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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.

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

CASES

BEZANILLA & BEZANILLA REAL ESTATE DEVELOPMENT COMPANY

Leopoldo G. Arias-Bolzmann, Universidad Adolfo Ibanez, Chile
Maria Jose Cavada D., Universidad Adolfo Ibanez, Chile
Francisco Berroeta A., Universidad Adolfo Ibanez, Chile

CASE DESCRIPTION

Bezanilla & Bezanilla (B&B) faces a competitive environment in the Fifth Region. Sales of dwellings experienced a 10.8% growth on average in the year 2004. Low interest rates and lower inflation supported the growth of the market. Municipal policies gave more flexibility to the construction conditions in the downtown eastern area of the city. B&B faces a dilemma: to enter or not into the real estate business by focusing on the middle and middle-lower socio economical status. Currently, their target market is the upper and upper-middle customers. B&B differentiation is the innovation design. Their pricing strategy is cost-plus margin and they are above. Location of buildings is close to the ocean or near tourist centers. When it comes to promotion at the point of sales, there was no prior planning of activities; however, the personnel at the sales room were *well qualified. B&B enjoys positive word-of mouth due to prior success of construction projects. They pioneered post-sales service.*

A next issue examined by the case is the introducing a new brand to enter the middle and middle-lower socio economic segment; how to improve current B&B marketing strategies; whether or not the perception of the ratio price-product should be maintained in the target market, notwithstanding the entry of new competitors from the capital of Chile, Santiago.

The case is meant to four, senior level regarding difficulty level. This case has been designed to be taught in 1.5 class hours and it is expected to require 4 to 5 hours of outside preparation by students.

CASE SYNOPSIS

Bezanilla & Bezanilla is a family company having two strategic business units. On the one hand, it has the Real Estate Company, and on the other it has the Construction Business. It is a company that has been active for many years in the local market of Viña del Mar as well as a leader in the development of buildings targeted at the upper and middle-upper socioeconomic segment.

At the beginning of 2005, executives were appraising the introduction of marketing tools in the management of different activities carried out by the company. An important dilemma was how to maintain growth given the great competition in the real estate market of Viña del Mar, as well

as add to the boom that the real estate market was experiencing. To this end, the executives were analyzing the possibility of creating a new real estate brand to manage the projects aimed towards a lower socioeconomic level.

INTRODUCTION

Bezanilla & Bezanilla (B&B) Real Estate Development Company specializes in the construction of apartment buildings targeting the upper and upper-middle socio-economic segments. By mid 2004 they were considering how to face the following year due to the great threat posed by the arrival of companies from Santiago to the Fifth Region market (Chile is divided into twelve Regions or States and Santiago is its capital). The main reasons for this immigration were: an interesting growth in the regional construction industry, incentives promoted by the Municipality for urban renewal of the downtown-eastern area of the city, and the great attraction of the bidding process for a tract of land of 17.8 hectares, located in the waterfront of Las Salinas area.

Sergio Silva, Chief Executive Officer, and Ignacio Smith, Business Manager of the company, were seriously considering the possibility of integrating marketing strategies to the company's management with a view to strengthen the brand with both internal clients (suppliers, workers, outsourcing firms, etc) and external clients (buyers).

The main concern of the company's management was the perception of the ratio price-product should be adequately maintained in the target market, notwithstanding the entry of new competitors from the capital. Another debatable issue was the possibility of developing another brand for a real estate development company aimed at building apartments, primarily in the downtown-eastern area of the city, though aiming at another socioeconomic segment of buyers.

The B&B products were priced at between 195 and 390 US dollars per square meter over the main competitors (See APPENDIX 1).

An overpriced condition was created due to the degree of quality and differentiation stamped by the company in its buildings, creating an acceptance by the market to have a greater value for the product.

However, it was forecasted that this situation could well undergo changes as a consequence of the arrival of competitors from Santiago.

HISTORY OF THE COMPANY

Alberto Bezanilla started to perform professionally as both an Architect and Civil Engineer in Viña del Mar in the year 1966. His main purpose was to incorporate aesthetic and technical values in buildings in the region.

Alberto Bezanilla Gándara, following his steps and based on the pillars created by his grandfather, founded the Company Bezanilla & Bezanilla Inmobiliaria in the year 1977, was

convinced that it was possible to improve people's quality of life, and also take up an active role in the city's urban development, through the differentiation in his architecture, service to client, and improvement of the organization's human capital.

The products developed by Inmobiliaria Bezanilla were among the most expensive in the industry in the Fifth Region (between 156,000 and 300,000 US dollars), designed for clients who demanded properties of high quality and durability. Ignacio Smith, an executive of the company, distinguished two types of clients, those who looked for an apartment as their first dwelling and those who sought an apartment as a second dwelling and belonged basically to the upper and upper-middle socioeconomic segment in Santiago. The latter type of building was at its very best moment as far as sales were concerned in the last five years, due to the auspicious economic projections afforded by both the national and real estate market.

One of the most difficult periods in the history of the real estate development company were the pressing years of the Asian crisis, where projects of national expansion were erased from the agenda, due to financial reasons. In addition to the foregoing, the company had to bring about a reduction in its payroll, in order to face the real estate drop in both the region and the country. Currently, the company has three construction projects under way, two of which are located in Viña del Mar (Pontevedra and Nueva Libertad) and one in Reñaca (Palmas de Reñaca). Despite the fact that they are still in the construction phase, the three projects have had a very good reception by the clients. (See APPENDIX 2)

BASIC CORPORATE INFORMATION

B&B is a real estate company made up by two strategic units: real estate and construction business.

The mission of the Real Estate Company is managing urban development projects. From its very inception, it was concerned with managing the sales of apartments.

Some of the activities were not performed in-house, but rather were outsourced to external companies, such as, structural calculations and the completion of the finishing of basic services for each apartment. The requisite which these external companies had to meet was that of offering the best quality and service, so as to fully tune in with the global strategy of B&B of providing quality and differentiation to their clients. To maintain a long-term relationship with these suppliers, and not sacrifice the quality required by the company's position in the market, B&B was willing to pay a higher price for a service that was both responsible and different.

The way in which the company operates in each new project differed due to the fact that each of them was led by Alberto Bezanilla, though different strategic partners. As new projects arose, different companies were formed, which were maintained, to the maximum extent possible, through a long-term profitable relationship.

On the other hand, the financing structure of the projects was divided as follows:

40% Owner's Equity
30% Apartments pre-sold before the construction begins
30% Banks

B&B always expected that clients' pre-payments should exceed 1/3 of total financing, in order to lessen the financial risk and thereby limit, as far as possible, the participation of Banks and partners to fund the projects.

The second strategic unit was the Construction Company, which was responsible for carrying out all projects managed. One of the main tasks of this area was to generate a margin of 15% for each project undertaken in order to generate appropriate returns for the company. The organizational chart of the construction company varied depending on each project, but, in general, it had a Chief Engineer in charge of each construction project. (See APPENDIX 3)

ECONOMIC ACTIVITY OF THE FITH REGION

GDP in the Fifth Region equaled 9.2% of national GDP, according to figures for regional GDP, placing it as the third most important region after the capital, Santiago (48.5%) and the Eight Region (9.5%).

During the first quarter of 2004, the Economic Activity Indicator for the Fifth Region (INACER) was experiencing a 5.6% growth relative to the same quarter in 2003. The sectors having the greatest bearing on this growth were Construction, mainly due to engineering projects, Transports and Communications (See APPENDIX 4).

This positive behavior of the INACER (Index of Regional Economic Activity) was also observed in most of the twelve regions: nine of which grew, including the Fifth Region, by over the country's average (4.8%).

CONSTRUCTION SECTOR

Employment

Paradoxically, despite the increase in construction, the growth in this sector went down by 4.9% in the Fifth region, involving 10,300 employed less than the previous quarter January-March 2003. Thus, construction was the activity recording the greatest drop in employment. This result was consistent with what was taking place in the rest of the country, where employment in the construction area showed a cumulative drop of 4.2% in the first five months of the year.

Real Estate Market

Sales of dwellings (houses and apartments) in the Fifth Region experienced a 10.8% growth on average, in the period January-April 2004, with a decreasing trend from the beginning of the year. Even though the figures showed a practically null growth in yearly terms it was ascertained that in April and May sales had gone up by 67% and 19%, respectively. Thus, by comparison to the same period of 2003, sales recorded during 2004 had evolved positively, reporting a monthly average of 268 units sold. (See APPENDIX 5).

The number of applications for new dwellings increased by 74.4% in the period January-April relative to what occurred in 2003. The approved dwelling surface showed an 82.9% increase for the same period. Unfortunately, there was a significant decrease in the surfaces approved for Industry, Trade, Financial Services and Services.

As a result, the total surface approved between January-April 2004 went up by 54.8% with respect to the total surface approved in the same period of 2003.

Sectoral Sales

At a national level, the month of July 2004 recorded sales of 1,206 units (750 apartments and 456 houses), representing a 4.3% increase relative to the same month in 2003, whereas in the Fifth region, sales totaled 228 units (162 apartments and 66 houses) standing for an 18.3% increase relative to June 2003.

Marketing Activities Over-Time

The company B&B has based its marketing strategy over time, without having any prior plan for marketing activities. Aspects such as product and pricing have had a greater emphasis on the part of the company's management, but other marketing elements such as implementation at the sales point, setting up of a data base, and creating a brand are factors that have not received a full and due attention by the company's management.

Product

B&B has devoted itself exclusively to the construction of apartment buildings targeted to the group of consumers belonging to the upper and upper-middle socioeconomic strata. However, the company decided to experiment in the construction of office buildings. The most important project developed in this area was the "Coraceros" building, which encountered difficulties to be sold in full, due to the fact that this niche in the market was saturated and lacked for any demand in Viña del Mar. Despite this, in the year 2004, the market for office buildings showed a great development

in Santiago, reaching a growth rate, in square meters, of 238% over and above what had been built in the year 2003 (See APPENDIX 6).

The location of the buildings had to meet a very definite requirement. Alberto Bezanilla, chairman of the Company, said that the projects "had to be close to the sea and have a privileged sight, otherwise, they had to be near tourist centers such as the Viña del Mar Casino".

Alberto Bezanilla was most emphatic in stating that the company's buildings had a great ratio space/living area as compared to those of its main rivals, which is, his products have less rooms per square meter than the main competitors, due to the fact that it resorted to state-of the art construction techniques.

On the other hand, he further explained that in order to be different from his competitors, their buildings had to provide added value to the clients, such as for instance put up buildings with elevated squares/look-outs to fully enjoy the view and locker and changing area for residents' servants on the ground floor.

Regarding the architectural style, B&B was concerned in making an aesthetic contribution to the city through innovation in the designs. The main idea was that the buildings should not become obsolete in the short-term and make the owners incur in a loss at the moment of selling-off the property.

B & B suppliers received a higher payment for their products and services in exchange for a better quality of the goods required. Differentiation by means of high quality standards was sought.

PRICES

The price of the apartments ranged from 156,000 to 300,000 US dollars. The prices of the penthouses ranged between 450,000 and 550,000 US dollars, figures, which were above the more direct competitors (Solari, Numancia, Dhelos and Greco Building Companies) and fluctuated between 120,000 and 250,000 US dollars. This gap in price is based mainly on the application of differentiating traits bearing the stamp of B&B on all its buildings.

The company did not have a pricing strategic policy, and only applied the usual tool of Cost plus Margin, which did not generate any differential in relation to its competitors.

The price of the apartments depended only on the moment at which they were sold, that is, if it was a sale before construction began or a sale after completion of construction. In like manner, the price decreased in accordance to the apartments left without selling, but without resorting to any established discount policy.

IMPLEMENTATION AT SALES POINT

According to Ignacio Smith "the company's image was fully reflected in the sales rooms". He added that it was necessary to implement more creative and entertaining ways to draw clients' attention.

In regards to the implementation at the sales point, there was no prior planning of the activities in order to increase sales and communication to the client at symbolic dates such as Christmas, Independence Day, Month of the Sea, etc. Due to this, there was no such thing as a flexible budget available to carry out such activities

In some respects the personnel who were currently available at the sales rooms were well qualified both in technical aspects of the materials used in the apartments, as well as in closing a sale. Despite this, most of the clients preferred to close their sale with either Sergio Silva or Ignacio Smith.

BUILDING BRAND EQUITY

The company has based this concept on three fundamental pillars:

- Developing prior construction projects: Resorting to the quality buildings erected in prior periods, a powerful tool was developed and which to date has been very beneficial. This tool consisted in making the information available to clients and potential clients (resorting to word of mouth).
- Application of a Warranty: Apart from the five-year period warranty that all building companies must have, B&B had its own warranty. In order to generate a long-term relationship with its clients and to increase their credibility, B&B's warranty consisted in covering any defect in the constructions up to three years after having delivered the apartment. This warranty was included within the frame of the five year-period of legal guarantee which SERNAC (National Consumer Service) mandated.
- Post-sale Service. As a part of its positioning in the market, B&B was a pioneer in implementing a post-sale service in the construction industry, which generated a perception of differentiated value in the target segment. This service consisted in providing assistance to apartment owners in the face of any problem arising in their dwellings. For instance, if any apartment had pipes filtering, the B&B building company made itself responsible for repairing or changing the entire system.

THE ATTRACTIVE OF THE DOWNTOWN-EASTERN SECTRO OF VIÑA DEL MAR

B&B executives analyzed the real estate market of the downtown-eastern sector of Viña del Mar, made up principally by clients from the middle and middle-lower socioeconomic strata (See APPENDIX 7), Description of Middle and Middle-Lower Socioeconomic Groups), considering key aspects that would exert an influence on its potential entry to this market.

MUNICIPAL POLICIES

The Municipal Council of Viña del Mar had approved the dispatch of the Urban Renewal Sectional which gave more flexibility to the construction conditions in the downtown-eastern area of the city, which contributed to an incentive for the investors to develop real estate projects in this area.

This planning instrument was the step needed to award validity to the Urban Renewal Subsidy –granted by the Ministry of Housing–, since previous conditions instituted in the Zoning Plan in no way made the business attractive for construction companies.

In fact, this planning instrument, established considerable increases in the density; from the 434 dwelling units per hectare authorized, it now nearly increased twofold. Also the constructability indexes were increased allowing for more square meters built on the same lot of ground.

Furthermore, the requirement to have a given number of parking spaces per square meter was reduced.

In this way, by imparting flexibility to the norms on soil use, a better communion between the private interests and the demand for housing was attained. This meant lowering construction costs and permitting the access of interested parties to the dwelling subsidy of 8,000 US dollars, if and when total apartment payments did not exceed 80,000 US dollars in value.

THE ATTRACTIVE MARKET

In the year 2004, the number of new buildings for the month of May totaled 3,152 units, broken down into 2,257 apartments and 895 houses. These numbers were slightly below from the previous month of April which totaled 3,492 units. However, the trend of the indicators kept concentrating the greatest number of projects for apartments in the hills of Valparaiso with 21%, flatland of Viña del Mar with 19%, Agua Santa/Recreo with 13%, and Reñaca/Concon with 15% of the total apartments available for sale.

Due to the implementation of the urban renewal municipal policies, the center of the city became a more attractive place to make investments in. This was confirmed by the entry of building companies from Santiago and Viña del Mar, focusing on the middle socioeconomic segment,

envisaging this sector as a successful hatchery of profitable products. Some of the projects carried during the year 2004 (See APPENDIX 8).

The conditions of this real estate market were more auspicious than in the year 2003 since sales of dwellings experienced a 10.8% growth on average, in the period January-April 2004. In addition to this, sales in October 2004 were 44.15% higher to sales affected in the same month of the year 2003. Another favorable aspect was the increase in sales of apartments as a second dwelling, which was being experienced in the areas of Viña del Mar, Reñaca and Concón.

Despite the factors mentioned previously, within the company there was a great reaction to the diversification project as Alberto Bezanilla considered that the diversification to other markets ran counter to the concept of the business imprint he had stamped on the company's strategic vision. Consequently, he rejected the idea of further analyzing this kind of market.

OTHER ASPECTS SUPPORTING THE GROWTH OF THIS MARKET

During the course of the year 2004, the economy remained stable, with GDP growth rates of 5.5%, this going hand in hand with higher rates of consumption by the population, on account of low rates of interest, led by the inter-bank rate of the Chilean Central Bank, which was at one of the lowest figures in history (2.18% at November 2004). On the other hand, inflation was kept under control at between 2% and 3%, hence generating a greater stability in the market.

With respect to the Fifth Region, the year 2004 showed great promise for the real estate market, on account of the fact that more than 2 million dollars were invested in road infrastructure works. Another incentive for the development of real estate projects (apartment buildings) was the 14% increase in the prices of land, which implied an increase of 17.6% in the prices of houses between the years 1997 and 2003.

Another element that explained the higher sales of apartments was that the investors who were returning to the market preferred this type of real estate property as a source of income, as it ensured them greater security, protection, and comfort.

CONCLUSION

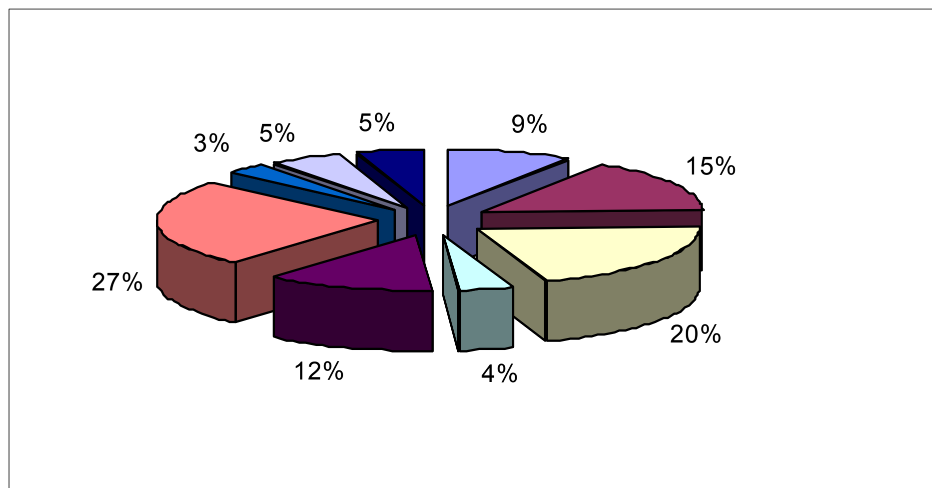
B&B faces a competitive environment in the Fifth Region. Sales of dwellings experienced a 10.8% growth on average in the year 2004. Low interest rates and lower inflation supported the growth of the market. Municipal policies gave more flexibility to the construction conditions in the downtown eastern area of the city. B&B faces a dilemma, to enter or not into the real estate business by focusing on the middle and middle-lower socio economical status. Currently, their target market is the upper and upper-middle customers. B&B differentiation is the innovation design. Their pricing strategy is cost-plus margin and they are above market level. Location of buildings is close to the ocean or near tourist centers. When it comes to promotion at the point of sales, there was no

prior planning of activities; however, the personnel at the sales rooms were well qualified. B&B enjoys positive word-of-mouth due to prior success of construction projects. They pioneered post-sales service.

ENDNOTES

[1] This case study was written in January 2005 by the students of Universidad Adolfo Ibañez obtaining a Master of Science in Marketing, María José Cavada D. and Francisco Berroeta A., under the direction and supervision of the Professor of Marketing, Leopoldo Arias-Bolzmann, Ph.D.

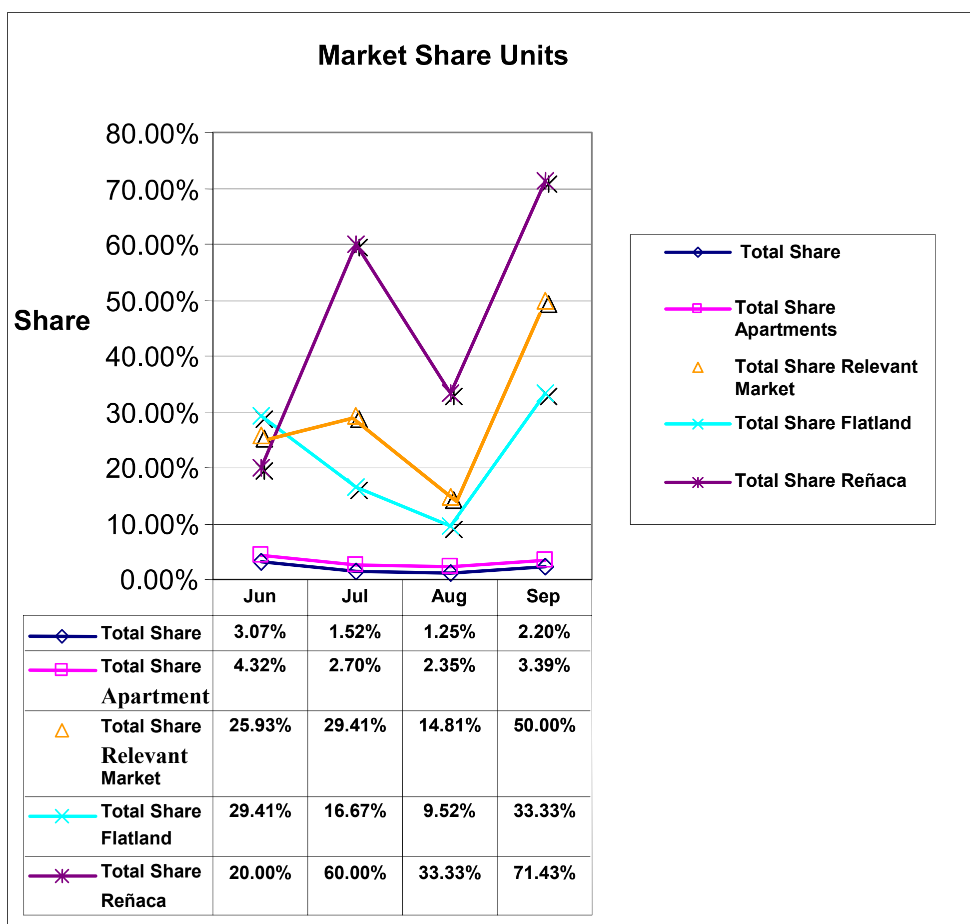
APPENDIX 1: MARKET SHARE OF B&B, FIFTH REGION



Source: Study performed by Bezanilla, year 2004

APPENDIX 1- Continues

Market share of Bezanilla (June-September 2004):
Market share in terms of square meters built
Market share in Units apartments sold



	Jun	Jul	Aug	Sep
Total Share	3.07%	1.52%	1.25%	2.20%
Total Share Apartment	4.32%	2.70%	2.35%	3.39%
Total Share Relevant Market	25.93%	29.41%	14.81%	50.00%
Total Share Flatland	29.41%	16.67%	9.52%	33.33%
Total Share Reñaca	20.00%	60.00%	33.33%	71.43%

Total share: total number of apartments units sold by Bezanilla relative to total number of dwellings sold in the Fifth region in each one of the months (it includes houses and apartments).

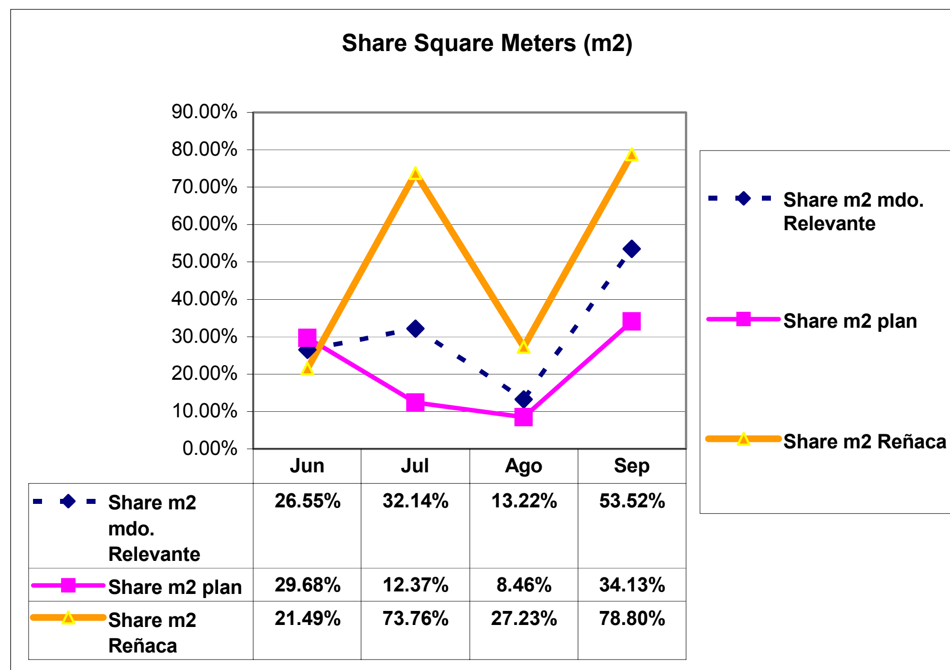
Total share apartments: total units sold by Bezanilla relative to total apartments units in the Fifth region.

Total share relevant market: total units sold by Bezanilla relative to total units sold during the period in the relevant sectors.

Share total flatland of Viña del Mar: total units sold by Bezanilla relative to units sold during the period on the flatland of Viña del Mar**.**

Total share Reñaca: total units sold by Bezanilla relative to total units sold during the period in Reñaca.

Market Shares in Square Meters Built



	Jun	Jul	Ago	Sep
Share m2 mdo. Relevante	26.55%	32.14%	13.22%	53.52%
Share m2 plan	29.68%	12.37%	8.46%	34.13%
Share m2 Reñaca	21.49%	73.76%	27.23%	78.80%

Share square meters relevant market: Total square meters sold by Bezanilla relative to total square meters sold by all relevant competitors.

Share square meters on the flatland of Viña del Mar: Total square meters sold by Bezanilla relative to total square meters sold by all relevant competitors on the flatland of Viña del Mar.

Share square meters Reñaca: Total square meters sold by Bezanilla relative to total square meters sold by all relevant competitors in Reñaca.

APPENDIX 2

Buildings constructed by B&B S.A. Period 1978 - 2004					
Nº	Name Building Reception	Date Municipal	Area Built Square M^2	Nº Floors	Total Apartments
1	San Remo	Nov-78	854	4	7
2	Las Rocas	Jul-80	679	4	4
3	Crisol	Aug-81	2,586	8	18
4	Los Ligustros	Jul-83	1,006	8	7
5	Los Robles	May-84	832	4	7
6	Los Acacias	Aug-85	1,670	7	12
7	Las Encinas	May-86	1,465	6	10
8	Los Olivos	Apr-87	2,019	8	14
9	Los Castaños	Nov-87	2,195	8	14
10	Araucaria	Feb-88	2,875	9	16
11	Oregon	Dec-88	2,782	9	18
12	Los Canelos	Jun-89	2,094	8	14
13	Los Cedros	Oct-89	2,662	9	16
14	Granada	Nov-90	2,198	9	8
15	Arrayan	Jan-91	3,893	12	22
16	Algarrobo	Dec-91	5,296	12	36
17	Ebano	Mar-92	1,979	8	17
18	Magnolio	Mar-93	5,633	12	31
19	8 Norte	Nov-93	578	3	1
20	Avellano	May-94	2,391	12	10
21	Libertad	Nov-94	9,321	12	36
22	Nogal	Sept-94	2,865	10	18
23	Palmira	Dec-94	3,207	12	11
24	Terrasol	Dec-95	16,190	24	81
25	Reina Victoria	Feb-97	13,361	20	70
26	Coraceros	Apr-98	24,867	20	114
27	Tamarugal	Mar-98	2,781	8	14
28	Altomar	Dec-01	14,632	20	50
29	Don Alfredo	Jan-03	6,240	12	36

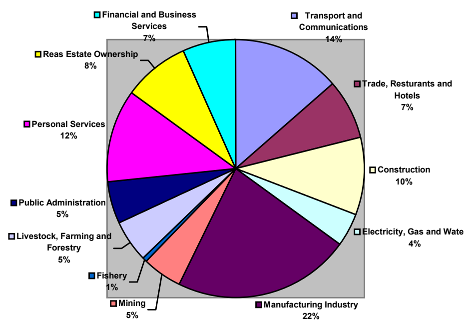
Buildings constructed by B&B S.A. Period 1978 - 2004					
Nº	Name Building Reception	Date Municipal	Area Built Square M^2	Nº Floors	Total Apartments
30	Palmas (Stage 1)	Aug-04 (Est.)	14,281	25	61
31	Nueva Libertad	Apr-05 (Est.)	10,700	19	51
32	Pontevedra	Jan-05 (Est.)	4,400	12	22
			168,532		840
Source: Document Bezanilla Inmobiliaria: prospecto Informativo de la Sociedad					

APPENDIX 3

HEADCOUNT, updated to year 2004				
		B&B Real Estate	B&B Building Company	Total
1.	Executives	4	2	6
2.	Technicians and professionals	3	10	13
3	Clerical	7	200*	207
	Total	14	212	226
*Average number of workers on construction sites Source: Document Bezanilla Inmobiliaria: Prospecto Informativo de la Sociedad				

APPENDIX 4

IMPORTANCE OF THE ECONOMIC SECTORS IN THE FIFTH REGION



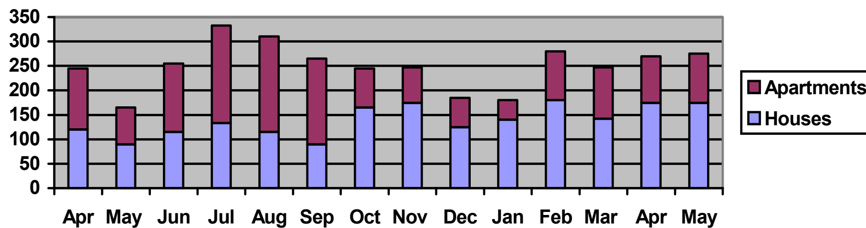
Source: Chilean Central Bank , MACH 8, June 2004 (Informe Mensual de Macroeconomía of the Chilean Construction Chamber).

a/ Participation in the year 2004

** Percentages have been rounded to the nearest whole number*

APPENDIX 5

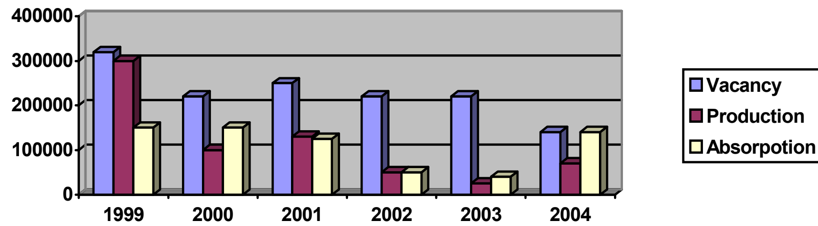
MONTHLY SALES OF DWELLINGS IN THE FIFTH REGION



Source: MACH 8, June 2004, Chilean Construction Chamber, Regional Delegation of Valparaiso

APPENDIX 6

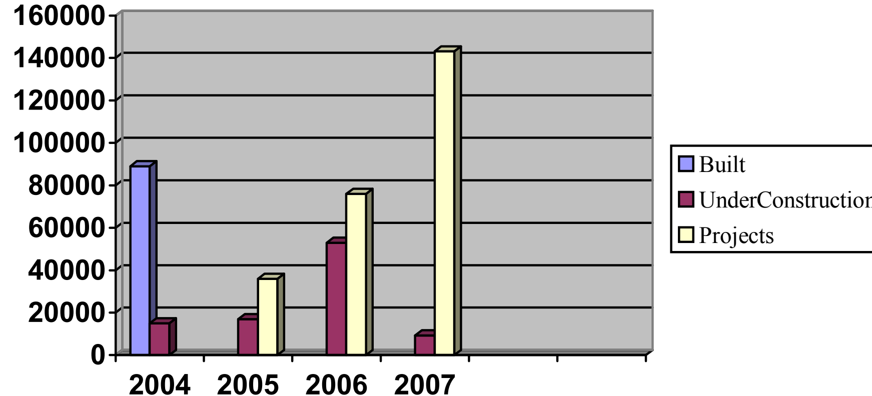
MARKET FOR OFFICES IN GREATER SANTIAGO



Source: Article: Adapted from: "*Demanda de oficinas retorna a niveles de mediados de los 90*", Diario Financiero (Tuesday, November 16, 2004)

APPENDIX 6-continues

MARKET PROJECTIONS FOR OFFICES IN GREATER SANTIAGO



	2004	2005	2006	2007
Built	89,000			
Under Construction	15,000	17,000	53,000	9,300
Projects		36,000	76,000	143,000
Source: Contémpora Servicios Inmobiliarios				

APPENDIX 7

DESCRIPTION OF MIDDLE AND MIDDLE-LOWER SOCIOECONOMIC GROUP

MIDDLE SOCIOECONOMIC GROUP

Neighborhoods: Traditional Sector.

