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LETTER FROM THE EDITORS

Welcome to the *Journal of the International Academy for Case Studies.* The editorial content of this journal is under the control 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 *JIACS* is to encourage the development and use of cases and the case method of teaching throughout higher education. Its editorial mission is to publish cases in a wide variety of disciplines which are of educational, pedagogic, and practical value to educators.

The cases contained in this volume have been double blind refereed, and each was required to have a complete teaching note before consideration. The acceptance rate for manuscripts in this issue, 25%, conforms to our editorial policies. The Instructor's Note for each case in this volume will be published in a separate issue of the *JIACS.*

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

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

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

Inge Nickerson, Barry University
Charles Rarick, Purdue University - Calumet

CASES

CARPET CAPITAL CULTURE CLASH

Marilyn M. Helms, Dalton State College
Judith E. Weber, Dalton State College

CASE DESCRIPTION

The primary subject matter of this case concerns the issues faced in a U.S. company with a large percentage of immigrant Latino workers and the resulting interactions with their original Anglo workforce. The case is appropriate for junior and senior-level business courses. The case is designed to be taught in two class hours and is expected to require one-to-three hours of outside preparation by students.

CASE SYNOPSIS

Teaching culture to business students is important, but often challenging. The authors developed this case study to describe the cultural issues and challenges encountered between an Anglo and Latino workforce in the U.S. This case is different from traditional cases that discuss culture in a new or "foreign" environment because this case is a domestic-based cultural case. This case profiles Dalton, GA home of the world's carpet and flooring producers. The industry, struggling for labor, actively recruited an able workforce from Mexico and Latin America to augment its local, Anglo workforce. Yet after years of working side-by-side, the Americans are puzzled over the behavior of a large group of Mexican workers in their midst. Specific situations outline the various encounters and behaviors that seem puzzling to both the Anglo and Latino employees. When viewed in the cultural context of the U.S., these exhibited behaviors violate cultural and social norms as well as common business practices. The case issues become understandable when viewed within the cultural norms of each group as presented in this Teaching Note.

The Human Resources Department is unclear how to address the issue facing the company. Students are asked to consider ways to educate the employees in the cultural norms and business practices of each group to improve morale and workplace functioning. Use of this case in various undergraduate international business classes can aid students in understanding the challenges of managing employees form several cultures. The issues of cultural misunderstandings should be generalizable to similar situations with other groups of mixed nationalities. The Latino culture was chosen for this case because it became a growing issue to the community of Dalton, Georgia and was and is experienced in a number of towns in the U.S., particularly along the U.S. Mexican border, in Arizona, Texas, and New Mexico.

THE HUMAN RESOURCES MEETING

Sam Haws left the meeting with his divisional human resources directors distressed his Anglo and Latino workforce was not working together as effectively as hoped. Many of the practices of the hardworking Latino populations staffing his 23 plants still perplexed Sam and his top management staff. Sam recalled the key points of his meeting.

Lee Floyd had mentioned his Mexican workers took all the overtime he offered, never called in sick, worked hard and steady on day or night shifts, but might just disappear for weeks at a time with no warning and would reappear and expect to go right back to their old job at the same place on the carpet manufacturing line. Lee could not understand why they were leaving without giving notice to human resources or to him. Others were often tardy and didn't seem to respect the work schedule.

Sam checked his expenditures for hiring bi-lingual employees to help translate company, policies, procedures, and key documents. Why did these problems persist? His bilingual translators were U.S. citizens, many graduates of the local college, and were good at their jobs. They seemed to be extremely fluent in both Spanish and English.

Judy Haynes, from Sam's largest plant manufacturing builder-grade residential carpet, brought a handful of anonymous worker complaints to the meeting that mentioned the “nasty Mexicans” who continued to toss used toilet paper all over the plant's bathroom floors. Others complained the Mexican workers broke the line at the cafeteria, congregated in the doorway, and would not move out of the aisle ways. Even the lift truck operators, moving large rolls of carpet to awaiting trucks for shipment to customers or regional distribution centers, complained about the large groups of Latino employees in the way of the many lift trucks.

Judy noticed the Latinos rushed to the mobile check cashing services that visited the company on payday. Judy wondered why the Latinos paid the check cashing fees instead of using direct deposit to their bank account, but later learned that few Mexicans use banks and seemed suspicious of banks. The fact these groups kept cash with them or at home made them targets for frequent robberies and burglaries. Most of the Latinos used services like Western Union and other wire transfer agents to send money home to family members in Mexico and Latin America. Judy wondered if any of the money the Mexicans earned was staying in the local community.

Tommy Mathis was particularly disappointed about the Latino employee he had recently promoted to supervisor. Tommy initially felt having a Latino manage other Latinos would be better for morale and diversity. Jose Alvarado was, without a doubt, the best worker on the line and knew all about the machines and the production and quality processes. Yet, Jose had difficulty supervising his Latino workers. Tommy noticed the workers, Jose's former friends, were not communicating with Jose as they had before his promotion. Tommy thought Jose would be happy with the increased responsibilities and accompanying pay raise but he could not understand the change with the team members or Jose's new dissatisfaction with his job. He wondered if the workers would even consider reporting to a Hispanic female as a supervisor and questioned whether he should promote another employee, Maria Sanchez, in the near future.

Janet Manning from sales also conveyed a similar story when she moved a Latino employee into sales. Stephania Hernandez, a bright employee, was completing her business degree at Dalton State College, and was fluent in both English and Spanish. Yet Janet reported Stephania frequently helped other sales representatives meet their monthly quota before she worried about her own lagging sales. Stephania seemed confused about the various sales contests and competitions the marketing division often used to motivate the sales force. Janet even received a letter of reference from Stephania's business professor who reported Stephania to be extremely intelligent, hardworking, and in fact one of only a handful of Latino business students among the slowly growing Latino population at the college. When Janet asked more about Latino enrollment in higher education, Dr. Tubbs mentioned she was encouraged that more area Latinos were coming to the college and were studying business to move up the corporate ladder. But, Dr. Tubbs felt these students were second generation children of the initial wave of immigrants to the area and were encouraged by their first generation immigrant parents to complete their education.

Sam's head was spinning from all these and other examples from his meeting. As an entrepreneur, he had founded the carpet company, was a leader in the floorcovering industry, and knew the growth of his business depended on a large labor pool. Without sufficient labor, the entire industry might be forced to relocate abroad. While carpet, rugs, tile, and hard surface flooring production was highly automated and not labor intensive, the fact his community produced over 80 percent of the world's flooring in their industry cluster headquartered in the mountains of Northwest Georgia bothered Sam. Sam needed the Latino labor since the local workforce was too small to staff his many floorcovering mills and the mills of his competitors. His company and the industry had survived in the community only because they had been able to attract the Latino workforce to come to the area. Most Latinos loved the area and were even making their homes in Northwest Georgia and had no plans to just make money quickly and return to Mexico. In fact the community was encouraging local builders to build more affordable workforce housing for the new residents. Programs were in place in the school system to transition the children of Latinos. Businesses targeting Latinos now lined the streets of the shopping areas in town.

IMMIGRATION HISTORY

The 60-mile region around Dalton, Georgia remains home to the largest concentration of the world's flooring manufacturers (carpet, rug, tile, laminates) and has earned the title "Carpet Capital of the World." A stable, happy, large workforce is needed to manufacture the carpet and raw material inputs. The 174 carpet firms in the area employ over 50,000 people with an annual payroll of almost $2 billion. When the economic boom of the 1990's erupted, manufacturers experienced a shortage of local labor. To cope with the labor shortage and to keep the plants in the area, the manufacturers actively recruited and welcomed the immigration of the Latinos. Now approximately 22 percent of Whitfield County's 89,000 residents are Hispanic, according to the U.S. Census Bureau. In Dalton, approximately 40% of the city's 30,000 residents are Hispanic.

The manufacturing jobs pay extremely well, on average $11 per hour plus full benefits and insurance and are attractive entry-level positions. Signs in Spanish throughout the city stress the great job benefits. The key jobs of creelers, who filled spools of nylon that feed the large carpet tufting machines, lift truck operators that moved the finished products, and other plant-floor jobs are largely held by the Latino workforce. These earning capabilities are also keeping the unemployment rate of Hispanics between the ages of 25-34 relatively low, at 3%.

In 1995, the Dalton, Georgia metropolitan statistical area had only five Mexican restaurants, one insurance agency, three grocery stores, and one bar catering to the Latino population. By 2006, there were over 278 businesses targeting the Latino customers (Jones, 2006) including meat markets, barber shops, travel agencies, furniture stores, bakeries, sporting goods, doctors and clinics, car lots, accountants, real estate offices, and banks (Dell'Orto, 2006). In fact the number of Hispanic-owned businesses was growing at three times the national average (http://www.census.gov/prod/ec02/sb0200cshisp.pdf).

Dalton is a “carpet cluster” (see http://data.isc.hbs.edu/cp/index.jsp). Dalton, Georgia was identified by Dr. Michael Porter, the Harvard Business School economist and strategists, as a “cluster” or grouped industry representing major manufacturers, suppliers, equipment vendors, and others within the supply chain for tufted carpets and flooring. Dr. Porter identified over 55,000 employees in direct employment plus some 28,000 in support industries when he studied the area in the late 1990s. In terms of production Dalton is among the world’s major clusters. In Whitfield County, alone, approximately 54% of the labor force is engaged in carpet manufacturing and carpet companies are the region’s largest employers. In addition 75-80% of the yarn raw materials for the industry are also produced in the state and machinery makers have been established in the area since the 1950s.

While in 1990 only about 4% of the students in Dalton’s Public Schools were Spanish speaking, more than 58% of the students in 2006 are Latino, with some schools boasting 80%. Whitfield County's school system witnessed a similar increase in these numbers, where in the 2002-03 school year 20% of its students were Spanish speaking.

According to the 2000 Census about 25% of Whitfield County’s population is Hispanic, but the dropout rates for Spanish speaking students at 67% are the highest in the whole country. The “Georgia Project” evolved as a community-based, non-profit organization to support the academic and social needs of Latino students, their families, and the citizens of Dalton, Whitfield County, and Northwest Georgia through collaboration with the University of Monterrey, the on-going professional development of teachers, and the provision of scholarships for future bilingual teachers (see http://www.georgiaproject.net/index1.html). Teachers from the wealthy, industrialized city of Monterrey, Mexico worked in the local school systems in Dalton each year to help the children of

Latinos make the transition to the US culture, yet some wondered if it was working to blend the cultures.

The Georgia Project was founded by former U.S. Senator Erwin Mitchell in 1996 in response to rapid growth in numbers of Spanish-speaking students in local schools. The project aims to make cultural transition less difficult and more productive for the entire community. The Georgia Project also provides professional development opportunities for existing teachers in the Dalton-Whitfield County school systems, including Spanish-language skills. Additionally, the Georgia Project provides ESL (English as a Second Language) training to area Latino parents.

Sam also recalled a conversation with Leah May, his corporate attorney. Leah's daughter Hilary was a third grader in the local elementary system. At a recent parent-teacher meeting, Leah recalled how the Mexican parents would not look their child's teacher in the eye and seemed inattentive during the conference. Leah's daughter mentioned Jesus, a Latino boy in her class, had made the lowest scores on their spelling tests. Leah couldn't believe the parents were not concerned. She wondered if the Latinos really valued education.

Even in the outside community, the two cultures remained separate, with their own stores, services, churches, sporting, and cultural activities. The only segment overcoming diversity in the community was the restaurant trade. Anglos seemed to love the Mexican food. In fact the community joke was how the wonderful and growing selection of refried beans and fried tortilla chips also made the city of Dalton a leader in the popular weight loss surgery of gastric banding surgery perfected by a doctor formerly from Mexico.

THE BUSINESS SEMINAR

At a local seminar sponsored by the area college, Sam listened with interest to a panel of business leaders who discussed the Anglo-Latino business issues. The four Anglo panelists had been successful in recruiting Latino customers to their companies. They mentioned using a Latino consultant to assist with their marketing and targeting of new customers. A furniture salesman mentioned Latinos rely on male customers to make most of the buying decisions, which was just the opposite of furniture purchase patterns in typical American families. He mentioned Mexican's desire for different styles and the influence of their relatives in purchase decisions. He added, "They are loyal; they tend to shop in groups and will bring their children with them. They prefer to speak Spanish when discussing the furniture among themselves and their limited credit history means they typically pay in cash. Once the furniture store owner became friends with his newly hired Mexican sales representatives, attended their church, weddings, funerals, and even a weekend goat roast, his business began to grow. He mentioned the importance of hiring a bi-lingual staff and posting bi-lingual signs. He agreed building relationships was important and that coupons and specials had not been successful in attracting Latino customers. Since business is earned and relationships are important, ending a transaction with a Latino customer with "thank you for your business," is not appropriate but "thank you for your visit," is more appropriate, he stressed.

Another seminar panelist mentioned the various and growing number of media outlets broadcasting or distributing printed media in Spanish in the area and their low costs, making them helpful in targeting Latino customers. Other points were the culture's love of soccer and the potential marketing tie-ins to this popular sport. An accountant with a growing Latino customer base agreed most Latinos follow a code of honor and can make handshake business deals without all the paperwork and lawyers an Anglo customer might require. He also mentioned few Latino customers used voice mail and other technologies. An audience member was concerned no Latino customers visited his popular Italian restaurant. A Latino participant mentioned more marketing to Latinos would help along with a bi-lingual menu and more information or descriptions about the unfamiliar pasta items as part of the menu. An office manager from a medical practice wondered whether he needed to add a website for his Latino customers. A media expert mentioned that while the current generation just arriving may be less inclined to use the Internet for information, their children, studying in the local school system, were more than comfortable with technology. For attracting this next generation of clients, the expert agreed on-line information was indeed needed.

The Latino moderator of the panel and founder of one of the local Latino newspapers and radio stations mentioned the differences he had seen in his ten years living in the area. He mentioned a popular ad for local dairy products with a tag line, "holy cow." The literal Spanish language translation of the sign conveyed a cow was holy or religious and confused Latino customers. Using an English version directly to create an advertisement for the Hispanic market should be avoided, he stressed. It is preferable to discuss the main points with a Latino marketing consultant and allow them to start from scratch to create an appropriate message. He also mentioned avoiding culturally sensitive messages and products, noting that not all cultures have the same humor or the same product and service needs. While the Latino culture has pets, dogs are not an integral part of the family as they are to the Anglo culture. Thus a new pet grooming business may not be frequented by Hispanic customers. He even clarified some of the confusing terms and defined Hispanic as referring to people who speak the Spanish language while Latin or Latino referred to people descending from Latin countries in Europe like Italy, France and Spain. The terms, often used interchangeably, cause problems when a person is named a nationality, for example, being from Spain or within Latin America and this nationality is not correct.

On his drive home from the seminar, Sam passed the second Wal-Mart Super Center that opened in 2004. It seemed positioned for the Anglo clients where the old superstore on the south side of town had signage and announcements in Spanish, a taxi stand out front, and numerous products targeted to Latinos.

Sam wondered what he could do to blend the cultures at work. What should he do to address the human resources issues at his plant? What role should the Anglo workforce play in the needed changes? He realized too most of the citizens of the region were culturally naïve about other countries and cultures, even when they were side-by-side in the same small town.

ASSIGNMENT QUESTIONS:

1. List examples of cultural misunderstandings you have encountered. Why did they exist?

2. Research the history and culture of Mexico. Assess the probable reasons for the unusual behaviors Sam Haws' human resources directors observed.

3. Gather facts on the number of Hispanics in America. What trends to the data predict?

4. Develop proposals to effectively deal with the various situations presented. Assume the role of the HR director as your plan your implementation. What programs would you develop for Latinos? What programs would you recommend for your Anglo workforce? Include an implementation plan and time-frame for this cultural change.

5. Is the Mexican workforce in Dalton, Georgia a diaspora (or a homogeneous ethnic minority group of migrant origins residing and acting in a host country but maintaining strong sentimental and material links with their countries of origin or homeland, typically maintaining both their own language and culture)?

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ODYSSEY HEALTHCARE: A DEPARTMENT OF JUSTICE INVESTIGATION RELATED TO THE FALSE CLAIMS ACT

John Newbold, Sam Houston State University
Laura Sullivan, Sam Houston State University

CASE DESCRIPTION

The primary subject matter of this case is the application of the False Claims Act by the Department of Justice to investigate the recruitment and patient care policies of a for-profit hospice: Odyssey Healthcare. The case provides examples of the types of marketing and management practices which could fall under the purview of the False Claims Act. Secondarily, the case gives instruction as to management practices which would help firms establish and maintain ethical and legally-compliant corporations.

This case has a difficulty level of" two" or" three", and is appropriate for undergraduate students who are being introduced to the topics of business ethics and/or business law. Through its focus on the hospice industry, the case provides a poignant backdrop for the need for ethical business behaviors. The case describes the basics of the Odyssey Healthcare business model, with an emphasis on the types of marketing and management practices which drive hospice businesses in the United States. It culminates with the investigation of the Department of Justice and sets up a beneficial discussion of why False Claims Act investigations are initiated and the specific types of corporate behaviors which are sometimes scrutinized. Finally, the case gives some instruction on the manner in which ethical and legally-compliant corporations can be established and maintained.

The case is designed to be taught in three class hours, with roughly one hour spent on understanding the hospice industry and Odyssey Healthcare, one hour spent on the specifics of the False claims Act. The final hour would be dedicated to the discussion of how to establish and maintain an ethical corporate culture and compliant operations. It is expected to take two hours of preparation by students.

CASE SYNOPSIS

Richard Burnham had major legal and public relations issues on his hands. He had stepped down as CEO of his for-profit hospice firm, Odyssey Healthcare, less than a year previously, in January of 2004. His cofounder, David Gasmire, had assumed his responsibilities, while he stayed *on as Chairman of Odyssey's Board of Directors. Now, less than a year later, a Department of Justice investigation was threatening the viability of his company.*

In October of 2004, Odyssey Healthcare senior management informed investors and analysts that the firm was under investigation by the Department of Justice for violations of the False Claims Act, with respect to the company's practices for patient admissions, patient retention and billing practices. Immediate action was required. The first thing Burnham needed to do was find out what had given rise to the DOJ investigation. Even if some "rogue" employees had disregarded the firm's Code of Ethics and engaged in illegal activities, could his firm really be held responsible for these actions? Going forward, what steps should the company take to create a more ethical corporate culture and maintain more compliant operations in order to avoid future investigations from the Department of Justice?

INTRODUCTION

Richard Burnham had major legal and public relations issues on his hands. He had stepped down as CEO of his for-profit hospice firm, Odyssey Healthcare, less than a year previously, in January of 2004. His cofounder, David Gasmire, had assumed his responsibilities, while he stayed on as Chairman of Odyssey's Board of Directors. Now, less than a year later, a Department of Justice investigation was threatening the viability of his company.

Founded in 1995, Odyssey Healthcare had enjoyed tremendous growth for nearly 10 years. Odyssey had grown its base of business through organic growth, acquisitions and newly constructed operations to become one of the largest for-profit hospice organizations in the United States. The number of Odyssey hospices had more than doubled from 2001 – 2003, from 30 to 74. However, as Burnham and Gasmire navigated into 2004, Odyssey began to experience some problems.

In February 2004, Odyssey released its earnings for the fourth quarter of 2003. While the numbers for 2003 came in on target, Odyssey management advised investors that their earnings estimates for fiscal year 2004 were being lowered due to operational issues. Based upon this news, the stock price dropped 26% in a single day (Yu, 2004).

In April, 2004, Barron's, a widely-read financial newspaper, wrote an unflattering article about Odyssey which strongly hinted at Odyssey engaging in less than ethical practices related to patient admissions, patient care and patient discharges (Ward, 2004).

Six months after the Barron's article, at the quarterly earnings announcement on Oct 18, 2004, Odyssey again announced that earnings would be below expectations. But this was just the beginning of the bad news. Chairman David Burnham informed investors and analysts that the firm was under investigation by the Department of Justice for violations of the False Claims Act, with respect to the company's practices for patient admissions, patient retention and billing practices. Finally, Burnham announced that CEO David Gasmire had left the company, and that Burnham would be assuming the role of CEO in addition to his role as Chairman.

Immediate action was required. The first thing Burnham needed to do was find out what had given rise to the DOJ investigation. Even if some “rogue” employees had disregarded the firm’s Code of Ethics and engaged in illegal activities, could his firm really be held responsible for these actions? Going forward, what steps should the company take to create a more ethical corporate culture and maintain more compliant operations in order to avoid future investigations from the Department of Justice?

THE HOSPICE INDUSTRY

Hospice Care

Hospice care is defined by the Hospice Association of America as:

> “…comprehensive, palliative medical care (treatment to provide for the reduction or abatement of pain and other troubling symptoms, rather than treatment aimed at cure) and supportive social, emotional, and spiritual services to the terminally ill and their families, primarily in the patient’s home. The hospice interdisciplinary team, composed of professionals and volunteers, coordinates an individualized plan of care for each patient and family.” (Hospice Association of America website, 2005)

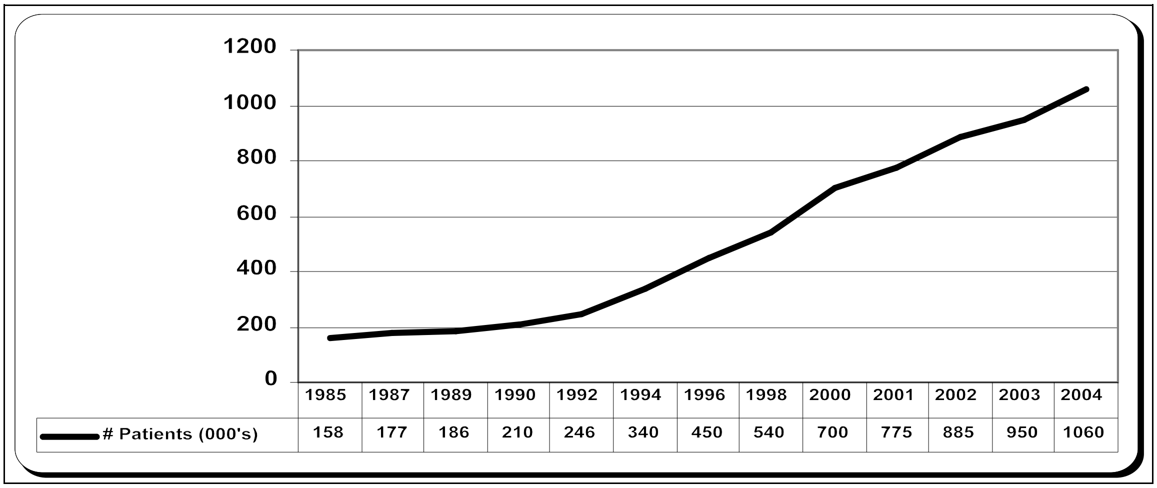
The palliative (pain reducing) care provided by hospices differs from curative care which is traditionally provided by hospitals in the sense that it is directed at making the patient more comfortable and improving the quality of life, rather than curing the patient of the ailment. A broad range of services, from traditional nursing care to respite care for family caregivers to bereavement services for family members is traditionally offered.

The Institution of the Medicare Hospice Benefit Spurs Industry Growth

In 2003, the hospice industry in the US was a relatively small and fragmented component of the overall healthcare industry, generating aggregate annual revenues of about $4.5 billion. Spending on hospice services amounted to less than one half of one percent of the $1.4 trillion in annual US healthcare spending. Further, hospice spending accounted for only 1.5% of annual Medicare spending (Shattuck Hammond Partners, 2004).

In 1982, Congress enacted the Medicare Hospice Benefit on a provisional basis. In 1986, the provisional law was made permanent. Each state was given the option of including hospice care in their Medicaid program. In addition, hospice care was made available to terminally ill patients in nursing homes. A significant jump in usage of hospices occurred at this time. Yet the number of hospice patients was growing exponentially to over one million patients, as is shown in Figure 1.

Figure 1: Number of Hospice Patients: 1985 – 2004 (000's)

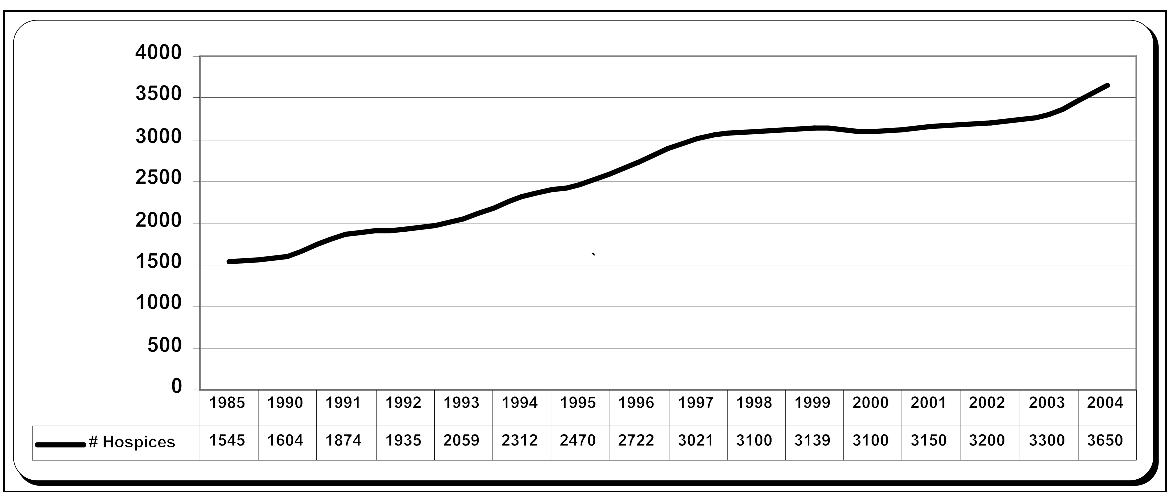


	1985	1987	1989	1990	1992	1994	1996	1998	2000	2001	2002	2003	2004
# Patients (000's)	158	177	186	210	246	340	450	540	700	775	885	950	1060

(National Hospice and Palliative Care Organization, 2005)

In 1996, the federal government initiated a program ("Operation Restore Trust") focused on preventing Medicare fraud across all provider groups. This increased level of regulatory scrutiny, while probably needed, likely inhibited referrals of patients and reduced average and median lengths of stay industry-wide. The Balanced Budget Act of 1997 further negatively impacted reimbursement rates, dampening the growth rate of hospice sites. This is shown in Figure 2.

