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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.

We intend 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

NOTES

PFF BANK & TRUST: "CUSTOMERS FIRST" BRAND OF BANKING

Olukemi O. Sawyerr, California State Polytechnic University, Pomona
Stanley C. Abraham, California State Polytechnic University, Pomona

CASE DESCRIPTION

The primary subject matter of this case concerns PFF Bank and Trust, a fast growing regional bank located in Southern California. Secondary issues examined include the structure of the banking industry, competition in the banking industry and the challenges facing the financial services sector. The case has difficulty levels of four, five and six. The case is designed to be taught in three class hours and is expected to require four hours of outside preparation by students.

CASE SYNOPSIS

The case presents PFF, a $4 billion full-service community bank headquartered in Pomona, California. The case begins with a discussion of the structure of the banking industry. It continues with a discussion of major industry trends such as consolidation, record earnings, declining mortgage volume, technological advances and the corporate scandals that have rocked the financial services industry in recent years. The case then presents PFF, beginning with its founding in Pomona in 1892 as The Mutual Building and Loan, continuing with its explosive growth mirroring the population expansion in the Inland Empire of Southern California, and ending with its current challenges. The case discusses the organizational and management structure of PFF, its corporate culture, and key elements of its growth strategy, sprinkled with excerpts from an interview with its CEO, Mr. Larry Rinehart. The case then turns to the competitive landscape in PFF's home turf, the Inland Empire, and discusses major regional and national competitors. The case concludes with the future challenges that PFF faces.

The case provides many tables and figures to support its content, especially detailed multi-year financial statements for PFF Bancorp. In addition, it includes an appendix that provides information on how to analyze a bank. Since accounting systems of financial institutions are different from those of other companies, we believe this would serve instructors and students well. The greatest strength of the case is that it focuses on a firm that has been very successful competing in a regional space against other regional and much larger national competitors in an industry with which students are seldom familiar. The challenge facing the student analyst is coming up with a defensible set of recommended strategies for a firm that has been very successful in doing what it does to continue to be successful in its competitive space.

INSTRUCTORS' NOTES

RECOMMENDATIONS FOR TEACHING APPROACHES

As an instructor, you have many options as to how you might use this case in class, depending on how you typically facilitate cases in your class. Four options are offered here. All assume, of course, that the students are assigned to read the case carefully before the class session in which it will be discussed. Since the case contains financial statements for several years, students should be encouraged to analyze those financial statements as well.[1] The four possibilities are:

- ♦ Lead the case for the students using the major analysis headings presented in this note. For each topic, ask the question and strive to get students to participate and discuss the issues. If this case is placed at the beginning of the course, the students may need more 'leading' or prompting to get them going.
- ♦ Divide the class into groups and assign different analysis topics to the different groups. Depending on the length of the class session, give them a reasonable amount of time to do the analysis and then have a spokesperson from the group report to the class as a whole, using the white board as appropriate. Get the class to receive these analyses critically, which is also your role in the process
- ♦ At the start of the course, assign different groups in the class the opportunity to do a strategic analysis of different entire cases (if the class has six groups, assign a different case to each group). The group then does a PowerPoint presentation to the class for its case, incorporating the various analyses involved, coming up with viable strategic alternatives, and making its recommendations as persuasive as possible. Afterwards, the same group stays standing and fields questions both from the class (mainly) and the professor. Such a presentation would be graded.[i] The professor could use the rest of the class time exploring aspects of the case that warrant further discussion.
- ♦ With a course design that calls for class sessions of 3-1/2 hours once a week—and I have used this approach in my MBA classes, which fits this scheduling—one group leads the case discussion (other groups then lead the other cases in different class sessions). Rather than simply presenting its own analysis of the case, the group leads the class in discussing the issues in the case and its use of various analytical tools available to the students. In fact, the group is graded primarily on the extent to which they involve the students in the class and draw them into the discussion, and secondarily on how well they analyzed the case. In this way, the case analyses serve as vehicles for the class to learn about doing a good strategic analysis. The instructor's role in all this is to immediately correct any misstep—a wrong definition,

conception, interpretation, etc.—and spark the discussion with questions should it sag.

ASSIGNMENT QUESTIONS

Because I have facilitated two MBA classes through an earlier version of this case, I prepared this instructor's note based on those experiences, and am indebted to the students in those two classes. In both cases, the purpose of the case study was to do a strategic analysis of the company in question and propose recommendations as to what it should do in the short- and long-term. Such a strategic analysis follows a particular format and encourages the students to use a variety of analytical tools, insofar as the information in the case allows such tools to be used. Accordingly, the format of a strategic analysis would make a good structure for this instructor's note. Its key parts, in the form of the following ten questions, are:

1. How is the banking industry changing?
2. How does PFF stack up against its competition?
3. Who are PFF's customers, how are they changing, and what do they need by way of banking services?
4. What other environmental trends might affect PFF?
5. How is PFF performing financially and what is its current strategy?
6. What are PFF's strengths, weaknesses, opportunities, and threats?
7. What key strategic issues does PFF face?
8. What viable strategic alternatives does PFF have?
9. Which is the best one, and which criteria make sense to use in the assessment?
10. What should PFF do in the short run (next year) and in the long run (three years hence)?

Below, each question is addressed in turn.

1. How is the banking industry changing?

At least four kinds of analysis enable one to learn more about the industry and how it's changing in 2005. These include:

- stage of lifecycle
- Industry driving forces
- Porter's Five-Forces-Model analysis
- Industry-attractiveness analysis
- Strategic group map

Often, students plunge into industry analysis without knowing precisely in which industry the company in question competes. *Labeling the industry correctly is critical in strategic analysis*.

Given the nature of the competition and current trends, one could be forgiven for saying that the industry is the financial-services industry. But this doesn't really make sense. PFF competes in the *banking* industry. And as to the scope of the industry—local, regional, national, or international—clearly PFF is a regional bank, even though it competes with national as well as local and regional banks. So the correct label, finally, is the *regional banking industry* (specifically the Inland Empire).

Stage of lifecycle

In most industries, lifecycle stage is determined according to these rubrics:

- Merging—the industry must be new, with total revenues growing at <5%/yr
- Growth—total revenues are growing at >5%/yr
- Shakeout—the industry has experienced a growth stage and is experiencing a lot of consolidation (M&A activity) [shakeout can occur even after maturity has been reached]
- Mature—revenue growth has slowed to <5%/yr
- Decline—revenue growth is actually *negative,* and must be so *for several years in a row* to distinguish it from periodic industry slumps that may last 2-4 years (e.g., defense industry as the government budgets wax and wane with different administrations, or the mortgage and construction industries following increases and declines in the interest rate)

In the case of the banking industry, "revenues," unfortunately, is not the measure used for stage in industry lifecycle. Other industries, too, have non-revenue measures, e.g., number of screens in the movie-theater industry, number of hospital beds in hospitals, and sales per sq. ft. in retailing. In banking, the key measure is *deposits*. Although net income for banks is increasing, *every other indicator, including deposits, is declining* primarily because of rising short-term interest rates. As the case states:

> *Mortgage volume keeps slipping from its recent record levels. Mortgage originations are expected to decline 36% in 2004 and 28% in 2005. The greatest drop is expected in the refinancing area, where total originations are expected to drop 43% in 2004 and 24% in 2005.*

The industry's net interest income (revenues) of $435 million declined 0.3% from Q4 2004. And while the case again states that deposit growth outstripped loan growth for the second quarter in a row, total deposits declined 38% and loans 40.5% from the previous quarter.

Thus, in keeping with the cyclical nature of interest rates, the industry is currently in the declining phase of its lifecycle, though because the decline is not permanent and will turn around in a few years, it is safer to consider the industry as mature.

Industry driving forces

Any strategic analysis should consider whether the industry in which the company competes is changing and, if so, in what ways. Not coming to grips with or understanding such changes is like continuing on your journey blindfolded.

There are at least five ways in which the industry is changing or, expressed another way, five driving forces that are together changing the industry:

- *Hanges in governmental regulations.* The regulatory landscape continues to change for banks. The Gramm-Leach Bliley Act of 1999 deregulated the financial services industry and modernized several provisions of the Glass-Steagall Act of 1933. While newer regulations, such as the Bankruptcy Abuse Prevention and Consumer Protection Act passed by Congress in March 2005, are favorable to the industry, others, such as Sarbanes-Oxley Act of 2002 (SOX) and the USA Patriot Act of 2001, have created additional costs for financial institutions. Corporate scandals such as those associated with "market timing" and "late trading" demand continued Congressional oversight and pose the threat of additional regulations.
- *Cross-product offerings in financial services*. The lines between various segments of financial services are blurring. Investment-banking houses are allowing customers to write checks on their investment accounts, banks are steering customers with higher savings-account balances to invest in mutual funds with higher returns than traditional savings accounts, insurance companies have developed life-insurance policies with cash values that customers can access or borrow against, and credit-card companies have for years been enticing customers to take cash advances when they are particularly strapped for cash
- *Emergence of global mega-banks.* To compete effectively on a global scale, banks have to be a certain size (principally to mitigate the increased risk of doing business internationally) and have a geographical scope that reaches into the far corners of every continent. International banks certainly have a foothold in the US, just as US banks are expanding overseas. The preferred method is acquisition, although

strategic alliances are sometimes used. This trend means that certainly large banks—perhaps foreign banks—would also target high-population-growth areas in the US (such as the Inland Empire) for expansion through acquisition, as well as developing a presence in the major US urban markets.

- *Emergence of Internet-based banks and financial-services companies.* Internet financial-services companies like *E-Trade, ING Bank (www.ingdirect.com) and Ditech have been around now for several years, which confirms the concept that banks and mortgage companies don't need bricks and mortar to exist or be effective. Enough people now regularly bank online and perform investment transactions online that the prospect of buying financial services from companies that exist only online is not that surprising. As this trend continues, the nature of competition in banking will also continue to change.
- *Changes in customer preferences*. More customers are demanding online banking, free checking accounts, ubiquitous ATMs, personal service (and access to a human being when calling the bank), protection from identity theft, and simplified and speedy transactions. Banks who do not respond appropriately will not be competing for much longer.

Other candidates for driving forces include *interest rates* (rising rates squeeze mortgage loans while lower rates reduce the number and amount of deposits), *rising population* (through net immigration and net births over deaths) that brings in new customers, *demographic changes* wherein younger professionals are buying homes and more seniors are taking out reverse mortgages, and *technological changes* that continue to cut costs and speed business operations.

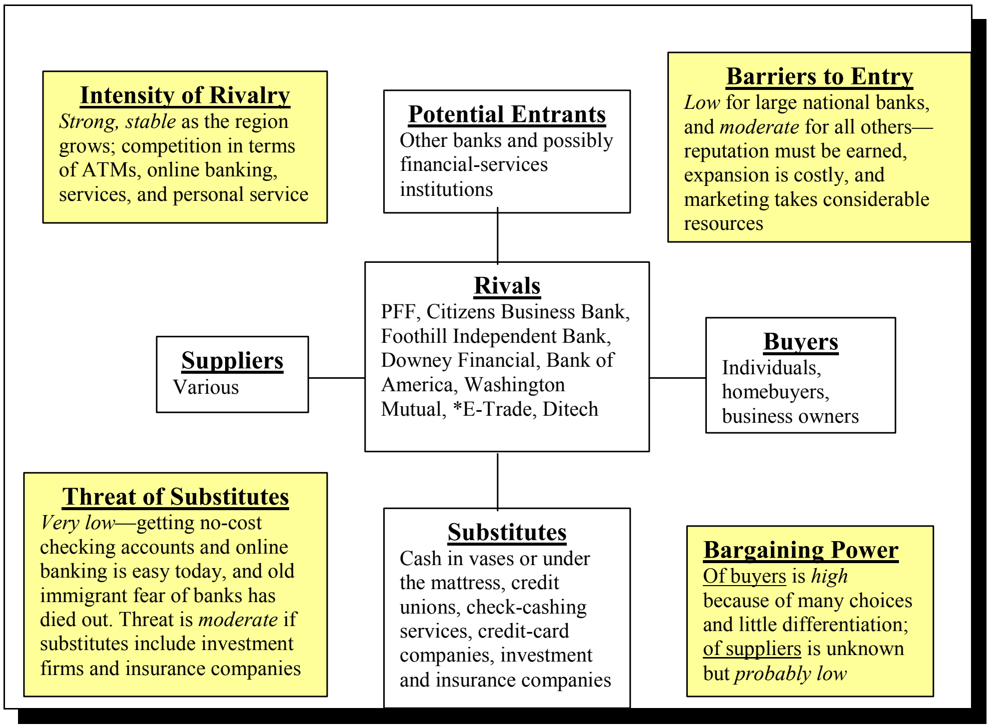
Porters Five-Forces-Model analysis

Figure N1 shows the familiar "cross" of Porter's Five-Forces Model and, in each corner, the four analysis parts (this makes a good format for a slide presentation, and a way of ensuring that the analysis parts are explained.

- *Rivals:* Besides PFF (which must be included because it is a part of the industry), the rivals include local competitors Citizens Business Bank, Foothill Independent Bank, Vineyard National Bancorp, and Downey Financial; national competitors Bank of America and Washington Mutual; and online companies like *E-Trade, ING Bank (ingdirect.com) and Ditech
- *Buyers:* Principal customers include individuals (both homebuyers and those that don't own homes) and business owners

- *Suppliers:* Failing specific information in the case about suppliers, it is best to put "various." Typical suppliers to banks include the Fed, which supplies funds, PC and software manufacturers, software-system vendors, vault manufacturers, furniture makers, the telephone company, electrical utilities, and so on.
- *Potential Entrants:* Other banks wishing to enter this region, and possibly financial-services institutions wanting to get into banking
- *Substitutes:* Cash in vases or under the mattress, credit unions, check-cashing companies (especially targeting illegal aliens and those who cannot get bank accounts), and possibly credit-card companies. Substitutes could also include investment firms, insurance companies, and other financial-services companies
- *Intensity of Rivalry:* Competition is strong on several fronts—from the numbers of ATMs available and over what area (BofA's ATMs cover the entire country), the kinds of services offered to customers, the ease of online banking, and personal service (the way the bank makes a customer feel and the extent it is willing to go for him or her). Because the Inland Empire is one of the fastest growing areas in terms of population in the country, competition is not yet so intense as to become cutthroat.
- *Barriers to Entry:* Barriers must always be assessed with respect to who is trying to get into the industry. For large national or international banks, the barriers are fairly low—they already have a brand and reputation, and expanding into the area by building branches or through acquisition is well within their resources. For any other kind of potential entrant, the barriers are moderately high, as reputations must be earned, expansion is relatively costly, and the investment in marketing would be considerable.
- *Bargaining Power:* Despite efforts on the part of the larger banks, they are not differentiated. The smaller ones, particularly PFF and Foothill, are differentiated on the basis of personal service. However, from the customers' perspective, the array of choice and the minimal switching costs mean that they have bargaining power, not the industry. Online banks and mortgage companies do not change this conclusion. No information is given about suppliers, so we assume that their bargaining power is probably very low.
- *Threat of Substitutes:* The threat of substitutes is very low—getting no-cost checking accounts and online banking is easy at any bank, and fewer people are hoarding their savings under the mattress. Few people also use credit cards without at least a checking account. What might increase the threat to 'moderate' is a propensity to invest in stocks and mutual funds as an alternative to a savings account. In general, while the threat of losing all or part of one's investment is real, the rewards are much higher than the interest banks pay on savings accounts. Similarly, life insurance policies typical carry a cash value and are used as savings instruments as well.

Figure N1 – Porter's Five-Forces Model of the Inland Empire Banking Industry



Industry-attractiveness analysis

Table N1 shows a weighted industry-attractiveness matrix. The choice of industry factors, weights, and ratings are subjective and all could be challenged. The truth is that both students in the class and the instructor would all have different matrices were each to do their own matrix. The factors, weights, and ratings shown are thus illustrative rather than definitive.

Table N1 – Industry-Attractiveness Analysis

Industry Factor	Weight	Rating	Product
Market size	25	0.8	20
Industry growth rate	20	0.6	12
Profitability	20	0.7	14
Intensity of competition	18	0.5	9
Degree of regulation	17	0.4	6.8
Total	100		61.8

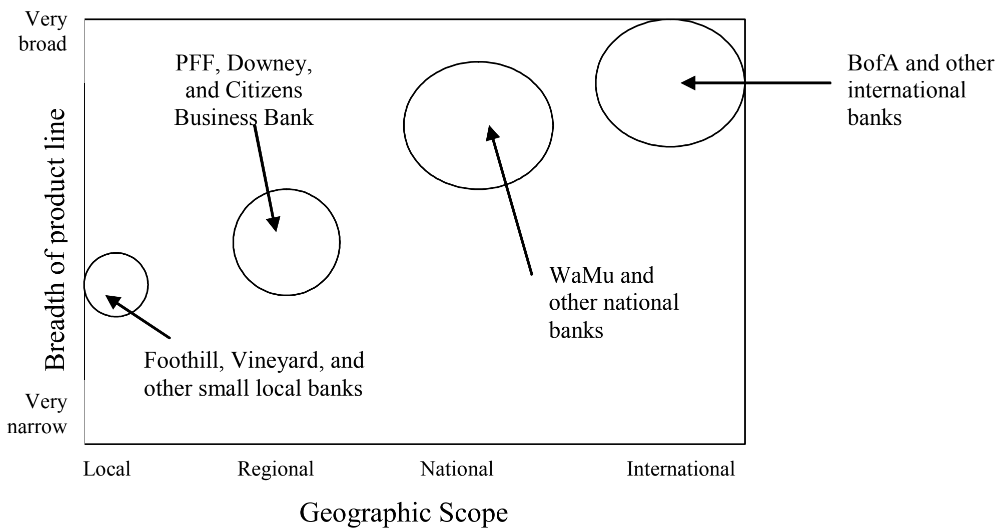
First, try not to have fewer than five or more than six factors listed. Secondly, make sure the weights add up to 100; it's also nice to place them in decreasing order of weights. The relative weights you assign signify your perception of their importance in assessing the industry. Finally, the ratings is the place where you assess *this* particular industry—the Inland Empire banking industry. Because the Inland Empire is one of the fastest growing areas in the country, I gave it a rating of 0.8 on a scale of 0-1.0, 1.0 being best. The industry, typically mature, is growing slightly faster in this region, so I gave it a 0.6. Profitability is quite good (but not great), so I rated it a 0.7. Intensity of competition is tricky—no competition would rate a 1.0 (makes the industry very attractive) while the worst kind of cutthroat competition might rate a 0 or 0.1. In this case, while there is a lot of competition, the region is growing, which lessens the intensity somewhat. However, the barriers to entry for other large banks to enter the region are low. So a rating of between 0.5 and 0.6 makes sense. I gave it a 0.5. Since this is a heavily regulated industry, the rating should be low for this industry; however, the regulations apply equally to all competitors, though in terms of costs, are more easily borne by the large banks. I gave it a 0.4.

The total IA (industry-attractiveness) index is 61.8%, not a very encouraging figure (puts the company in the middle third of the y-axis of the GE matrix). The GE matrix is shown later in this note.

Strategic group map

The value of strategic-group maps lies in their ability to sort out the competition into strategically similar and dissimilar groups. Companies compete primarily with their competitors in the same or adjacent strategic groups. However, in this case, we cannot say that PFF competes only with other local and regional banks; the truth is that it competes with *all* banks that do business in the Inland Empire. Thus, the value of doing a strategic-group map in this case is marginal, except as an exercise to become more proficient in constructing them (see Figure N2).

Figure N2 – Strategic Group Map of the I.E. Banking Industry



2. How does PFF stack up against its competition?

Certainly, against the larger banks in its competitive arena as well as those that might enter in the future, it doesn't "stack up" very well. It is undersized and undermanned. But can it compete? The answer has to be an emphatic "Yes." As Chairman and CEO Larry Rinehart says in some excerpted portions of our interview with him, the Achilles heel of the large banks has been personal service. And through extraordinary personal service, as well as an entrepreneurial attitude, PFF has flourished and grown and produced strong results year after year.

A critical-success-factor analysis directly compares the company in question with its major competitors along several critical success factors. The ratings, on a scale of 1-10, 10 being best, are again subjective and challengeable; while the numbers themselves are really not that important, the discussion surrounding them is often insightful and revealing. Table N2 shows a sample CSF analysis.

Table N2 – Critical-Success-Factor Analysis				
Critical Success Factor	PFF	Foothill	BofA	WaMu
Portfolio of services offered	8	6	9	9
Customer loyalty	9	9	7	7
Reputation/Image	9	8	8	9
Convenience (Branches/ATMs)	7	5	10	9
Personal service	10	9	7	8
Total	43	37	41	42

In the Inland Empire region, market shares are as follows (other banks have < 4%):

Bank of America	19%
PFF Bank and Trust	15%
Washington Mutual	13%
Wells Fargo	5%
Citizens Business Bank	5%
Other	43%

Source: *Source: PFF Bancorp, Inc. Brand & Advertising Awareness Tracking, 2004*

3. Who are PFF's customers and how are they changing?

PFF's customers are homebuyers, homeowners, and other individuals, as well as business owners, in the Inland Empire (Riverside and San Bernardino Counties in California, including eastern Los Angeles County and northern Orange County). This market contains a large and growing Hispanic population, growing numbers of Asians, and a growing number of small businesses.

The Inland Empire is also growing in terms of building and infrastructure; blue-collar construction and manufacturing and logistics sectors are expected to increase 2.6%/yr, adding 89,800 jobs over the next five years. This serves as a magnet to attract more people not only from other states, but also from other parts of California.

In general, PFF's customers continue to want better, more personalized service, more ATMs, continued ease of online banking and other transactions, being in control of one's own accounts and assets, and speedier business transactions on more advantageous terms.

4. What other environmental trends might affect PFF?

Always one of the basic trends critical to the banking industry is the movement of interest rates. In 2004-05, after a prolonged period of low interest rates and rising housing prices, interest rates have been inching up, slowing mortgage growth and housing construction. Housing prices have also seemingly leveled off, and opinion is divided as to when the real-estate “bubble” would burst, in which people would lose most of the value built up in their home. Another impact of rising interest rates would be an increase in deposits, a reduction in loans (e.g., auto loans), and perhaps increased activity in the stock market. Some of these effects favor PFF, while others don’t. Having said that, banks are used to the ups and downs of interest rates and have learned to take advantage of positive changes and minimize the effects of adverse change. Those banks that can act more quickly will have a slight competitive advantage.

In the regulatory sphere, the Fed, of course, has been raising interest rates in an attempt to balance the economy as well as increase the profitability of member banks. Sarbanes-Oxley and the Patriot Act continue to be costly to implement. Unfortunately, we have not done the kind of research that looks at legislation and regulations that are in committee and that will be proposed and even enacted in the future; but this is the sort of research that PFF itself, and its competitors, should do. Fortunately, such laws affect all competitors equally.

Demographically, the Inland Empire continues to swell in population, and more jobs and opportunity spell higher incomes and lower unemployment. These are definitely pluses for PFF. While we don’t have recent data, in all likelihood the numbers of Hispanics and Asians will also continue to grow, which represents an opportunity for PFF.

In the technological area, much is changing. First, more people own computers and are able to control their accounts and pay their bills online. That trend will continue, and banks have to continue to make it easy for customers to do that while lowering their own costs as much as possible. Secondly, with the increased risk of identity theft, banks are investing in better fraud-detection systems and procedures, and are working together with other banks and law-enforcement agencies in this regard. Thirdly, banks are learning how to cross-market their various products on the Internet—mortgage and other loans, CDs, mutual funds, credit cards, mortgage insurance, and other services. These Internet capabilities are now being extended to the mobile environment, namely PDAs and mobile phones. Lastly, the number of ATMs from which a customer can deposit and withdraw money has always been important to customers; while the technology is no longer “new,” their value and geographical coverage continues to remain high.

5. How is PFF performing financially and what is its current strategy?

Table N3 shows year-to-year changes for income-statement line items, Table N4 shows common-size statements, and Table N5 presents key data and financial ratios for 2001-05.

Table N3—Year-to-Year Changes, Income Statement, 2001-05

	Percentage Increase/ (Decrease) 2001 to 2002	Percentage Increase/ (Decrease) 2002 to 2003	Percentage Increase/ (Decrease) 2003 to 2004	Percentage Increase/ (Decrease) 2004 to 2005	5-Yr Average Percentage Increase/ (Decrease) 2001-2005
Loans and leases receivable	-5.70%	-9.66%	-1.56%	16.78%	-0.03%
Mortgage backed securities	-29.92%	-47.45%	12.39%	7.86%	-14.28%
Collateralized mortgage obligations	-49.73%	-97.14%	-455.43%	100.00%	-125.57%
Investment securities and deposits	-25.44%	-18.79%	-42.15%	11.57%	-18.70%
Total Interest Income (Revenues)	-10.09%	-14.07%	-2.73%	16.42%	-2.62%
Total Interest Expense	-27.08%	-30.95%	-31.72%	18.10%	-17.91%
Net Interest Income	15.16%	1.82%	15.79%	15.79%	12.14%
Provision for loan and lease losses	-0.08%	-3.20%	-43.70%	-2.61%	-12.40%
Net Interest Income after Provision for Loan and Lease Losses	16.00%	2.06%	18.45%	16.18%	13.17%
Earnings Before Interest & Taxes (EBIT)	16.00%	2.06%	18.45%	16.18%	13.17%
Total noninterest income	-19.02%	-16.75%	-25.83%	-9.73%	-17.84%
Total noninterest expense	9.31%	8.47%	19.27%	12.87%	12.48%
Earnings before Taxes (NIBT)	24.62%	-0.35%	19.96%	17.60%	15.46%
Income Tax Expense	23.90%	-1.06%	26.01%	25.02%	18.47%
Net Earnings (NIAT)	25.14%	0.16%	15.60%	11.78%	13.17%

In Table N3, while total interest income (revenues) has been declining to 2004, it did increase 16.42% in 2005. However, thanks to declining total interest expense, net interest income after provision for loan and lease losses (net operating revenues) increased each year, and averaged over 13%/yr growth over the five years. Also, because noninterest income rose slightly faster than noninterest expense, NIAT experienced steady gains in all five years (only a marginal gain in 2003), also at an average 13.1%/yr.

