.
 - The business needs more than money to grow.
 - The business is not financially viable.Please discuss openly with your family the dimension of such decision. Take your time and think it over carefully.
- 2) Once you choose your motive and everybody agrees on it, look for an intermediary who can help you initiate the sale effort, value the business being sold, set the appropriate asking price and the structure of a transaction that would be most advantageous to you. The intermediary is in a better position to do these things than the owner of the business. He is not emotionally tied to the business.
- 3) An expert in M&A Consulting is also an excellent source of knowledge of potential buyers.
- 4) The Company's financial records and operations must be evaluated and analyzed to determine the strengths and weaknesses of the firm. Proper planning will help to minimize any operational or financial risk during the negotiation process.
- 5) The Company's worth is calculated by the valuation expert, but remember that only the marketplace can determine what a business will sell for. Timing considerations, proposed transaction structure, industry and market conditions are all elements to consider in estimating the market value range for Zeit.
- 6) Generally, a business takes six to eight months to be sold. The sooner you define the previous steps, the shorter the time period should be.
- 7) Surveys have shown that sellers who ask for all cash receive an average of 70% of their asking price, while sellers who accept terms receive on average 86% of their asking price. With reasonable terms the chances of selling increase dramatically. Most sellers are unaware of how much interest they can receive by financing the sale of their business. In some cases it can greatly increase the amount received.

Finally, I will help you decide how to price Zeit and how to structure the sale so it makes sense to you. I can assure you that I can find the right buyer for your business. As your M&A

consultant, I will be happy to answer any questions you may have regarding this issue. I eagerly await your reply.

Sincerely yours,
Joseph Smith
M&A Consultant

12. Supposed that Eduardo keeps the control of the company and he hired you to analyze a five years strategic plan. Prepare a written business proposal to inform him. Consider the following issues:

Definition of the Company mission, vision and values

a. Definition of the Company strategy according to its mission.

Determine the Company goals and its priorities. Consider these aspects: marketing, innovation, productivity, people development, social responsibility and profits.

Analyze the SWOT matrix (strengths, weaknesses, opportunities, threats.)

We suggest the following memo to address these issues.

Dear Mr. Eduardo Brown,
CEO of ZEIT SAIC

I am writing you in response to your earlier letter. I am fortunate to have the opportunity to present my ideas about Zeit's five-year strategic plan. I am also grateful to you for relying on me to advise you on Zeit's third generation succession process.

This five years strategic plan should serve a framework for important decision as well as provide a basis for more detailed planning. Some essential points should be consider during the strategic planning process such as:

- Mission, vision and values.
- Zeit's strategies.
- Zeit's goals.
- Zeit's SWOT.
- Zeit's action plan and budget.

The first step is to develop a realistic vision, mission and values for the business. The vision should be presented as a picture or image of the business in the near future you seek to create. By contrast, the determination of the mission expresses the nature, the reason for being or the purpose of a business. The mission provides an orientation or direction, not a checklist of accomplishments. The values are the way the company intents to live as it pursues it mission.

Proposed Zeit's Mission, Vision and Values:

Vision: Zeit will empower stakeholders to achieve their full potential and realize their dreams. Zeit would be a leading company in the integrated control and communication solutions business through a high quality services and state-of-the-art technology.

Mission: The Company devoted to providing the very highest quality, best technical and customer services and state-of-the-art technology. Serving as a model that socially responsible business can make a difference. Providing an enjoyable, productive and healthful workplace for all employees to recognize the obligations to stockholders by providing an excellent return on their investment.

Values: Integrity, dedication to excellence, respect to for the individual and the community. Secondly, it is time to develop the Company's strategy. The strategy is general rules and guidelines by which the mission may be achieved.

Proposed Zeit Main Strategies:

- 1) Launch a Rental Equipment system and ultimate quality support maintenance. The idea is to establish the key factors that made Zeit one of the leading companies in the past. Through the former, the company will be able to rent control access system devices to their wide range of customers. Through rental systems, both parties get several benefits. The customers get updated hardware and software and excellent technical support. Zeit receive an increasing and steady cash flow and loyal customers. Literally, the latter strategy is a fundamental condition for the success of the former. Without excellent and on-line technical support and software updating, nobody would trust Zeit as their strategic partner to implement control access solutions.
- 2) Invest at least 50% of their profit in R&D. Literally, Zeit learned from the past. The company leadership won't make the same mistake twice. A satisfied customer and competitive advantage demand important amounts of money in R&D. Thirdly, are the Company goals. These are specific time based measurements to be achieved by implementing strategies. Goals should be quantifiable, consistent, realistic and achievable. They relate to factors like:

Proposed Zeit's Goals for the next five years:

- Marketing: to grow the business at a challenging 10% per year.
- Innovation: to improve at least 25% of the products and services offering in market.
- Productivity: to reduce a 20% of fixed cost and to minimize the maintenance supporting time by 25%.

- People Development: to invest in coaching and people intellectual development for 100% of the payroll.
- Social Responsibility: to contribute 5% of pretax profits to charity.
- Profits: net profits of at least 15% of sales.

Finally, the SWOT analysis is a useful matrix that identifies and lists the firm's strengths, weaknesses, and its opportunities and threats.

Zeit's Strengths:

- Efficient Operations.
- Quality and Competitive Services.
- Healthy Financials.

Zeit's Weaknesses:

- Low Investment in R&D.
- Low Distribution Scale.
- Small Sales Structure.

Zeit's Opportunities:

- Competition from Imports Without Technical Support.
- Attractiveness of New Niches.

Zeit's Threats:

- Economic and Social Factors.
- New Technology.

As your strategy consultant, I will be happy to answer any questions you may have regarding this issue. I eagerly await your reply.

Sincerely yours.

Joseph Smith
Strategy Advisory Consultant

BADGER SERVICE & SUPPLY: PRICING STRATEGY, VALUE CREATION, AND CHANNEL DISINTERMEDIATION IN WHOLESALE DISTRIBUTION

**Jesse Frickenstein, Robert Welch University
James E. Finch, University of Wisconsin - La Crosse**

CASE DESCRIPTION

The primary subject matter of this case is pricing strategy within the context of complex interactions that have resulted from changes in three elements of the competitive environment: the commoditization of product markets, disintermediation in marketing channels, and a fundamental change in buyers' perceptions of value. Each topic is addressed within the context of marketing management. This case challenges conventional ideas about the value added by channel intermediaries and the role of pricing strategy in value creation. Secondary issues include globalization, e-commerce, and distribution strategy. This case has a difficulty level of four, appropriate for senior level courses. This case is designed to be taught in one class hour and is expected to require two hours of outside preparation by students.

CASE SYNOPSIS

Badger Service & Supply is a regional wholesale distributor of heating, ventilation, and air conditioning (HVAC) equipment in Wisconsin. The competitive challenges that threaten the firm's continued existence and the strategic alternatives available to them illustrate a crisis that confronts distribution companies in many sectors of the economy. Radical shifts in the nature of competitive dynamics are rooted in the globalization of product markets, disintermediation in marketing channels, and a fundamental change in buyers' perceptions of value. Badger's response to the havoc produced by these forces has relied heavily on revisions to the firm's pricing policies. However, chronic price dealing and other defensive pricing strategies over the past five years have accelerated the decline in profitability rather than curtailing it.

The commoditization of products, increasing emphasis on price as the almost exclusive basis for competition, the impact of e-commerce across a wide range of applications, and the growth of intense competition from foreign products can be observed in virtually every service- and product-oriented industry to a greater or lesser degree. At one time, wholesale distributors and other

channel intermediaries were regarded as immune from the direct impact of foreign price competition by virtue of both the value-added functions they provided and their proximity to channel end-users. The protective wall that being closer to the customer once provided is being rapidly eroded, however, as foreign competitors have pursued strategies to shorten distribution channels or eliminate independent intermediaries altogether. The solutions posed in this case study provide a range of useful alternatives for managers confronting these challenges.

INSTRUCTORS' NOTES

This case can be taught in several different ways. At the most fundamental level, students can be required to simply answer each of the seven questions posed by Dana Meeker at the end of the case. An outline of appropriate answers to these questions is provided at the close of this note. More advanced applications of the case will promote a wider array of discussions about the fundamental issues facing Badger within the context of other sectors of the economy. Having students role play the parts of various channel members has proven to provide a lively and valuable approach to teaching many dimensions of this case study.

LEARNING OBJECTIVES

- ◆ Help students understand the complex interactions between distribution channel choices and pricing strategy.
- ◆ Critically examine the value of the functions provided by channel intermediaries and the consequences of shifting functions from one channel member to another.
- ◆ Appreciate the significance of value creation and value-added services in setting pricing policies.
- ◆ Examine how enhanced global competition and the Internet have impacted distribution and pricing practices in the HVAC industry.
- ◆ Emphasize the need for firms in highly competitive markets remain adaptive to shifts in the technological and competitive environment.