Figure 2: Number of Hospices: 1985 – 2004



	1985	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
# Hospices	1545	1604	1874	1935	2059	2312	2470	2722	3021	3100	3139	3100	3150	3200	3300	3650

(NHPCO, 2005)

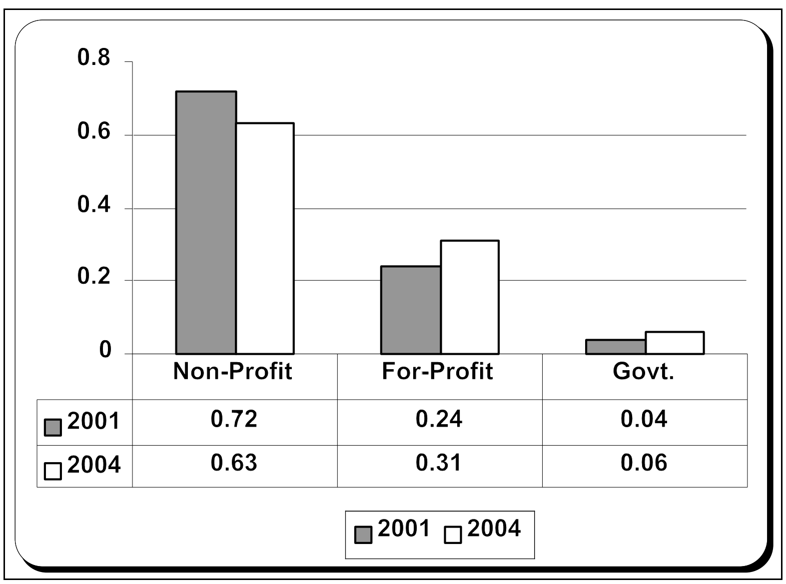
Factors Driving the Increasing Acceptance of Hospice Care Services

In 2004, there were several factors driving growth in the hospice industry. Foremost was the overall aging trend in the US and the increasing size of the over 65 population. In addition, there was an increasing role of advocacy groups in promoting hospice care over other end-of-life alternatives. Finally, The Center for Medicare and Medicaid Services (CMS) appeared to be promoting hospice care through its liberal policies for reimbursement. The CMS's favorable treatment of hospice care in their reimbursement policies was thought to be at least in part because hospice is viewed as a lower cost alternative to traditional, hospital-based end-of-life care.

Trends in Medicare-Certified Hospice Operations

Traditionally, the hospice industry had been comprised of non-profit operations with an average of less than 50 patients at any given site at any given time. In 2004, 63 % of all hospices were non-profit, with for-profit operations comprising 31%. However, as Figure 3 shows, the trend had been toward growth in the for-profit area.

Figure 3: Trends in Hospice Profit Status (2001 – 2004)



(NHPCO, 2005)

At year-end 2003, 48% of hospices were free-standing entities, with 30% being affiliated with hospitals and another 22% affiliated with a home health agency or a nursing facility. The trend had been away from free-standing toward affiliation (NHPCO, 2005). The strategic rationale for a hospice to be a part of an integrated healthcare system was threefold. First, hospice was a critical and growing piece of the healthcare continuum and enabled acute care providers to offer patients an alternative to traditional end-of-life care. Second, hospice programs could act as a strong link to the community, given the large number of volunteers and the high level of emotional attachment to patients. Finally, affiliated hospices offered "hard-wired" opportunities to transfer patients from high-cost acute care situations to the relatively lower-cost hospice environment, thereby enhancing the financial performance of both entities.

ODYSSEY HEALTHCARE

Background

Odyssey was founded by Richard Burnham and David Gasmire, both former employees of another large, publicly held hospice organization – Vitas Healthcare. Burnham was a former regional manager for Vitas and Gasmire a former hospice site manager. With headquarters in Dallas, Texas, Odyssey Healthcare, Incorporated operated 74 hospice care facilities in 30 states and employed over 4,000 healthcare workers in 2004. However, roughly half of those operations were located in California, Texas and Arizona. With an average daily census of 7700, they were the second largest hospice organization in the United States.

Odyssey's Business Strategies

Odyssey Healthcare's business strategies revolved around the following three imperatives: 1) Rapid expansion into new geographies with the ultimate objective to establish a broad geographic footprint, 2) A focus on marketing directed at increasing the admissions rate and average daily census, including the extensive training of their marketing, sales and operations personnel, and 3) Strict cost control and attention to the bottom line.

Rapid Expansion into New Geographies

In organizing for rapid growth, Odyssey established eight regional territories. Each territory was headed by a Regional Vice President, who, in turn, managed teams of District Managers. At headquarters, Odyssey maintained a dedicated acquisitions team, as well as a dedicated expansion/startup team for newly established operations. Having extensive coverage in a particular geography aids large for-profit hospices in receiving referrals from similarly broad-based health care providers. National and regional nursing home and assisted living communities often seek the administrative and service consistency benefits resulting from working with a limited number of broad-based hospice service providers.

Increasing Scale and Geographic Breadth

The hospice business model is also highly sensitive to scale. Once the average daily census breakeven point was reached (between 30 – 40 patients per month), operating margins in the 10% range were achievable and increased as the census rose.

Hospice providers who achieved significant scale were able to negotiate volume discounts on the purchase of pharmaceuticals, durable medical equipment and medical supplies. In addition, they were in a better position to enter into favorable contracts with private insurers HMOs and pharmacy benefit managers. Finally, large hospice operations were able to spread certain fixed costs (corporate overhead, IT infrastructure, and marketing spending) over a large patient population.

Controlling Operating Costs

In 2003-2004, Odyssey struggled to adequately control their pharmaceutical costs. In many locations, they were paying local rates. In 2004, Odyssey completed an extensive project whereby a national formulary plan and an electronic drug adjudication system was implemented. This system provided better visibility and control over the drug side of the business. Odyssey also completed a switch-over to a new internal management IT infrastructure. The new software and hardware system, obtained from the McKesson healthcare consulting firm, and dubbed the "Horizon" system, was intended to improve the clinical and billing systems. It provided management at Odyssey better real-time visibility into the day-to-day operations of the firm, such as drug usage rate, patient length of stay and Medicare Cap accrual issues. Perhaps more importantly, the system helped to prevent errors in claim preparation, thereby avoiding lengthy delays in Medicare reimbursements.

Odyssey's Marketing Strategies

Products/Services Strategy

In order to be certified by Medicare, marketers of hospice services were required to offer specific core and non-core services. However, marketers at certain for-profit hospices recognized the value of differentiating their services to appeal to certain types of referrers. Hospices were beginning to differentiate themselves by specializing in services for specific diagnoses. For example, some facilities began to invest in the durable medical equipment necessary to care for cancer patients with acute symptoms and a need for continuous care.

The Impact of Fixed Pricing on Odyssey's Target Market Strategy

With over 90% of their revenues obtained from Medicare and Medicaid, all hospice operators worked under a fixed pricing system. Thus, the revenue function for a hospice operator was linear – a fixed per diem payment over time. The cost function, however, was not linear. The cost of a marginal day of care was relatively high at the onset of care, when there were initial costs of learning about the patient's background, and when the hospice developed a plan for facilitating the move to a hospice environment. Similarly, costs were relatively high in the days immediately prior to death. Between the high costs at the start and at the end of the period of care, costs were lower (Huskamp, et. al., 2001). This pattern of cost was the same regardless of diagnosis. The important implication of the linear revenue function and the U-shaped cost function is this: *Longer lengths of stay would yield higher profits*. Further, a patient's diagnosis served as a predictor of length of stay: Cancer patients tended to be referred late and have relatively short stays. In contrast, non-cancer patients tended to have longer lengths of stay. For these reasons, there had been a natural tendency of for-profit hospices to target *non-cancer* patients for admissions.

Managing Patient Length of Stay

Patient length of stay appeared to have the most impact on net patient revenue. For each patient, if length of stay was only a few days, the high costs were spread over fewer days of care, which increased patient care expenses as a percentage of net patient revenue. Consequently, profitability was negatively impacted. Clearly, the ideal scenario for a for-profit hospice was to have each patient stay as long as possible so that the patient care expenses were spread over more days, positively impacting profitability. Thus, Odyssey was faced with a challenge of managing the type and number of their patients in an environment where they were expected to take on all types of cases.

Driving Admissions Growth through Personal Selling

By May 2004, Odyssey had added 17 new hospice sites in just the past 12 months. To assist in ramping up the patient counts in these nascent programs, Odyssey dedicated an increasing share of its operational budget to establish personal selling teams to call on the various referring entities. In some cases, the teams specialized by type of client, such as nursing homes and cancer centers. These referral representatives were referred to as "Community Education Reps" or CERS. In 2004, Odyssey employed more than 200 CERs. They had over 70 hospice sites, with the number of CERs per site fluctuating between 2 and 6 depending on the market conditions of each individual site.
Compensation plans were geared around numbers of referrals and types of patients obtained. In January 2004, the compensation plan was modified. Base salaries were set slightly higher than

market (i.e., other hospices in each area). Bonuses were established to be awarded after each quarter based upon growth over the previous quarter.

AN UNFAVORABLE TURN OF EVENTS

An Earnings Miss

In February of 2004, Odyssey released its earnings for the fiscal fourth quarter of 2003. While the numbers for 2003 came in on target, Odyssey management advised investors that their earnings estimates for the fiscal year 2004 were being lowered. The primary drivers of Odyssey's reduced profit outlook included:1) higher than anticipated costs in the form of newly acquired hospices, 2) greater pharmacy and salary expenses, and 3) greater than anticipated costs in the form of Medicare cap accruals (give-backs to Medicare, their primary source of revenues). It appeared that the prodigious growth rate of the company had finally outstripped its management's ability to effectively control operations. The market was caught off guard by this negative announcement from the industry high-flier. The stock price lost over a quarter of its value in a single day. (Yu, 2004).

Unfavorable Publicity: The Barron's Article

The last thing Odyssey needed on the heels of their February 2004 earnings announcement was to have an unfavorable article come out in a prominent business newspaper. Yet on April 12, 2004, Barron's featured an article by reporter Sandra Ward entitled: "Troubling Odyssey, Questions Arise About Hospice Company's Patient Care, Level of Medicare Payments". The article discussed the operational problems associated with Odyssey's tremendous recent growth. In addition, the article intimated that Odyssey may have been engaging in less-than-ethical marketing practices. Consider the excerpt below:

> "There are also suggestions that some of Odyssey's strong growth is the result of providing a level of care and services below the standards set forth under government guidelines, including providing adequate bereavement services for patients' families. A son tells *Barron's* of Odyssey's ignoring calls from a nursing home as the staff sought the assistance of the hospice firm with which he'd contracted. Some former nurses and marketing representatives tell *Barron's* of patients being kicked out of Odyssey programs after 90 days upon being 'reevaluated' or because they required hospital care. Former staffers complain about lack of access to supplies, and caseloads that are heavier than industry norms. The company's CEO, David Gasmire, says Odyssey follows all federal guidelines."

The article went on to imply that Odyssey may have been skirting Medicare requirements for admission into hospice care:

> "In a business almost entirely dependent upon Medicare for reimbursement for revenues, adherence to guidelines is crucial. People familiar with the Medicare system say that exceeding the reimbursement cap is very unusual and is considered a serious breach of accepted practice by the Centers for Medicare and Medicaid Services, as well as by the insurance intermediaries who handle Medicare claims. Such breaches raise red flags about admittance procedures and the possibility that ineligible patients are being accepted into hospice programs, which are supposed to admit only those whom doctors believe have no more than six months to live."

Toward the end of the article, the author highlighted the tension caused by the incursion of for-profit firms in a traditionally non-profit industry:

> "In a business expanding as fast as the hospice industry and at a company expanding as quickly as Odyssey, growing pains are to be expected. Nonetheless, there is mounting concern within the industry that the quest to show profit growth and stock price gains can sometimes conflict sharply with the needs of dying patients and their families. Nonprofit hospices increasingly complain that they are shouldering a heavier burden than the for-profits – caring for a higher proportion of expensive-to-care-for patients and providing services that should be available at all hospices.
>
> Says Dorothy Deremo, president and chief executive of Detroit-based Hospice of Michigan: 'For-profit organizations in health care have a different social contract: to deliver a return on investment and improve the equity of their stockholders. The social contract for the not-for-profit is….to return value to our shareholders who are the patients, the families, and the community-at-large'".

Despite the intimations of the Barron's article, at the time of its publication, Odyssey was not under investigation by the U.S. Department of Health and Human Services' Inspector General's Office, the watchdog agency for the Centers for Medicare and Medicaid Services.

Odyssey's Operational Failure

Odyssey faced several significant organizational failures. Like many organizations that have faced rapid growth and the corresponding growing pains, Odyssey had focused its priority on growth. Odyssey's corporate documentation and training requirements had become secondary to the requirements of simply maintaining the day-to-day growth of the business. Unfortunately, this is a familiar story for many companies whose growth occurs rapidly and usually through acquisition. Odyssey had policies and procedures in place, but there was insufficient oversight to ensure that the established policies and procedures were followed.

In addition, during a period of rapid growth, many companies let training and employee development fall to the wayside. Odyssey was no exception. The lack of training and employee development was a major contributing factor to Odyssey's dilemma. Odyssey was growing exponentially, and due to resource limitations did not take the time to properly train or develop its employees.

Odyssey operates its business in a highly regulated industry. Record retention and internal reviews are an integral part of operating within government regulations. Odyssey was not aligned with the proper government agencies. In heavily regulated industries, companies often want to report errors immediately to the regulating agencies. The reason is simple: If the company reports the error, it illustrates to the regulatory agency that the company has control over its processes and regulatory requirements. Usually, in this scenario, the regulatory agency shows leniency on the reporting company.

THE DEPARTMENT OF JUSTICE INVESTIGATION

Odyssey Receives Notice

In late September of 2004, Odyssey Healthcare received a one-page letter from the Department of Justice informing them that they were looking into Odyssey's patient certification (admissions), patient referral, coordination of benefits, and billing practices, as well as for claims for payment submitted to Medicare dating from January 1, 2001. At that time, the qui tam complaints were sealed and Odyssey had little information about the specifics of the complaint. Despite the lack of specifics, Odyssey made the announcement of the DOJ investigation at its earning announcement on October 18, 2004. They did not wish to speculate on the impact of the investigation on Odyssey's future operations or financial results

The False Claims Act and Qui Tam (Whistleblower) Provisions

Medical fraud is an increasing problem in the United States today. Medical fraud or abuse approaches 10% of all health care expenditures, or roughly $100 billion dollars. To combat this increasing problem, the Justice Department has used the False Claims Act as their primary tool. However, the federal government cannot hope to uncover all instances of fraud without the help of the common citizens. In order to promote the participation of private citizens in its battle on fraud, the government gives them the standing to file civil suit on the federal government's behalf by the FCA's *qui tam*, or whistleblower's provisions.

Qui tam is short for "qui tam pro domino rege quam pro se ipso in hac part sequitur", which is Latin for "he who brings the action for the king as well as himself". When a private citizen files a qui tam case, it is submitted as a "sealed document" (that is, not to be seen by anyone but the claimant and the government) to the Department of Justice, who studies the case and decides if it will take up the case for further investigation. The government has up to 120 days from the time they receive the sealed complaint to decide whether or not to intervene. If the government decides to intervene, it literally takes over the case from the claimant, who essentially loses all control over the proceedings. However, the claimant still stands to be rewarded between 15% and 25% of the total amount recovered by the government, as well as attorney's fees and expenses. This type of reward provides additional incentive for ordinary citizens to "blow the whistle" when they see a firm engaging in fraudulent activity. If the Department of Justice does not choose to intervene, the private citizen can still move ahead on their own to investigate the case.

The False Claims Act covers virtually all forms of fraudulent behavior except tax fraud. The Act prohibits:

- ♦ Knowingly presenting, or causing to be presented to the Government a false claim for payment;
- ♦ Knowingly making, using, or causing to be made or used, a false record or statement to get a false claim paid or approved by the government;
- ♦ Conspiring to defraud the government by getting a false claim allowed or paid;
- ♦ Falsely certifying the type or amount of property to be used by the Government;
- ♦ Certifying receipt of property on a document without completely knowing that the information is true
- ♦ Knowingly buying government property from an unauthorized officer of the Government; and
- ♦ Knowingly making, using, or causing to be made or used a false record to avoid, or decrease an obligation to pay or transmit property to the Government.

The False Claims Act can be applied to a broad variety of situations. Subcategories of medical fraud that are pertinent to hospice care include:

- Double-billing,
- Use of untrained personnel to provide services,
- Forgery of physicians' signatures,
- Kickbacks for referrals and other activities,
- Services provided without the medical necessity,
- Fraudulent cost reports, and
- Inadequate care

(False Claims Act, 1986)

Odyssey's Response

In October of 2004, it was hard to imagine things being much worse for the management team at Odyssey Healthcare. The firm was rife with problems ranging from negative publicity to federal investigations. This list does not even include the significant challenges of effectively operating a rapidly growing business. Some of the more significant questions they faced included:

What circumstances have led to this DOJ investigation?

Why would the Department of Justice send a letter to Odyssey with such little information regarding the offense?

What types of misconduct would come under the purview of the False Claims Act?

If the investigation turned up some form of misconduct, can Odyssey be held responsible for the behavior of a few rogue employees?

What, if anything, could Odyssey do to promote a corporate culture where the ethical issues were better balanced with its business objectives?

What business measures should Odyssey take to avoid this type of investigation?

What types of specific operational practices under the following categories should Odyssey put in place to avoid any further investigation by the United States Department of Justice?

a. training
b. written standards or policies
c. disclosure program
d. internal compliance audits

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THE MID-CITY CONVENTION AND VISITOR'S BUREAU (CVB)

Kyle Ristig, Louisiana State University at Shreveport

CASE DESCRIPTION

This case can be used to illustrate concepts of leading an organization with multiple issues and priorities. Secondary considerations include the need for long-range planning and the effective utilization of resources, the need for partnering with other groups and organizations to achieve desired results, and, in this case, the ability to read the political climate to reach desired goals. The case has a difficulty level of two to three and is designed to be taught in one to two class hours. Depending on the depth of detail the instructor intends to pursue, preparation time for the students will take from one to three hours.

CASE SYNOPSIS

The Mid-City Convention and Visitor's Bureau (CVB) is faced with low employee morale, relatively fixed current funding, a lethargic, patronage-style board of directors, an uninformed public, and the requirement to deal with a state legislature and disgruntled voters to increase its revenue. The manager of the CVB believes additional revenue is necessary to increase marketing efforts in order to bring in more conventions and tourists. To increase revenue, the manager of the CVB would like to raise the current room tax, which is the CVB's primary source of revenue, or institute a restaurant tax. Both the room tax increase and restaurant tax plans are opposed by associations that represent hotel/motel and restaurant owners and operators. In addition, passage of either of the taxes will require significant political maneuvering to implement. The manager of the Mid-City CVB is faced with a catch-22 situation: CVB revenue cannot increase without conventions and tourists, yet current funding levels will apparently not allow additional marketing to the conventions and tourists they are attempting to reach.

THE MID-CITY CONVENTION AND VISITOR'S BUREAU (CVB)

The Honorable Fred Gann, Messrs. John Barnes, Ricky Bartholemew, Martin Hall, Robert Fulco, and Mrs. Debbie Jones have a common problem – how to improve the operations of the Mid-City Convention and Visitor's Bureau (CVB) and encourage tourism in Mid-City. The mayor of Mid-City, the Honorable Fred Gann, appoints all members of the eleven member board. He realizes that he must appoint members that are willing to work in the best interest of Mid-City but, as is the custom, he typically appoints those that will support his re-election efforts. Although there is no requirement in the Mid-City CVB charter to do so, mayors have traditionally appointed a representative from the Mid-City Hotel and Motel Association (HMA) as well as the Mid-City Restaurant Association (RA) to a two-year appointment. Although Mid-City has an active Chamber of Commerce, that organization is not represented on the board. Once seated, the board elects a president for a two-year term which is currently held by John Barnes. He is joined by Ricky Bartholemew, the president of the Mid-City Hotel and Motel Association (HMA), Debbie Jones, the president of the Mid-City Restaurant Association (RA), and Martin Hall, an outgoing small business owner. Hall is considered the “main player” on the Mid-City CVB board. Hall has served on the board for 8 years, the longest tenure of any member, and has managed to form alliances with most of the members of the board and the CVB staff. The president and members of the CVB board work with Robert Fulco, the manager of the CVB for the past five years and a permanent board member, to further the aims of the CVB. Hall, Barnes, and Fulco enjoy a congenial relationship and have known each other for a number of years.

Mid-City is a medium sized city within a four-hour drive of a major metropolitan area. It has an active regional airport, freight rail service, and is located on the interstate highway system in the Midwestern United States. The economy of Mid-City is based on agriculture and manufacturing, although one significant portion of the manufacturing sector is experiencing a decline due to deteriorating economic conditions and competition from overseas manufacturers. The Mid-City Chamber of Commerce has been aggressively pursuing new industries but their efforts to date have met with somewhat mixed results. There are several small colleges located within a two-hour drive of Mid-City, but there are few major tourist attractions in the immediate area, and sporting events are not usually supported by the local community. The climate and geography of the Mid-City area, however, allow for outdoor activities (hunting, fishing, camping, and boating) for a good portion of the year. Mid-City voters recently rejected bond proposals supported by the Mid-City Chamber of Commerce and the Mid-City CVB for the construction of a zoo and additional parks.

MID-CITY CVB EMPLOYEES AND BOARD

The Mid-City CVB is a non-profit organization with thirteen full-time employees, including the manager. The number of CVB employees is typical for a city of this size, with oversight provided by a board of directors. Employees of the CVB seem to focus on tourism and conventions, although the by-laws of the bureau charge the CVB with the responsibility of promoting the Mid-City area as a desirable area to live and bringing as many meetings and visitors to the area as possible. Employee surveys appear to support this conclusion with only a few of the employees mentioning the need for community interaction. CVB employees usually work alone and the CVB does not have a formal employee development program.

The members of the Mid-City CVB board receive no compensation for their work. Although board members come from relatively diverse backgrounds, including business and government, only one of the current board members has direct experience in the tourism industry. That board member, Ricky Bartholemew, is also the president of the Mid-City's Hotel/Motel Association (HMA). The Mid-City HMA is made up of representatives of the local hotels and motels with the purpose of furthering the interests of their members - primarily increasing hotel and motel occupancy rates. Members of the association have previously spoken out against further hotel development due to the low occupancy rates they have experienced in the past and have asked the CVB to pursue ways of increasing tourism in the Mid-City area. The Mid-City Restaurant Association, comprised of restaurant owners and operators and currently led by Debbie Jones, has similarly requested help from the CVB to bolster tourism.

Historically, the CVB monthly board meetings have had high levels of absenteeism and board members seem uninterested or unable to provide guidance to the manager and staff of the CVB. No job descriptions exist for members of the board and previous attempts to involve the board in goal planning sessions as well as other CVB activities have failed for lack of board participation. Although Martin Hall has encouraged members to take an active role in the CVB, other than John Barnes and Robert Fulco, the members seem to occupy their positions only to "help out" the mayor or to gain free entrance to local events, consisting mainly of craft shows, gun shows, rodeos, and the state fair. The employees of the CVB feel they are overworked and underpaid. Morale is low, but a poll of the CVB employees shows that they believe the bureau is doing a "good" job of promoting conventions and tourism for the Mid-City area. Outside consultants, however, have determined that definitive analysis of the effectiveness of the bureau is not possible due to the bureau's use of vague and inconclusive measures.

MID-CITY CVB OPERATIONS

To measure its effectiveness, the CVB uses tourist inquiries and convention bookings as performance criterion. It has been noted that convention bookings may not provide an accurate nor effective measure since one large convention could produce a greater economic impact than several smaller conventions. In addition, the extended time lag between a booking and the convention could skew the results from one year to another. Measuring tourist inquiries does not provide reliable data since an inquiry does not necessarily translate into an actual visit and, if a visit does occur, there is no indication as to the length of stay.

The primary source of income for the Mid-City CVB is a three percent room tax from hotels and motels within the city and immediate surrounding area. Supplemental sources of income include state funds, interest income, and rental fees of the city's convention center. Although funding is limited, the bureau has shown the ability to control its expenses and operate within existing revenues. Expenses of the Mid-City CVB are classified as tourism, convention, or administrative depending on the application of the expense, with administrative related expenses absorbing all personnel costs and overhead of the CVB. Payroll expenses are forty percent of the approximately $1.2 million operating budget. Expenses seem to be reasonable in all categories for a CVB of this size and no significant reductions can be expected.

PROBLEMS FACED BY THE MID-CITY CVB

The Mid-City CVB has targeted three markets: conventions, recreational tourists, and corporate business travelers. Their efforts have met with some success but it has been noted that the CVB suffers from lack of recognition within the local community. Although their finances are sound they believe that they cannot capture additional market share in their target markets without an increase in funding for marketing. The likelihood of an increase in state funding is almost nonexistent and an increase in rental rates for the convention center would not have a significant impact on revenues. Additionally, an increase in convention center rental rates could result in loss of convention business to other, less expensive facilities in other cities. The manager of the CVB has proposed an increase in existing taxes or implementation of a new tax as ways of increasing their revenues. He has argued that the proposed taxes are necessary for expansion of the CVB's marketing efforts in order to effectively compete against other mid-size cities for convention and tourist business. He has also noted that each dollar spent in marketing the Mid-City area returns $75 in tourist expenditures.

Plans for increasing revenue include raising the room tax from three percent to four percent, which would raise the total tax rate for hotels and motels to seventeen percent. This increase would compare favorably with others throughout surrounding states, while generating approximately $340,000 in additional income. Another alternative is to establish a one percent restaurant tax, similar to that used in some metropolitan areas. This proposed tax could provide an estimated $400,000 in increased revenue for the CVB. All of the tax proposals would have to be authorized by the state legislature after approval by a vote of Mid-City residents. The bureau does not have a formal plan regarding how the increased income will be spent, although the manager of the CVB has indicated the need for additional "marketing."

Fearing that an increase in room rates will cause a loss of business to other nearby cities, the increase in the room tax is adamantly opposed by Ricky Bartholemew and the Mid-City HMA. Bartholemew has stated that a tax on the restaurants is needed since it would yield more money and spread the cost among visitors and residents. Similarly, Debbie Jones and the local restaurant association oppose the implementation of a restaurant tax dedicated to the CVB. She and the restaurant association believe a restaurant tax is unfair and she has indicated that she would support a tax increase on the local hotels and motels if it came to a board vote. Hall, Barnes, and Fulco want to do what's best for Mid-City but aren't certain which option to support. They know that it's not likely that they'll be able to satisfy everyone and the other members of the board are ambivalent.