In Table N4, loans and leases receivable increased over the five year period from 83.2% to 93.1% of total interest income, at the expense of mortgage-backed securities, collateralized mortgage obligations, and investment securities and deposits. Total interest expense shrunk from 59.8% to 27.8% of total interest income, the prime reason why net interest income rose from 40.0% to 72.3% of total interest income, along with all the other measures of profitability.

Table N4—Common-Size Income Statements, 2001-2005

	2001	2002	2003	2004	2005
Loans and leases receivable	83.15%	87.21%	91.68%	92.78%	93.07%
Mortgage backed securities	9.28%	7.24%	4.43%	5.11%	4.74%
Collateralized mortgage obligations	2.66%	1.49%	0.05%	-0.18%	0.00%
Investment securities and deposits	4.91%	4.07%	3.84%	2.29%	2.19%
Total Interest Income (Revenues)	100.00%	100.00%	100.00%	100.00%	100.00%
Total Interest Expense	59.79%	48.50%	38.97%	27.36%	27.75%
Net Interest Income	40.21%	51.50%	61.03%	72.64%	72.25%
Provision for loan and lease losses	2.09%	2.32%	2.61%	1.51%	1.26%
Net Interest Income after Provision for Loan and Lease Losses	38.12%	49.18%	58.42%	71.13%	70.98%
Earnings Before Interest & Taxes (EBIT)	38.12%	49.18%	58.42%	71.13%	70.98%
Total noninterest income	-5.97%	-7.90%	-10.73%	-13.89%	-13.09%
Total noninterest expense	23.65%	28.75%	36.29%	44.50%	43.14%
Earnings before Taxes (NIBT)	20.44%	28.33%	32.86%	40.52%	40.93%
Income Tax Expense	8.66%	11.94%	13.75%	17.81%	19.13%
Net Earnings (NIAT)	11.78%	16.39%	19.11%	22.71%	21.80%

In Table N5, deposits, loans, and noninterest income have all been increasing steadily over the five year period, excellent indications that the bank is being well managed. Yield on earning assets (YEA)(interest income on earning assets divided by the average value of current assets) has also increased, albeit modestly, from 3.21 in 2001 to 3.87 in 2005. Provision for loan losses reflects the risk inherent in the bank's portfolio, and has dropped by almost 50% over five years, signifying improving quality of the loan portfolio. The efficiency ratio, a measure of efficiency in operations, has fluctuated between 58.5-62.1% over the five-year period. The debt-to-assets ratio has been constant at around 91% (perhaps too high for manufacturing companies, but typical for banks). Finally, the ratio of reserves for loan losses to total loans receivable has been very low and has still declined over time.

All in all, a very well managed bank that has been performing well financially and is in strong financial condition.

Table N5—Key indicators and financial ratios: 2001-2005						
Indicator or Ratio		2001	2002	2003	2004	2005
Deposits	$ M	2021.30	2169.00	2326.10	2455.00	2735.90
Loans receivable	$ M	2285.30	2494.70	2689.00	3149.30	3431.50
Noninterest income	$ M	14.3	17	19.9	25	27.5
Yield on earning assets	%	3.21	3.53	3.48	3.53	3.87
Provision for loan losses	$ M	5	5	4.84	2.73	2.65
Efficiency ratio	%	62.03	58.46	62.13	62.56	60.78
Debt-to-assets ratio	%	91.06	90.66	91.34	91.4	91.39
Reserve for loan losses as a percentage of loans receivable	%	0.22	0.2	0.18	0.09	0.08

PFF's current strategy involves expanding in its market area (the Inland Empire) to reach new customers, and has special programs to reach Hispanic customers (**concentration—market expansion**). In addition, it has embarked on program of buying back its own shares in order to keep the stock price buoyed (there was a 7 for 5 split in 2003 and a 3-for-2 split in 2005). Table N6 shows recent stock-price performance for PFF.

Table N6 – PFF Stock Price, 2001-05		
Year	Book Value Per Share Outstanding	Shares Outstanding
As of March 31	$	
2005	13.6	24,782,623
2004	12.69	24,922,496
2003	11.05	24,716,180
2002	10.36	27,423,071
2001	9.28	27,800,741
Source: PFF Bancorp 2005 Annual Report, http://www.pffbank.com/ir/2005_pff_bancorp_annual_report.pdf		

6. What are PFF's strengths, weaknesses, opportunities, and threats?

Strengths

- Its brand name and reputation—as a community bank—developed over the 130 years of its existence; participates in and sponsors community events
- Its extraordinary level of customer service, demanded and sustained from the CEO on down
- Very strong and entrepreneurial management team
- Is strong and well known in its Inland Empire region that it knows so well, and has recently expanded out of the region into the Sacramento area
- Very strong financial performance, including NIAT, NPM, effective interest spread, and deposits rising every year over the past five years
- Developed a strong niche business (Diversified Building Services) serving construction contractors in the area with speedy loans when they are needed
- Making inroads into the Hispanic market (accepts the *matricula* card as proof of identity instead of a California driver's license) through Spanish language promotions and advertising

Competitive Strength

Earlier, an analysis was presented for industry attractiveness that used industry factors, weights, and ratings. This analysis is very similar in format, being a weighted analysis, though the factors are very different. Here, the challenge is to come up with 5-6 competitive factors that account for the company's ability to compete. I have chosen five that illustrate the concept, though another person's list could be quite different, as might that person's weights (see Table N7).

Table N7 – Competitive-Strength Analysis

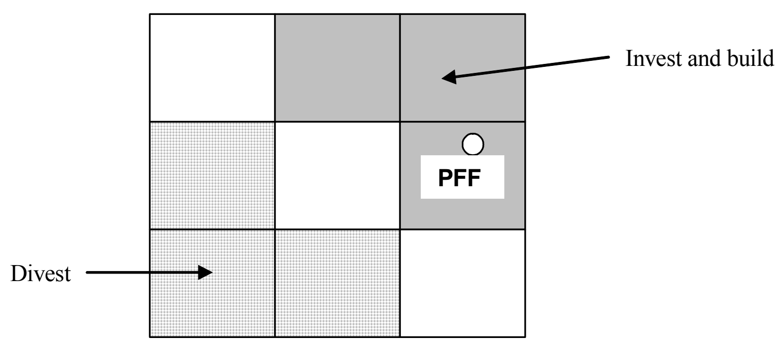
Competitive Factor	Weight	Rating	Product
Range of services	15	0.7	10.5
Ability to please customers	25	1	25
Bank reputation	25	0.9	22.5
Management	20	0.9	18
Financial resources	15	0.6	9
Totals	100		84

The ratings (on a scale of 1-10, 10 being best) deserve some comment. Because PFF is a regional bank, it cannot offer the full portfolio of services that a large national or international bank could offer, so its range of services is rated at only 0.7. Its ability to please customers is extraordinary, so the rating here is 1.0. Both its reputation—certainly in the Inland Empire—and its management are excellent and have been given ratings of 0.9. Financial resources, while adequate for its current needs, are nowhere near what the large banks can draw upon, and probably not adequate to support a strategy of acquisition or very fast growth, so have been rated at 0.6. The resulting CS (Competitive Strength) Index is a strong 84%.

G. E. (General Electric) Matrix

This matrix, created decades ago at General Electric and known at the G.E. Matrix, is a plot of industry attractiveness against competitive strength. The matrix for PFF is shown in Figure N3. Notice that PFF's IA Index and CS Index puts it in the top-right three (solid gray) cells of the matrix, which means that PFF should invest to build market share and its presence in this industry. (Landing anywhere in the bottom-left three cells (patterned gray) would mean harvesting and divesting the business, exactly the opposite.)

Figure N3 – GE Matrix for PFF



Weaknesses

Since 2001, revenues (interest income) and net return on assets (ROA) have both been declining, the latter most likely due to expansion costs where assets have been increasing faster than net income

- Weak market image outside the Inland Empire region
- Weak in providing complementary financial services such as insurance and investment services
- Small number of ATMs (compared to larger banks)
- Not as sophisticated technologically as the larger banks
- Higher cost of capital (relative to competition); PFF has a smaller customer base and lower revenues than its large counterparts, so its cost to fund loans is typically higher
- Inability to attract new loans and slow to develop new loan products
- No strategic alliances with other service providers

Opportunities

To further penetrate the Inland Empire (anticipate and follow the growth already taking place)

- Population continues to increase by about 4%/yr
- Forty-five percent of local residents can afford median-priced homes
- New businesses forming in the region and businesses migrating to the Inland Empire from overcrowded and overpriced parts of Los Angeles County
- Expand to adjacent areas outside the Inland Empire, possibly through acquiring other small local or regional banks
- Build up its investment-advisory services to include investment banking
- Target the Hispanic community not only in the Inland Empire, but also in the other Southern California counties
- Target the Asian community in Southern California

Threats

- Continually rising interest rates is going to slow down mortgage and construction activity
- The large banks not only offer more services, more branches, and more ATMs, but could start improving the level of service they render to customers, thus slowly negating PFF's edge
- Large and foreign banks could enter the region
- Being acquired by a mega-bank
- Computer hackers and virus creators pose a continued threat to the integrity and security of bank data and operations

- If the real-estate bubble should actually burst in the near future, it could plunge many homeowners into positions of negative equity and possible bankruptcy and thus adversely affect the quality of the bank's mortgage portfolio
- Changing legislative environment

7. What key strategic issues does PFF face?

Coming up with strategic issues is an act of *synthesis* with respect to the case so far. What of all the external and internal situation analysis are critically important? Note that the key strategic issues are all expressed as questions:[2]

Should PFF…

- Expand only in the Inland Empire or build on the expansion move already made in the Sacramento area?
- Should it follow Hispanic customers wherever they are, i.e., in other parts of the state?
- Offer higher-risk loans to customers?
- Offer new kinds of loans (e.g., student loans) and financial services?
- Target the wealthy and offer financial services tailored for that market?
- Form strategic alliances with other service providers or real-estate companies?
- Acquire small local banks as part of an expansion strategy or to reach particular target customers?
- Be acquired by a larger competitor?
- Continue to buy back shares and eventually go private?
- Pursue other emerging markets, e.g., Gen Y, Asians in Diamond Bar, and Vietnamese in Orange County?

In addition to questions in the above format, the following appear to be relevant strategic issues:

- How can PFF increase its revenues and return on assets?
- Can PFF continue to compete as interest rates rise and (possibly) the real-estate bubble bursts?
- Should PFF try to become the Hispanic bank of choice in Southern California?

8. What viable strategic alternatives does PFF have?

I get my students to observe several rules when coming up with strategic alternatives: they must be *mutually exclusive* (doing one means being unable to do the others), must be *feasible,* must *lead to success,* must be *substantially different from each other,* must *"stretch" the company* in some way (the exception is if the company is currently doing exceptionally well, then the 'status quo' could form one bundle, the challenge being to come up with something better), and must *address all the strategic issues*. With respect to this last rule, if there are one or more strategic issues unaddressed at the end, then they should be deleted from the list of strategic issues—clearly, they were not as important or critical as first thought. Also, a *minimum of two* alternatives (or "bundles" as I prefer to call them) should be developed for there to be a decision; three is better, four or more is very difficult.

Defining a strategic alternative as a combination of a future vision, strategy, and course of action, PFF has *at least four* strategic-alternatives bundles:

- **Continue market expansion** both by penetrating the Inland Empire further and acquiring small banks outside it in the Southern California area
  - Open new branches and ATMs in developing parts of the Inland Empire (keep ROA from declining)
  - Continue spreading the culture of outstanding service and community involvement
  - Look for small banks that are doing well in Southern California (both in and out of the IE) to acquire
  - Make the acquisition(s) using stock and cash, temporarily halting the program to buy back the firm's stock
  - Continue improving ease of online banking and current promotion and advertising programs

- **Grow DBS** to reach customers throughout the state, **and focus more on the Hispanic market,** both in the IE and outside it
  - Construction of housing takes place throughout the state, and certain areas (like the IE) are hot spots; focus on these by opening DBS offices throughout the state
  - PFF should capitalize on its success with the Hispanic market in the IE and open small branches in Hispanic areas throughout the state (Oxnard, central valley, south San Diego, etc.)
  - Open branches in Latino supermarkets

  - Acquire check-cashing outlets in Hispanic neighborhoods and transform them into mini-branches
  - Continue spreading the culture of outstanding service and community involvement
  - Continue improving ease of online banking and current promotion and advertising programs

- **Offer a range of new services** that meet the needs of existing customers and that attract new customers, but in the IE
  - Expand trust services
  - Add insurance products and services (through a strategic alliance with a reputable firm)
  - Offer riskier loans at 125% of net worth
  - Offer the bank's own credit card (again, possibly through a strategic alliance with Visa or MasterCard)
  - Continue to offer tax and investment services for wealthier clients (with >$100K in assets invested in PFF) through its Glencrest unit
  - Continue spreading the culture of outstanding service and community involvement
  - Continue improving ease of online banking and current promotion and advertising programs

- **Be acquired** by a mega-bank
  - Choose a buyer that is national or international, that offers additional services of interest to PFF's customers, and that will agree to continue the bank's current culture of customer service and community values
  - Don't be in a hurry to be acquired; timing is everything (but don't wait until the real-estate bubble bursts, either)
  - Wait until two or more suitors want to buy the company (bid up the price)
  - Continue spreading the culture of outstanding service and community involvement
  - Continue improving ease of online banking and current promotion and advertising programs

9. Which is the best one, and which criteria make sense to use in the assessment?

To think through these options and decide which one is best, construct a Criteria Matrix such as the one shown in Table N8, which is presented only as an illustration and should in no way be construed as providing a “right” answer. The 5-6 criteria used should reflect your best guess of what “success” means to the bank; using more than this number runs the risk of guaranteeing that an alternative that does well on some will do badly on others. The choice of criteria obviously affects which bundles will “win,” and that is the idea. The Criteria Matrix simply helps an analyst (or CEO) develop arguments that will be persuasive for the preferred bundle. The ratings in the matrix are on a scale of 0 to +10, 10 being best (for *positively correlated* criteria, marked P), or on a scale of 0 to -10, 0 being best (for *negatively correlated* criteria, marked N).

The preferred bundle should “win” by at least three points. If you, the reader, think that I should have used different criteria, different ratings, and ended up with a different preferred alternative, then you have understood what this is all about. It’s subjective, and it all depends on the ability to marshal persuasive arguments in support of your choice. The absolute numbers are not nearly as important as the *relative* ratings, i.e., the ratings when compared to each other. And these relative ratings are important *only* insofar as they help you to develop a persuasive argument in defense of your preferred choice.

Table N8 – Criteria Matrix

		A. Expand market in Inland Empire	B. Grow DSB & Hispanic market in CA	C. Offer new services	D. Be acquired
Criteria	P/N				
Revenue growth	P	9	8	8	10
Profitability	P	8	7	6	7
Capital investment required	N	-7	-8	-5	-4
Fit with corporate culture	P	10	7	7	6
Gain a competitive advantage	P	8	8	7	7
Riskiness	N	-3	-6	-5	-5
Totals		25	16	18	21

The following briefly explains the ratings assigned in Table N8, and then presents a sample argument in support of the preferred alternative. In this part of the analysis, where the bundles are rated against particular criteria, give students wide latitude, but demand that their final arguments be persuasive.

- *Revenue growth:* Certainly the revenues of the combined entity will be greatest, but of the other three, market expansion in the region it knows best will probably produce the most revenue growth (over the next three years, the planning horizon)
- *Profitability*: Offering new services involves experimentation and market research, and time to make strategic alliances, all in unfamiliar territory – so profits will be least. Expanding its market in the IE and acquiring small banks that are doing well should yield greatest profits. The other two are between them
- *Capital investment required*: The lowest is being acquired, though it will cost something to ready the company for sale, find buyers, and do the deal. Expanding out of the IE region into the rest of California on two fronts will probably take the most capital, while the cost of offering new services would be shared by the strategic-alliance partners. The cost of expanding in its own region would normally not cost so much, but acquiring small banks bumps this upward.
- *Fit with corporate culture*: Expanding in the IE is closest to what PFF does now, and acquiring small banks won't change this. The company that acquires PFF, whether similar or not to PFF, will change the feeling of PFF being small and entrepreneurial and so change the culture appreciably. The other two bundles will change the culture somewhat as they demand PFF become a different kind of company, in different ways.
- *Gain a competitive advantage*: None of the bundles will give PFF a clear competitive advantage, but the first two bundles will strengthen its current advantages slightly more than the last two ones.
- *Riskiness*: The first one involves the least risk, while the second one – venturing out of its comfort region – involves the most. The last two bundles involve some risk, just not as much.

A good, persuasive argument for a bundle involves two elements: (1) reasons why the chosen bundle is *better* than the others, and (2) why the others were rejected. Remember, none of the bundles are inherently "bad," otherwise they should not even be considered. (NOTE: We are in no way suggesting that this is the "right" answer. This was the best bundle based on the assumptions and choices made by the analyst throughout the analysis. A different group of analysts using different assumptions may come up with different bundles and a different recommendation.) So an illustrative argument for the first bundle could go something like this:

Expanding its market in the Inland Empire and acquiring small banks builds on what the bank does best, produces the most profits, has the best chance of maintaining its culture and reputation, and is the least risky. Focusing on DSB and the Hispanic market in California is the most risky and requires the most capital investment, offering a range of new services is least profitable and still appreciably risky, and being acquired has the most chance of altering the firm's culture and reputation ("PFF" would cease to exist) and is somewhat risky, although it would give PFF the size and revenues it lacks.

The final question below deals with recommendations, and concludes the strategic analysis. In fact, real companies doing this in the form of strategic planning would, after these recommendations, engage in operational and budget planning, a critical step before actually implementing the chosen strategic bundle. However, in my course on strategic planning, we end the analysis with these recommendations.

Recommendations contain objectives (measurable targets to be achieved within a certain timeframe), strategic intent (concerning market share or position), programs (to achieve the objectives and realize the strategic bundle, taken in large part from the bundle itself), and a trigger-contingency pair—what might go wrong to affect revenues or profits (trigger) and what the company might do in that eventuality (contingency). Triggers must be quantitative, and contingencies must be an operational quick fix that cannot shift to a different bundle. The chosen strategy should not be changed until all possible tweaking of the current one has been exhausted.

10. What should PFF do in the short run (i.e., next year, FY 2006) and in the long run (three years hence, FY 2008)?

For 2006:

Objectives:	Increase deposits and loans by 10% (currently 11% and 9% respectively), net interest income after provision for loan and lease losses (net operating revenues) by 18% (currently 16.2%), and NIAT by 12.5% (currently 11.8%)
Strategic intent:	Maintain market share in the IE and remain #2
Programs:	Continue opening new branches and ATMs in developing parts of the Inland Empire
	Continue spreading the culture of outstanding service and community involvement and sponsorship
	Look for small banks to acquire that are doing well in Southern California (both in and out of the IE), but not make the acquisition this year
	Continue improving ease of online banking and online banking services
	Continue current promotion and advertising programs, particularly to the Hispanic community
	Continue buying back stock, but at a reduced rate

Trigger-contingency: If mortgage-interest rates continue to climb, causing the number of mortgages written to decline, hence net operating revenues to lag projections by 15%, then PFF should accelerate the acquisition of another smaller bank

For 2008:

Objectives: Increase deposits and loans by 12%/yr, and net operating revenues by 20%/yr, and NIAT by 15%/yr

Strategic intent: Unchanged

Programs:[3] Board of directors to decide on acquisition targets (well managed small banks used to giving good customer service)
Make the acquisition(s) using stock and cash
Temporarily halt the program to buy back the firm's stock
Continue opening new branches and ATMs in the IE
Continue making inroads into the Hispanic community in the IE
Continue to provide outstanding service to customers both in person and online
Continue advertising and promotion programs
Continue participating in and sponsoring community events

Trigger-contingency: If operating costs rose beyond expectations, not only with respect to the recent acquisitions but also complying with existing (SOX) and new regulations, causing NIAT to lag projections by 15%, then additional steps to reduce noninterest expenses must be taken

EPILOGUE

We do not have information regarding the decision actually taken by PFF. The top management was reorganized in the fall of 2005 when Larry Rinehart retired from being President. Larry retains the position of CEO and Mr. Kevin McCarthy was made President in addition to his position of COO. We believe the firm is positioning itself to continue its growth strategy. However, how it would choose to grow remains to be decided.

The strategic analysis described here is based on the book by Stanley C. Abraham, *Strategic Planning: A Practical Guide for Competitive Success,* with CD-ROM, Thomson South-Western, 2006 (published in January 2005). The CD-ROM enables students to do a full financial analysis; all they have to do is input the income statement and balance sheet accurately for all the years for which data are given and the software does the rest. However, additional analyses need to be performed because this is a bank and what works for typical corporations (e.g., revenues and profits) doesn't work well for banks.

ENDNOTES

1 With experience using this format, the instructor should vary his expectations of each group's performance, from low for the first group (the "pioneer") to high for the last group (which should have learned from the mistakes of prior groups *and* has had the most time to prepare). Also, with this design, the instructor must find a way to coach each group into preparing a decent presentation, often involving reviewing a draft version of their slides and giving feedback.

2 If you know the answer to the question, it's not a strategic issue (e.g., should PFF continue to offer superlative customer service?); there has to be an element of ambiguity and uncertainty that the subsequent strategic bundles will resolve.

3 Programs in the long run may be very different from the short run. Students will need to "think through" what the company might do year by year—conceptually tough to do—yet not stray too far from the chosen bundle. For example, coming up with a variety of new financial services to offer could not be put down *unless,* of course, such new services were in the original bundle.

ACKNOWLEDGMENT

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ACCOUNTING FOR GLOBAL ENTITIES AND THE EFFECT OF THE CONVERGENCE OF U.S. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

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CASE DESCRIPTION

The primary subject matter of this case concerns strategic decisions that global entities, their executives, and accountants face in light of the almost certain convergence of U.S. Generally Accepted Accounting Principles (GAAP) to International Financial Reporting Standards (IFRS). Secondary, the effect of convergence to IFRS on the financial statements of U.S. based global entities, on financial statement users, and the accounting profession is explored. This case has a difficulty level of three to four and can be taught in about 45 minutes. Approximately two hours of outside preparation is necessary to fully address the issues and concepts. This case can be utilized in Intermediate Accounting as part of the coverage of pending changes in U.S. financial accounting and reporting, in an International Accounting course, or in a graduate accounting course focusing more extensively on underlying conceptual issues and the research components of this case. The case has analytical, critical thinking, conceptual, and research components. Utilizing this case can enhance students' oral and written communication skills.

CASE SYNOPSIS

In December 2007, the Securities and Exchange Commission (SEC) issued a rule entitled, "Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP" (SEC, 2007). This new rule eliminates the typically costly reconciliation of financial statements prepared using International Financial Reporting Standards (IFRS) to U.S. GAAP that previously was required of non-U.S. companies reporting to the SEC. This rule is likely to significantly affect foreign entities, U.S. multinational entities, financial statement users, and the accounting profession.

The SEC's decision is part of a broader movement in the U.S. toward the acceptance of IFRS and is supported by the Financial Accounting Standards Board (FASB). The SEC also is

considering allowing U.S. companies to choose between U.S. GAAP and IFRS when reporting to the SEC and may require that all U.S. public companies utilize IFRS by the year 2016 (SEC, 2008).

While no final decisions have been reached, it is virtually certain that the U.S. will be moving away from the traditional U.S. GAAP and toward a convergence with IFRS, which already are required or permitted in more than 100 nations. U.S. and global entities, the accounting profession, accounting majors, and financial statement users must prepare for this change. Educators play a key role in this process.

The primary focus of this case concerns the U.S. convergence to IFRS and explores the effects of IFRS on global entities' financial statements, financial statement users, and the strategic decisions accounting professionals and entities may face.

This case can be taught at the same time that expected changes in U.S. financial reporting are discussed in Intermediate Accounting or in a more advanced accounting course focusing primarily on underlying concepts and the case's research components. The case has critical thinking, analytical, conceptual, communication, and research components.

**This is an illustrative case. Any similarities with real companies, individuals, and situations are solely coincidental.*

INSTRUCTORS' NOTES

Teaching Strategies

Convergence of U.S. GAAP to International Financial Reporting Standards (IFRS) will affect current and future accounting professionals, educators, global as well as U.S. entities, and financial statement users. Public accounting firms and especially the "Big 4" are spending tremendous resources to prepare their professionals for the coming change.

Not everyone is prepared for the pending convergence. For example, a national survey by Grant Thorton, the sixth largest U.S. accounting firm, found that only 22% of surveyed chief financial officers (CFOs) and senior controllers had experience preparing IFRS-based financial statements.