In the event of a new building, they are normally groups of many dwelling, located at a certain distance from the downtown area. There is a great concern for decor, maintenance and cleaning of streets and sidewalks. If rented, the amount would be higher than 500 US dollars..

Exterior of the dwelling:

Groups of housings, blocks of apartments. Facades have a good appearance, garden small, driveway for vehicle. Usually, they do not have quarters for domestic aide.

General description:

21% of the population.
260,000 families with a family income exceeding 1,800 US dollars.
They cover food, clothing, dwelling and education needs.
Low saving ability.

Distribution of the dwelling:

Generally living and dining-room together. Two or three bedrooms, they usually have one fully equipped bathroom and another half bathroom.

Furniture and decoration:

Modern furniture produced industrially, of good quality. Sober decoration, cozy setting. They are tidy and well-kept. Modern kitchen and bathroom appliances and fittings.

Household possessions:

They have electrical appliances of common use, modular radio and sound sets, washing machines, kitchen center, etc.

Motorcar:

80% of the families own modern cars, though models are not necessarily new, such as Toyota, Fiat, Suzuki, Daihatsu, Nissan and new models of Daewoo and Hyundai.

Telephone: 85% of families have a telephone.

Domestic aide: Some have domestic aide. It may be part-time, 2 or 3 days a week.

MIDDLE-LOWER SOCIOECONOMIC GROUP

Neighborhoods:

Popular/old and relatively modest, mixed at times with Middle and Lower socioeconomic groups. They are multi-family dwellings having a high density. Scarcely any concern for maintenance of streets and implementation of green areas. The rent would be in the order of 200 US dollars.

Exterior of the dwelling:

In modest neighborhoods they correspond to the dwellings showing most progress and in middle sectors they are the households which have the lower income. If it's a modern type of construction, small. Façade and painting somewhat renewed.

General description:

22% of the population.
272,000 families with a family income of no less than 800 US dollars.

Distribution of the dwelling:

Few rooms, generally two bedrooms, a small bathroom. Linoleum or wood flooring.

Furniture and decoration:

Cheap type of furniture or old. Decoration modest, without any given style. In a very limited space they distribute the living, dining-room and others. Kitchen and bathroom furniture and appliances old or of very low cost. Usually, the TV is located in the living-room.

Household possessions:

They have electrical appliances of a very low cost or old. Refrigerator, a common washing-machine, vacuum cleaner, etc.

Motorcar:

45% of families own cars. These are small vehicles with several years of use, a utilitarian vehicle, such as work vehicles, taxis or pick-up trucks.

Telephone: 50% of families have a telephone.

Domestic aide: hardly ever.

APPENDIX 8

Building	Location	Real Estate Company	Building Company
Sta. María de los Reyes	Von Schröeders 229	Stitchkin	SMW
Nueva Vista	Alvares 322	Stitchkin	DLP-INGEVEG
Quinta Vergara	Alvares/Quinta	Vecom	Texas-Vecom
Viña Park	Viana 433	ISN (Viña del Mar)	Bid pending December 15,2004

REFERENCES

The history of the company was extracted from Bezanilla & Bezanilla's official website: www.bezanilla.cl.

Appendix 2, Bezanilla Inmobiliaria Document: *Prospecto Informativo de la Sociedad*

Appendix 3 "Headcount": Bezanilla Inmobiliaria Document: *Prospecto Informativo de la Sociedad*

Appendix 3 "Economic Activity of the Fifth Region": The Chilean Construction Chamber, Report Mach 8 (July 2004) *Informe Mensual de Macroeconomía y Construcción.*

Appendix 4 and 5 "Economic sectors in the Fifth Region" extracted from: The Chilean Construction Chamber, Report Mach (June 2004) *Informe Mensual de Macroeconomía y Construcción.*

Appendix 6, Diario Financiero (Tuesday, November 16, 2004) Information adapted from the article *Demanda de oficinas retorna a niveles de mediados de los 90*; other source: *Contémpora Servicios Inmobiliarios.*

Appendix 7 "Municipal Policies": information obtained from the Municipality of Viña del Mar, www.vinadelmar.cl
"Market Performance": information obtained from *El Mercurio de Valparaíso* newspaper, July 23, 2004.
"Description of Middle and Middle-Lower Socioeconomic Group" Information obtained from the study *CORPA Investigación de Mercado*, Descripción de grupos socioeconómicos 2002".

Appendix 8 Information obtained from *El Mercuric de Valparaiso*, December 5, 2004, *interview to Ricardo Gutierrez, Regional Manager of Fuenzalida Propiedades.*

Information obtained from:
"Viña del Mar vive su segundo boa vial e inmobiliario", *El Diario*, May 24, 2004.
"Ventas inmobiliarias suben 4.3% y anotan un récord para Junio", *El Mercurio*, July 30, 2004.

ALABAMA POWER RESPONSE TO KATRINA: MANAGING A SEVERE SERVICE SUPPLY CHAIN DISRUPTION

Joseph B. Skipper, Auburn University
Joe B. Hanna, Auburn University
Brian J. Gibson, Auburn University

CASE DESCRIPTION

This case is designed to provide students with a business case based practical example of how an unexpected event can impact a business operation. This is a multi-part case designed to provide business students with a unique perspective on the many issues that a company must confront and address when an unexpected event disrupts the normal operations of a business. The case is designed to appeal primarily to a broad range of undergraduate students, and to a lesser degree graduate level business students. The case is challenging because it encompasses a wide range of issues, but the focus of the case is designed to entice meaningful and insightful discussion about how to effectively manage a business when confronted by a specific type of disruption. As a result, the case is not complex from the standpoint of developing a "correct" or "incorrect" answer.

CASE SYNOPSIS

Part A of the case is designed to provide students with a multi-faceted situation with the focus being on requiring students to identify, analyze, and prioritize the key issues, their relative importance, and how to address each issue to minimize the impact of the disruption on business continuity and performance levels. Part B complements Part A by providing the student with an in-depth discussion of how the company featured in the case identified, analyzed, and prioritized the key issues they faced during and immediately after hurricane Katrina.

PART A: INTRODUCTION

The risks of, and impacts from, environmental disruptions on businesses are tremendous. As we continue to progress towards an increasingly global marketplace, the risk of a potential business disruption tends to escalate. The ability to manage these disruptions and develop effective continuity response plans in the event of a disruption involves resources, a dedication to planning, and early involvement of key participants (Zsidisin, Melnyk, & Ragatz, 2005). Risk management has placed

many professionals in an unfamiliar and relatively new territory, forcing the application of new techniques (Elkins, Handfield, Blackhurst, & Craighead, 2005) and highlighting the need for improved visibility and communication (Christopher & Lee, 2004).

Given the large potential impact on business from a disruption, interest in, and application of risk management tools is expanding. One of the many challenges for businesses today is to plan, control, and monitor the potential risk associated with uncommon or undesirable business interruptions. Ultimately, to be highly effective in a constantly changing marketplace, a business must have a contingency plan that incorporates the identification and valuation of various risk events, the probability of occurrence, and the firms' contingencies for alternative actions.

Clearly one size does not fit all in the management of potential risk. With a better understanding of the causes, identification, assessment, and management of risk has come the realization that there is no single method of controlling the risk of a disruption. Recent natural disasters such as Hurricane Katrina and the typhoon in the Indian Ocean have highlighted the need for better disaster preparedness planning (Alff, 2006; Hale & Moberg, 2005). Therefore, the remainder of this case focuses on how Alabama Power successfully utilized a contingency planning process in disaster recovery efforts to achieve dramatic and positive results immediately subsequent to Hurricane Katrina.

BACKGROUND

Hurricane Katrina struck the Gulf Coast as an extremely large Category 3 storm on the morning of August 29, 2005. The storm surge from Katrina caused catastrophic damage along the coastlines of Louisiana, Mississippi, and Alabama. In Louisiana, the surge breached several levees separating Lake Pontchartrain from New Orleans, ultimately flooding about 80% of the city. With damages estimated at $75 billion, Katrina was the costliest hurricane in United States history. In addition to the financial devastation, the storm killed 1,417 people, making it the deadliest U.S. hurricane since 1928.

While publicity was heavily focused on the large metropolitan area surrounding New Orleans, the damage went well beyond New Orleans. Record storm surges smashed the entire Mississippi Gulf Coast, peaking at 34 ft in Bay St. Louis, Mississippi and reaching 13 feet as far away as Mobile, Alabama. The extensive storm surge contributed to massive, wide spread damage. The devastation of the storm surge was extensive due in large part to the massive size of the storm plus the fact that a large part of the region is at, or just above, sea-level.

IMPACTS

Over 1.2 million people were under an evacuation order before Katrina hit land on August 29, 2005. Less than a day later, the levee protecting New Orleans began to fail, and within days,

residents were forced to evacuate the city, as many roadways became riverways. Similar evacuations took place along the Mississippi and Alabama Gulf Coast regions as well as many inland areas. Ultimately, more than 1.5 million people were displaced, a major crisis on a scale unseen in the U.S. for many years. With $75 billion in damages, Katrina earned the dubious distinction of being the costliest hurricane in US history. Katrina caused almost double the dollar value of destruction when compared to the previously most expensive Hurricane Andrew that blew into the Eastern U.S. and devastated the Carolinas.

Images of damage to a wide area encompassing both major cities and small towns were prevalent immediately after the storm. Unfortunately, the bad news did not end when the storm made landfall along the coast. Months after the storm, pictures continued to show the massive and widespread devastation Katrina left behind. Relief efforts to assist people remained in effect for months after Katrina as response teams struggled to overcome the large-scale destruction left by the aftermath of the storm. Coastal areas were the areas hardest hit, however, wind damage, heavy rain, and large-scale flooding were all reported hundreds of miles inland. Along the Gulf Coast, wind gusts were clocked in excess of 115 mph in Pascagoula, MS and over 100 mph on Dauphin Island, AL. Farther inland, Mississippi experienced wind gusts of 100 mph and higher as far north as Hattiesburg. In Alabama, wind gusts topped 50 mph as far north as Birmingham.

Federal disaster declarations blanketed 90,000 square miles of the United States, an area almost as large as the United Kingdom. The hurricane left an estimated three million people without electric power, not only severely hampering rescue efforts but hindering their ability to function. Soon after the storm ravaged the coast, Homeland Security Secretary Michael Chertoff described the aftermath of Hurricane Katrina as "probably the worst catastrophe, or set of catastrophes" in the country's history!

Katrina's economic impacts may be more lasting and far reaching than typical natural disasters due to the severity of damage and the unique geography of the region affected. By blasting New Orleans, the storm hit a vital organ of the U.S. economy -- a concentration of ports, rail lines, barge traffic and major highways making up one of the nation's major trade hubs.

While it is still too soon to determine the exact long-term business impacts of Hurricane Katrina short-term impacts have already been tremendous. In the six months immediately after Hurricane Katrina struck, the US Small Business Administration approved $5.2 billion in disaster loans to over 73,000 homeowners, renters, and small businesses in Texas, Louisiana, Mississippi, Alabama, and Florida (DHS, 2006). While all business areas in the region were affected, several key industries and infrastructures were considered particularly vital due in large part to the ripple effect felt throughout the entire U.S. economy.

INFRASTRUCTURE AND INDUSTRY DAMAGE

Hurricane Katrina along with previous damage caused by Hurricane Rita impacted over twenty ports in the Gulf of Mexico. The impact of the hurricanes varied, with the largest impact being on the ports of Louisiana, Texas, Alabama and Mississippi. For several ports, including New Orleans, the impacts were considerable; some of the facilities were damaged beyond repair while others required extensive re-building efforts before they would again be suitable for commercial use. Maritime trade drives, or contributes to, many important facets of many U.S. industries, causing a tremendous ripple effect throughout the economy. U.S. ports and waterways handle over 2 billion tons of cargo annually with much of that commerce flowing through Louisiana, Texas, Alabama and Mississippi.

Along with the port infrastructure damage, Katrina also interrupted oil production, slowed the import of crude oil, and limited refining capacity in the Gulf area, thus having a major effect on fuel prices. One tenth of all crude oil consumed in the United States and almost half of the gasoline produced in the country comes from refineries in the southern states located along the shores of the Gulf. In addition to having a major impact on crude oil, 24 % of the entire U.S. natural gas supply is extracted from, or imported to, the affected region. The initial disruption to the energy infrastructure was astounding as 91% of offshore crude oil production was temporarily lost and 83% of daily gasoline production capacity temporarily extinguished (Anonymous, 2005).

Katrina also had a significant effect on agriculture. Winds from Katrina affected significant percentages of the corn, rice, soybean, fruits, vegetables and nursery crops in the effected region with expected losses estimated to be around $190 million. Livestock losses were sizable in the poultry and dairy industries with dairies in the affected areas reported losses exceeding $3 million per week. Early estimates from the Forest Service also point to sizable timber losses from Hurricane Katrina that will amount to 4.2 billion cubic feet of timber and possibly billions of dollars worth of assets destroyed.

Port infrastructure damage had a dramatic effect on our nation's petroleum, grain and farm products industries, as well as our, fruit, poultry, coffee bean, chemical and steel trades. For example, the Port of New Orleans, which was non-functional immediately after Katrina, typically serves as a focal point for cargo to 28 states, supporting nearly $37 billion in economic benefits. As ports in the Gulf coast region were damaged, the impact was felt globally. Not only was the U.S. economy impacted, but with over half of the grain exports for the U.S. departing from ports directly impacted by Katrina, foreign markets counting on U.S. grain to feed their citizens also suffered severe negative impacts.

ALABAMA POWER RESTORATION CHALLENGES

Alabama Power is the second largest subsidiary of Southern Company, the nation's largest generator of electricity. Alabama Power, an investor-owned, tax-paying utility, serves 1.3 million homes, businesses and industries in the southern two-thirds of Alabama. More than 78,000 miles of power lines carry electricity to customers throughout 44,500 square miles.

Alabama Power's peak outage occurred at 6:30 a.m. on Tuesday, August 30, 2005, about 24 hours after Katrina's initial landfall. As Katrina barreled up the Alabama-Mississippi border, it left 636,891 Alabama Power Company customers in the dark. Nearly half of the company's total customers were without power during the immediate aftermath of the storm. By sheer outage numbers, this storm was the second-largest in the company's history, behind September 2004's Hurricane Ivan (825,000 customer outages).

According to Alabama Power statistics, 1,914 miles of power transmission lines were out of service, roughly 15% of the total line length maintained by the company. The transmission lines are vital to the power distribution infrastructure since they are responsible for transferring power from the generating plants to substations throughout Alabama Power's service area. In addition, the company was facing 940 transformers that were damaged, 1,376 poles that needed to be replaced, and 384 miles of distribution power lines that were out of service. These distribution lines provide the basic infrastructure that allows for service to homes and businesses. Without this infrastructure, the management at Alabama Power is facing a monumental challenge!

CASE DISCUSSION QUESTIONS (PART A)

Recent natural disasters such as Hurricane Katrina have highlighted the need for better disaster preparedness planning. As a result, address the following five issues.

1) What actions can an organization take to prepare for potential disruption?
2) How do seemingly local, or regional, events impact the larger supply chain network (or even the entire economy) as a whole?
3) Discuss why you think some companies are able to react quickly to disastrous situations when others cannot. What are the key differences between those companies who can react quickly and effectively to a situation and those that can not?
4) Given the enormous task ahead and the limited information available, provide thoughts on how to approach a recovery plan. This should include a prioritized list of key accomplishments for restoring power, as well as a list of company needs required to accomplish the restoration.

5) Discuss how the company's dedication to quality and their philosophy of continuous process improvement could be utilized upon completion of the response to Katrina to enhance future efforts.

PART B: THE ALABAMA POWER RESTORATION PROCESS: ANSWERING THE CHALLENGES

According to Senior Vice President of Power Delivery Mr. Robin Hurst, "the key to managing a crisis is not waiting until the crisis occurs to begin planning." Alabama Power has practiced this philosophy of actively planning for a crisis well before the crisis begins. The results have been dramatic. For example, while there were longer-term repairs that needed to be made to the infrastructure after Katrina, the company accomplished an amazing feat—they restored power to all of their customers in an impressive eight days. In spite of severe electrical and general infrastructure damage and destruction from Hurricane Katrina, over 600,000 customers had power re-established within a week! Furthermore, many of those customers only experienced outages for a few hours to a couple of days.

Alabama Power has been dealing with these types of situations for many years. In 1979, Hurricane Fredric caused 239,400 Alabama Power customers to lose power and, given the severity of the storm, it took the company a respectable 21 days to fully restore power. Roughly twenty-five years later and based on the results achieved immediately after Katrina, it appears their dedication to continuous process improvement has continued to pay dividends to the company and its customers. It is clear that continually identifying disruption areas, training and equipping personnel, and updating the disaster response plan certainly makes a difference in business and in the lives of people.

Successful crisis planning requires dedication to continuous development and refinement of the contingency plan at both the organizational and employee levels. Properly developed, the plan should be designed to address the crisis and should always provide details for timely and complete responses to both specific and general risks. A well-prepared plan must also take into account the lessons and experiences learned in previous events. Unfortunately, like many management plans, this is much more easily said than done. Nevertheless, if properly executed, the proactive process of business continuity planning, contingency planning, or disaster planning provides the foundation for reaction once an event occurs. This special type of planning provides a blueprint for responding to the risks associated with an unknown event.

How is it possible to provide a blueprint for responding to an event that is unknown? Clearly, it is impossible to accurately predict every future unknown event. Managing a crisis often includes handling disruptions to normal operations caused by unplanned events. Through the benefit of experience, research intelligence, hard work, continuous refinement and updating of the plan with

current information, and a little luck, these efforts can lead a company to success in continuing their operations in the face of adversity. In the case of Hurricane Katrina, a geographically widespread natural disaster, Alabama Power found success by employing their crisis recovery plan.

AWARENESS – DEVELOPING THE PLAN

The risk of a disruption is very real and can cause severe consequences. Therefore, creating awareness of risks to the business is a vital first step to successful continuity planning. Included in this first step for Alabama Power was identifying the purpose for the crisis plan. Alabama Power made it clear that the primary purpose for its disaster plan was to reduce customer outage time to an absolute minimum within the guidelines of safe, practical and orderly practices. The purpose provided planners with a solid foundation for all future planning, management, and operational efforts in the event of a crisis. The purpose serves as the basis for strategy development in a crisis as well as affecting plan implementation processes.

Due to the nature of their business, and the geographical location, Alabama Power has developed extensive experience in dealing with disasters of all sorts, ranging from hurricanes to ice storms. One important lesson they have learned was that in order to meet the stated purpose of their disaster plan, they must move, or be prepared to move, the necessary personnel, equipment, and logistical support to the affected areas as soon as it is safe to do so. In order to do so takes a well organized, prepared team of professionals who are familiar with the requirements and resources at hand.

A critical step in developing any plan is determining the assignment of responsibility and outlining how the organization will be organized to best manage the situation. To borrow from military logistics expertise and terminology, the plan must outline the ‘Chain of Command’ and delineate who does what, when, and where. While never perfect, the basic organizational plan provides an excellent starting point and aims to reduce vast amounts of confusion early in the management of a crisis. The plan also allows personnel to be trained to meet specified, well-defined requirements that are assigned to each position on the crisis management staff. The plan and key managerial personnel are then responsible for informing the company of exactly what the personnel requirements will be in the event that the organization’s disaster plan is activated. Once the organizational structure is defined and personnel/skill requirements are determined, basic functions can be published, dictating the responsibilities of each individual position. By doing so, the plan helps to alleviate confusion during the event and supports training of personnel.

PREVENTION – THE WINDS OF CHANGE

With the organizational structure of the disaster team in place, the positions identified, and personnel selected to fill the positions, it’s time to review and prepare for mobilization. The plan

provides guidance and responsibilities, but it is ultimately up to the people involved to be familiar with what and how they will fill their roles when called upon. Simply put, it is not enough merely to be aware of potential problems and to plan; managers and personnel have to be familiar with the plan and take action when necessary.

Once the plan is written and the people are trained and familiar with it, what is the next step in a successful disaster response? The organization must have the tools in place to support the personnel charged with key responsibilities. This ranges from designating a facility, or facilities, that will serve as the operations center(s) to incorporating communication systems, to providing technology that will assist in providing advanced warning when possible. Alabama Power utilized its day-to-day control centers as part of its contingency plan. The Alabama Control Center (central point of contact for power transmission), the Distribution Operation Center (Regional Control Centers in Birmingham, Montgomery, and Mobile charged with responsibility for monitoring power distribution), and the Customer Service Center (central customer service centers in Birmingham and Montgomery) were all vital to the success of Alabama Power's disaster response plan. In a situation like Hurricane Katrina where a major disruption is expected to impact multiple regions, the corporate office provides the central role in the disaster recovery plan. In these cases, the Corporate Storm Center in Birmingham, Alabama is also manned as part of the disaster response plan. This facility provides a central point of contact when regional facilities require additional restoration support or when restoration assistance outside Alabama Power's service territory are requested.

Oftentimes certain situations pose obvious threats to business operations and can be proactively addressed. Preventive action, where feasible, enables the company to 'head-off' potential problems before they are problems. The intent is to understand potential weaknesses and to take action. This step not only prevents some potential disruptions, it also helps the organization deal with other situations as they arise.

Now the stage is set, the plan is up to date, the personnel are trained, and the facilities have been identified and equipped. In late August 2005, the decision was made to activate the Alabama Power Emergency Operating Procedures. Preliminary analysis was conducted to determine the most likely impact areas and the professionals within each division of Alabama Power began work on making the plan operational. In preparation for the storm, five specific focus items were developed. This short list of focus areas or key priorities was developed with the primary goal of minimizing customer outage times in mind. The five key areas were identified based in large part on lessons learned from previous storms. As part of their commitment to excellence, management at Alabama Power has a continuous improvement process to aid in effective disaster planning. The result of the continuous improvement process was the identification of five key areas to address through the implementation of the disaster recovery plan.

First, staging areas for incoming personnel and supplies were identified. This process enables the flow of material in an organized fashion. It also makes the job of storing and moving required supplies and equipment more efficient. Next, decisions had to be made on the division of labor and

prioritization of areas of control. There are only so many resources available to the company and important decisions have to be made concerning where those resources will be focused first for maximum value. Third, resources necessary to support each staging area were identified. This allowed for early supply movement and pre-staging decisions to be made and adjusted as the storm approached. Fourth, Alabama Power contracted with a third-party logistics company just in case additional resources were required to fully implement the disaster recovery plan. The contractor provided temporary eating, sleeping, and restroom facilities at designated staging areas. Finally, the plans for use of company facilities as back-up operating locations and refuge shelters was reviewed and finalized. The key decision to commit resources to logistics/ supply chain related areas and to relocating critical resources became crucially important in the days immediately following the storm.

REMEDIATION – IMPLEMENTING THE PLAN

Even if the company has taken the necessary steps to increase disruption awareness and has taken action to anticipate and prevent problems before they can occur, supply disruptions cannot be completely eliminated, especially in crisis situations. With this assumption, the company relies on its plan for quick action to fix problems when they occur. The plan provides a blue print for appropriate actions and allows trained, knowledgeable personnel to take immediate action.

In our case, Alabama Power faced a tremendous task. As discussed, over 600,000 customers were without power; 1,376 poles needed replacing, 940 power transformers were damaged, and close to 2,000 miles of power lines had to be restored. Efforts to restore power had to begin as soon as possible. Due to continuous planning conducted by the company, trained personnel went into action immediately. They utilized the disaster response plan, the resources of the organization, and the technology available to tackle the many problems facing the company.

Communication is vital to successful coordination of the disaster response plan and the Katrina response was no exception. Communication is required to effectively establish the priority of repair, schedule proper distribution of supplies and resources, and help to ensure safety of workers and customers. Previously coordinated support from SouthernLINC Wireless provided communications between field employees and various operation centers as well as many public safety departments. This enabled Alabama Power to begin its survey and repair efforts immediately after the storm had passed.

Several logistical issues also had to be addressed if the primary goal of the disaster recovery plan was to be met. During the peak period of restoration efforts in Alabama and Mississippi, the Alabama Power Company managed or assisted in managing 20 staging areas in Alabama and Mississippi. Overall, the company processed 200 trucks loads of material and coordinated 100 buses and numerous personnel support vehicles. In addition, the company managed 40 refueling sites managed by 80 employees dispensing 306,529 gallons of fuel. In direct support of personnel, the company coordinated service and provision for 74,088 breakfasts, 82,198 lunches, 75,617

dinners, and 3.36 million pounds of ice. In this type of contingency, many items that are taken for granted become an issue. Alabama Power also coordinated service for over 25,000 pounds of laundry, 60 dumpsters, 12 office trailers, and 350 port-o-lets. The combination of a business continuity plan, well defined tactical processes, sufficient levels of pre-planned logistical support, and the effective utilization of qualified personnel led to total restoration of power in only eight days, a truly remarkable feat.

KNOWLEDGE MANAGEMENT – CONTINUOUS PROCESS IMPROVEMENT

The last big piece of the planning puzzle is knowledge management. When disruptions occur, it is very important that organizations learn from the experience – from both positive and negative aspects. This sounds easy enough. While sometimes this is relatively easily achieved at the individual level, learning at an organizational level takes a special effort. This is in large part why Alabama Power employs an active continuous process improvement program as part of its management philosophy. This is particularly important when examining the disaster response plan employed by the utility.

During and immediately after the crisis, personnel have been working full steam in preparation and mobilization for the event. During this period, they have serious concerns about their own families, friends, and property. Nevertheless, they serve their company and its customers in a professional manner, responding to the crisis. Now, immediately after working countless hours in adverse conditions, sleep deprived professional employees are expected to record detailed success stories and problem areas so the disaster response plan can be enhanced prior to the next event. In order to properly prepare for, and not relive the same situation over and over again, it is vitally important to document both successes and problems as soon as possible after they occur. The fresher the issue and company reactions are in the minds of the employees, the more accurate and thorough the employee recount of the situation is presumed to be. This allows the organization to improve the plan and effectively manage their continuous improvement process through continuous enhancement of their disaster recovery plan. Even if everything goes relatively well, the 'post-mortem' examination is a means of continually enhancing the plan. Ultimately, the continuous planning mindset is essential to long-term success.

Alabama Power continued their planning process improvement efforts throughout and subsequent to Hurricane Katrina. As part of the contingency plan and its requirements for personnel, detailed event logs were kept, both to support restoration effort decision-making processes and to assist in continuous process planning improvement for future crisis events. Reporting experiences from an event are critical, whether the lessons are truly new experiences or just a re-emphasis of the expected, it is important to record, prioritize, report, and address each experience. Lessons learned from Hurricane Katrina included such issues as the need for increased logistics support for personnel and potential vulnerability of communication capabilities. Enhancing the identification of alternate

facilities, managing competition for scarce resources, and support of employees with property losses and family crises were also identified as key areas that could be addressed to aid disaster response improvement. As shown above, lessons from such a widespread event are indeed widespread themselves. Since no two crisis situations are the same, new lessons can be learned from each event.

The impact of Hurricane Katrina will have long-term impacts. Many businesses are only now recovering from losses while other businesses will never recover. Natural disasters of this type cause massive business disruptions, regardless of industry. In the case of Alabama Power, the company was able to successfully manage restoration efforts in minimal time. This is due, in large part, to the continuous dedication of the company to contingency planning efforts conducted through implementation of a continuous process improvement philosophy. By focusing their efforts on awareness, prevention, remediation, and knowledge management, Alabama Power was able to recover quickly and efficiently from the mass devastation created by Hurricane Katrina.

CASE DISCUSSION QUESTION (PART B)

1) Given what Alabama Power has experienced (Part A), and how they responded (Part B) identify any additional issues and potential tools that management may be able to use to help them achieve continuous improvement in their contingency planning process.