The mayor of Mid-City, Fred Gann, is concerned with his re-election so will not provide strong support for fear of raising the ire of either of the associations represented on the board.

Ricky Bartholemew, Debbie Jones, Martin Hall, Robert Fulco, and John Barnes have scheduled a meeting to discuss, and hopefully decide on, actions that must be taken.

AUNTIE ANNE'S PRETZELS: A KNOTTY PROBLEM

Sherry Robinson, Penn State University
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CASE DESCRIPTION

This case involves growth and management issues, and is appropriate for small business and management courses. A secondary issue is the owner's social motives for the business, thereby making this case appropriate to a discussion of entrepreneurial goals and social responsibility. It traces the birth and growth of a new business into an international franchise system. It is a level 2 case designed to be covered within one class period and is appropriate for small business or management classes. The purpose of this short case is to expose students not only to real-world questions of strategic management and franchise development, but also the way an entrepreneur's personal goals can influence business decisions.

CASE SYNOPSIS

Auntie Anne's is a family owned and operated snack eatery business that holds a strong commitment to customer satisfaction. The company focuses on product quality, strong support to its franchisees, and a commitment to relationships that will help in the long-term growth of the franchise system. Auntie Anne's success can be seen in its growth from a farmers' market stand to the expanded franchise system it offers today. Founder Anne Beiler started the business as a means to fund charitable work, and now Anne is considering selling the business in order to focus on her charitable projects. In addition,there has been an expansion of Auntie Anne's to include a new café format as well as the furthering of the charitable aspect of the business. This case study will examine Auntie Anne's past and possibilities for the future from a corporate and franchisee perspective.

INTRODUCTION

Auntie Anne's Pretzels started selling soft pretzels at a single stand at a farmers' market in Pennsylvania. Mainly via its franchise system started in 1989, this private enterprise offers customers its products at more than 900 outlets in 43 states and 12 countries including Japan, Thailand, Malaysia, Saudi Arabia, the Philippines, and the United Kingdom (as of January 2007). As with many franchises, outlets are primarily located in high-traffic areas, such as malls, transportation hubs, and stadiums. (Hoovers, 2007) The company's sales have grown every year as has the price of a franchise outlet, paving the way for Auntie Anne's current status as a segment leader.

BIOGRAPHY OF ANNE BEILER

The story of Auntie Anne's begins with founder Anne Beiler, whose overall goal for the business was to make enough money to fund a counseling center that would help people of Amish background find psychological help and healing. Anne and her husband, Jonas, had become interested in mending people's lives after their daughter died in a tragic accident. They wanted to help people in the same way their friends and neighbors had helped their family. As a family business, Auntie Anne's Pretzels' goals have been closely intertwined with the goals of the founders, so it is important to understand the Beilers in order to understand the company.

According to her autobiography (Beiler, 2002), Anne's story begins on January 16, 1949, on a farm in Lancaster County, Pennsylvania. Born to Amish parents, she grew up without using electricity. A horse-drawn buggy was the only means of transportation. As the third of eight children, Anne gained a lot of experience baking and loved doing it. When she was 12 years old she baked her own cakes and pies for a Philadelphia market stand where she worked with her parents. By the age of 14 she had her first job as a waitress in a truck stop, where she developed her philosophy that "kindness and a smile would open the door to anyone's heart"(Beiler, 2002).

Anne met her future husband, Jonas Beiler, at a friend's birthday party and they were wed in 1968. They moved to Texas and lived there for 20 years. Upon returning to Pennsylvania in 1987, Anne managed a soft pretzel stand at a farmers' market in Maryland. After seven months, she and Jonas purchased a booth at the farmers' market in Downington, Pennsylvania, where they sold pizza, stromboli, ice cream, and hot hand-rolled soft pretzels.

As she worked with the stand, Anne noticed the pretzels were the most popular item and they appealed to people of all ages. She set out to develop her own pretzel, and for two months Anne tinkered with the recipe but with disappointing results. Just when she was about to give up, Jonas suggested some ingredients his mother used when he was a young boy. They added them to the pretzel mix and a "new" recipe was created--the Auntie Anne's pretzel. The hot, salty treat was a hit with customers. Long lines of people who wanted only pretzels and fresh lemonade formed in front of the stand. Within a year they opened a second stand and then a third and fourth. The Beilers' garage became an office and family and friends helped her mix batches of pretzels, paint signs, construct booths, and deliver ingredients, in addition to working at the market stands. The original pretzel logo on the Auntie Anne's signs came from a photocopy her sister Becky made of one of the actual pretzels.

THE SUCCESS OF AUNTIE ANNE'S

The success of the stands made the news and Anne received her first request for a franchise. She knew nothing about franchising but decided to try it, learning the business by trial and error. The first franchise outlet went to her brother in 1989 for $2,500. Cousin Sam Beiler was another of the first franchisees. In just a few years the price for a franchise rose to $7,500 and by 2005 it had risen to $28,000.

Auntie Anne's 2003 sales were approximately $234 million, rising to $247 million in 2004. Same-store sales were up 2.1% during this time with an average check of $3.45. Revenues in 2005 totaled $252 million and they are projected to be $266 million in 2006 as well as rolling their "billionth pretzel" (Burns, 2006). Auntie Anne's Pretzeldog, the most successful new product in many years, takes Auntie Anne's closer to the sandwich market, yet, like a pretzel, is easy for consumers to eat on the go. The outlook for 2006 includes the opening of about 45 new stores in the United States and possible further international expansion into Japan in China (Jennings, 2006).

FRANCHISING & AUNTIE ANNE'S

As Auntie Anne's is a network of franchised locations, a basic understanding of franchising is essential. Auntie Anne's 900 locations are managed by 250 franchisees worldwide. Franchising entails a business model in which a franchisor (e.g. Auntie Anne's, Inc.) licenses trademarks and tested business processes to a franchisee (operator of a local outlet) in exchange for a recurring payment known as royalties, including a percentage of profits as well as the annual fees. The franchisee typically "have the ability to secure the necessary funds for locations within the United States, which represents the initial investment to open an Auntie Anne's franchise concept" (Auntie Anne's Pretzels, 2006). Specifically for Auntie Anne's, the potential franchisee must typically have the ability to secure around $350,000 in order to be considered qualified for an Auntie Anne's store location. For international locations the capital requirement ranges from $1 million to $2 million USD. These amounts represent the initial investment for the opening of a location. The system entails risk taken by both the franchisor and the franchisee.

To assess risk and opportunity, consider the following analysis from both the franchisor and franchisee perspectives of the Auntie Anne's concept. For the franchisor, the following can be considered when offering the trademark and/or business process to a franchisee. A strength of a franchisor is its size and potential to quickly expand due to the mobility of the franchising business model. Additionally, since the localized risk is assumed by the franchisee, a franchisor can more easily absorb the negative effects of a failed venture due to the initial investment by the franchisee. A weakness of a franchisor is that intellectual property is vulnerable and ideas can be used by franchisees to become a competitor. Opportunities include quick expansion and a turnkey process which leads to a competitive advantage in many local markets. Independent businesses (non-franchise) are threatened by the spread of franchises. Specific threats to franchise operations include unfavorable legislation, processes required in certain states, as well as the possibility of franchisees stealing ideas and becoming competitors.

From the franchisee perspective, a strength is that an entrepreneur can obtain quick access to a proven brand and business model yet employ his/her enterprising spirit by entering into a franchising agreement quickly. The franchisee usually has access to marketing, training, ongoing support and an established supplier or distribution network. On the other hand, the established suppliers may not be the least expensive or most efficient. The franchisee has minimal leeway in this area in most franchise contracts. This is typically due to quality concerns. A weakness for the franchisee is a loss of control that the entrepreneur starting from scratch retains in a business venture. The franchisee is required to follow a certain protocol determined by the franchisor. Among different opportunities figure the potential for good return on investment, a solid brand name, and training opportunities. Threats include competition and risks with snack food location employee turnover. Additionally, strong brand can hinder expansion into other products due to the consumers' brand/product associations.

DUE DILIGENCE AND COMPETITION

The due diligence investigation of a potential investment serves to confirm the fundamental material facts in regards to a sale. This refers to the care a rational party should take before entering into an agreement or a transaction with another party. Due diligence analysis usually yields a go or no-go decision with regards to a purchase of an asset, or in this case a franchise commitment (franchisor <-> franchisee). This process should entail a thorough study of financial records in addition to anything else material to the sale. Sellers (franchisors) should also perform a due diligence analysis on the buyer (franchisee). Factors to be reviewed include the franchisee's ability to purchase, as well as other items that will affect the franchisor after the sale has been completed. Due diligence serves the purpose of preventing unnecessary harm to either party involved in a transaction.

Beiler moved up the learning curve quickly with regards to franchising. She seemed to develop a keen acumen for the key criteria for potential franchisor/franchisee investment decisions. Beiler realized the importance of national or international advertising, training, and other support services are commonly made available by the franchisor. As franchising tends to be longer term than a licensing agreement, greater due diligence by both franchisor and franchisee is advised. A prospective franchisee has an array of franchises and industries from which to choose. Table 1 can serve as a quantitative starting point for comparing Auntie Anne's and direct competitor Wetzel's Pretzels. Conversely, qualitative factors tend to be subjective judgments based on non-quantifiable information. Examples include perceived strength of brand, management expertise, firm reputation, and industry cycles.

Table 1 – Franchise comparison		
Revenues – Systemwide		
	Auntie Anne’s	Wetzel’s Pretzels
Year	U.S. only	Worldwide
2003	$234,000,000	$394,000,000
2004	$247,000,000	$453,000,000
2005	$252,000,000	$567,000,000
Revenues – Per unit (U.S.)		
Year	U.S. only	Worldwide
2003	$336,690	$1,931,372
2004	$363,770	$2,097,222
2005	$350,974	$2,486,842
Number of units (U.S.)		
Year	U.S. only	Worldwide
2003	695	204
2004	679	216
2005	718	228
Initial Franchise Fee	$30,000	$30,000
Royalty Fees	7.0% of gross sales	6.0% of gross sales
Advertising Fees	1.0% of gross sales	1.0% of gross sales
Initial Training Fee	No charge, 3 partic. min.	No charge for first two partic.
Initial capital requirements	$192,875 to $373,600	$129,875 to $353,000
*Sources-FRANDATA.com, Hayes, Jennings, AuntieAnnes.com, Entrepreneur.com		

Wetzel's Pretzels, with well over 200 locations, is a national competitor with 2004 sales of almost $453 million. Same-store sales were up 7.5% from $346,000 to $372,000 between 2003 and 2004. Wetzel's pretzels weigh 6 ounces, 50% more than competitors' average 4 ounce pretzels. The pizza pretzel, topped with cheese and pepperoni, and a pretzel wrap with a hot dog and cheese are two items that are, like Auntie Anne's pretzeldog, closer to the sandwich category.

Two of the largest competitors, Pretzel Time and Pretzelmaker, are owned by Mrs. Field's Famous Brands. Each brand has more than 200 units, with Pretzel Time mostly in the east, and Pretzelmaker in the west. Customers spend an average of $3.90 each on items such as cheese stuffers (pretzel dough wrapped around cheese cubes), pretzel bites (small bits of pretzel with toppings) and pretzels around hot dogs. Pretzel Time, has conditions similar to Auntie Anne’s: ongoing royalties of 7% of gross sales, advertising fees at 1-3% of gross sales, no charge for first two individuals as an initial training fee and a total estimated initial investment ranging from $107,000 - $238,500. The quickest and easiest way for potential competitors to set up a soft pretzel outlet is to go through a type of generic company such as Pretzel Plus. This company provides supplies and ingredients needed for a potential entrepreneur to open a pretzel shop under any name (not restricted to Pretzel Plus). To open a 500-1,000 square foot franchise outlet with this organization, a total investment of approximately $80,000 to $103,000, with a minimum net worth of $150,000, of which $40,000 needs to be in liquid assets. The franchise fee is $12,000 with 4% royalties.

The Pretzel eateries are similar in many aspects, with Auntie Anne’s having the highest initial investment, probably due to their more ornate store style and perhaps a more valuable and recognizable brand. There is anecdotal evidence indicating that it’s near impossible for an individual franchisee to open up an Auntie Annie’s anymore in the U.S.A. while most other brands are actively seeking individual franchisees. Several franchisers predictably have expanded their menu to include hot dogs, frozen custard and burgers, or from the other direction to include pretzels in their existing menu. When evaluating which franchise system to buy into, one might pay special attention to the franchisor with the lowest food and supply costs as a location will only support a narrow range of sales regardless of the franchise, ergo lower costs and fees over the year is very important. Additionally, the importance of a competent level of responsive service must be considered. A franchisee should also consider whether there is room for entrepreneurial selling, such as supplying local businesses, schools, or other events with tasty pretzels as the extra sale can make the difference between taking a salary or not.

Auntie Anne’s is a current leader in the soft pretzel business, but it does face competitors that would like their own piece of the market. This may hinder Auntie Anne’s future ability to charge premium prices as the market comes closer to saturation. In addition to the Pretzeldog, a hotdog wrapped in pretzel dough, Auntie Anne's has considered expanding its operations with a new café concept. Unlike the typical pretzel outlets that offer no seating, each Auntie Anne's Café seats approximately 30 people. Similar to other modern cafes, these serve gourmet coffee, offer a lunch and light dinner menu (sandwiches, pizzas, breads, soups, etc.), and provide wireless internet access. Most items on the menu are made from the same pretzel dough, but prepared in different ways. Five Auntie Anne's Café opened in Lancaster, Pennsylvania. Others may be opened if this concept proves to be a success.

SOCIAL RESPONSIBILITY

To some degree, the level of social responsibility that Auntie Anne’s undertakes can serve as a source of competitive advantage. Auntie Anne’s Incorporated started with an objective of funding a counseling center and has also been involved with the Children’s Miracle Network. Additionally, for employees, Auntie Anne’s provides some educational scholarships as well as home down-payment gifts. The organization also has sponsored events such as the national competition for the recitation of the tongue twister "picky pretzel people pick pretzel perfect pretzels" which took place during the summer of 2006 and resulted in each participant receiving book donations, as the winners receiving substantial prizes of $2500 for 1st and $500 for 2nd place. The tongue twister is also part of a new branding program

Charitable work is Anne and Jonas Beiler's passion. Auntie Anne's was created primarily to support the couple's charitable projects. In 1992, Jonas opened the doors to the Family Resource and Counseling Center, which is still in operation. The company also funds a non-profit organization, the Angela Foundation, named after the daughter who was lost to them years before. Anne feels that this is the part of the company that extends the belief to give back a portion of the gifts God has given her and her husband. Such activities have positive impacts on the brand.

CHANGE IN OWNERSHIP

Anne has considered selling Auntie Anne's to her distant cousin Sam Beiler, who is also the President and CEO of the company. He has been part of the Auntie Anne's family since 1989 when he became one of the company's first franchisees. Since then, he has concentrated on opening 137 foreign stores and overseeing 37 company owned units. If the company is sold, it is likely that he will take it in a new direction. Sam Beiler has already stated that he would like to open about 40 pretzel stores a year. He alsoplans to introduce the Auntie Anne's Café slowly to see if it will be profitable. With the right marketing and products the Café may be a very profitable franchise.

By selling the business she created, Anne will have the time she wants to work towards her long-term goal of helping families in need. Anne and her husband would also be able to work to open a family center that will provide help to children in their hometown. However, Anne wonders if her strong beliefs in commitment, giving, and customer satisfaction will continue to be instilled in employees if she leaves.

If Sam buys Auntie Anne's, he will be purchasing a brand that is synonymous with good quality, reliability, and profitability. He will have to maintain the good reputation that the company currently holds. Since he has succeeded in the past with providing more business opportunities for Auntie Anne's, he may be able to further succeed with the core business. However, the question remains as to the future of Auntie Anne's Café.

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PROPERTY RIGHTS IN CYBERIA A STUDY OF "INTENT" AND "BAD FAITH"

A Case Study in the Adventures of Creating Property Rights in Cyberspace

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CASE DESCRIPTION

The primary objectives of this Case Study is to address the dynamics and challenges of harmonizing present day business practices that may be impacted by traditional legal concepts, identifying current government/international organization regulatory initiatives that influence Internet policy, and coordinating case law principles that have application to resolving business disputes pertaining to "Cyberspace Property" status and other related property activities on the Internet. This Case Study provides primary subject matter insights into complexities of intellectual property rights as related to Cyberlaw principles and E-Business activities that have been profoundly effected by recent technology changes. Another important aspect within the framework of this environment of changes are the continuing dynamics of Internet oriented commercial activities and its effects on managing and conducting business transactions, both locally and globally. In this instance, intellectual property rights, commercial activities, and the business transaction process are directly related to each other and have profound effects on business outcomes.

Secondary issues examined in this Case Study pertain to numerous "ethical dilemmas" created by commercialization of advancements in technology and, again, the effects that such "changes" have on law and the business community. Also, within the context of intellectual property issues, U.S. Constitutional issues and criminal activities will be evaluated. Additionally, student preparation for the Case Study is exclusively assigned to On-line legal research activities.

This Case Study has the difficulty level of two or three, and is suitable for sophomore and junior course work in "Legal Environment of Business" or "Business Law." It is also applicable to various specific topics within E-Business/E-Commerce curricula (e.g. E-Marketing, E-Law, E-Strategy/Policy among others). Primarily, it is designed as a supplement and update to materials introduced in textbook chapters relating to intellectual property and Internet law. This Case Study may be taught in a cumulative four-hour class session(s) and requires four hours for student preparation.

CASE SYNOPSIS

The pioneering journey of this Case Study explores new and exciting adventures of virtual property rights in the world of Cyberspace. The objectives, in this instance, is to investigate on the merits the facts of this spirited Case Study and determine current relevant issues relating to On-line/Internet oriented Cyberlaw principles that are directly applicable to contemporary practical business approaches and will help reveal and solve some of the mysteries of Cyberjustice trends. Key material factors are addressed specifically through uniquely fashioned commercial events enumerated within the Case Study during an exhaustive fictitious 30 day period. A sampling of topics include: Cybertrespass, Cyberstuffing, Pagejacking, Spoofing, Cybersquatting, Cyberpiracy, Typosquatting, Protest Domains and Cybergripers, Metatagging, Keywording, Linking, Framing, and Mousetrapping.

The second feature of this Case Study is in teaching specific On-line business and legal research skills. All student preparation is Internet based. "Student Instructions" include an exhaustive section pertaining to On-line research.

This is where the virtual rubber hits the virtual road. The "Student Instructions" also includes a number of detailed instructions and approaches that address the formulation of case issue/issues through the process of understanding the basic operative facts enumerated within the fictitious 30 day period of the basic Case Study and by applying legal principles most suitably related to the stated facts that will essentially establish the rule of law for each identified issue. Next, the transition from the previous process of establishing the issue is to present the reasoning and analysis of why there is application of the law in resolving the original dispute as presented by the stated facts. Finally, the conclusion states the outcome in a definitive style that establishes the results of the decision making process. The hope at this point: predictability, stability, and continuity. Students use a combination of "Student Instructions" that follow the Case Study, evaluation of the fictitious 30 day period of facts presented in the Case Study, and On-line research in the learning process. Finalization of the process is extensive and challenging student discussions in the classroom. [Hint: The outcome of this Case Study ends with a twist of fate not foreseen by Dr. Ima Goode and Dr. Rob M. Phast, competing university presidents.]

THE CASE STUDY

Old Ivy University

Old Ivy University (OIU) is a prestigious private nonprofit university located in the small college town of Oxford-Cambridge. The University celebrated its 200th anniversary this year. Students enjoy the traditional formal environment of the campus. Entrance requirements are very competitive, selecting 3,000 new students per year from more than 50,000 applications. The OIU has been recognized as one of the top academic institutions in the nation for the past century, and has competed successfully for numerous NCAA titles in various sports for the past 51years. Dr. Ima Goode, a noted and respected administrator and academic, has been President of the University for the past 25 years.

The University registered trademarks with the U.S. Patent and Trademark Office (PTO) in Washington, D.C., for (i) "Old Ivy University;" (ii) the Old Ivy University "Winners," the university's sports teams; (iii) the traditional school symbol, a golden goat with the letters "OIU" emanating from its crown; and (iv) the school slogan "Let's Win the Big One." All the above identified trademarks have been properly registered and renewed at proper intervals with the PTO. Also, OIU has utilized various university trademark clearing house organizations to post, notify, and protect its trademarks from potential infringement in sports memorabilia and the like. Since the original trademark registration in 1949, there has been no infringement activity involving the trademarks.

The University registered its Internet Domain Names, "www.oldivyuniversity.edu" and "www.oiu.edu," through Network Solutions, Inc. in 1996, and with "www.register.com," a registration site accredited by the Internet Corporation for Assigned Names and Numbers (ICANN), in 2001. Its uniform resource locator (URL) address has been in operation for over fifteen years. The University uses its Internet site to inform the public about its highly accredited academic programs as well as its accomplishments on the sports fields. The University has been recognized as one of the top tier universities in the world for many years.

International Olympic University

The International Olympic University (IOU) is a for-profit corporation properly registered with the state. It is located across the street from Old Ivy University and is housed on the second floor of an office building in a three room suite. IOU has been approved by the State Department of Education as a degree granting institution of higher learning. Dr. Rob M. Phast is the founder, President, CEO, and Chairman of the Board of the corporation.

Previously, Dr. Phast was the sole proprietor and operator for fifteen years of an independent used car lot, "Old Ivy-Let's Win Used Cars," in Oxford-Cambridge. Following the sale of the car lot to a local partnership, "Swift, Takem & Leavem," Dr. Phast established IOU and employed three clerks on February 29, 2005. Dr. Phast's educational background includes an Associate of Arts degree from Oxford-Cambridge Community College in physical education, and a Ph.D. from Cambridge Technical College, Cayman Islands. His dissertation is titled, "Indigenous Tribes and Headhunters from the South Pole."

The University properly registered trademarks on March 1, 2005 with the U.S. Patent and Trademark Office in Washington, D.C., for (i) "International Olympic University;" and, (ii) the school symbol, a golden goat with the letters "IOU" emanating from its head. IOU registered its Internet domain name, www.iou.edu, with www.register.com, a registration site accredited by the

Internet Corporation for Assigned Names and Numbers (ICANN), on September 1, 2005. This website describes the various university degree programs offered by IOU.

All IOU programs are offered through non-traditional education approaches, such as experience, previous knowledge, hobbies, and book reports. There are no residence requirements. Awarding of degrees is by submitting requirements to the IOU Degree Committee, composed of Dr. Phast and his three clerks, for review along with a check for substantial fees payable to IOU. Final degree approval is granted by the IOU Executive Committee, composed of Dr. Phast and his three clerks. The education community generally regards IOU as a diploma mill.

Opening day of IOU was a big day for Dr. Rob M. Phast. Immediately, he felt as though he had become his own education entity. During the first six months he exhausted his advertising budget buying T.V. commercials (professional wrestling and cooking shows) and by taking out ads in a number of magazines (National Geographic, Mechanics Illustrated, and several comic books) promoting various degree programs offered by IOU, such as the B.S. in Leaf Raking and the M.S. in Scrap Booking. Unfortunately, there was little response to the ad campaigns during this time. His only customer was his former mother-in-law, who was awarded a Ph.D. in Bird House Construction.

Additional Facts

To the surprise of the IOU staff, interest in IOU degree programs became very active during the month of September, 2005. By October IOU had a student body of 800 from around the world. By the middle of October, Dr. Phast hired a fourth clerk and immediately gave her the job title of “Register.” Amazingly, during the month of October, interest in IOU programs continued and 400 additional enrollees were accepted to the various programs. Dr. Phast noticed that 99.999% of the responses were from E-mails. He also noticed that half of those registered in the programs were international students.

On November 1st, Dr. Phast directed his brother, Drew Phast, a computer and Internet graphics designer, to insert several embedded text messages on IOU’s home page, including: (i) Old Ivy University, (ii) OIU, (iii) OIU Winners, (iv) Old Ivy Winners, and (v) “Lets Win the Big One.” The messages were placed in darkened areas on the home page so as not to be readable by Internet users on November 2nd.

On November 3rd, Dr. Rob M. Phast registered Domain Names “oldivyuniversity.org, oldivyuniversity.net, “oiu.org,” “oiu.net,” “oiu.winners.edu,” “oldivyuniversitywinners.edu,” “olivyuniversity.edu,” “olivy.edu,” “olivywinners.edu” “iou.runners.edu,” “oivy.edu,” “oivyrunners.edu,” and “oivyuniversity.edu” through www.register.com, a registration site accredited by ICANN.

On November 4th, Dr. Rob M. Phast directed his brother, Drew Phast, to insert a “redirect” command embedded messages for all of the above newly registered Domain Name sites that would immediately reroute all the users to www.iou.edu.

On November 5th, Dr. Phast contacted eight search engine groups representing a total of 400 search engine sites per group and subscribed with each group on a quarterly basis to prioritize keywords for searches for IOU’s home page as follows: Old Ivy University, OIU, Old Ivy Winners, International Olympic University, IOU, and university. Dr. Phast also made the same requests for each of the Domain Name sites that were registered on November 3rd above.

On November 6th, Dr. Phast directed his brother, Drew Phast, to bypass Old Ivy University’s Internet home page and link an extensive section that identified regional attributes of university life in the Oxford-Cambridge regional area to IOU’s Internet site. This action essentially bypassed Old Ivy’s home page and appeared on IOU’s site embedded and displayed as part of its site, though OIU’s logo and URL identifier was displayed on IOU’s internal pages. This request was completed on November 7th.

On November 8th, Dr. Phast directed his brother Drew to capture four pages of pictures of picturesque red brick and ivy university buildings from Old Ivy’s web site and chop up the images into different frames and display the various frames as part of several pages throughout IOU’s website. On November 9th, Dr. Phast expanded his directions to include the capture of a unique drawing of one of OIU’s red brick and ivy university buildings on its home page and frame it on the very top portion of IOU’s home page. The framing was to conceal the origin of the original site (the OIU Website). These requests were completed on November 10th.

Dr. Phast noticed that the International Olympic University’s home page, www.iou.edu, was averaging about one thousand hits a day. On November 11th, he concluded negotiations with six businesses that signed contracts for advertising space on IOU’s home page. Provisions of each contract charged each business one cent for each hit.