Educators play a critical role in helping accountants and especially current accounting students - the future accounting professions - prepare for the coming convergence. At the 2008 annual meeting of the American Accounting Association, the largest U.S. accounting educator member organization, many sessions, presentations, and manuscripts focused on issues surrounding convergence to IFRS (American Accounting Association, 2008).

This case addresses many of the current and some of the future issues relating to the convergence of U.S. GAAP to IFRS. The introduction to this case provides developmental background for the trend toward globalization of accounting standards and a brief summary of current differences between U.S. GAAP and IFRS. This can be used as a basis for class discussions and help address many of the questions in the case. Two sets of independent questions (the second set requires research) focus on the effect of IFRS adoption on financial statements, financial statement users, and accounting professionals; the advantages of a global standard; and strategic issues and decisions faced by accountants, entities, and their executives. In-class discussions regarding issues that may arise prior to and during the convergence to IFRS and strategic decisions arising from these issues should be encouraged.

The case can be solved in groups during class time, or it can be assigned as a group or individual homework project. In either case, students should review the case prior to discussion in class. The research component can be utilized as an extra credit assignment or as a regular assignment. The case has been tested in an International Accounting course and was well received by the students. Approximately two hours of outside preparation is needed if the case is utilized as an assignment. Detailed in class discussion will require about 45 minutes.

Students should be encouraged to focus not only on the financial statement effects, but also and importantly on the long-term strategic consequences for entities, financial statement users, and accountants. The instructor may wish to emphasize that the accounting profession will become a global discipline, greatly enhancing the marketability of accounting professionals. In addition, instructors may want to empathize that competence, critical thinking, and professional judgement are becoming even more important, particularly in light of the principles-based foundation of IFRS.

SUGGESTED ANSWERS TO QUESTIONS

Company-Specific and General Questions:

1. **Consider Wichtel Corporation's most current financial statements presented in this case (See Tables 2 and 3). What would be the likely effect of adopting IFRS on Wichtel Corporation's financial statements? How would use of IFRS affect the company's key financial ratios?**

Wichtel Corporation's financial statements will change significantly if the company utilizes IFRS. The most significant changes are presented below in balance sheet item order.

A. Inventory: Wichtel Corporation carries a significant amount of inventory on its balance sheet using the LIFO cost flow assumption. If the company utilizes IFRS, it will no longer be allowed to utilize LIFO. Assuming that prices are rising over time, the company would report lower cost of goods sold, higher income and earnings per share on its income statement, and higher cost of ending inventory and higher equity on its balance sheet. In addition, currently, the Internal Revenue Service (IRS) requires that companies that use LIFO for tax purposes also use it for financial reporting. If the IRS retains this so called "IRS conformity rule" and companies can no longer utilize LIFO, corporate taxes and cash outflows for taxes will increase.

Furthermore, if any inventory is written down because of impairment or obsolescence, market value will be solely based on net realizable value. In addition, if the market value of inventory subsequently increases, previously recognized impairments can be reversed under IFRS, increasing reported value of inventory and increasing stockholders' equity.

B. Property, plant and equipment: IFRS allow that property, plant, and equipment are carried at current market value, instead of cost less accumulated depreciation. If Wichtel chooses to utilize market values, the amounts of property, plant, and equipment, total assets, and stockholders' equity reported on the balance sheet likely would increase.

C. Intangible Assets: Just as with tangible assets, IFRS permits companies to value intangible assets at market value. Thus, Wichtel could choose to value its intangible assets at market value, which likely would be higher than unamortized cost.

D. Research and Development Costs: Under IFRS, development costs that meet specific criteria can be capitalized as assets. Since Wichtel currently expenses its R & D costs, some or all of its development costs probably could be capitalized as assets. This would increase the company's long-term (and total) assets, increase current year income and equity, and increase amortization expense in future periods.

E. Discontinued Operations: Wichtel currently reports a loss from discontinued operations. If during future periods, the company discontinues a segment or product line, it will have to assess whether that particular item meets the criteria of "discontinued" under IFRS. If a loss occurs that meets the criteria of "discontinued" under U.S. GAAP, but not under IFRS, the related revenues and expenses would have to be shown under income from continuing operations, decreasing those subtotals on the income statement.

F. Extraordinary Items: Extraordinary items are not permitted under IFRS. Wichtel Corporation would have to reclassify the loss as "other loss" thereby decreasing income from continuing operations.

G. Convertible Bonds: Wichtel's bonds are convertible. Consistent with IFRS, a portion of the proceeds would be allocated to equity. This would decrease liabilities and increase equity.

H. Terminology: Changes in terminology include changing "retained earnings" to "reserves."

Overall, the likely financial statement effect of adopting IFRS would be to increase Wichtel Corporation's total assets, equity, income, and earnings-per-share, and to decrease the company's total liabilities.

Changes in key financial ratios: If Wichtel Corporation were to implement IFRS, several key ratios would change. These include liquidity, solvency, activity, and profitability ratios. For example:

Current ratio (increases if inventory increases).
Debt/equity ratio (decreases if equity increases due to asset revaluations and reclassification of some of the convertible bond proceeds to equity)
Several profitability ratios, such as the gross profit margin ratio, the profit margin, and earnings per share would change. Based on the information above, overall these profitability ratios would increase. Several turn-over ratios also would change, such as the inventory turn over ratio and the asset turn-over ratio.

2. How would use of IFRS affect Wichtel Corporation's cost of capital? How could this affect Wichtel Corporation's strategies regarding future sources of capital?

In the long-run, Wichtel Corporation's cost of capital may decrease making it less costly for the company to raise capital. This may occur because financial statement users will perceive less risk if all companies utilize the same accounting rules, making comparisons easier. If an investment is perceived as less risky, investors demand a lower return, which typically decreases the cost of capital. If globally, companies prepare financial statements using IFRS, comparability will be enhanced.

Wichtel may want to consider raising capital in Europe. If the company prepares IFRS-based financial statements, it will be able to raise capital on European exchanges without first having to convert its financial statements using a different set of financial reporting standards. This may be a strategic advance if the cost of capital were lower in Europe. Alternatively, because of the SEC's decision to permit foreign entities to use IFRS when reporting to the SEC, the company's European subsidiaries could more easily raise capital on U.S. markets.

3. What are the advantages for Wichtel to continue preparing financial statements utilizing U.S. GAAP?

Wichtel's financial accounting and reporting system currently is designed using U.S. GAAP and the company already has established procedures and methods to convert its subsidiaries' financial statements into U.S. GAAP. In the short-run, it likely would be less costly if the company continues using U.S. GAAP. In addition, in the short run, consolidated financial statements will be more comparable to prior years. In addition, the company could continue utilizing LIFO, which would result in tax savings if the LIFO conformity rule remains in effect.

4. What would be the advantages of preparing financial statements utilizing IFRS?

In the long-run, the consolidation process will be easier and most likely less costly for Wichtel Company. This is because Wichtel consolidates the financial statements of several entities that currently prepare their financial statement using IFRS. In addition, as IFRS become the global financial reporting standards, global comparability of financial statements will be enhanced. This may lead to potential global opportunities for Wichtel (and other entities).

5. What would be the likely effect on financial statement users if the SEC allows U.S. companies to choose between U.S. GAAP and IFRS for preparing their financial statements. What do you recommend that Wichtel Corporation should choose in that situation?

If the SEC allows U.S. entities to choose between U.S. GAAP and IFRS, some companies likely will choose to continue using U.S. GAAP, particularly if they do not consolidate subsidiaries that currently utilize IFRS. Other companies, particularly those that consolidate subsidiaries preparing IFRS-based financial statements may choose to prepare their statements using IFRS. If the SEC allows companies to choose, this resulting dual financial reporting system will make it more difficult for financial statement users to compare entities that use different financial reporting systems. In addition, earnings management opportunities may influence companies' choices; this would be undesirable.

Recommendations for Wichtel: Answers will vary, but students should support their answers. Support for choosing U.S. GAAP: In the short-run, costs of preparing consolidated statements remain lower if Wichtel continues to use U.S. GAAP. Financial statement users are accustomed to U.S. GAAP and may - initially - perceive less risk if the company continues to use U.S. GAAP. Support for choosing IFRS: In the long-run, Wichtel's consolidation process will be easier and less costly. In addition, the company's ability to raise capital in European countries will be enhanced.

6. What would be the likely effect on financial statement users if the SEC requires that all U.S. public companies utilize IFRS for preparing their financial statements?

Initially, a learning curve will occur. Financial statement users in the U.S. who are not familiar with IFRS may feel uncertain about the value of the information provided in the financial statements. This may temporarily increase the cost of capital. In the long run, U.S. financial statements will become significantly more comparable globally, which should lower the cost of capital and may enhance global investment opportunities.

7. **Draft a concise letter addressed to the SEC to express your opinion regarding the issue of whether U.S. companies should be (a) permitted or (b) required to prepare financial statements consistent with IFRS. Support your position and focus on advantages and disadvantages. Also indicate whether you would support early adoption of IFRS, if permitted, and whether you agree with the SEC's proposal to phase-in adoption over several years. Address the letter to Florence E. Harmon, Securities and Exchange Commission, 100 F Street, NE, Washington, D.C. 20549-1090.**

Examples of actual comments to the SEC can be found on the SEC website at: http://www.sec.gov/comments/s7-20-07/s72007.shtml and http://sec.gov/comments/s7-27-08/s72708.shtml

8. **Indicate any additional issues that the company may want to consider.**

Answers may include consideration of the initial adoption cost, cost of external and internal audits, and cost of training accounting department employees. In addition, the company may consider the need for providing informational materials for their investors as convergence nears und during the first year of implementing IFRS.

9. **The SEC is considering requiring that all companies use IFRS by the year 2016. How will this affect the accounting profession?**

If eventually all public companies are required to utilize IFRS, the accounting profession must prepare for this change. This involves education and training of accounting professionals and education for company executives and financial statement users. Current accounting majors likely will have to learn both U.S. GAAP and IFRS, since for the next few years, U.S. GAAP will still be used. In addition, at least for some time, private companies are likely to continue utilizing U.S. GAAP. In addition, global career opportunities will be enhanced for accounting professionals.

Researchable Questions:

1. **Research and briefly describe the perceptions of the corporate, or the financial community regarding allowing U.S. companies to choose between U.S. GAAP and IFRS.**

    Answers will vary. Comment letters to the SEC provide a good source of opinions: for example, KPMG supports the temporary choice between U.S. GAAP and IFRS as a pathway toward IFRS for all SEC registrants (http://www.sec.gov/comments/s7-20-07/s72007-23.pdf), while Moody Investor Services does not support choice, but instead strongly supports use of IFRS by all registrants (http://www.sec.gov/comments/s7-20-07/s72007-88.pdf). In addition, according to a survey by Grant Thorton, less than 47% felt that all U.S. companies with extensive foreign operations should be allowed to utilize IFRS in reporting their financial results to the SEC (Grant Thorton, 2007).

2. **What are some of the most important critical issues that must be addressed prior to convergence of U.S. GAAP to IFRS?**

    The interview with Robert Herz in the *Journal of Accountancy* (Herz, 2008) provides a good source of information for this question.

    Some issues that need to be resolved are: differences between current U.S. GAAP and IFRS must be resolved (e.g., LIFO is permitted under U.S. GAAP but not under IFRS); implementation guidance must be provided to allow for smooth transition and to minimize negative effects on capital markets (the SEC currently proposes a "Roadmap" toward the adoption of IFRS); a decision has to be made regarding accounting standards used by private companies.

3. **Research current developments regarding convergence to IFRS.**

    Answers will vary and change over time. The SEC received a significant number of comments on its concept release regarding allowing U.S. companies the choice of using IFRS or U.S. GAAP and is beginning to receive comments on its "Roadmap" proposal. In addition, large public accounting firms provide web-based updates on IFRS and the pending conversion. FASB and IASB continue to work toward the resolution of differences and issues.

4. Convergence to IFRS has not yet occurred. Research and briefly describe major joint projects between the FASB and IASB.

Joint projects between the FASB and the IASB can be found under "Project Updates" on the fasb.org website. For example, currently, FASB and IASB are working together on a project to revise financial statement presentations. Some expect that all financial statements may, in the future, be organized in a similar format as the cash flow statement - using the operating, investing, and financing activities classifications. A discussion paper was issued in October 2008 and is available on the FASB and IASB Websites. Another example is the FASB and IASB project to develop a joint conceptual framework.

5. Research the convergence issue from the perspective of non-public entities.

The answers to this questions may change over time as new developments occur and rules may be issued by standard setters. Currently, the SEC's rules, concept releases, and proposals address the issue of IFRS from the perspective of public entities (both U.S. and non-U.S. companies) that are required to report to the SEC (SEC registrants). FASB and the SEC have not yet decided whether private entities and non-SEC registrants should use IFRS, continue to use U.S. GAAP, or utilize modified private entity specific accounting rules. Good sources of information are the FASB.org website and the interview with Robert Herz in the *Journal of Accountancy* (2008).

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A CAREER DILEMMA FOR PAT CARPENTER

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CASE DESCRIPTION

The primary subject matter of this case is that of a high potential young manager, Pat Carpenter, employed by a successful large organization who is highly conflicted on the course of action to take when given a new assignment. Discussion questions range from the specific situation Pat faces to issues of corporate social responsibility. The case generates useful discussion on issues of values and value conflict, conflicting loyalties, identification of core beliefs and how they are lived, problem solving, corporate guiding principles, outsourcing, off-shoring, and government policy. Secondary issues address through role playing are how the same situation can be experienced differently, leading to different assessments as to the most appropriate courses of action. Case difficulty is 2-3 (sophomore to junior, depending on issues raised). The case is designed to be taught in a management or ethics course requiring from 30-50 minutes of class time and either no outside preparation, or about 10 minutes of pre-class preparation.

CASE SYNOPSIS

Pat Carpenter grew up in the small, somewhat poor town of Racton, WV, enjoying the sense of community it provided while working in Carpenter's General Store – Uncle Bob's store. Motivation and hard work, along with Uncle Bob's mentoring and coaching, contributed to Pat's success at college, and then at work for a major retailer – Shop-Mart. Pat's career progression for 7-years has been 'star-like' – from management trainee, to assistant store manager, store manager, and now Real Estate Manager, Mid-Atlantic Region. This job involves locating new Shop-Mart store sites within targeted locations, then beginning community relations so that the opening would go smoothly.

After three successful openings, Pat is asked to locate a site for the next Shop-Mart in Racton, WV. Pat knows that local stores often go out of business when Shop-Mart arrives, and this means Carpenter's will be at risk. In considering the situation Pat begins to experience significant stress, leading to depression and nightmares. To whom should Pat speak – spouse, boss, Uncle Bob? What will Pat say – or do – to move forward?

INSTRUCTORS' NOTES

Recommendations for Teaching Approaches

The Pat Carpenter case can be used with any size class. It is best to start by asking the full class to respond to the discussion questions below. One can end at this point (about 30 minutes) or move to the highly engaging role play possibilities. Asking students to role play Pat (a gender neutral name so that either gender can be Pat), Pat's spouse (gender neutral), Pat's boss (gender neutral), and Uncle Bob will greatly increase the students' experiential learning. Use a fishbowl design for the role plays, limiting each to a few minutes and giving several students a chance to participate.

DISCUSSION QUESTIONS

1. What are the value conflicts Pat is facing?

2. Can Pat reconcile these value conflicts in the present position? How? If not, what do you recommend Pat do?

3. Should providing the greatest good to the greatest number of people through low prices be Shop-Mart's guiding principle in decision-making? What other principles might be taken into consideration?

4. Who are the other stakeholders affected by Shop-Mart's decisions? Are there ethical issues each of these other stakeholders face? How should each stakeholder reconcile these ethical challenges?

The discussion questions progress from the specific to broader value-laden and ethical challenges. Each is designed to allow open ended, thought provoking commentary within groups or as a class as a whole. The questions allow for a diversity of opinions, which should enhance the discussion, thought, reflection, and learning.

1. What are the value conflicts Pat is facing?

This question requires students to explicitly articulate what the value conflicts are. There is a range of possibilities, with different students likely to assign varying degrees of importance to each. Possibilities include:

Loyalty to Pat's family
Loyalty to other townspeople who are business owners and employees
Loyalty to Shop-Mart
Responsibility to his immediate family
Responsibility to himself and his career
Responsibility to articulate and live his core beliefs

2. Can Pat reconcile these value conflicts in the present position? How? If not, what do you recommend Pat do?

This question is the natural extension of Question 1, and should generate a great deal of debate and clarification of student values. For example, can Pat reconcile loyalty to townspeople who are business owners and employees and loyalty to Shop-Mart? It is important for students to articulate the criteria they are using to reconcile competing values. For example, one student might be guided primarily by the criterion "survival of the fittest" while another student might be guided primarily by the criterion "do no harm."

3. Should providing the greatest good to the greatest number of people through low prices be Shop-Mart's guiding principle in decision-making? Are there other principles which need to be taken into consideration?

This question broadens the discussion from Pat's personal challenges to the larger issue of corporate social responsibility. There is a subtle element to the first part of the question that astute students will recognize. If students answer affirmatively to this question, the implication appears to be that growth is good; some might argue even an imperative to provide goods and services at low prices to the greatest number of people. The second part of the question asks students to explicitly articulate if there are legitimate mitigating principles which should constrain growth.

4. Who are the other stakeholders affected by Shop-Mart's decisions? Are there ethical issues each of these other stakeholders face? How should each stakeholder reconcile these challenges?

This question asks students to explicitly articulate other stakeholders impacted by Shop-Mart's decisions who might not have been discussed up to this point. In addition, the question asks what the ethical challenges are for other stakeholders. This question can produce a broad ranging discussion. For example, what are the ethical issues facing customers, governments, and suppliers. In relation to suppliers, this question allows for a broadening of the discussion into issues of outsourcing and off-shoring to enable low prices for consumers.

ROLE PLAY OPTIONS

Role plays should be conducted with a minimum amount of coaching of the role players. Let Pat have a conversation with his/her spouse. In private, you might ask the first 'spouse' to be also be from small-town WV and as such be supportive of Pat's concerns, sensitive to the issues being shared, and empathic towards Carpenter's store and Uncle Bob. For the second 'spouse' role play, have the spouse be from the Washington DC area and career focused (for Pat). This spouse wants to continue having the family get ahead, likes the progressive lifestyle they have started, and is looking forward to having a family. Pat's continued career success is very important to this spouse.

For the first 'boss' role play, privately ask the boss to be very open, interested, and accommodating of Pat's concerns – even to the point of supporting a location change or even not pursuing a Racton location at this time. For the second 'boss' role play, take the opposite approach – business is business. If Pat doesn't like the work, you are sure other's will.

For the first 'Uncle Bob' role play privately ask Uncle Bob to be ready to let go of his store and livelihood. He has done well, and his son doesn't have much passion for it. In the second 'Uncle Bob' role play, have Uncle Bob be really sad about the news, a bit angry with life and with Pat for bringing this bad news into his life.

In debriefing the role plays, **do not** revisit the issues raised in the class discussion. The process of role playing will have made the issues sufficiently salient to no longer need summarizing. Focus the final discussion on how Pat will not know how any of these three stakeholders will respond until Pat enters into a dialogue with them. Assuming one knows someone else's values, and how those values will play out around a given situation, is presumptuous. The ultimate learning point is that value-laden and ethical issues must be identified so as to discuss them with stakeholders. It is through discussion that positions are clarified to the point of permitting one to make ethical choices.

IMPLEMENTING IMAGING TECHNOLOGY IN GRADUATE ADMISSIONS AT GEORGIA SOUTHERN UNIVERSITY

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CASE DESCRIPTION

This case concerns the implementation of a document imaging and workflow routing system in a university graduate admissions context – a setting familiar to both students and faculty. Secondary issues include the identification of bottlenecks and inefficiencies in paper-intensive manual processes, an appreciation for the organizational and management challenges associated with the introduction of new processes and systems, and recognition of strategic/competitive advantages afforded by the adoption of information technologies. The case has a difficulty level of 3-4 and would be appropriate for junior-to-senior level students. The case is designed to be taught in two class hours and is expected to require 2-4 hours of outside preparation by students. It might also be helpful to invite representatives from your campus graduate (or undergraduate) admissions office to join in the discussion of this case.

CASE SYNOPSIS

This case describes the implementation of a document imaging and workflow routing system in the Office of Graduate Admissions at Georgia Southern University. The new system, which replaces a paper-laden, labor-intensive manual process, is intended to address a number of organizational issues. Specifically, the new system is intended to streamline the graduate admissions process by: (1) reducing the amount of paperwork across multiple departments; (2) improving the ability of these departments to locate, retrieve and share vital information; and (3) reducing the time required to process applications for admission to the graduate programs, thus improving the quality of service to prospective graduate students. The process problems that existed prior to implementation of the document imaging system as well as the strategies and approaches used to deploy the new system are detailed in this case. The case also describes the technological infrastructure required to support the document imaging system, the challenges faced in

implementing document imaging and workflow routing, and the benefits derived from implementation.

INSTRUCTORS' NOTES

Teaching Recommendations

There are several strategies that can be employed to teach the case. A few are:

- *Have the students read the case prior to class and discuss a subset of the discussion questions. Assign some of the remaining questions as homework. (sophomore or junior level course)*
- *Use the case as a group project to research additional vendors with similar technologies and write a request for proposal (RFP) for a vendor based on the details provided in the case. Use the strategic plan as a guideline for what the organization needs in the system. Present results in class. (junior to senior level course)*
- *Use the case as an assignment to teach interview techniques and some requirements gathering techniques. After reading and/or discussing the case, ask students to go out and interview various units (1-2 units per group or student) on campus to determine their use of imaging software and/or suitability of an imaging application for their units' needs. In addition, determine who the system impacts (or would impact if no such system exists) besides the first interviewee and interview these additional users, focusing on how an imaging system might impact their workload. This might emphasize why some users are resistant to change and others are not. Present results in class. See discussion question #10 below. (sophomore to junior level course)*

Teaching Objectives

Upon successful completion of the case, students should be able to:

- *Demonstrate an understanding of the implementation and training phases of the systems development life cycle (SDLC).*
- *Explain uses of imaging technology.*
- *Discuss the benefits and limitations of imaging technology.*
- *Discuss some of the problems encountered when dealing with different user groups.*
- *Discuss users' resistance to change.*

CASE DEVELOPMENT

This case was developed based on a real-world implementation of a document imaging system at Georgia Southern University. All information was obtained through interviews of the administration and staff involved in the implementation and training as well as the faculty, staff and administrators that use the system. In addition, several rough drafts of the case were reviewed by the actual participants in the case.

Overview

Although this case describes the implementation of a document imaging and workflow routing system specifically, it could be used to highlight the implementation and training phases for any systems development project. The material should be tied to these stages in the SDLC.
In addition, this case provides insight into why some of the users of the system (in particular, faculty) were resistant to change in the graduate admissions process. The reasons for this resistance should be discussed.

Finally, the case provides the background for discussing the pros and cons of saving "images" as opposed to filling out "forms". As we know, images are not searchable. You cannot access documents on any field other than the ones used for indexing. If you want to search for applicants with GPAs over 3.0 in their last college program, you cannot do it with this system as it is not part of the index. Alternatives for providing truly searchable documents should be discussed (online forms, Optical Character Recognition [OCR] technology, standardized transcripts in XML format, etc.).

DISCUSSION QUESTIONS

1. **Discuss how document imaging at GSU has contributed to obtaining goals/objectives set forth by the university. How did it improve the graduate admissions process?**

One of the six strategic themes in the University's strategic plan is technological advancement. The strategic plan states:

- *"To enhance Academic Distinction, the University must use the best and most appropriate technological tools available to support teaching and learning opportunities and effective administrative practices."*

The imaging application is a key example of how a technological tool has been implemented to support effective administrative practices. Their problem: the ability to handle bigger volumes in order to grow the applicant pools and the student body, and quicker turnaround is crucial to attracting students. They can't grow the programs without these things . . . and they must grow the programs in order for them to remain viable. Improving customer service for students also ties into the strategic theme of a "student centered university".

For graduate admissions: The system reduced turnaround time on the decision for applications from 6- 8 weeks to 2 weeks. This is a key factor in a student choosing a graduate program.

2. Compare document imaging to an OCR system. If necessary, research OCR systems.

The content of an image is not searchable. An OCR system recognizes characters and groups them into words. The text recognized by an OCR system is searchable.

3. Is there any evidence of duplication of effort? If so, what is duplicated and why? If not, explain.

The files are still printed & photocopied by staff in the program directors' offices. The paper comes in, OGA scans it and shreds it. Then the program directors print it again, then either file it or shred it.

OGA changes the STATUS to COMPLETE when the applications are done. The program directors or their staff run a query to see if they have a COMPLETE applications for review. The system knows the STATUS and the program to which the applicant is applying. Why shouldn't the system automatically notify the program directors when an application is ready?

OGA runs queries to see when a decision is made. Why not notify OGA when the STATUS is changed to DECISION and post the decision to the student information system (Banner) automatically?

4. Identify the various user groups identified in this case. Explain the impact of the system on each group.

- *SAEM Tech Support – Had to oversee purchase and implementation of system. Did initial training. Handle ongoing technical support issues.*
- *IT Services – Handle ongoing support issues.*
- *Office of Graduate Admissions – Has saved space, improved "customer" service, allowed resources to be redeployed, automated backup, improved security, made it*

easier to share documents across units, saved time and money, and increased efficiency.

