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LETTER FROM THE EDITORS

Welcome to the *Journal of the International Academy for Case Studies.* The editorial content of this journal is under the control of the Allied Academies, Inc., a non profit association of scholars whose purpose is to encourage and support the advancement and exchange of knowledge, understanding and teaching throughout the world. The purpose of the *JIACS* is to encourage the development and use of cases and the case method of teaching throughout higher education. Its editorial mission is to publish cases in a wide variety of disciplines which are of educational, pedagogic, and practical value to educators.

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

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

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

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

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

NOTES

BEZANILLA & BEZANILLA REAL ESTATE DEVELOPMENT COMPANY

Leopoldo G. Arias-Bolzmann, Universidad Adolfo Ibanez, Chile
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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.*

INSTRUCTORS' NOTES

Recommendations for Teaching Approaches

An effective analysis of the Bezanilla & Bezanilla case date must be placed within the frame of a type of proactive thinking. A way to open the session is to ask the students a question as to Which aspects had led B&B to occupy the position that it holds nowadays?, and vote on the decision of the dilemmas whether Should B&B introduce a new brand to embrace another segment of clients for apartments? Which marketing tools should B&B develop in order to manage the business? There will arise, on the side of the students, problems related to the two types of dilemmas (enter a new segment of clients in the center-eastern area of the city and establish a long-term marketing strategy). The analysis of current marketing operations resorted to by the company could lead to a more general discussion on the role played by these elements in the business success of a real estate company. As regards to the possibility of introducing a new brand with a view to embrace another segment of the market, there will be positions both in favor and against. At this stage, the instructor should ask the students to evaluate both options.

QUESTIONS AND ANALYSES

Opening Question

1. **What situations in the environment have led the real estate industry, and concurrently B&B, to their current situation?**

The year 2004 was auspicious for growth of the industry on account of the following aspects:

- A growth in the national economy was expected for the year 2004, in the order of a rate between 5% and 5.5%.
- The interest rates during the year 2004 were the lowest in Chilean history, with an inter-banking rate of 2.18% at November 11, 2004.
- Inflation was under control between a 2% and 3%.
- During the year 2004, more than 2 million dollars were invested in works of road infrastructure in the Fifth Region (Chile is divided into twelve regions or states and its capital, Santiago).

- Initiatives of the local government in the Fifth Region for the urban renewal of the center-eastern area of Viña del Mar.
- Another element accounting for the higher sale of apartments was that the price of the land had increased 14%, bringing as a consequence an increase in the price of dwellings of 17.6% between the years 1977 and 2003.

Analysis

2. What should B&B's course of action be to take advantage of the boom in the real estate sector, which was taking place at a local, as well as at a national level?

The following alternatives reflect what Bezanilla could do to take advantage of the real estate boom:

- Continue developing projects for the upper and upper-middle segment of clients in the Fifth Region.
- Explore the market in the capital city of Chile (Metropolitan Region), undertaking real estate projects centered on the upper and upper-middle clients.
- In line with the strategic vision of the Chairman of B&B, real estate projects could be undertaken in areas of tourist interest in the country, centered on the upper and upper-middle socioeconomic segment.
- Diversify the portfolio of projects, investing in office buildings, hotels and medical office buildings located in the different areas of Viña del Mar.
- Invest in projects of condominiums of houses in the Fifth region, addressing the upper and upper-middle socioeconomic segment.
- Undertake projects for the construction of buildings in the center-eastern area of Viña del Mar, centered on the middle and middle-lower socioeconomic segments.
- Alternatives a, b and c seem to be feasible alternatives to be carried out by the company.

Explanations

Explanation: This alternative is already under way with projects in the area of Reñaca, 5 Norte and Nueva Libertad (see photograph on page 2 of the case).

Explanation: This option was being planned for the next years, in order to obtain a presence of the brand in the upper and upper-middle market in Santiago. On obtaining this brand recognition, the chairman of the company expected to attract new clients from Santiago to the projects undertaken in Viña del Mar.

Explanation. It is a feasible alternative to the extent that local real estate partners are detected; these partners should contribute their know-how, regarding the likes and preferences of the tourists, their relationship with the local suppliers and their capacity for the implementation of the project.

Alternatives d and e are difficult options to be carried out, due to the characteristics of the company and the setting:

Explanation: in what respect the market for offices in the Fifth region, this was a stagnated market showing no signs of recovery. The last office building developed by the company was "El Coraceros, which encountered difficulties for its total sales. However, in the area of Reñaca and Bosques de Montemar, there are no offices for medical and dental offices, which could represent a business opportunity for the company.

With respect to hotels and medical offices, these are a type of construction where the company did not feel qualified to develop them, as they estimated that they did not have enough know-how. A possible solution to this aspect could well be a strategic alliance with a company specialized in this type of construction.

Explanation: the market for the sale of houses was very unstable in the Fifth Region, presenting a greater variability than the market for apartments.

Explanation: this alternative will be explained later in the answers to questions 2 and 3.

3. Should B&B enter the real estate market of the central-eastern area of the city? Justify your answer.

Students may answer either in the affirmative or positive; therefore both cases will be analyzed.

Case 1 If the answer is positive, the arguments are as follows:

- ♦ Because of the incentives from the municipal government for the urban renewal of the center-eastern area of the city.

- Because of the recent investments in road infrastructure to prevent congestion and offer a better quality of life in the center of the city.
- To make the company grow within a new socioeconomic segment of clients.
- To prevent real estate companies from Santiago and also Viña del Mar (Inmobiliaria Sol Naciente), from capturing the market of clients from the middle socioeconomic group in the region.
- To diversify the portfolio of investments, in a manner such as to lessen risk.