On November 12th, Dr. Phast directed his brother Drew to make an exact digital copy of Old Ivy’s home page, www.oiu.edu, including the imbedded text messages. He then instructed Drew to insert a “redirect” command imbedded in the copycat OIU site that would immediately reroute the user to www.iou.edu.

On November 13th, Dr. Phast directed his brother Drew to incapacitate the “back” and “close” buttons on the www.iou.edu site and,instead, have each user returned to the original copycat OIU site or other registered Domain Name sites, as discussed above, that would again reroute all users back to the www.iou.edu site instead of exiting in a seemingly unavoidable endless loop.

On November 14th, Dr. Rob M. Phast registered the Domain Name www.oldivyuniversitysucks.edu through www.register.com, a registration site accredited by ICANN. This Internet site was designed for those who had complaints about OIU, such as critics of the university, dissatisfied students, candidates not admitted to the university, etc. The site also includes a discussion bulletin board where all complainers can communicate their dissatisfactions.

Dr. Phast instructed his brother, Drew, to insert several embedded text messages on this new site, including: (i) Old Ivy University, (ii) OIU, (iii) OIU Winners, (iv) Old Ivy Winners, and (v) "Lets Win the Big One." The messages were placed in darkened areas on the home page so as not to be readable by Internet users. Drew Phast posted the requested messages on November 15th.

On November 16th, Dr. Phast again contacted the eight search engine groups representing a total of 400 search engine sites for each group and added a subscription for www.oldivyuniversitysucks.edu on a quarterly basis to prioritize keywords for searches for this identified site as follows: Old Ivy University, OIU, Old Ivy Winners, International Olympic University, IOU, and university.

On November 17th, Dr. Phast directed his brother Drew to incapacitate the "back" and "close" buttons on the www.oldivyuniversitysucks.edu site and reroute all users to www.iou.edu instead of exiting. On the same day he contracted with SpamBomb, Inc. to deliver 100,000 E-mails a day to OIU for the next 90 days. Though sent out by SpamBomb, Inc., the E-mails were to look as though they were from the World Federation of Wrestling. Additionally, a second contract was signed with SpamBomb, Inc. to deliver over 2,000,000 E-mails a day for 30 days from numerous E-mail lists that were advertising the attributes of IOU.

On November 18th, Dr. Ima Goode, President of Old Ivy University (OIU), is informed by administrative officials at the university that numerous complaints have been surfacing from various users of the OIU Website for the past two or three weeks as to unusual and confusing activities on the OIU Webpages. Many of the users indicate that the OIU home page and many internal pages within the site are no longer user friendly. There are reports of user frustration, disappointment, despair, and even that of feeling or being dejected. The OIU Register reports that there may be irreparable harm in the form of less applicants (student pool) for next years entering students compared to the number that applied for this year. The OIU Alumni Club and sports teams report similar problems.

On November 19th, Dr. Goode is informed by administrative officials at the University that OIU's E-mail system is over utilized to the point of creating a demand beyond the capacity of the University's computer system as to disk space and processing power. There are multitudes of E-mails that are not able to be processed and the system has been overwhelmed to the point where E-mails are no longer delivered anywhere on campus and other University integrated computing centers on campus are inoperable. Dr. Goode requested that University officials, including the OIU general counsel, investigate the reported problems discovered yesterday and today and report back to her as soon as possible with all deliberate speed as to their findings. She specifically requested that the general counsel's office be directly involved with all the officials, but especially officials from the University computer services staff.

On November 20th, The Oxford-Cambridge Daily Journal, the town's newspaper, printed eight letters-to-editor critical of Old Ivy's Website from disgruntled Internet users. On November 21st, Channel 13 News, the major TV station in Oxford-Cambridge, reported from a negative perspective the problems users were experiencing from the OIU Website and criticized the University for the problems. It was also reported that the University refused to comment, except to say that the issues were being reviewed by the administration.

On November 22nd, the Register of International Olympic University reported to its President and staff that enrollment had increased by an additional 1,400 students during the month of November. Again, 99.999% of the responses were from E-mails and that half of the new registered students in the various programs were from international locations.

On November 23rd, the University administration, including the general counsel, reported back to Dr. Goode that after extensive and detailed investigations, the continuing problems appeared to be caused by or through the International Olympic University Website. Many of the problems reported were related to numerous re-routings to the IOU home page. The computer services staff reported that the E-mail problem origin appeared to be the World Federation of Wrestling. To everyone's surprise, it was also reported that IOU was located in Oxford-Cambridge across the street from OIU. The general counsel suggested, at the closing of the meeting at 6:00pm, scheduling a meeting as soon as possible with OIU and the World Federation of Wrestling for the purpose of immediately resolving the problems.

On November 24th, Dr. Imma Goode of OIU, in a telecom with Dr.Rob M. Phast of IOU, requested an immediate meeting with him. The two agreed to meet the next day at OIU. She then had a telecom with the president of the World Federation of Wrestling, Wild Bill Tuff. He adamantly and loudly denied any knowledge of his organization sending any E-mails whatsoever to OIU, let alone voluminous quantities as described by Dr. Goode. Following the telecom, Dr. Goode demanded additional investigations into the E-mail question by the computer services staff. Later in the day, the OIU general counsel delivered a just completed comprehensive "white paper" addressing many possible legal violation and approaches to resolving the reported problems, including suggestions and scenarios as how to proceed with civil filings and procedures and, if needed, the filing of criminal charges.

On November 25th, a meeting between Dr. Goode and Dr. Phast was held at OIU. Dr. Phast introduced his brother, Drew Phast, as his Web Master. Dr. Goode brought in her administrative staff, including the general counsel, to explain in detail the problems that OIU was experiencing on its Website, and to show how many of them were apparently linked to the IOU Website. A report was handed to Dr. Phast that contained the same information as presented at the meeting. Dr. Phast graciously accepted the information and said he needed time to review the numerous issues before making any comments and would telecom with Dr. Goode the next day. Following the meeting the general counsel left on a scheduled business trip to Washington, D.C. for talks with the U.S. Department of Education. She promised to keep in close contact with Dr. Goode during her absence from the OIU campus *via* cell phone. She is scheduled to return to campus on the afternoon of November 30th.

On November 26th, Dr. Phast phoned Dr. Goode and related that he was ready to state his position pertaining to the matter with OIU. On November 27th, a second joint meeting between the two parties was held at OIU. Dr. Phast indicated immediately that he had no intention of relinquishing the use of the various Domain Names assigned to IOU nor changing the rerouting techniques he has employed in using the various Domain Names. Dr. Phast continued that he was simply exercising his “Freedom of Speech” and “Due Process of Law” rights as specified under the U.S. Constitution. Dr. Goode related that such would not resolve the dispute and that an immediate solution was needed or OIU would start immediate legal action. Dr. Phast assured Dr. Goode that he would work out settlement suggestions that would satisfy everyone and converse with Dr. Goode on the next day.

On November 27th, Dr. Phast leaves a phone message on Dr. Goode’s answering machine that stated he would (i) relinquish Domain Names relating to OIU; (ii) exise from all IOU Websites all digital copies taken from OIU Website, including linkages from OIU; (iii) exise all re-routing techniques from IOU Websites; (iv) delete all embedded messages from all IOU Websites; (v) receive payment in the amount of $50,000 from OIU to IOU, the value of the items listed above; receive two free lifetime passes to all “Winner” games from OIU to show good faith. Dr. Phast also ended with a friendly “good-by” and a statement that the above were only settlement suggestions and a starting point and that he would look forward to additional friendly negotiations with Dr. Goode.

On November 28th, Dr. Goode, after arriving back to work following a sick day, sent a Fax, since her E-mail was out of order, to Dr. Phast that his settlement suggestions were not solutions to the dispute regarding Domain Name issues and that OIU would not pay money or give free Winner tickets to IOU. Additionally, she stated that the items on the IOU list were incomplete. She added that legal proceeding would start as soon as the OIU legal counsel returned to campus on November 30.

On November 29th, Dr. Phast responded to Dr. Goode’s Fax by sending an invoice to OIU through Dr. Goode office for $50,000 and two lifetime passes to all “Winner” events. The cover letter to the invoice states that he will not stop using the Domain Name techniques relating to the OIU Website until the invoice is paid in full by OIU. Late in the day the computer services staff presented Dr. Goode with a report that stated the voluminous E-mails were coming from a company in Slippery Rock, Pennsylvania, named SpamBomb, Inc. The report indicated suspicion as to IOU’s involvement with SpamBomb, but there was no proof to back it up. When Dr. Goode arrived home there was an overnight package waiting for her on her door step. It was an addendum to the original white paper from the OIU legal counsel that updated a number of factors since the original meeting with Dr. Phast. The general counsel and Dr. Goode had kept in daily contact during the general counsel’s absence.

On November 30, at 8:30am, after receiving the IOU invoice from Dr. Phast, Dr. Goode became uncharacteristically enraged and indicated to her secretary that she wanted to have a telecom with the "idiot" Dr. Phast immediately. Three top OUI administrative members were summoned within five minutes. Dr. Goode was not able to contact her legal counsel by cell phone. On the IOU side there were four staff members, Dr. Phast, and Drew Phast. Grabbing the addendum to the white paper provided by the OIU legal counsel, Dr. Goode turned to a page that she had marked the previous evening.

Vocabulary/Key Words	
Bombing	(Internet) Domain Name
Burden-of-Proof	Intellectual property
Civil law	Keywording
Corporation	Keywords
Copyright	Linking
Criminal Law	Megatags
Cybergripers	Metatagging
Cyberjustice	Non-Profit Corporation
Cyberlaw	Pagejacking
Cyberpiracy	Patriot Act
Cybersquatting	Possessory interest
Cyberstuffing	Private non-profit
Dilution by Tarnishment	Trespass-to-Chattel
Domain Protest Site	Uniform Resource Locater (URL)
Due Process of Law	Search Engine
E-mail	Spamming
First Amendment Freedom of Speech	Spoofing
Framing	Trademarks
Infringement	Typosquatting
in rem	
Internet	

She then yelled into the conference phone device, "Don't say a word Dr. Phast. Just listen. I have had enough of your stalling tactics. Here is the way it is going to be. You and your brother, Drew, are to return our computers to the status as they existed before November by disengaging all your various computer, Internet, and E-mail techniques you and your brother have devised against us in order to interfere with our various computer systems. We believe that you are associated in some way with SpamBomb, Inc. in interrupting our E-mail system also. You "black hats" (hackers who act with intent to cause harm) have caused enough cybervandalism. Dr. Phast and Drew, listen to this part very carefully. If my request is not granted by you and your brother within the next day, I am going, in person, to the local off ice of the Federal Bureau of Investigation, that is the FBI, to bring felony charges against both of you for "conspiracy in restraint of trade" under Section 1 of the Sherman Antitrust Act and I will give all of our documentation we have collected on these events to the officers as evidence." Dr. Phast quickly answered with, "Please, Dr. Goode, don't do anything rash." With that Dr. Goode ended the conversation by hanging up the phone. She placed the addendum to the white paper, that she had been referring to, on the conference table and returned to her office.

Government Agencies/Associations/Organizations
Federal Bureau of Investigation (FBI)
Federal Communication Commission
Federal Trade Commission (FTC)
Internet Corporation for Assigned Names and Numbers (ICANN)
Network Solutions, Inc.
U.S. Department of Justice, Antitrust Division
U.S. Patent and Trademark Office (PTO)
World Intellectual Property Organisation (WIPO).
www.register.com

STUDENT INSTRUCTIONS

The purpose of this case study is in developing *issues* specifically relating to Cybersquatting and various subtopics of Cybersquatting for class discussion. There are also several secondary issues that will be addressed in class that will supplement many of the primary issues, such as intellectual property, Constitutional Law, and criminal law. First, read the above Case Study in its entirety. Then review the suggested topics following the Case Study: *vocabulary/key words*; *government agencies/associations/ organizations;* and *codes, statutes, and regulations.* There are suggested Internet sites identified below for researching for more in-depth understanding of these identified topics. This activity is an exercise for introducing and developing basic concepts relating to the general topics and issues that are being introduced in the Case Study.

Next find and read each *case* opinion (the last listed topic above) *via* research on the Internet. Generally, the facts and law of each case will be relevant to particular facts within the Case Study. There are suggestions given below as to possible Internet research tools, techniques, and URL addresses that are available for this assignment.

Codes, Statutes, and Regulations
Anticybersquatting Consumer Reform Act (ACRA); Amendment to Lanham Act
Federal Trademark Dilution Act of 1996
Lanham Act (Section 1127)
Lanham Trademark Act of 1946
U.S. Code
Cases
E. & J. Gallo Winery v. Spider Webs Ltd., (S.D.Tex., Jan. 29, 2001) [Cybersquatting]
Nissan Motor Co., Ltd. V. Nissan Computer Corp., 289F.Supp.2d1154 (C.D. Cal., 2000) [Metatagging]
Bernina of America, Inc. v. Fashion Fabrics Int'l, Inc., (N.D. Ill. Feb. 8, 2001) [Metatagging]
Ford Motor Co. v. Lapertosa, (E.D. Mich., Jan. 3, 2001) [Cyberpiracy]
Playboy Enterprises, Inc. v. Global Site Designs, Inc., (S.D. Fla. May 15, 1999) [Cyberpiracy]
Playboy Enterprises, Inc. v. Welles, 7F.Supp.2d 1098 [Metatags]
Playboy Enterprises, Inc. v. Universal Tel-A-Talk, Inc., No. 96-6961, 1998 U.S. Dist. LEXIS 17282 [Trademark Infringement]
PaineWebber Inc. v. Fortuny, Civil Action # 99-0456-A (E.D. Va. Apr. 9, 1999) [Cyberpiracy]
Playboy Enterprises, Inc. v. Netscape Communications, Inc., 55F.Supp.2d1070 (C.D. Cal., 1999) [Keywording]
Nettis Environment Ltd. V. IWI, Inc., 46F.Supp.2d722 (N.D. Ohio 1999) [Keywording]
Ticketmaster v. Tickets.com, 2000 (C.D. Cal., August 2000) [Linking and Deep Linking]
The Washington Post, et al. v. TotalNews, Inc., Civil Action # 97-1190 (S.D. N.Y.) [Framing]
FTC v. Carlos Pereira d/b/a atariz.com [Pagejacking and Mouse Trapping]
Hasbro, Inc. v. The Internet Entertainment Group (Dilution by Tarnishment)
Ticketmaster Corp v. Tickets.com Inc., 54U.S.P.Q.1344 (C.D.Cal.2000) (Framing)
Hard Rock Café Intern. (USA) Inc. v. Morton, 1999WL717995 (Framing)
Compuserve, Inc. v. Cyber Promotions, Inc., 962F.Supp.1015 (Cyber Trespass and Bombing)
FTC v. GM Funding, Incl, Global Mortgage Inc., et al., SACV 01-1026 DOC-U.S. District Court, CA (Spoofing)
Shields v. Zuccarini, 254F.3d 476 (in rem & Cybersquatting)
Ringling Bros. – Barnum & Bailey, Combined Shows, Inc. v. Utah Division of Travel Development, 935F.Supp.736 (Trademark Slogans)
America Online, Inc. v. AT&T Corp., 64F.Supp.2d549 (Trademark Slogans)
eBay v. Bidder's Edge, 100F.Supp.2d 1058 (Cyber Trespass)

Your out-of-class assignment is to develop a specific *issue* for each designated date listed above in the case study. Generally, the issue is the single, certain, and material point that is deduced from the information derived within the paragraph of the listed date by the operational facts so presented that illustrates a pertinent concern. Such facts have the strong potential of being affirmed on one side and denied on the other and relate to a real or potentially specific disputed point or question that is in need of a resolution. The concept is to frame the essential point accurately as the ultimate question (or, let's ask the right question from the beginning).

An issue is usually stated in a one sentence question form that may be answered by a simple "yes" or "no." After formulating the issue, analyzing the facts of the situation and applying appropriate standards (such as the law) should lead to a proper conclusion. This process is usually referred to as the "reasoning of the case." The stated conclusion is usually a positive restatement of the original issue. For example, take the following issue: *Is "Let's Win the Big One" a phrase that could be a legitimately protected trademark as the specific "slogan" for Old Ivy University? Yes.* The stated conclusion (of law) would be the positive restatement of the original issue as follows: *"Let's Win the Big One" is a phrase that could be a legitimately protected trademark as a specific "slogan" for Old Ivy University.*

As additional clarification for this exercise, the "issue" is designed to address basic and fundamental assumptions that will solicit open participation by students in the classroom and that promote open dialogue in an environment that develops various arguments in a rational manner on the merits from the persuasive points-of-view of the participants. The class discussion will start with identifying operative facts from the Case Study and possibly including the contentions and assumptions of the parties involved. The issue will be identified, followed by analysis and reasoning of the facts, standards, and law as related to the issue, followed by a conclusion. Essential preparation for this discussion exercise is to develop quality issues for each designated date in the Case Study. The instructor may introduce additional approaches as to addressing the issues of the Case Study.

Internet Research Tools, Techniques, and URL Addresses

Again, preparation includes reviewing topics, including *vocabulary/key words; government agencies/associations/organization; and codes, statutes, and regulations,* all listed above following the Case Study. Also listed are *cases* that are related to the issues to be presented within the Case Study. The following instructions include suggested approaches in locating the above identified information at various Internet sites. The challenge is to develop and enhance skills in using the following URLs as a tool for Internet research. If not familiar with the process, there is a learning curve as to using various URLs efficiently, and, as you proceed, you will essentially be developing your own style and approach to Internet research. If there is access to "Lexis Nexus," there are a number of additional options and approaches for Internet research for the topics listed below. It is the quality of research that is the objective of this case study, not the speed. Best wishes.

General and Special Search Engines

A key element for Internet research is to develop a useful list of general and special "search engines" for locating basic information. The information from your search engine investigations are the basic building blocks to your specific knowledge base. Listed below are general search engines, a table matrix of uses for several general search engines, and a listing of special search engines. The idea is to develop your own individualized listings of various customized sites as a tool for present and future research interests.

General

1. *Search Engine Guide* is always good if everything else fails: http://www.searchengineguide.com/searchengines.html
2. Another general search engine is *The Best Search Engines* provided by the U.C. Berkley Library and listed in a table format: http://www.lib.berkeley.edu/TeachingLib/Guides/Internet/SearchEngines.html
3. This site includes extensive Web links to more than 500 resource topics specifically divided into subject collections: http://www.ipl.org.ref/AON

Vocabulary/Key Words

There are numerous dictionary sites for reviewing various terms and definitions. The following suggestions, with listed URL's, are basic starting points in the process:

1. *The Marriam-Webster Online Dictionary* is a good source for deriving basic meanings for basic words: http://www.m-w.com/dictionary
2. A site for specialized dictionaries has 7,934,909 words in 974 dictionaries indexed: http://www.onelook.com
3. *On-Line Dictionaries* includes links to more than 500 dictionaries in over 140 languages: http://www.yourdictionary.com
4. The University of San Francisco Internet site offers an extensive directory for specialized terminology, including a "Glossary of Internet Terms: http://etc.usf.edu/dict/special.htm
5. *The Lectric Law Library's Legal Lexicon's Lyceum* offers thousands of definitions and explanations of legal terms, phrases and concepts: http://www.lectlaw.com//def.htm

Government Agencies/Associations/Organizations

Listed below are several URLs for locating various government agencies, associations, and organizations. These listings may be expanded for individualized interests.

1. *FIRSTGOV.gov* is a comprehensive Internet site for federal, state, and local government agencies: http://www.firstgov.gov
2. California State University, Bakersfield, Walter W. Stiern Library includes complete government information as to local, state, and national agencies at: http://www.lib.csub.edu/gov/index.html
3. *Yahoo List of business and professional organizations:* http://dir.yahoo.com/Business_and_Economy/organizations/professional
4. University of North Carolina E-Reference Links – General Topics – Associations and Organizations: http://www.lib.unc.edu/reference/quick/index.php?display=print_items&item_id=4

Cases, Codes, Statutes, and Regulations

The following listed sites are basic for finding cases, codes, statutes, and regulations for federal, state, and local jurisdictions. Again, these listings may be eventually expanded for individualized interests.

1. The University of Michigan Library State Legal Sources on the Web: http://www.lib.umich.edu/govdocs/statelaw.html
2. FindLaw State Resources by Jurisdiction: http://www.findlaw.com/11stategov/index.html
3. State and Federal http://www.findlaw.com/casecode
4. Law Guru Internet Law Library: http://www.lawguru.com/ilawlib/index.html
5. Cornell Law School Legal Information Institute: http://www.law.cornell.edu/

DEEP SOUTH FOREST PRODUCTS: MANAGEMENT UNFAIR LABOR PRACTICES DURING UNION DECERTIFICATION?

Mel Schnake, Valdosta State University
Robert J. Williams, Valdosta State University

CASE DESCRIPTION

This case examines the process by which the unionized employees of a firm take steps to decertify their labor union as their bargaining agent. Further, the case examines certain actions taken by the firm's management during the decertification process, and whether those actions are illegal as defined by the provisions of the National Labor Relations Act.

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 one to two hours of outside preparation by students.

CASE SYNOPSIS

A firm and its employees' labor union(s) often share a tense and adversarial relationship. From time to time, employees may decide that the bargaining advantages provided by their union no longer secures them the wages and benefits they seek, and they may seek to have the union decertified as their bargaining agent. This case examines this scenario, and demonstrates how a firm's management can legally express its views to its employees regarding the pros and cons of a union decertification. This case is an effective teaching tool for students in a labor relations course, a human resources course, and can also be used in the introductory management principles course.

DEEP SOUTH FOREST PRODUCTS

Background

Deep South Forest Products, located in south Georgia, is a manufacturer of utility poles and other lumber products. The company was founded in 1934, and employs about 200 workers. The company is one of the largest employers in the area, and the firm's management has had a fairly good relationship with its employees over the years. Employees at Deep South Forest Products

Company had been represented by the United Food and Commercial Workers Union, Local 1996, AFL-CIO for the past 30 years. The current labor agreement expires on November 21, 2003.

Beginning in July, 2003, Deep South Forest Products got employees to sign petition forms headed "We, the undersigned employees of Deep South Forest Products Co., no longer wish to be represented by the union." Additional employees signed individual cards or slips of paper rather than the petition. On August 26, 2003, employee Wallace Henderson filed a decertification election petition with the NLRB based on this showing of interest.

August 28-30 Speech to Employees

During a three day period between August 28, 2003 and August 30, 2003, General Manager, James Green held a number of meetings with employees during which he read the following prepared speech.

Good to see everyone. I hope everyone knows me. I'm Jim Green. I've been your general manager for the past 8 months. Let me get right to the point. We received word yesterday that employees here have filed a petition to get rid of the UFCW union. Quite frankly, I'm real proud of you for doing this. I'm glad that many of you feel like me that we're better off without a union here now.

Of course, most of you all know this union has been around here for a long time – as I understand it, for over thirty years. Heck, this union has been around here longer than I have been alive. I appreciate the fact, that over the years, several of our older employees have told me why this union came in here to begin with. We did some things in this company and around this part of the country to blacks I'm not proud of. It was wrong. I can understand why you all went after this union. Obviously, at 24 years of age, I wasn't around then – but my family was. We all take responsibility for the discrimination and the unfair treatment that took place. That certainly doesn't change anything – but I want you to know exactly how I feel.

Secondly, I want you to know that I will not tolerate any discrimination now or in the future. All our older employees have made enormous contributions to our company over the years. You have worked long and hard in very difficult circumstances to make us successful. I pledge to you that I will never forget that. I consider this decertification petition as giving us a second chance. We can't change the past but we can do something about the future. It's a second chance for all of us as managers. As for me, I do not want to blow this chance.

Let me talk about this decertification petition and what it means. You may know that our contract expires at the close of business on November 21, 2003. We have notified the union that even though we have a bargaining session scheduled for October the 9th, that it is our intent to terminate the agreement on the 22nd of November. Normally the NLRB will conduct an election within 45 days after the decertification petition is filed. That would mean we would have an election *around the first or second week of October. About 6 or 7 weeks from today. We'll have plenty of time between now and then to give you the exact time and place of the election.*

In the meantime, we still have an obligation to bargain with the union over the contract that's in place. With a decertification petition filed there's a quirk in the law, that even though a decertification petition is filed, we still have to bargain with the union unless the company has been notified that more than 50% of the employees have signed the petition. If that occurs, then the company can withdraw from bargaining and withdraw recognition from the union. In other words, if you all give us more signatures so that you exceed the 50% mark, the union will be gone. If this doesn't occur, any contract that would be reached in bargaining before the current contract expires on November the 21st would be null and void if you all voted the union out.

When we got notice of this petition we really had several options. Actually three choices. Our first choice was to use this decertification petition to cut a deal with the union. Last time the union was so afraid of not reaching a contract that they jumped on our first offer. At your expense, they saved us a lot of money in our last contract. So from a pure business standpoint – it's clear that the company could save money with the union. But there's more to this business than just money. Certainly we've got to make a profit. We feel you deserve a company that really cares about you and shows it. Our second choice was to be neutral and not do anything and let you make up your mind without any input from us. But our final choice – our third choice was to work as hard as we could at communicating our views and letting you know how we feel about this decision.

In any event, we expect the union to campaign hard and if we didn't do anything, then the union would be out there campaigning against our employees who worked so hard on this petition.

Speaking of union campaigning – I have received information that the union has been telling you that if you vote them out, the company is going to reduce your wages, benefits and pensions. That is an absolute lie. Let me state this as clearly as I can. If you vote the union out, we will not cut your wages and we will not take away any of your fringe benefits. The union is only trying to use scare tactics to frighten you into voting for them. Don't let them do that to you. Ignore their scare tactics. I feel so strongly about this – I'm going to put a guarantee in writing that we will not cut your wages or benefits.

In making this decision, we analyzed the pros and cons. Here's what we thought about. Unfortunately, we'll have to pay those damn lawyers to make sure we do things right. Quite frankly, if I never have to deal with another lawyer or union representative I'll be happy – real happy. They drive me crazy. But we know, the union will try to file unfair labor practice charges and all that stuff, so we have to have an attorney. And of course it will take time and effort to work on this and take time away from our normal duties so it will be expensive to wage a campaign.

Second, there's no guarantee that the union will be voted out. That decision is y'alls. We certainly don't know for sure how it will turn out, so we could spend all this effort and money and y'all could still be stuck with this union here.