- *Program Directors (and their staff) –*
- *BEFORE: review application and supporting documents, record comments/stipulations on the recommendation form (generated for them and already in file), record decision on recommendation form, return physical file and recommendation form to COGS.*
- *NOW: Run query to obtain list of complete applications, pull applications for review, update status to "Reviewing", print electronic file, review application and supporting documents, record comments/stipulations on electronic recommendation form, use rubber stamp tool to record decision & update status to "Decision".*
- *Students – Can check online for a decision 4-6 weeks sooner than they could when the old process was in place*

5. When describing the implementation of the system, it is mentioned that after the documents are imaged, they are archived. Why archive the documents when the goal was to reduce paperwork? How did this "archiving" affect the archive office? What considerations should be made when deciding whether or not to archive documents?

Archiving was done initially to ensure that the system worked properly before shredding all documents. When the system was implemented graduate admissions archived all of the old application materials. At the time of implementation, the archive office was inundated with documents. However, as belief in the reliability of the system increases, fewer documents are archived. The only documents that must be archived are those that are mandated by regulatory bodies.

6. Why do you think program directors were resistant to changing to the new system? Does the system put additional workload on them? Is there a strategy that could be used to address their concerns?

Some program directors were resistant because they felt that the new system would increase their workload and some still believe that it did increase their workload. See summary of changes made by the new system for the program directors below. Before they received the files already printed with a form where they placed a check-mark next to their decision (might write some comments on the form too). Now, they have to query the system to find applicants, pull each applicant from the system and save their information, print it, post the decision to the system and remember to change some field (STATUS) so that OGA knows the application is done.

BEFORE: review application and supporting documents, record comments/stipulations on the recommendation form (generated for them and already in file), record decision on recommendation form, return physical file and recommendation form to COGS.

NOW: Run query to obtain list of complete applications, pull applications for review, update status to “Reviewing”, print electronic file, review application and supporting documents, record comments/stipulations on electronic recommendation form, use rubber stamp tool to record decision & update status to “Decision”.

In addition, there seems to be no involvement from program directors in the decision to move to this system or in the choice of system. However, program directors are an important user group.

Highlighting the benefits of the system and asking for program director’s input on what upgrades need to be made to the system, might improve their overall perception of the system. OGA can work in conjunction with program directors to determine upgrades needed in the system. Then, the lines of communication need to remain open to update program directors on changes to the system. In general, if a user group feels that their problems with a system are being addressed, they will be more likely to respond positively to the system.

7. Define change management. Is this case a good example of change management? Why or why not?

“Change management is a systematic approach to dealing with change, both from the perspective of an organization and on the individual level. A somewhat ambiguous term, change management has at least three different aspects, including: adapting to change, controlling change, and effecting change. A proactive approach to dealing with change is at the core of all three aspects. For an organization, change management means defining and implementing procedures and/or technologies to deal with changes in the business environment and to profit from changing opportunities.” http://searchsmb.techtarget.com/sDefinition/0,,sid44_gci799426,00.html. (many sources for definitions from the web)

The way change was managed in the implementation of this system is mostly positive. In the OGA, they ran two systems in parallel until they were ready to “go live”. They learned to use the system in the meantime. They prepared training materials. They had the benefit of support from senior administrators with the “it will not fail” attitude. They had champions of the system in their office. They heard about the benefits of the system to their office and saw the benefits of the system firsthand. It did increase productivity, save money, save time and improve customer service. These are all part of being able to “profit” from change. This indicates that change was managed successfully.

The way change was managed for the program directors user group was not perceived as positive by some members of that user group. There seems to be no program director involvement in the decision to go to this system, which may explain the resistance by some, and no involvement in how the system would be implemented (how the changes would be made). From a program director's standpoint, one year they got their applications in the campus mail already in file folders & ready to be reviewed. The next year they're required to go to training on a new system where they find out that with the new system they will have to pull all the paperwork from the system themselves and put the decision in the system themselves.

Overall, the system does save money and improves customer service so is an example of change that was managed well.

8. How is the success or failure of this project judged? What factors should be considered in this judgment?

Typically judgment about success or failure depends on factors such as profitability of the project, improved efficiency/productivity in people's work, project is in alignment with the goals of the organization or improved service to customers.

There is no hard data to judge the success or failure based on profitability. This is quite common when a system impacts many independent departments in a large institution. On of the goals of the institution is to increase graduate enrollment. In addition, part of the strategic plan is to improve technology to support effective administrative practices. The system did contribute to these. Finally, the system did reduce the time it takes for students to receive a decision about acceptance from 6 – 8 weeks to less than 2 weeks. From a student perspective, this would definitely be improved customer service. The system did improve the efficiency and/or productivity of Graduate Admissions. However, program directors perceived that the system increased their workload.

9. This case describes the implementation of a document management system. Describe how some of the issues encountered in this case, such as change management, training strategies, building it as you go, generalize to the implementation of any information system.

To the teacher: The implementation of any system will encounter these same problems. Provide a case of your own and tie it into the issues seen in this case. This will enable the student to understand how the issues in this case are not unique.

Example: Taken from Williams and Aasheim (2005):

In February 2001, the Charlotte-Mecklenburg Police Department began the rollout of a "mobile" information system that will eventually enable all information relating to incident reports, arrests, and investigations to be collected, distributed, and managed in a paperless, wireless environment. The system, dubbed Knowledge-Based Community Oriented Policing System (KBCOPS), began as a "grass roots" project within the police department to reduce paperwork, increase data accuracy, share knowledge and information, and promote a problem solving analytical framework.

Restructuring CMPD's business processes forced changes in the daily activities of police officers. These changes met with some resistance.

Although many users were satisfied with the system, pockets of user resistance were visible. Some officers see the system as pushing extra work on them. KBCOPS requires them to spend a significant amount of time entering information that populates the incident database — a database that is subsequently used primarily by detectives. Although the implementation of search features has helped, some patrol officers still question the value added by the system.

Additionally, the software has some shortcomings that frustrate users. Specific issues include the delay time for submitting forms, the inability for the officers to save a form before it is submitted, and the lack of support for spellchecking. The last two issues are particularly problematic for forms that require narratives. As a temporary solution many officers enter their narratives in Word so that they can save their work intermittently and use the spelling and grammar features. They then copy the narrative to the required form. Although this workaround accomplishes the task, it takes extra time and leads to frustration.

Another challenge is created as officers become familiar with the system and take "shortcuts" to avoid filling in extra forms. Entering certain information in one form may generate many additional forms to fill in. Additionally, officers sometimes fill in the required fields in a form and leave non-required fields blank. Consequently, the information stored is sometimes incomplete and inaccurate, compromising the quality of the data and the resulting investigation. The shortcuts and incomplete forms also lead to problems between officers who enter the information and the detectives that depend on it.

Although CMPD trains officers on the use of KBCOPS, training focuses on how to use the system rather than why it should be used and how it fits into the bigger picture of crime investigation.

In the case described above, there were issues with the technology, perceptions of increased work load for one group (the officers) for the benefit of another (the detectives). This is similar to the perception of faculty that the workload was being pushed down to them in this case. In the training sessions for the officers, the benefits of the system were not emphasized and therefore the system was seen as more work with no added value. This is similar to the implementation of the imaging system in that faculty were not involved in the decision to adopt the imaging system and training focused on using the new system, not the benefits of it. In addition, KBCOPS was rolled out in stages. They built new parts of the system as they were implementing others. This was the same approach at Georgia Southern. Many of the benefits of a system are not realized until completion of the project.

10. Identify another unit at your institution that might use document imaging (i.e. health services or financial services).

What would be imaged in that department?
What are the user groups? Explain the impact of the system on each?
Identify the user group(s) that might be resistant to imaging technology. What are their concerns?
How could imaging improve the efficiency of the department?
Was the change managed effectively in the process of implementing the system? Why or why not?

Answers will vary…

11. Access to prospective student files carries with it responsibility for protecting the privacy of the information contained within those files. Privacy/security issues existed with the paper-based system, but there are also privacy/security risks associated with an electronic imaging system. What are some of these privacy/security risks?

The most obvious risk is someone hacking into the system. Additionally, a potentially larger number of individuals have access to the private information when it is available in electronic format. Other risks include employees walking away from their computers with information visible on the screen, using screen capture programs to “steal” information, printing hard copies for unauthorized use, etc.

12. What is the proper balance of the goals reflected in this case (reduced paperwork, shared information, faster turn-around time, etc.) versus the goal of protecting privacy? Which of these goals has the greater value and why?

Answers will vary…

To the teacher: For greater instructional value, you could ask students do some elementary research on the issue of information privacy and education. You may also want to ask students to make comparisons with the privacy of medical record and/or financial data.

REFERENCES

Williams, S.R. & C.L. Aasheim (2005) Information Technology in the Practice of Law Enforcement. *Journal of Cases on Information Technology*, 7(1), 71-91.

RECEIVABLES MANAGEMENT: A CASE STUDY

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CASE DESCRIPTION

The primary subject matter of this case concerns receivables management. Secondary issues examined include the impact of a client's financial distress on a firm's cash flows; the use financial accounting data to challenge a firm's going concern principle and the formulation of new business strategies when the unexpected happens to a firm. The case is appropriate for first year graduate level. The case is designed to be taught in two class hours and is expected to require five hours of outside preparation by students.

CASE SYNOPSIS

Delta Inc. was formed in 1998 by Thomas Dake and George Roberts. The firm was organized and located in Baltimore, Maryland. It provided brokerage services for a wide range of financial transactions for businesses in the state of Maryland. Delta's strategy was to position itself as a discount broker because it perceived that borrowers' resistance to broker fees was much weaker when the lender paid the fees. Pink Tree Finance, a public company listed on the New York Stock Exchange, was Delta's major business partner. About 60 percent of Delta's receivables were due from Pink Tree. Although Delta regarded new client and lender relationships as opportunities for growth within the brokerage business, it also looked for opportunities in other businesses. As a result, the firm identified the West Baltimore Senior Housing Project as a good investment opportunity.

Delta planned to develop a property on West Baltimore Street into a senior housing facility and commercial spaces. The entire project was estimated to cost $10.5 million. Delta executed the purchase agreement for the existing West Baltimore Street property in September, 2001. In October, 2001, Delta applied to a bank in Baltimore for a commercial loan of $10.5 million to purchase and develop the property. The term sheet provided Delta with 90 days to close the loan transaction. It required a refundable fee of $100,000 on executing the term sheet. Delta planned to use the outstanding brokerage fees to be collected from Pink Tree to close its loan transaction. In the middle of January, 2002, Pink Tree filed for chapter 11 bankruptcy. Mr. Thomas Dake, CFO of Delta Group was now in a difficult situation of raising $100,000 to close the loan and to ensure that the West Baltimore Senior Housing Project would be realized.

INSTRUCTORS' NOTES

Research Methods

This is a field-based research case. The case utilizes information from a firm's internal documents. The names of both firms and individuals involved have been altered to protect their privacy. Some of Delta's financial information was altered at the firm's request.

Recommendation for Teaching Approaches

The recommended approach for teaching the case is the three-stage learning process which involves students first analyzing the case individually, then in a small group, and finally discussing the case in a large group (Naumes, P., and Naumes, W., 1999).

A less structured discussion of the case is recommended. It is ideal to have the students analyze the case prior to the class discussion and then have group presentations in class. The case analysis should clearly identify the critical issues facing Delta Inc., provide alternatives, recommend a solution and provide justification for the recommended solution. The time for each presentation may be about 20 minutes, and then the remaining period may be used for class discussion and the instructor's summary. The instructor may assign the following discussion questions before or during the class discussion.

Discussion Questions

1. What is the critical issue facing Delta Inc.?
2. List some topics related to receivables management.
3. To what extent did Delta's business strategy impact the firm's accounts receivable and cash flow problems?
4. Calculate the Altman's Z-Score for Pink Tree and discuss whether Delta Inc. should have anticipated the risk of dealing with Pink Tree?
5. How should Delta report the Pink Tree debt in its financial statements?
6. What are the major constraints against the continued success of Delta as a discount broker?
7. What suggestions related to the liquidity and solvency of Delta's operations would you make?
8. What recommendations related to Delta's financing of the $100,000 would you make?

ANSWERS TO DISCUSSION QUESTIONS

1. What is the critical issue facing Delta Inc.?

Receivables management and the risk of failure are critical issues for Delta Inc. A key issue was how to ensure financial flexibility in relation to the amount and timing of its cash flows. Financial flexibility would enable the firm to respond to unexpected needs such as Pink Tree's bankruptcy. However in order to survive in a highly competitive market Delta Inc sacrificed one of two sources of revenue. This resulted in Delta's inability to respond to the unexpected situation of Pink Tree defaulted on the outstanding broker fees. Delta had liquidity and solvency problems as well. The firm's liquidity ratios were below the industry averages. Delta's current ratio was 1.46 in 2001, 1.12 in 2000, and 0.58 in 1999 while the industry averages were 3.22, 3.20, and 2.27 respectively. Current cash debt coverage ratio was 0.082 in 2000 and 0.061 in 2001 while the industry averages were 0.08 and 1.15 respectively.

Delta's solvency ratios were higher than the industry averages. The firm's debt to asset ratio was 0.80 in 1999, 0.74 in 2000, and 0.66 in 2001 while the industry averages were 0.60, 0.63, and 0.64 respectively. Cash debt coverage ratio was 0.033 in 2000 and 2001 while the industry averages were 17.67 and 10.55 respectively.

Delta's liquidity and solvency ratios:
Current ratio for 2001 = current assets ÷ current liabilities = 752,999 ÷ 514,227 = 1.46
Current ratio for 2000 = current assets ÷ current liabilities = 425,142 ÷ 380,986 = 1.12
Current ratio for 1999 = current assets ÷ current liabilities = 112,286 ÷ 195,224 = 0.58
Current cash debt coverage ratio (2001) = net cash provided by operating activities ÷ average current liabilities = 58,210 ÷ (514,227+380,986) = 0.065
Current cash debt coverage ratio (2000) = net cash provided by operating activities ÷ average current liabilities = 47,146 ÷ (195,224+380,986) = 0.082
Cash debt coverage (2001) = net cash provided by operating activities ÷ average total liabilities = 58,210 ÷ (944,257+811,016) = 0.033
Cash debt coverage (2000) = net cash provided by operating activities ÷ average total liabilities = 47,146 ÷ (811,016+625,254) = 0.033
Debt to total asset ratio for 2001 = total debt ÷ total asset = 944,257 ÷ 1,427,180 = 0.66
Debt to total asset ratio for 2000 = total debt ÷ total asset = 811,016 ÷ 1,099,323 = 0.74
Debt to total asset ratio for 1999 = total debt ÷ total asset = 625,254 ÷ 786,467 = 0.80

A related issue was ensuring the collectibility of Delta's accounts receivables, and evaluating the risk of financial distress of the firm's major business partners such as Pink

Tree. For the graduate class, the instructor may want to assign an additional reading on the subject of corporate financial distress such as: E. I. Altman, *Corporate Financial Distress and Bankruptcy*, (New York: John Wiley and Sons, 1993).

Delta should revisit and revise their receivables management policies. They should look into various factoring options, securitizing their receivables and regularly analyzing the default risk of all receivables.

2. List some topics related to receivables management.

i. Granting Credit: Delta must establish procedures and guidelines for evaluating which clients qualify for credit. These guidelines should be based on credit investigation of clients such as examining the payment record or history of clients as well as other risk factors such as business risk and bankruptcy risk of clients.

ii. Billing: Delta must establish procedures for prompt billing for services provided. Delta must also maintain information on the status of all unbilled accounts to insure that all actions necessary for the preparation of the bill have been taken as required so that the bill may be issued as expeditiously as possible.

iii. Aging and Analysis: Delta must maintain adequate information concerning the age of outstanding bills and claims for proper overall control of accounts receivable and related reserves for bad debts. Delta must collect, maintain, report, and act upon aging information in a standardized and consistent manner.

iv. Collection: For effective collection, Delta must establish who is responsible for collection and when to refer the receivables to collection agencies. Delta must also analyze the levels of effort in record keeping and collection to ensure that it is commensurate with collection value.

v. Factoring: Delta can improve collection and obtain financing by factoring its receivables. A factoring company offers credit coverage and can guarantee payment of accounts receivable. When Delta's accounts receivable are assigned to a factoring company, customers and clients obtain business line of credit from Delta based on the credit management expertise of the factoring company. The factoring company collects the accounts receivables once they become due. If the customer or client becomes unable to pay because of financial inability, the factoring company can pay the receivables. Therefore, accounts receivable factoring can provide a business line of credit to Delta and allow the company to obtain financing by borrowing against the factored receivables.

vi. Provision for Bad Debts: Delta must establish a policy on provision for bad debts. Delta must also establish and maintain a reserve for bad debts. Procedures for writing-off of bad debts and the approval and policies for writing-off bad debts must also be established.

3. To what extent did Delta's business strategy influence the firm's accounts receivable and cash flow problem?

Delta's strategy was to be a discount broker. The firm provided brokerage services to clients without billing the clients directly. Delta collected its brokerage fees from the lender after a client's loan transaction had closed. Delaying the collection of brokerage fees contributed to Delta's low receivable liquidity and increased the risk of the firm's cash flows. This is common industry practice. Delta's receivables turnover ratio, a measure of receivable liquidity, was lower than the industry average. Receivable turnover was 2.5 times in 2000 and 1.6 times in 2001 while the industry averages were 5.86 and 4.14 respectively. Delta's receivable liquidity problem also contributed to the firm's low cash flow position.

Delta's receivable turnover ratios:

Accounts receivable turnover ratio in 2001 = net sales ÷ average trade receivables
= 820,226 ÷ (668,932+359,285) = 1.6 times or 228 days
Accounts receivable turnover ratio in 2000 = net sales ÷ average trade receivables
= 531,617 ÷ (359,285+63,575) = 2.5 times or 146 days

4. Calculate the Altman's Z-Score for Pink Tree and discuss whether Delta Inc. should have anticipated the risk of dealing with Pink Tree?

Delta should have anticipated the risk of dealing with Pink Tree because an in-depth analysis of Pink Tree's publicly available financial statements would have revealed that Pink Tree was in financial distress. Although Pink Tree's solvency ratios provided mixed signals about its financial condition, Altman's bankruptcy prediction model clearly indicated that Pink Tree was experiencing serious financial problems.

Pink Tree's debt to asset ratio was more favorable than the industry averages but its cash debt coverage ratio did not compare favorably with the industry average. The firm's debt to asset ratio was 0.91 in 2001 and 0.90 in 2000 while the industry averages were 6.05 and 5.56 respectively. Pink Tree's cash debt coverage ratio of 0.013 in 2001 was far below the industry average of 0.17.

Pink Tree's solvency ratios:

Cash debt coverage for 2000 = net cash provided by operating activities ÷ average total liabilities = 516.7 ÷ (18,748.8+20,278.5) = 0.013
Debt to total asset ratio for 2001 = total debt/total asset = 20,278.5/22,228 = 0.91
Debt to total asset ratio for 2000 = total debt/total asset = 18,748.8/20,838 = 0.90

Another measure that could have been used by Delta to evaluate the risk of dealing with Pink Tree was Altman's bankruptcy prediction model or Z-score. Companies with Z-score above 3.0 are unlikely to fail while those with Z-score below 1.81 are very likely to fail (Altman, E.I., 1993). Pink Tree's Z-score was 0.048 in 2001 and 0.033 in 2000. These scores were consistently far below 1.81 showing that Pink Tree was very likely to fail.

Z score = [(working capital ÷ total assets) x 1.2] + [(retained earnings/total assets) x 1.4] + [(EBIT ÷ total assets) x 3.3] + [(sales ÷ total assets) x 0.99] + [(market value of equity ÷ total liabilities) x 0.6]
Z score (2001) = [(-6,711.6 ÷ 22,228) x 1.2] + [(98.7 ÷ 22,228) x 1.4] + [(1069.2 ÷ 22,228) x 3.3] + [(2,683.6 ÷ 22,228) x 0.99] + [(4,266.01 ÷ 20,278.5) x 0.6] = 0.048
Z score (2000) = [(-5,093.5 ÷ 20,838) x 1.2] + [(268.9 ÷ 20,838) x 1.4] + [(409.8 ÷ 20,838) x 3.3] + [(2,444.8 ÷ 20,838) x 0.99] + [(3,965.23 ÷ 18,748.8) x 0.6] = 0.033

5. How should Delta report Pink Tree's debt in its financial statements?

As Pink Tree had filed chapter 11 bankruptcy and Delta's receivables were not securitized, the firm should report the receivable as uncollectible and write it off. The receivable must be removed from the books by debiting allowance for doubtful accounts and crediting accounts receivable.

6. What are the major constraints acting against the success of Delta as a discount broker?

The major constraints acting against Delta are the following:

i. Ensuring the timely collection of its accounts receivable.

ii. Assessing the financial risk of its business partners.

iii. Ensuring the firm's financial flexibility or the firm's ability to act effectively to alter the amount and timing of cash flows to enable it respond to unexpected needs or opportunities.

7. What suggestions related to the liquidity and solvency of Delta's operations would you make?

Some of the options available to Delta have already been discussed. The instructor can lead a discussion in this area by focusing on whether the firm should revise its business model and make clients pay for its services, how to effectively collect its receivables especially from future tenants at West Baltimore Street, and an effective accounting reporting system that would alert the management of potential problems with financial flexibility.

8. What recommendations related to Delta's financing of the $100,000 would you make?

As Delta Inc. has only two weeks to finance the $100,000 escrow and close the loan, it is recommended that the firm finance the loan transaction through a fast-track bridge financing program offered by some lending institutions. An example of such a program is the "front-end financing of commercial loan closing costs." Although the interest rate of such programs can be as high as 15% for 90-days, the advantage is that financing can be obtained in as little as 10 days and no upfront fees are required.

EPILOGUE

Delta Inc. obtained financing to close the loan transaction within the two weeks period. Since the time of the case, Delta Inc. has revised its business strategy and clients are charged a fee for the loan application process. The firm has put in place comprehensive risk analyses of both its clients and business partners and strengthened its accounts receivables collections department.

ENDNOTES

1 Federal bankruptcy laws govern how companies go out of business or recover from crippling debt. A bankrupt company, the "debtor," might use Chapter 11 of the Bankruptcy Code to "reorganize" its business and try to become profitable again. Management continues to run the day-to-day business operations but all significant business decisions must be approved by a bankruptcy court (http://www.sec.gov/investor/pubs/bankrupt.htm).

REFERENCES

Altman, E. I. (1993). *Corporate financial distress and bankruptcy*. New York: John Wiley and Sons.

Naumes, P. & W. Naumes (1999). *The art and craft of case writing.* California: Sage Publications Inc.

HABITAT FOR HUMANITY: CAN MORTGAGE ASSET UTILIZATION BE IMPROVED?

Michael Tucker, Fairfield University

CASE DESCRIPTION

The primary focus of the case is mortgage valuation and building models from income statements that lead to cash flow projections under differing assumptions. This case is suitable for 2nd level undergraduate corporate finance courses (senior level), first or second level graduate corporate finance courses, or financial modeling courses. Levels of technical sophistication using Excel will enhance possible outcomes. The model and graphs used below to arrive at projections may be more sophisticated than some courses would require, particularly the use of the "spinner" in Excel to change values in the graphs. Preparation time: 5 hours.

CASE SYNOPSIS

The Board of Directors of Habitat for Humanity (HFH) of Bridgeport, Connecticut asked Fairfield University's MBA director to put together a team to study the possibility of securitizing some of its mortgages. The professor led MBA team research within the local organization and HFH organizations in other parts of the country. They discover that mortgages are routinely sold at varying discounts from face value. Using financial projections from HFH staff, the case requires the creation of a dynamic plan and forecast that shows how many additional houses could be built in the coming years under varying parameters such as sale price of the mortgages at different discount rates from face value, number of mortgages sold, and delinquency risk. Other issues raised in the case include precluding HFH mortgagees from selling their homes at a substantial profit and managing increases in property taxes.

INSTRUCTORS' NOTES

Discussion Questions

1. **Can HFHCFC use funds it could raise through sale of mortgages? Note issues that need to be considered to significantly ramp up their construction program.**

Land is becoming more expensive and scarcer. HFHCFC could consider building multi-family dwellings and they do have experience here (limited). Some issues with multi-family units: common areas need to be maintained and residents will have to work together on this which may cause friction. Selling multifamily units may be more difficult though with a waiting list of over 300 families that is not likely to be a concern. Legal paperwork may be more complicated.

2. Are there risks inherent in selling mortgages and, if so, how might HFHCFC protect itself against those risks?

Note that HFHCFC will be guaranteeing mortgages. In the event of an economic downturn, there may be considerably more delinquencies and perhaps even defaults they will need to make up for in payments to purchasers of mortgages. The way to cushion this is to hold aside sufficient numbers of mortgages so as to guarantee enough income to cover shortfalls. Outright mortgage sales could be adjusted any year or construction reduced resulting in considerable excess cash from sales made to cover emergencies.

3. What is the actual percentage rate on the AAR loans?

Because HFHI withholds 15% of the loan as security against bad debts, borrowers receive just 85%. Thus the actual rate on the loan is calculated as:

$$.0385/.85 = 4.529\%$$

This is comparable to a compensating balance. While this is below mortgage rates at the time, it is not a "cheap" loan per se.