Case 2 If this answer is negative, the arguments are as follows:

- Requirements of new sources of financing, which may increase the risk of the business.
- On entering another type of market of clients, the company could well lose the position attained with the brand Bezanilla in the upper and upper-middle segment of clients. The latter could affect in like manner the image of the brand, since it is possible to generate confusion in the perceptions, both of old clients as well as of potential clients.
- There is possibility of damage to the organizational structure since it has been developed on the basis of a culture of a family company. If Bezanilla grows, the organizational structure will require changes for which the company seems not be prepared as yet.

4. Which should be B&B's entry mode to the market of the center-eastern area of Viña del Mar, which is constituted mainly by the middle socioeconomic segment?

The possible ways of entry for Bezanilla are as follows:

- Acquisition of another real estate company.
- Strategic alliance or joint venture with another real estate company from either the capital city of Santiago or from Viña del Mar.
- Own investment maintaining the name Bezanilla.
- Own investment under another name.

Acquisition of Another Building Company

Arguments in favor:

- ♦ The name of another brand is acquired and if it is well positioned in a market targeted to the middle socioeconomic segment, it would be beneficial for the company.
- ♦ On acquiring another company, also acquired is the human capital and the know-how with respect to developing buildings aimed at the middle socioeconomic segment.
- ♦ The portfolio of clients of the company bought-out is also acquired.

Arguments against:

- ♦ Strong investment required to buy-out another firm, which involves a high risk.
- ♦ Possible clash between the organizational cultures.

Strategic alliance or joint venture with another building company either local or from Santiago

Arguments in favor:

- ♦ Lower investment required than in the case of a buy-out.
- ♦ A better performance of both companies can be attained.
- ♦ The risk of undertaking the project is shared.
- ♦ In the case of a joint venture, resulting from the synergy of two companies, another juridical person is created, and hence a lower risk of damaging the brand image of both companies.

Arguments against:

- ♦ Possible clash between the organizational cultures.
- ♦ If the allied company is not 100% reliable, there is the risk of possible frauds.
- ♦ Conflict of interests.
- ♦ Possible problems relative to the distribution of profits.
- ♦ Difficulty to maintain the brand.

Own investment maintaining the name of Bezanilla

Arguments in favor:

- ♦ The company ensures that all capital assets are part of the ownership of B&B.
- ♦ Power of decision over the projects to be undertaken.
- ♦ Good perception from the new segment of consumers thanks to the brand equity.

Arguments against:

- ♦ Possibility of damage to the company's brand, which is already established in the segment of upper and upper-middle clients.
- ♦ If the company enters with the name Bezanilla to another market segment, there is always the possibility of destroying the positioning of the brand attained over so many years.
- ♦ High risk, due to the lack of knowledge of the new market.
- ♦ High financial risk.

Own investment under another name

Arguments in favor:

- ♦ The company ensures that all capital assets are part of the ownership of B&B.
- ♦ Power of decision over the projects to be undertaken.
- ♦ Entry to a new market without risking the brand equity already established in the segment of upper and upper-middle clients.

Arguments against:

- ♦ High risk, due to the lack of knowledge of the new market.
- ♦ High financial risk.
- ♦ Lack of Know-how in this type of buildings, which call for another type of finishing and materials.

5. Which Pricing Policy may be applied at B&B for selling the apartments?

Analysis prior to the answer:

The demand for the products shows one or another inclination in the face of elasticity effects and the variables that determine it. This must assume that the provision is based on the development of strategies, resources, and budgeting of the company, that is, on a logical and coherent marketing plan.

Bear in mind that above conditions assume that:

Total Demand: Size and income of the target market = Potential of the market
Target Market: Current level of the combined effort of B&B marketing and the industry

Factors exerting an influence on price setting

	Production Costs + Margin
Internal Factors:	*Computation of Break-even Point*
	Return on Equity Invested
Price Setting	
	Elasticity Demand/Prices
External Factors:	*Value as Perceived by the Client Competition*

Current Situation

- Prices of apartments range between 156,000 and 300,000 US dollars and a penthouse between 450,000 and 550,000 US dollars.
- The company did not have a strategic pricing tool and only applied the usual tool of Cost-plus-Margin, which did not generate any differentiation with respect to competitors.
- The price increases when the demand for sale of apartments before actual construction begins increased.
- The price decreases according to the number of apartments left unsold, but without using any previously defined price discount policy.

Proposed Situation:

- Perform an analysis of the data base of clients in order to determine the profile of the company's clients. Upon obtaining this information, it will be possible to establish in a better manner a pricing strategy in accordance to the profile and willingness to pay of the clients.

Perform price discrimination by:

Timing: At which moment of the construction of the building the apartment is bought. It is worth stressing that B&B begins its constructions after having sold a 15% of the apartments (pre-sold before the construction begins).

- *At this stage we suggest carrying out a strategy of discounts depending on the time of the sale.*
- *Pre-sale before the construction begins: make discounts higher than those at the following stages.*
- *Sales while construction is under way: the discounts at this stage will be higher than when the project has reached its completion, but lower than those pre-sold before the construction begins.*
- *Sales after project has reached its completion: The discounts at this stage are the lowest which are granted throughout the life cycle of the building.*
- *Exceptional cases: If with the discount at the end of the project it has not been possible to sell all the apartments, the discount must be increased, in order not to have unused capital. Another is the case of the client who pays cash down; in this case a specific discount should be made.*

By amount of purchase: Depending on the amount of the purchase in conjunction with the timing at which the asset is acquired, different types of discounts may be applied.

Proposed Table of Discounts According to Timing and Amount of Purchase:			
	Amount of Purchase in US dollars		
Timing	156,000-195,000	195,001-234,000	234,001-300,000
Pre-sold before construction begins	5%	7%	9%
Sold during construction	4%	6%	8%
Sold on completion of construction	3%	5%	7%
The percentages in this table are only referential, as they depend on the financial and productive situation of B&B			

6. What aspects should B&B consider to give higher value to the clients and so continue charging a Premium price in the upper and upper-middle market of clients?