AUTHOR BACKGROUND INFORMATION

Joseph B. Skipper is a Doctoral Student in Management in the Dept of Management at the College of Business, Auburn University and a Major in the United States Air Force. Ben has served as a Logistics Officer in the USAF for 13 years holding positions at the tactical, operational, and strategic level. He holds a B.S. degree in Marketing from Troy State University, as well as a M.S. in Logistics Management from the Air Force Institute of Technology. His primary research interests include contingency planning, risk management, and supply chain disruption. He has published in the *International Journal of Physical Distribution and Logistics Management* and the *Journal of Transportation Management*.

Joe B. Hanna (PhD. New Mexico State University) currently serves as Departmental Chairperson and Professor of Supply Chain Management in the College of Business at Auburn University. Dr. Hanna has authored or co-authored numerous journal articles appearing in journals such as *Journal of Business Logistics, International Journal of Logistics Management*, and *Journal of Transportation Management*. Dr. Hanna has also co-authored a logistics textbook and has participated in government funded transportation research. Joe is also an active member of several professional organizations and regularly conducts professional training seminars for various organizations. Dr. Hanna's area of interest in supply chain management allows him to instruct undergraduate, graduate, and executive education students at Auburn University. Prior to entering academia, Joe gained professional experience working for Phillips Petroleum Company, Phillips 66 Chemical Company, and Coopers and Lybrand.

ADJUSTING INTERNATIONAL AGREEMENTS IN LIGHT OF CHANGE: A CASE OF ASSISTED RENEGOTIATION

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CASE DESCRIPTION

The case is based on a true story. The primary subject matter of the case concerns conflict resolution via mediation and conciliation meetings. Secondary issues examined include the effect of economic conditions on price, personal and emotional involvement in the negotiation, the creation of effective business partnerships and the contrast between distributive and integrative negotiation strategies. The parties will engage a mediator to resolve their dispute. The exercise consists of simulating the mediation/conciliation meetings. Neither one of the two parties in the dispute is sure that they have a solid case. The case is expected to be taught in two hours with additional student preparation time of thirty minutes. Student preparation may be done inside or outside of the classroom. The case is designed for an upper level undergraduate or graduate course and could be used in a strategy course, or as part of a conflict/negotiation module of a general course in business management.

CASE SYNOPSIS

Set in the context of a conflict over a business agreement, this negotiation exercise explores the dynamics of two companies with resource asymmetries. These parties choose mediation to resolve their dispute. The dynamics of a large industrial corporation against the independent owner in the retail gas industry the main premise of the case. The role play activity highlights the difficulties of fulfilling obligations when there are changes occurring in the political and economical environment.

Two parties, Global Gas Inc. (GGI) and Gas Station Janet (Mr. Tony Martinez) agree to remodel an existing gas station and build two more. Mr. Tony Martinez provided the land lots and he operates the gas stations under an exclusive relationship with GGI regarding branding of the gas station and supply of gas, lubricants and any other oil product for 15 years. GGI paid for the exclusive rights, the remodeling and construction of one gas station but GGI did not complete the original investment plan since they did not construct the third gas station as stated in the Mortgage Warranty Contract. GGI argues that the third station was only a project and that there was no actual commitment to build it. In addition, the original premises of the business plan have changed

since the Government of Colon has frozen the price of gas for the last two years. Mr. Tony Martinez contends that GGI made a clear commitment in the Mortgage Warranty Contract and therefore they are subject to liabilities. The main incentive of reaching an agreement at this stage is that the parties will have control over the cost of the outcome; otherwise, they will be subjected to the cost uncertainty of the final arbitration. Several other concepts are illustrated including the effect of economic conditions on price, personal and emotional involvement in the negotiation, the creation of effective business partnerships and the contrast between distributive and integrative negotiation strategies. The mediator's role is crucial for building viable options and reaching a final agreement. The present case is a simulation of a conflict and its resolution via mediation and conciliation. This exercise consists in simulating the conciliatory meetings.

THE OIL INDUSTRY IN THE REPUBLIC OF COLON

The politics, economics, and social conditions of the Republic of Colon changed radically since the first signs that the country was rich in oil deposits, in the second decade of the 20th century. In the 1920s, the majority of the population was extremely poor. The economy was highly dependent on coffee and cacao exports. The country suffered from a succession of civil wars, which only ended when the ruthless dictator Gonzalez took power in 1920. Gonzalez effectively got rid of all the local factions, and while he was not keen on setting a democratic course for the country, he did take decisive steps into economic modernization. He developed a series of infrastructure projects throughout Colon that marked the beginning of a modern era. It was the discovery and first exploitation of oil, however, that steeped social and economic change, and particularly the transformation of what had been small, basically rural towns into large urban areas. Modernization, however, was limited and did not automatically lead to a less unequal income distribution.

During the first two thirds of the 20th century, oil exploitation, distribution, and refining and commercialization processes were under control of a small number of U.S. and British corporations. In the early 1970s, however, a populist government led by the left-centrist political party Acción Popular began a process of nationalization of the oil industry. The thrust of the nationalization process was the creation of a national, government-controlled, corporation that would monopolize all aspects of the industry. Given this tight monopoly, the government was to exercise an unlimited control over the price of oil and its derivatives. After huge indemnifications to foreign companies, to which the government obliged after a series of negotiations, Petroleos de Colon Sociedad Anonima (PDCSA) emerged in 1975 as a State-owned and operated Oil Company, with the monopoly of the oil business in Colon. One of the results of this process was that gasoline in Colon was extremely cheap by any international standard. While at any given moment of the year gasoline in the U.S., for instance, fluctuated greatly and could reach as much as US$1.50 per gallon, gasoline in Colin remained with fixed prices for years, and never reached more than 50 cents per gallon (in U.S. currency).

OPENING THE MARKETS FOR GASOLINE RETAIL BUSINESSES

In the early 1990s, most of governments in the region engaged in deep, at times traumatic processes of economic and political reform, marked primarily by increased deregulation and privatization efforts of major industries, as well as a gradual opening up of traditionally closed, tightly controlled markets. Following the signs of the times, in 1994 the Government of Colon decided to open up its market of gasoline retailing to prospective national and international investors. Gas would be supplied to retailers by Petroleos de Colon Sociedad Anonima (PDCSA), the State-owned and operated Oil Company that controlled the monopoly of exploration, exploitation and refining of oil in Colon. The distribution and commercialization of gas would be opened to competition. The basic premise of the Colon Government's proposal was that the price of gas, although so far regulated by the state, would be allowed to fluctuate according to market trends. The government offered guarantees of an attractive return on investment based on international standards, presuming that gas retailers had performance indicators (operating cost) and business practices comparable to international benchmarks.

Global Gas, Inc. (GGI) Starts Operations in Colon

Global Gas, Inc. (GGI) is a corporation in the oil business that operates world wide with an extremely good financial performance as illustrated in Table 1.

Table 1: Global Gas Inc. Financial Highlights (billions of dollars)

	2001	2000	1999
Total Revenue	213.5	232.7	185.5
Net Income	15.3	17.7	7.9
Capital and Exploration Expenditures	12.3	11.2	13.3
Average Capital Employed	88.0	87.5	83.8
Return on Average Capital Employed (Percent)	17.8	20.6	10.3

In the point of view of GGI's top management, this superior performance is the end result of well-thought short, medium and long term strategies; the best business and management practices; the best human capital, and the most up to date technology, developed in-house or elsewhere.

Given the Colon government's efforts to attract foreign investments into the recently opened gasoline retail business, Global Gas Inc. (GGI) decided to launch a major investment initiative in Colon in 1995. The plan consisted of acquiring or building three gas stations in the five major cities, and a major investment in the capital city of Colon of ten gas stations. The plan was scheduled to

be concluded by the end of 2000, provided the general basic conditions offered by the Government remained valid (see table 2).

Table 2: Investment Execution Schedule							
City	No. of gas stations	1995	1996	1997	1998	1999	2000
Colon	10	xxx	xxx	xxx	xxx		
San Juan	3	xxx	xxx				
Valencia	3		xxx	xxx			
San Francisco	3		xxx	xxx			
Bolivar	3				xxx	xxx	
Merida	3					xxx	xxx

Global Oil Inc. had devised a strategy to operate each of the projects with a local partner, preferably with firms or individuals that already had a gas station or experience in the business. In the specific case of the Bolivar initiative, Mr. Tony Martinez had been selected as partner because he already owned a gas station and has extensive business experience.

Mr. Martinez owned a gas station in a prime location in the city of Bolivar and he had twenty years experience in gas retailing. This was the opportunity of his lifetime; an international partner, who would provide the financial backing that Mr. Martinez needed to expand and grow his business. Texaco and BP had also approached Mr. Martinez with interesting offers. He finally decided to negotiate a joint venture with Global Gas Inc. in view of their generous offer.

After several meetings between Mr. Martinez and GGI, they finally reached an overall agreement on an investment plan that consisted in the remodeling of an existing gas station (Janet) and the construction of two others (Jolly and Justine). A "Mortgage Warranty Contract" (see Exhibit 2) was signed between the two parties in March 1998 outlining the commitments of each side.

The project execution schedule had been progressing fairly well. However, towards the end of 1998 the Government did not authorize the gasoline price increase that was promised. Price increases are based on accumulated inflation during the year. The majority of gas dealers accepted this situation hoping that next year prices would be adjusted taking into account a two-year lag. In 1999, the Government expressed concern over consumer price increases and since it was an election year, they again decided not to increase gas prices. In view of all this, Global Oil Inc. decided to cancel investments in the city of Merida and freeze investments in the city of Bolivar. In the meantime, the National Association of Gas Retailers negotiated with the Government a possible compensation scheme for the losses incurred so far.

Current situation

The Mortgage Warranty Contract was signed on March 11,1998, according to the investment schedule shown in Exhibit 1 for summary and Exhibit 2 for full contract). Two gas stations (Janet and Jolly) were successfully completed and they are fully operational today. However, it is already May 2001 and the third gas station (Justine) has not been built by GGI even though Mr. Tony Martinez bought the land according to the terms of the Mortgage Warranty Contract in December 1998. During the last two years, Tony has unsuccessfully tried to convince and then pressure GGI to comply with the Mortgage Warranty Contract and build the third gas station. GGI has reacted by arguing that with the freeze on gas prices imposed by Government, the project was not currently feasible (according to the Operations and Supply Agreement in Exhibit 3). Mr. Martinez argued that GGI commitments in the Mortgage Warranty Contract had nothing to do with the price of gas and that GGI had to comply.

THE CONFLICT

Aside from the significant delay in building the third gas station, which has caused Mr. Martinez a lot of stress and anger, the business relationship between the partners is working very well in the two gas stations that are in operation. However, six weeks ago Mr. Martinez lost his patience and proceeded to sue GGI after they cancelled, without an explanation or even an apology, two consecutive meetings Mr. Martinez had arranged. He then filed suit against GGI for the amount of US$564,438.63, on account of lost income (i.e., income that Mr. Martinez has not been able to realize because of GGI's delay in building the third gas station). Mr. Martinez assigns full responsibility for this delay to GGI, since he already fulfilled his part of the agreement by purchasing the land in the city of Bolivar (see Exhibits 4 & 5 for the summaries of the plaintiff's and the defendant's legal motions). These legal demands have triggered off the arbitration provision in the Mortgage Warranty Contract regarding conflict resolution.

As part of the standard arbitration process, the parties are required to go through a sequence of two conciliation meetings prior to the final arbitration. In these meetings and with the help of a professional mediator-conciliator, the parties must search for a mutually satisfactory agreement. In case they are unable to reach an agreement, the arbitration process takes place. The decision of the arbiters is final and not subject to appeal, therefore it is beneficial to both parties to reach agreement in the conciliation meetings.

The mediation meetings are scheduled to start next week, before the arbitration process, Martinez has high hopes that they can reach an agreement to build the third gas station. At this point, he is afraid that he may be overcome by rage, and so he has been trying to prepare himself for the meetings. Of course, Mr. Martinez prefers to avoid the arbitration process.

GLOBAL GAS INC. TAKES A STAND

GGI operates in Colon in four areas: oil exploration and exploitation services as a contractor to the state owned operating company (PDCSA), their own exploration and exploitation activities, chemical processing of oil to extract oil products for export and the gas retailing operations. The company's policy is that all business units must be profitable and they attempt to avoid any cross subsidies. So far, all operations in Colon have been very profitable with the exception of gas retailing,. The top management's perspective is that the lack of profitability of gasoline retailing in Colon is due to the changing social and political conditions.

The management of GGI in Colon is very much aware that their local partner, Mr. Martinez, is extremely upset because of GGI called off the construction of the three gas station projects they were developing with him. They argue, in turn, that the termination of the agreement is due to the general economic and political conditions of Colon and GGI's own corporate policies. The only real issues are business strategy. They do know, however, as they have been informed by several sources, that Mr. Martinez has made very nasty remarks about their corporation. They realize that he is frustrated and may be willing to make the situation more difficult through his actions.

In the meantime, GGI has taken short term measures, such as freezing all investment in old and new projects to force firmer and clearer policies from Government. This is standard policy for GGI, as they have encountered similar issues in most developing countries that are in the process of modernizing their economies. They have seen before how local partners may be forced to suffer the consequences of project cancellation. Such is the case of Mr. Martinez. Several of the local GGI management know him well.

GGI's representative in the conciliation/mediation meetings has received clear instructions to make substantial efforts to reach an agreement, to avoid the cost of the arbitration process.

SELECTING THE MEDIATOR

The selection of the mediator for the conciliation meetings between GGI and Tony Martinez took more than three months. Mr. Martinez was weary to commit to a mediator whom he feared might be all too willing to acquiesce to the power of a multinational corporation. On the other hand, GGI was afraid of potential damage that might take place if the impasse became politicized or gained press or otherwise public notoriety. Finally, the two parties agreed on asking Raul Montero, an Academic Dean of a local business school, to become the mediator. As an academic, Dr. Montero had gained national and international reputation in his field of electronic engineering. He had presided over the Board of the Engineering Institute, a non profit research and consulting organization, and had been widely praised for his uncanny negotiation skills. Later in his career, he had become a pioneer of the teaching of negotiation and conflict resolution theory and practice in

Colon. He was seen by both parties as clearly independent of any possible influence, and with professional credentials more than sufficient to grant him the respect of all.

Dr. Montero accepted the role of mediator out of intellectual curiosity and also to gain increased international recognition as a practicing negotiator and mediator. As he evaluated the situation and the level of conflict involved, he was uncertain of how to start the meeting, and above all, how to make it past the first rounds, which would surely produce a significant amount of irate comments from Mr. Martinez, and might produce a negative reaction from GGI. He knew that a mediating process requires exploring options. He needed to create a climate in the meetings so that both parties would be willing to make a list of options, not discarding any in the first meeting. Dr. Montero was confident that if they made it past the first, most likely difficult moments of the first meeting, he would be able to promote a satisfactory agreement.

DISCUSSION QUESTIONS

The following discussion questions may be used for discussion:

1. What did each party want out of the mediation?
2. What role did emotions play in this negotiation? Was either side right?
3, How effectively did each team approach the negotiation?
4. What role did the mediator play in the negotiation?
5. Why is the selection of a mediator so important?
6. What effect did competition have on the dynamics of the negotiation?
7. How did asymmetries in the resources available to both parties effect the negotiation?
8. Was this an integrative negotiation or a distributive negotiation? Why? Were there any attempts at creative problem solving?
9. Did you reach an agreement in the mediation? If so, how satisfied are you with the agreement? If not, is there anything that could have been done to reach agreement?
10. What areas involved ethics in the negotiation?

Exhibit 1: SUMMARY OF THE MORTGAGE WARRANTY AGREEMENT

I. GGI plans to invest US$ 1,718,000.00 on the whole project. This money will be distributed according to the following schedule: a) Upon the signing of this agreement, GGI will pay Mr. Tony Martinez US$ 470,000.00 for the rights to identify the three gas stations with the Global Gas Inc. brand name and logo in all the billboards, banners and pumps that may be set up; b) US$ 695,000.00 will be allocated to construction and civil works in the three sites; and c) and the equivalent of US$ 553,000.00 will be provided in equipment (tanks, pumps and dispensers) for the three gas stations over the years 1998 and 1999.

II. Specific and detailed agreements will be signed for each gas station once construction is initiated, and will go into effect right after the first delivery by GGI of gas, lubricant oils or any other petroleum-derived product to

each gas station. The duration of each agreement will be 15 years. These agreements will be referred to as the "Operations and Supply Agreements" (see Exhibit 3).

III. Mr. Tony Martinez will provide the land for the three gas stations. The title deeds for the land of the first two gas stations (Janet and Jolly) will become collateral to guarantee GGI's initial investment of US$ 470.000,00 paid to Tony Martinez upon signing this agreement. Mr. Tony Martinez will purchase the land for the projected third gas station within one year of the signing this agreement.

IV. GGI will be the exclusive provider of gas, lubricant and any other gas or petroleum derived product for sale in the three gas stations.

V. After the 15-year period all the equipment and buildings will become the sole property of Mr. Tony Martinez.

VI. Mr. Tony Martinez and GGI agree that any differences between the two parties that may arise during the execution of this agreement will be resolved in the following sequence: 1) the parties will make every attempt to reach resolution in a friendly manner via discussions and dialogue; 2) the parties will follow a standard arbitration process; and 3) the parties will go to court.

Exhibit 2: MORTGAGE WARRANTY CONTRACT

Between Global Gas Incorporated, a corporation domiciled in the city of Colon and registered with the Commercial Registry of the Judicial Circuit of the Federal District and State of Miranda on July 7, 1994, under No. 54, Volume 37-A, hereinafter referred to as "GGI" as party of the first part; and as party of the second part, Gas Station JANET, hereinafter referred to as "THE OWNER" a company domiciled in Ciudad Bolivar, represented herein by its President Tony Martinez, have agreed to subscribe the following Mortgage Warranty Contract.

I. The objective of this warranty contract is to norm the terms and conditions in which the mortgage warranty will become effective between GGI and THE OWNER, according to the agreement in which GGI will invest in the remodeling and technological modernization of gas station "Janet", which is identified further ahead in this document, and in the construction of two (2) other gas stations as stated in clause III of this contract. On the other hand, THE OWNER will affiliate the referred three gas stations to the GGI network, he will only purchase and trade gas, lubricant oils or any other petroleum derived product to each gas station delivered by GGI, in addition "THE OWNER" will identify all three gas stations with the GGI brand name in all banners, logos, billboards and stationary in the terms and conditions established in the "Operations and Supply Agreements" that each party will subscribe in a separate agreement for each one of the gas stations identified in Clause III of this contract.

II. "THE OWNER" declares that (a) he is the sole owner of Gas Station Janet, a business whose main object is the commercialization and supply of gasoline, diesel fuel, lubricant oils and any other related product and (b) he is going to purchase, in this very same act, a land lot located at the intersection of Prospero Reverend Avenue and Republic Avenue, City of Bolivar, in which a gas station will be constructed for the purpose of commercializing and supplying gasoline, diesel fuel, lubricant oils and any other related product.

III. "THE OWNER" is committed and obligated irrevocably for the duration of fifteen (15) years to purchase exclusively fuel and lubricants products from GGI, to maintain the three gas stations fully identified with the GGI logo in all banners, billboards and stationery in terms and conditions of the "Operations and Supply Agreements" that the parties have signed separately; in addition, "THE OWNER" is committed and obligated to affiliate under the same said conditions the two new gas stations: (a) Gas Station "JOLLY" that will be built in the land lot that will be purchased by "THE OWNER" in this very same act and (b) a new project for the construction of a third gas station in the term of one year from the date of signature of the present document.

IV. GGI will invest the amount of six hundred and ninety five thousand US$ (US$695.000,00) in civil works, improvements and reforms to modernize gas station "JANET" and the two new gas stations mention in clause III in conformity with the investment plan previously agreed by the parties pending the constitution of the mortgage warranties to the entire satisfaction of GGI. The administration of these funds will be carried out by GGI as well as the execution and supervision of all the work. As part of this agreement, GGI will provide as a loan for the duration of the "Operations and Supply Agreements" the equipment necessary in each gas station for the amount of five hundred and fifty three thousand US$ (US$ 553.000,00). In addition, GGI will pay "THE OWNER" in this act the amount of four hundred and sixty thousand US$ (US$ 460.000,00) for the full affiliation of the three gas stations to the GGI network.

V. The overall investment made by GGI will be waived as long as the three gas stations operate for the duration of the fifteen-year period provided in the "Operations and Supply Agreements". After such a term, GGI will consider the invested money as paid and "THE OWNER" will be free from any obligation to pay any money back.

VI. Exclusive rights of GGI.

VII. Parties' right to authorize any transfer of this contract to third parties.

VIII. Extent of warranties

IX. Execution of Mortgage

X. Of the "Operations and Supply Agreements"

XI. City of contract

XII. Reference exchange rates

XIII. Arbitration: the parties agree to resolve any controversy that may arise during the execution of this contract via arbitration. The parties agree to abide to the Arbitration Rules of the Center for Conciliation and Arbitration of the Colon American Chamber of Commerce (Colamcham). The decision of the arbitration tribunal will be final.

Exhibit 3: THE OPERATIONS AND SUPPLY AGREEMENT

Between Global Gas Inc., a corporation domiciled in the city of Colon and registered with the Commercial Registry of the Judicial Circuit of the Federal District and State of Miranda on July 7, 1994, under No. 54, Volume 37-A, hereinafter referred to as "GGI" represented herein by John Lewis of legal age, domiciled in Colon and bearer of passport No. A-0032455 as party of the first part and as party of the second part, Gas Station JANET, hereinafter referred to as "THE OWNER" a company domiciled in Ciudad Bolivar, and registered with the Commercial Registry of the Judicial Circuit of the Bolivar State on November 12, 1995, under No. 30, Volume 77, represented herein by its President Tony Martinez, of legal age, domiciled in Bolivar and bearer of the Republic of Colon Identity Card No. 3.503.102, have agreed to subscribe the following "Operation and Supply Agreement"

I. System of Operation

II. Protection of the Registered Trade Marks and Quality Control of Products

III. Equipment Loan

IV. Operation Level of the Gas Station

V. General Conditions of Supply

VI. Termination of Contract: GGI will consider the present contract terminated under the following conditions:

   a. Closure of Gas Station JANET as a corporation
   b.. Death of "THE OWNER"
   c .Withdrawal of operating permits by Government for not complying with regulations.
   d. Bankruptcy of "THE OWNER"

e. Termination for causes attributed to the Government: GGI will terminate this contract at any given time the Government of the Republic of Colon changes the basic rules under which GGI considered participating in the Colon Gas Retailers Market. GGI will immediately notify "THE OWNER" and termination will take place within sixty days. This termination will not give rise to any payments for indemnification, compensation and for any other concept to "THE OWNER" and for any other damages, future income not realized or any other payment.

VII. Damages
VIII. Preferential buyer's right and lease rights
IX. Transfer of Contract
X. Arbitration
XI. Notifications
XII. City of Contract

Exhibit 4: GAS STATION JANET'S MOTION TO FILE SUIT AGAINST GLOBAL GAS INCORPORATED

Gas Station Janet
Tony Martinez in his capacity as President of Gas Station Janet
Plaintiffs
v.
Global Gas Inc.
Defendants

Summary of Plaintiffs' Motion to File Suit Against Global Gas Inc.

To: Center for Business Conciliation and Mediation, Colon

A suit against Global Gas Inc. (GGI) is being filed for the reasons that are expressed below.

On March 11th 1998, Gas Station Janet and Global Gas Incorporated agreed to a Mortgage Warranty Contract (see Exhibit 2) in which GGI committed itself to remodel Gas Station Janet and to construct two other gas stations (Jolly and Justine) with an overall investment of US$ 1.718.000,00. In addition, GGI was obligated to supply all the equipment required to operate all the gas stations. In the same contract, Mr. Tony Martinez is committed and obligated irrevocably for the duration of fifteen (15) years to purchase exclusively fuel and lubricants products from GGI, to maintain the three gas stations fully identified with the GGI logo in all banners, billboards and stationery in the terms and conditions of the "Operations and Supply Agreement" that the parties had signed separately; in addition, Mr. Martinez was committed and obligated to affiliate under the same said conditions the two new gas stations: (a) Gas Station "JOLLY" that was built in the land lot that was purchased by Mr. Martinez in that very same act and (b) a new project for the construction of a gas station ("JUSTINE") in the term of one year from the date of signature of the Mortgage Warranty Contract.

Both parties have complied with their commitments regarding the first two gas stations. Additionally, Mr. Martinez acquired the land lot for the construction of Gas Station Justine within the year provided in the Mortgage Warranty Contract. However, to this date May 5th 2001, GGI has not built Gas Station Justine as stated in the Warranty Contract. Moreover, GGI has avoided discussing this matter and as a consequence my client has had a frozen investment in the land lot that was acquired for Gas Station Justine. For this reason, we invoke Clause XIII (Arbitration) of the Mortgage

Warranty Contract and in this act we are proceeding to file suit against Global Gas Incorporated for the amount of US$ 564.438,63 to initiate the arbitration process.

The defendant is a very successful oil corporation that operates world wide. This corporation had revenues in the year 2000 of $232.7 billion, with earnings of $12.4 billion and a return on average capital invested of 20.6%. Revenues have been steadily increasing in the last few years. There is indeed a notorious disregard for the small business entrepreneur and an abuse of power since our pleas have not been heard or answer in numerous times in a period of two years.

We demand retribution from the Defendants for the following damages, losses or opportunity cost incurred by my client

1. Damages: The defendant acquired obligations according to the Mortgage Warranty Contract to invest $179,940 in construction alone to build Gas Station Justine since $153,000 were invested in Gas Station Janet and $362,060 were invested in Gas Station Jolly. This investment would have become part of the total assets of Mr. Martinez (the Plaintiff) once the new gas station became operational according to the contract. Two years ago my client was supposed to increase his assets by the amount of $179,940, which did not happen since the defendant did not comply with his commitments. For this reason, we request reparation for damages for the amount of US$ 237,154.65 (This figure is the net present value of $179,940).

2. *Forfeited benefits: One immediate consequence of the unilateral cancellation of the third gas station project is that neither the expected sales of gas, nor the corresponding profits for my client, were realized. This is considered forfeited benefits or lucrum cesans for which we request reparations for the amount of US$ 201.688,11. Another consequence of the unilateral cancellation of the third gas station is that the profits derived from the sales of lubricants and other derived oil products were not obtained by my client. Once again, the figure of indemnification for profits which my client failed to obtain applies for the amount of $24,277.27 (*This figure has been obtained from the very same business plan that was proposed originally by the defendant to my client).

3. *Opportunity cost: As stated earlier in this document, my client missed various business opportunities for his loyalty and full compliance with the contract subscribed with the defendant. We request reparations for this concept for the amount of $101,118.60*

4. *Viability of the Mortgage Warranty Contract: There is a clear imbalance in the contract, on the one hand my client has guaranteed his commitment with very solid collateral such as the two land lots but on the other hand such solid guarantees do not exist for the defendant. In addition to that, there has been a flagrant violation of the Mortgage Warranty Contract by the defendant. We believe that my client has no guarantees that that the defendant will continue honoring the contract and for those reason we request that the Mortgage Warranty Contract should be declared void. We kindly request the arbitration tribunal to suggest a contractual way or form that my client can continue doing business with the defendant without having to carry such a burden.*

*In summary, we are suing the defendant for the overall amount of $564,438.63 (*My client is willing to present detailed information of this estimate during the arbitration hearings). *plus we request that the Warranty Mortgage Contract be declared void.*

It is justice that we claim in Colon on the day of May 24th 2001.

Exhibit 5: GLOBAL GAS INCORPORATED'S MOTION TO REPOSOND TO GAS STATION JANET'S SUIT AND TO COUNTER FILE SUIT AGAINST GAS STATION JANET

Gas Station Janet
Tony Martinez in his capacity of President of Gas Station Janet, Plaintiffs
v.
Global Gas Incorporated, Defendants

Summary of Defendants' Motion to Respond to Gas Station Janet's Suit
and to Counter File Suit against Gas Station Janet

To: Center for Enterprise Conciliation and Mediation (CEDCA), Colon, Colon

The legal counsel of Global Gas Incorporated, submits the following motion to respond to the suit that has been filed against us by Gas Station Janet (Mr. Tony Martinez) and to counter file suit against Gas Station Janet (Mr. Tony Martinez).

On March 11th 1998, my client Global Gas Incorporated subscribed two contracts with the plaintiff. One contract identified as the Warranty Mortgage Contract, which norms the terms and conditions under which my client was going to invest on the remodeling and modernization of Gas Station Janet, the construction of Gas Station Jolly and the eventual participation in a project for a third gas station. The other contract is referred to as the Operation and Supply Agreement that sets the terms under which my client supplies gas, lubricants and any other of my client's products to each the gas stations.

Today the two gas stations that had been planned are fully operational and my client considers the whole agreement a complete success. The projected gas station was just that "a project" and as stated in the Mortgage Warranty Contract the term of one year after signing the contract was established as reference time to define its launching, which never took place. A careful examination of the Mortgage Warranty Contract does not establish clear terms for the construction of the third gas station and a clear obligation of my client after the one year period established in Clause III of the said contract.

My client paid the plaintiff $470,000.00 just for the rights of branding the two gas stations and the projected one with the GGI brand names. Since the third gas station project has been cancelled according to our interpretation of the contract, the plaintiff owes my client the amount of $156,666.00. Aside from the argument given above for the cancellation of the third gas station project, there is the fact that the price of gas has been frozen for the last two year by the Republic Colon Government. According to Clause VI of the Operations and Supply Agreement, this is sufficient reason to cancel the third gas station project. I would like to reproduce Clause VI for the sake of clarity:

VI. Termination of Contract: GGI will consider the present contract terminated under the following conditions:

a. Closure of Gas Station JANET as a corporation
b. Death of "THE OWNER"
c. Withdrawal of operating permits by Government for not complying with regulations.
d. Bankruptcy of "THE OWNER"
e. Termination for causes attributed to the Government: GGI will terminate this contract at any given time the Government of the Republic of Colon changes the basic rules under which GGI considered

participating in the Colon Gas Retailers Market. GGI will immediately notify "THE OWNER" and termination will take place within sixty days. This termination will not give rise to any payments for indemnification,, compensation and for any other concept to "THE OWNER" and for any other damages, future income not realized or any other payment.

In summary: we reject all the claims made the plaintiff and we are hereby counter suing for the amount of $159,000.00 plus the cost of the arbitration process.