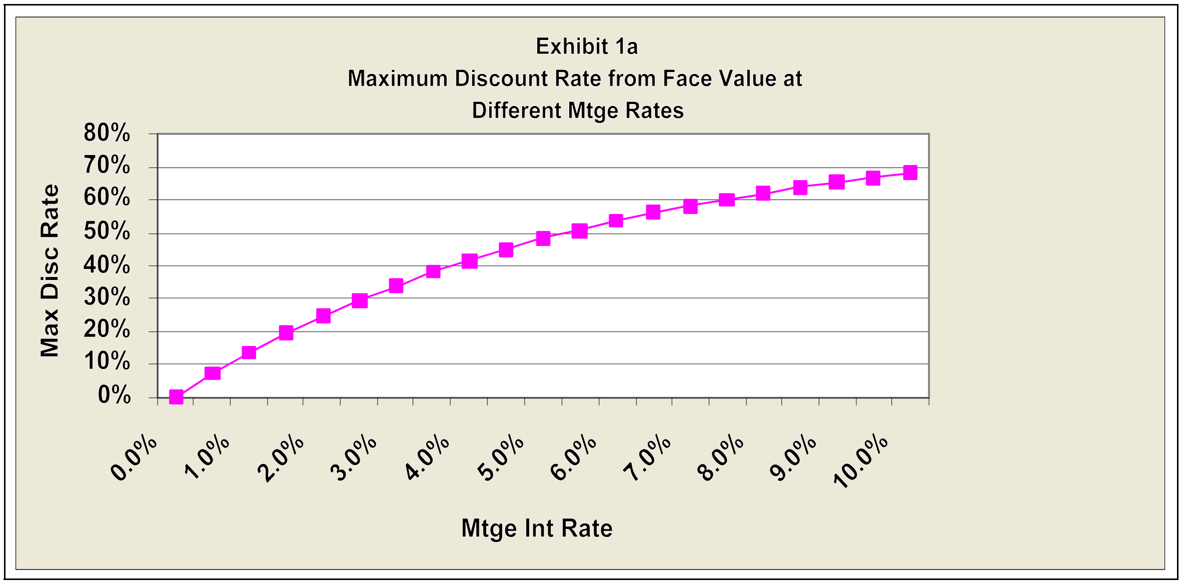
4. What is the implied rate of FCBC's purchase of mortgages at a 6.5% discount from face value if the mortgage is a 30 year mortgage for $90,000? Discount from face value is equivalent to dividing the mortgage amount by (1 + discount rate).

$90,000 mortgage has 360 equally mthly payments (no interest) over 30 years each of which will be $250.
Purchase price of the mortgage at 6.5% discount from face value: (1-.065)*90,000 = 84,150.
Rate of return (int rate) for FCBC: $\Sigma^{360}_{t=1}(250/(1+\text{rate})^t = 84150$
Solving by calculator or in Excel: 0.45% is the rate; considerably below market and a worthwhile sale for HFHCFC.

5. Calculate monthly payments for a principal only 30 year mortgage of $100,000. At a discount rate of 6% applied to payments what is the present value of the mortgage? What is the maximum discount rate from face value that a seller of the mortgage would accept, i.e., the discount rate from face value that will ensure a 6% rate of return to the buyer of the mortgage? Show graphically the maximum discount rate from face value for mortgages with interest rates ranging from 0% to 10% in 0.5% increments. Hint: use a data table to set this up.

Payment: 100,000/360 = 277.78
$\Sigma^{360}_{t=1}(275/(1.005)^{t} = 46331$
max discount from face value: 1 – (46331/100000) = 53.67%

Table 1a: Maximum Discount Rate from Face Value Acceptable at Various Interest Rates	
0.0%	0%
0.5%	7%
1.0%	14%
1.5%	20%
2.0%	25%
2.5%	30%
3.0%	34%
3.5%	38%
4.0%	42%
4.5%	45%
5.0%	48%
5.5%	51%
6.0%	54%
6.5%	56%
7.0%	58%
7.5%	60%
8.0%	62%
8.5%	64%
9.0%	65%
9.5%	67%
10.0%	68%



6. **Using supplied projected financial data (Table 1) determine how many additional houses could be built annually with the following assumptions:**

- HFHCFC sells 9 mortgages per year (2006-2010) at 0% discount from face value.
- with 1% of new mortgages delinquent or in nonpayment (1% of expected annualized monthly payment is not made)
- the $140,000 in mortgage revenues shown for 2006 is correct. Add to these revenues in subsequent years any new mortgage payments from housing sales. Note: be careful not to include mortgage revenue from sold mortgages.
- in calculating potential new construction from the sale of mortgages, round down the number of additional houses. The cost of the additional houses will be the average cost per house minus administration costs.

Table 2a: Projected New Housing With Sale of 9 Mortgages Annually at 0% Discount

	2005	2006	2007	2008	2009	2010	Total
Finances	**Actual**	**Plan**	**Plan**	**Plan**	**Plan**	**Plan**	**Plan**
Avg cost per house minus admin	87,518	91,000	95,500	97,500	100,000	104,000	
Programs & services	194,135	243,918	628,489	659,913	692,909	727,554	3,146,918
Construction costs	1,533,781	1,485,000	1,620,000	2,024,000	2,090,000	2,328,000	11,080,781
Development costs	95,288	205,000	220,000	228,000	230,597	239,821	1,218,706
General administration	274,722	254,000	275,000	285,000	295,000	305,000	1,688,722

Table 2a: Projected New Housing With Sale of 9 Mortgages Annually at 0% Discount							
	2005	2006	2007	2008	2009	2010	Total
Total Annual Funding Needs	**2,097,926**	**2,187,918**	**2,743,489**	**3,196,913**	**3,308,506**	**3,600,375**	**17,135,127**
Cash contributions	1,672,968	2,000,000	2,300,000	2,660,000	2,800,000	3,100,000	14,532,968
Gifts in kind	72,504	150,000	150,000	150,000	150,000	150,000	822,504
Mortgage revenues from existing mtges	151,281	140,000	157,749	182,906	222,374	263,129	966,159
New Mtges Sold		806,760	857,647	828,000	855,000	873,000	4,220,407
Mtge Rev from new mtges (not sold)		17,928	25,412	39,867	41,167	48,500	172,873
Less Delinq New Mtges		179	254	399	412	485	
Cash from mtges & mtge sales		964,509	1,040,553	1,050,374	1,118,129	1,184,144	5,357,710
Other cash revenues	159,821	220,000	100,000	165,000	110,000	80,000	834,821
ReStore NET	18,606	35,000	45,000	55,000	65,000	75,000	293,606
Total Cash Revenue		3,369,509	3,635,553	4,080,374	4,243,129	4,589,144	19,917,710
NET CASH		1,181,591	892,064	883,461	934,623	988,769	4,880,509
Potential Add'l Houses		13	9	9	9	10	50
Cost of Add'l Houses		1,183,000	859,500	877,500	900,000	1,040,000	
Mtge Pmts from Add'l Houses		38,844	28,588	27,600	28,500	32,333	
Delinq, etc		388	286	276	285	323	
Net Add'l Mtge Pmts		38,456	28,302	27,324	28,215	32,010	
Cum Add'l Mtge Pmts		38,456	66,758	94,082	122,297	154,307	
Revised CF		37,046	99,322	100,043	156,920	103,076	

The final analysis requires that students are familiar with the "spinner" function in Excel and the manipulation of text format in graph titles. Alternatively, instructors can request these two graphs at particular settings such as 9 mortgages sold at a discount from face value of 20% (shown below). A two-way data table (Table 3a) can also be set up to show the impact on additional housing construction under different combinations of the number of mortgages sold annually and discount from face value at which they are sold.

7. **Assume prevailing mortgages rates are 6.5%. Create two dynamic graphs which can show changes as you change the inputs (mortgages sold and discount from face value):**

- the first graph shows (spreadsheet has spinner embedded) the number of additional houses that can be built at different numbers of annual mortgage sales from 0 to 9 mortgages being sold and sales at different discounts from face value of mortgages on annual basis. Include total additional houses for the overall 5 year period in the graph.

- The second graph shows annual cash flow per year and total cash flow for the period at different numbers of annual mortgage sales from 0 to all mortgages being sold.

Exhibit 2a

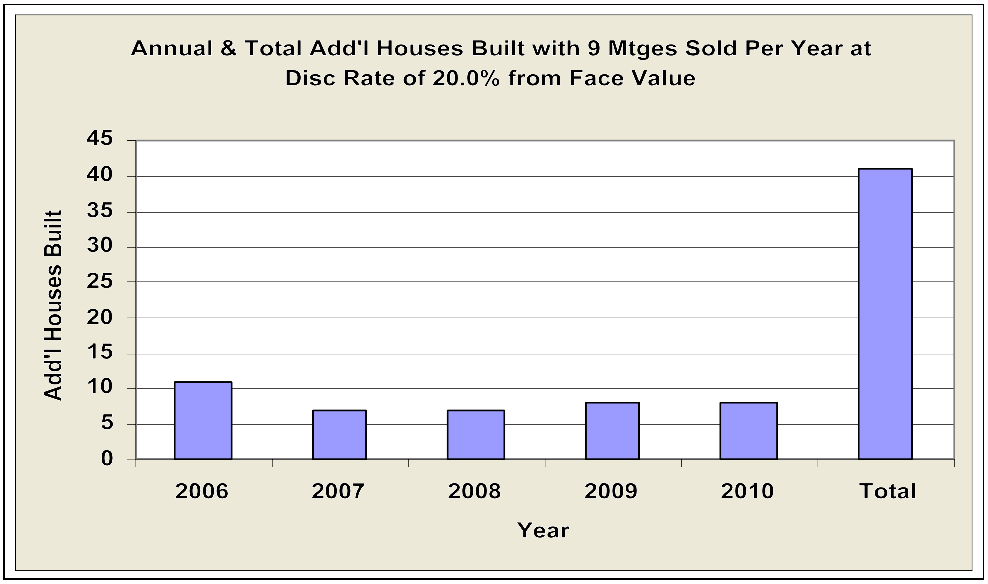


Exhibit 3a

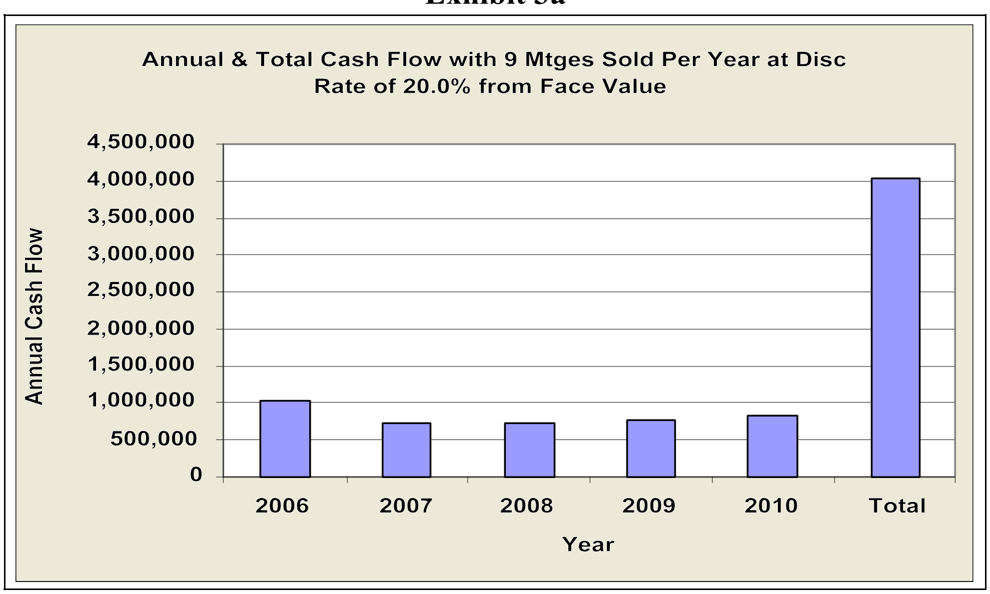


Table 3a: Number of Total Additional Houses as a Function of Mortgages Sold and Discount from Face Value of Those Sales										
	Number of mortgages sold per year									
	41	1	2	3	4	5	6	7	8	9
Discount from face value	0	13	18	23	27	32	36	41	45	50
	0.05	13	18	23	26	31	34	39	43	47
	0.1	13	18	21	25	29	33	37	41	45
	0.15	13	17	20	24	28	32	36	40	43
	0.2	13	16	20	23	27	31	34	37	41
	0.25	13	15	18	22	26	29	32	35	38
	0.3	13	15	18	21	24	27	30	33	36
	0.35	13	15	18	20	23	26	29	31	35
	0.4	12	14	16	19	22	24	27	30	32
	0.45	11	13	16	18	21	22	25	27	30
	0.5	10	13	15	17	19	21	23	25	27
	0.55	10	13	14	16	18	19	21	23	25

8. **What are some other issues in regard to ramping up construction? As the case points out, Bridgeport is becoming increasingly popular among developers which is driving up the price of land. Can sufficient land be purchased for even the projected construction program?**

Perhaps multi-family housing could be considered if sufficient land is not available. This could increase administrative costs because there may need to be more time spend on owner relations where property is shared.

Will the city of Bridgeport be willing to continue to extend low assessment valuation to habitat homes?

Given the current demographics of the city, this would be assumed. If demographics change and gentrification accelerates, those paying full assessment taxes could put pressure on the city to change some of its charitable assessment practices.

HFHCFC should be cautious in selling mortgages and utilizing the proceeds. The model as constructed here uses all proceeds possible to build more homes. If more caution is desired – and cash flow appears robust in the projections – the same number of mortgages could be sold but the proceeds from one of those sales set aside in a "rainy day" fund each year in case of economic slowdown that could be accompanied by increased mortgage delinquencies and even foreclosure.

The model uses the same fixed costs even though more houses are built. This may not be realistic but can be adjusted fairly easily and should not have a major impact on cash flow.

9. Who is going to buy the mortgages?

CHFA may buy one or two but even that is uncertain because of state budget constraints. A marketing program will need to be initiated by Development. One issue that could arise is that the same organizations approached for donations (particularly financial institutions) would be approached again to buy the mortgages. This could create donor fatigue. What is needed is a program under which financial institutions will agree in advance to purchase a specified number of mortgages each year for the 5 year period. The fact that it has been done elsewhere makes it feasible in one of the richest counties in the U.S. to repeat that success.

MOUNT CEDAR TECHNOLOGIES, INC.: A CASE STUDY IN DESIGNING A HIGH PERFORMANCE ORGANIZATION

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CASE DESCRIPTION

In today's global economy, organizations are faced with many challenges including motivating and rewarding employees; communicating and making effective decisions; evaluating group and team behavior; assessing their organizational structure and determining its effectiveness, assessing its leadership and determining its effectiveness; and evaluating alternative methods to managing change in the newly designed organization. Successful managers must learn the importance of creating functional and effective structures, processes, and understanding and managing the human side of the organization as this will enable people to effectively work together to achieve agreed upon goals. Therefore this term-long group case study, designed to cover multiple aspects of Organizational Behavior and Theory and Organization Design, will give you an opportunity to design an effective organization.

The author developed the case for class discussion rather than to illustrate either effective or ineffective handling of the situation. The names including the organization have been disguised. The case, instructor's manual, and synopsis were anonymously peer reviewed and accepted by the Western Casewriters' Association for its annual meeting, March 27, 2008, Oakland, CA.

CASE SYNOPSIS

Mount Cedar Technologies, Inc. was founded in Los Angeles, California in 1995. It began as an importer and distributor of computer accessories, but by 2000 had evolved into an IT infrastructure integrator specializing in hardware and software products, storage and security solutions, and technical services to Enterprise, Small and Medium Businesses, and to Government, Educational, and Medical institutions. Its employees grew rapidly from 6 in 1995 to more than 170 employees in 2006.

The company lacked an organizational structure to improve its operations' effectiveness. Additionally, there were complaints from employees who did not feel equitably treated, resulting in the loss of talented employees. Department managers acknowledged that they were very busy reacting to problems and customer issues, allowing them little time to coordinate and listen to their employees.

Decision making was highly decentralized. This resulted in the loss of possible gains to be obtained from cooperation among other managers. The silo effect that resulted from this structure meant that departments were making decisions based on what was best for them.

While John Curtis (CEO) had been instrumental in growing the organization, his present leadership style had become increasingly problematic to many including upper management. He liked to surprise people by showing up un-invited to meetings and all employees and managers were expected to provide off the cuff answers to questions he would throw at them during these visits.

Managers were asked to focus mostly on financial measures. The culture was described by many people as a task oriented one that did not encourage risk taking or empowerment. Additionally, the organization was lagging in the areas of training and the advancement of women and minorities. Finally, upper management wanted to grow its business by adding new product offerings.

INSTRUCTORS' NOTES

Intended Course and Levels

This term-long group case study explores the subjects (i.e. Organizational Behavior and Theory and Organization Design) and could serve as an outcome assessment for such courses. It is intended for class study application and review. It gives students' enough time (a complete academic term) to apply concepts learned in class.

This integrated and comprehensive case is intended for advanced undergraduate or graduate courses in Organizational Behavior and Theory and Organization Design.

This comprehensive term-long case is designed to compliment knowledge derived from theories and concepts in organization design and organization theory and behavior with their application by means of designing an effective organization for Cedar Tech. In other words, it seeks to provide an applied, hands-on format for students to increase their understanding of the subjects of organization design, theory and behavior. Answers to the questions in the case will derive from what students learn from theories and concepts. The case is expected to be completed by the end of the term.

This comprehensive group case study covers the following topics: Organizational culture and ethical values; the nature of work motivation; management of diversity; the nature of work groups and teams; leaders and leadership, power and empowerment; communications in organizations; decision making and organizational learning; organizational design and structure, and organizational change and development.

Specific Learning Objectives

In today's global economy, organizations are faced with many challenges including motivating and rewarding employees; communicating and making effective decisions; evaluating group and team behavior; assessing their organizational structure and determining its effectiveness, assessing its leadership and determining its effectiveness; and evaluating alternative methods to managing change in the newly designed organization. Successful managers must learn the importance of creating functional and effective structures, processes, and understanding and managing the human side of the organization as this will enable people to effectively work together to achieve agreed upon goals. Therefore, this integrated term-long case is designed to give you an opportunity to design an effective organization.

After reading and responding to the case questions, students should be able to:

- ♦ Assess an organization's mission statement and tie said mission to the organization's goals.
- ♦ Evaluate an organization's culture and suggest a culture that promotes creativity.
- ♦ Identify the factors responsible for creating and transmitting organizational culture and for getting it to change.
- ♦ Identify and suggest effective techniques for motivating employees.
- ♦ Suggest and describe some of the steps needed to manage diversity in the workforce and their effectiveness.
- ♦ Explain the basic characteristics of organizational structure (i.e. hierarchy of authority, division of labor, span of control, line versus staff, and decentralization).
- ♦ Evaluate the different approaches to departmentalization-functional organizations, product organizations, matrix organizations, and boundary-less organizations; and suggest a structure to improve organizational effectiveness (pertaining to this case).
- ♦ Suggest and explain various methods to improve an organization's communication effectiveness.
- ♦ Suggest and describe various techniques (including high-tech techniques) that can be used to enhance the quality of individual and group decisions.
- ♦ Distinguish between the forms of leader behavior (i.e. person-oriented behavior and production-oriented behavior), and explain how grid training develops leaders.
- ♦ Describe various techniques used to develop leaders.
- ♦ Suggest and describe various techniques used to empower employees and managers.
- ♦ Define what groups are and identify the different types of groups operating within an organization.
- ♦ Define what teams are and identify the different types of teams that exist in an organization, and the necessary steps to build effective teams.

- Understand the nature of change process.
- Evaluate alternative methods to managing change in your newly designed organization.

DISCUSSION QUESTIONS AND ANSWERS

While there is no one single approach/answer to designing an organization's effectiveness, an application of what students learned in the class is required. In five-member groups, students will be asked to consult the management of Mount Cedar Technologies, Inc. to help design a more effective organization. A power point presentation and a written report of 20-30 pages should address the following questions:

1. **Suggest a company's mission statement. List the organization's official goals (where the organization wants to go), and make sure to tie said mission statement to the organization's official goals and suggest a strategy or strategies to accomplish it (how it will get there).**

   While students' answers vary, students should focus their discussions and evaluations on the fact that the organization's culture reflects its leaders' basic organizational philosophy. Accordingly, its mission expresses its philosophy, as well as its basic values, beliefs, and its underlying cultural assumptions (Gordon, 2005). Griffin (2008) defined strategy as "a comprehensive plan for accomplishing an organization's goals" (p.238). Therefore, whatever strategy students present must correlate with the organizations' goals.

2. **Evaluate the current organization's culture and suggest a culture that promotes creativity.**

   Students' answers will vary. It seems that Cedar Tech has an inert culture which will lead to values and norms that fail to inspire or motivate employees. Such cultures lead organizations to failure and stagnation. According to Hofestede and Hofestede (2005), "culture is the unwritten book with rules of the social game that is passed on to new comers by its members, nesting itself in their minds" (p. 36). Based on this concept, the organization should seek an adaptive culture whose values and norms help an organization grow and build momentum, and facilitate change as needed to be effective and achieve its goals (George & Jones, 2008). In an adaptive culture, employees often receive rewards linked directly to their performance and to the performance of the organization as a whole.

   Therefore, in changing its culture, Cedar Tech must take into consideration all four factors that shape culture: The characteristics of its members, human resource policies, its ethical values, and its organizational structure (George & Jones, 2008). It is important to know that changing culture is not simple because of the interaction of these factors and their effect on each other.

Additionally, students are expected to discuss and connect ethics-moral values, beliefs, and rules that govern the relationships of the organization to the employee, the employee to the organization, and the organization to the other economic agents (people and entities outside the organization), all of which form an important part of an organization's cultural values (Griffin, 2008); George & Jones, 2008). Students could also argue how effective they think their proposed culture will be.

3. Suggest effective techniques for motivating Cedar Tech's employees.

Students' answers will vary. Regardless, students' responses should focus on how to create a motivating work environment through job design, socialization, organizational objectives, and goal setting. Obviously, people work for many different reasons. The most obvious reason is the need for money. However, for many, money alone is not what keeps them showing up for work every day (Greenberg & Baron, 20003). Therefore, understanding why some people enjoy their work and others do not becomes a complex issue.

While there is no one single solution to satisfy all in the workplace, it is imperative for students to understand and discuss the concept of job satisfaction and dissatisfaction and its related factors. In addition, it will be beneficial for students to discuss the importance of some of the theories learned and their impact on employees' motivation such as the equity theory, ways to restore it, and the effects of inequity; organizational justice, its forms, and its consequences; and expectancy theory that explains how employees make choices among alternative behaviors and levels of efforts (Griffin, 2008; George & Jones, 2008; Kreitner & Kinicki, 2007).

In addition to this, managers should promote a healthy workforce by satisfying employees' physiological needs through providing them with membership in a fitness center or subsidizing such membership. In addition to that, management should provide a supportive working environment and safe working conditions. It is important to also provide an opportunity to socialize. More importantly, management should compensate employees in relation to work performed, thereby avoiding underpayment. Organizations that practice underpayment are always looking to fill out vacancies resulting from voluntary turnover. Managers also need to identify goals and clarify the amount of work needed by employees to achieve and tie it to an effective reward system. Additionally, it is also recommended that managers should involve employees in the formulation strategy of their work goals especially if these goals directly affect them. Employees tend to accept and easily commit to goals if they helped formulate them or took part in their formulation (Ghazzawi, 2007). To be effective, mangers also need to provide timely performance feedback.

Finally, management should recognize employee achievements. Such recognition and award will satisfy employees' esteem needs. In doing so, managers should clearly link rewards to performance (Greenberg & Baron, 2008).

4. Suggest and describe some of the steps needed to build effective training and diversity programs at Cedar Tech's.

Students' answers will vary. It is important that students understand that training in organizations must share the dynamic nature of today's organizations. Cedar Tech must become a learning organization where individuals have an important self-directed responsibility to learn and share what they know (O'Connor et al. 2002). Students also must believe that because of our competitive economy, increasing the productivity of Cedar Tec's employees becomes a priority.

Managers must understand and value individual differences and develop better diagnostic skills through a diversity and sensitivity training (Ghazzawi, 2008; Gordon, 2002). Additionally, managers should have continuous professional development and training workshop to help them provide better understanding and support to their subordinates.

Therefore, they need to design a training and development program for both employees and managers so that they can learn and enhance their creativity (students' programs ideas will vary). More importantly, they should focus on the fact that learning is an ongoing process in people and organizations. They should also focus on the many ways in which learning takes place, including how to promote reinforcement learning, how employees learn from watching others, how they learn on their own (the importance of self-efficacy), and how they learn by doing things. Additionally, students must have an appreciation for multiple learning techniques that are essential for an effective organization.

According to George and Jones (2008), "learning theorist Peter Senge has identified five key activities central to a learning organization: 1. Encourage personal mastery or high self-efficacy; 2. Develop complex schemas to understand work activities; 3. Encourage learning in groups and teams; 4. Communicate a shared vision for the organization as a whole; and 5. Encourage system thinking" (pp.169-170). In addition, since the goal of management is to promote diversity, two major approaches have been taken by many organizations to combat discrimination. These approaches are affirmative action plans and diversity management programs (Greenberg & Baron, 2008).