SUMMARY OF CHALLENGES AND TRENDS

A number of challenges and trends within the HVAC manufacturer-wholesale supply chain have been identified within this case. These can provide valuable “jumping off” points for more in-

depth discussions about channel issues. Having groups of students role play the parts of different channel partners has been an effective way to get students involved in these topics. These issues include:

- ◆ *Manufacturers' opinions of the value of wholesale distributors are changing as both channel partners grapple with sales, profit, costs, and service issues. Manufacturers believe that wholesalers are not performing effectively to meet customer and market demands and wholesalers believe that manufacturers should be responsible for more channel/supply chain activities.*
- ◆ *Customer changes in channel preference and pricing/service demands are driving changes within the supply chain and channel relationships. Changes in channel preference (channel migration) are generally driven by actual or perceived differences in "added value". Wholesale organizations are caught in a trap as customers increasingly demand higher levels of support but are increasingly unwilling to pay for the value added (Dancer, 2003).*
- ◆ *Proliferation of competition, deflationary pricing pressure, and general economic pressure are forcing wholesalers to fight harder to minimize customer migration. In the competitive market, channel partners find it increasingly difficult to generate margin dollars from product markups. All are pressured to reduce costs and operating expenses while maintaining a heightened level of service.*
- ◆ *Both manufacturers and wholesale distributors are experimenting with alternative distribution and sales channels such as e-commerce. The number of organizations moving into this channel is putting increasing pressure on wholesale distributors to increase service to maintain customers. E-commerce and the Internet create price transparency in the HVAC marketplace. Contractors are able to quickly access competing prices from different vendors before placing an order. The power and ease with which this information can be quickly obtained pushes power down the channel towards the customer.*

Experts in the HVAC supply chain also point to a number of other trends that will affect pricing within the chain as well as channel relationships. These include the following trends:

- ◆ *The growing use of e-commerce and Internet sites by manufacturers and wholesale organizations has reduced the value of the sales force in the eyes of the customer. Customers can now quickly access information themselves without relying on a sales representative.*

- ◆ *With the growing trend towards e-commerce and use of the Internet as a sales tool, companies will need to strengthen operating systems and broaden the product line to meet the variety of demands. Companies operating on slimmer profit margins may be unable to afford the required upgrades to participate in this new channel medium.*
- ◆ *Customers are increasingly seeking strategic sourcing or integrated supply agreements with wholesale organizations. The result has been customers working together to increase bargaining power. The push towards integrated supply agreements gives a single distributor all of a particular customer's business in a particular product category. In exchange for this agreement, however, the wholesaler is forced or expected to deliver a higher level of service as well as "good" pricing. This push will force distributors to evaluate its pricing policies as compared to the level of service that is required to determine the level of profitability that must be achieved for the relationship to work.*
- ◆ *Wholesale organizations are beginning to feel a threat from 3rd party logistics providers (3PLs). Organizations offering logistical services nearly equal to that provided by many wholesale organizations are increasingly "moving inside the box" to form exclusive operating agreements with manufacturers. Assuming the roles of the traditional wholesale distribution supply channel and doing so in a more cost effective and efficient manner, these organizations are creating incentives for manufacturers to reconsider the channel role of wholesale organizations.*
- ◆ *Customer relationships are becoming increasingly critical as competition within the general HVAC market increases and as the commoditization of the product line increases. Both manufacturers and wholesale organizations must focus intently on their customers' needs and desires as they move forward. Failure to do so will mean rapid customer migration towards those willing to offer superior service and to those able to do so at a lower relative cost.*

STRATEGIC ALTERNATIVES

There exists a range of strategic alternatives for Badger and other distributors in comparable situations to consider. Effective options are those that recognize and address the complex interaction between pricing, channel strategy and value creation. When strategy is translated into practice, these strategic variables become inextricably bound and ultimately shape the firm's core business model.

Activity-Based Pricing

Wholesale distributors in many industries have used pricing models that rely heavily on granting quantity-based discounts. Large buyers receive price breaks based solely on the frequency and dollar-volume of their purchases. This approach fails to explicitly recognize that many large buyers are also disproportionately expensive to serve. An alternative pricing strategy would be to utilize a functional activity-based pricing model that “rewards valued behavior” such as “performing certain functions or desired activities” (Olsztynski, 2002). Under this model, distributors like Badger would bill customers according to how much it costs to service them, rather than simply how much they buy. To replace the volume factor in determining supply chain pricing, the organization would utilize factors such as inventory depth and breadth, sales effort, technical support and proficiency, and customer satisfaction. Instead of offering large discounts to customers based on volume goals, discounts would be offered to those who maintain consistently “high levels of customer satisfaction and are committed to building up their service infrastructure” to better service the available customers in their respective market.

For a wholesale distributor to make this strategy work, it would first have to establish a “street price” for each product – a price that covers variable product costs, including an estimate of the costs required to service the product before and after the sale. From that street price, various discounts would be offered based on customers’ participation in company-sponsored programs. If, for example, a customer met specified levels of inventory, sales, advertising, customer satisfaction, and technical proficiency, discounts of up to 15% off of the street price could be offered. If customers completed a specified training program related to servicing the equipment, an additional discount could be offered. Buyers who placed orders utilizing a company’s e-commerce site could be granted other discounts. Each discount would be tied directly to a functional activity performed directly by the customer. Each is an activity that has the potential to directly reduce the variable costs a distributor realizes in marketing its products. By stocking more inventory, less frequent deliveries are required. By implementing advertising and promotional campaigns, the customer is creating greater brand awareness. By completing training programs, the demands on wholesalers’ technical service personnel would decline and warranty claims would be reduced. Finally, by utilizing a company’s e-commerce site to place orders, less customer service time is required to process a customers’ order.

Fee-For-Service Pricing

This pricing model encourages wholesale distributors to separate product costs from the distributors’ costs of providing services. Under traditional pricing systems, these services seem *free* to customers as they are typically covered by the margin realized on product sales. By separating the product cost from the service costs, the wholesale distributor demonstrates to the customer the

true value of the service that is provided. In moving to this type of pricing strategy, wholesalers must be able to deliver value to customers and must be accountable for guaranteeing the promised level of service if the customer is to recognize the benefit of the system. Customers in turn will demand guarantees of service that will help them realize productivity gains, labor savings, ergonomic improvements, or faster times to market. Working with customers to offer custom-tailored services that will make them more efficient and profitable fosters a partnership mentality. Using service as the basis for differentiation in industries where products have grown increasingly commoditized is an essential strategy.

Value-Added Pricing

For wholesale distributors, value-added activities have traditionally formed the foundation of the argument justifying their value-based pricing strategy. Attitudes toward that value proposition and the wholesaler's role in the supply chain are shifting however. New channel alternatives, an increasingly competitive market environment, and new customer demands are forcing manufacturers to reevaluate the actual value added by the wholesale distribution supply chain. "Wholesalers are pushing work back up the channel to manufacturers. Manufacturers are now expected to create demand, monitor inventory, ship direct, and provide competitive prices. At the same time, wholesalers expect to earn the same margins. It is no wonder that manufacturers are questioning the value that wholesalers provide" (Ruppersberger, Failer, Fein, 2000).

Many of the problems confronting distributors have roots in their failure to demonstrate real value to both manufacturers and customers. Wholesalers need to move customers away from the focus on price and towards an understanding of value. This requires identifying those services that are most important to customers and those for which customers are willing to pay a premium. From this perspective, distributors need to evaluate and manage the services they provide as a "product portfolio."

E-Commerce Innovations

Wholesale distributors are increasingly squeezed between the competing needs to reduce operational costs while maintaining or increasing customer service. As competitive, price-driven markets have forced down prices and margins, organizations must do more with less. E-commerce may be an essential part of the strategic mix if wholesalers hope to maintain their position as an important part of the HVAC channel. Though many wholesalers regard the Internet as an evil, it is increasingly becoming a necessary evil. Due to the price transparency it facilitates, it drives power down the channel towards the customer. Nonetheless, the technology and the medium are here to stay. Wholesale organizations must learn to use the technology to their advantage and to

demonstrate to customers their commitment to providing the highest level of customer service and product support.

The Internet also has the potential to reduce the variable costs associated with the sale of products. The challenge to any wholesale organizations in price-competitive markets is to drive costs out of the supply chain by improving organizational efficiency, productivity, expediency, and accuracy. In addition to improving customer service, technology solutions can help managers track and manage inventory, monitor and process electronic commerce, and control all company logistical matters. Radio Frequency Identification (RFID) technology is one of many technologies that can help wholesalers improve supply chain management and increase the level of customer service.