Exhibit 6: RULES OF CONCILIATION

Article 1 – Starting a conciliation process

1.1. Any interested party may at any time without need for any arbitral process request the conciliation services of CEDCA. The Executive Secretary shall notify the parties of the day and time on which a hearing at which the parties or their attorneys-in-fact shall proceed to nominate a conciliator or several conciliators.
1.2. If the parties or their attorneys-in-fact state their intention to initiate the conciliation they shall proceed to establish by mutual agreement in said act the duration of the conciliation.
1.3. In the respective hearing, the parties shall proceed to the nomination of the conciliator or conciliators. If they do not achieve said nomination, the General Director of CEDCA shall proceed to nominate one.

Article 2 –Impartiality of the conciliators

No person may act as conciliator in those disputes in which they have or may have personal or economic interest, unless they obtain the written consent of all parties.

Article 3—Representation of the parties

During the conciliation, it is not necessary for the parties to be assisted by attorneys, counselors or any other person.

Article 4—Powers of the conciliators

4.1. The conciliator shall act with impartiality, taking into consideration the arguments and points of view of the parties and stimulating the search for effective forms and mechanisms for the peaceful solution of the dispute.
4.2. The conciliator shall attempt to help parties to reach a satisfactory agreement according to the procedure that he considers most appropriate, but he shall not have authority to impose a solution on them. The conciliator, as considered appropriate, shall be authorized to hold joint or separate meetings with the parties, and to make recommendations to them.
4.3. The conciliator is authorized to declare the conciliation terminated if at anytime in his judgment, future efforts will not contribute to the resolution of the dispute between the parties.

Article 5—Identification of the matters submitted for conciliation

Prior to the hearing each party shall submit to the conciliator a document containing their opinions and propositions on the matters submitted for conciliation.

Article 6—Place and time of the conciliation

6.1. The conciliator shall determine the place, date and time of the conciliation meetings.

Article 7—Act of conciliation

7.1. If the conciliation is successful, the conciliator shall prepare an act of agreement, which shall be signed by the latter and by the parties.

7.2. If any of the parties unjustifiably cease to attend a conciliatory session or no agreement can be reached within the set period, the conciliator may declare the conciliation terminated, without prejudice to any of the parties requesting its resumption at another time.

7.3. If conciliation is successful while an arbitral process is pending, the conciliator, unless otherwise agreed by the parties, shall submit the act of conciliation to the Arbitral Tribunal hearing the dispute. If the arbitrators have no objections they shall proceed without delay to make an arbitral award, in conformity with the terms stipulated in said act of conciliation.

MOHAWK INDUSTRIES, INC. (MHK): ASSESSING FINANCIAL PERFORMANCE DURING A PERIOD OF RAPID EXPANSION

Larry A Johnson, Dalton State College
Marilyn M. Helms, Dalton State College
Joseph T. Baxter, Dalton State College

CASE DESCRIPTION

The primary subject matter of this case concerns the financial performance of Mohawk Industries, Inc. a leading company in the floorcovering industry. Secondary issues include industry competitiveness, competition, and ways to maintain the company's continued growth and successful performance given their many recent acquisitions. The case has a difficulty level of three, appropriate for junior level students. The class is designed to be taught in 1.5 class hours and is expected to require two hours of outside preparation by students.

CASE SYNOPSIS

Headquartered in Calhoun, GA, Mohawk is a full-line flooring producer and manufactures carpet, rugs, ceramic tile, laminate flooring, vinyl, and other surfaces for commercial and residential customers. Mohawk Industries, Inc. is the leading floor covering producer in the world and second only to Shaw Industries, Inc. in the production of tufted carpet.

Mohawk acquired nineteen firms in thirteen years (1992-2005) as they continue their consolidation in the carpet industry while broadening their product line into hard surface flooring. Mohawk's 2005 acquisition of Unilin, a Belgian-based laminate floor covering manufacturer, followed their purchase of Dal-Tile in 2002; which combined, doubled the size of the company in three years from (2002-2005). Students are provided six years of Income and Balance Sheet data and asked to assess Mohawk's financial performance and present their rationale as to whether Mohawk can continue their pace of continued growth and successful financial performance given the many recent acquisitions.

Students are asked to examine the company as it becomes an even larger player in the rapidly consolidating carpet and floorcovering industry.Mohawk's sales have been boosted by a strong U.S. housing market and higher selling prices. However, Mohawk's share of carpet and vinyl flooring has fallen while laminate, wood, and ceramic flooring segments have grown. Laminate sales comprised only five percent of the U.S. floorcovering market but they were up nine percent in

2005. Industry-wide, carpet and rug sales continued to grow by seven percent from 2004 to 2005, wood flooring grew by eight percent, and all hard surfaces grew by five percent. The rise in the rug segment by five percent was a result of the growth in hard surface flooring since even with wood or laminate floors, consumers continue to decorate with area and scatter rugs (Floor Focus 2006 Annual Report).

INTRODUCTION

Can Mohawk maintain their rapid acquisition rate of nineteen firms in thirteen years and continue their consolidation of the carpet and floorcovering industry while maintaining their past record of financial performance? Mohawk's 2005 acquisition of Unilin, a Belgian-based laminate floor covering manufacturer, follows the 2002 purchase of Dal-Tile; which, combined doubled the size of the company in three years from (2002-2005).

Mohawk began in the carpet industry over 127 years ago. Today they are the leading producer and distributor of home and commercial flooring worldwide including all major flooring categories: carpet, rugs, hardwood, laminate, ceramic tile, and vinyl sheet flooring. They are also a leading producer of yarn, area rugs, and bath mats. While Mohawk has traditionally been a carpet manufacturer, the latest acquisitions are an attempt to diversify into the faster growing hard surface flooring (non-carpet) market segment.

Unilin had 2004 revenues of $1 billion and employed more than 2,400 people in Europe. The Unilin acquisition adds the European company's wood flooring, shelving, chipboard, and roofing products to Mohawk's range of products. Since their acquisition of Unilin, U.S. Mohawk's sales have been boosted by a strong U.S. housing market and higher floorcoverning selling prices as evidenced by eight percent gain in second quarter profits in 2005. However, Mohawk's share of carpet and vinyl flooring are falling while laminate, wood, and ceramic flooring segments are growing. Laminate sales comprised only five percent of the U.S. floorcovering market but they were up nine percent in 2005. Industry-wide, carpet and rug sales continued to grow by seven percent from 2004 to 2005, wood flooring by eight percent, and all hard surfaces grew by 5 percent. The rise in the rug segment by five percent was a result of the growth in hard surface flooring. (Floor Focus *2006 Annual Report*) Even with wood or laminate floors, consumers continue to decorate with area and scatter rugs.

Mohawk's acquisition of Unilin was greeted with surprise by others in the flooring industry. In the *2005 Mohawk Annual Report*, Jeff Lorberbaum (Mohawk Chairman, President and CEO) and Frans De Cock, (Unilin President), gave justification for the Unilin acquisition. Mr. De Cock cited Mohawk's strength in its distribution channel while Mr. Lorberbaum cited Unilin's patented technologies, European market presence, and the continued diversification of Mohawk's product line.

Carpet tile is a growing category among designers and architects. Mohawk designs, manufactures and markets residential and commercial flooring products distributed through authorized Mohawk dealers. The retail replacement business, however, is down as fewer consumers shop in traditional retail stores. The move to shopping at "big-box" home improvement retailers has also reduced the number of retail locations for purchasing floorcovering.

Mohawk operates under four divisions with its own products, features, and brand names, providing goods for all significant market segments, distribution channels, and price points. Mohawk's family of well-known brands include: Aladdin, Alexander Smith, American Olean, American Rug Craftsmen, American Weavers, Bigelow, Dal-Tile, Galaxy, Harbinger, Helios, Horizon, Image, Karastan, Lees Carpet, World, WundaWeve, Custom Weave, Mohawk, and Mohawk Home. In addition to the Unilin acquisition, Mohawk has added carpet tile products to the Lees' and Mohawk brand.

History of Mohawk Acquisitions

Mohawk Carpet Mills had its beginning in 1878 when four brothers from the Shuttleworth family brought 14 second-hand looms from England to New York. By 1908, the fledging firm introduced a new carpet. Flooded with orders, the weavers worked five years without changing either the color or the pattern on their looms.

In 1920, the Shuttleworth Brothers Company merged with the nearby firm of McCleary, Wallin and Crouse to form Mohawk Carpet Mills, Inc. The corporate name was derived from the Mohawk River Valley in upstate New York. Even in the 1920s, mergers were strategic and designed to give the resulting company a competitive edge. The 1950s became a period of expansion for Mohawk. They moved south, constructing manufacturing facilities in Mississippi and South Carolina. During the next fifteen years, through product innovations, market expansions, mergers and acquisitions, Mohawk expanded its offerings. Beginning in 1992, a series of strategic mergers and acquisitions redefined not only Mohawk but also the entire floor covering industry.

Each acquisition expanded Mohawk's presence in the floor-covering industry -- Horizon Industries in 1992; American Rug Craftsman and Karastan-Bigelow in 1993; Aladdin Mills in 1994; Galaxy Carpet Mills in 1995; certain assets from Diamond Carpet Mills in 1997; Newmark Rug Company; American Weavers & World Carpets/WundaWeve in 1998; Durkan Patterned Carpets and Image Industries in 1999; Alliance Pad in 2000; Dal-Tile and American Olean in 2001 (a move that made Mohawk a leading supplier of ceramic and stone floor covering); Lees Carpets in 2003; Wayne-Tex in 2005 and Unilin in 2005. Through aggressive acquisitions and internal growth, Mohawk's goal was to create a strong, diversified company - the world's largest floor covering supplier, the country's leading recycler of plastic soda bottles (which becomes polyester carpeting) and one of the country's largest and most efficient distribution and trucking companies. They employed more than 34,000 employees in 2005, half of them in Georgia.

Mohawk also offers woven bedspreads, tapestries, pillows, throws and window blinds. Mohawk products are found in major retailers across the country and the world -- from Home Depot to Bloomingdales, from Lowe's to Macy's, from Target and Wal-Mart to specialty boutiques in large cities and small towns.

Consolidation in the Flooring Industry

The floorcovering industry is recognized by most analysts as an attractive industry. The purchase of Shaw Industries Inc. by Berkshire Hathaway in 2001 attests to the hidden value of this “old world” industry by Warren Buffet, founder of Berkshire Hathaway. With the vertical integration of the industry, most firms are dependent on suppliers for nylon pellets and other petroleum-based raw materials; but Mohawk, like other large manufacturers, extrudes their own yarn. They purchase dye and use large quantities of water for carpet dyeing. Entry barriers are high due to the size necessary to be competitive. With industry consolidation, customers have a number of color and texture choices, but have few choices of manufacturer. Most manufacturers make a number of floorcovering products and most retail outlets sell the products of multiple manufacturers. Switching costs between companies by customers is low and few buy carpet based on brand name or manufacturer but rather rely on information provided by sales representatives in the retail outlets.

Consolidation of the flooring industry is a major strategic objective for Mohawk Industries. For Mohawk and Shaw, the two leaders in the carpet and floorcovering industry, growth by acquisition has historically been the norm. Most mid-sized players have been acquired. They will not significantly increase their horizontal presence by further acquisitions since they are already selling or manufacturing flooring in every hard and soft surface category and few large or mid-sized competitors remain. Since most wood, vinyl, and stone flooring products are purchased by these two firms, the potential exists to integrate backward into these sourced products and raw material production. Other vertical acquisitions are possible moving backward toward the source of supply (raw materials, backing, dyes) or forward toward retail outlets. However, Shaw’s past move into retail sales alienated their competitors and was quickly abandoned. Further global expansion is also possible. With rising fuel costs, it makes sense to have a manufacturing presence in Europe and Asia to reach these growing markets faster and cheaper. European buyers are concerned more about recycled content and one avenue for growth to make floorcovering products appealing in the international market is to further adapt their manufacturing processes toward this goal. While Mohawk has environmental programs in place, the acquisition of other “green” companies will further their environmental goal. Still other home or office textiles might also be acquisition targets (i.e., wall coverings, sheets, towels, etc.).

Analysts seem positive about the acquisitions by leading players within the floorcovering industry and of Mohawk in particularly. With each acquisition, the stock price increased each year

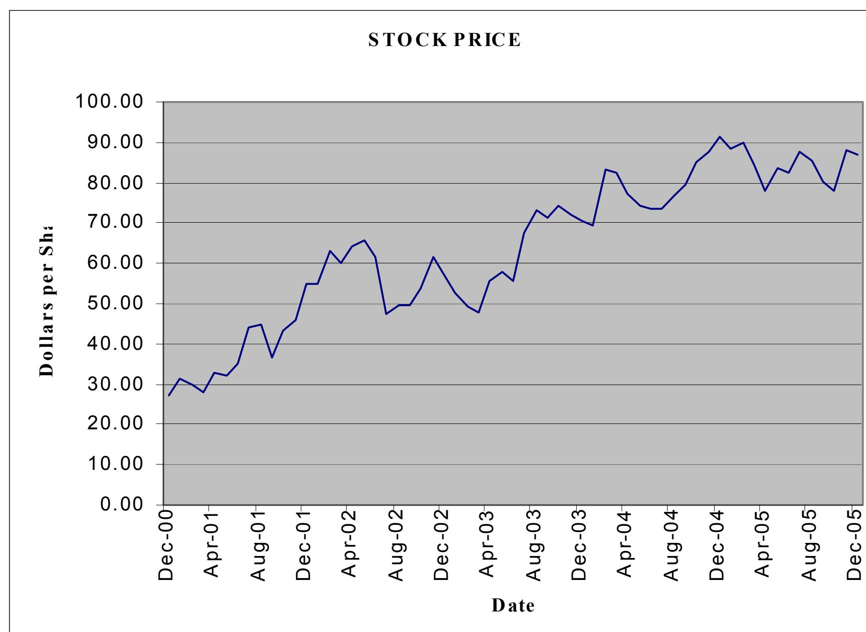
(except 1996, 2002, and 2006) the company has made acquisitions. (See the Stock Price History, Exhibit 1 and 2.)

This trend in stock price is typical of companies in the late-growth, early-maturity stage of their life cycle. Beginning in 1992 a series of strategic mergers and acquisitions redefined Mohawk and the entire floorcovering industry. As in any merger or acquisition, management faces challenges of assimilation of the various corporate cultures into one organization. There is also an issue of changing or redefining the management and organizational structure. Problems may exist due to the nature of the various computer software packages and hardware and the programming staff is left to combine data and information. While the IT issues are beyond the scope and coverage of this case, they do represent an important point to consider.

The relatively large market share of the two industry leaders (Mohawk and Shaw combined have a floorcovering market share of 46% in 2005 according to the Floor Focus Annual Report (2006) is evident, yet further mergers and acquisitions seem likely as the industry continues its consolidation. Small players that remain are niche players offering custom, one-of-a-kind, products for an up-scale customer or market. Other small players may also be low-end producers of entry-level bases-grade floorcovering products.

Finance and Accounting

Exhibit 1. History of Mohawk Stock Price



Source: http://www.yahoo.com

Mohawk reported net earnings of $358.2 million and earnings per share (EPS) of $5.30, for 2005, which is slightly lower than $368.6 million and $5.53 per share in 2004, but up 15% compared to net earnings of $310.1 million and $4.68 EPS for 2003. In 2005, Mohawk had annual operating revenues of $6,620 million and a $627 million operating profit before depreciation. Total 2005 net income was $358 million. This represents a five-year annual revenue growth rate of 17.99% and a five year earnings per share growth rate of 9.72%. The income statement, balance sheet, and stock price history for six years are shown in Exhibits 1, 2, 3, and 4.

Exhibit 2. History of Mohawk Industries Inc. Stock Price

					2005							
Month	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan
Stock Price	86.98	87.98	78.05	80.25	85.38	87.82	82.50	83.42	77.81	84.30	89.74	88.51
					2004							
Month	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan
Stock Price	91.25	87.70	85.08	79.39	76.92	73.54	73.33	74.24	77.14	82.35	83.30	69.58
					2003							
Month	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan
Stock Price	70.54	72.08	74.12	71.32	72.96	67.41	55.53	57.71	55.47	47.94	49.38	52.68
					2002							
Month	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan
Stock Price	56.95	61.61	53.55	49.65	49.50	47.50	61.53	65.52	64.33	60.09	62.93	54.96
					2001							
Month	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan
Stock Price	54.88	45.86	43.20	36.75	44.60	44.00	35.20	32.03	32.66	28.08	29.95	31.50
					2000							
Month	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan
Stock Price	27.38	23.69	21.81	21.81	23.75	26.69	21.73	23.81	24.81	22.37	22.19	23.44

Source: http://www.yahoo.com

Exhibit 3 – Income Statement 2000-2005, Mohawk Industries, Inc.						
	(In thousands, except per share data)					
	Years Ended December 31, 2000-2005					
Year	2005	2004	2003	2002	2001	2000
Net sales	6,620,099	5,880,372	4,999,381	4,522,336	3,445,945	3,404,034
Cost of sales	4,896,965	4,259,531	3,605,579	3,282,269	2,613,043	2,581,185
Gross profit	1,723,134	1,620,841	1,393,802	1,240,067	832,902	822,849
Selling, gen. & admin. expenses	1,095,862	985,251	851,773	718,002	505,745	505,734
Legal settlement						7,000

Exhibit 3 – Income Statement 2000-2005, Mohawk Industries, Inc.

	(In thousands, except per share data)					
	Years Ended December 31, 2000-2005					
Year	2005	2004	2003	2002	2001	2000
Operating income	627,272	635,590	542,029	522,065	327,157	310,115
Other expense (income):						
Interest expense	66,791	53,392	55,575	68,972	29,787	38,044
Other expense	11,714	9,731	6,252	13,455	7,780	5,660
Other income	-8,254	-4,922	-8,232	-3,991	-1,826	-1,218
Total other expense (income)	70,251	58,201	53,595	78,436	35,741	42,486
Earnings before income taxes	557,021	577,389	488,434	443,629	291,416	267,629
Income taxes	198,826	208,767	178,285	159,140	102,824	105,030
Net earnings	358,195	368,622	310,149	284,489	188,592	162,599
Basic earnings per share	5.35	5.53	4.68	4.46	3.60	3.02
Wtd-avg common shares outstanding	66,932	66,682	66,251	63,723	52,418	53,769
Diluted earnings per share	5.30	5.46	4.62	4.39	3.55	3.00
Weighted-average common and dilutive potential common shares outstanding	67,644	67,557	67,121	64,861	53,141	54,255
Source: *2005 Mohawk Annual Report*						

Exhibit 4 Mohawk Industries Inc. and Subsidiaries
Consolidated Balance Sheet
December 31, 2000-2005
(In thousands, except per share data)

Year	2005	2004	2003	2002	2001	2000
ASSETS						
Current assets:						
Cash and cash equivalents	134,585					

Exhibit 4 Mohawk Industries Inc. and Subsidiaries
Consolidated Balance Sheet
December 31, 2000-2005
(In thousands, except per share data)

Year	2005	2004	2003	2002	2001	2000
Receivables	848,666	660,650	573,500	501,129	404,875	358,809
Inventories	1,166,913	1,017,983	832,416	678,008	531,405	574,595
Prepaid expenses and other assets	140,789	49,381	43,043	37,368	24,884	26,973
Deferred income taxes	49,534	55,311	84,260	82,074	70,058	66,474
Total current assets	2,340,487	1,783,325	1,533,218	1,298,579	1,031,222	1,026,851
Property, plant and equipment, net	1,810,728	905,332	919,085	855,324	619,703	650,053
Goodwill	2,621,963	1,377,349	1,368,700	1,277,453	109,167	112,376
Tradenames	622,094	272,280				
Other intangible assets	552,003	50,366	325,339	146,700		
Other assets	44,248	14,466	17,233	18,687	8,393	6,098
Total Assets	7,991,523	4,403,118	4,163,575	3,596,743	1,768,485	1,795,378
LIABILITIES AND STOCKHOLDERS' EQUITY						
Current liabilities:						
Current portion of long-term debt	113,809	191,341	248,795	27,427	158,366	224,391
Accts payable & accrued expenses	998,105	623,061	637,940	630,306	423,495	375,268
Total current liabilities	1,111,914	814,402	886,735	657,733	581,861	599,659
Deferred income taxes	625,887	191,761	183,669	145,973	84,955	75,808
Ltd, less current portion	3,194,561	700,000	763,618	793,000	150,067	365,437
Other long-term liabilities	32,041	30,618	31,752	17,158	3,051	114
Total Liabilities	4,964,403	1,736,781	1,865,774	1,613,864	819,934	1,041,018
Stockholders' equity: (see yearly notes in Annual Reports)						

Exhibit 4 Mohawk Industries Inc. and Subsidiaries Consolidated Balance Sheet December 31, 2000-2005 (In thousands, except per share data)						
Year	2005	2004	2003	2002	2001	2000
Common stock					614	608
Additional paid-in capital	1,123,991	1,058,537	1,035,773	1,006,550	197,247	183,303
Retained earnings	2,268,578	1,910,383	1,541,761	1,231,612	947,123	758,531
Accumed other comprehensive loss	-47,433	-2,441	2,313	1,126	-2,837	
	3,345,921	2,967,254	2,580,577	2,240,051	1,142,147	942,442
Less treasury stock						
	318,801	300,917	282,776	257,172	193,596	188,082
Total stockholders' equity	3,027,120	2,666,337	2,297,801	1,982,879	948,551	754,360
Total Liab.es & Stockholder Equity	7,991,523	4,403,118	4,163,575	3,596,743	1,768,485	1,795,378
Source: *2005 Mohawk Annual Report*						

QUESTIONS

Through 2005, Mohawk has continued a strategy of expansion through internal growth and acquisitions. Assess Mohawk's financial performance and present your rationale as to whether Mohawk can continue their pace of successful financial performance given the recent acquisitions.

1. Prepare graphical highlights of Mohawk's financial performance over time and discuss changes over time.
2. Prepare common size financial statements (Income Statement and Balance Sheet) and discuss significant changes over time.
3. Calculate liquidity, leverage, asset management, and profitability ratios. Show major trends graphically and describe the strengths and weaknesses of each ratio category.
4. Use the DuPont Identity framework to decompose Mohawk's Return on Equity and discuss changes in operating efficiency, asset use, and financial leverage over time.
5. What are Mohawk's internal and sustainable growth rates and earnings per share? How have they changed and why? (Mohawk has a 100% dividend retention rate)

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TIMKO EXPORT MANAGEMENT COMPANY: THE DYNAMICS OF INTERNATIONAL ENTREPRENEURSHIP

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CASE SYNOPSIS

The story of Timko Export Management Company offers a number of lessons to international entrepreneurs. First, economic risk is a reality that can have an enormous impact on a small to medium-sized business. It is not enough to simply recognize that economic risk is part of the landscape of international business. Businesses must be proactive in dealing with exchange rate fluctuations. They need to integrate safeguards that can mitigate exchange rate risk.

Secondly, payment structures involving cash transactions need to be placed into proper context. Timko should have required a deposit equivalent to the cost of the motorcycles. If a transaction was $100,000, the partners only asked their distributors to send $50,000. As a result, Timko had to make another $50,000 just to cover expenses. Currency swaps should have been used from the beginning as a way to hedge against exchange rate risk put into place early in the process. The firm should also have discounted the Letters of Credit in a much more concerted effort. This did not occur until very late in the business.

Ultimately the problem came down to arrogance. When a company is born out of the success of a previous venture, and is then wildly successful, its managers run the risk of adopting a mindset that says, "We are invincible. No matter what we attempt we will be successful." In 1994, in the wake of the Tequila Effect, Timko experienced what the partners thought to be a one-time event. When they became successful again – successful beyond their wildest imaginations with the opening of Africa and the bringing back of Latin American economies– they became arrogant, and were unable to recognize the media warning about the unraveling of the Asian economies were applicable to their company.

In summary, arrogance is something that an entrepreneur needs to guard against. Markets change and you constantly need to be vigilant in order to manage your activities in those markets.

CASE DESCRIPTION

This case would best be used in an international entrepreneurship class or a strategic management class at the junior or senior level. It should take about three hours of class time and a bit more time outside of class in preparation.

INTRODUCTION

In June of 1997, Tom Wilson and Dave Richards congratulated themselves on the success of their company, Timko Export Management. Thanks to their hard work, ability to read international markets, and willingness to risk millions of dollars in deals, their business was very successful. They were a formidable pair: Richards, 20 years older than Wilson, had already made a small fortune before they formed their dynamic partnership. Wilson brought three key assets to the table: several years of experience in international trade, fluency in Spanish, and an MBA that gave him an understanding of business management.

Timko Export Management had posted $30.7 million in pre-tax earnings in 1996 with sales of $127.5 million. At this rate of growth, they projected that their company would soon reach $200 million in sales.

Exhibit 1: Pro Forma Income Statement: 1992-1998 (in millions)							
	1992	1993	1994	1995	1996	1997	1998
	$	**$**	**$**	**$**	**$**	**$**	**$**
SALES (millions US$)	20.90	32.67	37.80	65.80	127.50	52.90	47.00
COST OF GOODS SOLD (millions US$)	11.70	17.68	19.70	38.90	78.80	49.80	55.60
GROSS PROFIT (millions US$)	9.20	14.99	18.10	26.90	48.70	3.10	-8.60
OPERATING EXPENSES.(millions US$)							
Employee Wages	0.51	0.51	0.53	0.63	1.70	1.90	1.90
Management Wages	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Health Insurance	0.25	0.25	0.26	0.36	0.59	0.59	0.62
Real estate taxes	0.03	0.03	0.03	0.03	0.03	0.03	0.03
Utilities	0.04	0.04	0.04	0.04	0.05	0.05	0.05
Errors & Omissions Insurance	0.01	0.01	0.01	0.01	0.07	0.07	0.09
Bank fees	0.05	0.05	0.05	0.08	0.24	0.11	0.20
Postage / UPS	0.12	0.15	0.08	0.11	0.14	0.10	0.14
Telephone / Fax	0.29	0.27	0.15	0.45	0.65	0.74	0.69
Telex	0.04	0.04	0.04	0.03	0.03	0.03	0.03

Exhibit 1: Pro Forma Income Statement: 1992-1998 (in millions)							
	1992	1993	1994	1995	1996	1997	1998
	$	**$**	**$**	**$**	**$**	**$**	**$**
Depreciation	0.10	0.10	0.10	0.10	0.10	0.10	0.01
Travel	2.80	2.80	1.10	1.90	4.60	5.90	4.70
Regional Distributor Conferences	0.00	0.00	0.25	0.70	1.70	1.90	1.70
Legal Expenses	2.60	2.60	1.60	3.40	3.20	2.10	1.95
Miscellaneous	1.70	1.70	2.50	3.90	4.50	3.20	2.70
TOTAL EXPENSES	8.94	8.95	7.12	12.12	17.99	17.21	15.21
PRE-TAX PROFITS (millions US$)	0.26	6.04	10.98	14.78	30.71	-14.11	-23.81

They could not believe their good fortune. What they did was fairly simple. They saw an opportunity to export low-cost motorcycles to Latin America and Africa. In order to achieve this opportunity, they created a partnership with a Chinese manufacturer and developed an international distribution network.

In June of 1997, when they decided to send $5 million to the manufacturer in China for their next order, they appeared to be lucky, brilliant, and successful entrepreneurs. Unfortunately, they had no idea that several large financial institutions in Thailand were about to default on loans that they had taken from international banks. Nor did they know that foreign investors would soon begin a selling spree on the Thai stock market, which would lead to a perception of risk everywhere in Asia. Soon, everything would change.

In July, most of the economies of Southeast Asia suffered a major, meltdown, later called the Asian Flu where currencies plummeted in Asia, Africa, and Latin America. Wilson and Richards soon realized that their situation had become desperate. The devaluation in the currencies meant that the market for imported motorcycles had vanished virtually over night. Unfortunately, they had the $5 million in inventory that they had already paid for, with no prospects for recuperating their investment. When the partners met in December, it soon became clear that they only had three options:

1. They could sell their stake in their joint venture to their Chinese manufacturing partner for pennies on the dollar.
2. They could ship the motorcycles to their distributors, who would be compelled to take the merchandise -- effectively dumping it on their customers -- even though they would not be able to sell anything in the foreseeable future. While this move could result in a rebound, it also had the potential of failure and the appearance of being unethical.

3. They could do nothing and simply absorb the costs associated with the disaster, which would mean losing millions of dollars.

As 1997 came to a close, the partners asked themselves how they could have gone from being brilliant successful businessmen to being distraught and desperate. What could they have done? More importantly, what should they do next?

HISTORY OF TIMKO EXPORT MANAGEMENT COMPANY

Timko Export Management Company was founded in January 1992. It was the second company that evolved out of a partnership between Wilson and Richards.

Wilson and Richards were very different people. Richards, 46 years old, was 20 years older than Wilson. A high-school dropout, Richards was the quintessential "up by your own bootstraps" story. Leaving an abusive family in the Midwest when he was only 16, Richards headed to California in search of a better life. He pumped gas, washed dishes, parked cars, and even walked dogs. At 18, he took a job as a salesman at a truck parts outlet in Los Angeles. He excelled. Richards possessed an uncanny ability to read customers and their needs within a few seconds. Within a year, he was made sales manager. Working sometimes 20 hours a day, Richards doubled the sales of the company within 18 months. Eventually, Richards became frustrated with the office politics and left to start his own company. He quickly built one of the largest firms specializing in wholesale truck parts on the West Coast. By age 30, Richards was a multi-millionaire.

When interviewed Richards had this to say, *"Frankly, I never thought about becoming wealthy. I loved to work – and still do. I started my own company because I really thought I could do things better and wanted to control my own destiny."*

As his sons became older, they began racing motorcycles. Frustrated by the poor level of service from the local motorcycle dealerships in Los Angeles, Richards bought one. The first shop, in Torrance, was a representative of Honda, Yamaha, Suzuki, and Kawasaki. Richards jumped in with both feet and turned the store into one of the most profitable in Southern California. He later bought two more dealerships, and by the early 1990's, was one of the biggest motorcycle dealers in the entire country.