Effectively managing a diverse workforce starts with securing the commitment of top management to diversity, diversity training, education, and mentoring. Thus, students should recommend a plan to promote and comply with affirmative action, and create a diversity management program that encompasses awareness-based training and skills-based diversity training. Students should argue how effective they believe these plans will be.

5. Design a new organization structure that takes into consideration the contextual variables in the case and the information flows in Table 3 and Figure 2.

While there is no one best way to organize, the right structure depends on prevailing circumstances and considers organization goals, strategies, technology, and environment. According to Robey and Sales (1994), "in practice, very few examples of purely functional and self-contained departmental structures can be found. Rather, we find a wide variety of mixed structures, which contain elements of both bases at the same level of management (p.195). In designing the new structure to improve Cedar Tech's effectiveness, students should take into consideration its management's vision and the pursuit of the growth strategy including adding new offerings. You may give students a hint of the general approaches that could be taken. One approach would be to add a new vice president for technology. In this regard, a director of newly formed VOIP practice, the director of enterprise storage practice (formerly manager), and the director of services (formerly help desk manager) report to him/her instead of reporting to the vice president of operations.

Additionally, VOIP and security engineers and project managers will report directly to the new director of VOIP; whereby storage engineers and storage project managers report directly to the director of enterprise storage. Finally, all technicians will report directly to the director of services (since the organization has many technicians, suggest that 3-4 supervisors are needed).

According to Burton et al. (2006), the choice of an organization's configuration, known as structure or architecture, is a critical decision. According to them, "In the literature on organization design two fundamental dimensions have been used to distinguish the basic configurations: Product/service/customer orientation and functional specialization" (Burton et al. 2006, p. 58). These two dimensions generate four basic configuration-namely: Simple, functional, divisional, and matrix (Burton, 2006; Miles & Snow, 1978).

Hint to students that organizational charts in most growing organizations are not static, they are ever changing. At the heart of any organizational design are the twin issues of differentiation and integration. While vertical differentiation is the method by which an organization designs its hierarchy of authority and decides its reporting relationships to link roles and subunits, horizontal differentiation is how an organization groups tasks into roles and groups roles into subunits, meaning functions and divisions (Daft, 2004; Jones, 2007). Students should show the variety of specialized roles, functions, and units and tie the various elements together by means of vertical and horizontal techniques for integration. It is important that students address the advantages and disadvantages of their design; and argue that the number of levels in its hierarchy and the span of control at each level are appropriate.

It makes sense to promote or add new director to head each major sales specialization; example: Director of government, education, and medical sales, director of small and medium sales, and director of enterprise sales. Promoting human resources manager and other key mangers to director's position might make sense too. Another general approach would be to create a separate software licensing department under a director that marker and fulfill software licensing sales requirements. Said director might report to the vice president of sale. Ask students to draw their specific alternatives on the board. A hybrid form of structure would be one specific possibility, with software licensing advisors reporting to both director of software licensing and to the various key sales specialization (Enterprise, GEM, and SMB sales) using the "matrix" form, and other functional departments such as sales, operations, finance, and technology reporting to each of the functional vice presidents via director (s). The functional heads who would still report directly to the president would probably be finance, technology, sales, and operations.

The new structure must take into account the high coordination across functions relative to any given customer's requirements, necessary for the projects to complete. Additionally, the new structure must emphasize client satisfaction with vertical and horizontal information easily flows by grouping together the individuals who communicate with one another.

6. Suggest and explain various methods to improve Cedar Tech's communication effectiveness.

Students' answers will vary. As a practical matter, students may suggest the computer-mediated communication-video-mediated communication (VMC), e-mail and instant messaging in addition to the traditional communication techniques (meetings and phone communication). Additionally, students should discuss the formal organizational communication and how organizational structure influences communication-downward communication (from supervisor to subordinate); upward communication (from subordinate to superior); lateral communication (coordinating messages at the same organizational level); and communicating inside versus outside the organization (strategic communication). Important to note to students that the emphasis on the open and hones formal communication will undermine and minimize the need of informal communication networks (including: Organization's hidden pathways, grapevine, rumors etc...).

Managers at Cedar Tech's need to be also trained on cross-cultural communication to understand the barriers caused by cross-cultural communication that include: language difficulties, word connotations, tone differences, and barriers caused by differences among perceptions (Greenberg & Baron, 2008). Students should suggest techniques for improving communication skills at all levels and training its employees and managers to: To use jargon sparingly; to become active listeners, to gauge the flow of information (avoiding overload); to give and receive feedback (open channels of communication), to be supportive communicators (thus enhancing relationships), and to use inspirational communication tactics.

7. Suggest and describe various techniques (including high-tech techniques) that can be used to enhance the quality of individual and group decisions.

Students' answers will vary. As a practical matter, many organizational situations are different. That means there is uncertainty about what the organization is trying to achieve or about how to solve its problems and attain its goals. Hint to students that while many believe that quantitative analysis, common sense, and economic logic underlie most decisions, this is true only for decisions for which individuals and organizations have experience (Daft, 2004, George & Jones, 2008).

In many instances where non-programmed decisions occurred, such as the case of most top management decisions; intuition, judgment, and hunch may determine the decision outcome (Daft, 2004, George & Jones, 2008). Based on managers' experience, they often have a feel for relevant problems and its possible solutions. In addition to that, students could apply the concepts of the Carnegie model of decision making that emphasizes the need for political coalitions in the decision making process. This technique provides a mechanism to negotiate and reach agreement among various managers and departments whose ideas and cooperation are needed for implementation (Daft, 2004, George & Jones, 2008). Students could be touching on the three phases in Mintzberg's incremental decision process model. This model is very applicable to organizations where in the phase of problem recognition, managers become aware of the problem and engage in diagnosis to identify the problem before they develop a solution from previous organizational experience or to design a custom made solution-the second phase is called development, in which managers may use search procedures to find a solution. Finally, the organization enters the selection phase where the solution is chosen (Daft, 2004; Greenberg & Baron, 2008; George & Jones, 2008).

Important to note that organization may select decision(s) via the process of judgment, analysis, or bargaining, that is then followed by formal approval by upper management (Greenberg & Baron, 2008). Students could also suggest when to use group's decisions and when to use individuals ones. In addition to that, encourage students to research and suggest the widely available and inexpensive computer-based effective decision-making techniques- including electronic meeting systems, computer-assisted communication, and group decision support systems (GDSS).

Any failures are called "interrupts." In these cases, the organization will go back to an earlier stage to reevaluate whether such problem exists, whether a different solution needs to be developed, or whether an alternative solution should have been elected (Robbins, 2005). An organization theorist once said that organizations usually make small decisions that eventually add up to a big decision (Robbins, 2005).

8. You need to analyze the leadership styles of Cedar Tech's top management team and its climate. Explain which styles seemed most and least effective. You have also been asked to craft a leadership development plan and provide management with your recommendations on how they should lead people and the organization into the future. How effective do you believe this plan would be? Why?

Students' evaluation and opinion of current leadership will vary. What a leader does is a major determinant of an organizational climate (Stringer, 2002). The leader drives climate, which arouses motivation that influences performance (Stringer, 2002). Leadership and organizational climate are issues that must be taken into consideration the most when designing an organization (Burton et al., 2006). Additionally, "leaders are responsible for fostering learning and are themselves learners" (Senge, 1990. p.3). It is important to remember that successful organizational leaders are able to influence three key determinants of their organization performance-namely efficiency, adaptation, and human resources (Yukl & Lepsinger, 2008).

Hint to students to address the key dimensions that underlie the concept of trust in organizational relationship (deterrence-based, knowledge-based, and identification-based) and that the most fragile relationships in organizations are contained in deterrence-based trust. This form of trust is based on fear of reprisal if the trust is violated (Robbins, 2005). An inconsistency or a violation might destroy the relationship.

Hint to students the fact that a small minority of individuals still believe that charisma cannot be learned, most experts believe that individuals can be trained to exhibit charismatic behaviors.

Suggest that set of authors propose the following three steps to develop individuals to become charismatic: First, an individual needs to develop the aura of charisma by maintaining an optimistic view, by using passion as a catalyst for generating enthusiasm, and through communicating with the whole body; secondly, an individual needs to draw others in by creating an inspirational that leads others to follow; and thirdly, the individual should tap into followers emotions to bring out their potential (Robbins, 2005). Students could also address the importance of EI (emotional intelligence), explain its five key components (selfawareness, self-management, self-motivation, empathy, and social skills), and the need of the leaders to have the basic intelligence and job-relevant knowledge.

Additionally, students should explain the role of a mentor and why a leader would want to be one. Finally, students should suggest a developmental plan for leaders to create self-leaders through: Model self-leadership; encourage employees to create self-set goals; encourage the use of self-rewards to strengthen and increase desirable behaviors; create positive thought patterns; create a climate of self-leadership; and encourage self-criticism (Robbins, 2005).

9. Design a company-wide empowerment master plan.

Students' response will vary. Hint to students that it means "giving employees authority to make decisions and be responsible for their outcomes" (George & Jones, 2008, p. 520). A good response should address two objectives: a focus on how to make managers powerful in their position, addressing how to empower employees in all departments, and decide on how effective they believe this plan would be.

10. Identify the different types of groups and teams that needed at Cedar Tech's to ensure its effectiveness, and propose the necessary steps to build effective teams.

Students' response will vary. A good response will show and explain how to redesign work-groups and teams (based on the new proposed organizational structure) to make the organization more effective. Hint to students to tie such response with the system of rewards to support team performance. Students' response should also explain what roles team members play; show how to develop successful team (meaning-performance compensation, team's mission, training members in team skills, promoting cooperation within and between teams, and selecting team members based on their skills or potential skills); and explain how effective their proposed plan would be.

11. Explain the difficulties that are associated with initiating the changes that you are recommending. You need to identify and recommend possible change agents and specify which type of change agent makes most sense for your plan. Important note to remember that: All of the above components of the organization are interdependent. What happens in one, affects others.

Students' answer will vary. One approach would be to identify the specific forces for change at Cedar Tech's; another approach is to follow the five steps of the action research process (i.e. diagnosis, analysis, feedback, action, and evaluation). Regardless, a good response requires a plan to implement planned change including: Clarifying organizational goals, inducing change by sharing information (survey feedback), appreciative inquiry (identify the unique qualities and special strengths of an organization), action labs (rolling out only small changes in a deliberate sequence), and very importantly-humanizing the workplace (enhancing quality of work life programs) (George & Jones, 2008; Robbins, 2005). In addition to that, students should be aware of the major sources of organizational resistance to change and how to overcome such resistance.

GENERAL NOTES

Figures and tables are essential to understanding the case discussions and analysis and should be embedded in the report and numbered separately.

Teaching Plan

Before using this case study, be sure to provide a clear introduction of the case to students.

Introduction of the case in the Syllabus and in Class

It is recommended that you add the case to your syllabus and introduce the script on the 1st day of your class (duration from 1.30 minutes-2.00 hours). If the case is not integrated in the syllabus, in-class copy of the script with its instructions will suffice. This group case study could be used by the instructor entirely or in parts.

Reasons for this Comprehensive Group Case Study

Students need to understand on the first day of class why you are requiring them to do this case in a team environment. It is because they need to understand the key concepts of organizational theory and behavior and/or Organizational design. In addition to that, you want to encourage them to be successful. Successful managers must learn the importance of creating functional and effective structures, processes, and understanding and managing the human side of the organization as this will enable people to effectively work together to achieve agreed upon goals. Therefore, this case is designed to give you an opportunity to design an effective organization.

This case seeks to provide an applied, hands-on format for students to increase their understanding of the subjects of organization design, theory and behavior. Answers to the questions in the case will derive from what students learn from theories and concepts. The case is expected to be completed by the end of the term.

Forming Teams

During the first and second class meetings, students will be encouraged to network and get to know fellow students in order for them to decide who they want to team with. Allow 10-15 minutes towards the end of the second class meeting to submit team members' names. Students need to form a team of up to five (5) students to conduct this required project. Group projects will be coordinated with the instructor for presentations towards the end of the term.

Team Report and Presentation

Each team is required to write at least 20 page report (12 point font, double-spaced and followed the APA's writing style- only one report is needed for each group) and do a 30 minute's PowerPoint presentation of their recommendations. Students are required to use the chapters assigned for the course. To support their responses and enhance their report, students must include outside references such as books, journals, newspaper, Internet information, or a direct interview as resources for the case answers (in case of an interview, they need to include their interview questions as an appendix of their report).

Process

Each team will start working on this case and progress as the course progresses on weekly basis. Students should be able to build on their acquired knowledge. On weekly basis, the instructor should address and clarify case question(s) that pertaining to the specific discussed subject for the week as planned in the syllabus.

Use of PowerPoint and Audiovisuals

It is recommended that students be encouraged to create an effective team presentation through the use of whatever audio-visual materials, including but not limited to PowerPoint. The case itself does not come with a video.

Content and Grading

Students' answers and presentations should clearly and concisely demonstrate their knowledge and comprehension of the course concepts, as well as the team's ability to apply knowledge learned in class and through research, synthesize, analyze, and evaluate their work. Students will be graded based on the following criteria: 1. Use of innovative and creative ideas; 2. Application of concepts learned to the; and 3. Use of outside research to support the case.

At the end of the term, teams are required to report their results and present it to the class. Presentation time will be coordinated with the instructor 5-6 weeks in advance. Other teams will evaluate the results of the presenting team. While class evaluation is recognized for grading purposes, it may or may not be reflected in the grade assigned by the instructor. It is recommended that this comprehensive team project constitutes 35-40% of the student's final grade.

Analysis

Since this case is an application of topics covered in the subjects of Organization Theory and Behavior and Organization Design, student understanding of the following topics will be essential: Organizational culture and ethical values; the nature of work motivation; management of diversity; the nature of work groups and teams; leaders and leadership, power and empowerment; communications in organizations; decision making and organizational learning; organizational design and structure, and organizational change and development.

Research Methodology

This research is based on the author's professional experience as a vice president of 2 IT-related organizations. It is also based on the author's experience as a management consultant to IT organizations. Therefore, the case study is built on the author's field experience. Over the last ten years, the author has served on the channel advisory board for several well-known technology organizations in the US. However, the names and the very nature of the business have been disguised.

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RECOMMENDED OUTLINE

The structure of the written report is critical. In the first part of the case write-up, students need outline briefly what the organization does, how it developed historically, what problems it is experiencing, and how they are going to approach the issues in the case write-up. It is important for students to start by providing a synopsis of the case, discussing the environment of the organization, its goals, challenges, and provide recommendations for taking the organization to the next level.

In the second part of the case write-up, the strategic analysis section, students are suppose to analyze and discuss the nature and specific problems facing the organization as outlined in the questions: culture, motivation, training and diversity, structure, communication, decision making, leadership, empowerment, groups and teams, and managing change.

Students are supposed to break up information by means of headings and subheadings. Chapter format is preferred (e.g. Chapter 1: Organization Mission Statement, Goals, and Strategies; Chapter 2: “Building an Effective Organizational Culture; etc.).

In the third part of the case write-up, present your solutions and recommendations. Be comprehensive, and make sure that they are in line with the previous analysis so that the recommendations fit together and move logically from one to the next.

In the fourth part of the case write-up, list references alphabetically. In my class, I ask students to follow the APA manual (American Psychological Association).

FINAL NOTES

Figures and tables are essential to understanding the case discussions and analysis and should be embedded in the report and numbered separately.

Students are encouraged to comment on their own team dynamics in the writing of the paper and also show how they might present recommendations to this organization as consultants.

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CAPE SHOE COMPANY

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CASE OVERVIEW

The primary subject matter of this case concerns entrepreneurial start-up and strategic management and marketing issues. The objective is to provide students the opportunity to apply their research skills and knowledge regarding highly competitive industry and buyers to develop strategic management and marketing strategies. It is suitable for a senior-level course as well as students in an MBA program and can be taught in a 75 minute class session with two hours of preparation by students outside of class.

CASE SYNOPSIS

The Cape Shoe Company case focuses on an entrepreneurial start-up in the highly competitive shoe industry. Upon the closing of a Florsheim shoe factory in a region of the Midwest that was once home to a large number of shoe and apparel manufacturers, with the majority of these having closed over the previous 30 years due to lower cost of overseas production, and concerned about the continuing loss of shoe manufacturing in the U.S., an entrepreneur from Chicago with minimal experience in the shoe industry, visited a Florsheim factory prior to its closing by Florsheim. After deciding that the facility represented too valuable a resource to be abandoned, the entrepreneur subsequently purchased the shoe plant and named his new venture the Cape Shoe Company. Based on his concern about losing American manufacturing jobs, and the belief that he could produce a competitively priced product, his plan was to produce ***100 percent Made in America*** *shoes.*

The interesting focus of this particular case and ensuing discussions is that the entrepreneur has made the decision to go forward with Cape Shoe Company and his ***100 percent Made in America*** *theme, although having yet to determine target market(s), competition, product differentiation, marketing channels, marketing strategies, etc. Regarding the rather unique nature of the Cape Shoe Company start-up, and current industry scenario, students virtually have a clean slate in which to begin discussions concerning recommendations on strategic management and marketing questions.*

INSTRUCTORS' NOTES

The interesting focus of this particular case, Cape Shoe Company, and ensuing discussions, is that the owner/entrepreneur, Mr. Eli Fishman, has made the decision to go forward with Cape Shoe Company and his **100 percent Made in America** theme, although having yet to determine target market, competition, product differentiation, marketing channels, marketing strategies, etc. Regarding the rather unique nature of the Cape Shoe Company start-up, and current industry scenario, students virtually have a clean slate in which to begin discussions concerning recommendations on five strategic points:

1. Students will identify specific industry target markets and provide appropriate recommendations and reasoning for Cape Shoe Company.
2. Students will identify industry competition and provide appropriate recommendations and reasoning for Cape Shoe Company.
3 Students will identify various ways in which industry products are differentiated and provide appropriate product line and differentiation recommendations and reasoning for Cape Shoe Company.
4. Students will identify various marketing channels for the industry and provide appropriate recommendations and reasoning for Cape Shoe Company.
5. Students will identify specific marketing strategies and provide appropriate recommendations and reasoning for Cape Shoe Company.

DISCUSSION TOPICS

1. TARGET MARKETS. Defining a market segment for Cape Shoe Company products is predicated on the extent to which a distinguishable consumer group would be responsive to Cape Shoe Company's **100 percent Made in America** commitment. An immediate and obvious market is male industrial workers who, themselves, create American-made products and would be inclined to acquire U.S. made goods. The type of footwear identified with these individuals is work boots and shoes, particularly those with safety toes. Most factories and warehouse operations require their employees to wear steel toe footwear for protection. Possibilities would include a line of men's work boots and casual shoe lines – casual oxford, desert boot, loafer, and Wellington boot styles which can include steel toes for work or regular toes for casual wear. Women's boots and casual styles could follow.

   Another reason for targeting the group is related to the cost of the shoes and boots. Since Cape Shoe Company's product is competing with lower labor cost foreign-made shoes and boots, it is necessary to tap into a market segment willing to pay for possibly higher cost

U.S. made goods. Male industrial workers have traditionally been likely to spend more than women on individual shoe purchases.

Currently, work boots and shoes are also worn by style conscious young adults. Although styles are temporary, work boots, as fashion statements, have endured well over five years. The priority for the fashion conscious group is brand, and since Cape Shoe Company is not an established brand, it would be difficult to make a major break-through in the style market.

2. COMPETITION. There are different competitors within various industry categories. These categories consist of, (a) Branded vs. Unbranded; (b) Work vs. Style; (c) Higher Cost vs. Low Price; and (d) U.S. Made vs. Foreign Made.

	Branded	Unbranded	Higher Work	Low Style	U.S. Cost	Price	Made	Foreign
Red Wing	√			√		√		√
Timberland	√			√	√			√
Caterpillar	√			√	√			√
Wolverine	√		√		√		√	√
Carolina	√		√		√		√	
Justin	√		√		√		√	
Brahma	√	√	√		√		√	
Texas Steer		√	√	√		√		√
Cape Shoe Company		√	√		√		√	

Since Cape Shoe Company has not established a brand presence, it may be necessary to compete with the higher cost, American-made product on the basis of cost, features, and service.

3. PRODUCT DIFFERENTIATION. Once a target market strategy is established (work boot, higher cost, U.S. Made), it becomes necessary to formulate compelling reasons for individuals to change from their existing brands. Brand loyalties with respect to fit and durability are difficult to overcome. Styles in the work boot and shoe categories are not necessarily trendy or whimsical. Therefore, the dominant considerations could be comfort, service and, of course, cost. The comfort issue can be a primary focus.

Service is also critical to all ventures. As a start-up, service is easier to maximize since there are so few initial customers. However, over the long-term, Cape Shoe Company could position itself to offer exceptional service because all products will be made in the U.S. Unlike importers, who must depend on selling container loads of product shipped from the Far East, Cape Shoe Company could position itself to produce needed stock on short notice, without long overseas shipping delays.

A cost advantage over other U.S. made brands, in many cases, is a result of low overhead. As a new company, given the nature of their buyout “deal” with Florsheim, Cape Shoe Company should not be encumbered with a vast entrenched bureaucracy endemic to older and more established firms. Cape Shoe Company’s lower overhead translates to lower costs which can be passed on to consumers.

4. MARKETING CHANNELS. A series of different approaches (industry research/analysis) could be undertaken at this point to determine appropriate channels and pricing. Subsequent discussion could focus on traditional channels, use of shoe representatives, commissions to be paid, margins, costs, and so on. For example, the traditional shoe marketing channel flows from the factory, through a commissioned sales rep, to a retailer to the final consumer. The factory margin is about 60 percent; the commissioned rep receives approximately 7 percent, and the retailer margin is another 66 percent. A pair of shoes with a $40.00 direct labor and material cost would retail for approximately $114.00.

   In attempting to maintain the initial factory margin and bypassing the sales rep, the retail would be approximately $106.00 (7% less). This retail cost is approximately 15 percent less than branded shoes who use an extensive sales rep network and require higher factory margins.

   Cultivating a saleable good requires a focus on style, quality, and cost. The product should have appealing design attributes. It should also embody innovative features and construction standards. And, it should be competitively priced. Each of these elements is measured by its effect on a specifically targeted market.

5. MARKETING STRATEGY. There are literally tens of thousands of independent shoe retailers in the U.S. These include family shoe stores, athletic shoe stores, women’s shoe stores, comfort shoe stores, dress shoe stores, children’s shoe stores, outdoor (hiking and climbing) shoe stores, etc. There are many clothing stores that sell shoes. Also, in many small communities, there are farm supply stores, construction material outlets, army-navy, and hardware stores that sell shoes.

   The initial concern is locating retailers selling men’s work boots and casual shoes. Since most of Cape Shoe Company’s competitors are large companies, they maintain extensive websites. These websites include information on the location of independent retailers carrying their product. Retailers offering the product of Cape Shoe Company’s direct competitors would be potential Cape Shoe Company customers.

   After developing a list of potential retailers on a state-by-state basis, Cape Shoe Company could introduce the line to these customers. There are a couple of traditional means of accomplishing this introduction.

The first is setting up booths at national and regional trade shows attended by other shoe manufacturers and importers, and by shoe retailers. Booth fees and the costs of travel and manning the booth represent a substantial financial commitment.

The second conventional method for disseminating information about new shoe products is the hiring of shoe reps. Shoe reps travel a specific territory, going store to store with a bag of shoe samples. Shoe reps, called "Shoe Dogs" in the industry, are essentially traveling salespeople working on sales commissions averaging 4 percent to 7 percent of their gross sales volume. They generally represent several non-competing lines.

The reliability of Shoe Dogs can be suspect. They tend to focus on their existing lines where sales have been established. Having them promote a brand-new line will yield mixed results, at best.

Thus, as a new company with limited advertising and promotional means, it would be necessary to develop a more reliable and less expensive sales strategy. The answer could be a *Shoe-Dog-in-a-Box* program.

The elements differentiating Cape Shoe Company are its (1) sentiment; (2) features; (3) service, and (4) price. These qualities would be readily apparent to a shoe retailer, if appropriately displayed. The *Shoe-Dog-in-a-Box* is a vehicle in which Cape Shoe Company could reveal its product's distinctive character.

Using state-by-state store lists, each retailer could be called on the phone by a Cape Shoe Company in-house salesperson. These salespeople could introduce the brand by describing its purpose and its product line. Catalog and pricing information could then be forwarded to the retailer.

About a week after the retailer receives the catalog information, the salesperson could call to describe the *Shoe-Dog-in-a-Box* program. The *Shoe-Dog-in-a-Box* is a box that would be shipped to each retailer containing the following items:

1. Catalog and pricing information.
2. A pamphlet, "A Call to Action," describing Cape Shoe Company's history and purpose.
3. Four single shoes representing each type of shoe offered by Cape Shoe Company.
4. A Cape Shoe Company 6" boot cut in half, lengthwise, revealing its construction.
5. A single shoe in the size of the store owner for them to try on.

The *Shoe-Dog-in-a-Box* could be shipped to the retailer by UPS. A salesperson could then call a couple of days after the retailer receives the *Shoe-Dog-in-a-Box*. That gives the retailer a chance to review the literature, the different styles, the shoe construction and feel the comfort of the shoe in their size. The salesperson then could make a sales presentation with intent of securing an initial shoe order. The first order should perhaps consist of several different sizes enabling various store customers to try the shoe or boot. The salesperson could then arrange to have the *Shoe-Dog-in-a-Box* returned by UPS at Cape Shoe Company's expense.