Industry Consolidation

The HVAC industry is characteristic of a general trend in many sectors of the economy. It is experiencing consolidation at the manufacturing, wholesale, and contractor levels of the supply chain as players push for greater economies of scale and increased buying power. All channel levels are striving to reduce transaction and procurement costs. For wholesale organization, one option would be to form or join a “buying group” to command better pricing from manufacturers, cut costs, and invest in new services. In some industries, this type of cooperation has become an essential tactic in helping wholesalers counter similar moves by their customers. Additionally, this has the potential to create a powerful source of competitive advantage in their respective market that would be costly and difficult to duplicate.

Segmented Marketing

Wholesale distribution is often regarded as strictly a *volume business*. Typically, the primary measures of performance are market share and sales revenue. For HVAC wholesalers and others in service-oriented enterprises, however, profitability occurs in an inverse proportion to volume, because customers with the highest sales and service cost per revenue dollar will undoubtedly be at the low end of sales volume. The reseller markets with the highest volume and significant price sensitivity will maintain the lowest margins in a truly competitive marketplace.

A segmented marketing approach requires sellers to focus only on those customers with goals and objectives that complement those of the wholesale organization. The inherent tradeoff is that wholesalers must be willing to accept lower sales in exchange for greater profitability and be able to make decisions about which customers to pursue and which ones to leave alone. Wholesalers need to prioritize segments based on their ability to generate profitable sales by targeting customers within the most attractive segments.

CONCLUSIONS

While the ostensible focus of this case study is one HVAC wholesale distributor, the competitive threats facing Badger illustrate a crisis that confronts distribution companies in many industries. Although the specifics of every company's circumstances are unique, the strategic alternatives offered in response to Badger's dilemma have applications for many other firms facing similar challenges. The commoditization of products, increasing emphasis on price as the almost exclusive basis for competition, the impact of e-commerce across a wide range of applications, and the growth of intense competition from foreign products can be observed in virtually every service- and product-oriented industry. Channel migration and disintermediation have increased the pressure on channel members to shift responsibilities within the supply chain and exerted pressure on all organizations to reduce service and distribution system costs. E-commerce and pricing transparency have empowered customers and reduced the relative importance, if not the necessity, of channel intermediaries in many sectors of the economy.

In naïve terms, the essential problem confronting Badger can be identified in the profit equation: Total Revenue – Total Cost = Profit. However, at the core of the strategic alternatives posed within this study is the Value Equation: Perceived Benefits / Price = Value. For wholesale distributors, value-added activities have traditionally formed the foundation of the argument justifying their value-based pricing strategy. For all of the reasons identified in this case study, buyers' recognition of distributors' value has been substantially eroded. Evolving channel alternatives in an increasingly competitive market and new customer demands are forcing manufacturers to reevaluate the actual value added by the wholesale distribution supply chain. Consequently, the strategic alternatives posed in this study have at their core the creation, promotion, and delivery of value.

Another characteristic of the strategic alternatives facing Badger is that none alone is necessarily sufficient to address the firm's problems. The threats confronting the firm are multi-dimensional – encompassing pricing, distribution, promotion, positioning, and segmentation issues. The solutions must be correspondingly comprehensive in scope. An amalgam or composite of strategic shifts will be required.

Too frequently, managers aim to optimize the performance of one variable or one segment of the company while ignoring others. Wholesale distributors like Badger cannot afford this overly simplistic or narrow perspective. It will not be enough to implement a functional activity-based pricing model while ignoring customer needs and demands. It will not be enough to explore and define customer preferences without moving forward to implement technological solutions that will improve organizational efficiency and effectiveness. Finally, it will not be possible for any player in the channel to succeed if the critical connections and dependencies between channel partners are not understood by all. If the contractor does not see the value in his relationship with his supplier and the supplier does not see the value and importance of his relationship with the manufacturer, the

only driver left in the chain will be price. Every partner in the channel must focus on creating and adding value to the distribution process. The failure of any channel member to contribute to the creation of value may result in irreparable breaks in the supply chain.

ANSWERS TO END-OF-CASE QUESTIONS

1. What forces are contributing to the pressures that have forced Badger to drop prices?

Very competitive global market, need to lower prices to stay competitive.
Diversification of distribution channels, need to keep market share
Everybody has the same quality products, prices are the only way to compete
High inventory and low turnover for some products. They have to get rid of them.

2. Have new channel options for the distribution of HVAC products impacted Badger's pricing?

The new channel options did impact Badger's pricing. The market is changing and manufacturers are trying to deal directly with consumers and/or contractors. The pressure on Badger is to cut their margins to stay competitive. The more intermediaries you have in a distribution channel, the more margins increase the final price. If manufacturers deal directly with the end users, they have the option to set lower prices without adversely affecting their own profit margins.

3. Are changes in manufacturer's attitudes toward the value of wholesale distributors hurting our business?

Manufacturers are questioning the utility of the wholesalers. Many of the functions that wholesalers used to perform (advertising, repairs, etc) are being shifted back to the manufacturers. That's one of the reasons that manufacturers are exploring new ways of selling their products directly to end users.

4. Are there value-added or channel management strategies that Badger can implement to counteract changing attitudes about the value of distributors?

One option would be to create and manage a large network of HVAC contractors in order to create a powerful buying pool. Their relative buying power would allow them to buy in larger volumes at lower prices. In turn, the supplier's reputation would rest directly on the level of service they provided to the network.

An alternative would be for Badger to sell directly to end users. In this way, they could extend their scope of business operations by leveraging their purchasing power as wholesalers. This would allow them to capture contractors' margins while providing a comparable array of services to the end user segment.

5. Can Badger demonstrate real economic value in the HVAC industry?

Badger's position in the HVAC industry may belong more to the past than to the future if they do not change their business model. As indicated above, diversification could be one solution ... combining wholesale and contractor functions in order to reach a wider market. The Activity-Based Pricing, Fee-for-Service Pricing, and Value-Added Pricing alternatives discussed in the preceding section provide less radical means of demonstrating economic value and value-added.

6. Is there a pricing strategy that can reverse the course of Badger or is the problem much larger than that?

This question is at the very heart of this case study. The options discussed in the Strategic Alternatives and Conclusions sections of this Instructor's note examine the efficacy of these choices.

7. Will the pressure of ever-increasing demands for cost-control measures and greater efficiency ultimately make Badger obsolete?

The answer to this question is subject to wide disagreement. The functions performed by wholesale distributors and supply companies, however, can not be eliminated. The question ultimately becomes, who will perform those functions? The drive toward ever-greater economic efficiency and the manner in which distributor functions are shifted and shared will ultimately determine the fate of Badger.

WHITTAKER MEMORIAL HOSPITAL

Edwin L. Makamson, Hampton University

CASE DESCRIPTION

The primary subject matter is strategy under adverse conditions for a small community hospital. The case examines operational, financial and market factors for strategy development. Issues of governance and stakeholder claims for a non-profit, community organization are also examined. As a student case analysis assignment the case is appropriate for an undergraduate capstone course in business policy presented in the context of strategy for non-profits, single business strategy, or governance topics, and for a senior or master's level course in health case management. While class presentation depends on the instructor's choice of scope of the subjects covered, a full discussion and analysis can be rendered within a 50 minute period. A student should anticipate a 2-3 hour commitment to complete the case questions.

CASE SYNOPSIS

Whitaker Memorial Hospital is a small community hospital created to serve the health needs of the African American community in the early 1900's. The hospital has over time expanded but by the 1980's has experienced declining demand and growing financial problems which result in an attempt to reorganize under Chapter 11. The Hospital Director Dr. Bryant in 1995 has successfully led an attempt to save the hospital from a merger by contesting the authority of the sitting board and pledging to continue the hospital's operation as a community institution.

The case narrates in background the history of a unique American institution, the African American hospital, and traces through the case of Whitaker Memorial the complexities of surviving in a changed society. The case presents the hospital's difficulties with management, operations, and changed market conditions. As the original "community" of the East End has changed by 1995 the issues of "Who is the 'community' served by the hospital?" and "Who has a claim to govern the community hospital?" are raised and resolved in the narrative.

INSTRUCTORS' NOTES

RECOMMENDATIONS FOR TEACHING THE CASE

Although the case has been used in an introductory management course for class discussion to introduce issues of governance and stakeholder theory, the case is constructed for delivery in a

senior policy course, or comparable course, to take advantage of interrelated information that can be brought to bear on strategic decision making by an executive facing overwhelming problems. Because the case engages issues of production capacity and utilization, financial analysis, operating an organization under Chapter 11, and requires integration across these topics, it is a case appropriate for inclusion near the end of the course or within a module on strategies for non-profits.

In introducing the case for class discussion after students have read and provided their own analyses, I start with the statement and question:

1. Community, non-profit organizations such as Whitaker Memorial Hospital unlike corporations which are owned by stockholders and unlike privately held business are “owned” by whom?