The following aspects should be considered for the creation of value aimed at the client:

Service: "The differentiation between the offer of the different companies tends to migrate to the service that attends the products and the treatment which the client receives"

Facilitating aspects: The sales room represents the image of the company at the different sales points, for which reason it cannot be overlooked. In order that the client has a good perception, there should be facilitating elements such as:

Parking
Adequate ventilation system
Audiovisual equipment with virtual samples of the building and apartment.
Bathrooms.
Waiting room.
Specific schedule for attention to the client.
Environmental music.
Physical evidence.

Socializing elements: These are aspects which help to the interaction between client-employee and employee -client.

- ♦ The sales staff may use some type of clothing that identifies it with the company, I so as to suggest to the client which is their role and also to reinforce the image of the company's brand.
- ♦ Another aspect could be the waiting room, where the clients may interact in order to share information.
- ♦ Should it be necessary and the client so demands it, have a specialized tour conducted by the engineer in charge of the work, in order to solve technical doubts.
- ♦ Another socializing element would be to offer the client coffee and cookies in order to relax the setting.

Differentiating aspects: They are aspects which make the company stand out with regards to its competitors and point to the market segment which the service is intended for.

The company could do the following:

- ♦ Create a club of apartment and office owners of B&B, in order to have more information on the profile of its clients.
- ♦ Have a guided tour conducted by the engineer in charge of the construction (should it be required).
- ♦ B&B has a unique post-sale service. This service consists in providing assistance to the owners of apartments in the face of any problem that may occur in their dwellings.

Quality: B&B's uses specialized suppliers of high quality, which are paid a Premium price to obtain the best quality in their buildings. This is an aspect that should be stressed in its publicity (brochures, catalogues, pop), as it is a differentiating aspect from the competition.

7. In what respects to the materials used, these are of first quality and differentiate the product, positioning it as the best in the segment which it is aimed at (marble. Bolivian Mara wood, premium bathroom appliances, etc)?

Subcontracting top calculators and engineers in order to attain the best performance in the construction of the building.

Delight: Due to the increasing competition and the real estate boom in the Fifth Region, one way to attract clients and at the same time to be able to differentiate the product, is to generate sales promotions aimed at the client, such as, for instance, "*buy an apartment and participate in a sweepstake to obtain the complete decoration and furnishing for the apartment.”* The important thing in this promotion is who will be responsible for decorating or furnishing the apartment, as this is a very valued aspect by the client. This promotion can be carried before, during or after the completion of the construction of the building.

Convenience: This aspect is valued more and more by the clients, due to the lack of time and willingness to seek for information.

Some elements that adjust to this change in the market are:

- ♦ Location of the building: the building must be near commercial centers, schools, transportation availability, entertainment centers, and, whenever possible, have a privileged sight.

- B&B apartments ensure a greater ratio space/living area, that is, they have fewer rooms per square meter than the main competitors. For instance, in a 100 square meter apartment the competition offers 4 bedrooms, whereas B&B only offers 3.
- B&B could offer a service for expediting the paperwork related to financing.
- The company should send personalized information wherever the client deems convenient (home, office, etc.).

Experience: B&B should, in its dealings with its clients, emphasize that it is a family company and that it:

- Has a favorable tradition and history in the real estate market in the Fifth Region.
- Has a sound reputation among the different stakeholders.
- Has successful projects built.

Innovation: The capacity of the company to adopt new technologies or ways of doing things is rewarded by the market. It is for this reason that B&B has innovated in the following aspects:

- Better use of interior spaces, due to new architectonic techniques.
- New construction techniques.
- Set up lockers and changing space on the ground floor of the building for residents' servants, in order to use the space available in the apartments as best as possible (Edificio Pontevedra, 5 Norte).
- Install elevated look-outs to enjoy the view (Edificio Las Palmas de Reñaca).
- The company could use recycling techniques, in order to lower rates (this information is not in the case, but the teacher may mention to encourage creativity in the responses from the students).

Design: An aspect which generates value for the client is the external and internal design of the product. B&B has implemented the following design elements:

- Landscaping.
- New trends in architectonic design.
- Lay-out of the apartment (use of internal space in the apartment).

Exposure of the brand: In order to generate a perception of long-term quality for the brand, it is recommended to use the following communicational media:

- ♦ Sponsor events (tennis, gold, polo, as they are sports for the elite).
- ♦ Use blown-up posters and panels. Even though, the company has these elements, they are somewhat deteriorated and outdated.
- ♦ Advertisements in magazines targeted to the upper and upper-middle socioeconomic segment, such as Tell Magazine, decoration magazines, etc.

8. How do you think that the positioning attained by B&B has exerted an influence in creating value for the brand?

In order to attain a clear positioning, it is necessary to make some strategic decisions and answer questions such as the following:

What: Here the objectives that the company wishes to attain are structured. The strategic objectives of B&B are to develop projects that satisfy the expectations of quality and service required by the market.

Where: This aspect is related with the strategy of market segmentation. Where does B&B wishes to compete? In the segment of consumers belonging to the upper and upper-middle socioeconomic group of Viña del Mar and of Santiago?

How to compete: B&B is a family company with a great tradition in the market of the Fifth Region which emphasizes the quality of the product and improving the service to the client. Besides these aspects, B&B has always wanted to have a position of leadership in the real estate industry.

When to compete: Timing is critical for the company to know when the right moment to enter the market is. B&B was the first real estate company that addressed a high socioeconomic segment of consumers in the Fifth Region.

The positioning of B&B has exerted an influence on its brand equity due to the following aspects:

- ♦ It has been able to generate a clear perception regarding the differentiating traits (tradition, quality, and service) in the mind-set of the consumer.
- ♦ It has been consistent with the target segment set by the company. There has always been a relationship between positioning and what the business strategy of the company is (pricing, market share, and costs).

- Over the years, there has existed, a stability in what regards positioning, which generates a great credibility for the company in its value proposal. Due to the latter, it appears that clients know well what to expect or obtain, when they buy a B&B apartment.
- The projects carried out have always been in accordance with the value proposal which the company offers its clients.
- It has allowed B&B to be at the top of mind of its target market segment of clients. Even nowadays, the offspring of former clients, still buy B&B apartments.
- It has strengthened the brand in a manner such that it has created the possibility of generating extensions to the brand.