The *Shoe-Dog-in-a-Box* program can possibly meet with far more success than the usual sales methods, and should be considered as an innovative way to approach the market. The effectiveness of the program would be based on a number of factors. First, having an in-house sales force assures better productivity monitoring. Second, having the samples available for a period of time enables store owners to take a long look at the shoes, as well as showing them to others. Third, retailers don't have to be annoyed by actual Shoe Dogs. And fourth, the program would be extremely cost effective.

SUMMARY

This particular case allows students to begin with a clear slate in terms of discussions to establish strategic directions and recommendations for an entrepreneur who has gotten as far as only having made the decision to purchase the assets of a closed shoe factory. In addition, according to the owner of Cape Shoe Company, at the time of purchase, the only other strategic decision that had been considered was to produce a **100 percent Made in America** shoe. The owner had yet to decide on target markets, kinds, styles and brands of shoes to produce, how to ultimately differentiate his product(s) from competitors, channels in which to sell products, promotion strategies, pricing strategies, and so on.

This case, although brief, engages students to research and analyze an industry which is experiencing significant challenges, and causes students to draw on other lessons and experiences ultimately leading to viable recommended strategic directions for a start-up in an enormously competitive industry.

WORKPLACE VIOLENCE HITS HOME: ARE YOU READY?

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CASE DESCRIPTION

The primary subject matter of this case concerns human resource management, workplace violence, and organizational politics. The case can be used to explore the intricacies of developing a HR workplace violence policy and getting that policy adopted by upper administration. Students are asked to develop a written workplace violence prevention policy. Developing such a policy requires them to research the elements which should be included in such a policy, to develop a plan of action to implement the workplace violence policy, to identify the critical issues of risk/liability to the company's officials, management's responsibility and legal liability for maintaining a safe work environment, and how to get senior management to "buy off" on the plan. The case has a difficulty level of three. The case can be presented and discussed in two to four class periods depending on the number of issues considered. Students can be expected to spend about 10 hours of outside preparation to be fully prepared to complete the case.

CASE SYNOPSIS

Digital Logistics Systems (DLS), as is true of many companies, never considered the possibility of workplace violence. However, a near fist fight in the Advertising/ Promotions department brought the issue firmly to the attention of Tom Ross, the department manager. By chance, the incident was overheard by Sarah Davis, the HR manager. Ross and Davis meet over the issue, where it is agreed that Ross will handle the disciplinary action for the employees while Davis will develop a workplace violence prevention plan. Davis recognizes that not only will she need to develop the plan, and develop a program to implement it, perhaps her biggest task will be in convincing upper management of the necessity of adopting the plan.

INSTRUCTORS' NOTES

This case provides an opportunity for students to write a workplace violence policy. In order to write such a policy, students will need to conduct considerable out of class research into the components of such a policy. These instructor notes include information that will be useful to the discussion leader in guiding students through the delicate political web of writing a human resource management policy and securing adoption of that policy.

The preferred teaching strategy for this case includes student assignments and class discussion. After assigning the case for reading ask the students to prepare written responses to the questions listed below in the "discussion questions" section. Since the case involves writing a policy, the difficulty level of the case and the amount of out of class time needed to complete it can vary by how many, if any, of the issues the policy should cover are provided by the instructor. Researching all of the potential issues that a workplace violence policy should contain and then writing a policy which incorporates all of them will obviously require more time than if those elements are provided to the students. The instructor may choose to use teams to write up the policy. Each team could present its policy in class and be critiqued by the other teams.

To provide an introduction to the complexities of workplace violence, the instructor may want to use a video to frame the issues. Three excellent videos are available. *Violence on the Job* discusses the effect of violence and ways to prevent and reduce violence in the workplace. This 27 minute, 2004, video is produced by the National Institute for Occupational Safety and Health. It is available as a videotape and for our of class viewing is available on line at http://purl.access.gpo.gov/GPO/LPS57314

Workplace Violence: The Legal Role in Keeping Your Workplace Safe is a 17 minute video which illustrates the legal obligation managers face in preventing workplace violence. It identifies five common issues managers face, and offers three specific actions they can implement immediately to prevent violence and avoid liability. *Workplace Violence: Danger on the Job* is a 46 minute video which appeared on "Investigative Reports with Bill Kurtis" on the A & E Television Network. The 2001 video examines instances of workplace violence and examines methods of keeping all safe on the job.

Note that the decision point in this case is very apparent, Davis will have to develop a workplace violence policy and then sell that policy to upper management. The complexity of the case can be increased by also dealing with "turf battles" by having Davis a staff person take over the disciplinary actions of the two employees from Ross a line manager. Similarly, the complexity of the case can be reduced if the instructor provides students with a list of the elements a workplace violence policy should include.

This case will allow the instructor to meet the following objectives: To explore:

- ♦ the issues involved in developing a workplace violence policy.
- ♦ the political implications of getting a policy adopted by upper administration.
- ♦ the responsibility / accountability issue of company management in preventing workplace violence.

CASE OVERVIEW

This case revolves around the development of a workplace violence policy. When a line manager and the HR director became aware of the importance of having a workplace violence prevention policy, the HR director realized that she must develop such a policy and then persuade upper management to adopt it.

The strength of the case lies in combining research, writing and persuasion skills. Students must demonstrate the importance and the necessity of a workplace violence prevention policy, examine the elements such a policy should contain, and write both a policy and a plan for its implementation. Students must also develop a strategy for convincing upper management of the need to implement such a policy. The instructor has the flexibility of deciding how much policy content will be provided to the students.

DISCUSSION QUESTIONS

1. What would a workplace violence plan look like?

A comprehensive plan should address the following issues: the company's legal liability, which include legal accountability of the company officials; risk management and the resulting insurance implications; what constitutes a safe work environment; what are appropriate and more importantly, inappropriate behaviors?; what is enough versus what is too much security?; surveillance versus privacy issues; potential use of employee identification cards; effects of security measures on employee turnover, productivity, and morale; how are visitors to the building treated?; what changes to the physical nature of the building are required?

2. Can a workplace violence plan actually prevent violence from occurring?

No plan is foolproof, but did they consider what actions can be achieved to minimize the likelihood of violence?

3. What is the company's legal responsibility with respect to workplace violence? Does any legal liability fall upon the company officials i.e., senior management?

While legal questions are settled in the courts, the answer should reflect an awareness of the fact that companies, and senior management, can be held liable for actions which occur in the workplace. Based on the principle of negligence, employers are being held responsible for providing a safe workplace (e.g. Fenton, Kelly, Ruud, & Bulloch, 1997; and Paetzold, O'Leary-Kelly, & Griffin, 2007).

4. How can Davis convince upper administration of the need to adopt a workplace violence prevention plan?

Davis should do so with data provided in Table 2. Urge them to take a proactive approach to avoid potential problems and to minimize company exposure. It is also a moral and ethical issue.

4a. (Optional issue). Should senior management be made aware of the incident which occurred in the Advertising/Promotions department?

The answer should reflect awareness that while such a disclosure might help Davis build the case for adopting a violence prevention policy, it also opens the door to a number of political issues: What are the distinctions between line and staff areas of responsibility and authority? What role should HR play in the "cleaning up the aftermath" of the incident [i.e. should HR take over, or leave the issue to Tom?] What role should HR have in disciplining the employees? Should HR conduct any follow up with the offending employees?

5. Once adopted, how would the plan be implemented?

There would need to be a formal written policy on workplace violence and a method of dissemination of the policy to all current and future employees of the company. In all likelihood, workplace violence will need to be included in the company training programs.

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LAYING IT ON THE TABLE: LINESTAT CORPORATION

Keith Jenkins, Sam Houston State University
Robert Stretcher, Sam Houston State University

CASE DESCRIPTION

The primary issue in this case involves the managerial response to an unusual exchange between two managers of Linestat Corporation. The case is appropriate for undergraduate management, human resources management, and business law courses. The case is designed to to introduce students to the concepts of sexual harassment and be taught/discussed in a 45-minute time frame, and should require about an hour of outside preparation by students.

CASE SYNOPSIS

Marinda Vasquez, a senior branch officer for Linestat Corporation, and her boss, Ron Farrington, are faced with an unusual situation. Another of the branch's night managers, Derek Randle, a night technical services operator, has been observed in an inappropriate act after-hours in the company's boardroom. Statutes and precedents are presented relating to the incident, and the reader is tasked with determining a solution to the situation, deciding on appropriate managerial actions.

INSTRUCTORS' NOTES

The instructor can make individual or group assignments as appropriate to the size of the class. Groups would then be required to come to a consensus as to conclusions.

Specific Questions, Assignments and teaching Methodologies

1. What would you want to know from Marinda in reference to Derek?

Marinda should be requested to furnish a complete review of Derek's employment history prior to this event. In any action involving employee conduct that is not acceptable the complete work history should be examined. This would include the hiring process, examining his application, background check, and reports of his interviews. The work history, consisting of his annual reviews or special reports should be reviewed to see if there have been any prior violations of company policy. In addition, Marinda should submit a complete written report of the incident describing the events in sequence. The report should include a complete dialogue of the conversations identifying each speaker.

2. Does Derek's action constitute sexual discrimination? Could Ron's response or lack of action constitute sexual harassment of Marinda?

Derek's act was not directed at Marinda, nor did the act attempt to influence his job rating or acquire another benefit from Marinda. The act therefore does not rise to the level of quid pro quo harassment. Derek's act does, however, have the possibility of having created a hostile environment for Marinda. The court has defined a five element test that should be used to determine whether Marinda has been subjected to hostile environment by Derek. 1. Was Marinda a member of a protected class? 2. Was Marinda subjected to an unwelcome harassment? 3. Was the harassment sexual in nature? 4. Did the harassment affect the condition, term or condition of Marinda's employment? 5. Did the company take remedial action upon knowledge of the harassment?

Marinda is clearly a member of a protected class as a woman. The conduct of Derek was uninvited in any manner by Marinda thereby qualifying it as unwelcome. Derek's action was not directed towards Marinda but his girlfriend. Derek could argue that he was not harassing Marinda. The courts have, however, held that a single act even if not directed toward an individual can be harassing depending upon the severity. Failing to take any action could result in the company allowing a hostile environment to be created for Marinda.

3. What instruction should Ron give to Marinda? What should Ron do in regard to Marinda and her security?

Ron should review the information with Marinda concerning Derek's file to help him determine Derek's value to the company. Marinda, as Derek's immediate supervisor can best provide current information as to Derek's job performance and the problems of replacing him if it becomes necessary. Since Marinda is Derek's supervisor and there is potential claim for sexual harrassment, Ron should instruct her to communicate with Derek only when in the presence of another person or in writing. The company has a duty to prevent Marinda from being exposed to further unwanted conduct of a sexual nature. The company should take appropriate security measures to preclude Derek's further contact with Marinda. Marinda should be given the opportunity to relocate if she feels threatened.

4. What action should be taken with reference to Derek?

Ron should relieve Derek of his duties until a meeting with Ron can be arranged. If Ron cannot reach him by phone he should send a notice to Derek's home address by registered mail. Ron can terminate Derek for violation of company policy, assuming that the company does not permit unauthorized persons (the girlfriend) to use company facilities. Discharge based on these grounds would be for Derek bringing his girlfriend to the company facility. Derek would also be subject to dismissal for failure to use his time for the benefit of the company, since he is the night technical services operator, and was not engaged in company technical services (but was on a personal lark).

Ron should make a complete review of Derek's work record. If he does not do this personally, it should be assigned to another supervisor who does not directly work with either Marinda or Derek. If this the first event of any problem in Derek's work history, Ron could reprimand him, transfer him to another position that requires no contact with Marinda, and require an agreement signed by Derek that any future conduct of sexual character would result in termination. If there have been other events of harassing behavior, Ron should terminate Derek.

5. What steps should the company take to provide for the company's interest?

The company's first steps should be to document the entire incident and the follow up investigation. Ron or some other person independent of the events should take statements of Marinda, and if possible, Derek. The company should review the company's policies in relation to employee behavior as set forth in employee handbooks, and/or training sessions to highlight what violations of company policy have occurred. Based on Marinda's observation of Derek "with someone else in the parking lot" the company should try to determine who the person was and if they were present at the time the incident occurred. The person could have been a witness to the event. If he person was present the company should get the statement of the person.

EPILOGUE

Derek never returned and Ron and Marinda were spared the confrontation, a rather difficult situation to resolve. No lawsuit was ever filed regarding the event by either Derek, Marinda, or Linestat Corporation.

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CHANGING THE HR FUNCTION AT BELLA'S: A CASE STUDY

Bobby Medlin, USC Upstate

CASE DESCRIPTION

The primary subject matter of this case concerns analyzing and evaluating a decision a small business must make concerning the management/administration of its human resource function. The case depicts a general manager's concern that individual performance as well as organizational performance/effectiveness of a small business is beginning to suffer due to the human resource management demands that have become part of her position's role in the firm. This case has a difficulty level of four. It is designed to be taught in one class hour and is expected to take approximately three hours of student preparation time.

CASE SYNOPSIS

Students are provided with a management scenario describing a general manager's request to the owner of a small business to change the HR management function within the firm. This change would involve either A. hiring a full time HR professional who would become part of the management team, B. outsourcing the entire HR function to another organization, or C. outsourcing selected portions of the HR function while keeping select areas inside the organization. Students are asked to review the scenario, evaluate each alternative, and make a recommendation to the owner of the firm. Within the evaluation of alternatives, students are also instructed to develop a job description and a job specification to support the recruiting/selection process that will occur if option A. is chosen; to offer a step by step process that should be followed if option B. is chosen; to identify and support areas that should/shouldn't be outsourced if option C. is chosen. In addition, students are asked to evaluate any additional alternatives that would address the issue. Finally, students must make and support recommendations to the management of this organization. HR outsourcing statistics to supplement the class discussion is provided as an Appendix.

INSTRUCTORS' NOTES

Recommendation for a General Teaching Approach

This case was specifically designed and has been successfully used to reinforce the idea that small businesses often grow to the point in which professional HR management is necessary for organizational effectiveness. The case requires students to explore and evaluate a number of alternatives available to a small business to enable this to occur. A general instruction approach includes a discussion of change associated with growth, the potential impact of the decision on HR outcomes, the need for updated job descriptions and job specifications, the advantages and disadvantages of outsourcing, and a thorough analysis of a number of provided alternatives. A brief general description of outsourcing to supplement the class discussion is provided as an Appendix.

Discussion and review should take approximately two in-class hours. The case instructs students to thoroughly analyze and evaluate three specific alternatives that are provided in the case. It also asks students to consider other potential alternatives beyond the ones listed. Individual instructors may require each student to submit a written report or he/she may prefer to require teams of students to make informal presentations of their analysis. Reports should be graded primarily for content with specific attention being paid to students' ability to thoroughly examine alternatives to solve the problems/issues as presented in the case. If instructors decide to make the case a team presentation assignment, grading could also include an oral communication skills and/or a teamwork component. A general in-class discussion of the case is recommended after assignments are submitted or presented. The instructor may choose to highlight specific items from the case that offer significant concerns or challenges and ask students to identify the actions to address these items.

INSTRUCTIONS TO STUDENTS

Address each of the following:

1. **Thoroughly evaluate each alternative provided. Develop a job description/job specification for the new position as part of the evaluation of option A. For option B., include a discussion of how generally accepted advantages and disadvantages of outsourcing might apply to this firm. For option C., be certain to identify areas of HR that you feel should/should not be outsourced. Also, for each alternative, address any implementation concerns as well as specifics regarding how each might impact the performance outcomes that Lynne feels are declining.**

    Option A., hiring an HR professional:

    Students should address the costs/benefits\\advantages/disadvantages of hiring a full time HR professional. Anticipated performance improvements should also be explored. Implementation issues will probably be primarily related to the recruitment and selection of the new HR professional.

Job descriptions/job specifications will vary among students; however, it is important to recognize that duties, responsibilities, and essential job functions are aligned with the needs of the organization. The job description provided below should be comparable to what students develop:

JOB DESCRIPTION
POSITION TITLE: Human Resources Manager
POSITION
SUMMARY: Performs Human Resources-related duties at the professional level; may carry out responsibilities in some or all of the following areas: recruitment and selection, employee relations, training, orientation, employment, compensation, performance management, and equal employment and equity programs.
DUTIES AND RESPONSIBILITIES/
ESSENTIAL FUNCTIONS:

1. Administers various human resources plans and procedures for all company personnel; assists in development and implementation of personnel policies and procedures; prepares and maintains employee handbook and policies and procedures manual.
2. Participates in developing department goals, objectives, and systems.
3. Administers compensation program; monitors performance evaluation program and revises as necessary.
4. Performs benefits administration to include claims resolution, change reporting, approving invoices for payment, and communicating benefit information to employees.
5. Develops and maintains affirmative action program; files EEO-1 report annually; maintains other records, reports, and logs to conform to EEO regulations.
6. Conducts recruitment and selection effort (including screening and interviewing) for all exempt and nonexempt personnel and temporary employees; conducts new-employee orientations; writes and places advertisements.
7. Handles employee relations counseling, outplacement counseling, and exit interviewing.

8. Participates in administrative staff meetings and attends other meetings and seminars. Maintains company organization charts and employee directory.
9. Assists in evaluation of reports, decisions, and results of department in relation to established goals. Recommends new approaches, policies, and procedures to effect continual improvements in efficiency of department and services performed.
10. Maintains compliance with federal and state regulations concerning employment.
11. Performs other related duties as required and assigned.

KNOWLEDGE AND SKILLS:

1. Considerable knowledge of principles and practices of human resource administration, effective oral and written communication skills, excellent interpersonal skills.
2. Must have the ability to make recommendation to effective resolve problems or issues, by using judgment that is in consistent with standards, practices, policies, procedures, regulation or government law.
3. Ability to organize and prioritize work.

EDUCATION AND WORK EXPERIENCE:

1. A bachelor's degree and one (1) to two (2) years of Human Resources experience
2. Professional in Human Resources (PHR) certification preferred.

Option B., outsourcing the entire HR function:

Students should evaluation the cost/benefits\\advantages/disadvantages of outsourcing. Cost savings, access to expertise, and employee morale will be three areas mentioned by students as advantages. Loss of management control will be prevalent among the disadvantages. The evaluations should identify specifically which ones would be most applicable to Bella’s. Also, the analyses need to address how outsourcing will impact the outcome issues identified by Lynne Gibson.

Students should identify steps that must be taken once the decision to outsource has been made. Though specific processes will vary, they should include the following areas:

- ♦ Identifying and selecting vendors
- ♦ Negotiating contracts
- ♦ Planning and managing transition
- ♦ Managing and evaluating the contract
- ♦ Managing the renegotiation and the end of the contract

The instructor should orchestrate a discussion of the potential dangers within each of these areas.

Option C., outsourcing selected areas of the HR function:

Students should identify which areas of the HR function would lend themselves to outsourcing opportunities for Bella's and why. Factors to consider would include expertise inside the organization, confidentiality concerns, acceptance issues among employees, financial cost/benefits, etc. Payroll and benefits are two areas that will be mentioned often as outsourcing possibilities.

2. Are there additional options that Lynne and Illa should consider? Are they more attractive than the ones under consideration?

Responses to this question will vary significantly among students. Decentralizing the operation to give greater HR decision-making authority/responsibility to store managers will probably be mentioned by many. Restructuring the company will also be suggested by students as well. All options should be thoroughly evaluated by students.

3. What would be your recommendation(s) to Lynne and Illa?

Students should choose among A., B., and C. alternatives; support should be provided for each recommendation.

AN INSURANCE CLAIM: A DISPUTE OVER ACCOUNTING RULES

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CASE DESCRIPTION

A grower, an individual, claiming damage to his grape crop, files an insurance claim. The claim is more than a million dollars and asserts that inclement weather forced a late harvest of the crop resulting in a loss. The grower sales the late harvested grapes to a corporation owned 100% by the grower based on an agreement that the corporation will pay the grower the amount of the sales proceeds of the concentrate after all expenses are paid. The corporation converts the grapes into concentrate and then sells the concentrate to an unrelated party. The corporation prepares and provides a worksheet to show that the amount available to be paid to the grower (the net income from the transaction) is clearly less than the insured amount. The worksheet is presented in an income statement like format and is purported to be in conformity with Generally Accepted Accounting Principles (GAAP) by a Certified Public Accountant (CPA) hired by the grower. The insurer disagrees that the worksheet appropriately reports the net income from this transaction and further disagrees with some of the assertions relied on to prepare the worksheet. The dispute goes to arbitration. The arbitration board has the difficult task of determining whether the worksheet appropriately reports the net income from the transaction and, further, whether the worksheet is in conformity with GAAP and whether it includes expenses that are reliable.

CASE SYNOPSIS

This dispute provides a practical example of an attempt to use accounting to justify an insurance claim, as well as an examination of the relevance and reliability of the accounting presented to justify the claim. This case has been used in a forensic accounting course and could also be used in intermediate accounting courses to provide a practical discussion of GAAP rules and auditing courses to provide a practical discussion of GAAP rules and auditing techniques used to analyze financial statement assertions. The case provides examples of cost allocations, related party transactions, adequate documentation and other accounting issues.

INSTRUCTORS' NOTES

Recommendations for Teaching Approaches

Analysis of Expenses by the Forensic Accountant

Some of the expenses listed in the worksheet were analyzed by the forensic accountant hired by the insurance company to illustrate potential concerns with the objectivity principle:

Concentrating fees of $270,000 were paid to a processing plant that was 100 percent owned by the grower. The grower later allocated the fees to the corporation. The grower admitted that fees paid to the owned processing plant to reduce the grapes to juice and then to concentrate were allocated arbitrarily. In fact, the invoices totaled more than $270,000. The difference was explained by the grower to be an amount allocated to a different load of grapes also owned by the grower and processed at the same time.

The depreciation expense could not be supported by a depreciation schedule. There was also no support for the depreciable basis of the assets. The grower had contributed the assets to the corporation in an earlier year. A request for more detail concerning the computation of depreciation and the assets was not complied with.

The lease expense was presented as two separate line items, one "from outsiders" and the other from related parties. However, upon further inspection of the underlying documentation, all leases were with related parties. There were no lease agreements, just corporate resolutions. There was no basis for the lease payments. It appeared to be an arbitrary amount.

The $32,000 property tax was questioned because the corporation owned no real property and apparently very little personal property. The grower would not produce the property tax statements as requested.

The management fees are paid to the grower. There was no contract. The grower asserted that the monthly amount is based on allocated costs for employees' office space, and use of a helicopter but provided no details of how the amount was determined.

When questioned about the profit as an expense, the grower responded, "Any entity would be entitled to make a profit". Unfortunately, not all entities are profitable, especially those that are just beginning operations. When asked whether 20 percent was appropriate, the grower responded it is "going to be essential that it builds up some working capital." However, business entities dealing at arms'-length with their customers can't set profit simply on working capital needs.

The total of the six expenses listed above is $1,679,000.

Alternative Methods to Compute Sales Price

There are other methods besides the grower's worksheet method that can be used to determine whether the sales price of the grapes exceeds that of the insured amount, on a per ton basis. First, the grower expresses this transaction in his personal financial statements as a sale to his controlled corporation in 2004. A Note Receivable in the amount of $3,746,000 is explained in the footnotes, as follows:

"The company sold 23,537 tons of grapes to their solely owned corporation for processing and marketing. This sale was evidenced by a promissory note to be repaid from the proceeds of the sale of concentrate and juice."

The sale for $3,746,000 is the representation of the grower. According to Statements on Standards for Accounting and Review Services (SSARS), all information included in financial statements is the representation of the grower.

It is also interesting to note that the grower's CPA did report the financial statements to be in conformity with GAAP. This is the same transaction that the CPA reports to be in conformity with GAAP using the worksheet. This is the same transaction but there is a difference of $1,646,000 between the two methods of reporting the transaction (i.e., the $3,746,000 reported as a receivable in the grower's personal financial statements and the $2,100,000 reported on the worksheet).

A second approach to determine the sales price of the grapes would be to take the sales price of the concentrate and reduce it by the amount of the industry average cost to reduce grapes to concentrate. The sales price of the concentrate of $4,545,000 is objectively determined because the concentrate was sold to an unrelated party. There was some industry data available on expenses incurred to convert grapes into juice and then to concentrate. The expense data provided a range of total expense that when subtracted from the $4,545,000 resulted in an average net amount that was very close to the $3,746,000 amount.

A third alternative would use Exhibit 1, the revenues less expenses worksheet provided by the grower adjusted by the questionable expenses listed in the analysis section. The total of the six expenses is $1,679,000. When the $1,679,000 is added to the $2,100,000 remainder on the worksheet, the total of $3,779,000 exceeds the insured amount, on a per ton basis. This amount also becomes more consistent with the $3,746,000 receivable on the grower's personal financial statements.

TEACHING APPROACHES

This case has been used successfully in a forensic accounting course. It is especially effective to pass out and give students time to work on, either individually or in groups, the text of the case up to and including discussion question one. After the instructor covers discussion question one with the entire class the text of the case up to and including discussion question two can be passed out and worked on by the students. After the instructor covers discussion question two with the entire class the text of the case up to and including discussion questions three and four can be passed out and worked on by the students. After classroom discussion of discussion questions three and four is completed by the instructor the remainder of the case can be passed out and the discussion of the case by the entire class can be completed. Depending on how much time an instructor wants to give students to work on the discussion questions, individually or in groups, the case can easily take one or two hours of class time or even more. The three parts can also be given, separately, to students for out of class work. For example, the first part could be handed out at the end of class with instructions to be ready to discuss in the next class session, and so on.