If the instructor’s institution is not a state school, another approach is to start the case with the question, “Who owns (school name) University?” The question of ownership for community organizations is an issue most students have not contemplated and as the case demonstrates is not always clear. Students often cite the Board as the “owners.” This is an opportunity to compare the role of a corporate board fiduciary responsibility to stockholders and that of the non-profit organization’s board to its community. We look to the organization’s Board to articulate “community interests” and the concern is not typically measured by stock price, sales, or profitability. How much focus you want to give the subject will depend on your course plan, but this issue can move to related issues. One might ask, “How does one gauge that the Board is acting in a fiduciary and responsible manner with respect to its community?” This discussion may include such elements as degree of community voice or participation on the Board; extent to which the Board communicates or surveys community opinion of strategic matters; consistency of Board actions with the organization’s mission; personal conflicts of interests by Board members (acting for personal gain rather than community interests); and, performance.

The issue of stockholder suits against corporate boards could be engaged here. The business press usually provides information to construct this discussion, or an instructor might refer to recent, contentious stockholder fights at Disney and Hewlett Packard to illustrate parallels with the suit against the hospital board.

Focusing on definition of community can miss a larger stakeholder issue. This discussion question can be omitted if the instructor has covered it with a prior case:

2. Who are the hospital’s stakeholders and how are their interests and claims satisfied?

As students identify each group I list each stakeholder, discuss and assess the corresponding interests:

Stakeholder	Interests
Residents of the East End	Originally residents formed an Association to meet needs for hospital services not otherwise available. Today their interests may be availability of the neighborhood health services and pride of community ownership.
African American Community and physicians	The wider community by 1980's is not connected to the hospital. It is not the closest hospital. Those with health care professions, including physicians, find jobs in other hospitals. There is likely a sense of loss for a historical institution.
Management	Management has an interest in continuation of the organization. (What is to be made of the frequent turn-over of administrators?)
Employees	We expect that employees (nurses) will be interested in the survival of the organization. There are different, collective interests in pay and security illustrated by calling in "sick" when employees were laid off.
Suppliers/Venders	These are business with their own interests. While the hospital is a buyer its bankruptcy illustrates the risk that suppliers assume. Ought community businesses be expected to support another community enterprise in financial distress?
Financial Investors	Hospital bonds were held by private investors. These were guaranteed by the federal government who now has a major stake in the hospital.

At the conclusion of this discussion the student should have an understanding of "community ownership" and the fiduciary responsibility of the Board to stakeholders. I then assess students' understanding of the nature of what it means to be a "non-profit" business by asking:

3. By the mid-1980's it is obvious that the hospital is in dire financial straits. As a "non-profit" hospital why should this be a problem?

I pursue this issue only when students indicate they failed to learn the requirement for financial sustainability and emphasize that the for-profit and the not-for-profit organization must realize revenues in excess of costs. For the for-profit firm earnings are either distributed to owners (as dividends) or retained for future growth and operations. Not-for profit enterprises must generate income to meet expenses and any excess is retained for future growth and operations. While the taxes of a business operating under an Internal Revenue Service tax-exempt status (Section 501(c)(3)) may be an advantage for a community organization, this does not suspend the need that to sustain an enterprise there must be income to cover costs. As the case demonstrates non-profits can become bankrupt.

4. Describe the forces that explain the early success of Whitaker Memorial Hospital. To what do you attribute the hospital's later decline?

The first Whitaker hospital was created to provide medical services to people either denied admission to “white” hospitals or admitted to racially segregated hospital wards. It also provided a resource to African American physicians as they were denied admitting privileges to “white” hospitals. (An instructor may wish to develop this subject to discuss the implications for “Jim Crow” laws on the development of business in the African American community and the state of these enterprises today.)

Desegregation in the 1960's created social change. African American doctors joined the medical staff and gained admitting privileges at previously “white” hospitals, and they referred their patients to these facilities. Patients exercised their choice for where they would be admitted. Since desegregation removed housing restrictions and the region grew economically and in population, there was a demographic shift away from the East End location of the hospital. The hospital by the 1970's was surrounded by an impoverished neighborhood. The impact of desegregation on the number of African American hospitals nationally is evident: in the mid-1920s there were over two hundred black hospitals, in 1996 there were three such hospitals (Note: General Hospital is not listed):

Howard University Hospital	Washington, DC	Founded 1862
Norfolk Community Hospital	Norfolk, VA	Founded 1915
Riverside General Hospital	Houston, TX	Founded 1925
(Source: 1996 AHA <i>Guide to the Health Care Field</i>)		

Increased hospital competition for patients affected Whitaker Memorial Hospital. Hospital care to the poor historically was written off as “bad debt.” Medicare and Medicaid changed this. While hospital reimbursement from these sources has been near a hospital's cost of providing the service, Medicare and Medicaid coverage encourages a hospital to fill unutilized beds. Since all hospitals in the region are not operating at capacity, there is a strong incentive for them to compete for Medicaid and Medicare admissions, undermining Whitaker Hospital's reliance on this category of patient revenues.

Responsibility for the hospital's deteriorating situation must also be borne by the Board and management. There were missed opportunities.

5. If you were the hospital administrator prior to bankruptcy, what actions or decisions would you have made to avoid further financial decline? Explain your recommended action.

The case illustrates the frantic responses typical of a stressed enterprise: layoffs, financial belt tightening, and schemes that are not practical. Students may develop ideas that should be discussed. The most commonly offered actions are: (1) Convert the hospital to a psychiatric or drug abuse treatment facility. While this might require re-licensing of the hospital, the idea has merit because demand is increasing. (2) Sell to the physician investment group. Private investors would be motivated by profit potential. The doctor group provides a ready source of patient referrals. The group is largely African American and would maintain the historical community identity of the hospital. (3) Merge with Riverside. It is not clear that Riverside would be committed to any permanent facility in the East End. The action could entail transfer of the hospital's liabilities ending the financial crisis and forestalling bankruptcy. (4) The hospital requires an infusion of capital. Students may entertain possible sources but given the financial state of the hospital private funding seems unlikely. The city historically has assisted the hospital, for example with bond issues. Assumption of hospital debts and responsibility to manage the hospital given that there are other hospitals in the city and nearby are not likely actions by the city. (The hospital did ask the city for assistance and received a modest donation.)

A follow up question to ask is: Why didn't the Board take these actions? The case makes it clear that community control was the guiding principle. When the board proposed to merge with Riverside an opposition group emerged to contest the legitimacy of the board.

6. Given Dr. Bryant's commitment to keep the hospital operating, what are his options? Use the case data to assess the hospital's capabilities and option. Develop a recommended strategy.

This question is the foundation for rigorous analysis of the case. I suggest that it be developed in two steps of an examination of interior or organizational factors and of external factors. For the internal assessment of strengths and weaknesses I proceed with asking, "What does General Hospital offer that is (1) valuable, (2) rare, (3) non-imitatable, and (4) can be exploited by the organization?"

Valuable resources: The ability to provide care is valued. The hospital location and provision of neighborhood clinic services is valued by the East End. The psychiatric and drug abuse services have value. The hospital's institutional legacy has historical value. Of these, the fact that this is a hospital has most financial value potential that has not been realized in the recent past. The financial resources of the hospital have been exhausted and the future revenue stream is questionable. The issues to examine are: Is the historical legacy sufficiently strong to induce doctors to admit patients to General Hospital? Is there sufficient potential for development of neighborhood clinic services or drug rehabilitation services?

Rarity of resources: Because resources and capabilities are available elsewhere, these are not rare. The history of the institution is rare but may not translate to financial value.

Imitability of resources: This is not the only hospital in the area. Area hospitals have unused capacity (see hospital utilization data, Table 3). If there is sufficient value of an East End neighborhood clinic this can be usurped by other hospitals, private physician groups, or city health services. Other psychiatric and drug abuse care providers are in the regional market (see Table 1). Most valued resources held by General Hospital are also held by other hospitals. The unique history of the institution is not imitable. Other existing facilities offer strong substitutes. This can be tested by asking students: "If you needed medical care and had an option of being admitted to any of the region's hospitals, which you choose?" "If you were a recent graduate of a medical school trying to build a lucrative practice, at which hospitals would you choose to practice?"

Ability of the organization to exploit valued resources: A quick examination of the financials is illuminating. Students may focus on the growth in revenues as promising, but you might remind students that this includes charges for services delivered but not yet actually paid. Profitability measures are improving (1994 ROS = -.088, 1995 ROS = -.07), but the hospital is not profitable. The liquidity ratio is acceptable (1995 CA/CL = .68), but an examination of current assets shows that accounts receivable account for more than half of revenues (1995 AR/Revenues = .58). This is a concern because (1) receipt of cash is critical and delays in payments from patients and insurance will undermine an ability to operate and (2) many of these accounts may be "bad debt," uncollectible. It is not helpful to examine the hospital's leverage: There is nearly \$22 million in debts awaiting disposition under Chapter 11.