Third, as I said with the union in here we've been able to save a lot of money in negotiating our contract. As you know, wages and benefits have not increased much at all in the past several *years. Certainly – significantly under the national average. Apparently the union has agreed to all of this because they've had no strength or don't care any more. So getting the union out of here would not save us money. That's for sure, in fact we would probably save more money by keeping the union in here and continuing to drive a hard bargain. Now fourth, we know that the union is going to scream and raise all kind of hell if we fight them. So those are all the negatives.*

On the other hand, we have a large number of employees who don't want this union in here. I know from talking with your managers and supervisors that they don't want the union in here. I sure know that I don't want the union in here. I'd like to see a new era begin where we are truly a family. Where we worked together as a team with a real family atmosphere of mutual respect and trust. I know as managers we have to earn your trust everyday. I understand that many of you would like to see what would happen here if there weren't a union. I think you deserve that chance to have a real family atmosphere.

I'm real excited about this myself and I'm committed to spending a lot of time over the next several weeks before this election to be able to talk with you in detail about what all of this means. As I told you earlier, we have told the union of our intention to terminate this agreement when it expires on November the 22nd. That means everything will be back on the table. Everything would be bargained for. Everything would be up for grabs. You all know in bargaining there is nothing certain.

With regard to the union I know many of you are paying dues to the union – spending money paying for them to represent you. That's your choice. It's your money. You've worked hard for it. I'm not going to tell you how to spend your money. If you want to pay it to the union – that's your business. On the other hand, many people have asked how they can get out of the union. Well if you have any questions about how to do that it's covered by the checkoff authorization on the last page of your contract – page 55, which requires you to give the company written noticed of stopping your dues. Or you can just see Personnel.

Other people have indicated that while they haven't paid union dues they may still vote for the union because they feel they need it as a security blanket. Perhaps they can't in their minds ease the memories of the past. Maybe they're concerned that if the union's gone – they're not sure the company will do right by them. Well, first of all you've got my word, for whatever it's worth to you, that we are going to do what's right. But more importantly, it would make no sense for us to make the decision to communicate to you our views against this union – if we were not prepared to do what was right. We know it'll probably cost us more money this way but we feel you deserve it and we want to take responsibility for your future and be held accountable. We know that if we don't do what's right, then you can go get this union back here in a heartbeat. I think that's the best insurance you've got.

I don't think this union has represented you very well for at least the past 10 years. I think you know that. Their approach has been to sell you all out for some dues money.

Since I've been your general manager I see a change. I see us communicating and being honest with each other. That's the approach I want to have – that's the way I want to manage this *plant. I want us working together without the interference of lawyers and union reps – just us – working together as a team. I don't like the approach we've taken with this union where we were out to just get the best deal we could for the company and basically the hell with our employees. I don't want to have that approach. I would like for us to say our employees have voted the union out – they fought for us and we need to fight for them. I'll commit to you that I'll do just that. Let's get rid of this union and let's get back to working together as a family. Thanks.*

Deep South also signed a "No Cut Guarantee" which stated "I, Jim Green, Guarantee you, The Employees of Deep South Forest Products, That If You Vote the Union Out, Deep South Will Not Cut Your Wages And Will Not Take Away Any of Your Benefits Or Pensions."

***Tall Pines* Newsletter**

On August 30, 2003 in the *Tall Pines* newsletter mailed to employees, Deep South included the following statement.

I have been asked whether we will make improvements if the union is voted out. I can't make any promises about that during this election process because that would be illegal. Even though I have strong feelings about this, because of the law I have to be very careful about what to say.

If there is no union, the law would allow us to make improvements without first having to bargain with the union about those improvements. There have been several times during this contract where we wanted to give wage increases immediately. Instead, we had to go through the negotiation process with the union before we could put those increases into effect. Keep in mind that it was the Company that told the union we wanted to make increases.

Without a union, there is no requirement to bargain before we give an increase. Again, I can't promise you that we will grant benefit and wage increases if the union is voted out. However, based on the small increases negotiated by UFCW here, compared with the larger increases given in our other non-union facilities, you certainly would have been better off here without the union.

I can tell you that no reductions will be made if you get rid of the union. Also, since the union has no power to deliver wage and benefit increases, the UFCW can make you all sorts of promises. If you have any questions, please let me know. Thank you.

September 4-6 Meetings

During a series of meetings with employees held between September 4-6, 2003, Jim Green discussed differences in pay rates of unionized employees and employees at Deep South's non-union facilities. Green stated that average pay levels were higher at the non-union facilities. On September 6, Deep South announced that it would withdraw recognition of the Union as the official bargaining agent of the employees and would no longer bargaining with the Union once the collective-bargaining agreement expired.

Withdrawal of Union Recognition and Wage and Benefit Increases

On October 31, 2003, Deep South announced to its employees that it intended to raise wages 8% "across the board" once the current collective-bargaining agreement had expired. Further, Deep South announced that on January 1, 2004 it would implement a new health benefit plan, and issue a new employee manual with workplace rules different than those in place under the collective-bargaining agreement.

On November 22, 2004 Deep South, as promised, raise the wages of all employees by 8%. On December 6, Deep South issued a memo to its employees that beginning on January 1, 2004 the company planned to double the pension benefits of its employees.

The UFCW filed unfair labor practice charges alleging that Deep South violated Sections 8(a)(1) of the NLRA by promising to increase wages and benefits if employees ceased supporting the union, and encouraged employees to resign from the union and revoke their dues checkoff authorizations. The complaint alleges that Deep South's speech and statements "interfered with, restrained, and coerced employees in the exercise of employees Section 7 rights, in violation of Section 8(a)(1) of the Act." The UFCW alleges in its complaint that it believes the following specific actions to be illegal:

- the August 28-30 speeches
- the statement in the company newsletter
- statements made at the September 4-6 meetings
- withdrawal of recognition and refusal to bargain
- announcement of unilateral changes in wages, benefits and work rules
- wage increase on November 22
- memo notifying employees that pension benefits would be doubled

SUMMIT ENTERPRISES

Arnold Schneider, Georgia Institute of Technology

CASE DESCRIPTION

The primary subject matter of this case concerns cost/managerial accounting – more specifically, transfer pricing and divisional performance evaluation. Secondary issues examined include cost estimation and cost-volume-profit analysis. The case has a difficulty level appropriate for junior level courses. The case is designed to be taught in a one hour class period and is expected to require three hours of outside preparation by students.

CASE SYNOPSIS

The case involves the application of transfer pricing, divisional performance analysis, cost estimation, and cost-volume-profit analysis. The setting is a diversified corporation with one division requesting services from another division. The objective of the case is for students to think about appropriate transfer prices and the use of ROI for service-oriented divisions, as well as to have students provide solutions for break-even points, operating leverage, and high-low cost estimates. Students often have trouble seeing how seemingly disparate topics in cost/managerial accounting relate to one another and this case offers an illustration of how a variety of topics are woven into one scenario.

INTRODUCTION

In 1970, Summit Enterprises was formed as a home remodeling company by Stan Stein in Columbus, Ohio, and has grown to a diversified corporation operating in over ten industries and in 35 states. The company has six separate divisions which are managed as independent investment centers. Over the years, the different divisions have done a very limited amount of business with each other, so corporate headquarters has seen no compelling reason to implement any transfer pricing policies. Recently, however, transfer pricing has evolved as a contentious issue as one of Summit's divisions (Chittenden Division) tries to launch a new business opportunity which requires the services of another division (Norwich Division).

NORWICH DIVISION

The Norwich Division, which was created in 1980, installs and services heating and air conditioning systems in commercial as well as residential buildings. Division revenues have grown rapidly over the past few years largely due to its reputation of high quality expertise and customer service. In 2006, Norwich Division expects to operate at full capacity and thereby increase its revenues over 2005 by 13 percent.

The Norwich Division is evaluated yearly on the basis of return on investment (ROI), measured as its pretax direct profit divided by its total direct assets. Indirect costs are not allocated from corporate headquarters. Dan White, the division's general manager, achieved a 33 percent ROI in 2005 and was rewarded by Summit Enterprises with a 12 percent salary bonus for his performance. Norwich's 2005 ROI far exceeded Summit's minimum required return of 25 percent. White hopes to improve even more, expecting to achieve a 35 percent ROI in 2006 and earn a promotion to one of the two corporate vice-presidencies that are expected to be vacant upon pending retirements.

The Norwich Division charges a rate of $60 per hour for the work it does. Its variable expenses are $40 per hour, direct fixed expenses are $860,000, and the division currently has $900,000 invested in directly traceable assets (vehicles, tools, and other equipment).

CHITTENDEN DIVISION

In contrast to the outstanding performance of the Norwich Division, the Chittenden Division has seen a downturn in its installation of swimming pools. From 1983 to 2001, the Chittenden Division was the market leader in installing outdoor swimming pools for health clubs, community centers, hotels, apartment complexes, and municipalities. In recent years, however, competitors' prices have come down while quality has improved, so that Chittenden's market share has eroded. As a consequence, Chittenden Division operated at only 75 percent of its practical capacity in 2005. Summit's controller has informed Shelley Greenberg, Chittenden's general manager, that unless capacity utilization improves to at least 80 percent by the end of the year, sizable staff cuts and other budget reductions will be made at Chittenden Division.

NEW BUSINESS OPPORTUNITY

To recapture its lost market share, the Chittenden Division has spent the past 18 months on a concerted effort to improve its product. A special project team formed for this purpose has developed a new swimming pool design that is supposed to significantly reduce maintenance costs over the pool's lifetime. Further, the project team estimates that this pool will last at least 10 more years than existing pools before major overhauls need to be made. The pool also includes a small waterslide. Prototypes have been constructed, tested, and demonstrated to a sample of prospective purchasers and the reception thus far has been very encouraging. In fact, one hotel chain has already agreed to purchase these new pools for six of its locations with the intention of possibly acquiring pools for 40 to 50 additional locations within the next two years. Greenberg views this order of six pools as key to significantly increasing Chittenden's capacity utilization in the near term, as Greenberg believes it will stimulate demand not only from this hotel chain but also from other prospective customers who have already shown some degree of interest.

Because of the new pools' advanced technology, they require specialized heating systems that are complex to install. The current personnel at Chittenden do not have the requisite expertise for these installations and training them would be costly. After much research, Shelley Greenberg has concluded that the Norwich Division's employees appear to be well qualified to perform the job. The new pools will have a price tag of $48,000, but the six ordered by the hotel chain had an agreed upon introductory price of $42,000 each. Shelley Greenberg believed this price break was necessary to accomplish the deal. Because of this discounted price, Greenberg has asked the Norwich Division to work on these six pools at a reduced hourly rate of $45. Greenberg and Dan White are scheduled to meet with the corporate controller in Columbus next week to discuss this issue at length. In the meantime, Greenberg is attempting to derive estimated profit figures for the introductory-order pools as well as beyond that for future regular orders. Greenberg has begun to prepare cost and price data as shown in Exhibit 1. To estimate the other incremental costs for the new pools, Greenberg gathered data on total costs (exclusive of heating system installation) and total number of pools built for the past six years, as shown in Exhibit 2.

Exhibit 1		
Cost and Price Figures	Regular Orders	Introductory Order
$48,000	Price	$42,000
7,500	Heating System Installation	5,625
?	Other Incremental Cost	?
$?	Total Cost	$?
$?	Profit	$?

Exhibit 2: Data on Costs and Number of Pools		
Year	Total Costs*	Number of Pools
2005	$ 98 million	2,740
2004	100 million	2,900
2003	103 million	2,980
2002	104 million	2,870
2001	107 million	3,040
2000	105 million	3,020
* These total costs do not include heating system installation costs.		

DISCUSSION QUESTIONS

1. How many hours does the Norwich Division need to work in order to break even? How many hours need to be worked for Norwich to attain its target ROI of 35 percent?

2. Presuming that the hours needed to achieve the target ROI of 35 percent is full capacity, calculate Norwich's operating leverage (i.e., contribution margin divided by pretax income) and use that to determine its expected percentage increase in pretax income for 2006.

3. If you were Dan White, would you agree to Shelley Greenberg's request to supply heating installation at the requested rate of $45 per hour?

4. Using the high-low method of cost estimation, determine the estimated "other incremental costs" per pool for the new pools. Presume that these are variable costs.

5. Discuss how Summit Enterprises would benefit from the deal with the hotel chain. Provide support by computing the incremental profit to Summit from the introductory order of six pools. (Hint: Use Exhibit 1 to determine the time required for Norwich to install the heating system in each new pool.)

6. Evaluate the reasonableness of the proposed transfer price of $45 per hour. Should Summit Enterprises institute a general policy on transfer prices?

7. Suppose that Norwich was not operating at full capacity and could service Chittenden without affecting other revenues. How would your answer to part (6) change?

8. (a) Discuss the use of ROI for a service-oriented division like Norwich.
   (b) Compute the projected 2006 return on revenues for Norwich.

URBAN OUTREACH MINISTRIES' ORGANIC GARDENS: DEVELOPING A SUSTAINABLE, TRIPLE-BOTTOM-LINE BUSINESS FOR A NONPROFIT SOCIAL ENTERPRISE

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Matt Brock, Seattle University
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CASE DESCRIPTION

The primary subject matter of this case is a for-profit or nonprofit organization developing and implementing a triple-bottom-line strategy, including concern for people, profit, and planet, to help assure the profitable sustainability of its operation in the long run. Secondary issues include the challenges of developing a business plan that will accomplish the desired results, identifying and weighting relevant stakeholder values in order to develop organizations that maximize the value of stakeholders in the long run, and issues of the competency and capacity of the management team, including the Board of Directors, to implement such a strategy. The case has a difficulty level of 3 to 5 and works well in the undergraduate senior Business Policy Strategy class, first-year MBA, as well as final policy course in MBA. It can either be used requiring 50 to 75 minutes of class time with no outside preparation or 30 minutes to 2 to 4 hours of outside preparation.

CASE SYNOPSIS

Nonprofits or for-profits with an explicitly responsible social agenda, from microenterprise to highly scaleable operations, are increasingly venturing into new territory--how to do social good, make money, and be responsible to relevant stakeholder groups, especially the people, profit, planet of the triple bottom line. This case study can give useful insights to potential clients and consultants inside and outside the classroom who have been previously assumed to not be affected by triple-bottom-line/sustainability issues. In this post-Enron era, these issues are seen as a basis for strategic competitive advantage that will help maximize a profit or social agenda. These issues will be increasingly relevant to doing business in the 21st century.

The executive director of the nonprofit Urban Outreach Ministries engaged a team of consultants to do a business plan for an organic garden that would be environmentally friendly, provide jobs, and job training for Urban Outreach's target immigrant population. In addition, it *would generate profits, which could help support other Urban Outreach activities and its outreach. A preliminary feasibility study showed a profit the first year if the $200,000 startup and land costs would be donated. What should the executive director do with the study results?*

What are the critical factors for long-term success in an entrepreneurial startup within an organization? Social responsibility, triple bottom line, sustainability, ethics, values, and environmental consciousness are issues increasingly vital to business and nonprofits in this post-Enron era. What else needs to be measured? How does one compare/weigh social return on investment?

A FOR-PROFIT TRIPLE-BOTTOM-LINE ORGANIC GARDEN FOR A NONPROFIT SOCIAL ENTERPRISE: A CASE STUDY

In June 2005, Marc Greenburg, the executive director of Urban Outreach Ministries, had successfully started a fitness center and was looking for ways to satisfy his entrepreneurial urges while expanding the reach of services of Urban Outreach. He decided he wanted to create a sustainable business that would make a profit and that would have a multifaceted positive impact on society. His desire was to be environmentally friendly and provide jobs to low-income individuals and homeless youth living in South Baldwin. After brainstorming many ideas, he determined that many of his neighbors were from Southeast Asia and were wonderful gardeners and often did so in local pea patches.

He wanted to capitalize on this skill by creating organic gardens beginning with a pilot garden on a plot of land in the middle of South Baldwin. He envisioned profit centers which included:

- Selling compost
- Using worms to compost and selling those online ($30/pound for worms)
- Selling produce to local Pacific Consumer Co-op
- Selling produce at local farmers' market
- Selling produce on site
- Selling "shares" to buyers prior to harvesting the produce

In addition, he wanted to set aside a portion of the produce to have an on-site organic food bank.

It would be great to develop a model that could be replicated in Portland and then by other cities and organizations.

Urban Outreach Ministries was in the process of merging with another similar organization, and this was taking all of Marc's time. He contacted a local university to get a team of MBAs from a class that was working with nonprofits to help them establish "Triple Bottom Line Social

Enterprises" . . . revenue-generating activities which kept in mind maximizing value to relevant stakeholders, especially within people, profit, and planet arenas.

Ten weeks later he received the following:

LETTER OF TRANSMITTAL

Dear Marc:

You requested our consulting services to do a feasibility study for an organic garden. We have completed that, and it is attached. The plan is set up to accomplish the following triple-bottom-line returns:

People

* Wages paid to underemployed staff/trainees: at least $29,120 each year (assuming no expansion of training center)
* Hours of useful skill training: 2,080 hours/year (again, assuming no expansion)
* Other gardeners who want to realize the benefits of worm casting over conventional fertilizers

Planet

* Estimated solid waste diverted from landfills: 21 tons
* Estimated emissions avoided by local sales: 75%-95%
* Estimated fossil fuel consumption avoided by local sale: 80%-90%
* Pounds of produce grown through organic methods: 31,000
* Beautification of local community

Profit

* Estimated yearly net income to fund the social goals of the organization: $34,866

For your interest, we have attached Starbucks mission statement as an interesting model for incorporating the triple bottom line into one's mission statement.

We foresee increasing challenges with your missions being housed under one umbrella organization.

1. *Urban Outreach Ministries Mission Statement*: Partnering to empower city people to find wholeness through their lives and communities.

2. *Educational Excellence Mission Statement*: To enhance the educational experience of students through an adaptive learning environment and prepare them with the skills to excel in the classroom and succeed in life.
3. *South Baldwin Health and Fitness*: To provide an easily accessible high quality and education based health and fitness center resulting in healthy lifestyles and strong bodies. You started South Baldwin Health and Fitness in February and are hoping that will become a self-sustaining operation. It is noted that entrepreneurship is in your blood and experience base.

ATTACHMENTS

Starbucks Mission Statement

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.

ORGANIC GARDENS

Feasibility Study

Mission.

Bring healthy organic food to the local community while enhancing the neighborhood, creating jobs and job training for community members, and creating a sustainable revenue source to further the social values of the Gardens.

Defining Principles:

- We create jobs and provide job training for community members, build their equity in the operation, and help them become entrepreneurs.
- we provide education and awareness about nutrition, food security, and environmental issues.
- We generate organic products for the local community in an environmentally sustainable manner.
- We enhance the community by creating a beautiful space.

Markers of Success.

The Organic Gardens should be self-sufficient by year three, without assistance of outside funds.

- Garden should have a sustainable and fruitful operation, without sacrificing organic principles.
- Employees working the garden are trained, efficient, knowledgeable, and feel ownership over their jobs.
- Our neighbors appreciate our presence in the neighborhood, due to beautification efforts and the value of our services.

Value Propositions

Overview.

Organic Gardens plans to create a half-acre prototype garden that hires one full-time person to sell vegetables directly to the public through farmers' markets, provide direct vegetable sourcing to restaurants, and grow a micro worm farm. The intent of this prototype garden is to train individuals with the purpose of starting and owning their own urban garden. Organic Gardens is a self-sustaining job-training entrepreneurial center for the under-employed.

Long-term plans to the social service components of the organization include providing free/discounted produce to the poor, as well as providing classes on individual gardening and nutrition.

Value for Trainees.

Training to include growing vegetables, worm farming, organic practices, marketing and sales, computer skills, business startup, professionalism and communication skills, managing retail, operations management, purchasing, negotiations, finance, and bookkeeping. These trainees will be able to start their own urban garden, or take these skills to market in other jobs.

Value for Direct Consumers.

Portland has a ready population of consumers who are used to purchasing fresh, usually organic, produce direct from farmers. We will provide fresh produce to them at a competitive price through their local farmers' market sales channel. The fact that our produce will be sustainably grown and distributed by an organization with a triple-bottom-line mission will add to their value perception.

Value for Restaurants.

Restaurants need fresh produce, and Organic Gardens' proximity to restaurants will allow the freshest possible supply. Since we will work with restaurant customers to grow what they want and deliver to them, they will benefit from having more control over their supply and greater convenience to get it. Restaurants could also benefit from the worm farm part of our operation, because that could help them manage their solid waste related expenses. Finally, restaurant staff might perceive greater value in working with a triple-bottom-line organization.

Value for Organic Gardeners.

Our worm products would create value for those who want to garden more sustainably. However, since worm castings are actually more effective than conventional fertilizers, they would also appeal to conventional gardeners who just want their plants to grow bigger. As with other customer segments, people oriented toward sustainable gardening would also find value in our overall triple-bottom-line orientation.

Stakeholders and Triple-Bottom-Line Goals

Stakeholders and accompanying goals by category and in priority order:

Our First Priority is the People.

1. *Employees:* We will not compromise our focus on job and entrepreneurship training and skill building. We commit to providing a living wage--based on median home prices in the area and socioeconomic studies--and positive working environment.

2. *Customers:* We will not compromise our goal of providing good quality produce and garden products, at competitive prices, created in an environmentally sustainable manner.
3. *Neighbors:* We want our neighbors to appreciate and support our presence. Decisions will be made in a manner that minimizes negative impacts to neighbors and maximizes positive impacts.

Our Second Priority is the Planet (considered as itself a stakeholder).

Goals:

1. We will reduce solid waste streams by using organic and paper waste as inputs in our vermicompost production process and as natural compost for crops.
2. We will reduce groundwater pollution by using only organic fertilizers and by containing runoff from the vermicompost operation.
3. We will reduce air pollution by focusing on nearby markets, thereby minimizing emissions from transporting products to market.

Our Third Priority is Profits (considered as a means of attracting social investor stakeholders).

1. *Employees*--the primary use of profits will be incentive compensation for employees and expansion of the operation, thereby allowing more people to be trained and employed.
2. South Baldwin Health and Fitness--the secondary use of profits will be to support these sister organizations with compatible missions under the Urban Outreach Ministries umbrella.
3. *Other service clients*--the third use of profits will be to expand the service component of the organization, for example, into nutrition classes, gardening classes, and possibly a produce food bank for local urban poor.

Business Description.

Organic Gardens plans to create a half-acre proto-type garden that hires one full-time person to sell vegetables directly to the public through farmers' markets, provide direct vegetable sourcing to restaurants, and grow a micro worm farm. The intent of this proto-type garden is to train individuals with the purpose of starting and owning their own urban gardens. Organic Gardens is a self-sustaining job-training entrepreneurial center for the under employed. The business model is predicated upon operations running on donated property, which is not owned by Organic Gardens. Due to the probability of high turnover of property, it may be necessary for Organic Gardens to run more than one training center to ensure there is no downtime between properties. The focus of this business plan is to start up the initial training center, which can be duplicated for the new gardens.

Products.

The benefit of organic food and organic farming practices are becoming more well known. We will be selling to people who want to eat food that tastes better, that is healthier and more nutritious, and that promotes sustainable growing practices. Examples of high yield, high margin crops that would be appropriate for our climate and market include tomatoes, beets, onions, lettuces, garlic, and carrots. Winter crops could be sold through a subscription plan allowing customers to enjoy seasonal organic food year-round. In addition to food, the garden will produce worms and worm castings for market.

Markets.

Interest in healthy eating and safely produced foods is growing in the United States, and there is already a high awareness in the Portland area. Nationwide the organic food market has experienced 20% growth rate since the ‘90s, and this rate is expected to continue through 2010. In addition, home gardening is a huge pastime in the United States. The market for organic fertilizers hit $11.7M in 2003 and is expected to grow at 10% through 2020. Consumers place a high value on organic products and will pay a premium, in some cases, up to 30% higher than non-organic products. Because the garden will be located in a dense urban environment, customers are nearby and plentiful. South Baldwin is also beginning to gentrify, bringing in even more educated customers for this type of product.

Distribution Channels.

Because of the ready availability of direct selling channels like farmers’ markets, produce will be sold to individual consumers via farmers’ markets, walk-ups, and subscription plans, as well as to local restaurants. Worms and worm castings will be sold via the same channels, and they could also be sold through the Internet and garden publications.

Competition.

Demand for these products is high and there seems to be room for more producers. The primary competitors for produce and flowers are other growers at farmers’ markets, local subscription farms, and local and national organic retailers such as Pacific Consumer Co-op and

Whole Foods. Worms and worm castings competitors include local nurseries, garden supply stores, and Internet suppliers such as Happy D Ranch and the Yelm Earthworm Farm.

Table 1: SWOT/Risk Analysis

Strengths:	Weaknesses:
Good SME support on growing and fertilizer	Idea not tested in this form--numbers only an estimate, lots of experimentation will be required.
Minimal internal organizational conflicts (main decision maker on the project has the authority)	Urban location increases risk of vandalism, increasing security costs (i.e., fences).
Parent organization, NWUM, recognized in the community	High startup costs/financing needs for an operation that creates few jobs.
Location close to markets	Land tenure--keeping costs low creates tradeoff with ownership
Existing direct sales channels (Farmers' Markets)	Would not be able to be certified organic for 3 years.
Lots of possible support organizations within Portland area (for both produce and worms).	Neighbors may not like the garbage involved in worm operation.
Opportunities:	**Threats:**
At risk youth organic gardens--partnership.	Portland Youth Garden Works (similar model and goals)
May be able to get good prices even if we don't reach full organic certification (as long as stay transitional).	Organic is becoming more mainstream, creating more competition
Job training center	Weather risk
Paid classes as a revenue source	Land tenure issues
Could capitalize on bad weather in other regions that affects imported produce	Merger partner and its board may not be receptive to social enterprise model
Organic distribution subscription (CSA) on our own, or partner with other services (e.g. Cascade Organics).	

Management.

In the initial stages, management of Organic Gardens will be undertaken by a current trainee/client skilled in gardening, Mr. Oh, in the nonprofit's program under the umbrella of Urban Outreach Ministries. A professional, S.W., will provide organic farming and composting consultation. Over time, the plan is to transfer ownership of the enterprise to local community members.

Revenue Projections.

Startup costs will be approximately $101,250, and land would cost approximately $100,000 for an unoccupied parcel in that area. We will attempt to get as much as possible donated. Not including startup costs and land, net income for the first four years will be $8k, $38k, $38k, and $28k. Worm castings will be sold at $2.50 per pound, and worms sold at approximately $17 per pound.