ENDNOTES

1 This "Instructor's Notes" 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.

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

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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.

INSTRUCTORS' NOTES

The best way to administer this case is to divide the case into Part A and Part B. Part A is distributed first, with students asked to respond to the questions provided at the conclusion of Part A. Then, once Part A is complete, Part B can be distributed and the students asked to respond to the questions for Part B.

Part B contains some of the "answers" to Part A and/or details how Alabama Power responded to the challenges associated with a severe service disruption. Below are suggested short answers and/or areas to begin class discussions of the case.

CASE DISCUSSION QUESTION (PART A)

1, What actions can an organization take to prepare for potential disruption?

The point of this question is to drive discussion of the activities that organizations typically take in preparation for a disruption. This might first entail a discussion of different types of disruptions (causes) followed by actions taken to prepare for those specific events. As discussion continues, the point should be made that many of the seemingly independent actions brought up are probably very much related. Managing risk or planning for a contingency incorporates these independent actions under a single umbrella.

2. How do seemingly local, or regional, events impact the larger supply chain network (or even the entire economy) as a whole?

This question is designed to encourage the student to thinking about the 'so what' part of the equation. While everyone may be empathetic with the victims of a natural disaster or other business disruptions, it is often difficult to completely understand the impact on your own organization. This discussion should focus on what impact a Katrina type event will have on other organizations in the short, medium, and long range. Potential short term disruptions within the supply chain might include port closures, highway infrastructure damage, and loss of containerized freight or empty containers. Mid-term impacts might include loss of suppliers or other business partners. Finally, long term impacts might include the loss of organizational capabilities that are not easily replaced (manufacturing facilities', etc…)

3. What are the key differences between those companies who can react quickly and effectively to a situation and those that can not?

Based on the discussion generated in question 1 and 2, what actions, policies, or processes differentiate companies that can and cannot react quickly? This discussion should include active participation in listing the actual activities that would logically make a difference. One discussion area might include asking whether the listed actions are appropriate for all organizations in every situation.

While there is not one "correct" answer, the following is an example of how a student might appropriately respond.

Alabama Power delivers a universal product, much like the oil and gas industry, and must be able to respond quickly to disasters. Frequently, Alabama Power must deal with minor disasters due to storms, damaging winds, etc., on an ongoing basis. Companies that do not have the masses as its customers may not see a cost benefit in having a disaster recovery plan in place. Hence, when a disaster does strike, the lack of training is evident by non-proficiency exhibited in the actions or tasks related to emergency preparedness. In other words, practice makes perfect and first responders, as well as other team members, take actions similar to those actions taken in drill scenarios.

Another aspect of a company having the ability to respond effectively to an emergency is the financial status of the company. During disasters, individuals and groups are more willing to give of themselves, whether it is via their time, know-how, or donations. Companies with large cash reserves may already have the needed resources on hand to deal with the emergency – or at the very least, the ability to rapidly acquire the necessary material needed for restoration purposes.

Management at Alabama Power attributed the quick power restoration to Southern Company being vertically integrated, i.e. the company performing the 3 functions of generation, transmission, and the distribution of electricity to its customers.

Management also indicated that the recovery plan had decision-makers who understood their responsibilities, but incorporated enough flexibility and decentralization to allow decisions to be made at the disaster areas. Another key was communication. With the help of Southern Link - a Southern Company - communication was maintained, thus allowing coordination between parties responding to specific disasters.

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.

List of key accomplishments:

Safety – top priority

Electricity availability – power substations and generating plants on-line and capable of supplying power to their customers.

Power restoration – short-term is to maximize use to restore power to structures that are not severely damaged.

Rebuilding – long-term is to have the damaged or destroyed areas rebuilt and the infrastructure [water, electricity, and gas] restored.

List of company needs:

Communication – Southern Link mobile phones; involves interfacing with local & federal authorities as well as other companies, in the assistance of restoration efforts.
Resources on hand – poles, lines, transformers; transport to affected areas.
Manpower – overtime hours required.
Staging areas – inventory that may be used in other affected areas.

One example of an answer might read something like the following:

Like most everything else in life, pre-planning up front helps alleviate problems down the road. However, regardless of forethought put into disaster prevention or disaster recover, one essential key element would be top on the list. The top priority is maintaining the safety of the public and the employees engaged in restoration efforts. Communication ranks second. Without adequate communication, resources and manpower will be used haphazardly, rather than optimally. A satellite-based communication system is superior to land-towers for acquiring an incoming signal. In most instances, communication towers will be damaged or destroyed in the storm.

Next on the list, is determining what equipment is salvageable. If equipment cannot be salvaged, then it must be replaced with new parts. This is the short-term outlook – i.e. restoring power to the existing structures that were not destroyed by Katrina. A long –term approach is the rebuilding of the areas affected by Katrina and re-establishing the infrastructure of these towns and cities.

Last on the list will be the allocation of resources and the staging of resources needed to bring power back on-line. This will be a major labor-intensive undertaking involving overtime to return the electricity to its customers in the minimal amount of time. Teamwork is of paramount importance as well. Items needed for restoration efforts include electric line poles, lines, and transformers.

As for management, they will need to be kept abreast of the developments as they occur, to help ensure a timely completion of activities. Additionally, they must be empathetic to the workers and families affected by the storm. Along those lines of cooperation, Alabama Power must also interact with other companies, local and federal agencies, knowing that the rebuilding is an all-hands evolution.

5. Discuss how Alabama Power'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.

The impact of Hurricane Katrina will have long-term impacts. Many businesses have taken a year to recover from losses while other businesses may never fully 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 and restore power in minimal time given the extreme circumstances they faced. 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. In the aftermath of the company's response to the disaster, they can review what portions of the plan were executed smoothly and which parts of the plan need to be revised for better disaster preparedness and improved disaster response the next time Alabama Power faces a similar tragedy.