Richards added, *" I got into the motorcycle business on a whim. I spent a lot of time and money at these dealerships; a small fortune on parts, accessories, and repairs, and got lousy service in return. I knew that I could run a business better than they did."*

Wilson, on the other hand, was an army brat. His father was a logistics officer who moved the family 10 times in his 22 year career. Richards and Wilson were introduced to each other through Richards' sister, an army wife whose best friend was Wilson's mother. Wilson was an ROTC cadet in college for two years before deciding that a military career was not for him. He decided, instead, to study economics, and by the time he was 22, had a Master's Degree. Wilson also

learned several languages as a child. He was a product of the elitist culture found in the officer corps of the military.

Wilson noted, *"I was a cocky young kid who had grand visions. I really thought I could do anything. My family taught me that with hard work, anything was possible."*

In early 1991, the two began to export Japanese brand motorcycles out of Richards' three motorcycle dealerships in Los Angeles, California. The motorcycles they exported were initially targeted for sale within the U.S. dealer network. However, Wilson and Richards saw opportunities elsewhere. The first country that they targeted was Argentina. Argentina had closed its borders to motorcycle imports as well as almost every other consumer product, for many years. These restrictions began to ease up in early 1990 as the military junta, which was in charge of the country, changed to a more democratic and open trade policy.

Figure 1: Example of Motorcycle Sold

Pent-up demand in Argentina for the high-end, Japanese-made bikes was exacerbated by the fact that even after the import restrictions had been eased, availability of the product within the country's distribution network was extremely limited. For Timko Export Management Company, the timing could not have been better. The U.S. dealer network had an abundance of available Japanese motorcycles. Evidence of the demand in Argentina was the number of Argentines who would travel to Los Angeles with suitcases full of cash to purchase motorcycles from local dealers at prices often 30-40 percent above manufacturer's suggested retail price (MSRP)!

Seeing this tremendous opportunity, the partners quickly decided to "go direct". Wilson got ready to leave for Buenos Aires where he set out to establish a small import office. Still, the partners

were clueless when it came to knowing how to accomplish this. Neither one had set up a foreign company before. Although Wilson was bilingual and had lived many years across South America, the company needed to build the infrastructure necessary to begin receiving the U.S.-spec Japanese-manufactured motorcycles from Richard's dealerships.

Ultimately, they reached out to their bankers in the U.S. – ABN AMRO- and explained what they wanted to do. ABN AMRO was and remains one of the most global of all banks. This turned out to be a brilliant move. In international business, it is extremely difficult to build mutually beneficial relationships. For many companies, this becomes a major cause of failure in their global ventures. By aligning with their bank – an already-existing strategic alliance partner- they were able to tap the tremendous resources of ABN AMRO and get a business created in Argentina in a very short period of time.

The U.S. branch introduced the partners to the Buenos Aires office, which facilitated the proper introductions with the right law firms, accountants, and governmental officials. Both parties benefitted. The partners were able to seamlessly lay the foundation they needed, and the bank took care of an important client who would make them a lot of money in the coming years.

Even with this forward-thinking strategy and the fact that every motorcycle they imported sold within hours at two or three times the price in the U.S., they still had seriously underestimated the market. Timko imported and sold nearly 3,000 motorcycles in six months – and could have easily sold more than 4,000.

According to Richards, *"There was no way in our wildest dreams that we could have anticipated the demand for these bikes. My gut instinct said that there had to be a market, but I had no idea of the magnitude of the built up demand. Sometimes being an entrepreneur has to do with a little luck; being in the right place at the right time."*

By the end of 1991, the supply /demand curve began to stabilize. However, Richards and Wilson would continue to sell Japanese-made motorcycles in Argentina for the next several years at a nice level of profit.

The initial revenue generated from Argentina prompted the partners to consider expanding their operations. Based on their initial success in Argentina, they formed a company called the Timko Export Management Company.

THE GLOBAL MOTORCYCLE INDUSTRY

The motorcycle was invented through a succession of experiments carried out in Europe and the U.S. in the late 19th century. A series of inventors strapped an array of motors onto bicycles until Swedish immigrant Carl Hedstrom, fitted a 1.75-horsepower single-cylinder engine to a bike thereby creating the first modern motorcycle. Hedstrom and his business partner George Hendee, began building and selling what was called the Indian Motorcycle in Springfield, Massachusetts, in 1901. In the same year, bicycle racer Glenn Curtiss also began making motorcycles and in 1907 he became

the fastest man alive by strapping himself to a 40-hp V8 engine and then shooting down the road at 135 mph.

Soon motorcycles were the trend with over 50 new companies successfully building and selling this new form of transportation. Among this group was a firm founded by William Harley, an engineering student at the University of Wisconsin-Madison, and Arthur Davidson, a pattern maker in a railroad shop. The Harley-Davidson Motor Company, was incorporated in 1907 and was financed by the life savings of Davidson's 80 year old bookkeeper uncle.

The Harley Davidson Company marketed its motorcycle as a less expensive alternative to the popular motor car. The first model sold for $200, and got approximately 180 miles per gallon. By 1914, the firm was producing 1,600 units each year of its new 45-degree V-twin engine model.

Because the motorcycle had become popular in law enforcement circles, it was only natural that the military would see its wartime potential. General Pershing ordered 20 machine gun laden Harleys to the Southern border to drive Pancho Villa's raiding parties out of Texas. This was followed by a yearly deployment of a 20,000 bikes to the European theatre during WW I.

JAPANESE ENTRY INTO THE MARKET

The Japanese entry into the motorcycle industry began in 1938 when Soichiro Honda and Takeo Fujisawa began their business through the perfection of a piston ring in Honda's Japanese machine shop. In order to facilitate Honda's interest in motorcycle racing, the two formed a motorcycle production company called Honda Motor Company in 1948. A year later Honda's engineering genius paid off. Honda created a technological innovation that doubled the horsepower of the four-stroke engine used with Japanese motorcycles of the day.

In 1956, Honda decided to build a commercial motorcycle focused on a specific market segment, Japanese housewives. The Honda 50cc Super Cub featured a three-speed transmission, an automatic clutch, and most importantly, an automatic starter. By the end of the decade the bike was the bestselling motorcycle in Japan, with sales of $55 million.

The Japanese firm's introduction of the Super Cub was a new conceptualization of the motorcycle. Instead of being solely the purview of racers, warriors, police, stuntmen, and gangsters, the motorcycle was transformed into an inexpensive form of transportation for consumers around the world. By 1997, the company reached the production milestone of 100 million motorcycles produced during its 60 year history. By the late 1990s the firm was producing motorcycles in India, Vietnam, Turkey, Brazil, and Indonesia. Today, Honda is by far the largest manufacturer of motorcycles in the world (Honda Motor Co. Annual Report, 2007).

MOTORCYCLES AND EMERGING MARKETS

In most of the emerging markets in the world, motorcycles have historically been viewed differently. Motorcycles were treated as a means of basic transportation. Whether in India, China, South America, Sub-Sahara Africa, or Southeast Asia, small-engine motorcycles were widely held to be an attainable alternative to other forms of transport such as walking, burros, or buses. This was due to the fact that most people in these places did not have the financial wherewithal to purchase their own automobile. As a result, an affordable, low-end motorcycle became the primary option for people who sought to have their own motorized transportation. In 1992, it was estimated that 15-20 million motorcycles were sold all over the world. China sold eight million bikes domestically.

Viewing China as a viable export option in 1992 was not a popular choice. At that time, Japan, not China, was perceived as one of the biggest global opportunities for U.S. companies. China still had the political after effects of Tiananmen Square in the summer of 1989.

Still, the partners were convinced that China held the future, especially in the area of small, basic transportation motorcycles. Corporate decisions by Honda, Yamaha and Suzuki, were pushing those companies away from the manufacture of small motorcycles. Honda and Suzuki had decided to focus on building automobiles, while Yamaha shifted its emphasis to electric-domestic products.

The scaling back of these major players created a hole in the marketplace. At the same time there was rising growth in many emerging markets around the world. In Latin America, sub-Saharan Africa, India, and China, demand for inexpensive modes of transportation was rising.

Wilson pointed out the following, *"At that time, there was little confidence that China could build anything of quality, -except t-shirts. Everyone kept saying Japan, Mexico or South Korea. As a kid, I remember the famous shortstop Pee Wee Reese saying, Hit em where they ain't. The first time I went to China in 1991, I landed at Beijing International Airport. Our plane was the only flight. I remember the lights were turned on when we entered the immigration and customs area. Nothing was working. I saw this as an opportunity. Little or no competition."*

Wilson began a research project with the goal of identifying one or more markets where demand for motorcycles would be high. He was astonished to learn, in an examination of U.N. documents, that only about one out of five people on the planet had ever been inside an automobile. His reading further convinced him that the vast majority of people could not conceptualize a car as easily as they could a basic transportation motorcycle.

As incomes increased in those countries, consumers desired automobiles. However, because they could not afford cars, the pent up demand for individual means of transportation was focused upon motorcycles. Ironically, just as the Japanese started to phase out of the small motorcycle business, the demand for motorcycles began to take off. While demand was great, the supply was limited. Timko Export Management Company was at the right place at the right time.

In other words, the low-end motorcycle market that had served tens of millions of customers around the world for decades was undergoing a significant change. In light of this, the partners came

up with a simple strategy; provide basic, low-end motorcycles for the people of the developing world using China as the manufacturing source. In late 1992, Timko Export Management Company reached an agreement with a joint venture partner after extensive market research and interviews with prospective motorcycle manufacturers in China.

Timko soon realized that the Chinese companies they spoke with were generally unsophisticated with regard to Western business concepts of service, consistency, and quality. They did, however, know how to build things at a very low price.

JOINT VENTURE WITH A CHINESE MANUFACTURER

In 1992, Timko established a joint venture with Shanghai Jaiek Motorcycle Limited in Shanghai. This company was part of the giant Shanghai Automotive Industrial Corporation (SAIC). Shanghai Jaiek Motorcycle Company was the first company in the history of China to go public on the New York Stock Exchange. Half of its holdings were owned by the Chinese government, or the SAIC division, and the other half of the company was held as a joint venture of CP Group in Bangkok.

Timko formed a joint venture with Shanghai Jaiek Motorcycle Limited for the production, exportation and ultimate distribution of a line of motorcycles. The motorcycles were very similar to domestic models, except they were modified to ensure higher performance and quality for the international market.

Timko knew the quality issue would be critical. If they could develop a quality product at an affordable price then they knew that success would be within reach.

The motorcycles were sold under the Jaiek brand, as they were in China. Timko initially exported motorcycles to existing customers in Argentina. Within a short time, the firm exported the motorcycles to other parts of South America, Central America, and Mexico. Leveraging previously established relationships, the firm rapidly built an exclusive distribution network. Business was very good throughout 1993 and the first half of 1994. Several exclusive distributors were established in Argentina, with others established in Brazil, Peru, Chile, Bolivia, Paraguay, Uruguay, Columbia, and Ecuador.

The firm then turned its attention to the Caribbean, and found distributors for its motorcycles in Haiti and the Dominican Republic. The biggest markets during the initial phase of operations (from 1993 to mid-1994) were Argentina, Brazil, Peru and increasingly Mexico.

The partners felt good about the timing of their venture. Not only had they jumped into the motorcycle business as the major players were pulling out, but their target markets were exhibiting new signs of economic growth and stability. Latin America was recovering from the debt crisis of the 1980s. For example, Argentina had beaten back inflation and was growing at an annual rate of 5.7 percent, Brazil replaced a military dictatorship with a democratic government, and Mexico initiated a privatization program and an attack on its age-old policy of import substitution (Hill 2006,

p. 358). It appeared that the partners had made the right move when they decided to meet the growing demands of emerging market consumers with a new line of motorcycles.

PAYMENT STRUCTURE

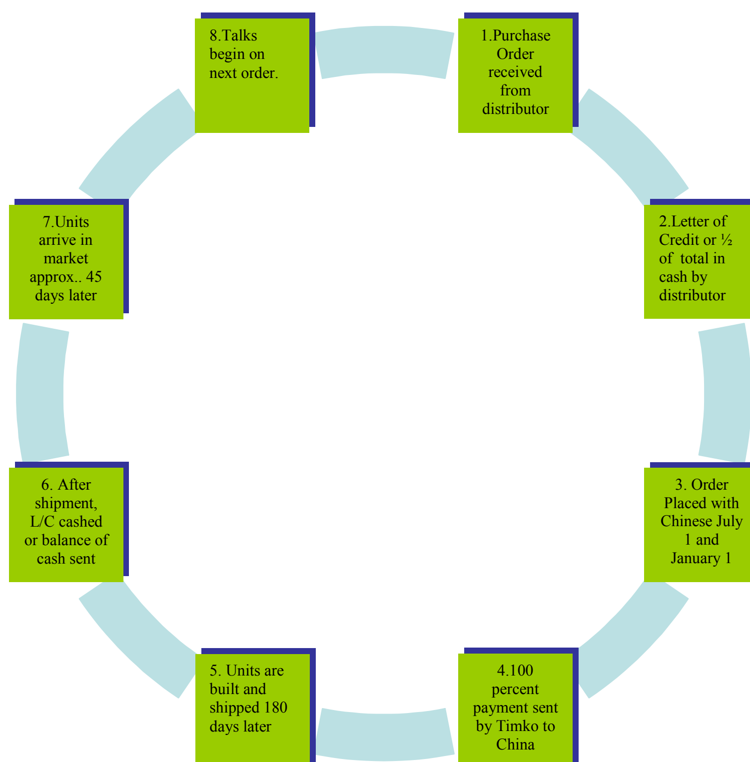
Figure 2 shows the Timko Export Purchase Order Processing Process. Timko set up a payment structure that was fairly conventional. A purchase order would be sent from a distributor, processed, and then submitted to the Chinese partner for production. After a formal purchase order was established and sent to China, production would begin. At the same time, the financing mechanism of the entire transaction, in U.S. dollars, was executed. Either a wire transfer cash payment or a letter of credit originating from one of the Latin American distributors would be sent to the United States. In order to enhance sales, Timko required distributors to provide on the front end only one-half of the cost of the motorcycles. They fronted the rest, waiting to cash the Letters of Credit after the shipment to receive the balance. This financing mechanism, it was believed, would give distributors the ability to sell more units and fill the pipeline much sooner. Having plenty of available cash on hand, the partners were willing to assume the risks in order to grow the business.

Calculating the gross profit was not complicated. The gross profit was simply the difference between what the distributor would send and the amount required by the Chinese joint venture partner to produce the motorcycles. Operating in this manner made it easy to handle the accounting and taxes. The Chinese were not sophisticated about global trade so they liked the simplicity of the arrangement.

The motorcycles were shipped on the first of July and the first of January. Purchase orders were obtained, money was collected, motorcycles were produced and manufactured, and then money was sent and the product was shipped. The letters of credit could be cashed after the shipment was confirmed by presenting the export documents to the negotiating bank.

The simple way of operating that Timko and its Chinese manufacturers adopted had left the partners vulnerable. With a letter of credit, a firm does not get paid until after a shipment is delivered. As a result, in many cases the partners would send on a bi-quarterly basis $5-10 million dollars in cash to China. This would pay for a shipment of motorcycles and cover the Chinese partner's expenses. Several months would pass before they were able to recuperate their money, including their profits. The partners were seemingly aware of the risks.

Figure 2: Timko Export Purchase Order Processing



ECONOMIC CLIMATE IN SOUTH AMERICA

In the beginning, the loose operational mode of Timko worked well. The countries of Latin America experienced economic stability throughout 1992 and early 1993. However, trouble was around the corner.

In the early 1980s the International Monetary Fund bailed Mexico out of a financial crisis. As a condition of the bailout the IMF forced the Mexican government to "peg" the peso to the dollar within a band of plus or minus three percent. The band was also allowed to "crawl" downward daily. This created an annual depreciation of the peso against the dollar of about four percent.

On January 1, 1993 the Mexican government instituted the Nuevo peso – the new peso – in response to the extreme devaluation that had occurred during the 1980s. One new peso was worth 1,000 of the obsolete Mexican pesos. In the international community, there was grave concern that the new peso was being artificially maintained by the Mexican government. Currency speculators began to put pressure on the Mexican government to float the peso on the open market in order to

determine the true value of the currency, especially relative to the U.S. dollar. The partners did not pay attention to any of this.

The first half of 1994 was a great time for Timko Export Management Company. They were able to coordinate the shipment of three quarterly orders of motorcycles, $45 million to their distributors in Latin America. The partners had began to think of expanding into new markets with a broader product line. They had even drew up plans for opening assembly plants in local markets around the region. Unfortunately for them, the global economy was about to teach them a painful lesson.

Timko was approaching the quarterly manufacturing cycle. A shipment of motorcycles worth $3.3 million dollars was to be sent on January 1, 1995. Over the previous six-month period purchase orders had been received from distributors along with wire transfers and letters of credit. More than $10 million dollars had been sent to China to fund the manufacturing of the motorcycles.

During the second half of 1994, pressure began to be exerted against the Mexican peso *vis a vis* the U.S. dollar. The exchange rate, which was 3.111 Nuevo pesos to $1 U.S. dollar, was widely considered artificial and unsustainable. As Christmas approached, the Mexican government indicated that it might do something short of floating the peso. This timing was likely due to a slowdown in the financial markets during the holidays. On December 20, 1994, the Mexican government decided to devalue the peso by 13 percent. By the end of the month it fell another 15 percent. On December 20th the peso was worth 3.940, on March 19, 1995 it stood at 7.220 per dollar. Over the course of the previous several months, 50 percent of the value of the peso evaporated.

The sudden devaluation of the peso, and the subsequent realization that Mexico was in the midst of a currency crisis, sent shock waves throughout the Latin American distribution network of Timko Export Management Company. The problem was the motorcycles were bought and sold in dollars on the international market (by Timko, the Chinese, and the distributors) and were sold in local currencies in the home market (to retail customers). Projections in terms of pricing and financing were based on the valuations of those currencies prior to what had happened in Mexico. In what came to be called the "Tequila Effect", the Mexican financial crisis soon spread throughout Latin America. As a result, Timko's motorcycles became cost prohibitive for its distributors.

For example, in Mexico, the cost to the local distributor of the motorcycles before the peso devaluation was approximately 3,100 pesos (the sale price from Timko was US$1,000 per unit x 3.11 pesos). A few months after the devaluation, the cost to the local distributor had jumped to over 7,200 pesos. Although the sale price from Timko remained US$1,000 per unit to the Mexican distributor, the cost in the local market had increased by over 40%! This scenario repeated itself across Latin America, where currencies across the region fell spectacularly against the U.S. dollar.

After wallowing in self-pity over the holidays, the partners decided that the only solution to a warehouse full of motorcycles was to come up with new customers. Wilson thought back to a conversation he had with an individual he met on one of his trips to Brazil. James Boachie-Adjei

was a Ghanaian who had expressed an interest in selling Timko motorcycles in Africa. Because no other options came readily to mind, Wilson flew to Ghana and visited Mr. Boachie-Adjei.
After a long lunch, it became evident that Boachie-Adjei did not have the resources or capacity to do business. However, he did tell Wilson about an area in northern Ghana, on the border with Burkina Faso, where there was a huge market for small-end motorcycles, especially Japanese motorcycles. Wilson made the 18-hour trip in the back of a small pick-up. Wilson was encouraged by the consumer demand that he witnessed and began a year and a half of travels that took him to 50 countries throughout Africa.

According to Wilson, *"It was paradise! I knew we were going to make it. Of course the amount of work required was monstrous. But I was convinced we could survive."*

His mission was simple, set up new distributors and liquidate the inventory remaining in Shanghai from the Tequila effect debacle. By mid-1995, Timko sold its way out of the Mexican currency crisis by meeting the demand for low-end motorcycles in Africa. By this time, things were looking up in Latin America. Currencies in the region had stabilized and economic growth was beginning to take off. The Mexican economy had revived; Both Brazil and Argentina began to experience near double digit growth, and the Tequila Effect had rapidly dissipated.

The economic crisis hangover was gone, and with new African distributors on line, Timko Trading, in conjunction with its Chinese partner, had visions of expanding markets, increased revenue and fat profit margins. Things had never been in better shape – or so it seemed.

The partners remained convinced that they could overcome whatever obstacles the global economy threw in front of them. Richards called himself "The Terminator" when he closed a deal and Wilson began to think himself a kind of management guru in the making. They often joked about how "all the so-called experts never had the guts to do what they had done."

Despite the difficulties of the previous months none of the parties voiced concern over the payment structure. To better manage economic risk, the partners decided to change the product/payment sequence from six months to a three month cycle. In other words, motorcycles would be ordered, shipped, and paid for in three months instead of six. The Chinese were amicable, their customers were cooperating, and business was booming.

From 1995 to 1996 100,000 motorcycles were manufactured and sold. Spare part sales were in the millions of dollars. The company was approaching $200 million a year in sales.

ASIAN MONETART CRISIS

In 1997, the partners were once again so fixated on business, that they did not notice new rumblings in the international financial markets – rumblings about the valuations of the currencies in Southeast Asia, particularly in Thailand, Malaysia, Indonesia, and South Korea. Both partners were logging about 500,000 miles a year, flying all over the world. Wilson would be gone two-to-three weeks at a time in Africa or Latin America, only to return home for a few days, and get back

out on the road. They were managing their Chinese partner, helping successful distributors grow their business, axing non-productive ones, and looking for new ones.

At this time, Wilson and Richards were thinking about how smart they had been. Having overcome the "Tequila Effect" they were sure that a billion dollar business was not that far off. They were already talking about an IPO and spin-offs around the world.

The Asian export boom of the 1980s had led to a boom in commercial and residential property investment. As the valuation of real estate in major Asia cities soared, a "bubble" was created. Heavy borrowing from banks financed huge infrastructure projects throughout the region. However, because the underlying economic fundamentals were unsound, pressure from international financial markets began to build.

In mid-1997 it became evident that several large financial institutions in Thailand were about to default on loans they had taken out from international banks for the purpose of financing local development. Sensing a financial meltdown, investors began a selling spree on the Thai stock market, with some individuals even shorting the Thai baht. Suddenly, investors began to perceive risk everywhere in Asia. What came to be known as "contagion" spread throughout the region, as investors sold their positions in Asian markets, demanded dollars, and exited the area. Because there were not enough dollars to cover the dollar-denominated debt, Asian governments began to rapidly devalue their currencies. The "Asian Flu" of 1997 had arrived.

It was déjà vu for Timko. Now shipping on a quarterly basis to their customers in Africa and Latin America, the partners had experienced a good first two quarters of 1997. In October, at the beginning of the third quarter as the partners waited for their motorcycles to arrive, the economies of Asia suffered their meltdown.

During the previous month, $5 million had been sent to China. As the Asian Flu hit, currencies plummeted relative to the U.S. dollar, not only in Asia, but also in Sub-Saharan Africa and Latin America. Because of the millions of dollars that had been sent overseas during the previous month, Timko Trading faced an even graver, more dangerous situation than it had in 1993.

Timko now had to decide what to do. They had $5 million in inventory, which they had already paid for and had no prospects for recuperating their investment. The partners narrowed their options down to three options:

1. They could sell their stake in their joint venture to their Chinese manufacturing partner for pennies on the dollar.
2. They could ship the motorcycles to their distributors, who would be compelled to take the merchandise -- effectively dumping inventory on their distributors -- even though they would not be able to resell any of it in the foreseeable future. While this move could result in a rebound for Timko, it also had the potential of failure and the appearance of being unethical.

3. They could simply absorb the costs associated with the disaster, which would mean losing millions of dollars.

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OPTIMIZING THE ADVERTISING BUDGET FOR A REGIONAL BUSINESS: THE CASE OF CYCLE WORLD

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CASE DESCRIPTION

The primary goal of this case is for you to learn how a media planning consultant can optimize the effectiveness of a client's magazine marketing campaign budget. Other objectives include: (1) showing the usefulness of Excel and (2) recognizing that some solutions are better than others. This case has a difficulty level of 2-4. This case requires you to have some Excel experience and it can be taught in an Excel spreadsheet course to help better illustrate the usefulness of skills students are learning (difficulty level=2), or it can be taught in a marketing management course to illustrate the value of media planning consultants add to their clients (difficulty level=3-4). This case is also appropriate for M.B.A. students who are taking a pre-requisite course in statistics, spreadsheets, or marketing. This case is designed to be taught in two to three sessions of one-hour fifteen minutes at the undergraduate level. You are expected to spend 6-8 hours of out-of-class time working on the case.

CASE SYNOPSIS

This case illustrates a challenge that many regional private business owners face as their business grows, that is, marketing their services. Lance Landis is a retired professional cyclist who started a regional sport cycling business about three years ago, and although he has valuable skills necessary to repair and sell bicycles, he has no business education training. In the past, Lance has relied on word-of-mouth marketing, but has recently decided to market his business in some magazines. Lance is uncertain to as the most appropriate magazines to advertise in and has hired the company you work for, Keels, to help him determine which magazines best utilize his marketing budget. This case shows the value of (1) using statistics to help optimize managerial decisions, (2) marketing research, and (3) being able to think through a problem when it is not well structured, which is usually the case in the real business world.

INTRODUCTION

After a productive career as a professional cyclist, Lance opened Cycle World in Seattle, WA, U.S.A. Seattle is located in the northwest corner of the U.S.A. and is a city that seems to

become more environmentally conscience every year. And with the recent increase in gas prices, his firm will hopefully continue to grow. Lance is now contemplating marketing his business in some magazines to help his business to continue to grow. However, he lacks sufficient skills necessary to make an informed decision. Currently, he has developed a list of magazine names. Table 1 shows Lance's list of magazines.

Table 1

Magazine	Magazine
Alive	Outdoor Fun
Bus World	Parent's Digest
Chinese Cooking	Runners' World
Comp Tech	RV Country
Country Cooking	Software Review
Crafters	Sporting World
Creative projects	Sports Line
Cycle Time	Today's Cyclist
Electronics oday	Today's Home Video
Entrepreneur's Day	Traveler's Digest
Family Living	Who' Hot Movies
Fashion Flair	Who Hot Music
Fisherman's Line	Who Hot Sports
Gourmet's Kitchen	Woman's World Today
Naturalists	Wood Crafters

Lance is aware of his lack of marketing skills and is uncertain to as the most appropriate magazine to advertise in. To help him make a more informed decision, he has hired Keels Inc., a company you work for as a media planning consultant. To better understand Lance's business, you suggest a meeting with him at your firm's headquarters in downtown Seattle.

THE MEETING

At the meeting Lance shows you his list of magazines. And during your discussions it becomes clear that Lance strongly believes some magazines are more appropriate to advertise in than others, even though he admits lacking any evidence supporting his conclusions. In fact, he

eventually yells at you and tells you to just advertise in the magazines he is suggesting. You quickly realize that the meeting is getting out of control and suggest a break.

THE BREAK

During the break you re-direct the conversation to the operations at his bicycle shops and the selling process that he uses. This re-direction of the conversation turns out to be a pivotal point in your relationship with Lance. Interestingly, during his explanation of his selling process, Lance unknowingly offers some important information that you think can be very useful. In fact, you interrupt him to ask him to better explain the survey that he has his customers fill-out after purchasing a bicycle. Lance explains that his market research contains the following information on 180 customers: (1) the product line of bicycle purchased (novice=1, intermediate=2, advanced=3), (2) gender (male=1 or female=2), (3) education level (1=no high school diploma, 2=high school diploma, 3=some college level work, 4=college degree, and 5=graduate work or degree), (4) marital status (1=single and 2=married), (5) yearly income, (6) the number of times per week the bike is used, (7) the number of miles per week the customer rides, and (8) fitness level (1=poor shape to 5=excellent shape). During the break you ask Lance if you can have this database of customer information and he agrees. He gives you his flash drive and you download the database onto your computer. After coming back from downloading the data, you explain to him that his survey information is going to be really helpful in formulating a better solution to his advertising problem. Lance smiles and seems pleased. He then states that he knew most bicycle shops kept records on their customers and so he did too, but he didn't know what to do with the data he was collecting. He is glad that his market research is going to be useful. Table 2 shows the complete results of his customer survey.