VERMONT TEDDY BEAR COMPANY

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CASE DESCRIPTION

This case is intended for use in undergraduate business ethics, marketing, entrepreneurship or management courses. The primary subject matter of this case concerns an dilemma that faced a company in the business of making people feel good. This case allows the student to carefully evaluate the situation that occurred and decide whether the company made appropriate or inappropriate decisions. The case is designed for one to two hours of class time and is expected to require two to four hours of outside preparation.

CASE SYNOPSIS

Remember when you had a teddy bear as a child? Perhaps you still have it. How could a simple stuffed toy cause an business dilemma? That is just what has happened to the Vermont Teddy Bear Company. This small business has approximately 290 employees in a factory in Shelburne, Vermont, and does most of its business over the Internet or by mail (Gram, David, 2005.)

The Vermont Teddy Bear Company is the largest hand-crafter of teddy bears in North America. Approximately 450,000 "Bear-Gram" gifts (teddy bears) will be delivered around the world this year (http://ir.vtbearcompany). There are over 100 bears from which to choose for any occasion. The situation that has developed in 2005 is especially interesting for a company that is located in a state that demands appropriate conduct, following standards set by Ben & Jerry's. This company set a high standard for being socially responsible with their "Save-the-Rainforest" campaign. (Gram, David, 2005).

What actually happened? The Company decided to market a bear called "Crazy for You" for the recent Valentine's Day holiday. They began selling the bears in January, 2005 and were sold out by early February. The $69.95 brown bear comes with a straitjacket and commitment papers that read: "Can't Eat. Can't Sleep. My Heart's Racing. Diagnosis: Crazy for You"(Gram, David, 2005, p.1). Complaints began to roll in. Mental Health groups felt that in marketing this bear the Vermont Teddy Bear Company was showing insensitivity toward those who are mentally *ill. The CEO of the company decided that they would no longer manufacture the bear, but continued the sale of those bears that were already in inventory. (Gram, David, 2005). Will this decision cause problems for the Vermont Teddy Bear Company or will they escape unscathed?*

CRAZY FOR BEARS

The teddy bear has recently celebrated its 100th birthday. In November, 1902 President Theodore Roosevelt went south to settle a border dispute between Mississippi and Louisiana. He took a break to participate in a bear hunt in Mississippi. Stories emerged about the hunt. It seems that some in the group caught a bear and tied it to a tree. It was offered to the President who declined to kill it. The incident became immortalized in a political cartoon. A Brooklyn shopkeeper placed two bears made by his wife in his shop window and received permission from the President to name them for him. Thus, Teddy's Bears were born! Toy companies began making bears about 1903. They were called "teddy bears" after President Roosevelt (http://ir.vtbearcompany.com).

Collecting teddy bears today has become a billion dollar industry. According to Daniel Agnew of Christies, "The whole business has grown over the last ten years by 70 to 80 percent" (http://www.ir.vtbearcompany). There may be as many as three to ten million teddy bear collectors. The majority of those who exhibit the teddy bears consider it an art form. Some bears can sell for as much as $20,000 or more. Collectors usually buy them to keep rather than to sell. Collectors are of all ages, genders, nationalities, cultures and religions. Some may hold on to their bears for a lifetime (http://ir.vtbearcompany.com).

COMPANY HISTORY

In 1981, John Sortino was playing with his son and his collection of teddy bears. He noticed that each bear was made outside of the United States. He decided that he wanted to bring the teddy bear back to its roots here in America by starting his own business manufacturing them. The first bears were made in his home and sold to friends. By 1983, he was selling bears at an open market in Burlington, Vermont. He only sold 200 that year. When a tourist asked him to mail it to her home, Sortino decided to add the delivery service to his business, and thus, the Bear-Gram concept was born. The company made little progress until 1990 (www.store.yahoo.com).

In 1990 before Valentine's Day, the company asked a radio station in New York City to advertise its Bear-Gram concept and suddenly the company was flooded with calls. Within 2 days they had reached sales goals for the entire year! They became a major competitor in the direct response gift delivery business (http://www.store.yahoo.com).

In 1992, INC Magazine recognized the company as the 80th fastest growing private business in the US. By 1993 it was ranked 58th(http://www.store.yahoo.com). Immediately following the company's initial public offering in 1993, they began to have problems. The company spent millions on worthless strategies and projects. By 1995, the Vermont Teddy Bear Company built a new manufacturing facility in the Vermont Champlain Valley and John Sortino moved on to develop other ventures. Elisabeth Robert (roh-bear) was hired in 1995 as CFO and was appointed president and CEO two years later (http://ir.vtbearcompany.com).

Before Sortino left the company, he was growing the company by selling through three retailers. Customers could have the bears shipped through the retailers or could order over the phone, but phone orders were not doing well. The company was in serious trouble and had lost its focus of being a phone-order business. When Ms. Robert came along she reset the marketing strategy to return to the gift-delivery business with emphasis on a phone-order business. Only seven minutes could elapse from the time a call came in until the bear was ready for shipping (http://ir.vtbearcompany.com).

However, the company lost money from 1993 until 1999, when the turnaround began. Sales and profits were up more that 100 percent. Robert credits the turnaround with concentration on what the company did best, which was the gift-delivery business (http://ir.vtbearcompany.com).

Today the Vermont Teddy Bear Company has grown tremendously. They have more than 450,000 bears for sale. For the fiscal year ending June 30, 2004, the company had annual net revenues of $55,828,000 compared to $40,275,000 for FY 2003. That is an increase of $15,553,000 or 38.6%. In addition to the Bear-Gram segment they also have a Pajama-Gram segment (pajamas and spa products), a Calyx & Corolla floral delivery business segment, and a Tasty-Gram segment (gourmet foods and sweets) (http://ir.vtbearcompany.com).

The Vermont Teddy Bear Company seemed to have the right marketing strategies in place for continued growth as of 2004. However, the decision involving the production of the "Crazy for You" bear caused many outside the company to speculate about the insensitive decision from the CEO. How does this decision fit with their mission and values?

MISSION AND DISTINCTIVE COMPETENCE

The stated mission is to "make the world a better place…one bear at a time" (http://www.ir.vtbearcompany.com). The Vermont Teddy Bear Company makes the following statements as to what sets their company apart from the rest:

> "Rooted in the enduring Vermont values of hard work and quality craftsmanship, The Vermont Teddy Bear Company earns the confidence and trust of its customers with friendly, reliable service and the best bears in the universe. Our bears are alive with personality, attitude, and a touch of the unexpected to bring people together in a totally different and fun way. We, the Bear Crew, are people who are passionate about our work, are willing to take risks, reinvent constantly and above all…we love teddy bears." (http://ir.vtbearcompany.com)

This company provides a service for people who are busy but still want to keep in touch with friends and family. It provides a way of communicating in this fast-paced world.

CRAZY BEARS CAUSE CONCERNS

Vermont Teddy Bear Company President and CEO, Elisabeth Robert stated, “The Crazy Bear campaign has come to its conclusion. The bear was not intended to diminish the serious nature of mental illness in any way and was meant to convey the sentiment of love at Valentine’s Day.” Robert met with local health advocates to explain the position of the company. While apologizing and expressing concern for anyone offended, Robert made another statement during a round of interviews that did not help the situation. She said, “We’re not in a position to be told what we can and cannot sell” (http://signonsandiego.com).

Robert’s remarks were not well received by her critics. The company is a member of the group Vermont’s Businesses for Social Responsibility, which was appalled. Ken Libertoff, executive director of the Vermont Association for Mental Health noted that their state was the first to require health insurers to cover mental illnesses on the same basis as other illnesses and felt that this event was not going to be well received in Vermont (http://signonsandiego.com).

The company received 214,000 orders during January, 2005 and the first half of February, 2005, which was a 33 percent increase from last year, but much of that was from the pajama line. They would not indicate how many “Crazy for You” bears were sold during that period. The media attention appears to have played a part in boosting the sales. Company stock has also improved during the same period from $6.45 in early January, 2005 to $7.23 during the week of Valentine’s Day, 2005 (http://signonsandiego.com).

The company appears to be winning in the customer arena with their current strategy. Time will tell however. Several experts in the area of public relations feel that there may be long-range problems that Vermont Teddy Bear may experience. Howard Rubinstein, a public relations executive, said that the cost to the company may be to damage their reputation, while Clark Caywood, a professor at Northwestern said, “The company’s stance undercuts their good will and they live on good will. They’re trying to be warm and cuddly. What’s warm and cuddly about a straitjacket” (http://signonsandiego.com)?

QUESTIONS FOR DISCUSSION

1. Was the Vermont Teddy Bear Company wrong to continue selling the bears?
2 Did the company respond appropriately to the criticism from the public? What would you have done if faced with the problem?
3. Has the company been criticized unfairly or are they insensitive as accused?

4. How can this marketing mistake cost the company in the future?
5 Does the situation with Vermont Teddy Bear relate to ethical problems experienced by other businesses during recent months?

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CAPE CHEMICAL: CASH MANAGEMENT

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CASE DESCRIPTION

The primary subject matter of this case concerns the development and use of a cash budget as a key component in a cash management system. The case also allows an examination of the difference between accounting profit (based on accrual accounting) versus cash flow. The case requires students to have an introductory knowledge of accounting, finance and general business issues, thus the case has a difficulty level of three (junior level) or higher. The case is designed to be taught in one class session of approximately 1.25 hours and is expected to require 3-4 hours of preparation time from the students.

CASE SYNOPSIS

Cape Chemical is a regional distributor of liquid and dry chemicals. Growth has been steady since its beginning, but cash to pay employees and vendors in a timely manner has frequently been a problem. While the company ended its last year with a healthy cash balance, there were many occasions during the year that it was necessary to delay vendor payments or obtain short-term bank loans in order to keep the company operating. On one occasion when a major vendor threatened to stop shipments until all outstanding balances were current and the bank credit was fully used, company credit cards were used to obtain $20,000 to pay (satisfy) the vendor. In an effort to resolve the cash problems, the company has developed a projected income statement, balance sheet and cash flow statement for the next year of operation. Cape Chemical's bank officer suggested the company prepare a monthly cash budget as another cash management tool and as an additional test of the adequacy of the current $200,000 line of credit.

CAPE CHEMICAL BACKGROUND

Cape Chemical is a relatively new, regional distributor of liquid and dry chemicals, headquartered in Cape Girardeau, Missouri. The company, founded by Ann Stewart, has been serving southeast Missouri, southern Illinois, northeast Arkansas, western Kentucky and northwest Tennessee for three years and has developed a reputation as a reliable supplier of industrial chemicals. Stewart's previous business experience provided her with a solid understanding of the chemical industry and the distribution process. As a general manager for a chemical manufacturer Stewart had Profit & Loss (P&L) responsibility, but until beginning Cape Chemical she had limited exposure to company accounting and finance decisions.

To improve management of the accounting and finance area, Stewart hired Kathy Ford, an accountant who had worked with the accounting firm that conducted Cape's first audit. Ford was hired near end of the second year of operation.

CHEMICAL DISTRIBUTION

A chemical distributor is a wholesaler. Operations may vary but a typical distributor purchases chemicals in large quantities (bulk - rail or truckloads) from a number of manufacturers. Bulk chemicals are stored in "tank farms", a number of tanks located in an area surrounded by dikes. Tanks can receive and ship materials from all modes of transportation. Packaged chemicals are stored in a warehouse. Other distributor activities include blending, repackaging, and shipping in smaller quantities (less than truckload, tote tanks, 55-gallon drums, and other smaller package sizes) to meet the needs of a variety of industrial users. In addition to the tank farm and warehouse, a distributor needs access to specialized delivery equipment (specialized truck transports, and tank rail cars) to meet the handling requirements of different chemicals. A distributor adds value by supplying its customers with the chemicals they need, in the quantities they desire, when they need them. This requires maintaining a sizable inventory and operating efficiently. Distributors usually operate on very small profit margins.

THE SITUATION

While the company ended its last year with a healthy cash balance, there were many occasions during the year that it was necessary to delay vendor payments or obtain short-term bank loans in order to keep the company operating. On one occasion when a major vendor threatened to stop shipments until all outstanding balances where current and the bank credit was fully used, Ann Stewart used her company credit cards to obtain $20,000 to pay (satisfy) the vendor.

During the first three years of operations, the company operated with a sales forecast and a few operating budgets but a complete set of pro forma statements were not prepared. In an effort to resolve the cash problems, Stewart, with the help of Ford, developed a projected income statement, balance sheet and cash flow statement for the next year of operation (tables one, two and three).

Ford thought the statements indicated the company's cash problems were solved. "Look Ann, if our forecasts are correct, and our forecast should be accurate, since our assumptions were based on historical data and current market conditions, we are in a very good financial position. We begin the year with a cash balance of $226,350 and our projections indicate an ending cash balance of $85,645, well above our target of a minimum balance of $20,000. The income statement projects our highest profit ever and while our ending cash balance is lower than our beginning cash balance, we will not have used any of the $200,000 bank line of credit. Our cash problems should be history." Stewart agreed the projected performance looks good, but she was still not ready to agree that cash problems were history.

When Stewart and Ford were reviewing the projections with Cape Chemical's bank officer, he suggested the company prepare a monthly cash budget as another cash management tool and as an additional test of the adequacy of the current $200,000 line of credit. Stewart liked the idea.

Later when Stewart and Ford discussed preparing a cash budget, Stewart indicated she had no experience in preparing or using a cash budget. Ford stated that she also had limited experience preparing and using a monthly cash budget but she thought it was similar to preparing forecasted financial statements. The big difference is that monthly rather than annual projections would be needed. The Ford stated the first step would be to prepare a list of monthly operating assumptions.

ASSUMPTIONS

The assumptions used to develop the pro forma financial statements were used by Stewart and Ford as a starting point. Historical information and current market conditions were also used in developing the cash budget assumptions.

1. A minimum $20,000 cash balance will be maintained.

2. The company has negotiated a $200,000 line of credit for short-term cash needs.

Cash Inflows

3. Ford stated that the primary cash inflow will be the collection of accounts receivables. Projected revenue for the year is $6,000,000 and monthly sales forecasts were provided by the marketing department.

	Revenue			Revenue			Revenue
2006 (actual)	$		2007 (projected)	$		2008 (projected)	$
November	260,000		January	240,000		January	280,000
December	326,000		February	300,000		February	350,000
			March	360,000			
			April	360,000			
			May	420,000			
			June	480,000			
			July	540,000			
			August	600,000			
			September	660,000			
			October	720,000			
			November	720,000			
			December	600,000			
			Total	6,000,000			

4. Ford indicated that last year receivables were collected as follows:

	% of sales
Current Month	20.0
Month following the sale	50.0
Second month following the sale	30.0

Ford thought the new credit policy implemented by the new credit manager should allow an acceleration of collections in the coming year. The projected collection schedule for 2007 is:

	% of sales
Current Month	25.0
Month following the sale	60.0
Second month following the sale	15.0

Stewart suggested they use the 2007 collection assumptions for the cash budget. For example, 25% of January sales will be collected in January, 60% of January sales will be collected in February and 15% of January sales will be collected in March. Note: 15% of 2006 November sales and 60% of 2006 December sales will be collected in January and 15% of December 2006 sales will be collected during February. Ford stated there would a small amount of bad debts in 2007 but for planning purposes these would be ignored.

Cash Outflows

5. The purchase of inventory represents the largest cash outflow. Inventory is typically purchased two months prior to expected sales and is paid in the month of purchase. Example, inventory for January sales would be purchased in November and paid for in November. Inventory for February sales would be purchased and paid for in December, etc. Cost of Goods Sold in 2007 were 76% of sales, assume that 2008 cost of goods sold will also be 76% of sales.

6. Annual plant operating expenses were projected to total $688,500. Ford suggested that these expenses be distributed equally over the twelve months. She stated that in some cases this was probably an over simplification but a reasonable assumption. Stewart agreed. Example: One twelfth, or $4,375, of the annual manager salary and benefits of $52,500 will be distributed monthly.

Plant Operating Expenses	Annual Expense $
Manager (salary and benefits)	52,500
Employees (wages and benefits)	225,000
Lease Expense	72,000
Utilities Expense	12,000
Repairs & Maintenance Expense	6,000
Supplies Expense	9,000
Delivery Expense	120,000
Miscellaneous Expense	12,000
Total	688,500

7. Selling Expenses were projected at $301,500 for the year. Ford stated that most could be spread evenly over the twelve months. The exceptions would be Commissions and Promotion and Advertising. Commissions are paid in the month following the end of a quarter and will be allocated based on sales for the previous quarter. Example: ($30,000 *

first quarter sales/annual sales). The accounts payable on the 2006 year end balance sheet represents the fourth quarter 2006 commissions that will be paid in January of 2007. One fourth of the annual promotion and advertising expense will be spent during the first month of each quarter.

Selling Expenses	Annual Expense $
Sales Representatives	105,000
T&E	36,000
Commissions	30,000
Auto Expense	24,000
Internal Sales Representatives	52,500
Promotion and Advertising	54,000
Total	301,500

8. Annual general administrative expenses will be treated the same as plant operating expenses. These expenses will be distributed equally over the twelve months.

General Administrative Expenses	Annual Expense $
Officer's Salaries	83,700
T&E	24,000
Auto Expense	12,000
Administrative Staff	52,500
Utility Expense	12,000
Office Supplies	12,000
Insurance	36,000
Legal & Professional	6,000
Miscellaneous	6,000
	244,200

9. Annual interest expense is forecasted to total $90,000 and interest payments are made in the third month of each quarter. Again for simplicity purposes, Ford suggested the $90,000 be spread evenly over the four quarters.

10. Capital expenditures for the year include a $40,000 expansion to the warehouse and $20,000 for new drum filling equipment. The warehouse expansion is scheduled for April and the

equipment acquisition for June. Assume the expenditures are paid for in the month of their installation. The depreciation expense associated with the projects is included in $180,000 projected for the year.

11. Income taxes are expected to total $34,740 and payments are made quarterly with the first payment of 2007 taxes to be made in April. The $34,740 will be spread evenly over the four quarters. The taxes payable on the year end 2006 balance sheet will be paid in January of 2007.

THE TASK

Prepare answers to the following questions:

1. Construct a monthly cash budget for Cape Chemical for the period January through December 2007. Assume that all cash flows occur on the 15th of each month. Is the current $200,000 line of credit sufficient to meet the needs of Cape Chemical during the year? Explain your answer.

2. The cash budget contains both cash inflows and cash outflows. Which do you feel are likely to be the most accurate? Explain your answer.

3. Stewart thought it would be beneficial to prepare an additional cash budget based on the 2006 collection schedule (a less optimistic assumption).

2006 Collection Schedule	% of sales
Current Month	20.0
Month following the sale	50.0
Second month following the sale	30.0

Will the $200,000 revolving credit agreement be sufficient? Explain your answer.
Note: Assume $39,000 of November and $195,600 of December revenue will be collected in January. Assume $48,900 of December revenues will be collected in February.

4. Why is depreciation expense not part of the cash budget?

5. The monthly cash budget prepared assumes that all cash flows occur on the 15th of each month. Suppose most of Cape Chemical's outflows are at the beginning of the month, while its collections are toward the end of each month. How would this fact alter the cash budget?

6. Temporary excess cash can be invested in marketable securities. What are the characteristics of marketable securities? If excess cash is projected to be continuing rather than temporary, are marketable securities the appropriate investment? Explain your answer.

7. Once again assume all cash flows occur on the 15th of each month. How large of a line of credit would you recommend Stewart and Ford arrange with the bank? Defend your answer.

8. Suppose the bank refused to grant a larger line of credit what options are available to the company?

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Table One: Cape Chemical Company
Projected Income Statement
(For the Year Ending December 31)

	2007
	$
Revenue	6,000,000
Cost of Goods Sold	4,560,000
Gross Profit Product	1,440,000
Plant Operating Expenses	508,500
Depreciation Expense	180,000
Total Plant Operating Expenses	688,500
Gross Profit	751,500
Selling Expenses	301,500
General & Administration Expenses	244,200
Total Selling & G&A Expenses	545,700
Total Operating Expenses	1,234,200
Earnings Before Interest & Taxes	205,800
Total Interest Expense	90,000
Earnings Before Taxes	115,800
Income Tax Expense	34,740
Net Income	81,060

Table Two
Cape Chemical Company
Actual and Projected Balance Sheets
(As of December 31)

	2006	2007
	$	$
Assets		
Current Assets		
Cash	226,350	85,645
Accounts Receivables	283,500	558,000
Inventory	410,400	478,800
Total Current Assets	920,250	1,122,445
Fixed Assets		
Plant, Property and Equipment	900,000	960,000
Less Accumulated Depreciation	120,000	300,000
Net Plant, Property and Equipment	780,000	660,000
Total Assets	1,700,250	1,782,445
Liabilities and Equity		
Current Liabilities		
Accounts Payable	9,300	10,200
Income Taxes Payable	8,450	8,685
Short-term Note	100,000	100,000
Total Current Liabilities	117,750	118,885
Long-term Bank Loan	300,000	300,000
Total liabilities	417,750	418,885
Shareholders' Equity		
Paid in Capital	1,000,000	1,000,000
Retained Earnings	282,500	363,560
Total Shareholders' Equity	1,282,500	1,363,560
Total Liabilities and Equity	1,700,250	1,782,445

Table Three Cape Chemical Company Projected Cash Flow Statement for 2007 (For the Year Ending December 31)	
	2007
	$
Cash Flow from operating activities	
Net income	81,060
Sources (Uses) of Cash	
Depreciation	180,000
(Increase) Decrease in A/R	(274,500)
(Increase) Decrease in inventories	(68,400)
(Increase) Increase in A/P	900
(Increase) Taxes Payable	235
Net cash flow from operating activities	(80,705)
Long-term investment activities	
Acquisition of fixed assets	(60,000)
Financing activities	0
Increase in Short-term Bank Loan	0
Increase in Long-term Bank Loan	0
Issue of Common Stock	0
Net cash flow from financing activities	0
Net increase (decrease) in cash	(140,705)
Cash at beginning of year	226,350
Cash at end of year	85,645

THE FEDERAL GOVERNMENT VS. YORK COUNTY: A TRANSFER PRICING CASE FOR MANAGERIAL ACCOUNTING STUDENTS

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Dean DiGregorio, Southeastern Louisiana University
Abigail Royce, Texas A & M University-Corpus Christi

CASE DESCRIPTION

The primary subject matter of this case concerns transfer pricing. Secondary issues examined include opportunity costs, sunk costs, the use of progressive levels of critical thinking skills, the application of classroom knowledge to real life situations, and effective communication skills. The case has a difficulty of level of two and is appropriate for sophomore-level students in managerial accounting classes. The case is designed to be taught in a 1.25 hour class and is expected to require 2.5 hours of outside preparation by students, preferably working in small groups. Alternatively, the case could be assigned as a project that requires minimal classroom time.

CASE SYNOPSIS

During their college experience, students are exposed to facts and theories in many different subject areas. By the time they graduate, students are expected to have developed critical thinking skills. They should be able to apply what was learned in the classroom to real life situations and be able to effectively communicate their analysis and conclusions. This case is derived from an actual situation occurring between the federal government and York County, Pennsylvania in 2003, as described on National Public Radio's Morning Edition. The case requires students to assume the role of a consultant to York County. They need to identify the conflict, consider relevant theories, analyze the situation from both parties perspectives, and suggest a reasonable solution to the conflict.

THE FEDERAL GOVERNMENT VS. YORK COUNTY: BACKGROUND INFORMATION

You have been hired as a consultant by York County, Pennsylvania to assist with their negotiations with the federal government. Over twenty years ago, York County remodeled an unused wing of its county prison to exclusively house detainees for the Immigration and Naturalization Service (INS). The county prison holds up to 850 detainees. Currently, 550 detainees (men and women) are being housed. The current facility is well suited for housing INS detainees. Per the prison warden, “This is a unique facility. When we set it up, it was designed specifically for INS.” The prison includes a gym, law library with computer terminals, a property storage area, and hearing rooms where INS judges sit to hear detainees' cases.

York County charges the federal government $60 per day for each inmate they house. This is less than the $75 average federal rate paid for housing detainees, but more than the federal government thinks is appropriate. The INS General Inspector researched the facility and estimated that it should only cost $38 per day per detainee. York County believes that the INS estimate is grossly understated. The INS estimate appears to have excluded overhead for the facility and is below the alleged actual direct costs incurred by York County. York County reinforces its case for $60 per inmate per day by demonstrating that the average price to house INS detainees is $75 per day per inmate. If a negotiated price cannot be agreed upon, INS has threatened to move the detainees to other facilities.

CASE QUESTIONS

Observe the Situation and Identify the Conflict

1A. What is the primary dispute in this case?
1B. Identify typical materials, labor and overhead costs that would be incurred by York County to house INS detainees?

Consider Relevant Theories

2A. What managerial theories or concepts specifically relate to pricing decisions between somewhat related parties?
2B. What is the general decision rule for the identified theories?

Analyze the Situation from Both Parties Perspectives

3A. What motives might INS officials have to renegotiate the daily cost to house INS detainees?
3B. Should York County automatically assume that INS wants to reach an agreement with them?
3C. If York County refuses to renegotiate the daily rate to house detainees for INS, what four main options does the federal government have?

3D. If York County refuses to renegotiate the daily rate to house detainees for INS, what additional costs and benefits would be incurred by the federal government under each of its four main options?

3E. If the INS officials choose to act in an apparently irrational or unfair manner, what can the York County officials do about it?

3F. If York County refuses to renegotiate the daily rate to house detainees for INS, how will each of the federal government's four main options affect York County?

3G. If the INS does leave the prison, what alternatives does York County have regarding the prison?

3H. If York County accepts the $38 per day per detainee offer by INS, what effect will this decision have on York County's expected revenues and expenses.

3I. If York County chooses to negotiate a new rate somewhere between the current rate and the INS desired rate, which costs identified in question 1B must be considered and which can be ignored to determine the lowest acceptable rate to charge INS?

Choose a Course of Action and Justify Your Decision

4A. As a consultant, what do you suggest that York County do? Please explain your conclusions and limit your response to no more than three (3) paragraphs.

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COST ALLOCATIONS FOR HOSPITAL MANAGEMENT

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Lorraine Ruh, Northern Kentucky University

CASE DESCRIPTION

The primary subject matter of this case concerns structuring cost accounting information. A secondary issue is the focus on how the information might be used and to this end there are no numbers in the case. Depending upon the requirements chosen by the instructor, this case could be successfully used in an undergraduate cost accounting or accounting information systems course. It could also be an effective tool for an MBA-level managerial course. Level of difficulty would therefore be at the four or five level. The case is designed to be discussed in one and one-half hours and should take students no more than five hours of outside preparation.