In short, Southern Company is a "learning" type of organization. Employees are encouraged and expected to conduct post-job briefs after evolutions, in order to incorporate lessons learned into future activities. This is a part of the company's continuous improvement process, which is designed for getting employees to strive for better methods and to seek ways to become more efficient. Many items are documented and stored in a database that can be used for lessons learned. Such examples would include safety concerns, near misses, injuries, suggestions for improvements, revisions to existing procedures to enhance the existing version, etc. Management frequently performs observations of subordinates to help ensure quality is maintained in the work ethic and culture. By employing a continuous improvement process, the firm will always learn from any situation requiring implementation of the plan. Those parts of the plan that were not as effective as originally anticipated can be re-examined and the process re-engineered for improved results in the future.

CASE DISCUSSION QUESTION RESPONSE: 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.

In a recent company-based publication, Barry Inman writes an article titled "**Katrina provides real-life experience, but what's next?"**. He goes on to quote one of the members on the Southern Company Security Council during a meeting in December 2005. Some of the excerpts that include the application of lessons learned to that of real-life experiences due to the Hurricane Katrina's aftermath, are as follows:

> *"Hurricane Katrina represented the first time in Southern Company's history that electric operations and business infrastructure were disrupted at the same time."*
>
> *The council learned plenty of positives from Katrina. Among them were the teamwork across the core functions; all those functions being engaged in the thick of the response; every incident response team member being fully committed to the cause; and a healthy exchange of information forming the basis for important decisions that helped thousands, such as the purchase of trailer homes and the distribution of payroll cash advances for displaced employees in Mississippi.*
>
> *"Katrina taught us that the weather can wreak just as much havoc on our business infrastructure as a terrorist attack."*
>
> *"In 2006 we will focus more on building relationships with other critical infrastructure providers that rely heavily on electricity, such as gas pipelines, hospitals and telecommunications companies," he said. "We will also spend more time on employee communications and what employees need to do in times of emergencies."*

Additionally, employees are encouraged to call the 1-866-600-NEWS number for the latest information, such as clarifying the roles and expectations of participating state and federal agencies, and making better use of communication tools such as SouthernLINC Wireless phones and satellite phones.

This part of the case is merely designed to provide the student with an opportunity to practice problem-solving on their own by identifying additional key issues and potential tools to use to enhance Alabama Power's continuous improvement process when applied to contingency planning efforts. The above bullet points serve to identify key areas that are of interest to the management team of Alabama Power.

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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.*

INSTRUCTORS' NOTES

Learning Objectives

The main learning objectives of this simulation are as follows:

1. *Become familiar with the mediation process*
2. *Practice the role of mediator-conciliator*
3. *Generate a range of options to solve the dispute*
4. *Understand the effects of the political and economical climate on business agreements*
5. *Explore the dynamics of emotion in negotiation*
6. *Understand the role of trust in a business agreement*

It is important to remember, when discussing the case and providing specific instructions to the three parties (GSJ, GGI and the mediator), to emphasize the fact that neither one of the two parties in the dispute is sure that they have a solid case.

OPERATIONAL NEEDS

Group size:	Two small groups are used to role-play the company teams involved in the negotiation. One person will be chosen as the mediator.
Time required:	About 30 minutes read the case and prepare for the negotiation (this can be done prior to class or in class, depending on time availability); 75 minutes to role-play and 45 minutes to discuss and summarize and discuss key principles (total time about 2 and 1/2 hours). The time can be divided into two teaching sessions, if necessary.

Materials: The case must be copied for the class in which the case is to be taught. The instructor should make one copy of each case for each student. Copies are also needed for the confidential information given to each team member participating in the role-play.

Physical Requirements: A room that is big enough where the teams can discuss strategy privately within their teams. Where possible, two "break-out" rooms can be used for maximum privacy.

OPERATING PROCEDURE

Choose two teams: GGI should have at least 2 more members than Gas Station Janet (no more than six members on the GGI team). The team with the most players will role-play the management team of GGI. The other team will role-play the management team of Gas Station Janet (GSJ). Both teams should jointly select the moderator from the remaining students. The teams should sit far enough from each other to allow private meetings. If possible, a breakout room should be used to ensure privacy.

Have students read the background information for case and answer any preliminary questions. Next, hand out each team's "confidential information" sheets that provide additional information for the exercise.

Table 1: Role-Play Steps

Step	Time	Instructions
1	30 minutes	All students should read the case and be prepared to participate in the role-plays. Depending on the size of the class, all or some may participate.
2	5 minutes	Choose people to participate
		Team GGI – 3 to5 students
		Team GSJ – 2 to 4 students (note the GGI teams should have at least 1 more person that the GSJ team)
		Both teams selected should choose the mediator from the remaining students
3	10 minutes	Each team reads their confidential role-play information and discusses strategy
4	10 minutes	Team GGI meets privately with mediator to discuss their issues. In the meantime, Team GSJ continues discussion on strategy.
5	10 minutes	Team GSJ meets privately with mediator to discuss their issues. In the meantime, Team GGI continues discussion on strategy.

Table 1: Role-Play Steps		
Step	Time	Instructions
6	15 minutes	Both teams meet with mediator
7.	10 minutes	Each team meets privately to discuss strategy without the mediator present.
8	15 minutes	Both teams meet with mediator
9	varies	If necessary, complete one more cycle of teams meeting alone and then again with the mediator
10	45 minutes	Debrief and discuss negotiation and discussion questions

LECTURE CONCEPTS

This case provides the opportunity to illustrate many concepts that occur in negotiation that can be highlighted during discussion:

Mediation: Understand the role of mediation and the process in a negotiation situation

Power: The case illustrates the idea that asymmetries in power in negotiation exist and may affect the outcome of a negotiation.