It is possible to construct a scenario from the financial data that could turn the hospital around. For example, assuming a 100 bed psychiatric operation with 100% occupancy, a per diem charge of \$650, in a year revenues would be near \$24 million. Assuming all patients were Medicare/Medicaid a 85% reimbursement of charges would yield income of about \$20 million. Costs could be expected to be less than the costs for general medical-surgical care, and profits could be improved. The problem with this kind of reliance only on the financial information lies in an examination of market conditions.

The hospital's environment (Opportunities and Threats) is hostile to the hospital. The greatest concern is evident in Table 3. A casual examination of the number of hospital beds in operation with the average daily census makes it clear that there is considerable unused capacity in the region. Students can estimate average hospital occupancy by dividing the Average daily Census by Total Operating Beds at each hospital to confirm this. Added to this is the observation that the larger hospitals (Riverside and Sentara) have reduced the number of beds in operations in the period 1980-1994. Mary Immaculate has increased hospital beds and Sentara has announced its intent to open a new, larger facility. An unexpected increase in population might mitigate this, but Table 4 (a four year population growth of about 8%) does not support his optimism. These facts will lead to intensified competition for patients. Among hospitals competition typically means competition to encourage doctors to admit patients to a preferred hospital and, recently, by channeling patients to preferred providers (doctors and hospitals) through hospital based insurance plans and agreements

with insurance providers. Also, the market for psychiatric care is not favorable. Table 1 reports that psychiatric care faculties have entered the regional market. The poor financial performance of existing psychiatric facilities undermines the logic of General Hospital's development of this service.

When all suggestions offered by students for reorganizing General Hospital have been discussed, consider: *What might be a feasible exit strategy for NNGH?* This, likely, will turn the discussion to issues already covered, but rejected by the community: merger or selling to investors. It is likely too late. This is an enterprise that is burdened with considerable debt that few investors or other hospitals would seek to assume.

EPILOGUE

General Hospital continued to operate through the summer of 1997 with a deteriorating financial position. The city provided funds to meet payrolls and purchase supplies. At the end of the summer the State Department of Health made a surprise visit to investigate conditions and ordered the hospital closed. There were insufficient funds to meet the final payroll. The Board promised that the hospital would be reopened. In 2005 the hospital was still closed.

THE WESTERN NORTH CAROLINA PLAYHOUSE

Philip L. Little, Western Carolina University
Beverly L. Little, Western Carolina University

CASE DESCRIPTION

The primary subject matter of this case concerns managerial accounting cost behavior concepts. The case has a difficulty level of five, appropriate for first year graduate students. The case is designed to be taught in 3 class hours and is expected to require 5-6 hours of outside preparation by students.

CASE SYNOPSIS

This case requires students to apply managerial accounting concepts beyond the traditional manufacturing/production problems, by having them make recommendations to a regional playhouse as to how many plays to produce (evening v. matinee), how much to spend on those plays, and how to raise outside funds for renovation.

INSTRUCTORS' NOTES

The WNCP Board has asked your consulting firm to assist them in preparing the three-year planning report, 2005-2007. The Board has suggested the following format for the report:

Executive Summary

Western North Carolina Playhouse
Executive Summary

The Have Briefcase Will Travel (HBWT) Consulting Group was engaged to prepare reports for the Western North Carolina Playhouse (WNCP) to aid the organization in deciding on the best schedule of performances for the three years 2005-2007 that will provide the maximum cash flows from ticket sales and help the organization to determine how much money they need to raise from outside contributors. HBWT used data provided by WNCP to prepare the reports and perform the necessary analyses.

HBWT performed a cost/volume/profit analysis to determine the best mix of performances to ensure the maximum cash flows to the WNCP. Also, data are provided from the

cost/volume/profit analysis that shows how many performances are necessary in order to cover the direct fixed cost of each play. A cash flow budget for the 2005-2007 planning period was developed from the mix of performances indicated by the cost/volume/profit analysis. The cash flow budgets for each year in the planning period indicate how much money WNCP will need to obtain from outside contributors.

Recommendations were developed to inform the company of the best schedule of performances for the 2005-2007 planning period as well as requirements for outside contributions. Also, additional recommendations were developed regarding special issues. All of the recommendations were developed using estimates of attendance and costs that are uncertain. HBWT makes no assurances about the quality of the estimates. Accordingly, actual results may vary from expectations.

Cost/Volume/Profit Analysis

1. Spreadsheet showing revenues, variable costs, and contribution margin per evening and potential matinee performance for each play

Solution: Cost/Volume/Profit #1

Play	Rev/Perf	Top Act/Perf	Oth Act/Perf	Oth VC/Perf	VC Per Perf	CM/Perf	Mat Rev/Perf	CM/Mat
Bay at the Moon	19950	9000	300	320	9620	10330	7600	-2020
Beat	19950	6000	0	320	6320	13630	7600	1280
Beautiful Woman	19950	9000	200	320	9520	10430	7600	-1920
Bill of Rights	19950	9000	0	320	9320	10630	7600	-1720
Admissions	19950	9000	500	320	9820	10130	7600	-2220
The Bill Show	19950	9000	600	320	9920	10030	7600	-2320
The Box	17900	6000	500	280	6780	11120	6850	70
The Brightest Light	17900	6000	1800	280	8080	9820	6850	-1230
Cairo	17900	6000	900	280	7180	10720	6850	-330
Captain 11	17900	6000	1000	280	7280	10620	6850	-430
Cat and Mouse	17900	6000	200	280	6480	11420	6850	370
Chitterling Heights	17900	6000	600	280	6880	11020	6850	-30
Christmasless	17900	6000	400	280	6680	11220	6850	170
Circumference	17900	6000	0	280	6280	11620	6850	570
Counsellor Adams	17900	6000	700	280	6980	10920	6850	-130
Hate Mail	16450	3000	700	210	3910	12540	6300	2390
Hell to Pay	16450	3000	600	210	3810	12640	6300	2490
The Hidden Place	16450	3000	400	210	3610	12840	6300	2690
A Hole in the Dark	16450	3000	900	210	4110	12340	6300	2190

Play	Rev/Perf	Top Act/Perf	Oth Act/Perf	Oth VC/Perf	VC Per Perf	CM/Perf	Mat Rev/Perf	CM/Mat
A House of Cards	16450	3000	300	210	3510	12940	6300	2790
Dreaming of Norton	16450	3000	500	210	3710	12740	6300	2590
Eastwest	16450	3000	100	210	3310	13140	6300	2990
Eighteen	16450	3000	1500	210	4710	11740	6300	1590
Evergreen	16450	3000	800	210	4010	12440	6300	2290
Heights	14850	1500	800	140	2440	12410	5713	3273
The Coyote Bleeds	14850	1500	300	140	1940	12910	5713	3773
Cupid & Psyche	14850	1500	100	140	1740	13110	5713	3973
Dangerous	14850	1500	900	140	2540	12310	5713	3173
Debt	14850	1500	500	140	2140	12710	5713	3573
The Desk	14850	1500	700	140	2340	12510	5713	3373

2. Recommended schedule of plays per year that will maximize cash flows and satisfy constraints established by the WNCP Board

Solution: Cost/Volume/Profit #1 (supporting schedule)

Section	Evening Tickets	Matinee Tickets		
AAA	40	35		
AAA	30	25		
AAA	20	15		
B	10	5		
Play Category	AAA	AA	A	B
Cat 1	0.95	0.95	0.95	0.95
Cat 2	0.9	0.85	0.85	0.8
Cat 3	0.85	0.8	0.75	0.75
Cat 4	0.8	0.75	0.65	0.65
Number of Seats	100	200	400	300
	Cat 1	Cat2	Cat 3	Cat 4
Revenue Per Perform	19950	17900	16450	14850
Matinee	7600	6850	6300	5713
Number Top Actors	3	2	1	1
Salary	3000	3000	3000	1500
Top Actor Salary	9000	6000	3000	1500
Supporting	100	100	100	100
Rights	120	80	60	40
Orchestra	200	200	150	100
Total VC/Perf	9420	6380	3310	1740

3. Number of performances of each play required to cover the play's direct fixed costs.

Solution: Cost/Volume/Profit #3

Play	Category	Year	# Perf
Beat	1	1	20
Eastwest	3	1	20
The Coyote Bleeds	4	1	20
A Hole in the Dark	3	1	20
Dangerous	4	1	20
Eighteen	3	1	20
Circumference	2	1	15
Captain 11	2	1	5
The Bill Show	1	1	5
The Brightest Light	2	1	5
A House of Cards	3	2	20
Dreaming of Norton	3	2	20
Debt	4	2	20
Evergreen	3	2	20
Heights	4	2	20
Cat and Mouse	2	2	20
Counsellor Adams	2	2	15
Bill of Rights	1	2	5
Cairo	2	2	5
Admissions	1	2	5
Cupid & Psyche	4	3	20
The Hidden Place	3	3	20
Hell to Pay	3	3	20
Hate Mail	3	3	20
The Desk	4	3	20
Christmasless	2	3	20
The Box	2	3	15
Chitterling Heights	2	3	5
Beautiful Woman	1	3	5
Bay at the Moon	1	3	5