This dispute provides a practical example of an attempt to use accounting to justify an insurance claim, as well as an examination of the relevance and reliability of the accounting rules used to justify the claim. A grower of grapes put in the insurance claim, asserting the sales price of grape juice concentrate was substantially below the insured amount. The sales price the grower used for the claim was the gross amount received for the sale of the juice concentrate less costs to convert the grapes into the concentrate the net amount, the net sales price. The grower submitted a worksheet showing the detail arriving at the net sales price. On its surface the worksheet appeared to be an appropriate attempt to arrive at the actual sales price of the grape juice. The format was a familiar one and was prepared by an experienced accountant and “blessed” by a CPA.

Upon closer scrutiny some troubling issues arose as to the objectivity of some of the expenses included in the worksheet. Most of the expense amounts were determined based on related party transactions. Expenses were arrived at by the use of allocations made between related parties or payments made to a related party without sufficient documentation to determine the objectivity of the expense. A substantial amount of the total expense appeared to be quite arbitrarily determined by the grower.

An arbitration board determined the worksheet not to be in conformity with GAAP, even though the grower’s CPA made assurances that is was. The arbitration board further determined the worksheet not to be one of the financial statements listed as acceptable for GAAP and the worksheet’s format not to be acceptable for GAAP purposes and that the principle of objectivity required for GAAP did not appear to be satisfied.

The dismissal of the use of the worksheet, however, was not sufficient for the insurance company to win the arbitration. The arbitration board still had to determine whether the grower received a price for the grapes that exceeded the insured amount. The board concluded that the price the grower reported as a sale in personal financial statements to his 100% owned corporation was appropriate even though it also represented a related party transaction. The sales price for the grapes exceeded the insured amount and there was no evidence that the grower was trying to accomplish any other objective other than sell the grapes.

SUGGESTED SOLUTIONS TO THE DISCUSSION QUESTIONS

1. Based on the facts as explained in the previous section if you were hired as a forensic accountant by the insurance company would you be concerned that the revenues and expenses reported in Exhibit I are not reliable? If not, why?

Exhibit 1, revenues less expenses, was used by the grower to support his contention that the remainder after expenses is subtracted from revenues is less than the insured amount. Exhibit 1 may not be appropriate because of concerns whether it is in conformity with GAAP, the effect of related party transactions and allocations, and control exerted by the owner. Also, there may be more appropriate methodologies to determine whether the grapes were sold at less than the insured amount.

2. Was Exhibit 1 prepared in conformity with GAAP? Why did the grower's CPA contend that is was in conformity with GAAP?

Exhibit 1, revenues less expenses, does not have to be in conformity with GAAP to be a useful source of information, especially in a cost accounting or special purpose setting. However, some credibility may be attached to any financial statement/worksheet by asserting that it is in conformity with GAAP. The grower's CPA did specifically testify that the worksheet is in conformity with GAAP and did so numerous times. The worksheet revenues less expenses, is not a financial statement that is acceptable for GAAP for three reasons:

According to Statements on Standards for Accounting and Review Services (SSARS) Number 1, AR 100.04, the acceptable financial statements are Balance Sheet (also Statement of Assets and Liabilities), Statement of Income (also Statement of Revenues and Expenses), Statement of Retained Earnings, Statement of Cash Flows, Statement of Changes in Owner's Equity (also Stockholder's Equity) and a few more that aren't relevant here. The worksheet is not one of the listed financial statements and therefore not GAAP.

Related to number 1 above is the format (methodology) of the worksheet, revenues less expenses. The worksheet format excludes from expenses the cost of grapes but includes profit as an expense. The profit "expense" is 20 percent of the gross sales of the concentrate. The cost of grapes should be considered a product cost and included in cost of goods sold. The exclusion of the cost of grapes as an expense is not GAAP. Profit is sometimes considered a cost for some cost accounting purposes, but is never considered an expense for GAAP purposes. For GAAP purposes, profit is always the difference between revenues and expenses.

There is also the concern that the principle of objectivity is being observed. GAAP relies on verifiable evidence to support accounting measurements, based on arms'-length exchange transactions. Because the corporation purchasing the grapes is 100 percent owned by the grower, it is possible that the transactions between the corporation and the grower were not arms'-length, and may not be verifiable.

The worksheet, revenues less expenses, is based on the format of an income statement as follows:

Revenues
Less Expenses:
Cost of Grapes
Costs to produce concentrate
<u>Other Expenses</u>
<u>Total Expenses</u>
<u>Net Income (Profit)</u>

The single-step income statement format above is based on the relationship of sales less expense equals net income. This relationship can be used to accomplish objectives other than the preparation of an income statement. Cost accountants, for example, use a variation of this relationship to compute break-even, the quantity of units sold where total revenues and total costs are equal, that is, where the operating income is zero. More recently, another variation of the relationship, used first by Japanese companies, is target costing. Target costing is used primarily to determine whether a new product should be undertaken. The anticipated sales price is determined first. Next, the company's engineers and cost accountants estimate costs. Costs are subtracted from sales to estimate profit. If an estimated profit is not acceptable the engineers and cost accountants can attempt to reduce or eliminate costs to make the profit acceptable or the project can be abandoned if the desired profit cannot be achieved. Target costing is proving to be a useful cost accounting tool because of the speed at which technology is producing new products.

The above paragraph explains how the basic income statement relationship, revenues less expenses equals' net income, can be useful for cost accounting purposes. The preparation of the worksheet by the grower's accountants is a variation of that relationship. To better understand why the worksheet is not in conformity with GAAP, it may be useful to discuss what GAAP is and what it is used for. GAAP is useful primarily for financial accounting purposes and represents "the consensus at any time as to which economic resources and obligations should be recorded as assets and liabilities, which changes in them should be recorded, how the recorded assets and liabilities and changes in them should be measured, what information should be disclosed, and which financial statements should be prepared," according to Accounting Principles Board (APB) Statement Number 4, paragraph 27. To aid accountants in their application of GAAP and users to confidently depend on accounting information, broad principles relate to the basic accounting functions of measurement and disclosure. One such broad principle is the objectivity principle. The objectivity principle provides that measurements should be based on verifiable evidence. Such evidence enables an accountant to generate measures similar to those that other competent accountants would develop under the same circumstances. In other words, verifiable evidence helps to ensure that different accountants, working independently to solve the same measurement problem, reach similar conclusions. Information based on verifiable evidence is not significantly distorted by personal biases, and the possibility of serious measurement errors is reduced. Because of the need for verifiable evidence to support accounting measurements, financial accounting is based primarily on the results of arms'-length exchange transactions. Arms'-length transactions are between unrelated parties in which the parties behave in their own best economic interests.

3. Were the expenses in Exhibit 1 objectively determined? Your instructor will provide you with the forensic accountant's analysis of some of the expenses on Exhibit 1 (see Analysis of Expenses by the Forensic Accountant in Instructor Notes). Based on the analysis of the forensic accountant has your opinion changed regarding the objectivity of the expenses analyzed?

The methodology used in the preparation of Exhibit 1 may not be appropriate because many of the expenses listed on the worksheet were paid to or allocated from the grower's other extensive operations. Whenever transactions are between related parties there is a concern that the parties may not behave in their own best economic interests. In other words, the expenses listed on the worksheet may not satisfy the objectivity principle because many of the expenses are based on transactions between related parties.

4. Was the grower's control over all the operations an issue with the usefulness of Exhibit 1?

The overriding problem with the worksheet being used to determine the amount that could be paid for the grapes/concentrate is the control that the grower had over all aspects of the grapes from growing to converting into concentrate. Another example of the grower's control over the amount and timing of the transactions is the removal of cash from the corporation. During the period in question all cash received by the corporation, after expenses were paid, was paid to the grower. The corporation's working capital was never considered. There was an attempt by the grower to explain the cash payments as payments for the expenses listed above. However, the corporation could not produce the appropriate tax forms (1099s) for the payments made to the grower that would have been required by law.

5. Is the method used by the grower appropriate to determine the net income from the grapes? If not, are there other methods that could be used to determine the net income from the transaction? Your instructor will provide you with other methods the forensic accountant provided to the arbitration board for the purpose of determining the net income of the transaction (see Alternative Methods to Compute Sales Price in Instructor Notes). Which method do you think the arbitration board chose to apply to determine whether the grower's claim was justified?

The arbitration board agreed with the insurance company that the worksheet provided by the claimant is not appropriate for the purpose of determining the price to be paid for the grapes/concentrate. In arbitration, the worksheet was disregarded completely. The arbitration board agreed that the expenses as presented in the worksheet were too arbitrarily determined. The control exerted by the grower was such that the worksheet did not provide reliable information. The board also concluded that the worksheet was not prepared in accordance with GAAP as the grower asserted.

The dismissal of the use of the worksheet, however, was not sufficient for the insurance company to win the arbitration. The arbitration board still had to determine whether the grower received a price for the grapes that exceeded the insured amount. The board concluded that the first alternative would be used even though it also represented a related party transaction, a sale of the grapes to his 100 percent owned corporation. The $3,746,000 sales price provided a price per ton that exceeded the insured amount and there was no evidence that the grower in 2004 was trying to accomplish any other objective other than sell the grape crop.

Interestingly, the most objective method was discussed but used only in support of the sale for $3,746,000 by the grower of the grapes to the corporation. In the second method the sales of the concentrate by the corporation to an unrelated party for $4,545,000 was objectively determined because it was an arm's-length transaction. The arbitration board did not feel comfortable using industry average data but did note the similarity of the results of this method to the first method.

The third alternative was abandoned when the worksheet was disregarded. The worksheet was rendered irrelevant because of the subjectivity in arriving at most of the expenses.

TICO MANUFACTURING

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Lou Fowler, Missouri Western State University

CASE DESCRIPTION

The primary subject matter of this case concerns Lee Tipton, who founded Tico in rural Missouri and quickly became a leader in pallet re-manufacturing, then dealt with a crisis in faith and family succession. The case has a difficulty level of three, appropriate for junior level. The case is designed to be taught in one 90 minute class and is expected to require 2 hours of outside preparation by students.

CASE SYNOPSIS

The primary subject matter of this case concerns Lee Tipton, who faced bankruptcy after a union strike, then found an entrepreneurial idea as a gift from God. Creating and successfully operating a small business is a challenge for virtually all entrepreneurs. In particular, the challenges facing rural entrepreneurs can often seem insurmountable. The entrepreneurial subject matter of this case concerns the successful growth of a backyard hobby to a thriving corporation. Willingness to adapt to changing market conditions and customer expectations were key criteria for this entrepreneur who went from bankruptcy to a multimillion dollar organization within one decade. The case emphasizes the organizational growth from a sole proprietorship, to a subchapter S corporation, to a spin-off of subsidiary corporations. Also seen in this case is the pivotal point technology has made for small rural entrepreneurs to compete on a global level.

The Teaching Note reviews the pivotal points in the case; entrepreneurship and spirituality, creativity, business evolution and the usefulness of segmented financial statements, which are included. This case is designed for an undergraduate entrepreneurship, accounting or management class and is based on Lee's own words and interviews.

INSTRUCTORS' NOTES

Spirituality

In my entrepreneurship and small business management classes, I have always had interesting discussions around spirituality and entrepreneurship. The topic can be anywhere the students take the discussion; personal faith journeys coupled with operating a business, marketing as a Christian (or any faith) business, operating a business based upon faith principles and so on. Lee's story is an excellent way to launch this discussion; where do you see his faith in the story? How did his faith journey impact him in a positive and negative way? Where is God in Lee's story? I have asked all these questions in class; however, the depth of this discussion is directly dependent upon your own faith and comfort level in discussing such issues. I have very close colleagues that, while possessing a deep and abiding faith, would never have such discussion in class. You will also find such views in your students.

Faith-based entrepreneurship is a growing phenomenon throughout the U.S., while at the same time, we often see a growing intolerance for spirituality and religion. Now we are mixing two of the bedrocks of the American experience; the freedom to be whatever you want to be (often realized via entrepreneurship) with the freedom to worship however you wish while not infringing on the rights of others. Certainly spiritual entrepreneurs have always been with us, but only recently have entrepreneurs actively promoted themselves as spiritual while considering the financial or business aspects of doing so. Lee made decisions based upon his faith and felt led in his life's journey by his faith. Ask what students think of this decision making process; always an interesting discussion since there can be no clear right or wrong, but gets at student comfort levels in working with people of faith. Then consider how this would impact having spiritual entrepreneurs as customers. For the bottom line is that if our students don't work for a spiritual entrepreneur, which is their choice, they most certainly will have spiritual business people as customers and clients.

From my experience, spiritual discussions have always been fascinating. Interesting enough, an academic search pairing entrepreneurship with Christianity will find you nothing. There are articles in the popular press however, such as *Time* and *Business Week*, that you may find helpful. In addition, these 2 websites offer search engines for students to explore the variety of Christian-based business existing today; www.shepherdsguide.com and www.agapechristiansearch.com.

Teaching the Tico Case

Initially, lead the class through a discussion of the following questions, in any combination or sequence that fits your class.

Funding sources were critical for Lee, in particular, Missouri state grants. Research government entities and tax-exempt sources of funding for a business idea; present the application process, selection criteria, availability and so on. Students are usually amazed that there is not a lot of free money out there, and what is available, is tailored quite narrowly for a well-defined objective, either by statute or by donor.

What would you recommend Lee do with Tico? Remember, Lee wants to retire from active management, yet his son and son-on-law, who would allow him to retire from active management, can't afford TICO, while an outsider, who could pay up-front for Tico, will not let Lee retire from active management. Hopefully this will lead to a discussion of family dynamics and succession issues in particular, especially if you have students that come from such a background, and you most likely will. How much of a sacrifice is too much or too little to keep a business in the family?

Start with a discussion of the four critical plans that a family business must have (Bowman-Upton, 1991) as shown below.

1. A firm strategic plan creates a template for each generation to follow while at the same time, allowing each generation to shape and mold the firm for their generation and successive ones to come. A strategic plan for a family business puts forth long-term goals creating a clear picture for the entire family
2. A family strategic plan, which formalizes the family's role in the business. This may take on a variety of shapes and sizes and detail according to the family; however, overall, the family strategic plan reflects how the values of the family are expressed in the business. Naturally, the devil is in the details, so many families get caught up more in defining roles, exits and entrances, compensation and so on.
3. A succession plan is designed to put at ease both the oldest owning generation as well as the generation to come in spelling out for all to understand what will occur when the business passes from one generation to the next. Keep in mind, this does not necessarily mean upon death; the succession plan could be implemented when any number of specified actions have taken place, e.g. education, training, or experience.
4. An estate plan that takes into account current tax law and policy to minimize the tax consequences of succession.

Next, after reviewing the case spreadsheet, suggest to the class that they prepare two different sets of income statements; one set showing a common size income statement to determine trends in revenues and costs, the second set a segmented income statement to determine which product lines are worth keeping and which product lines should be reconsidered. What recommendations would you make?

The Rest of the Tico Story

In reality, Tico was divided into three separate Subchapter S Corporations as a result of Lee facing his retirement and selling dilemma. The main manufacturing plant, for production of the standard size pallets, was spun off into a separate company and the second plant, which manufactured made to order pallets and heat treatment of pallets, was spun off into another company. The freight hauling portion of the business was kept as the original company. This provided separate legal protection for each of these three product/service lines.

Then consider several areas of inquiry; what can Lee do to minimize liability in Tico? Are all Tico's product lines viable? As students view their solutions to the segmented income statements, it should become clear that the corrugated packing boxes are no longer profitable and that the heat treatment of pallets are a rapidly growing and lucrative service. From the common size income statements one can see that the cost for the purchase of used pallets is on the rise. What can be done to improve profitability? By examining their work, the students should be able to come to a variety of conclusions, all of which are (usually) worth considering and discussing.

Tico Inc. **Common Size Income Statements**		% of Revenue		% of Revenue		% of Revenue
	2004	2004	2005	2005	2006	2006
Sales Revenues:						
Certified Heat Treated Pallets	43,500	0.012	239,840	0.052	310,310	0.061
Corrugated Packing Boxes	11,830	0.003	3,540	0.001	8,970	0.002
Mulch	15,880	0.004	22,000	0.005	28,620	0.006
Pallets	2,722,820	0.738	2,858,070	0.619	2,836,500	0.556
Packing Paper	71,620	0.019	87,160	0.019	66,830	0.013
Freight Hauling Revenue	825,340	0.224	1,406,670	0.305	1,850,100	0.363
Total Sales	3,690,990	1.000	4,617,280	1.000	5,101,330	1.000
Cost of Goods Sold						
Lumber to Make Pallets	440,700	0.119	526,000	0.114	570,000	0.112
Material to Make Boxes	5,080	0.001	3,500	0.001	5,030	0.001
Recovered Pallets Purchased*	387,900	0.105	540,000	0.117	615,300	0.121
Raw Paper Material	57,080	0.015	55,340	0.012	48,160	0.009
Total COS	890,760	0.241	1,124,840	0.244	1,238,490	0.243
Gross Profit	2,800,230	0.759	3,492,440	0.756	3,862,840	0.757
Expense						
Propane for heat treatment	1,530	0.0004	7,750	0.002	10,400	0.002
Freight Hauling Truck Expenses	4,090	0.0011	13,040	0.003	17,410	0.003
Lease Payments for Trucks for Hauling Freight	33,880	0.0092	51,320	0.011	136,250	0.027
Advertising	4,800	0.0013	2,010	0.000	2,590	0.001
Janitorial	6,350	0.0017	6,000	0.001	5,520	0.001
Donations	1,500	0.0004	3,920	0.001	4,950	0.001

Tico Inc. **Common Size Income Statements**		% of Revenue		% of Revenue		% of Revenue
	2004	2004	2005	2005	2006	2006
Saw Blades for Cutting Pallets	10,755	0.0029	23,454	0.005	5,220	0.001
Nails Used in Pallet Construction	110,167	0.0298	65,891	0.014	45,438	0.009
Shop Supplies and Tools Used in Making Pallets	42,500	0.0115	26,250	0.006	35,370	0.007
Fuel for Freight Hauls	384,750	0.1042	656,400	0.142	918,600	0.180
Depreciation on Building & Equipment	16,160	0.0044	14,241	0.003	14,664	0.003
Insurance for Employees	48,078	0.0130	49,572	0.011	62,556	0.012
Insurance on Truck and Trailors	31,380	0.0085	45,350	0.010	70,320	0.014
Work Compensation Insurance	21,950	0.0059	19,500	0.004	20,500	0.004
Interest Expense	7,670	0.0021	10,150	0.002	9,050	0.002
License and Permits for Trucks	980,000	0.2655	1,125,500	0.244	1,117,000	0.219
Office Supplies	81,190	0.0220	113,150	0.025	101,000	0.020
Payroll	70,420	0.0191	55,870	0.012	29,480	0.006
Professional Fee/Dues and Subscriptions	65,250	0.0177	97,480	0.021	89,340	0.018
Equipment Repairs & Maintenance	5,070	0.0014	5,000	0.001	5,300	0.001
Trailer Repairs & Maintenance	19,130	0.0052	15,180	0.003	15,953	0.003
Truck Repairs & Maintenance	14,870	0.0040	17,500	0.004	18,860	0.004
Retirement Contributions	93,400	0.0253	114,500	0.025	66,300	0.013
Taxes	108,900	0.0295	115,000	0.025	121,200	0.024
Utilities	29,800	0.0081	34,500	0.007	41,750	0.008
Total Expenses	2,193,590	0.5943	2,688,528	0.582	2,965,021	0.581
Net Income	606,640	0.165	803,912	0.174	897,819	0.176

	Allocations of		Payroll and		Utilities				
Total Payroll costs	1,196,860.00		1,392,000.00		1,336,820.00	Total Utilities Costs	29,800.00	34,500.00	41,750.00
Pallet Production	718,116.00		835,200.00		802,092.00	Pallet Production	17,880.00	20,700.00	25,050.00
Freight Hauling	239,372.00		278,400.00		267,364.00				
Office	179,529.00		208,800.00		200,523.00	Office	2,980.00	3,450.00	4,175.00
Heat Trt	23,937.20		27,840.00		26,736.40	Heat Treatment	8,940.00	10,350.00	12,525.00
Mulch	11,968.60		13,920.00		13,368.20				
Boxes	11,968.60		13,920.00		13,368.00				
Paper	11,968.60		13,920.00		13,368.00				
	1,196,860.00		1,392,000.00		1,336,819.60		29,800.00	34,500.00	41,750.00

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Tico Inc.
Segmented by product line

	Total			Pallets			Freight Hauling			Certified Heat Treated Pallets			Packing Paper			Mulch			Corrugated Packing Boxes		
	2004	2005	2006	2004	2005	2006	2004	2005	2006	2004	2005	2006	2004	2005	2006	2004	2005	2006	2004	2005	2006
Sales																					
Revenue	3,690,990	4,617,280	5,101,330	2,722,820	2,858,070	2,836,500	825,340	1,406,670	1,850,100	43,500	239,840	310,310	71,620	87,160	66,830	15,880	22,000	28,620	11,830	3,540	8,970
Expenses:																					
Lumber to Make Make Pallets	-440,700	-526,000	-570,000	-440,700	-526,000	-570,000															
Recovered Pallets Purchased*	-387,900	-540,000	-615,300	-387,900	-540,000	-615,300															
Saw Blades for Cutting Pallets	-10,755	-23,454	-5,220	-10,755	-23,454	-5,220															
Nails Usedin Pallet Construction	-110,167	-65,891	-45,438	-110,167	-65,891	-45,438															
Shop Supplies and Tools Used in Making Pallets	-42,500	-26,250	-35,370	-42,500	-26,250	-35,370															
Equipment Repairs & Maintenance	-19,130	-15,180	-15,953	-19,130	-15,180	-15,953															
Fuel	-384,750	-656,400	-918,600				-384,750	-656,400	-918,600												
Truck Repairs & Maintenance	-93,400	-114,500	-66,300				-93,400	-114,500	-66,300												
Trailer Repair &Maintenance	-14,870	-17,500	-18,860				-14,870	-17,500	-18,860												
Lease Payments for Trucks for Hauling Freight	-33,880	-51,320	-136,250				-33,880	-51,320	-136,250												
Insurance on Truck and Trailors	-48,078	-49,572	-62,556				-48,078	-49,572	-62,556												
Licenses and Permits for Trucks	-21,950	-19,500	-20,500				-21,950	-19,500	-20,500												
Freight Hauling Truck Expenses	-4,090	-13,040	-17,410				-4,090	-13,040	-17,410												
Propane for heat treatment	-1,530	-7,750	-10,400							-1,530	-7,750	-10,400				0	0	0	0	0	0
Raw Paper Material	-57,080	-55,340	-48,160										-57,080	-55,340	-48,160						
Material to Make Boxes	-5,080	-3,500	-5,030															-5080	-3500	-5030	
Payroll	-1,017,331	-1,183,200	-1,136,297	-718,116	-835,200	-802,092	-239,372	-278,400	-267,364	-23,937	-27,840	-26,737	-11,969	-13,920	-13,368	-11,969	-13,920	-13,368	-11,968	-13,920	-13,368
Utilties	-26,820	-31,050	-37,575	-17,880	-20,700	-25,050	0	0	0	-8,940	-10,350	-12,525	0	0	0	0	0	0	0	0	0
Total Segment Expenses	-2,720,011	-3,399,447	-3,765,219	-1,747,148	-2,052,675	-2,114,423	-840,390	-1,200,232	-1,507,840	-34,407	-45,940	-49,662	-69,049	-69,260	-61,528	-11,969	-13,920	-13,368	-17,048	-17,420	-18,398
Segment Profit Margin	**970,979**	**1,217,833**	**1,336,111**	**975,672**	**805,395**	**722,077**	**-15,050**	**206,438**	**342,260**	**9,093**	**193,900**	**260,648**	**2,571**	**17,900**	**5,302**	**3,911**	**8,080**	**15,252**	**-5,218**	**-13,880**	**-9,428**

Tico Inc.
Segmented by product line

	Total			Pallets			Freight Hauling			Certified Heat Treated Pallets			Packing Paper			Mulch			Corrugated Packing Boxes		
	2004	2005	2006	2004	2005	2006	2004	2005	2006	2004	2005	2006	2004	2005	2006	2004	2005	2006	2004	2005	2006
Selling and Advertising:																					
Advertising	-4,800	-2,010	-2,590																		
Total Selling and Advertising	-4,800	-2,010	-2,590																		
General and Administrative:																					
Payroll for Administration and Office	-179,529	-208,800	-200,523																		
Utilities for Office	-2,980	-3,450	-4,175																		
Office Supplies	-7,670	-10,150	-9,050																		
Janitorial	-6,350	-6,000	-5,520																		
Professional Fee and Dues	-5,070	-5,000	-5,300																		
Donations and Contributions	-1,500	-3,920	-4,950																		
Depreciation on Buildings and Equipment	-16,160	-14,241	-14,664																		
Total General and Administrative	-219,259	-251,561	-244,182																		
Income before Interest and Taxes	746,920	964,262	1,089,339																		
Interest Expense	-31,380	-45,350	-70,320																		
Taxes	-108,900	-115,000	-121,200																		
Net Income	606,640	803,912	897,819																		

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