Options: Generating options to solve a dispute – In this case there are several options to be considered. It will be a challenge to the students to determine options that will satisfy both parties. It will challenge the mediator to stay neutral in helping the teams to consider options.

Negotiation Effects: The effects of the uncontrollable and controllable factors in a negotiation. The uncontrollable factors are the political and economical climate. The controllable factors are management decisions on how to handle the agreement and what is said to other parties about the agreement.

Emotion: The dynamics of emotion in a negotiation – The owner of Gas Station Janet is angry and bordering on a state of rage over how he has been treated. Although to a lesser extent, the emotion from the management of GGI is also high because they admire the relationship with Mr. Martinez and realize it is not his fault that the company will not build the third gas station.

Trust: The role of trust in a negotiation – Mr. Martinez feels betrayed at the way he has been treated in the fulfillment of the contract. He feels he has fulfilled his part of the agreement and that GGI only cares about profits.

Ethics: In the negotiation situations both parties may practice bluffing. Although this practice is widely practiced and accepted, some believe this is lying and this practice may raise ethical questions. There is also the ethical dilemma of honoring a contract despite changes in the external and internal environments.

LECTURE MATERIAL

Several models may be applied to this situation, suggestions are as follows:

Mediation and Arbitration

The case can be used prior to or after a lecture on third-party approaches to conflict resolution. Mediators have no formal power over outcomes and must therefore meet with parties and understand the dispute. Their effectiveness is determined by their ability to help the parties compromise and to encourage concessions toward a mutually satisfying result.

Moore, C. (1996). *The mediation process: Practical strategies for resolving conflict*, 2nd ed. San Francisco, CA, Jossey-Bass.

Wall, J.A. and A. Lynn (1993). Mediation: A current review. *Journal of Conflict Resolution*, 37, 160-194.

Lewicki, R.J., H. Alexander and K.W. Olander (1996). When and how to use third-party help. In *Think before you speak* (New York: John Wiley & Sons), 177-197.

Gibson, K. (1999). Mediator attitudes toward outcomes: A philosophical view. *Mediation Quarterly* 17(2), 197-211.

Managing Negotiation Impasse:

The case offers a mechanism to explore the elements of impasses in negotiation and the fact the impasses is not always bad. Perceptions cloud reason and the intensity and complexity of the issues increase with difficult negotiations.

Mayer, B. (2000). *The dynamics of conflict resolution*. San Francisco: Jossey-Bass.

Integrative vs. Distribution Negotiations:

This case provides an opportunity to discuss distributive vs. integrative negotiations and the mixed-motive characteristics of a negotiation.

Thompson, L. (1998). The mind and heart of the negotiator. Upper Saddle River, New Jersey: Prentice Hall.

Ethics

Wokutch and Carson view analyze bluffing from an economic gain perspective. Reitz, Wall and Love describe questionable negotiation tactics and ethical criteria. Both articles provide a base for an ethics-based discussion.

Wokutch, R. E. and Carson, T. L. (1981). The ethics and profitability of bluffing in business. *Westminster Institute Review*, 1(2), 77-83.

Reitz, H.J., Wall, J.A. and Love, M.S. (1998). Ethics and negotiation: Oil and water or good lubrication? *Business Horizons*, (41), 5-14.

Emotions

This case allows for discussion of the effect of emotions on conflict resolution. Mr. Martinez is seeking revenge for the way he has been treated. This may add to impasse if angers GGI. When emotions are high, parties are less likely to think clearly and more likely to behave irrationally. The mediator must help parties to maintain a clear perspective.

Kim, S.H. and R. H. Smith (1993). Revenge and conflict escalation. *Negotiation Journal*, 9, 37-43.

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?

CONFIDENTIAL INSTRUCTIONS FOR THE MEDIATOR

You have been selected to act as mediator in the above mentioned case. Your role is to assist the parties in conflict to reach a negotiated agreement. You must read all the documents contained in the case so that you are fully prepared to propose options that that may satisfy all parties. You should explore the real interest of both parties to reach an agreement and also you should try to identify their underlying interests. This process will aid you in selecting the best option to reach a mutually satisfying agreement.

As you know, most conflicts arise from the fact that different people may perceive or interpret the same information or situation in a completely different manner. In this particular case, one party (Gas Station Janet or Mr. Tony Martinez) believes that GGI has a clear and irrevocable obligation to build a third gas station according to the Mortgage Warranty Contract. In case of cancellation of the project, Gas Station Janet is entitled to collect damages. On the other hand, GGI contends that there is not such a clear obligation since the third gas station was just a proposed project or idea. In addition, the basic premises of the original business plan have completely changed and under those circumstances GGI can terminate the contract at any time.

You should be aware of the fact that Tony Martinez, owner of Gas Station Janet, is very upset with the whole situation. He has taken it very personal. GGI, on the contrary, has a very objective and corporate approach to the impasse. You should be very careful with this situation since it may require patience and understanding. Once you get over the emotional issues, Mr. Martinez should adopt a more sensible business conduct.

At the first meeting you should give a full explanation of the rules of mediation (see Exhibit 6 - Rules of Conciliation). As a mediator you must build relationships with both parties, while remaining neutral. Trust built between you and both sides helps the parties to express their true feelings and interests. It may be necessary along the process that one party meets with the mediator without the other party being present. Most people feel most comfortable expressing their feelings to a neutral party. When it comes to expressing feelings that may not help the positive outcome of the mediation process, the mediator may act as a buffer. It should be clear to all parties that these types of meetings are taking place. A situation may arise where one party makes a private comment to you and you feel that it would help the process if the other party knows this information. In this case, always request permission of the party that originated the information before revealing the information to the other party. In other words, the mediator has to be transparent in the handling of information.