Table 2

ID	Product	Age	Sex	Education	marital	Income	Times/wk	Miles/wk	Fitness
1	3	22	1	4	1	26000	3	120	5
2	3	22	1	4	1	34000	4	200	5
3	3	23	1	4	1	29000	4	140	5
4	3	23	2	4	1	37000	3	100	4
5	3	23	1	4	1	33000	4	100	5
6	3	24	1	4	1	29000	4	100	5
7	3	24	1	5	2	39000	4	80	5
8	3	24	2	4	1	36000	5	200	5
9	3	24	1	4	1	32000	5	160	5
10	3	24	1	4	2	30000	4	120	5

Table 2									
ID	**Product**	**Age**	**Sex**	**Education**	**marital**	**Income**	**Times/wk**	**Miles/wk**	**Fitness**
11	3	25	1	4	2	30000	4	160	4
12	3	25	2	5	2	40000	5	200	5
13	3	25	2	5	2	39000	3	100	3
14	3	25	1	4	2	42000	6	180	4
15	3	25	1	4	2	47000	6	240	5
16	3	25	1	5	2	51000	3	170	5
17	3	26	2	5	1	50000	4	100	3
18	3	26	1	4	2	46000	5	180	4
19	3	26	1	4	2	42000	4	160	5
20	3	27	1	4	1	57000	4	100	3
21	3	27	1	5	2	61000	3	100	4
22	3	28	2	4	2	63000	6	180	5
23	3	28	1	4	2	64000	7	180	5
24	3	28	1	4	1	52000	4	150	5
25	3	29	1	4	1	61000	5	180	5
26	3	29	1	3	2	32000	7	300	5
27	3	29	2	4	2	59000	6	280	5
28	3	30	1	5	2	63000	4	160	4
29	3	30	1	5	2	73000	5	150	5
30	3	31	1	4	2	70000	6	260	5
31	3	33	2	4	2	62000	4	200	5
32	3	34	1	4	1	67000	3	150	5
33	3	35	1	4	2	64000	4	360	5
34	3	38	1	5	2	64000	3	150	5
35	3	41	1	5	1	74000	6	200	5
36	3	42	1	4	2	57000	4	200	4
37	3	44	1	4	2	62000	4	160	5
38	3	47	1	4	2	63000	4	120	5
39	3	48	1	4	2	74000	4	180	5
40	2	19	1	3	1	18000	3	60	2
41	2	20	1	3	1	19000	2	50	3
42	2	20	2	3	2	20000	3	100	3
43	2	20	1	3	1	24000	3	90	3
44	2	21	2	3	2	20000	5	200	4

Table 2									
ID	**Product**	**Age**	**Sex**	**Education**	**marital**	**Income**	**Times/wk**	**Miles/wk**	**Fitness**
45	2	21	1	3	2	20000	2	40	2
46	2	22	1	4	2	19000	2	50	2
47	2	22	1	3	1	24000	4	100	3
48	2	23	2	3	2	22000	3	90	3
49	2	23	1	3	2	24000	3	80	3
50	2	23	2	4	1	30000	3	90	3
51	2	23	1	4	2	30000	4	120	3
52	2	23	2	4	2	28000	3	70	2
53	2	23	2	3	1	26000	2	50	2
54	2	24	1	4	2	30000	2	60	3
55	2	24	2	3	1	26000	3	80	2
56	2	24	1	4	1	33000	3	100	4
57	2	25	2	4	2	34000	3	100	3
58	2	25	1	3	2	30000	2	80	4
59	2	25	1	3	2	28000	3	120	4
60	2	25	1	4	2	36000	2	40	2
61	2	25	2	3	2	32000	5	100	2
62	2	26	1	3	1	30000	3	90	3
63	2	26	2	3	1	28000	2	60	3
64	2	26	1	3	2	30000	4	160	3
65	2	26	2	3	2	28000	3	100	4
66	2	26	2	4	2	34000	2	50	3
67	2	27	2	3	2	30000	2	40	2
68	2	27	1	3	1	33000	4	120	3
69	2	27	2	4	2	30000	4	80	2
70	2	28	2	4	1	34000	4	120	4
71	2	28	1	4	1	35000	4	100	3
72	2	30	1	3	1	30000	3	50	2
73	2	30	2	4	2	35000	3	90	3
74	2	31	2	4	2	41000	3	70	3
75	2	31	2	3	1	31000	4	100	3
76	2	31	1	4	2	36000	3	90	3
77	2	31	2	4	2	35000	2	60	3
78	2	31	2	5	1	50000	1	20	1

Table 2									
ID	**Product**	**Age**	**Sex**	**Education**	**marital**	**Income**	**Times/wk**	**Miles/wk**	**Fitness**
79	2	32	1	4	1	43000	4	120	3
80	2	32	1	4	2	37000	3	90	3
81	2	33	1	3	2	37000	4	160	4
82	2	33	2	4	2	34000	2	80	3
83	2	33	1	4	2	35000	3	90	3
84	2	33	2	4	2	37000	3	90	3
85	2	34	2	5	1	32000	3	70	4
86	2	34	2	4	2	47000	3	90	3
87	2	34	1	4	2	42000	3	80	4
88	2	34	1	3	1	49000	3	80	3
89	2	35	2	3	2	36000	2	50	2
90	2	36	1	4	2	37000	2	50	2
91	2	37	2	4	1	34000	3	60	2
92	2	37	1	4	2	37000	3	90	2
93	2	37	2	4	2	33000	2	80	3
94	2	38	2	4	2	45000	4	80	2
95	2	38	1	4	2	42000	3	100	3
96	2	40	2	4	2	44000	3	80	3
97	2	41	2	4	1	41000	3	80	3
98	2	42	1	4	2	47000	3	90	3
99	2	46	1	4	2	38000	2	40	2
100	2	50	1	4	2	41000	2	60	3
101	1	18	1	3	1	16000	4	120	4
102	1	19	1	3	1	18000	3	80	3
103	1	19	2	3	2	17000	2	70	3
104	1	19	1	2	1	19000	3	90	3
105	1	20	1	3	2	21000	2	50	2
106	1	20	2	3	2	19000	3	70	3
107	1	21	2	3	2	21000	3	80	3
108	1	21	1	3	1	19000	3	90	3
109	1	21	1	3	2	21000	5	150	4
110	1	21	2	3	2	23000	2	90	3
111	1	22	1	3	1	22000	3	90	3
112	1	22	2	3	2	21000	3	70	2

Table 2									
ID	**Product**	**Age**	**Sex**	**Education**	**marital**	**Income**	**Times/wk**	**Miles/wk**	**Fitness**
113	1	22	2	4	1	22000	3	80	3
114	1	22	1	3	2	21000	3	80	3
115	1	23	1	4	2	24000	3	50	1
116	1	23	1	4	2	26000	3	80	3
117	1	23	2	3	2	20000	4	110	3
118	1	23	1	4	2	25000	3	100	3
119	1	23	2	4	1	24000	4	120	3
120	1	23	2	3	2	20000	2	40	2
121	1	23	1	3	1	24000	4	120	3
122	1	23	1	4	1	26000	4	100	3
123	1	24	2	4	1	27000	4	100	3
124	1	24	1	4	2	29000	5	200	5
125	1	24	1	3	1	30000	4	120	3
126	1	24	1	3	2	27000	2	50	2
127	1	24	2	4	1	31000	2	80	3
128	1	25	2	3	2	33000	3	80	3
129	1	25	1	3	2	30000	2	60	3
130	1	25	2	3	2	27000	2	50	2
131	1	25	2	3	2	25000	3	90	3
132	1	25	1	4	1	26000	3	120	4
133	1	25	2	4	2	26000	2	50	2
134	1	25	1	4	1	28000	3	90	3
135	1	26	2	3	2	29000	3	120	4
136	1	26	1	4	2	36000	4	120	3
137	1	26	1	4	2	37000	2	50	2
138	1	26	1	4	2	35000	3	90	3
139	1	26	1	4	1	22000	2	70	3
140	1	26	1	4	2	29000	4	140	4
141	1	27	1	4	1	34000	3	90	3
142	1	27	2	3	2	30000	3	70	2
143	1	27	1	4	1	38000	3	90	3
144	1	27	2	3	2	30000	2	60	3
145	1	27	2	3	2	31000	2	60	3
146	1	28	2	4	2	36000	2	70	3

Table 2									
ID	**Product**	**Age**	**Sex**	**Education**	**marital**	**Income**	**Times/wk**	**Miles/wk**	**Fitness**
147	1	28	1	3	1	36000	3	110	3
148	1	28	2	3	2	38000	3	100	3
149	1	28	1	3	1	38000	4	120	3
150	1	29	2	4	2	35000	3	60	3
151	1	29	1	5	2	50000	3	90	3
152	1	29	2	3	2	31000	2	40	2
153	1	29	2	4	2	34000	4	100	3
154	1	30	1	3	2	31000	4	150	4
155	1	31	1	3	1	38000	3	90	3
156	1	31	1	3	2	38000	2	50	2
157	1	31	2	4	1	30000	2	50	2
158	1	32	2	4	1	31000	3	120	4
159	1	32	1	4	2	36000	3	90	3
160	1	33	2	3	1	39000	2	40	2
161	1	33	2	3	2	31000	3	90	3
162	1	34	1	4	1	35000	4	180	5
163	1	34	2	3	1	36000	2	70	2
164	1	34	1	4	2	33000	4	90	3
165	1	35	2	3	2	43000	3	100	3
166	1	35	2	5	1	49000	3	90	3
167	1	36	1	2	1	29000	4	100	3
168	1	37	2	3	2	23000	3	90	3
169	1	37	1	4	2	31000	3	80	3
170	1	38	2	3	2	38000	2	60	3
171	1	38	1	3	1	36000	2	60	3
172	1	38	1	4	2	40000	3	80	3
173	1	39	1	4	2	42000	4	140	4
174	1	40	1	3	2	44000	3	70	3
175	1	42	1	3	2	38000	4	110	3
176	1	43	1	4	2	37000	3	70	3
177	1	45	2	4	1	41000	3	80	4
178	1	46	2	4	2	43000	3	50	2
179	1	49	1	4	2	40000	4	100	3
180	1	50	2	4	2	47000	3	70	3

THE MEETING CONTINUES

After the break the atmosphere in the room is very different and during this time you show Lance a database that Keels subscribes to. It contains the following descriptive statistics on the subscribers for all magazines on Lance's list: (1) age, (2) percent male, (3) education, (4) salary, and (5) level. Table 3 shows the database. You explain to Lance that age is the average age of the magazine's subscribers, percent male is the percentage of the magazine's subscribers that are male, education is the average level of education (BA=bachelor degree, HS=high school diploma, and Tech=technical certificate from a trade school), salary is the average salary of the magazine's subscribers (in thousands of dollars), and level (1=none, 5=very active) is the average activity level of the magazine's subscribers.

Table 3

Magazine	Age	%Male	Education	Salary	Level
Alive	26	45	BA	26	5
Bus World	30	70	BA	50	4
Chinese Cooking	38	30	HS/BA	34	3
Comp Tech	34	92	Tech/BA	37	2
Country Cooking	32	20	HS	20	2
Crafters	32	30	HS/BA	34	3
Creative projects	28	20	HS/BA	32	4
Cycle Time	29	65	BA	60	5
Electronics Today	42	90	Tech/BA	42	2
Entrepreneur's Day	26	90	HS	27	3
Family Living	30	55	HS/BA	31	3
Fashion Flair	20	10	HS	14	4
Fisherman's Line	50	90	HS	34	3
Gourmet's Kitchen	46	60	BA	56	3
Naturalists	38	60	BA	45	3
Outdoor Fun	27	55	HS/BA	30	3
Parent's Digest	28	50	HS/BA	29	2
Runners' World	43	70	BA	38	5
RV Country	57	69	HS/BA	28	2
Software Review	28	70	BA	48	4
Sporting World	28	52	HS/BA	31	4

Table 3					
Magazine	**Age**	**%Male**	**Education**	**Salary**	**Level**
Sports Line	35	76	HS	28	4
Today's Cyclist	25	10	HS	22	2
Today's Home Video	32	40	BA	36	2
Traveler's Digest	46	60	HS/BA	44	4
Who' Hot Movies	29	45	HS/BA	29	2
Who Hot Music	22	30	HS	18	3
Who Hot Sports	25	80	HS	22	3
Woman's World Today	28	10	BA	34	3
Wood Crafters	42	85	HS/BA	42	3

After showing Lance your database of magazine demographic information, you explain to him that his customer database and your magazine database may arrive at the same magazines to advertise in that he is suggesting, but you want to perform some additional analysis to make sure. You tell Lance that it should only take a few days to do the analysis, the meeting ends, and Lance goes back to Cycle World.

AFTER THE MEETING

After the meeting with Lance you go to another scheduled meeting where you learn that Keels has upgraded their magazine database that you just showed Lance. The upgraded database as shown in Table 4 has the following additional variables: (1) circulation, (2) advertising price per issue, and (3) people per dollar. Your boss explains that circulation is the number of monthly magazine subscribers, advertising price per issue is the cost of advertising in the magazine, and people per dollar shows how many subscribers will potentially see an advertisement in the magazine per dollar spent on advertising. Simply put, it is circulation divide by advertising price per issue. You believe that you can use this information to increase the effectiveness of Cycle World's marketing budget.

After learning about the new variables in the database you call Lance on his cell phone to let him know that Keels has purchased additional information on the magazines you discussed at your meeting. You explain to him that this investment by Keels will help optimize his advertising budget. Again, Lance is pleased and is excited to learn hear from you in a few days.

Table 4

Magazine	Age	%Male	Education	Salary	Level	Circulation	Ads Price per Issue	People/$
Alive	26	45	BA	26	5	830,000	$36,800	23
Bus World	30	70	BA	50	4	820,000	$36,900	22
Chinese Cooking	38	30	HS/BA	34	3	230,000	$31,000	7
Comp Tech	34	92	Tech/BA	37	2	880,000	$36,800	24
Country Cooking	32	20	HS	20	2	650,000	$34,800	19
Crafters	32	30	HS/BA	34	3	550,000	$30,100	18
Creative projects	28	20	HS/BA	32	4	980,000	$36,800	27
Cycle Time	29	65	BA	60	5	790,000	$34,500	23
Electronics Today	42	90	Tech/BA	42	2	950,000	$35,200	27
Entrepreneur's Day	26	90	HS	27	3	1,080,000	$39,200	28
Family Living	30	55	HS/BA	31	3	1,210,000	$39,400	31
Fashion Flair	20	10	HS	14	4	750,000	$32,700	23
Fisherman's Line	50	90	HS	34	3	560,000	$30,200	19
Gourmet's Kiechen	46	60	BA	56	3	970,000	$36,300	27
Naturalists	38	60	BA	45	3	630,000	$31,500	20
Outdoor Fun	27	55	HS/BA	30	3	940,000	$35,100	27
Parent's Digest	28	50	HS/BA	29	2	1,050,000	$38,900	27
Runners' World	43	70	BA	38	5	820,000	$36,900	22
RV Country	57	69	HS/BA	28	2	790,000	$34,500	23
Software Review	28	70	BA	48	4	750,000	$31,900	24
Sporting World	28	52	HS/BA	31	4	890,000	$35,200	25
Sports Line	35	76	HS	28	4	950,000	$35,300	27
Today's Cyclist	25	10	HS	22	2	540,000	$31,900	17
Today's Home Video	32	40	BA	36	2	700,000	$34,000	21
Traveler's Digest	46	60	HS/BA	44	4	1,120,000	$38,300	29
Who' Hot Movies	29	45	HS/BA	29	2	890,000	$36,300	25
Who Hot Music	22	30	HS	18	3	810,000	$36,500	22
Who Hot Sports	25	80	HS	22	3	750,000	$34,100	22
Woman's World Today	28	10	BA	34	3	940,000	$37,000	25
Wood Crafters	42	85	HS/BA	42	3	590,000	$31,400	19

YOUR MISSION

You are a young media planning consultant who is gaining experience in the area of helping attract and retain new clients for Keels Inc. Lance, the owner of Cycle World, is hiring you to help him put together an effective magazine advertising campaign. Lance wants to advertise in two magazines per product line and has an advertising budget of $1,500,000 per year. Initially, he said that he plans to divide the funds equally among the three product lines. In your report and presentation you should:

- Create a list of potential magazines to advertise in based on Lance's list of magazines that he showed you during the meeting. This is solution number one.
- Use Lance's customer database and Excel to compute the average for the following variables by product line (novice, intermediate, advanced): age, education, income, times/week, miles/week, and fitness. Moreover, compute the number of customers and percent of total sample by product line as well as the standard deviation of age and the standard deviation of income by product line. Note that you can use Excel's pivot table function to compute these statistics.
- Use Lance's customer database and Excel's pivot table to compute the percent of male and female customers by product line. Again, you can use Excel's pivot table function to compute these statistics.
- Comment on customer demographics by product line using your results in 2 and 3. Make a recommendation that will increase the effectiveness of Cycle World's advertising budget.
- Using the magazine database you showed Lance and based on your analysis thus far, find some magazines that have subscriber demographics that are similar to the demographics of Cycle World's customers. Use a search range that is plus or minus one standard deviation from the average.
- Make a recommendation to Cycle World based on your analysis in 5.
- Using the upgraded magazine database and your analysis thus far, find some magazines that have subscriber demographics that are similar to the demographics of Cycle World's customers and maximizes the number of subscriber's per dollar cost of advertising per issue. Again use a search range that is plus or minus one standard deviation from the average.
- Make a recommendation to Cycle World based on your analysis in 7.
- Write-up a magazine marketing plan for Cycle World.

CONCLUSION

This case is a way to introduce students to statistics for decision making. The case shows students that (1) descriptive statistics can help solve real-life problems, (2) Excel is a powerful and

convenient tool that can help solve real-life problems, and (3) rational and quantitative analysis is important in the decision making process. In this case, the search ranges in Figure 6 and 7 are a key step to the solution process and combining ads for the novice and intermediate product lines saves Cycle World 1/3 of their budget. As for the evidence of teaching effectiveness, student feedback on a survey that we conducted immediately after this case is positive. Our survey from 46 students indicates that 80% of students plan to use Excel to solve problems in future classes; and 77% of students understand the importance and limits of statistics in a decision making process, the importance of critical thinking, and the efficiency of Excel.

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AMERITECH IN THE PHILIPPINES: FAILURE TO ADJUST TO FILIPINO CULTURAL NORMS?

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CASE DESCRIPTION

The primary subject matter of this case concerns itself with cross-cultural issues and is appropriate for courses in cross-cultural management, international management, international business, and human resource management. The case has a difficulty level of three or four. The case is designed to be taught in 1 – 2 class hours.

CASE SYNOPSIS

An American computer supply company moves its operations to the Philippines in an effort to be more cost competitive but experiences cultural shock as it attempts to institute greater efficiency. The case details the struggles of the plant manager, William Dawson, as he learns the challenges of managing the "Filipino way." The case includes issues such as pakikisama, face saving, and collectivist behavior.

INTRODUCTION

AmeriTech was started in Lexington, Kentucky by a small group of former IBM employees who accepted a buyout package offered by the company when the Lexington division was reorganized in 1991. Originally, AmeriTech produced computer supplies such as ink cartages, cables, and other small computer supplies in a facility in North Carolina. The operation proved successful as the demand for such products rose globally, however, over time AmeriTech found itself less competitive in terms of cost over rivals from a number of Asian countries. In an effort to reduce labor costs, the founders moved their operations to Mactan Island near the city of Cebu in the Philippines. Instead of starting a Greenfield operation, AmeriTech was able to purchase an underperforming Korean firm that was operating in the economic zone of the island. AmeriTech purchased the facility and retained the entire workforce of the former Korean owned business. AmeriTech had hoped to continue its efficient and quality-oriented production techniques from North Carolina in the low wage environment of the Philippines.

THE PHILIPPINES

The Republic of the Philippines is a country in Southeast Asia consisting of over 7,000 islands (Figure 1). The capital is Manila, located on the island of Luzon. The Philippines was "discovered" by Ferdinand Magellan in 1521, who claimed the islands for Spain. The country was named after the Spanish King Philip (Felipe) and missionaries converted most of the population to Catholicism. The Philippines is unique in being the only Christian country in Asia. While Magellan met his death soon after arriving in the Philippines, the country was under Spanish control for a number of years. The Philippines came under the rule of the United States in 1898, when Admiral Dewey defeated the Spanish, and Spain ceded the islands under the Treaty of Paris. While Tagalog, or Filipino is the official language of the Philippines, English is widely spoken, especially among educated Filipinos.

In 1935 the Philippines became a self-governing commonwealth, and there continued to be a strong push by the Filipinos for complete independence. This independence movement was interrupted by World War II when the Japanese invaded the country. With the help of the American forces, the Filipinos defeated the Japanese and gained their independence in 1946. After a number of different administrations, strongman Ferdinand Marcos ruled the country for a number of years and maintained strong ties with the United States. With increasing discontentment of the Filipino people, a "people's revolution" occurred and Marcos was forced to leave the country. Political instability resulted for a time; however, democracy quickly retook a firm hold in the Philippines. Fidel Ramos became president of the Philippines in 1992, and he opened the economy to market forces and encouraged foreign investment, including the establishment of export processing zones (EPZ) and incentives for foreign firms to establish a presence in the Philippines.

AMERITECH IN THE PHILIPPINES

With an increasing wage rate in North Carolina and the incentives offered by the Philippines, AmeriTech made the decision to close its American facility and begin operating in the Mactan Economic Zone of the Philippines. The area is in the part of the Philippines called the Visayas. With a compatible operating facility being offered for sale, AmeriTech relocated with the hope of gaining a competitive advantage with lower labor costs and access to the emerging markets of Asia. The only employee from North Carolina that would be making the move to the Philippines was William "Bill" Dawson. Dawson was the son of a tobacco farmer in North Carolina, who while deemed by his teachers and peers to be highly intelligent, never attended college. He worked in a number of manufacturing jobs after high school, and through hard work and ability, gained a number of supervisory positions. He was hired by AmeriTech when the firm first began operating in North Carolina as a first line supervisor. Through an unusual series of personnel turnover and one death, he was promoted to plant manager in a few years after first being hired. Dawson instituted a number

of quality improvement and inventory management techniques and gained the respect of his superiors. While Bill could be intimidating to some (he was a large, and somewhat heavy man, with a loud voice), he was generally well liked and respected by the employees at AmeriTech. Bill was known for being "firm, but fair." He was very informal with his employees and dressed in a casual, or some would say "sloppy" fashion. The employees appreciated the fact that he was just a "regular guy." Bill was looking forward to his new assignment, however, he feared he would miss watching his beloved North Carolina Tar Heels play basketball on television. While he had never been to the Philippines, he did have a favorable impression of the country from the stories his uncle, who served in World War II, had told him about the Philippines, and the courage of the Filipino fighters. Bill also learned that basketball is a favored sport in the Philippines and so "maybe the place wouldn't be so bad after all."

With an unusually easy transition, AmeriTech took control of the former Korean facility. While adjustments had to be made in the production process, and many of the workers could not be used during this time, AmeriTech generated goodwill by paying the employees their normal salaries during this startup period. The employees that were needed to work were paid their normal salaries plus a 50% bonus during this time. AmeriTech realized that there were going to be additional costs during the startup, including increased training in the "AmeriTech way." In general the employees welcomed the new owners, and many commented that they much preferred working for an American company than a Korean one. One new hire was Miguel Santos, a 26 year old MBA graduate of De la Salle University in Manila. Miguel was hired as an assistant to Bill, and someone to help Bill with any cultural difficulties he might experience in his assignment.

TENSIONS BEGIN

Miguel was born and raised in Manila and did not consider himself to be a Cebuano (someone from Cebu or the surrounding area). The employees in the plant were mostly Cebuanos and were at time untrusting of people from Metro Manila. They felt that they were too urban, too serious, and too self-centered for their tastes. Miguel was very deferential to Bill Dawson, refusing to call him by his first name and always referring to him as "Mr. Dawson," and sometimes, "Plant Manager Dawson." Miguel was not as cordial with the lower level employees at the plant, however, and at time had strained relations with employees. Miguel also was not very happy with the fact that he had to leave his family in Manila, and because of the distance, only see them every few months.

The productivity level of the plant remained low for a number of months and Bill had decided that it was time for a change. While he had expected that it might take some time for productivity to reach the levels achieved in North Carolina, he was beginning to feel as if without some intervention, things would not improve. Of particular concern to Bill was the amount of "wasted time" he observed in the plant. Employees would often take extended breaks, chat endlessly among themselves, and often engage in non-work activities while on company time, such as

celebrating an employee's birthday. Miguel explained to Bill that it represented "pakikisama" and was quite common in Filipino culture. Bill seemed unconvinced, but proceeded with caution and allowed this to situation to continue, as he was in a phase of "employee relations building" with the employees. After a few more months productivity still had not improved, and Bill decided it was time to take action.

In North Carolina, Bill had learned that when employees were "schooled" in the ways of productivity, they improved their performance. The North Carolina plant also had an individual incentive plan which acted as a strong motivator. Bill reasoned that he should now begin to change the corporate culture of the plant. With the help of Miguel, he organized after-work training sessions and stressed the importance of reducing "wasted time" on the job. Most of the employees were females and many had not worked previously in a manufacturing environment. The training sessions were a bit frustrating to Bill as he could not get the employees to participate nor contribute their thoughts. He felt that if he allowed for employee input, he could win over the employees to his ideas for productivity improvement. The only employee who spoke frequently was a middle aged woman named Millet, who often joked and teased Bill during the training sessions. Bill had gotten the impression that Millet was romantically interested in him, and he was unhappy with the situation. After yet another training session in which little was achieved, so Bill thought, except the asking of personal questions from Millet, Bill decided to have her fired. He instructed Miguel to terminate her employment immediately. Miguel warned Bill that Millet was a productive employee who had worked for the previous company for many years, and that she was very well liked by her peers. Bill responded that he was tired of her teasing and personal questions and that "it was nobody's damn business if he is married or not." Miguel did as he was told and informed Millet she would not be returning to work tomorrow.

The mood of the employees, especially those in Millet's department, changed almost immediately. While it was common to hear cheery voices and laughter in the plant, in the days and weeks that followed, the plant was void of much humor. Employees seemed to be more formal and less warm to Bill, however, there was a slight improvement in productivity. This made Bill happy. He thought that, just maybe, he needed to use a firmer hand in dealing with the workers. He was a bit concerned that employee turnover had increased, but he reasoned that it was probably just employees who did not want to really work. Bill turned his thoughts to ways to introduce a monetary incentive program and to start a quality improvement program.

While Bill pondered such issues, Miguel informed him that another industrial plant was opening in Mactan and that he feared that AmeriTech might lose more employees. Bill was unconcerned, but finally agreed with Miguel that he would call a meeting and announce the incentive program he had been developing. The meeting was scheduled after work hours, and a number of employees did not attend. This angered Bill and he expressed his displeasure by calling out the names of the employees who were not present. He suggested to the gathered employees that maybe those missing employees would not be returning to work next week. The meeting went on,

with the rather complex incentive program being explained. The basic idea was that employees would no longer be "entitled" to a salary, but that they could, if properly motivated, earn more money. Within a week, almost 20 percent of the workforce resigned.

TIME FOR CHANGE, AGAIN

With turnover becoming a problem, and the resulting disruption to production, Bill was under fire from his superiors to turn the situation around. Bill decided to have yet another meeting with his employees, but this time to pay them for attending. Bill expected 100% turnout for the meeting but instead, roughly half the employees attended. Bill was outraged and proceeded to lecture the employees present that the work culture of the company must change. After a very tense 10 minutes of hearing this, Miguel politely interrupted Bill with the suggestion that a break be taken and food delivered to the plant for the employees. This suggestion was not well received by Bill, who then proceeded to criticize Miguel for not understanding the importance of profitability. The meeting ended with a somber mood, as it had begun, and employees quietly left for home. Miguel was one of the first employees to leave the building.

The following day Miguel called in sick, complaining of stomach troubles. Bill decided that maybe he had been too hard on Miguel and the other employees. As he sat at his desk wondering how to proceed, the assistant director of human resources called him to tell him that the director of HR had resigned, for "medical reasons." The department had been busy attempting to fill the vacancies created by the turnover and Bill worried that he was losing the respect of his employees. Bill decided to host an event for all employees in nearby Cebu City, honoring the most dedicated and outstanding employees. When Miguel returned to work the following day, Bill informed him of his decision. Miguel seemed less than excited about the idea. When pressed for an explanation, Miguel admitted that a party was maybe a good idea, but that he, Bill, should not take a very active role in the event. Surprised by this recommendation, Bill pressed Miguel for answers. After much pressuring Miguel blurted out that the employees had a nickname for him – "baboy." Bill was told it meant pig in Tagalog. With this revelation Bill decided to cancel any plans for a party and to resume his normal style of management. He instructed Miguel to begin looking for a new HR director and to ramp up the recruitment of employee replacements.

DISCUSSION QUESTIONS:

1. What mistakes, if any, did Bill make in his management of the plant?
2. Was it necessary for Bill to change, in any way, in his new assignment in the Philippines? Explain.
3. What is the significance of the nickname the employees gave to Bill?
4. If you were advising Bill, what would you suggest?

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Note: This case is illustrative and not intended to represent any real company or persons.

Figure 1: Map of the Philippines

Source: World Fact Book

LAUREN’S WARDROBE

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CASE DESCRIPTION

The case highlights the many human resources issues that challenge small business owners, including the sensitivity of conducting business in a predominantly ethnic community. Among the issues raised are job abandonment, willful misconduct, employee theft, hostile work environment, hiring practices, termination practices, progressive discipline, the importance of clearly promulgated employee policies, and constructive discharge. The case is appropriate for use primarily with undergraduate and graduate courses studying Human Resources Management in a small family owned business.

CASE SYNOPSIS

Lauren’s Wardrobe is one of two stores owned and managed by Kelly Brown. The stores are located in a heavily Hispanic border community in Texas. Kelly employs eight to twelve employees depending on seasonal demand. One afternoon, three of the four employees in both stores walk off the job, leaving one store abandoned, and the other covered by only one employee. The precipitating event seems to be prejudicial comments made by Kelly’s mother (not officially an employee) regarding the Hispanic employees, and her conduct toward them. After addressing the immediate issues of covering the stores until closing, Kelly talks with her one remaining employee, Rosie, who gives Kelly insight into the conditions faced by her employees. Now, Kelly must decide what actions to take before the stores reopen the next day.

INTRODUCTION

Kelly’s Tuesday afternoon quickly went from bad to worse. She learned that her two boutiques were open but not staffed. Kelly was at home when she received a call from a friend who was shopping at one of Kelly’s stores. The friend told Kelly that she had overheard two employees at Lauren’s Wardrobe talking and that one was saying how unfair “she” was being treated and that they were not going to take it. A few moments later, the two employees gathered their personal belongings and left, leaving the store unattended. Kelly’s friend, a customer, was the only person in the store. Suspecting Kelly was at home, the friend had called Kelly to tell her about the situation.

Lauren's Wardrobe and Mind's Eye were two small women's boutiques specializing in moderate to upscale priced clothing and accessories and were owned and operated by Kelly Brown. The stores were located in two strip-centers on the north side of a predominantly Hispanic community located in Texas along the Mexican border. Kelly's customer base was primarily Anglo and Hispanic women with middle- to upper- incomes. Despite only having been in business for four years and the stores being her first business venture as an owner or manager, Kelly had established a loyal customer base within the surrounding communities. She was also experiencing significant sales growth due to patronage from an increasing number of Mexican women who were crossing the border to shop at Lauren's Wardrobe. While both locations carried similar merchandise, Kelly would rotate older merchandise from Mind's Eye to Lauren's Wardrobe in the hope that the women shopping from Mexico would purchase the items the locals had not bought. Weekly sales had risen to approximately $15,000 for the two stores combined, however store profitability and cash flow remained low. The mark-up on merchandise averaged 65% and the stores' operating margin usually ran at a rate of 3%. The two stores, while operating under two different names, were incorporated as one entity.

Kelly employed a dozen high school and college-aged women, all of whom were Hispanic. Most of the women were hired because they looked appealing in the store's clothes or had been frequent customers when the stores had originally opened. Kelly served as the manager of both stores. Her mother often assisted her. Her mother had loaned Kelly a substantial amount of the money needed to open the business. The money was given to Kelly, interest free and without any due date for repayment. As a result of the loan and Kelly's inability to repay the loan, Kelly found it difficult to restrict her mother's involvement with the stores.

Kelly asked her friend to please wait there at the store, while Kelly called the other store, Mind's Eye. Kelly intended to have one of the two employees from Mind's Eye go to the unattended store. The friend agreed to stay at the store until relieved. When Kelly called Mind's Eye, it took much longer than usual for the phone to be answered. Rosie, Kelly's best employee, finally answered the phone. Kelly asked her why it had taken her so long to get to the phone. Rosie told Kelly that the other employee, Carla, had left the store saying she was quitting. Carla had told Rosie to tell Kelly that no one wanted to work for Kelly's mother. Rosie had customers in the store and was waiting on them when the phone had rung. Kelly told her to go back and wait on the customers and that she would make other arrangements to staff Lauren's Wardrobe, and have her daughter come to the store to help Rosie. Kelly's cell phone rang while she was on the house phone with Rosie. She said goodbye to Rosie and answered the cell phone.