4. Amount of money that must be raised from outside contributors to cover the projected deficits for each year.

Solution: Cost/Volume/Profit #4

Play	CM/Perf	DFC	# Perform
Beat	14628	500000	34
Eastwest	13963	200000	14
The Coyote Bleeds	13653	100000	7
A Hole in the Dark	13163	200000	15
Dangerous	13053	100000	8
Eighteen	12563	200000	16
Circumference	12515	300000	24
Captain 11	11515	300000	26
The Bill Show	11028	500000	45
The Brightest Light	10715	300000	28
A House of Cards	13763	200000	15
Dreaming of Norton	13563	200000	15
Debt	13453	100000	7
Evergreen	13263	200000	15
Heights	13153	100000	8
Cat and Mouse	12315	300000	24
Counselor Adams	11815	300000	25
Bill of Rights	11628	500000	43
Cairo	11615	300000	26
Admissions	11128	500000	45
Cupid & Psyche	13853	100000	7
The Hidden Place	13663	200000	15
Hell to Pay	13463	200000	15
Hate Mail	13363	200000	15
The Desk	13253	100000	8
Christmasless	12115	300000	25
The Box	12015	300000	25
Chitterling Heights	11915	300000	25
Beautiful Woman	11428	500000	44
Bay at the Moon	11328	500000	44

5. A Year by Year Cash Flow Budget (include outside contributions from individuals and corporate sponsors)

Solution: Cash Flow Budgets

Cash Flow Budget: 2005						
Play	Category	Year	# Perf	Total CM	DFC	Net CM
Beat	1	1	20	325750	500000	-174250
Eastwest	3	1	20	345350	200000	145350
The Coyote Bleeds	4	1	20	354223	100000	254223
A Hole in the Dark	3	1	20	313350	200000	113350
Dangerous	4	1	20	330223	100000	230223
Eighteen	3	1	20	289350	200000	89350
Circumference	2	1	15	201413	300000	-98588
Captain 11	2	1	5	57138	300000	-242863
The Bill Show	1	1	5	55138	500000	-444863
The Brightest Light	2	1	5	53575	300000	-246425
Total				2325510	2700000	-374493
Other Fixed Costs						600000
Debt Service Principal						500000
Debt Service Interest						60000
2005 Deficit						-1534493
Outside Contributors:						
Individuals						610000
Corporate Sponsors						400000
Remaing Deficit						-524493

Solution: Cash Flow Budgets

Cash Flow Budget: 2006						
Play	Category	Year	# Perf	Total CM	DFC	Net CM
A House of Cards	3	2	20	337350	200000	137350
Dreaming of Norton	3	2	20	329350	200000	129350
Debt	4	2	20	346223	100000	246223
Evergreen	3	2	20	317350	200000	117350
Heights	4	2	20	334223	100000	234223
Cat and Mouse	2	2	20	260550	300000	-39450
Counsellor Adams	2	2	15	180413	300000	-119588

Cash Flow Budget: 2006						
Play	Category	Year	# Perf	Total CM	DFC	Net CM
Bill of Rights	1	2	5	58138	500000	-441863
Cairo	2	2	5	58138	300000	-241863
Admissions	1	2	5	55638	500000	-444363
Total				2277373	2700000	-422631
Other Fixed Costs						600000
Debt Service Principal						500000
Debt Service Interest						210000
2006 Deficit						-1732631
Outside Contributors:						
Individuals						610000
Corporate Sponsors						400000
Remaing Deficit						-722631

Solution: Cash Flow Budgets

Cash Flow Budget: 2007						
Play	Category	Year	# Perf	Total CM	DFC	Net CM
Cupid & Psyche	4	3	20	362223	100000	262223
The Hidden Place	3	3	20	333350	200000	133350
Hell to Pay	3	3	20	325350	200000	125350
Hate Mail	3	3	20	321350	200000	121350
The Desk	4	3	20	338223	100000	238223
Christmasless	2	3	20	252550	300000	-47450
The Box	2	3	15	186413	300000	-113588
Chitterling Heights	2	3	5	61138	300000	-238863
Beautiful Woman	1	3	5	57138	500000	-442863
Bay at the Moon	1	3	5	56638	500000	-443363
Total				2294373	2700000	-405631
Other Fixed Costs						600000
Debt Service Principal						500000
Debt Service Interest						240000
2007 Deficit						-1745631
Outside Contributors:						
Individuals						610000
Corporate Sponsors						400000
Remaing Deficit						-735631

Summary of Recommendations

Special Issues

1. **How would the recommendations change if, in a worst case scenario, the forecasted attendance was 80% of the original forecast?**
2. **What if the top name actors are paid one-fourth of the stated salaries plus 1% of the proceeds from ticket sales? Would this be a better deal for the WNCP? The actors? Support conclusions with detailed analyses.**
3. **What means of raising outside contributions could the playhouse pursue? Develop a detailed plan.**

Solution: Special Issues -- Renovation Contributions

The raising of contributions beyond box office is crucial to the servicing of the debt for the renovation of the playhouse. However, the renovation also provides a unique opportunity for such contributions. For the renovation, means of raising contributions include:

Special one-time corporate sponsorships of the renovation by corporations, interested businesses and historical preservation societies.

During the renovation, specific fund-raising events could be promoted. Seats, rows of seats, the stage, the curtain, paving stones, etc. could be offered for sponsorship by donors, corporate or individual.

On an on-going basis, previous and new sponsors can be sought. Opportunities for such sponsorship include:

Corporate sponsorship of the playhouse itself, at different levels. These sponsorships are recognized in the playbills every performance. This could be promoted as powerful advertising to particular clientele for businesses.

Corporate sponsorship of particular plays. These sponsorships are prominently displayed, perhaps even on the cover of the playbill, on the tickets and in the lobby.

Matching gifts from corporate sponsors, whereby employees' or local citizens' gifts are matched. This is similar to Public Television's matching donor program. Again, these are marketed as powerful advertising to particular groups.

Individual donors could be offered special event such as Preview Performances, Pre- and Post-season Galas, Dark Night performances. These might also include tickets to some number of events.

Capital or Endowment gifts. The gift that keeps on giving.

QUIK SIX CONVENIENCE STORES: THE ANATOMY OF AN EXPENSE REDUCTION PROJECT

Dennis Kripp, Roosevelt University
Carl L. Witte, Roosevelt University

CASE DESCRIPTION

The primary focus of this case is on the problem solving processes and tools used by a large retail organization as it attempts to reduce legal expenses and improve efficiency. Secondary issues include project management, teamwork, organizational behavior, and action planning, following the implementation of a new strategy. The case is appropriate for undergraduate and graduate level students. It is designed to be taught in a two-hour course segment and does require several hours of outside preparation by students. The case requires a good understanding of management practices and quality management techniques.

CASE SYNOPSIS

The Quik Six Company was a leading retail marketing organization and had over 10,000, company-owned and independent dealer, convenience retailing/gasoline stores throughout the U.S. Both Quik Six and the convenience retailing industry as a whole were going through a rough business cycle. Although the company had already launched major cost-cutting efforts, the efforts had to be accelerated.

The company identified one major problem area as excessive legal expenses. The top priority was to figure out the root causes of the higher legal expenses, recommend corrective actions, and do the work as quickly as possible. It was necessary to initiate a cross-functional project involving the core corporate retail marketing function and the legal department to address this issue. The objective was to reduce legal expenses by \$1,000,000 within the next six months, with an additional objective of enhancing the efficiency of the interactions between the legal department and the rest of the company.

The next step was the formation of a cross-functional team to develop and rollout a plan. The Quik Six organization had officially adopted and mandated a formal Project Management Process (PMP) including project templates which is described in the case. The team would be using this process to manage and carry out the "Legal Process Improvement Expense Reduction" project. The case covers the formation of the team and goes in detail through each of the steps in the Project

Management Process, as the team constructs a plan to reduce excessive legal expenses. The process culminates in the development of a well-defined action plan.

INSTRUCTORS' NOTES

Recommendations For Teaching Approaches

Questions are provided at the end of the case. They are intended to serve as a basis for in-class discussion or may be given as a homework assignment and subsequently discussed.

DISCUSSION QUESTIONS

1. What is the major problem that Quik Six is facing? What are the three actions they are taking to address the problem?

Both Quik Six and the convenience retailing industry as a whole were going through a rough business cycle. Demand for convenience products was currently stagnant, and prices were low due to steadily increasing competition. Even as the broader economy began to improve, the company saw little likelihood of an immediate recovery in the short-term for the industry. Although the company had already launched major cost-cutting efforts, the efforts had to be accelerated. The company was undertaking a three-tiered attack to improve earnings and cash generation.