CASE SYNOPSIS

This hospital-based cost accounting case is unique in its lack of numerical information. The objective is to make students focus on the way the information should be structured and the way the information may be used rather than completing some financial reports. For most students this is far more challenging than it appears at first .Jamesville Hospital has grown rapidly, but its accounting system is still very basic. The financial records are adequate, but the hospital's growth has challenged the management team to provide improved information about revenue and cost centers in preparation for developing information about the costs of the various procedures. The real issue in this case is that as the hospital grew, its accounting system did not evolve in a useful, practical or logical manner. Few departmental managers actually use the data generated by the current accounting system so the hospital has no real way to manage its costs.

HISTORY

Jamesville Hospital (JH) opened its doors in 1861 as a church supported hospital and orphanage. The oldest building still in use by JH was occupied in the early 1900's. Over the years the city of Jamesville grew out and around the hospital site; consequently needed expansions were constrained by the physical location. Eventually in the late 1970's, the hospital opened a second site in the suburbs; the administrators had sufficient foresight to buy enough land to allow for major expansions after the initial building was occupied and growth continues at this location up to the present day. In the early 1990's JH branched farther out into the region with the purchase of a hospital 40 miles away. Currently the Jamestown Hospital has three fully utilized hospital sites as well as several satellite operations that support its healthcare mission. The satellite operations are not considered financially material to the hospital's operation. They are viewed as an outreach to the community of doctors and patients at a cost that the hospital management deems immaterial.

STRUCTURE

Organizationally, JH is composed of over 120 units – some are viewed as cost centers, while most (over 80) are revenue centers. Most departments are considered to be a single revenue or cost center, but some departments contain two or more revenue centers. (Examples of cost and revenue centers are listed in Table 1.) Because of the centralized administrative decision-making structure, no units are considered investment centers. Most of the units are managed by medically trained personnel (e.g., nurses, pharmacists, technicians, nutritionists, etc.) with no background in accounting or management; thus the financial management decisions are made by central administration.

Table 1: Examples Of Jamesville Hospital Revenue And Cost Centers	
Revenue Centers	Inpatient Psychiatry Wing Cancer Care Center Radiology Surgical Intensive Care Newborn Intensive Care Women's Medical Care Surgery Sleep Disorders Center
Cost Centers	Central Supply Purchasing Patient accounts Medical Records Security Plant Engineering Housekeeping

ACCOUNTING SYSTEMS

About 3 years ago, JH implemented the Costex cost accounting system. This purchased software is not a part of the financial accounting system, but downloads the general ledger information and recasts that data into expense reports for each cost or revenue center. These reports are distributed to the management team for each cost or revenue center. Although the Costex system is capable of quite sophisticated processes, the management team uses little of the system's capabilities due to a lack of managerial accounting expertise.

The original implementation of the Costex system was limited. The financial accountants, with the unsophisticated assistance of the managers of the revenue and cost centers, completed an initial cost allocation model which has never been updated or reviewed. With no experience or education in management or accounting, only a few of the managers understood the need for accurate cost information – most considered it useless, at best, and punitive, at worst. Generally the managers of the cost and revenue centers do not use any financial reports and have difficulty providing supporting information (such as the amount of medical supplies needed for a procedure or the length of that procedure or the number and type of staff needed) that is accurate, reasonable or timely. See Exhibit A for an example of a typical cost report for a revenue center. The only part of the report that managers of cost or revenue centers described as understandable is the total cost line.

Exhibit A
Sample Cost Report for a Revenue Center
Revenue Center Name

Account Number	Expenses	Increase	Decrease	Direct	Overhead
6000 Salaries	XXX			XX	XX
6350 Med/Surg Supplies	XXX			XX	XX
6355 Sutures	XXX				XX
6370 Food	XXX				XX
6380 Hskg Supplies	XXX				XX
6400 X-ray film	XXX				XX
6450 Gen Supplies	XXX				XX
6500 Paper Napery	XXX				XX
6540 Purchases Serv	XXX				XX
6548 Laundry	XXX				XX
Nutrition/Cafeteria		XXX			XX
Linen Replacement		XXX			XX
Info Systems		XXX			XX
Purchasing		XXX			XX
HR		XXX			XX
Depreciation	____	XXX	___	____	XX
Totals	XXXX	XXX	0	XXX	XXX
	=====	====	==	====	====

Data downloaded from the general ledger and entered into Costex is classified in one of three ways:

- Direct costs of the cost/revenue centers (only salaries/wages and medical/surgical supplies can be considered direct costs);
- Indirect costs of the cost/revenue centers (examples include paper supplies, laundry, oxygen and gases, film) which can be traced to the cost/revenue center but not to any procedures of the cost/revenue center;
- Indirect costs of the hospital (examples include purchasing costs, plant operations, depreciation, telephone, information systems) which can not be traced to the cost/revenue center and must be allocated.

The chart of accounts for the hospital's expenses is provided in Table 2 while Table 3 categorizes the expenses into the three broad categories described above.

Table 2: General Ledger Expense Accounts

Account number	Description	Account number	Description
6000	Salaries	6500	Paper Napery
6130	Other Benefits	6510	Books/Subscriptions
6140	Employee Relocation Expenses	6520	Purchased Blood
6150	Health Center Services	6540	Purchased Services, Training
6160	Social Security	6541	Software Maintenance
6170	Unemployment	6544	Contract Labor-Clinical
6180	Group Health Insurance	6546	Contract Labor – Non Clinical
6190	Retirement Plan	6548	Laundry Expense
6191	Pension Admin Costs	6560	Repairs & Maintenance
6200	Workers Comp	6662	Depreciation-Leasehold Impmnts
6210	Group Life Insurance	6663	Depreciation-Minor Equipment
6220	Group Dental Insurance	6664	Depreciation-Land Improvements
6230	Disability Insurance	6665	Depreciation-Buildings
6240	Student Books	6666	Depreciation-Building Services
6301	Data Processing (<$2000)	6667	Depreciation-Fixed Equipment
6310	Consulting/Professional Services	6668	Depreciation-Major Movable Equ
6320	Legal Fees	6669	Depreciation-Vehicles

Table 2: General Ledger Expense Accounts

Account number	Description	Account number	Description
6325	Legal Fees – Prof Liability	6682	Bond Issue Closing Costs
6330	Auditing Fees	6684	Bond Issuance Costs
6340	Open Heart Supplies	6690	Bond Issue Discount
6350	Medical/Surgical Supplies	6720	Interest Expense
6351	Orthopedic Supplies	6730	Property Rent
6352	Pacemakers/Defibrillators	6735	Brker/Dler fees (bonds/real estate)
6354	Endomechanicals, other	6770	Equipment Rental
6355	Sutures	6780	Utilities-Electricity
6356	Intraoccular Lenses	6790	Utilities-Gas
6360	Drugs	6800	Utilities-Water
6365	Flu Shots	6810	Fuel Oil
6370	Food	6815	Cable TV
6380	Housekeeping Supplies	6830	Postage
6390	IV Solutions	6850	Insurance-General
6400	X-ray film	6851	Insurance-Professional Liability
6410	Oxygen & Gases	6880	Telephone
6420	Disposable Patient Supplies	6890	Hospital Dues & Memberships
6430	Vehicle Operation/Maintenance	6900	Recruitment Advertising
6440	Linen Replacement	6902	Recruitment Expense
6450	General Supplies	6905	Advertising-Non Recruitment
6455	Grant Expenses	6912	Scholarships
6460	Office Supplies	6920	Business Travel
6470	Disposable Wearing Apparel	6925	Entertainment/Meals
6480	Dishes & Glassware	6990	Administrative Overhead
6490	Minor Equipment		

Table 3: Summary Of Cost Classifications (And Related Account Numbers)	
Direct costs of the cost/revenue centers	Salaries (6000) Medical/surgical Supplies (6350)
Indirect costs of the cost revenue centers (traceable)	Sutures (6355) Food (6370) Housekeeping Supplies (6380) X-ray Film (6400) General Supplies (6450) Office supplies (6460) Paper napery (6500) Purchased Services (6540) Laundry Expense (6548) Repairs and Maintenance (6560) Entertainment/Meals Reimbursement (6925) Oxygen and Gases (6410) Package Supplies (6420) Books (6510) Dues and Memberships (6890)
Indirect costs of the hospital (non-traceable but allocated by the Costex system)	General Nursing Expenses Nutrition/Cafeteria Plant and Security Housekeeping Linen Replacement Information Systems Purchasing Telephones Human Resources Benefits Building Costs Depreciation Hospital services
Indirect costs of the hospital (non-traceable and not allocated)	Administrative overhead

The management team believes that the direct and indirect costs of the cost/revenue centers are tracked accurately through the financial accounting system; JH has always had a clean audit opinion so the hospital's financial records are adequate. But, JH would like to be able to generate very specific cost information for procedures that are performed by the various revenue centers. However the indirect costs of the hospital, while correct in total, have generated some uncertainties in the way that they have been allocated to these revenue centers. The indirect costs of the hospital have been collected into 12 cost pools which are then allocated to the revenue generating departments; this cost pool allocation is summarized in Table 4a.

Table 4a: Cost Pools, Descriptions, and Allocation Bases (see Table 4b for Notes)		
Pool Name	Description	Allocation Basis
General Nursing Expenses (Notes 1 and 2)	All administrative expenses related to scheduling, training and development of the nursing staff. Includes the costs of orientation	Number of full-time-equivalent nurses at all sites
Nutrition/ Cafeteria (Notes 3 and 6)	All costs of cafeteria and vending (net of revenues) for all sites	50% of each site's costs are allocated on the basis of patient days at that site; the remaining 50% is included in the employee benefits pool (see below)
Plant and Security (Note 4)	All costs of security, plant engineering, and operations	Each site's costs are allocated on the basis of the square feet of space at that site
Housekeeping	Housekeeping supplies and wages	Each site's costs are allocated on the basis of the square feet of space at that site
Linen Replacement (Note 5)	Cost of replacing linens and other costs related to the laundry operation	Pounds of laundry (measured by departments)
Information Systems	Costs of computer technology	Number of CRTs per department
Medical/Surgical Supplies	Costs of the purchasing department and costs of materials management	Total cost of medical or surgical supplies purchased by departments
Telephones (Note 7)	Costs of phone services	Number of telephones per department
Human Resources	Costs of the human resources department	Costs of wages and salaries
Employee Benefits (Note 6)	All hospital costs for employee benefits including 50% of the costs of the cafeteria	Costs of wages and salaries
Facilities Cost	Building depreciation, amortization, loan closing costs, bond discounts and any other costs of facilities accumulated by location	Each location's costs are allocated on the that site's square footage
Depreciation (Note 8)	Depreciation on equipment	Based on net cost of major moveables purchased for departments
Patient Services (Note 9)	Costs of social, pastoral and patient services	Cost of services at each site allocated on basis of patient days at each site

Table 4b: Notes on Cost pools	
	Descriptions and Allocation Bases
1.	Nurses are in short supply and JH provides financial support as a means of retaining good staff. The financial support includes such things as on-going training classes, books for students, and a matching program with local universities. All of these costs are included in the General Nursing Expenses pool.
2.	The hospital hires nurses into full-time positions and into "on-call" positions. The "on-call" nurses can be called in for vacationing nurses, for nurses who are ill or for times when the hospital is operating with a larger than normal patient load. This is standard procedure for many hospitals but makes determining the full-time-equivalent (FTE) nurses difficult to determine. JH has used planned full-time positions when calculating FTE.
3.	All food is prepared in the kitchen at the suburban site and then transported to the rural location and the original urban site. The rural site does not have an employee cafeteria. Perishables (milk, bread, etc.) are delivered directly to each site and the charges are made directly to those sites. Vending, too, is directly associated with each site. The kitchen supervisor keeps detailed records on meals served to patients but there is no similar record for cafeteria items (other than the revenues).
4.	Security and plant operations records are maintained independently for each site, but plant engineering is centralized at the suburban location. Although all three sites utilize the plant engineering services, the costs are only allocated to the cost/revenue centers at the suburban location.
5.	All linens are centrally cleaned and the cost of the cleaning is not allocated but is the actual cost based upon the pounds of linen picked up from the various sites. Because the linens are interchangeable, they are not physically traced to any location and the annual replacement costs for worn or destroyed linens are the costs that are allocated in the cost pool.
6.	The employee benefits pool includes the traditional employee benefit costs (for example, 6190 Retirement Plan) as well as 50% of the costs of the nutrition/cafeteria pool. Employee benefits are not traced to individuals or to sites.
7.	Patient telephones are provided as a service, but do not have long-distance capabilities. Only administrative or selected nursing station telephones are equipped with long distance capability. Currently long distance charges are not traced back to the originating location, but are allocated along with the cost of basic services in the Telephones cost pool.
8.	Depreciation is not traced to individual machines or equipment. Instead, the depreciation is computed on the total pool of depreciable assets (excluding buildings) and that amount is then allocated to the departments on the basis of net major moveable assets. Major moveable assets are those that are typically of large dollar amount and are specifically medical machines (e.g., X-ray or MRI equipment).
9.	All the social, pastoral and patient services are segregated by location and then allocated on the basis of patient days at that site.

The accounting system has grown tremendously and not very systematically over the last decade. As JH grew, no administrator perceived a need to accumulate information into cost pools or even to logically group the account numbers by similar types of costs – such as benefits or direct departmental costs.

Other information about JH's accounting system is summarized below:

- ♦ The chart of accounts is very misleading. Some of the accounts have sub-accounts that are traceable. For instance, 6380 Housekeeping Supplies is really 3 separate accounts – one for each site. But 6000 Salaries and the other personnel/benefits related accounts do not have sub-accounts, i.e., the salaries for personnel for all sites and all jobs are commingled in each of these accounts.
- ♦ While all three sites provide general medical care, only the suburban site does open heart procedures. Although not all sites provide all services, management believes that expansion or development of specialty services could be possible at any site.
- ♦ Most recruitment advertising and expense is for nurses; only a small, immaterial part goes to recruiting other skilled or unskilled labor.
- ♦ The common practice is to share resources as needed or necessary. For instance, one pool of vehicles (cars, trucks and vans) is shared by all sites and no single vehicle is assigned to a location, but might be found at any of the three sites or even at a minor satellite location. Specialized software presents another example: unusual programs may be needed by individual departments, but most software is shared on the hospital's main server.
- ♦ Unlike depreciation, charges for repairs and maintenance are traceable to revenue/cost centers based upon the service requests initially generated by those centers.
- ♦ Not all costs are allocated to all revenue/cost centers. For example, the respiratory care unit does not use linens so no linen replacement cost is allocated to that revenue center.
- ♦ Although the Costex system is supposed to allocate the indirect hospital costs to a revenue/cost center, the allocation rules might commingle costs which have actually been recorded as a site-specific expense.
- ♦ The reimbursement accountant utilizes a step-down allocation system in the records maintained to support insurance and government reimbursements. In addition to the bases shown in Table 4a, this step-down allocation uses the following bases: cost of requisitions, purchase requisitions, patient revenues, outpatient revenues, housekeeping time, number of patient meals, pharmacy requisitions, medical records time, resident time and staff time. The pools used by the reimbursement accountant

are not the same as the pools used by the cost accounting system; the reimbursement system is constrained by rules and regulations of the various entities that provide funding (notably insurance companies and government agencies). The bases used by the reimbursement accountant are easily available and regularly updated.

Possible Assignments

1. Review the chart of accounts in Table 2. For each account, determine the need to designate any accounts as "controlling" and then to establish subsidiary accounts. For any subsidiary account, determine how that account is to be defined (what costs are to be collected in that subsidiary account). For example, should account 6000 Salaries be a controlling account with subsidiary accounts for nursing salaries at each site and other salaries at each site?

2. Review the cost classifications from Table 3. Redo using the information from Table 2 and any changes recommended as a part of question 1.

3. Make a list of questions to be asked and any further information needed to refine the proposed cost allocation system along with explanations of why the information might be useful.

4. Based upon your reviews for parts 1 and 2, list suggested changes to the accounting system.

5. Review the cost pools and allocation bases from Table 4a. Based upon (your recommendations above and) the information gleaned from the JH narrative, write a memo recommending and explaining changes in the cost pools and allocation bases.

MANAGING CLIENT RELATIONS: THE CASE OF PETER VOSEK

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CASE DESCRIPTION

The primary subject matter of this role play case is the interpersonal skills needed to handle a difficult client situation involving power and trust. Since difficult situations often stem from people having different goals, different approaches, and/or different personal styles, diagnosing and attending to these differences are fundamental to resolving both the interpersonal and task-related issues. Resolving difficult situations and retaining the relationship often requires planful dialogue – communications that: (1) are open to and respectful of the others' point of view,(2) treat others' as equals in the situation, and (3) seek to understand the others' views and the assumptions underlying those views. The role play case has a difficulty of five (graduate). It is designed to be used within 50-80 minutes. No outside preparation is necessary.

ROLE PLAY CASE SYNOPSIS

The "Peter Vosek Case" and roles for a role play (totaling 4 pages) present the same management consulting engagement from different perspectives. Peter, the officer in charge (OIC) of the engagement, and Joan, the job manager for one of the five teams on the project, relate their perceptions of the different stakeholders involved in this project and the challenges of managing these stakeholders.

CRC (a top tier international management consulting firm) is hired by a chemical manufacturer to lead a large service implementation project. Early in the project, Peter's counterpart on the project, the Corporate Manager of Service, is replaced. Peter finds it difficult to maintain a good working relationship with his new counterpart, Senal Dhola. His project is falling behind schedule, and he finds himself in a situation in which he has little access to the top management team of the company. We see Peter pondering how to turn the engagement around and prepare an effective, mid-engagement presentation for the top management group.

Joan Charoen is the job manager (senior associate) for the information technology (IT) team on the project. Joan has created a collaborative environment for her team, which is composed of both CRC consulting staff and managers from the chemical company. Joan believes the senior members of the consulting team need to actively strategize ways to gain buy-in for the project from the company's top management.

PETER VOSEK

Peter Vosek, a partner at CR Consulting (CRC), was 6 months into the largest project he had ever led. He was the officer in charge (OIC) of a service implementation project for a chemical company. Peter had five teams on this project, each with a job manager, and a senior job manager who coordinated all of the teams. From the start, Peter, a Wharton MBA, had looked forward to the challenge of this $10 million project.

Two months into the project, Senal Dhola became the chemical firm's corporate manager of service and Peter's new counterpart on the project. Senal thrived on challenges and had progressed rapidly in the chemical company. Peter was relieved when he learned that Senal was heading up the project as he had worked well with Senal in the past. Peter knew Senal from a 12-week assessment project he had did several years earlier. Senal had liked CRC's work and had implemented several of its recommendations. Peter felt that Senal respected his ability. He had keep in contact over the past few years and they had lunch together twice. Senal seemed eager to take on this large project, which was in the implementation planning stage.

In their first few meetings, Peter was uncomfortable with way that Senal questioned many of the decisions that were made with the former corporate manager of service. However, after several more meetings, Senal had agreed with the plan Peter laid out and Senal even convinced the CEO, Shawn Walsh, that this was the way to proceed. For several weeks, Peter thought that he and Senal were in agreement, but then he noticed that Senal's easy-going style was becoming more distant. His weekly meetings with Senal became more formal. Senal started to ask to see every document, every interview, and each spreadsheet. Senal also excluded Peter from two key project meetings with the top management team which included the CEO, CFO, VP of Sales, and VP of Manufacturing. Peter was acquainted some members of the top management team but did not know any of them well. Further, because Senal had never asked him for career advice, he had little information about the dynamics of the top management team. He was extremely uncomfortable knowing that they were discussing the project without his input.

Peter was uncertain about how to proceed but believed that his best bet was to continue to work with their original plan. Over the next month things did not improve. When problems arose with different streams of the project, Senal showed no flexibility in working around them, refusing to work with Peter to re-structure the project in ways that would efficiently deal with the issues they faced. As a result, intermediate deadlines were missed, even though the CRC people were working longer and harder.

At the six month point in the engagement, only one team was doing well – the information technology (IT) team. The job manager on this team, Joan Charoen, was an engineer by training and a Harvard MBA. Her team was two-thirds client and one-third CRC staff. In an unscheduled meeting that Joan created, Peter learned that Joan felt her team was working well. The client members of her team were all senior managers and everyone seemed to share the project's objectives. She noted that just yesterday one of her people said, "Hey this is great! You rarely work with clients like this!"

Then Joan shocked Peter by questioning his ability to manage client expectations. From conversations with other CRC job managers on the project, Peter knew that there were coordination problems between IT and the Firm's logistics area. Joan's team was recommending the establishment of another top management position – a Chief Information Officer (CIO) -- who would report directly to the CEO, Shawn Walsh. This was an important issue because the lack of integration among the company's current systems created redundancy in some areas and inefficiencies in others, but irrespective of the importance of this potential recommendation, Joan had overstepped her boundaries by questioning his leadership on the project.

Peter prepared for a mid-engagement presentation to top management. The meeting would be difficult because of his limited access to the team. Peter thought about calling a senior partner at CRC for advice, but he believed that he could still deliver on the project if he and his people just worked harder. He would present the CEO with a step-by-step plan for getting back on track and then keep his nose to the grindstone.

NOTE

Stephen A. Stumpf is the Fred J. Springer Chair in Business Leadership

ADAMS JEWELRY

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CASE DESCRIPTION

The primary subject matter of this case concerns the operational philosophy and actions of a small retail jewelry store. Secondary issues examined include the nature of the jewelry and diamond market, selecting an appropriate target market, developing a merchandise mix to satisfy target customers, pricing and promotion strategies for a small retail jeweler, and store location decisions. The case has a difficulty level of four, appropriate for senior level. The case is designed to be taught in one class hour and is expected to require one hour of outside preparation by students.

CASE SYNOPSIS

Jack Adams owns and manages an independent jewelry store in Florida. He is facing a number of issues concerning the store's competitive effectiveness in the local jewelry market. The immediate decision is whether he should move from his long-established store location. Although his store is not very up-to-date, it is in a high-traffic location and receives a lot of exposure. He caters to a middle class clientele, but fancies his business as a higher quality, upscale operation. Thus, there are issues of image and positioning in the local jewelry market among competitors. Other questions concern his lack of effective promotion activities and hours and days of operation. All of Jack's decisions relate to the issue of his customer service and marketing orientation. The case also incorporates global dimensions as it describes the nature of the diamond market.

BACKGROUND

Adams Jewelry is a moderate-sized jewelry store located on one of the busiest streets of a medium-sized town in Florida. Its location is at a very visible corner of a small strip mall on the west central side of the city. Its location is considered prime because it directly faces a very busy four-lane, U.S. highway running through the city. The town's population is around 100,000 with an MSA population of over 150,000.

Adams Jewelry started in 1995, when Jack Adams, at age 40, decided to leave Nashville, Tennessee where he worked for eighteen years as a jeweler, to move back to his hometown. Coming out of a divorce, Jack needed the financial help of his parents to buy an established local jewelry store for $15,000. The price included some inventory, jewelry display cabinets, and jewelry repair equipment. The purchase was considered an attractive deal for a store that was originally established in 1950. His parents co-signed for him at a local bank to help him obtain a credit line of $20,000 to help buy jewelry for inventory.

Jack is a very skillful jeweler in terms of fixing and even casting jewelry. Casting is the process of crafting jewelry from scratch. This includes custom creation of rings, bracelets, pendants, etc. However, Jack has an introvert's personality. He is normally a serious person. He arrives at work around 8:30 AM and stays until closing at 5:30 PM. His customers like him because he is very honest and does an excellent job creating and repairing jewelry. He rarely leaves the store during business hours. He always eats his lunch at the store. Jack likes to wear Bermuda shorts at work sometimes during weekdays and the weekends.

Although on a high-volume thoroughfare, Adams Jewelry is located in a 30-year-old U-shaped, strip shopping center. All of the center's tenants have turned over several times. The shopping center's anchor building (formerly a supermarket) is now a bingo parlor. The exterior of Adams' store is an out-of-style light brown brick with faded red canopies providing shade to two of several parking spots in front of the store. One of the awnings is torn. Jack and his mother park their vehicles in front of the store (under the covered parking) leaving customers to park elsewhere in the huge, largely unoccupied asphalt lot.

The large plate glass front windows of the store are covered with old, formerly white sheer curtains that have now been discolored by the sun to a light brown tone. The way the drapes are hung on the windows does not look very up-to-date. The carpet is a light pink color and the texture is worn out in the middle due to people walking on it over the years. The jewelry cabinets are made out of pink-colored Formica. The bottom of the cabinets that touches the store floor is rather worn.

Jack's mother, Kathryn, is a very sharp dresser who wears beautiful jewelry and has an outgoing personality and knows how to interact with customers. She keeps the books for the store and helps to wait on customers whenever needed. Jack's parents are well known in the area. In addition to Jack and his mother there are four other people that work for Adams Jewelry: "Ms. Johnette," Casey, Anna, and Ralph.

Ms. Johnette is a nice lady in her mid-forties. She is married to a carpenter and has three teenage daughters. She is the type of person who looks familiar, like the next-door neighbor. Her position is a sales person and she works three days a week at an hourly wage of $7 plus commissions. She comes across to customers as a natural "down home" lady. Casey is married to Jack's step-brother. She has a full-time job at a large local company and works at Adams only on Saturdays. Her main job is in sales. Anna is Jack's cousin. She is a beautiful lady in her late thirties. She works three days a week, especially whenever Ms. Johnette is not working.

Ralph, about 50 years of age, is a very nice person who was forced to retire from his job as a truck driver. He received a workman's comp settlement from a back injury due to driving long hours every day. The situation forced him to seek help from his friend Jack. Jack offered to train him to repair jewelry. Ralph makes five dollars on every ring he sizes for Jack whenever Jack does not have time to do extra work. Ralph comes to work using a cane and he likes to wear shorts in the summer. His adult son, Barry, is rumored to have had a substance-abuse problem and has lots of tattoos. He sometimes comes by the store dressed in a black T-Shirt and tattered black jeans and normally goes straight behind the counter to the workbench to talk to his father. Customers often look rather surprised when they see him going behind the counter.