Kelly's mother was calling from Lauren's Wardrobe. "Hello Kelly, this is mom. I just stopped by the store and nobody's here. What's going on?"

"I'm not sure. Can you stay there until I get there?"

"Well, I guess somebody has to. Your friend just left, so I guess I have to. The only other choice is to close the doors. Aren't those two Mexican girls supposed to be working today?"

"Yolanda and Estelle were working, and then for some reason they left, momma."

"Well, I'm not surprised. I think they were stealing from us anyway. We don't need girls like that working here. Someone just came in. I have to go before she loads up her purse with junk."

Kelly hung up the phone and wondered why she had ever agreed to let her mother work in the stores. Her mother was rude to the employees and suspicious of all Hispanic customers. As soon as her daughter Lauren got home from high school, Kelly took her to Lauren's Wardrobe, to work with her grandmother. Kelly then went to Mind's Eye to work with Rosie. Once at the store, Kelly called two of the other women who worked part-time and asked them to go to Lauren's Wardrobe to work the rest of the day. They agreed to relieve Lauren and her grandmother as soon as they could.

Later that evening after closing, Kelly asked Rosie to stay after work to talk about what had happened earlier in the day. Rosie was Yolanda's younger sister. Kelly thought Rosie would know why her sister and the two other employees had walked out.

"Rosie, I really need to know what is going on here. I can't run the stores with just one fulltime person, you. Why did they leave?"

"I don't know for sure," Rosie said reluctantly. "But I think it has something to do with your mother. Yolanda came home really upset the other day. She said she heard your mother talking to a customer about the employees stealing clothes or wearing them and then bringing them back and putting them on the rack. Your mother said you were going to fire all of us."

"Well, we have had some problems. Sometimes I find some of the clothes smell like smoke or perfume. I just assumed someone was taking them to wear out and then bringing them back and putting them on the rack."

It was actually Kelly's mother who had noticed some of the clothes had an odor. Kelly knew it was common for some customers to buy clothes, wear them, and then return them for a refund. The customers who did that usually returned them within a week or so after they were purchased. Over her mother's objections, Kelly would exchange the clothes or give the customer a store credit. Kelly would then have the clothes dry-cleaned and placed on a clearance rack after retagging the clothes. She also suspected some of the women who were working for her were taking clothes from

the store and then returning them to the rack. She had asked her mother what to do about the employees taking clothes without paying for them. Her mother said she should fire them.

Continuing her discussion with Rosie, Kelly asked, “Have you or the other girls been taking clothes without paying for them?”

Rosie’s head sank as she answered, “Oh Kelly, we thought it would be OK. Some of those customers do it. They come in here and buy such nice things and then wear them for one night and expect to get their money back. Usually we just take the things that the customers bring back.”

“No one ever keeps things without paying for them?”

“I don’t think so. I know I always pay for what I keep. I take the 50% discount that we get.”

“Who told you, you get a 50% discount? Employees only get a 10% discount.”

Rosie looked surprised. “Yolanda and the other girls told me it was 50%. Your mother and Lauren, when they do pay for the things they take, always take 50% off. So I just assumed that was what all of us got.”

“What do you mean, ‘when they do pay for things?’ We all have to pay for anything we buy or take out of the store.”

Rosie realized that perhaps Kelly did not know that her mother and daughter came into the store quite often and took clothes and accessories without paying for them. “Actually, they usually don’t pay. But we do.”

“So why did everyone walk out?”

“Because your mother was going around telling customers that we were stealing from you and that we were going to be fired. Kelly, she really treats us bad. And she treats the Hispanic customers bad too. I’ve had several people tell me they won’t come into the store when she works. She’s rude.”

Kelly asked, “Do you think the other girls will come back to work if I ask my mom not to be so involved with the stores?”

"I don't know. My dad is an attorney and when Yolanda told him how she treats us, he was really mad. He told us to quit and he was going to sue you. I told him not to. I really like working here."

"So can you get them to come back? I really don't want them to go back to work at my competitor's store. When they came here to work, they brought a bunch of their friends and customers with them."

"Oh, Yolanda won't be going back to Kaleidoscope. She got fired after you asked her to work here. The owner caught her giving her friends special discounts. Actually, that's how she's lost her last three jobs."

Kelly was surprised to hear Yolanda was fired from her earlier job. As a customer, Kelly had always received very good service from Yolanda at Kaleidoscope. Yolanda was always dressed very professionally and eager to wait on customers. When Kelly was preparing to open her stores, she had approached Yolanda to see if she might be interested in working at one of Kelly's new stores. Kelly had known Yolanda would bring customers with her if she were to leave Kaleidoscope and work at either Mind's Eye or Lauren's Wardrobe. Kelly recalled the day Yolanda came to the store to ask if Kelly's offer for a job was still available. Kelly was so excited about Yolanda's interest, she hired her on the spot. There was no need in Kelly's mind to have Yolanda fill out an application or check references, since Kelly had been one of Yolanda's customers at Kaleidoscope. Besides, Kelly had thought, the owner of Kaleidoscope probably would not have given Yolanda a good reference anyway since she was going to work for a competitor.

Shortly after Rosie left for the evening, Kelly's mother and Lauren arrived at the store. Kelly's mother had several brochures in her hand, which she tossed on the checkout counter. Kelly looked and saw the materials were about security cameras.

"What are these for?" asked Kelly.

"I'm tired of all these customers and kids you hire stealing us blind," her mother responded. " You shouldn't be having such a hard time making ends meet with the mark-up you have on all this stuff. I think its time we put in some hidden cameras to catch them in the act. We can put some in the back room where the girls take their breaks and hang out, and in the ceiling above the cash register. That way you know what's going on when you aren't here."

Kelly was not sure how to respond. "I'm not sure that's legal."

"What about it? You have a right to watch over your merchandise."

Kelly thanked her mother and prepared to leave the store for the night. She had a great deal to consider before the stores opened again on Wednesday.

THE DEVELOPMENT OF A FLEET VEHICLE REPLACEMENT POLICY FOR A FEDERAL GOVERNMENT CONTRACTOR

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CASE DESCRIPTION

This case presents a scenario to develop an equipment replacement policy for a large federal government contractor. This contractor serves as a facility maintenance manager for a federal government research and development organization. The maintenance company has a medium size fleet of cars, vans, pickup trucks and specialty vehicles. Currently, there is no vehicle replacement policy in the company. However, the company keeps some maintenance records of the vehicles that can be used in the development of a vehicle replacement policy. The objective of this case is to illustrate the basics of equipment replacement decision making and the practical application of the probability and statistics. The case is appropriate for use in a production/operations management, engineering, economics, business statistics or managerial accounting courses. The case should take no more than one hour of class lecture and two hours of preparation and research time from students. Total student time should not be more than four hours including research time.

CASE SYNOPSIS

The case is a simple but realistic application of business statistics models in the area of operations management and managerial accounting. It is an ideal case at the undergraduate level where students need practical application of statistical concepts. It superimposes generally difficult subject matter of statistics with easy to understand concepts of the operating cost of a small vehicle fleet. It will allow students to integrate simple regression, expected value and probability distribution concepts into vehicle replacement modeling.

BACKGROUND

A large federal government research facility is located in Southeastern part of Virginia. This facility is located on 810 acres of land. It has over 250 office and laboratory buildings including very large hangers, turbines and tunnels. The annual budget of the research facility is approximate $650 million of which 40 percent is operating budget. The research facility has about 2,000 direct employees and 2,500 contract/indirect personnel on the site. The maintenance budget is

approximately 10 percent of the operating budget of the research facility. The facility management functions for this federal government research organization are contracted out to a private company. The private maintenance company is responsible for all repair and maintenance of facilities other than specific scientific equipment repair. The current maintenance contractor was awarded the maintenance contract in 2003. This contractor took over all office space, equipment, vehicles and repair part inventory from the previous facility management contractor. The company has an on-site office, workshop and other necessary facilities needed for building and equipment maintenance. It employs approximately 150 repairmen, supervisors and support staff. The repair job varies from simple light bulb replacement to complex turbine engine repair. The company maintains inventory of necessary tools and some repair parts on the site.

Typically, a repairman responds to a service call according to a pre-determined priority scheme. A repairman completes a service call in one or more trips to the location of service call. Generally, the first trip involves assessment of the fault and determination of required parts for the repair, if it needs any parts. If repairman does not have the necessary parts with him, he would return to the shop. He will either to back to the repair site with necessary parts if parts are available in the part storage area. Otherwise, he will place an order of the part necessary to make repair in the future. Some repair jobs may require more than two trips. The service request completion time is one of the most important customer satisfaction measures in the organization.

To deliver the repair services, the company maintains a fleet of trucks, vans, cars, and specialty vehicles. Typically a repair van or truck is assigned to a specific repairman. The assigned vehicle serves as a small mobile workshop for the repairman. The cars are usually used by the supervisors for site visits. The specialty vehicles are called into service as the need arises. The mobility of repairmen and supervisor depends on the availability of the required type of vehicle at the right time. During the time when a vehicle is unavailable due to failure or other maintenance need, the assigned repairman's productivity is reduced and the repair work is delayed. Therefore, it is important that the vehicle down-time is as low as possible. The company desires a comprehensive vehicle usage policy, including a vehicle replacement policy so vehicle downtime and associated cost can be reduced. The objective of this case is to require consultant teams an opportunity to analyze and recommend a repair vehicle policy for the company.

DESCRIPTION OF FLEET TYPE

The company's repair vehicles are categorized in three areas. General vehicles- are driven by maintenance repairmen to perform the daily tasks. These vehicles include vans or pick-up trucks. Tasks that do not require specialty vehicle are performed with general vehicles. These vehicles also store repairman's tools and parts. Specialty vehicles-are used when the repair task is of a routine nature. Specialty vehicles include bucket trucks, cranes, flatbeds, etc.

Supervisory vehicles—include cars, fully enclosed golf carts, etc that are used by supervisors and management personnel for on-site inspections and general mobility. Supervisory vehicles provide a safe environment for transporting paper work, computers and other materials to the work sites.

DESCRIPTION OF FLEET MAINTENANCE

Regular Preventive Maintenance-- Normal annual preventive maintenance tasks for each vehicle include state inspection as required by the law; oil changes as stated by the manufacturer of the vehicle; tune-ups, as stated by the manufacturer of the vehicle; and minor maintenance and safety items performed as needed, such as wiper or headlight bulb replacement, etc.,.

Oil changes and minor repairs are carried out in a timely fashion at the specified vehicle maintenance facility. The federal facility contractor has selected a vehicle repair sub-contractor close to the research facility. Estimated time for most of these services is approximately one and a half hours including travel time.

Major maintenance--any vehicle failure not covered under regular preventive maintenance is defined as a major failure event. Currently there are no established assessment policies for major maintenance. Estimated repair time for major maintenance work is, on average, 8 hours. During this down time repairmen are constrained in carrying out the repair task. The company wishes to examine this policy to reduce this exposure.

Catastrophic failure—any vehicle placed out of commission with an estimated repair cost that could possibly exceed the future benefits from the usage of the vehicle in question. There is no formal system in place for estimating the future value of the vehicle. However, if in the opinion of the vehicle supervisor that the cost of repairs is “too high”, it is considered catastrophic failure and such an event triggers an automatic vehicle replacement process.

FLEET DATA

The available vehicle data includes make, model and type of vehicle, age of vehicle, years in service at the company, type of use, and assignment of vehicle. The available fleet financial data includes purchase price, book value, and the depreciation schedule used. The maintenance data on each vehicle is available including type and cost of maintenance of each vehicle each year. A total of 84 vehicles’ records are included in the following report. Table 1 indicates the number of vehicles and the distribution of the type of vehicles currently employed.

Table 1: Vehicle Type Distribution		
Type	Number	Percent
Car	13	15%
Pickup Truck	11	13%
Van	48	57%
Specialty Vehicle	12	15%
Total	84	100%

The age of the three main categories of vehicles, cars, vans and pickup trucks is shown in the Table 2. Specialty vehicles are ignored since an analysis of each is unique. The average age of the current fleet of cars, vans, and pick-up trucks is 9.95 years with a range of 2-24 years.

Table 2: Age of the Fleet by the Vehicle Type	
Type	Age-Years
Car	8.77
Pick-up	6.91
Van	10.98

Table 3 presents the distribution of the vehicles by the year of manufacture.

Table 3: Year of Make of the Fleet Vehicles	
Year of Make	Number of Vehicles
1983	1
1986	2
1989	23
1993	8
1995	1
2001	1
2003	1
2004	33
2005	2
Total	72

The total repair and maintenance cost due to major breakdowns for each vehicle over the last three years is presented the Table 4 which appears below. The table includes the number of major breakdown per vehicle. The year of make of the vehicle is included to determine age at 2007, the year of this study. As expected the oldest vehicles failed frequently and are more expensive to maintain.

Table 4: Maintenance data of the Vehicle Fleet

No.	Type	Year	Total Major Maint. Cost 2004-06	Total Number of Major Maint Cost 2004-2006	No.	Type	Year	Total Major Maint. Cost 2004-06	Total Number of Major Maint Cost 2004-2006
1	Van	1989	$2,689.40	13	37	Van	2004	$643.80	3
2	Van	1989	$2,495.85	14	38	Pick-up	2004	$359.03	2
3	Van	1989	$3,687.24	9	39	Pick-up	1983	$1,553.84	3
4	Van	1989	$2,371.43	8	40	Pick-up	2004	$375.00	1
5	Van	1989	$4,356.82	11	41	Van	2004	$263.55	1
6	Van	1989	$2,620.97	9	42	Van	2004	$240.74	1
7	Van	1989	$1,860.95	7	43	Van	2004	$232.85	1
8	Van	1989	$1,698.37	9	44	Van	2004	$202.24	1
9	Van	1989	$1,986.08	7	45	Pick-up	2004	$196.04	1
10	Van	1989	$1,982.37	7	46	Van	2004	$35.00	2
11	Van	1989	$1,682.85	6	47	Van	2004	$359.88	0
12	Van	1989	$813.30	8	48	Car	1993	$0.00	0
13	Car	1993	$1,819.53	7	49	Car	1995	$0.00	0
14	Van	1989	$3,534.95	5	50	Van	2001	$353.42	1
15	Van	1989	$1,676.48	4	51	Car	2003	$0.00	0
16	Van	1989	$1,134.96	6	52	Van	2004	$448.32	1
17	Van	1989	$1,179.16	6	53	Pick-up	2004	$262.25	1
18	Car	1993	$1,299.30	7	54	Van	2004	$180.15	1
19	Van	1989	$1,207.88	6	55	Van	2004	$103.31	1
20	Van	1989	$1,255.35	3	56	Van	2004	$0.00	0
21	Car	1993	$2,115.64	6	57	Pick-up	2004	$0.00	0
22	Pick-up	1993	$1,042.85	6	58	Van	2004	$0.00	0
23	Van	1989	$920.76	5	59	Van	2004	$0.00	0

Table 4: Maintenance data of the Vehicle Fleet

No.	Type	Year	Total Major Maint. Cost 2004-06	Total Number of Major Maint Cost 2004-2006	No.	Type	Year	Total Major Maint. Cost 2004-06	Total Number of Major Maint Cost 2004-2006
24	Van	1989	$2,303.21	4	60	Van	2004	$0.00	0
25	Van	1989	$437.33	4	61	Van	2004	$0.00	0
26	Car	1993	$1,553.55	7	62	Van	2004	$0.00	0
27	Van	1989	$892.17	4	63	Van	2004	$0.00	0
28	Van	1986	$1,359.55	5	64	Van	2004	$0.00	0
29	Car	1993	$2,416.77	5	65	Van	2004	$0.00	0
30	Van	1986	$1,159.41	4	66	Pick-up	2004	$0.00	0
31	Pick-up	1993	$459.93	4	67	Car	2004	$0.00	0
32	Van	2004	$835.05	2	68	Car	2004	$0.00	0
33	Van	1989	$573.47	2	69	Car	2004	$0.00	0
34	Pick-up	2004	$589.84	2	70	Car	2004	$0.00	0
35	Pick-up	2004	$791.17	3	71	Van	2005	$0.00	0
36	Van	2004	$431.58	2	72	Car	2005	$0.00	0

VEHICLE REPLACEMENT POLICY

The major consideration in the construction of the vehicle replacement model for this company is that the policy (or model) should be user friendly and can be easily applied. For example: Advanced mathematical programming models such as dynamic programming though an appropriate tool should not be used as a driver in this case. The appropriate model should be n easily automated into a basic spreadsheet structure such as EXCEL. Furthermore, the company is interested in having one policy for all non-specialty vehicles. In other words, differences in maintenance pattern of the three vehicle types, car, pick-up trucks and vans, should be ignored. The vehicle replacement policy/model should consider the purchase, capital, major repair, opportunity and salvage costs.

Assumptions:

1. Cost of insurance, fuel, supervisory personnel are ignored.

2. Tax implications are not considered.

3. Vehicle is fully depreciated in three years

4. Vehicle acquired is kept at least for three years (until book value is zero.) Once book value is zero, the company's overhead cost is reduced to maintenance related cost only.

5. Total vehicle requirement is not decreasing.

6. Vehicle retirement age is normally distributed with mean of 16 years and standard deviation of 1.5 years. These numbers are adjusted upwards here as vehicles have much lower mileage compared to national average.

7. Regular maintenance cost is ignored as those will roughly be similar in all vehicles.

8. It was given that each major maintenance incident results in slow down of two workers (50% efficiency.) Overall average cost of worker is assumed to be $40 per hour (including pay, benefits, and other associated costs.).

9. Due to lack of data available for each breakdown, it is assumed that the vehicle would be out of service for on an average for one day (8-hours).

10. Catastrophic failure results in average of $1,000 opportunity loss including supervisory time, loss to worker efficiency, time to remove tools, inventory from old vehicle restock, and refitting new vehicle.

11. Cost of capital and discount rate are 10%.

12. The year of assessment is 2007.

CASE QUESTION

Develop a replacement model for fleet vehicles where the total cost is minimized for each vehicle over a three-year period.

TO LOAN OR NOT TO LOAN: A SUBPRIME DILEMMA

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CASE DESCRIPTION

Students face a bank's decision to enter or not enter the subprime home lending market. The situation is set just prior to the problems that arose in 2007-2008. The case provides aggregate economic data available at the end of 2006 and asks students to utilize this data in recommending whether or not to enter this market. The case has a difficulty level of three and is designed for a junior level course. Including student presentations, the case is covered in three class hours. It is expected that students will spend 3-5 hours outside of class preparing this case.

CASE SYNOPSIS

A Senior Vice President for a midsized commercial bank is contemplating getting her bank to move forward in extending subprime loans. She has observed her competitors' profits rise following their entry into this market. The two percent lending premium on subprime loans is an attractive addition to bank income. In addition she wants to help those customers who do not qualify for traditional, prime home loans obtain the American dream of home ownership. With financial advice and counseling, the vice president believes that customers who have low credit ratings due to a few late payment, difficulty in documenting their income, or, perhaps, a prior bankruptcy deserve another chance and given the opportunity to move into their own home.

In making recommendations to the bank, the analysis is divided into three parts: a statistical examination of delinquency potential and credit ratings, an examination of aggregate economic implications (with statistical analysis) for the home loan market, and an evaluation of the ethical aspects of lending to subprime customers.

TO LOAN OR NOT TO LOAN: A SUBPRIME DILEMMA

Middletown, December 2006

Owning a home is part of the American dream. Having a home creates ties to the community, provides stability, and promotes civic pride. This desire for home ownership is so much

a part of the American culture that governments promote this ownership by providing significant tax incentives. Mary Taggert is Senior Vice President for Mortgage Lending at a medium sized bank, Citywide State, operating in the Midwest. Mary prides herself in her role of helping her customers realize this American dream. She wants to help extend the opportunity of home ownership to her customers who previously would not qualify for a home loan from Citywide by convincing the bank management to enter into the subprime home lending market.

Citywide has been a fairly conservative banking institution, concentrating on commercial lending to local business and low risk home loans. The home loans extended by Citywide are to prime borrowers. These borrowers have reasonably well established credit and borrow in loans conforming to Fannie Mae or Freddie Mac criteria. Such loans can be packaged and sold through these government-sponsored agencies. The risk to the bank is low, many of the loans are sold to other institutions and pension funds while the bank earns fees for processing the payments. Prime borrowers generally had credit scores of 640 or higher.

In managing the loan business for her bank, Mary sees her job as dealing with two significant problems. Prior to extending a loan she must deal with adverse selection. Once the loan is extended she needs to provide sufficient incentives to reduce the moral hazard problem. Adverse selection results from asymmetric information. The potential borrower knows more about their likely behavior and financial condition than the bank. If the bank establishes a lending criteria that is significantly more lenient than its competitors, the borrowers selected are more likely to be higher risk and less likely to maintain their payments. Once the loan is extended the borrowers might expose the bank to unanticipated risk by failing to maintain the property. Mary sees this moral hazard problem being reduced by requiring a minimum down payment of10 percent of the property's value. Since the first party to incur a loss, should the property value decline, is the homeowner, they have an incentive to maintain the value. The adverse selection problem is managed by screening the applicants. A potential borrower's credit score has proven to be a useful screening device.

Mary has been frustrated by having a screening rule that only permits loans to highly qualified borrowers. Since her bank only issues prime mortgage loans, she must turn away business from borrowers with 640 or lower credit scores. She has watched her competitors enter the less than prime (subprime) market with a high degree of success and seen many of the subprime borrowers succeed in making their housing payments, improve their credit scores, and achieve their dream of home ownership. Mary believed that these potential borrowers should not be denied the opportunity of home ownership just because of a few late payments, difficulty in documenting their income and, perhaps, a prior bankruptcy. If they were given the opportunity and provided financial counseling to help them manage their incomes, they would become good customers for the bank, provide an additional source of bank income, and become more productive members of the community.

The subprime market developed in the late 1990s. These loans were designed to provide potential homeowners with less than perfect credit the opportunity to get back on their feet, improve

their credit rating, and ultimately refinance into a prime loan at lower rates. The initial subprime loans required a 20 percent down payment, had a fixed interest rate for the first two years that was generally 2 percent above the prime, 30-year fixed rate, and moved into an adjustable rate mortgage (ARM) after two years. Moving into the 2000s, housing prices were rising, equity was being built up for the homeowners and the loans were profitable. With the subprime loans improving bank profitability, banks and mortgage lending institutions moved to make their loans more attractive. The down payment requirements dropped to 10 percent. Institutions, in some cases, would issue loans for 100 percent of the property's value (no down payment). In order to provide additional loans, second loans were sometimes issued to subprime borrowers to permit them to take acquired home equity out of the house. While the latest movement towards more lenient lending criteria has Mary a little worried, she still sees the subprime market as a vehicle to help both her bank, with higher profits, and her customers, by providing them with the opportunity of home ownership.

The subprime loans Mary wishes to make would require at least a ten percent down payment, have a fixed rate for two years, include a prepayment penalty during the first two years, and become an adjustable rate mortgage (ARM) after two years. To compensate for the added risk associated with these loans, the fixed rate would be 2 percent higher than the bank's traditional prime home mortgage loans. The ten percent down would protect the bank in the case of foreclosure, and the future adjustable rate would make the loan attractive on the developing secondary market for subprime loans. The ARM is indexed relative to the 6-mo LIBOR (London Interbank Offer Rate). Mary is comfortable with these features. She believes that her borrowers would make their mortgage payment, reestablish a higher credit score and be able to refinance after two years into a lower rate prime loan.

Mary has some concerns over entering this market and has hired your consulting firm to help her resolve these concerns and recommend how she should proceed in this market. (Note: This case takes place in December 2006. While you may have future events in this industry available, your recommendations should be made on information available prior to January 2007.)

1. Mary is concerned over how she should use credit ratings in making these loans. She has gathered sample data on credit rating and loan delinquencies which are provided for your use. Loans delinquent beyond 90 days are likely candidates for foreclosure. Mary believes that the bank is willing to accept a minimum credit score that has an expected foreclosure rate of ten percent.
    a. What is the relationship between days delinquent for a given credit score?
    b. What credit score is expected to yield an average delinquency of 90 days?
    c. If Mary used that credit score as a minimum for extending these subprime loans, what proportion of loans to individuals with that score would you expect to be 90 or more days delinquent?

d. Assuming that Mary gets the bank to enter the Subprime market, what minimum credit score would you recommend accepting? Why?

2. Mary is wondering whether or not the success seen by her competitors is the result of recent increases in housing prices. She has heard rumors that the Federal Reserve is likely to tighten Monetary Policy and wonders what the implications are for her success in this market. Mary has provided you with data on historic home price changes in her area along with data on price level (CPI) changes, and interest rates. Using this data, how concerned should Mary be over possible changes in Federal Reserve policy?

3. Mary believes that the ten percent required down payment will protect the bank from a loss of principal. However, should the loan default, the funds are likely to be tied up, without interest income for six to nine months. The funds could have been used to fund a prime loan at around six percent interest with a default rate of well under one percent. Mary is wondering whether or not the two percent premium paid on the performing loans will cover the expected loss from the nonperforming loans. She expects a potential default rate around 3-5 percent. The average home loan is about $200,000.

4. Mary wants to sell some of these subprime loans on the developing secondary market. However, she also wants the bank to retain some in their asset portfolio to add income and make the stockholders happy. She wants an evaluation of the associated risks and a recommendation on whether or not to hold or sell.

5. Finally, Mary is concerned over the potential ethical dilemma over lending substantial amounts of funds to customers who have demonstrated an inability to manage their finances or to not lend to them and deny an opportunity to move forward on home ownership. Is it ethical or not to extend loans in the Subprime market.

   In making your recommendations it is suggested that you look into the relationships between changes in home price, interest rates and inflation.

   The available data is in the excel spreadsheet subprimedata.xls. Note that the data is contained in two sheets. The data is available online at:

   INK"http://www.csun.edu/~hceco009/subprimedata.xls"http://www.csun.edu/~hceco009/subprimedata.xls

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Subprime Data - This data is on two sheets.	
credit scores	days del.
400	91
425	90
520	70
540	88
510	85
555	65
535	75
565	55
575	50
640	36
621	43
650	40
647	29
630	35
624	37
648	44
620	45
679	40
682	38

Subprime Data - This data is on two sheets.	
credit scores	days del.
665	36
680	35
695	25
705	22
712	15
730	18
720	13
795	1
760	8
745	15
800	1

Housing Data

Time	Year	Qtr	NONPerf**	CPI***	inflation	6 mo LIBOR*	Home Price Change****
1	1989	4	1.59	100.00	4.779	8.355	1.91
2	1990	1	1.72	101.82	7.219	8.521	2.45
3	1990	2	1.70	102.85	4.023	8.646	1.32
4	1990	3	1.79	104.91	7.927	8.219	0.41
5	1990	4	1.81	106.25	5.099	8.000	0.23
6	1991	1	1.86	106.73	1.784	6.849	0.33
7	1991	2	1.83	107.68	3.545	6.355	0.32
8	1991	3	1.84	108.47	2.930	5.959	2.88
9	1991	4	1.68	109.42	3.488	4.852	2.01
10	1992	1	1.65	110.13	2.596	4.391	3.69
11	1992	2	1.52	110.93	2.865	4.214	3.55
12	1992	3	1.44	111.72	2.845	3.525	2.17
13	1992	4	1.31	112.67	3.387	3.724	3.24
14	1993	1	1.23	113.46	2.801	3.254	2.67
15	1993	2	1.07	114.25	2.782	3.438	3.02
16	1993	3	0.99	114.81	1.936	3.459	4.51
17	1993	4	0.85	115.84	3.570	3.505	4.53

Housing Data							
Time	Year	Qtr	NONPerf**	CPI***	inflation	6 mo LIBOR*	Home Price Change****
18	1994	1	0.82	116.47	2.181	3.880	6.65
19	1994	2	0.78	117.10	2.169	4.958	5.02
20	1994	3	0.73	118.21	3.769	5.448	3.35
21	1994	4	0.66	118.84	2.138	6.479	2.39
22	1995	1	0.66	119.71	2.921	6.521	2.02
23	1995	2	0.70	120.67	3.162	6.047	3.54
24	1995	3	0.71	121.22	1.833	5.923	4.61
25	1995	4	0.79	121.85	2.085	5.751	4.40
26	1996	1	0.83	123.12	4.137	5.390	2.53
27	1996	2	0.81	124.07	3.075	5.636	2.25
28	1996	3	0.78	124.86	2.545	5.805	2.98
29	1996	4	1.05	125.97	3.535	5.581	4.53
30	1997	1	1.06	126.52	1.756	5.883	3.73
31	1997	2	1.01	126.84	1.000	6.008	4.27
32	1997	3	1.00	127.63	2.489	5.847	4.18
33	1997	4	0.97	128.11	1.486	5.951	3.82
34	1998	1	0.98	128.27	0.494	5.837	4.46
35	1998	2	0.93	128.90	1.970	5.787	5.56
36	1998	3	0.91	129.45	1.716	5.628	6.02
37	1998	4	0.90	130.17	2.196	5.194	7.63
38	1999	1	0.99	130.48	0.972	5.096	8.53
39	1999	2	0.93	131.43	2.902	5.300	9.36
40	1999	3	0.89	132.86	4.314	5.856	11.19
41	1999	4	0.87	133.65	2.377	6.114	11.31
42	2000	1	0.85	135.39	5.180	6.365	10.65
43	2000	2	0.86	136.34	2.797	6.897	11.93
44	2000	3	0.91	137.45	3.239	6.760	11.24
45	2000	4	0.96	138.24	2.298	6.536	11.52
46	2001	1	1.03	139.43	3.422	5.009	13.53
47	2001	2	1.13	140.70	3.618	4.016	12.51
48	2001	3	1.17	141.01	0.899	3.235	12.78
49	2001	4	1.13	140.46	-1.575	2.086	12.01
50	2002	1	1.21	141.33	2.473	2.130	9.57
51	2002	2	1.22	142.20	2.457	2.046	9.19

Housing Data							
Time	Year	Qtr	NONPerf**	CPI***	inflation	6 mo LIBOR*	Home Price Change****
52	2002	3	1.22	143.15	2.664	1.810	8.40
53	2002	4	1.20	143.94	2.206	1.491	9.04
54	2003	1	1.22	145.61	4.594	1.317	9.21
55	2003	2	1.21	144.97	-1.744	1.212	8.33
56	2003	3	1.15	146.56	4.346	1.180	8.71
57	2003	4	1.10	146.87	0.863	1.223	7.57
58	2004	1	1.03	148.14	3.435	1.180	8.16
59	2004	2	0.89	149.56	3.830	1.630	9.08
60	2004	3	0.86	150.28	1.901	2.049	7.80
61	2004	4	0.80	151.78	3.984	2.567	7.14
62	2005	1	0.76	152.73	2.496	3.165	6.63
63	2005	2	0.80	153.29	1.449	3.546	5.65
64	2005	3	0.80	157.40	10.602	4.074	5.53
65	2005	4	0.85	156.93	-1.209	4.572	5.95
66	2006	1	0.80	156.93	0.000	4.974	4.61
67	2006	2	0.78	158.04	2.815	5.416	3.49
68	2006	3	0.77	159.86	4.583	5.456	1.59
69	2006	4	0.78	160.65	1.976	5.370	-0.89

0 FannieMae.Com index averaged over each quarter.
** FRB 8th District data set
*** Department of Labor, BLS, CPI
**** Standard and Poor's MPLS housing index, percent change over a year prior.