- ◆ First, reduce current year's capital spending. A budget review is underway and a specific decision will be reached shortly.
- ◆ Second, intensify consideration of the sale of non-strategic assets, and
- ◆ Third, reduce operating and overhead expenses throughout the company.

2. What is the L-PIER project? Why was the project undertaken and how does it fit into the three major actions Quik Six is taking?

L-PIER stands for "Legal Process Improvement and Expense Reduction." The L-PIER project was undertaken to develop a high level plan to meet the objective of reducing legal expenses by \$1,000,000 within the next six months, with an additional objective of enhancing the efficiency of the interactions between the legal department and the rest of the company.

The project fits into the overall actions being taken by the company, as part of the move to reduce operating and overhead expenses

3. Who are the leadership/senior sponsors of this project? What is their role?

Anna Cheng (Corporate V.P. of retail marketing) and Steve Summers, (the company attorney) are the senior sponsors. As senior sponsors of the project, Cheng and Summers needed to be visible and to provide high level leadership for the project so that all levels of the Quik Six organization would be fully committed to the final action developed by the team. It was their ultimate responsibility to ensure the project objectives were achieved.

4. What is the Project Management Process (PMP)? What is its purpose?

The PMP is a formal process technique the company had adopted in an effort to transform an organization with relatively poor project management skills into an organization that was “world class.” It is shown in Exhibit I of the case.

The purpose of PMP is to provide a structure and process for the leadership, maintenance and continuous improve of project work in the Quik Six organization. Projects are broken down into stages, each of which has a “Gate” that must be passed. The “Gates” force the gatekeeper and the project team to make appropriate decisions. These decisions and the rationale behind them are captured in written team documents. All projects should be strategically driven, and PMP applies to all projects, regardless of size. By using the formal PMP approach, the organization sought to: institutionalize accountability in the organization’s project management process, develop an internal contracting process, create a mechanism to share organizational learnings, and develop sustainable continuous improvement processes.

5. Who assumed the gatekeeper roles in the project? What role does the gatekeeper perform?

On this particular project, both Anna Cheng and Steve Summers were acting as jointly accountable gatekeepers. The gatekeeper is the individual responsible and accountable for signing off on the decisions made at the end of each step before proceeding to the next stage in the project, and for securing resources and funds for the next stage. The gatekeeper is also the communicator of the objectives to the project team, and the definer and framer of decision alternatives and selection criteria. Finally, the gatekeeper would approve and communicate key decisions to the rest of the Quik Six organization.

6. ho are the facilitators/process champions in this case? What is their role?

Cannon and Dermody would act as facilitators/process champions throughout the project. In the role of facilitators, Cannon and Dermody were to help the team meet the assigned objectives. The facilitators were to use the PMP to facilitate participation by the cross-functional team members.

Cannon and Dermody were also to train and communicate with the team members on the approved common approach to project management.

7. What was the L-PIER team, what was it responsible for, and who were its initial members? Can membership in the team change?

The L-PIER team was a cross-functional team, made up of employees from corporate retail marketing and the legal department, responsible for developing and rolling out a plan to achieve the project objectives. The team members are shown in Table 1. Membership in the team could change, as other employees could be added to the team on an ad hoc basis as the need arose

Corporate Retail Marketing	Retailing Function	Legal Department	Legal Function
Anna Cheng	Senior Sponsor & Gatekeeper	Steve Summers	Senior Sponsor & Gatekeeper
Colleen Cannon	(OD)Marketing Consultant & Process Champion	Sean Dermody	Legal Consultant & Process Champion
Lou Geyer	Operations	Margo McDonald	Claims Litigation
Terry Wallis	Real Estate	Neil Dulles	Real Estate
Don Alston	Merchandising	Tom Cruz	State-Litigation
Steve Jefferson	Finance	Ron Phillips	Human Resources
Mary Michaels	Advertising	Don Johnson	Dispute Resolution

8. What are the five steps in the “Project Management Process” used at Quik Six? Describe what occurs in each step.

Step one, APPRAISE, was mostly about project initiation. In this step the team seeks to build consensus confirming the project goal, scope and objectives, before proceeding to step two of the project process. Team member roles and accountabilities needed to be established, and appropriate resources needed to be allocated. The team also had discussions about related points such as:

- What was the business impact of solving this problem?
- How will progress be tracked?
- Does the team have a good probability of success?
- What is the relationship of the team’s success to the accomplishment of the overall business strategy?
- What is the sense of urgency to get this project completed?

Step two, SELECT, was concerned with assessing the current state of the project environment. The team saw this as about defining the “size of the prize”. What was this project really worth? Was the benefit worth the effort for the organization.

In the third stage, DEFINE; the team determines the industry's best practices. Then they identify: critical success factors, measurements, targets, data sources, and the basic processes to be examined. Also, at this point the team determines a list of "Quick Hits", which can be pursued immediately while the rest of the project was still being developed. As an additional part of this step, the team brainstorms potential solutions and opportunities for improvement.

In the fourth step, EXECUTE, roles become more clearly defined as change management actions are determined. Proposed actions are analyzed for feasibility, the human resources component begins to be addressed, and a communication plan is developed.

The main purpose of the fifth step, OPERATE, is to roll out the final product. In this case, that meant institutionalizing and formalizing the program to keep the expense reductions permanent. This phase included project evaluation, the observation of any unintended effects (which would need corrective actions), and the sharing of best practice success stories. The final roles and responsibilities of process members would be locked and loaded, appropriate policies and procedures would be finalized, and the complete process would be communicated to the entire organization. The key final part of the OPERATE step was the action plan.

- 9. In the DEFINE stage, describe three of the Behavioral Issues the L-PIER team identified during their brainstorming sessions as providing opportunities for improvement. Explain why you Do or Do Not think that each of the solutions suggested by the L-PIER team would be effective.**

All behavioral issues and solutions are listed below; students should select at least three.

--Strategic Concerns

- Control the quality and quantity of strategic and tactical changes. Constant changes add rework and expense.
- Build legal safeguards into strategies as they are being developed rather than adding them afterward.

--Engagement Process Strategic Concerns

- Eliminate multiple requests for legal opinions regarding the same issue.
- Eliminate internal lawyer shopping for more favorable opinions.
- Get the legal department involved early in the program development process.
- Work with organizational members to change the mindset that certain legal decisions are optional.

--Relationship Building

- Develop a process for how attorneys and retail marketing personnel can incorporate performance expectation feedback loops into the cross-functional work process. Findings that would improve work unit effectiveness should follow.
- Get the legal department proactively involved on the front end of projects, not just after problems have been discovered.
- Change the organizational perception so that *the legal department is viewed as a retail marketing partner*, not just a legal provider.

--Shared Learnings

- Build a sharing learning process to teach the retail marketing organization about legal successes, failures, and best practices.
- Improve current decision-making process by looking at prior decisions and their resulting costs in order to predict future costs. The ramifications of decisions made today may not be felt until years in the future.

--Human Resources

- Legal orientation for new employees. Improve the organization's understanding of the legal process.
- Work with the human resources group regarding personnel issues that have legal implications.

10. In the DEFINE stage, describe three of the Structural and Process Issues the L-PIER team identified during their brainstorming sessions as providing opportunities for improvement. Explain why you Do or Do Not think that each of the solutions suggested by the L-PIER team would be effective.

All structural and process issues, and solutions are listed below; students should select at least three.

--Administrative Issues

- Need for an improved expense tracking system.

--Expense Management

- Explore opportunities to reduce rework.
- Identify the drivers of legal expenses, are there opportunities to leverage cost savings, and how do multiple organizational layers contribute to a higher overall cost structures?
- Identify what the corporate retail marketing and legal organizations can do jointly.

--Process Focus

- Develop core process designs and maps for the following critical legal processes: *leases, rents, independent dealer relations, administrative functions, and process accountabilities.*
- What processes are needed to manage expenses? Who are the process owners?
- Institutionalize (formalize) critical processes.
- How are processes measured, and what would a process scorecard look like?
- How will the process be tracked and controlled?
- What is the real time impact of various processes?

--Role Clarity

- Role clarification should be a factor that leads to the reduction of duplicate work and legal expense.

--Accountability

- Develop a more comprehensive process scorecard with linkage to accountability systems.

--Communication

- Improve organization communications regarding the availability and access to legal resources.
- Improve generic communications across departmental boundaries.
- Expectations need to be communicated more clearly.

--Organizational Learning Processes

- Focus on changes in approach, process redesign, and organizational behavior.
- Establish a process for legal knowledge transfer to the retail marketing organization.

11. In the DEFINE stage, what was the general benefit of the “Quick Hits” initiative? What specific “Quick Hits” were identified by the L-PIER team?

The benefit of the “Quick Hits” initiative was to generate a series of change actions that provided quick expense reduction savings while the project was still ongoing.