Once the parties have been introduced and the rules of the process are known to all the parties, the mediator should allow the parties to formulate possible solutions to the impasse. Make sure both parties understand that these are only proposals and that no one is committed to accept them. All options presented may be listed without disqualifying any of them. This may be the objective of the first meeting. For the second meeting each party should bring the options that are more acceptable to them and present the arguments in favor or against each option. During this discussion new options may arise, the mediator should pay the careful attention in this point since if no options satisfy the parties the mediator should contribute with options constructed mostly with information given by the parties. If every thing goes well two meetings should be enough if not a third round of options may be discussed in a third meeting.

In this particular case, one possible option may be the following. Mr. Martinez may be pursuing the construction of the third gas station because he has a goal of generating a certain amount of income a year. Is there any area of the two existing gas stations that can be expanded so that they both generate an equivalent income of the three gas stations operating? For example, a convenience store, an auto repair shop, quick lube, a car wash or franchise such as Subway, Burger King or Pizza Hut, constitute valid options. These are the type of solutions that the mediator should pose in case none of the options proposed by the parties are of mutual interest.

CONFIDENTIAL INSTRUCTIONS FOR TONY MARTINEZ AND THE GAS STATION JANET (GSJ) TEAM

You are the owner of Gas Station Jane and have been in the gas retailing business for the last 30 years. You started as manager of Gas Station Janet you now own the business. Your dream has been to have a network of gas stations, however, that dream has always been impaired by the monopoly of the Colon Government of the oil business. Until the opening of the retail market, ownership of gas stations was restricted to individual owners. The new conditions allow for multiple national and international corporations to operate in this market with the consequent competition.

These new market rules have opened opportunities and you were approached by various large oil corporations to affiliate your gas station to their networks and to launch some other gas stations in your city in some form of partnership. After reviewing all the offers you decided to go along with Global Gas Incorporated (GGI). The corporation is well known and respected around the world and has operations in five continents. In 1998, GGI had revenues of $166 billion and earnings per share of more than $1. In the last few years, GGI ‘s revenues have been impressive. Indeed the financial results of the last three years show that GGI had revenues of $213.5, $232.7 and $185.5 billion in 2001, 2000 and 1999 respectively with a return on average capital investment of 17.8%

in 2001. You are satisfied with GGI's overall performance but not with the way they have treated you.

You are angry at GGI and feel betrayed. The company cancelled your last two meetings without explanation and this enraged you. You had to go and see your doctor due to lack of sleep. You are stressed and depressed. This has had an effect on your family as well. You believe these are consequences of what a unilateral cancellation of the third gas station project (after reading their counter arguments to your suit against them). You refuse to cancel the project and you will fight until the end for that third gas station. You realize the gas business is going through tough times because of ill decisions by your Government. Nevertheless, you are in this for the long haul and believe the industry is a long term business. Projects cannot be cancelled because of a temporary situation related to the price of gas. You are sure things will change in the long-term. The irony is that you selected that partner based on their long-term vision of the business. You feel that GGI is out to make a quick profit. You are now 55 years old and very close to retirement. You wanted to have the three gas stations running so that you could begin to prepare for retirement and organize the transfer of the business to your eldest son. This unprofessional and irresponsible behavior of GGI is blocking your personal plans and it adds to your frustration and misery.

You and GGI are going to have these mediation meetings next week before the arbitration process. You have high hopes that an agreement can be reached and that the third gas station will be built. You are afraid that your emotions may get the best of you due to the rage you have felt in the past. Needless to say, you prefer to avoid the arbitration process in order to cut cost and most importantly, you are not sure that you have a solid case so you may end up losing money. Your attorney believes you have a solid case but then again, lawyers make money by convincing their clients that they have a solid case. Your attorney helps your to understand the legal aspects of the conflict and also the legal limits of your claims but you are the only one that can fully comprehend the importance of striking a deal at this stage.

Your strategy for this meeting is to start being very aggressive and very hard on GGI. You feel disrespected, let down and abused in part because you are a small business partner and they are a very large and powerful corporation. They have to know that you are angry, that your health has suffered, and that there is no peace and happiness in your family because of them. They have taken advantage of your good faith. These large corporations do not think of the suffering of people like you. You are prepared to let all these feelings out. That will make them look very bad in front of the mediator who is a very reputable man in your country. That will be your little revenge.

You have heard that the land lot you bought for the third gas station is located in an area that may not be very profitable for a gas station (the vehicular traffic in the area is not very high). GGI may propose that the gas station should be built in a different location or even in another city. This is not possible since you already have the land and if you sell it now, you will not recover the same amount of money you paid for it since the real estate market is very depressed right now. Unless GGI makes a very tempting offer, you will not accept this option.

These corporations have a tendency to avoid the embarrassment of being sued so you know that they may try to buy you out. That may be an option but it will have to be a lot of money, in the range of $700,000.00. The main argument is that whatever they give you will have to compensate all the damages (as stated in your suit against them) plus your silence.

You have an option that you will only propose if you do not see the possibility of an agreement. You know that GGI has frozen all investments (particularly cash) in Colon. You also know that providing all the equipment for the gas station is not a problem (they keep a large stock of equipment and they can provide it at a minimum cost in cash). Your proposal would be if you can finance the construction of the gas station (approximately $179,400.00), GGI will provide the equipment and installation. In addition, GGI will give you a small discount in the price of gas for the next ten years to compensate for your investment. You would also like to be relieved of the mortgage in the two land lots (Janet and Jolly) so that you can raise more cash with the banks for further investment. This would be your last minute proposal.

CONFIDENTIAL INSTRUCTIONS FOR THE GLOBAL GAS, INC (GGI) TEAM

You have been assigned the task of representing your corporation in a meeting with one of your local partners in the city of Bolivar in Colon. Mr. Tony Martinez, your local partner, is very upset because your company has cancelled one of the three gas station projects being developed. As you know there is nothing personal against Mr. Martinez, the cancellation is more related to the general economic and political conditions of Colon and to your own corporate policies. This has to be made very clear to Mr. Martinez. We presume that Mr. Martinez is taking this matter very personal when in reality these are more part of a business strategy. You know from friends and associates that Mr. Martinez has made very nasty remarks about your corporation. You empathize with him and realize that you have to be very patient with him. You may have to go through a period of time during the meeting in which Mr. Martinez will blow out a lot of steam. After that you should expect a very productive meeting.