Legend

NONPerf Nonperforming loans. Past due 90+ days. Ratio
CPI Consumer Price Index
inflation Annual percentage change in CPI
6 mo LIBOR 6 month LIBOR interest rate

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The authors are Professors in the College of Business and Economics, California State University, Northridge and would like to thank Fred Arnold for helpful information on the subprime mortgage market.

SECOND-DRAFT OF A BUSINESS PLAN: WHAT SHOULD IT CONTAIN?

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CASE DESCRIPTION

The subject matter of this case addresses the process and critical content elements in preparing business plans. This case would be most appropriate for undergraduate and graduate courses in business plans, new value creation, and entrepreneurship, as a written assignment or a group discussion. The case is designed to be discussed in one to one and one-half hours and should take students no more than three hours of outside preparation. This case is the second of two cases designed to help students learn how to prepare a business plan. The first case appeared in an earlier edition of the Journal of Case Studies—entitled," First Draft of a Business Plan: What Should it Contain." This case could also be used as a training tool for instructors who evaluate and provide feedback on business plans.

CASE SYNOPSIS

Tom Jacobs is a part-time entrepreneurship "prof" at HACC (Hagerstown Area Community College) and as such he must "judge and advise" student-entrepreneurs' ideas and business plans. This is the second time he has read and edited a business plan by four students in his New Venture Creation class. The problem is that this business plan is not clear or well thought-out in several areas --- making feedback difficult. Professor Jacobs likes this business plan because it involves a real service --- the sport of Paintball. The students have done a very good job of taking the feedback from the first edit and vastly improving the business plan. Still there are glaring problems with the second-draft of the plan and Tom must provide enough constructive advice and specific edits for the students to move this plan forward to the final-draft which is due in two weeks.

SITUATION

Tom Jacobs looked out of his home office window at the rolling hills of western Maryland. He loved living on his farm and all of the free time he now had to spend on his hobby --- The Civil War. Within 50 miles of his home two of the most important battles were fought --- Gettysburg and Sharpsburg. Tom moved from Washington, DC three-years ago after harvesting his software company because he wanted to be close to the actual places where the Civil War had taken place.

He spent the first three months of his "retirement" reading, writing, and touring Civil War battlefields, but realized even though he loved researching and learning about history he also missed the rough and tumble aspects of entrepreneurship. Consequently, he became a part-time instructor at the local community college (Hagerstown Area Community College) and an advisor to budding entrepreneurs.

Today he was re-reading a rough, second-draft of a business plan that a group of four students has given him. Tom liked the plan. It was typical of most student plans because it involved creating a business which the students enjoyed. Tom knew nothing about the sport of Paintball, but the student group convinced him that it was experiencing explosive growth and a real opportunity existed in this activity. Still he had many questions about the opportunity and the business plan.

Because Tom had been involved in entrepreneurship for over 35 years he usually could read two or three sections of a business plan and determine its viability. Tom believed that the plan and the business had some merit, but he questioned several parts of the concept. He decided to check-off the basic metrics of opportunity determination:

Are customers reachable?
Is the industry growing at more than 30% a year?
What is the time to break-even?
Is the market structure imperfect?
What market share could the new venture obtain after five years?
Is the ROI potential greater than 25%?
What are the capital requirements?
What is the free cash flow potential?
What is the sales growth potential?
What is the asset intensity?
What are the gross margins?
What is the harvest potential?
What are the competitive advantages?
What control over costs exists?
What are the barriers to entry?
Is the management team sufficient?
What is the strategic differentiation?

After reviewing each of these items Tom realized that some of the questions were answered by the plan, others were sort of answered, and some questions were left unanswered. Below is the second-draft of the students' business plan and pro-forma financials. What should Tom Jacobs say to the group?

Is this a good business opportunity? Why or why not?
What specific advice would you give the group about his business plan?
What improvements would you make in the group's business plan?
Would you invest in Paintball Palace?

PAINTBALL PALACE: ISN'T IT TIME FOR SOME COLORFUL FUN?

EXECUTIVE SUMMARY

Paintball Palace's focus will be providing a state-of-the-art facility for the people of South-Central Pennsylvania and North-Central Maryland to enjoy the fast paced and fast growing sport of Paintball. Our facility is targeted towards males and females ages 12 to 30 years old. The founders believe that an opportunity exists in the paintball industry for several reasons:

Rapid growth in the number of unique visits
Changing attitudes towards the sport of paintball
Changes in laws regarding playing paintball on public land and within city limits
Decreases in the wholesale prices of paintballs and paintball equipment
Industry standard of requiring players to purchase "field paint only" in order to use the facilities
Multiple styles/formats of paintball games, including TV/audience friendly formats

As a result of these conditions, there is a unique opportunity to provide a high quality paintball facility with excellent customer service at an affordable price to our customers, while still making a healthy profit.

While most paintball facilities are outdoors, and very few are indoors, Paintball Palace will provide outdoor fields as well as climate controlled indoor fields. This will allow the company to obtain our initial customer base during the winter, and, as a result of Paintball Palace's superior customer service, maintain that customer base throughout the year.

The total market size for the paintball industry in South-Central Pennsylvania is 49,420 participants. We estimate that we will be able to capture 10% of that market. The 4,942 customers will yield 25,586 visits. Paintball Palace will have positive net income in its first year of operation.

Each of the four managers will contribute $30,000 to the company as well as a line of credit established using Mr. Chapman's 5-unit apartment complex in Shippensburg. Paintball Palace is seeking partnerships with suppliers of paintballs and paintball equipment as well suppliers of Astroturf/artificial grass. In return for favorable terms with these suppliers, Paintball Palace will include advertisements for the suppliers in its facility as well as on its webpage.

THE INDUSTRY, THE COMPANY, AND ITS PRODUCT AND SERVICE

The paintball industry has experienced tremendous growth since the first game on June 27, 1981. Since this game, the number of paintball participants has increased at an average compound rate of 90.20%. Advances in the production of the paintballs themselves have caused the cost of paintballs to drop to a price that is more affordable for everyone. The acceptance of paintball as a sport has been energized by its participants as well as several big name companies such as Wal-Mart, K-mart, Cabelas, Gander Mountain, and Dick's Sporting Goods. Paintball paraphernalia can be found on the shelves of these stores as well as many other large department stores and sporting goods stores.

According to the Sporting Goods and Manufacturers Association International, wholesale sales of paintball equipment has been rising - $170 million in 1999, $195 million in 2000, and $225 million in 2001. The number of participants has also been on the rise. In 2002, approximately 3.1% of the total US population played paintball at least once that year; a 13% increase from 2001. In addition, the number of participants who played more than once per year increased 24.4% from 2001 to 2002, and the number who played at least 15 times per year increased 78% from 2000 to 2001.

Opportunity Rationale

There are six main reasons why an opportunity exists for Paintball Palace: rapid growth, changing attitudes, changes in the law, decreasing wholesale prices, "field paint only," and multiple styles/formats.

Rapid Growth

The sport of paintball is a relatively new sport, and, while experiencing moderate growth in the number of participants, it is experiencing tremendous growth in the number of unique visits. Despite the overall number of participants increasing only 13%, the number of participants playing 15 or more times per year increased 78%. So, not only is the number of participants increasing, but the average number of times that those customers play is exploding.

Changing Attitudes

When paintball first started back in 1981, the general public viewed it as a barbaric glorification of war. Since then, many paintball promoters and facility owners have worked hard to show the public that paintball is not just a war game; it is also great for learning/teaching teamwork, confidence building, and as a social activity. The new formats of paintball have also caused a change in attitude, but that will be discussed shortly.

Changes in the Law

Many cities, towns, boroughs, and even entire counties have enacted laws that ban playing paintball on public land or private property within their jurisdiction, with the exception of businesses with the proper permits. This means that in order to play, paintball players have to go to a facility with a permit. These permits are not hard to get. To obtain a permit, most counties require safety inspections, insurance (also requires safety inspection), and a certificate for filling pressurized paintball tanks. This certificate requires a two-hour training session that costs around $200.

Decreasing Wholesale Prices

As a result of technological advances in the production of paintball equipment and paintballs, wholesale prices are on the decline. This will allow Paintball Palace to purchase paintball equipment for rentals and paintballs in large quantities at low prices. This obviously equates to lower prices and higher gross margins for Paintball Palace.

Field Paint Only“

Field Paint Only” (FPO) is the industry standard of requiring paintball players to purchase the paint supplied by the field in order to play at the field. This allows field operators, including Paintball Palace, to charge a higher price than those found in retail stores and on the Internet.

Multiple Styles/Formats

When paintball first started it was played strictly in the woods on several acres of land – now called “woods-ball.” Now, not only is paintball played in the woods, but it is also played on fields approximately 120ft. by 135ft. where the only obstacles between players are inflatable objects – called “air-ball.” Air-ball is very fast paced and spectator friendly. This gives it a typical “sport” feel. It allows college and high school teams, as well as amateur and professional teams, to compete in leagues, tournaments, and conferences. The smaller fields, with few objects to hide behind, cause players to shoot more paint, which equates to more sales revenue.

The Company

The opportunity for a new paintball facility to enter the industry was conceived in January 2003. The company will open its doors on Saturday January 1, 2005. We will have a grand opening/New Years Day party, complete with DJ, party food, and special appearances by paintball “celebrities.”

The Service and Product

Paintball Palace will offer a wide range of indoor and outdoor playing fields to suit the needs of all paintball players. Indoors we will offer two small air-ball fields and two large air-ball fields, one with bleachers and one that we will call a "concept field." The concept field will be designed like a street corner; it will have several old cars, dumpsters, mailboxes, trashcans, and so on, for participants to hide behind. Outdoors we will have one small and one large air-ball field, and two to three woods-ball fields. One of the woods-ball fields will feature a village and a castle with a second floor. In order to keep things interesting, the layout of the air-ball fields will be changed every other week and the woods-ball fields will be changed every month.

A paintball player, for a fee of $15, can use our facilities for the entire day and receive all of the propellant, CO_2 or compressed air, that he or she needs. Players without there own equipment may rent ours at $10. While playing at our facility, the players will be required to purchase our paint at $17 per ¼ case (500 balls), $30 per ½ case (500 balls), and $50 per full case (2000 balls). This requirement of purchasing "field paint only," is, as stated before, an industry standard.

Additional Business

In addition to paintballs we will also sell shirts, hats, and other paintball paraphernalia. The estimated average gross margin on these items is about 40%. However, since this is not our primary line of business, and we do not expect a significant amount of revenue from these items, we have not included them in our financial statements. We will also offer concessions in our own vending machines. These products will be sold at a 50% gross margin, and they are included in the Other Income section of our income statement.

From time to time we will also sell advertising space to other local businesses. These advertisements will be both indoors (hung on the walls), and outdoors (hung on the building). In addition to selling these advertising spaces, we will also "trade" these spaces. For example, we will hang an advertisement for the local sandwich shop for free in return for advertising space at their establishment.

Competitive Advantages

Paintball Palace will strive to offer participants the best paintball experience possible. No other competitor has both indoor and outdoor fields, nor will they compare with our customer service and quality. This allows Paintball Palace four competitive advantages:

Quality

This will be achieved by having well-trained referees, high quality paint and equipment, and changing field layouts.

Training

Paintball Palace will show their first time users how to properly load and shoot a gun. Our company will give advice to those who seek it or point out things that customers are doing if it poses a danger.

Service

We will offer more opportunities to play versus our competitors. Compared to our competitors who only have one to two fields operating at any given time, we will have four to five indoor fields operating at one time. This will limit downtime between games and keep customers satisfied.

Affordability

Paintball Palace's prices are very competitive. We strive to make our prices affordable for our customers but stay aggressive against our competitors.

Entry and Growth Strategy

Entry

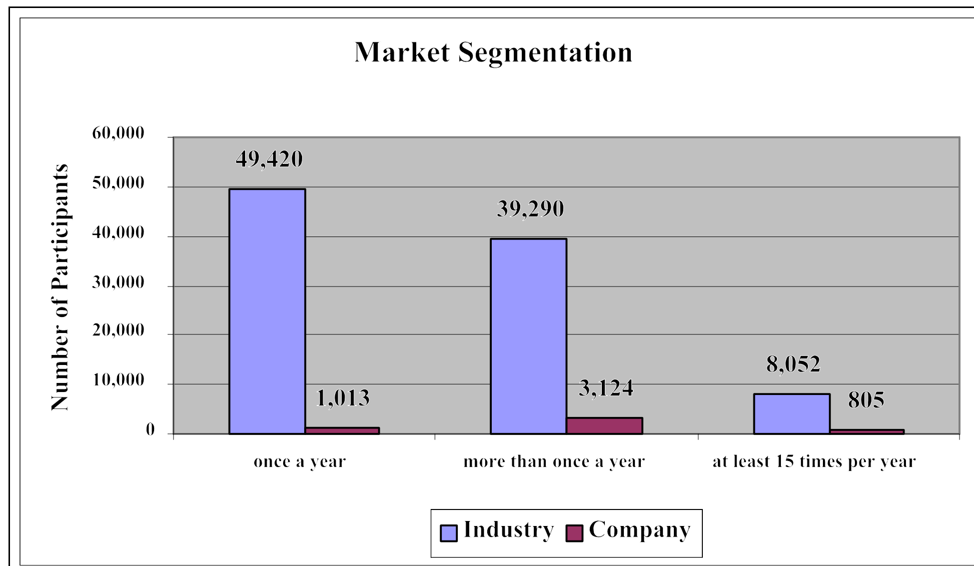
During the winter many paintball players either pack up their equipment for the season or travel considerable distances to indoor fields. This is where Paintball Palace steps in to "steal" customers from our "outdoors only" competitors. Many players will come to our establishment to play indoors in the winter and will find the quality of service, paint selection, prices, and atmosphere so inviting that they will continue to frequent us throughout the year.

Expansion Opportunities

In year two Paintball Palace will open a concession stand if there is sufficient demand. Also in year two we will conduct a study on the feasibility of opening a facility in the Philadelphia area. These are not included in our financial statements.

The most natural expansion route for Paintball Palace is to begin to offer a full retail line of paintball products, including paintball guns, goggles, clothing, add-ons/upgrades, and accessories. Once the company develops a significant customer base, it will begin to offer these products. Our customers are the perfect prospects for these products; they are already familiar with the sport, and most are always looking to "trade-up." Ask any paintball player and they will be able to rattle off a list of paintball guns and upgrades that they have purchased in the last year or so.

MARKET RESEARCH AND ANALYSIS



The paintball players market can be broken down into three segments; those that play once per year, those who play more than once per year, and those that play 15 plus times per year. The following is a description of major characteristics of each segment:

The players who play one time per year are somewhat price sensitive but concerned with quality and safety. These players usually rent his/her equipment from the field. These players make up approximately 20.5% of our target market customers, but only account for 4% of our unique visits. The players who play once per year are between the ages of 10 and 65, and usually prefer to play woods-ball.

The players who play more than once per year are less price-sensitive than the once-a-year players but are still concerned with quality and safety. These players own their own equipment and tend to use more paint than the once-a-year players. These players make up approximately about 63% of our target market and 49% of our unique visits. The players who play more than once per year range from 12 to 45 years of age and play both woods-ball and air-ball.

The players who play 15 or more time per year are not very price sensitive but are concerned with quality. These players own all of their own equipment and usually have more than one paintball gun. They also shoot more paint than the other two segments combined. They make up 16% of our target market customers and 47% of our unique visits. These are also the players who are most likely to compete in the tournaments and leagues that we will offer, which will be played on air-ball fields.

Market Size

In 2002, the total number of paintball participants in the US was 8,670,000. As illustrated in the accompanying charts, the total market for our service area is 49,420 potential participants.

Estimated Market Share and Sales

As illustrated in our appendix, our estimated market share of 10% will give us 25,586 unique visits in year one. This equates to 533 visits per week considering four weeks per month. We used 48 weeks per year in our calculations to allow for various holidays.

Ongoing Market Evaluation

In order to better serve our customers we will have customer suggestion cards available at the field. We will also have monthly polls on our website to assess customer satisfaction.

Direct Competitors

See SWOT analysis in appendix.

ECONOMICS OF THE BUSINESS

Gross margins

Paintball Palace has a projected gross margin on paint sales of 50%, and gross margin on field fees of 100%. Our high margin on paint is a result of both low wholesale prices and the requirement that participants must buy our paint to play on our fields. Our high gross margin on field fees is the result of having no direct variable cost associated with those fees.

Profit potential

As indicated in the accompanying financial statements, net income in 2005, 2006, and 2007 is $102,967, $239,623, and $386,767, respectively. These numbers are based on customer attendance of 533, 613, and 705 for the years 2005, 2006, and 2007, respectively. See financial statements in the appendix for more complete details.

Fixed, variable, and semi-variable costs

Our largest fixed cost is our property lease of $50,000 per month. The terms of our lease include a bargain purchase option at the end of our five-year term. The price of paintballs is our only direct variable cost. We can purchase paint in bulk from National Paintball Supply at a price of $25 per case. Breakeven for 2005, 2006, and 2007 will be 41 weeks, 36 weeks, and 31 weeks respectively.

MARKETING PLAN

Overall Marketing Strategy

Paintball Palace's overall marketing strategy is to appeal to our target markets' demonstrated desire for fun and action. The company will be the premier paintball facility in South-Central Pennsylvania. We will establish this position by:

Heavily advertising to the frequent (15+ times per year) paintball players. We will do this by advertising in various paintball magazines and at various paintball pro-shops. The magazines that we will use for targeting this segment are very tournament oriented. These include magazines such as Paintball Games International. In addition, we will also sponsor at least one team to play at all of the tournaments in the area. This sponsorship will include a small trailer with the team and company name on the side. When the sponsored team plays in local tournaments, the trailer will act as an advertisement for Paintball Palace. This will put our banner and sign at our competitor's fields on days when there is going to be a high number of participants.

We will advertise to the other two segments of our market with ads in paintball magazines such as Action Pursuit Games. This magazine is targeted more towards the players who prefer to play in the woods. We will also advertise to this segment

by placing flyers on cars in parking lots at high schools, colleges, and Wal-Marts. We will also make arrangements to advertise at local sporting goods stores.

Pricing

The price for field and air fee is $15, rental equipment is $10, and paint is sold for $50 a case.

Pricing			
	Field/Air Fees	Rental Fees*	Case of Paint
Paintball Palace	$15	$25	$50
Paintball Adventure Park	$15	$25	$55
Next Level Paintball	$20	$45	$70
Paintball Sportsland	$20	$50	$75
Outlaw Paintball	$15	$20	$65
Wanna Play Paintball	$10	$40	$55
* includes Field/Air Fees			

We charge field/air and rental equipment fees that are average compared to our competitors. While our customers may be willing to pay a premium for our indoor and outdoor facilities, we have chosen our fees in order to gain market share. Our paint prices are below that of all of our competitors because we are able to gain economies of scale.

OPERATIONS PLAN

Operating Cycle

Unlike other paintball facilities, Paintball Palace will not experience large fluctuations in sales throughout the year. Since we offer both indoor an outdoor fields our sales will not decline in the winter.

Geographical location

Paintball Palace will locate operations in central Pennsylvania, in either Cumberland or Dauphin County. Our ideal facility will be within five miles of Interstate 81 or the Pennsylvania

Turnpike. At this location we will be within a three-hour drive of most of our suppliers (National Paintball Supply in New Jersey, Supair Paintball and Smart Parts in Pittsburg). In addition, we will be within a one and a half hour drive of several colleges (Penn State main campus and Penn State Mont Alto, Shippensburg, Dickinson, and others). The students at these universities make up both a good portion of out target market and most of our labor force. At this location, we will be within a one-and-a-half-hour drive of an estimated 49,420 potential customers.

Facilities and improvements

Paintball Palace will lease a 200,000 sq. ft. warehouse and surrounding, undeveloped, land at a price of $3/sq. ft. This lease is accounted for as $50,000 per month rent expense. We are looking for a one-year renewable lease, with a bargain purchase price after five years.

We will need to purchase approximately 180,000 sq. ft. of Astro-Turf/artificial grass. This will cost approximately $2.20/ sq. ft. installed and is included in our startup costs. This is to be financed at 8.75% for six years with zero down. In return for these favorable terms, the supplying company will receive free advertising at our facility, reduced rates for play, and use of our facility for promotional events (such as a display model for future customers).

We will need to purchase and install 20 rolls of paintball-approved netting. This netting will be purchased from National Paintball Supply (NPS) at a cost of $300 a roll. In addition, we will be purchasing five prepackaged air-ball fields from NPS at a total cost of $25,000. NPS has agreed to allow us to finance these fields for three years, at 8.5% with 10% down.

We will need to purchase and install an air compressor and related equipment at a cost of $20,000. We are seeking financing from Bauer Compressors for five years, at 7.5% return with 10% down payment. In return for these favorable terms, Bauer Compressors will receive free advertising at our facility, reduced rates for play, and use of our facility for promotional events (such as a display model for future customers).

Regulatory and legal issues

Since we are leasing a warehouse and the surrounding land, it already has the necessary zoning permits. As per our insurance policy, all participants are required to sign a liability waiver, which prevents Paintball Palace from being responsible for any injuries, should they occur. There are currently no other regulations for the industry.

Paintball Palace will need to file the following forms:

Doing Business As
Employment Identification Number: Form SS-4
PA Enterprise Registration Form: PA-100

MANAGEMENT TEAM

Jeff Chapman, Accounting

Mr. Chapman has sufficient knowledge of the Paintball Industry. During his four years as a student at Shippensburg University he founded and led the university's paintball club. In his position as club president, he lead the SU Raiders Paintball team to the national championship in Disney World, where they placed fourth; he established contacts with many organizations and businesses in the paintball industry; and as part of a sponsorship deal, he gained experience in running a paintball field and hosting tournaments. Mr. Chapman received his bachelor's degree in accounting from Shippensburg University in May 2004.

Brooks Saunders, Management

Mr. Saunders has several years of experience in managing employees. He has worked at Weis supermarkets for several years and was promoted to manager several months ago. He also has established contacts in the vending machine business. While this is not our primary line of business, we do expect a fair amount of vending machine sales. Mr. Saunders received his bachelor's degree in management from Shippensburg University in May 2004.

Dawn Stalter, Marketing

Ms. Stalter's excellent communication and writing skills, as well as her artistic abilities, will be a great asset to the company. She has gained experience in advertising and management while working at a large music store chain. She will also serve as liaison with the students of Shippensburg University. In addition, Ms. Stalter's uncle, a prominent lawyer, has agreed to be Paintball Palace's legal counsel, free of charge. Ms. Stalter will receive her bachelor's degree in management from Shippensburg University in May 2005.

Alicia McCool, Information Technology

Ms. McCool has many years of experience with entrepreneurial ventures. At the age of 13 she started working at her parents' newly started restaurant. While working there she learned how to handle timing issues and day-to-day operations. At the age of 16 she began working at an accounting firm that her older sister started. While working there she leaned many things about the business world and gained valuable business contacts. Currently she has been working as a bookkeeper and advisor for several small businesses including an automotive garage that was started

by her younger brother. Ms. McCool received her bachelor's degree in management from Shippensburg University in May 2004.

Management Compensation and Ownership

Fifty percent of Paintball Palace's profits will be reinvested in the company, and the remaining will 50% will be evenly distributed among the four owners. Paintball Palace will be organized as a partnership in which the four owners equally share the company's ownership.

OVERALL PROJECT SCHEDULE

The facility lease will begin December 1, 2004. Between this date and January 1, 2005 when we open for business, Astro-Turf, netting, and bunkers will be installed indoors. Also during this time period we will find personnel to fill various positions within the company, including a maintenance crew and referees. In March of 2005, we will setup the outdoor fields to prepare for summer. In January of 2006 we will begin the installation of a concession stand if demand is sufficient.

Exit Strategy

Paintball Palace will analyze the industry's situation in the year 2010 in order to determine if it will be beneficial to retain ownership of the business or to sell the entire company. If we feel that it is beneficial to sell Paintball Palace, we will seek a company to acquire the entire business. Potential buyers will consist of our competitors, new entrants, or National Paintball Supply.

CRITICAL RISKS, PROBLEMS, AND ASSUMPTIONS

Assumptions

People want to play paintball indoors
Market will grow at 20% per year for the next three years
Competitors will not create indoor facilities
Even demand throughout the year
Paintball Palace will capture and maintain 10% of the market

Risks

County where our facility operates may require special permits in the future

Lawsuit for injury, despite the liability waiver customers sign
Sales projections not achieved
Running out of cash in year one

In order to minimize the first two risks listed above, Paintball Palace will employ the services of Mr. Stalter, Dawn's uncle and a prominent lawyer. The effect of a lower than expected market share would be damaging to Paintball Palace. In order to capture and maintain this 10% market share, we will advertise in prominent magazines, and establish ourselves as a highly respected paintball facility.

PROPOSED COMPANY OFFERING

Paintball Palace will require approximately $470,000 for startup costs. Each of the four founders will invest $30,000 from their own resources. The other $350,000 in startup costs represents furniture, fixtures, and equipment that will be financed through National Paintball Supply, Bauer Compressors, and an unknown Astro-turf company. As stated earlier, in return for these favorable terms, the supplying company will receive free advertising at our facility, reduced rates for play, and use of our facility for promotional events (such as a display model for future customers).

Market Data

Population Data*	
Location/County	Population
US Population	280,000,000
PA Counties	
Adams	94,437
Cumberland	217,743
Dauphin	252,933
Franklin	131,598
Lebanon	121,199
Perry	43,876
York	389,209
MD Counties	
Washington	134,246
Frederick	209,125

Paintball Statistical Data				
Participants	Year	Source**	Description	% increase
8,679,000	2002	SGMA	At least once year	13
6,900,000	2002	NSGA	more than once per year	24.4
1,414,000	2001	SGMA	At least 15 time per year	78
Calculations:				
% of Total US Pop. that play paintball at least once per year: 8,679/280,000 = 3.10%				
% of Total US Pop. that play paintball more than once per year: 6,900/280,000 = 2.46%				
% of Total US Pop. that play paintball at least 15 times per year: 1,414/280,000 = 0.51%				

Population of Service Area	
Adams	94,437
Cumberland	217,743
Dauphin	252,933
Franklin	131,598
Lebanon	121,199
Perry	43,876
York	389,209
Washington	134,246
Frederick	209,125
Total:	1,594,366
* 2002 US Census Bureau Data ** SGMA - Sporting Goods and Manufacturers Association International NSGA - National Sporting Goods Association	
Service Area Statistics (est.)	
Calculated using total population of Service area	
Players that play at least once per year: 1,594,366 x 3.10% = 49,420	
Players that play more than once per year: 1,594,366 x 2.46% = 39,290	
Players that play at least 15 times per year: 1,594,366 x .51% = 8,052	
Total Market:	49,420
Market Share	10%
# of customers	4,942

Paintball Palace's Customer's Playing Habits		
Habit	Customers	% of Total
At least once per year	1,013	20.50%
More than once per year	3,124	63.21%
At least 15 times per year	805	16.29%
Total customers	4,942	100.00%

Unique Visits Per Week: Year 1			
Customers	Visits Per Year	Unique Visits	% of Total
1,013	1	1,013	3.96%
3,124	4	12,495	48.84%
805	15	12,077	47.20%
	Visits/Year	25,586	100.00%
	Weeks/Year	48	
	Visits/Week	533	

Company	Strengths	Weaknesses	Opportunities	Threats
Paintball Palace	Indoor and Outdoor Air-ball + woods-ball Night games/leagues Contacts with several college paintball clubs as well as the National College Paintball Association	New entrant	Increased participation in the winter. Can steal the participants that travel from Harrisburg south to Paintball Adventure park.	New entrant. Unknown Name.
Paintball Adventure Park	Large established customer base Local Industry leader Quality Air-smiths Air-ball + woods-ball One owner is a semi-pro tournament player Economies of scale	Outdoors only Large stream runs through property (muddy) Ownership quarrels (Field may close)	They own the property and have room to expand.	At the mercy of the weather (rain, snow, cold) Stream on property floods often
Next Level Paintball	Air-ball + woods-ball	Outdoors only		At the mercy of the weather (rain, snow, cold)

Company	Strengths	Weaknesses	Opportunities	Threats
Paintball Sports land		Outdoors only Woods-ball only Currently closed		Currently facing legal problems. At the mercy of the weather (rain, snow, cold)
Outlaw Paintball	Night games/leagues	Indoors only Air-ball only Only one field Favors tournament players		Leased building with now land, cannot accommodate woods-ball
Wanna Play Paintball	Air-ball + woods-ball Certified airsmith Owner is a semi-pro tournament player	Outdoors only		At the mercy of the weather (rain, snow, cold)

Breakeven			
Year	2005	2006	2007
Total Fixed Costs	769,517	767,189	773,926
Sales/visitor	55	55	55
Variable Cost/Visitor	20	20	20
Breakeven in unique visits	21,986	21,920	22,112
Visitors/Week	533	613	705
Breakeven in weeks	41	36	31

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