Quick Hits identified by the L-PIER team were the following:

- Redesign and update, where appropriate, the legal rider system
- Begin performing spot audits of critical operational practices, such as insurance certificates and materials, and dealer operational practices to determine current expenses of present legal activities.
- Work with senior management on the overall issue of risk management (to sue or not to sue). Check and build consensus with the corporate risk management group on potential new strategic positions.

POTTERS FOR PEACE: THROWING CLAY IN NICARAGUA FOR PEACE AND PROFIT

**Charles A. Rarick, Barry University
Martine Duchatelet, Barry University**

CASE DESCRIPTION

The primary subject matter of this case concerns the strategic direction of a not-for-profit organization. Secondary issues include international trade theory and economic development. The case has a difficulty level of three, appropriate for junior level students. The case is designed to be taught in one class hour and is expected to require four hours of outside preparation by students.

CASE SYNOPSIS

Founded by peace activists potters from the United States, Potters for Peace seeks to change the world, one clay pot at a time. The grassroots organization promotes Nicaraguan pottery, provides educational support and training, and conducts intercultural exchanges. The ability of the organization to grow and develop is hampered by a lack of financial support and strategic planning.

INSTRUCTORS' NOTES

This case provides a look at an interesting micro organization that is involved in global trade. While the not-for-profit organization is not a large MNC, it still requires a global strategy and must consider the best ways to benefit its stakeholders. The case raises the important issue of developing an economically viable strategy for a not-for-profit organization. This case is probably most useful for an international business course that seeks to address social issues. The case can be used for group assignment, for individual homework, or general class discussion. While additional research could be conducted to analyze the case more in depth, it is written as a coherent whole so that students can complete the assigned questions without additional information.

DISCUSSION QUESTIONS:

- 1. Select one international trade theory and use it to explain the pottery industry of Nicaragua.**

Students have a wide selection of trade theories from which to choose to explain the success or lack of success of the Nicaraguan pottery industry. The choice of theories could include Adam Smith's absolute advantage theory with its discussion of natural advantages. People in Nicaragua have been making pottery for thousands of years, and they have developed a skill level that is difficult to match by people in other countries. The raw clay material is widely and easily available. Another theory that is useful to help explain the industry is Michael Porter's national competitive theory. Using Porter's theory we find that Nicaragua has some weaknesses. The lack of tourist infrastructure inhibits the development of the pottery industry as it lacks buyers for its products. The lack of a strong related craft industry is also a disadvantage. The lack of organized tours and of a marketing and distribution system further limit the market potential of the pottery. Overall management abilities are weak as well and suppress the ability of the industry to grow and develop globally. Another theory that could be invoked is that of comparative advantage leading to specialization and trade. Nicaragua seems to possess a comparative advantage in the production of artisan clay artifacts. The clay is widely available, the population is underemployed and the opportunity cost of working in artistic production is low, the population benefits from a long tradition of pottery production spawning teachers and mentors and the propagation of long tried techniques. Other surrounding nations would have a much higher opportunity cost to producing pottery as their unskilled manpower can serve a thriving tourism industry. Industrialized nations have even larger opportunity costs to devoting labor to pottery production as they need to man their large manufacturing and service sectors. Heckscher-Ohlin can be invoked to reinforce why Nicaragua would turn to producing hand-crafted pottery goods that are time consuming, and demand care and patience.

2. Evaluate the mission, activities, and success of Potters for Peace.

Potters for Peace is a unique organization. It has what may be considered by some to have a strong militant orientation. The mission statement of the organization refers specifically to the "overdeveloped North." It is a well-known expression in international trade to refer to "North-South" contrasts, meaning the distinction between the economically developed Northern hemisphere countries as opposed to the developing Southern hemisphere countries. However, qualifying the North as being "over-developed" implies a derogatory judgment as if the North's development were somehow responsible for the South's underdevelopment. Furthermore, the overall tone of the organization's literature and the links on its website gives readers a sense that Potters for Peace has an U.S. anti-establishment political agenda. The other stated element of PFP's Mission is "to provide socially responsible assistance to pottery groups and individuals in their search for stability and improvement of ceramic production, and in the preservation of their cultural inheritance." The implication here is that PFP will help potters develop their traditional craft to the point where they will achieve economic stability, if not prosperity. While it is certainly the organizations' privilege

to be critical of the establishment's policies, it seems that co-mingling a political posture with an economic development effort is counterproductive. It may inhibit the recruitment of mainstream support. While many people in North America have a social conscience and would be willing to support economic development in the poorer countries and peace within the Americas, any indication that their lifestyle is excessive and morally questionable will not be well received and may serve to turn them off.

Potters for Peace has been successful in advancing the economic well-being of the citizens of San Juan de Oriente. This alone is a noteworthy accomplishment. The development and promotion of the ceramic water purification system is a very significant accomplishment. The system is efficient and very cheap. Thanks to the lack of a patent, it is widely open for use by anyone who needs it, including citizens of poor countries anywhere in the world. This is a major accomplishment of which PFP may be justifiably proud. The current direction of PFP in Nicaragua to extend their outreach to remote parts of the country will prove to be challenging, yet it is an important component to maintaining peace in the country.

The organization has been successful, yet its success has been limited in two important ways. First of all, the organization has been moderately successful in finding a market for the Nicaraguan pottery wares to be sold. This has been a major impediment to bringing prosperity to the Nicaraguan potters. Second of all, the organization has failed to make an impact on other countries, despite interest in other South American, Asian and African communities. Greater success can be achieved through better management of the organization

3. What suggestions would you make to Potters for Peace in order to increase the effectiveness of the organization?

While PFP has been a success, the organization can achieve even greater success by reaching out to the larger community and promoting a different message. As Ron Rivera, Director of PFP, Nicaragua told one of the authors, "NGO's are run by people who have absolutely no business sense." PFP might wish to create two distinct and separate arms for the organization: a militant, politically activist arm that takes positions on world events and makes strong statements in the favor of Peace (as PFP currently does on their web-site to condemn the current war in Iraq) and an economic development arm that generates revenues to support potters from poorer regions around the world by encouraging training and production according to cultural traditions, by promoting their wares to buyers in richer countries, and by acting as agents to facilitate the export of their products.

Actually, the crux of PFP's mission is probably not to be critical of U.S. foreign policy but to improve the standard of living of the people of Nicaragua so that political stability has a greater chance of prevailing in the absence of economic desperation. The Nicaraguan civil war has been over for some time, and it may be useful to develop another emotional theme to attract interest. The abject poverty of this country in the Western hemisphere, coupled with the mission of developing

self-sufficiency can be a strong emotional theme that can attract attention and support. A less critical orientation as it relates to the United States and its citizens would go a long way to helping attract more mainstream membership and donations.

PFP needs to develop their website. A good website would show pictures of the facilities and products, success stories for individual potter families, descriptions of on-going and developing projects. It would also allow for spur of the moment, on-line donations. The fastest way to ensure a wide outlet for the pottery products would be to allow for online sales, retail and wholesale. This would be facilitated by full descriptions of the wares, photographs, price lists and shipping modalities and costs. E-markets, such as E-Bay have made potteries from other countries, notably China and Thailand, very accessible. The web site with good pictures, possibly some cultural information about the motives, techniques, etc. would help differentiate the Nicaraguan products. The public expects the convenience of online access to information and sales. A good website will encourage both donors and buyers.

PFP needs to push to the next step on two fronts. It needs to diversify its operations into other countries as its Mission promises, rather than limiting itself so narrowly to Nicaragua. In the best traditions of micro-development organizations where the recipients of help are expected to help in return (Heifer project <http://www.heifer.org/>, Fairtrade Coffee, Gramin micro-financing banks, etc.), some of potters should be trained and expected to travel to another location to demonstrate the use of the water filtration system, or the use of their traditional techniques. It also needs to encourage the more talented potters in Nicaragua to go beyond strict replications of traditional pottery into the production of signed, art objects that represent original departures from tradition. (As the U.S. Pueblo Indian and the Taxco Mexican silversmiths and potters have been doing for decades now.) PFP should promote and market such efforts as well since they would serve to establish the Nicaraguan pottery industry in the eye of collectors and interior decorators.

While the case is basically an investigation into strategic issues facing a non-profit organization, users may wish to explore the concept of social entrepreneurship as well. Additional questions could be raised such as 1) Do wealthy countries have a responsibility to help develop the economies of poorer nations? 2) Is it in the best interests of the United States to help reduce the abject poverty of countries in the region? 3) How can business school graduates help organizations such as Potters for Peace? Excellent additional reference material on social responsibility can be found in *Social Entrepreneurship: The Art of Mission-Based Venture Development* by Peter Brinckerhoff, (2000) New York: Wiley and *How to Change the World: Social Entrepreneurship and the Power of Ideas* by David Bornstein, (2004) New York: Oxford Press.

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