Adams Jewelry is open six days a week, Monday-Friday from 9:30 AM-5:30 PM and on Saturdays from 9:30 AM-1:30 PM. Although several independent jewelry stores in the city keep their doors open until 7:30 PM and the chain jewelers usually stay open until 9:00 PM, Jack insists on closing his store at 5:30 PM. The store closes on all major holidays, including the Friday after Thanksgiving. When asked about the reason he always closes the store on the busiest shopping day of the year, Jack replied that his daughters come from Nashville to visit him and he wants to spend time with them. Each of the other local independent jewelry stores are thought to be doing perhaps \$20,000-\$25,000 of business on that day alone. Jack also closes the store for a week every year around the Fourth of July. His mother usually takes the whole extended family at her own expense to the South Carolina coast. From 1995 (the year Jack bought the store) until 2001, Adams Jewelry experienced a steady growth in business. In those six years, Adams' sales went from \$120,000 per year to a record \$270,000. Although the growth percentage seems high, it is not so significant when compared to sales of other jewelry stores in the market. There are several small jewelry stores that started in business at about the same time and their sales had already surpassed the \$1 million mark per annum by 2001.

COMPETITION

Jewelry stores in Jack's city differ on a number of attributes: 1) Some are more repair-intensive than sales-focused. For example Adams does more business in repairing jewelry than selling jewelry. Other stores may not have a repair person on duty; therefore, they would contract with a repair jewelry store to do the work for them; 2) Social status of customers they attract (lower class to upper class); 3) Quality of diamonds (low-grade to high-grade diamonds). 4) Well-known designer lines carried (e.g. for jewelry - Simon G, Mickey Moto Pearls, etc; e.g., in watches -- Rolex, Movado, Tag Heuer, Baume Mercier, etc.); 5) Inventory (small vs. large); and 6) Location (prime location of town, regional mall, or in a poorer area, etc. Table 1 provides a brief description of jewelry stores categorized according to these types of criteria.

The jewelry business can be very lucrative. Some jewelers obtain as much as 100-400 percent markups. Jewelers like Hilton and Marvin's can demand higher markups for their fine jewelry due to the high quality of their jewelry and its immediate availability. Also the additional lines of luxury watches such as Rolex and Tag Heuer can bring more customers into the jewelry store and add more value to the credibility of the store.

Table 1: Jewelry Store Competitors

Store	Miles from Adams	(S)ales and/or (R)epair	Buyer Social Class	Diamond Quality	Designer Jewelry	Designer Watches	Inventory Size	$ Annual Sales	Location Quality
Austin Jewelers	2.2	S	Upper Middle to Upper	Medium to High	None	None	Medium	200K	Bad
Fantasy Jewelers (West)	1.5	S/R	Middle to Upper	Low to High	None	Seiko Citizen Fossil	Large	500K	Prime
Fantasy Jewelers (East)	3	S/R	Middle to Upper	Low to High	None	Seiko Citizen Fossil	Large	500K	Prime
Foster's Jewelry	7.2	S	Lower to Upper	Low	None	Seiko Citizen	Large	600K	Mall
Hilton Jewelers	3.7	S/R	Upper Middle to Upper	High	Several	Rolex Movado Tag Heuer	Very large	3+ Million	Prime
Gordons Jewelers	7.2	S	Lower to Middle	Low	None	Seiko Fossil	Large	400K	Mall
Jewelry Emporium	7.2	S	Lower	Low	None	None	Small	220K	Mall
Jewelry Place	1.8	S/R	Lower to Middle	Medium	None	None	Medium	70K	Fair
Kay Jewelers	7.2	S	Lower	Low	None	None	Medium	500K	Mall
Marvin's Fine Jewelry	4.5	S/R	Upper Middle to Upper	High	Several	Movado Tag Heuer	Large	1+ Million	Prime
Adams Jewelers		S/R	Lower to Middle	Medium to High	None	Seiko Citizen	Medium	180K	Prime
A-J Jewelers	5.8	S/R	Upper Middle to Upper	Medium	None	Rolex Movado Tag Heuer	Large	400K	Bad
Roland Samson Jewelers	4.7	S/R	Upper Middle to Upper	Medium to High	None	None	Medium	1.5 Million	Prime
Seventh Heaven	7.2	S	Middle to Upper Middle	Low	None	None	Small	300K	Mall
Displaycase Jewelry	0.9	S/R	Middle	Low to Medium	None	None	Large	400K	Prime
Sylvester Thompson Jewelry	4	S/R	Lower to Middle	Medium	None	None	Small	180K	Prime
Transitions Fine Jewelry	1.4	S/R	Middle to Upper Middle	Medium to High	Few	None	Medium	320K	Fair
Zales Jewelers	7.2	S	Lower to Middle	Low	None	None	Large	700K	Mall

Source: Adams' estimates

In addition to high markups, some jewelry stores such as Fantasy, Gordons, and Zales offer their own charge and credit card account. By doing so, they not only make it easier for a customer to purchase their products, but also reap a high rate of interest (19-25%) on charge account balances. Adams Jewelers only takes credit cards, cash, or checks and does not offer their own credit card or even a layaway plan.

In addition to jewelry stores, there has been a new contender in the jewelry business -- pawn shops. Pawn shops offer needy customers the opportunity to borrow money on many valuable items they "pawn" and leave with the shop in the form of collateral. Pawnbrokers normally advance these customers loans that amount to 10%-40% of the wholesale value of the item. If the customer does not come back and pay off the loan (with legally-allowable interest at a typical rate of 24% a month) in the specified period, they will automatically forfeit their ownership rights to the pawned merchandise. Pawn shop brokers have found the jewelry side of their business to be highly lucrative. In fact a major, publicly-held chain store pawn operation estimates that 60% of its profit is derived from jewelry. Many customers buy jewelry from pawn shops at very attractive prices. In fact, some jewelers hire buyers to regularly check pawn shops and buy jewelry for them, especially gold and diamonds. Table 2 provides data on local pawn shops.

Table 2: Local Pawn Shops

Store	Miles from Adams Jewelry	Quality of Diamonds	$ Annual Sales of Jewelry	Location
Rivers Pawn Shop	4.3	Low to Medium	120K	Bad
(East)				
Rivers Pawn Shop	1.8	Low to Medium	85K	Prime
(West)				
Dollar Country Pawn	4.3	Low to High	480K	Prime
(East)				
Dollar Country Pawn	0.6	Low to High	550K	Prime
(West)				
Dexter St Pawn	5	Medium	64K	Prime
Fair Pawn Shop	4.5	Low to Medium	86K	Prime
Florida Pawn Shop	0.5	Low to Medium	69K	Prime
Stewart	2.7	Low to Medium	64K	Bad
Pawn Shop				
Big City Pawn	4.5	Low to Medium	74K	Fair
Source: Adams' estimates				

THE DIAMOND AND JEWELRY MARKET

Most of the diamond supply around the world is controlled by a cartel, the DeBeers Group. From 2003-2006 the diamond market experienced an increase in diamond prices for stones weighing over 1.25 carats. The jump reached 100% at the beginning of 2006, which made it more expensive for jewelry stores to buy merchandise from wholesalers. The industry has also experienced volatility and a sizable increase in gold prices. The price of one ounce of pure gold went from $369 in May 2003 to a peak of $725 in May 2006. Many experts assert that the global war on terror in Afghanistan and Iraq has caused the U.S. to borrow billions of dollars which has prompted many investors to switch from investing in the U.S. dollar to more safe investments such as gold and precious metals. Table 3 tracks 36-month precious metal prices.

Table 3: Precious Metals Prices (3-year history)

Metal	High	Low	Change	Average
Gold	$725.00	$369.20	$355.80	$461.74
	5/12/06	10/09/03		
Silver	$14.94	$4.81	$10.13	$7.73
	5/12/06	10/06/03		
Platinum	$1,331.00	$692.50	$638.50	$918.90
	5/17/06	9/17/03		
Palladium	$404.00	$172.00	$232.00	$238.80
	5/12/06	7/05/05		

Jewelry stores can buy jewelry from wholesalers or brokers under several methods: cash, check, memo, and consignment. The success of the memo and consignment methods depends on several factors such as the credit worthiness of the jewelry store, willingness of the wholesaler and the jewelry store to take the risk, market prices, and jewelry store potential to sell the merchandise.

Cash — *the buyer gets the best deal on purchases because the seller does not disclose cash in their accounting practices; that is, the transaction is "off the books." This is an automatic immediate sale. The buyer examines the merchandise and decides immediately whether to purchase or not. If a decision to purchase is made, then payment for the merchandise is expected immediately.*

Check — *the buyer gets the second best deal because the seller will have to disclose the sale and pay taxes on the profits. Normally, the price of the merchandise is higher than if the buyer pays by check for the merchandise.*

Memo — *the buyer commits to buy the merchandise; however, he will be given flexible terms to pay for them. Terms differ from one wholesaler to another. Memos are usually from 30 days up to six months. Also, the longer the term the higher the price of the merchandise. Most jewelry stores use this method, especially when stocking up for Mothers Day and the Christmas season.*

Consignment — *the most expensive method for jewelers. The jeweler will make an agreement with a wholesaler to display their merchandise in the store before a huge selling season (e.g., Christmas). At the end of that period, the wholesaler will visit the jewelry store to take inventory of the merchandise. The jewelry store pays the wholesaler for the jewelry that was sold at the specified price agreed upon when the consignment arrangement was made, and takes back the jewelry that was not sold. At times, the wholesaler demands a low-interest payment for the consigned jewelry.*

CURRENT SITUATION

From late 2001 until 2006, Adams Jewelry experienced a steady decline in sales. Jack Adams attributes the decline to increasing diamond and gold wholesale prices and rising gasoline prices. He believes that people are worried about making enough money to pay for food and gasoline.

Despite the increase in precious metal prices many jewelry stores have experienced a growth in their sales. In fact the latest newcomer to the jewelry market was Jonathan Smart who opened Transitions Jewelry less than one-half mile from Adams. Smart worked for Arthur Jacobson (owner of A-J Jewelers) for several years as their main jewelry repair person. When Mr. Jacobson recently retired and closed his 60-year old business, Jonathan decided to open his own store. Many jewelry wholesale companies offered to supply him with jewelry and diamonds under flexible terms. These terms include memos reaching, in some cases, six months to pay, and jewelry offered on consignment.

Jack Adams has a penchant for high-quality jewelry. He likes to carry only inventory of diamonds that are near colorless or colorless grade (D-J), with medium to high clarity grade (SI2-F), and well-cut stones. (A number of diamond industry websites, such as www.gia.edu, provide a comprehensive discussion of diamond characteristics, including cut, carat, color, clarity, and prices). When Jack buys from wholesalers, he does not like to pay the prices these precious stones command. He makes sure that he pays as little as possible for them unless his customer pays him in advance for a diamond -- then he is willing to pay more money for them. He tries to pay only by cash or check for the jewelry he buys.

A part-time wholesaler who regularly visits pawn shops and buys lots of jewelry from them recently said, “It is hard to do business with Jack. I offer him a diamond ring for 30% below wholesale and he wants me to sell it to him for 50% below! When I asked ‘Why,’ Jack replied that he knows that I bought it very cheap." As a result, the part-time wholesaler shied away from doing more business with Jack.

Jack seeks to educate his customers about the four Cs in the diamond business: color, clarity, cut, and carat weight. Many of his customers like his low prices and diamond quality. He always tells his customers that his prices are lower than all other jewelers in the city, especially when compared on the basis of quality.

However, not all customers can afford to pay the prices for high-quality jewelry and not all of them have cash or a credit card such as Visa, MasterCard or American Express. Jack does not offer his customers a store credit card like most jewelry stores in the regional mall. He accepts cash, checks, and major credit cards and has an agreement with a small financing company that finances customers to buy jewelry from his store.

A local diamond wholesaler named Garrett Zucker is a friend of Jack's. Mr. Zucker sells jewelry for Mark Goyem, a diamond importer in New York. Jack normally calls Zucker whenever he has a diamond sold so that Zucker orders it from Goyem and has it delivered via Federal Express. Zucker has tried on several occasions to encourage Jack to invest more money in store inventory and to remodel the interior of his store. The following conversation between Jack and Garrett took place recently:

Zucker: Jack…why don't you buy stones of more that one-half carat in weight and keep them in stock.

Jack: (Laughing) I do not have lots of money to pay for them. I have $15,000 saved to add a third bedroom to my house so that my daughters will be more comfortable when they come and visit me with their husbands at Thanksgiving. Plus, why should I buy when, whenever I need a stone, you send it to me?

Zucker: But Jack, what if it looks like the customer may not be willing to wait until the diamond arrives?

Jack: Oh well…I guess I will take my chances.

Zucker: Just in the last seven years, I have seen three jewelry stores here take off with their business and they're selling lots of jewelry. In fact most of those jewelers have less experience than you and came to this market several years after you opened your store. I know this because they buy jewelry from me, and some of their orders include platinum rings with beautiful antique designs and diamond stones from one carat to three carats. Can you imagine how much money those jewelers are making off of these large stones?

Jack: Who are they?

Zucker: They are Marvin's, Transitions, and Roland Samson. That does not include your neighbor down the street, Dollar Country Pawn. Have you been to any of these stores lately?

Jack: No. You see me…I am always working here…I just do not have time.

Zucker: I think you will be surprised when you see the beautiful layout of some of these stores and the variety of inventory they carry. Also, you can buy jewelry from Dollar Country Pawn with unbelievably good deals…sometimes much less than wholesale prices….It is just a thought.

Jack: I will see. I will try to do that whenever I do not have too much repair work to get out the door.

Zucker: Why don't you hire a professional jewelry repair person?

Jack: For what?

Zucker: To help you with repair work

Jack: I do not have enough work for a professional jewelry repair person.

Zucker: Do you know that Ralph Samson does repair and sizes rings for all of the jewelry stores at the big mall? He hired an artist repair person by the name of Colin, and I tell you they are doing a phenomenal business. In fact, Ralph told me that he paid Colin $70,000 in income last year and he is on track to make $80,000 this year!

Jack: Wow…that is a lot of money! I make a whole lot less than that myself and I own the store.

Zucker: By the way -- changing the subject, but it's related to others' perceptions of your store – I see that you and your mother always park your vehicles in front of the store directly under the canopy. Jack…If I were you, I would park my vehicle in the parking lot and let customers park there instead.

Jack: WHY?!

Zucker: Because sometimes your customers may find it hard to park far away to come to your store. And some of them may just need to pick up their repaired jewelry…you know like in and out.

Jack: I cannot let anybody park in my special parking spot. I am the owner here! If they like it, fine, and if they do not like it, that is fine, too!

Zucker: OK…it is up to you my friend…like you say…you are the owner.

Franz Yeager, another wholesaler who frequently visits Jack's store, once advised Jack to dispose of the tall, rusty-looking sign outside his store and replace it with an electronic message board. He told Jack that he could program words and animations to display on the sign like rings and bracelets in various shapes and quote his prices. Jack liked the idea. A few days later, Jack purchased an electronic sign for $7,430 and financed the amount for three years. However, it was the type that is displayed on the inside window of the store and not on the outside.

A few days later, when Franz visited Adams Jewelry, he noticed the new sign and immediately thought that it was a bad decision. This was because the way the store is positioned at an acute angle toward the busy street makes it difficult for the sign to have full, direct exposure.

In addition, it is difficult for people traveling by at the speed limit to take it in, or for it to be read from a distance, or for people driving on the opposite side of the road to see it. Jack and Franz had the following conversation:

Franz:	Hello my friend.
Jack:	Hello Franz… how are you?
Franz:	I am fine thank you …how about you?
Jack:	I took your advice and bought the sign. What do you think?
Franz:	I saw it…but I think you should have bought the one that you can display outside rather than inside?
Jack:	That one is too expensive (around $13K) and I just cannot afford it!
Franz:	OK…I understand…how is business?
Jack:	It is slow…I hope it picks up.
Franz:	What is the problem?
Jack:	I do not know. I am only working on repairs and hardly selling anything.
Franz:	May I tell you something without you getting upset?
Jack:	Sure…
Franz:	The other day, I referred one of my friends to come and see you about buying an engagement ring. He told me that once he entered your store, he did not like it.
Jack:	Why?
Franz:	He said that it does not look like a jewelry store. But he said that Ms. Johnette was very nice to him.
Jack:	What do you mean?
Franz:	He said that the carpet was worn, the window drapes looked old. You did not have a selection of platinum or 18 carat gold wedding rings or men's wedding rings… all the diamonds you had were too small! Also, he said that your attire was not what he expected to see in a jewelry store. Please do not get mad at me; I am just telling you what he said.
Jack:	There is nothing wrong with my carpet and drapes. I will be more than glad to order him what he is looking for. You know my prices will be cheaper than all other stores out there.
Franz:	Unfortunately it is too late; he already bought a ring from Marvin's…he had it in stock.
Jack:	Oh well…I bet you, Franz, that your friend must have paid at least 30% more for the stone.
Franz:	I did not ask him what he paid for it, but he and his fiancé seemed very happy with the rings.
Jack:	Oh well…I cannot win them all.

Recently, Jack treated himself to a new vehicle. He traded in his eight-year-old Ford full-size truck and bought a new 2006 Chevrolet dual cab, full-size truck.

Jack does not believe in advertising on television or radio, or even in newspapers. He said that he tried it before and it was a waste of his money. He always believed that jewelry stores who offer a "sale" are actually deceiving the public. He thinks that the best way to advertise is through word of mouth. However, he has had an Adams Jewelry website established for a time now; though he has not had much luck selling jewelry through the site - only one customer who bought a ring. One of Jack's customers, a retired schoolteacher, mentioned to him when she visited the store recently that she found lots of grammatical mistakes on his website.

There are several problems to selling jewelry over the Internet. First, it is difficult to show a clear picture of jewelry on the web. Second, when you sell a piece of jewelry on the Internet and the person receives the item, it sometimes looks different from what they were expecting based on the website view. Third, whenever a jeweler characterizes a diamond on the web, they normally relax their descriptions in terms of the four C's, especially color and clarity. Finally, assume that the seller may offer a 7-day money-back guarantee. Upon receipt of the item the buyer may then take the piece of jewelry to another jeweler to see if it is worth the price paid for it. This jeweler may then try to sell them a piece from their own inventory. Normally, stores that do best when selling over the Internet are those with high credibility that offer diamonds with certificates of authenticity and description.

Jack is considering relocating his store because the lease is coming up for renewal and the owner of the property is increasing the monthly rental from $750 to $1,100. Included in the new monthly rate is the condition that the owner of the property will remodel the outside appearance of the store. Jack tried to offer to buy the building or even sign a lease with an option to purchase, but the owner of the property refused, saying he does not want to sell it. After searching out alternative locations, Jack has identified a possible new location for his business. It is less than a mile away from his current store. He is attracted to the location because he can avoid paying the planned $1,100 monthly lease; however, he would have to sacrifice some floor space. His new rent for the smaller premises would be $850 with an option to buy the building. Although not on a major U.S. highway, it is on a new 4-lane road accessed by many commuters as they exit the Interstate highway several blocks away. The new road is filling up with medical and other office buildings and small strip retail centers. His shop would be in a brand new small strip center being completed. It has an up-to-date looking exterior of brick, with two small windows and a door. He will be able to choose the carpet, but he plans to move his present, serviceable jewelry cabinets into the building if he takes it. Two parking spaces in the new concrete lot are directly in front of his section of the strip center. Within the next three months, Jack must decide whether or not to move to the new location or stay put.

PATAGONIA: CLIMBING TO NEW HIGHS WITH A SMALLER CARBON FOOTPRINT

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CASE DESCRIPTION

The primary subject matter of this case concerns corporate environmental responsibility. Secondary issues examined include strategic intent and marketing dynamics. The case has a difficulty level of three, appropriate for junior level students. The case is designed to be taught in one class hour and is expected to require three hours of outside preparations by students.

CASE SYNOPSIS

The California outdoor clothing and equipment company, Patagonia, has set a very high standard for firms seeking to be environmentally sensitive. The privately-held company has created a culture of reducing its impact on the environment through product design and manufacturing, energy usage, and waste management. The case explores the methods by which Patagonia reduces its "carbon footprint" and asks if other firms can follow its lead.

"There is no business to be done on a dead planet."
David Brower, Sierra Club Founder

A recent United Nations' Intergovernmental Panel report on the environment indicated that the earth's climate is changing quite rapidly. The report stated that global temperature is without a doubt rising, and there is a very strong chance that the reason for the temperature change is man-made pollution in the atmosphere. The eleventh warmest years ever recorded have occurred in the period of 1995 to 2006, with 2006 being the warmest year on record in the United States. The suspected cause of this global warming is the rise in carbon dioxide which traps solar heat and keeps it form radiating out of the atmosphere. Atmospheric levels of carbon dioxide have risen since the dawn of the industrial revolution and correlate with increases in global temperature. Still, not everyone is convinced that carbon dioxide is the cause of global temperature increases, and some argue that warming is part of the earth's natural cycle of changing temperature. An additional debate can be found in the appropriate human response to rising global temperatures. Some have argued that effort should be directed towards reducing the effects of global warming, such as building sea defenses and shifting agricultural production. This argument proposes that attempts to reduce greenhouse gases are simply too expensive and will take too long yield any significant gains. While the debate on the causes of global warming, and the appropriate response to it continues, many activists and politicians have found the issue worthy of their attention and they almost universally argue that global warming is a man-made event.

In recent years it has become fashionable to show concern for the environment. With increased concerns about global warming a number of celebrities, politicians, and companies have become outspoken about the perceived harm human beings are doing to the planet. Celebrities such as Brad Pitt, Leonardo DiCaprio, Susan Sarandon, and many others have staked a claim to environmental friendliness. Former Vice President Al Gore has devoted himself to the reduction of greenhouse gases and other harmful byproducts of industrialization, and has produced a popular documentary on the subject. A number of companies have also begun taking account of their impact on the environment and taking corrective action to reduce negative environmental externalities. One company that has risen above others in its concern for the environment is Patagonia.

Patagonia manufactures and sells apparel and equipment for rock and mountain climbing, surfing, paddling, fishing, and running. The company traces its beginnings back to a garage in Burbank, California where a young outdoor enthusiast named Yvon Chouinard began forging three inch metal strips used for rock climbing. Chouinard sold the strips for $1.50 each out of his car. From his parents' garage he moved the operation to Ventura, California, married, and began to branch out into outdoor clothing and accessories. With his wife as partner, the couple pledged that they would only sell quality goods produced in a socially responsible manner. Today Patagonia is a $270 million privately-held company, known for high-quality outdoor clothing and equipment and a social conscious.

Chouinard is the author of *Let My People Go Surfing: The Education of a Reluctant Businessman;* the story of his company and its philosophy. Chouinard, who states that he never really wanted to be a businessman, extols a different, and some would say kinder approach to business. The company was an early adopter of progressive employment practices such as flexible working hours and family-friendly practices including day care and after school programs. The company will also provide a sabbatical leave of up to two months with pay for employees who want to engage in environmental activities. Patagonia receives about 900 applications for every job opening. Many of Patagonia's 1,275 employees are like Scott Robinson, who with two MBA degrees and significant European internship experience decided to work for Patagonia stocking shelves, just to be part of this company. Robinson had read *Let My People Go Surfing* and decided that he wanted to work for an organization that was "driven by values" even if it meant less money and prestige. Patagonia encourages its employees to be creative and to be responsible citizens of the world.

One of the early environmental activities the company began was the promotion of organically grown cotton. Patagonia decided a number of years ago to reduce the environmental damage caused by cotton growing when traditional methods are used. Since the company's products at the time used much cotton, this move would be a major step in making the organization more environmentally friendly. Traditional methods of growing cotton, although more efficient, use pesticides and defoliants to increase plant yield. Organically grown cotton is more expensive to produce but avoids these environmentally harmful practices. The use of organic cotton raises the price of the finished product. Likewise, Patagonia has developed a more environmentally friendly wetsuit for surfers that replaces petroleum-based neoprene with recycled polyester and organically produced wool. The price of the Patagonia wetsuit is $470, compared to competitors with neoprene suits priced from $99-175. In addition to being better for the environment, the Patagonia wetsuit is considered warmer than competitor's products and does not have the typical wetsuit smell some find unappealing. Patagonia now conducts an environmental assessment of all the material it uses for its products.

It has created a fleece jacket made in part from used plastic soda bottles and encourages its customers to return old clothing so that it can be recycled. Patagonia discourages its customers from using overnight shipping of its products because this requires that the goods be sent by air, a higher carbon producing mode of transportation. The company's catalog is produced on recycled paper. The company also makes as much use as possible of solar and wind power for its energy needs. Recently Patagonia was awarded the Gold level certification in Leadership in Energy and Environmental Design from the U.S. Building Council for its distribution facility in Reno, Nevada. Patagonia's distribution center is only the second center to be certified at this level by this organization. The facility uses renewable energy for all its energy needs, used recyclable materials for construction, and has a greatly improved water conservation program in its operation.

Patagonia has established or supported a number of environmental projects including the Conservation Alliance and 1% for the Planet, and gives environmental grants to grass root level groups. The Conservation Alliance is a group of firms in the outdoor activities supply business that work together to support environmental causes. The organization, 1% for the Planet is a group of firms that have agreed to give one percent of annual revenue to environmental organizations. Patagonia has also given over $20 million to environmental groups for projects that other donors have rejected. For 2006-2007, Patagonia's environmental campaign was "to investigate the connection between the vitality of human life and marine environment." Patagonia said it wanted to understand how "the vast schools of tuna are like herds of buffalo," or "how bottom trawling is like clear-cutting an entire forest to get a single tree."

Some feel that Patagonia could grow even faster if it were to go public. The company has experienced annual revenue growth in the range of 3-8% and Chouinard feels even this may be too much growth. "We could grow the business like crazy and then go public, make a killing. But that would be the end of everything I've wanted to do." Patagonia is slowly increasing its group of devoted customers, and its higher prices have allowed the company to realize operating margins above the industry average. An argument could be made that if Patagonia were to go public and grow sales at a higher rate the company could do even more good for the environment.

While companies such as Patagonia have promoted themselves as environmentally friendly companies, many other firms have become actively engaged in sustainability issues, yet have not promoted themselves as "green firms." Anheuser-Busch for example has reduced industrial waste and energy consumption by focusing on its production processes, and has developed a lighter and more efficient aluminum can, however, A-B is seldom seen as an environmentally friendly company. Some feel that the green image may not be a selling point for all consumer groups. It is clear that Patagonia isn't concerned about appearing to be "too green," and the company takes the quote from David Brower (There is no business to be done on a dead planet) seriously. This quote is etched on the front door of the company's headquarters and the message is manifested throughout the company in its practices and policies.

DISCUSSION QUESTIONS

1. Is green business good business? Explain. Why aren't all companies green businesses?
2. What is the difference between green marketing and green business?
3. Can a corporation be environmentally sensitive and still be responsible to shareholders? Is this easier for a privately held company?
4. Do you think all businesses should follow Patagonia's lead in its environmental practices? Explain.

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