The Government of Colon has adopted policies for the development of the oil business that are confusing to your company. They have promoted the participation of foreign companies in the local retailing market yet they have severely regulated the price of gas to the point that the price of gas has been frozen for the last two years. The Government has promised all the foreign companies, time and time again, that there will be price increase. However, every time an increase is announced, wide spread public protests (public transportation entrepreneurs, taxi drivers, opposition parties, freight carriers and public in general) barred any such policy. To most people in Colon the price of gas symbolizes a form of redistribution of the wealth of the nation. The challenge that your corporation has is how to create favorable conditions for an increase in the price of gas without getting involved in the politics that goes with it. This requires that the majority of stakeholders in

Colon's society fully understand what operating at a profit in the oil business entails/ This includes moving away from price regulation and letting competition and the markets do their jobs.

In Colon, your company operates in four areas: 1. oil exploration and exploitation services as a contractor to the state owned operating company (PDCSA), 2. corporate-owned exploration and exploitation activities, 3. chemical processing of oil to extract oil products for export and 4. the gas retailing operations. All your operations are very profitable with the exception of gas retailing that has the local political and social implications explained above. That explains your company's strong overall financial performance. Once again your policy is that all business units must be profitable and the company attempts to avoid any cross subsidies.

In the meantime, your corporation has to take short-term measures such as freezing all investment in old and new projects to force firmer and clearer policies from Government. This is not new to the organization as this problem is encountered in most developing countries that are in the process of modernizing their economies. Unfortunately, this is done with a big sacrifice from your local partners that have to suffer the consequences of project cancellation. Such is the case of Mr. Martinez and Gas Station Janet.

Mr. Martinez has been an excellent partner. He knows the gas retailing business very well, he has excelled as a manager and he is very familiar with local business practices (hiring and firing people, being in the "loop" and managing customer service). Your company has to make every effort in this meeting to find a compromising way to satisfy him while not deviating significantly from your policies. Your policy in Colon is to cut drastically in cost and cash investments. That means that any on going business has to be self sufficient. In other words, the worst case scenario is that revenues have to equal expenses. This is a policy oriented towards minimizing your exposure in Colon, cutting any possible loses and avoiding unnecessary risks.

In the discussions with Mr. Martinez, you may entertain options that may imply a disbursement from your corporation for the purpose of exploring Mr. Martinez true intentions. A mediating process requires exploring options. You are advised to consider all options that are put on the table (from Mr. Martinez or the mediator) and you should not discard any in the first meeting.

You should show that you are willing to listen but do not commit yourself to anything. In the second meeting some of the options will be discarded, let Mr. Martinez be the first to discard the options that may not be convenient to him. If you coincide with Mr. Martinez in some of the options to be discarded, use this to show support for Mr. Martinez and his point of view.

One possible option is that Mr. Martinez may want to reach a settlement via a lump sum as a compensation for his losses and grief. That would be expected of a corporation like yours that is well known in order to avoid public embarrassment with conflicts like this. In other words, sometimes you have to buy peace. You may hear this option and add it to the list but that option is not possible. Remember you have other partners in Colon and elsewhere in the world expecting you to slip in this case. This course of action will allow others to initiate legal actions against you an increase their likelihood of settlement. There is always the perception that your company is very profitable. This is indeed true but that is done by making sure that each operation, however small, is profitable and that your corporation has developed the know-how to foresee and predict bad business results and to be proactive.

One possible option could be to build the gas station in a highly profitable location. A very high volume of sales may be an interesting option for you even in a depressed market like Colon. There is a location in the industrial city of Valencia (400 miles from Bolivar and 100 miles from Colon) that has these characteristics. If Mr. Martinez is willing to invest in Valencia, you may have a deal.

You should try to reach an agreement in these mediation meetings to avoid the cost of the arbitration process. In addition, you are not sure we have a solid case. You may end up losing more money than you are willing to spend if the arbitration process is unfavorable to your company. You have complete freedom as to the terms of any agreement so long as you keep yourself along the guidelines of company policy of no cash disbursements.

EPILOGUE

This case is based on an actual business situation and the story has been slightly changed for pedagogical reasons and to preserve the anonymity of the parties. In the real-life story that inspired this case, these were the options that emerged from the conciliation meetings:

Option 1

Increase the volume of business in the two existing gasoline stations, so that their revenues will compensate for the expected revenues from the third station. This option implies considering additional business, such as a convenience store or a quick lube. Janet (Tony Martinez) discarded this option in the second meeting (remember: three conciliation meetings took place, in accordance with the signed agreement, but the classroom exercise may be limited to two meetings). Mr. Martinez argued that he could always widen the scope of the business in the existing stations, regardless of eventual agreements with GGI. Tony understands GGI's position about the third station, and he reminds them that the investment plan is meant to be long-term, so there is no need to freeze all investments on account of temporary issues such as price regulations affecting gasoline retail. GGI was willing to invest on a quick lube in each of the existing stations, given that the prices of automotive oil, and the prices of automotive services, are not regulated. Tony keeps arguing that the real and only issue is the third station, and that those possible investments can of course be discussed in a future moment. Given the obvious rejection from Janet, the mediator abstained from further pursuing this option. He could always get back to it in future iterations, should the opportunity arise.

Option 2

Build the third gasoline station, in another city. GGI proposed this option, because of their obvious interest of moving to another area with greater sales volume, hence compensating the issue of price freeze. Tony argues that the other city, Valencia, is located 300 miles from the first two. He appreciates GGI's offer, since it means that GGI is not in outright rejection of any possible investment, and interprets it as an expression of their commitment to reach a mutually satisfactory agreement. Tony does not imply that he is completely against this option, but he does not prefer it, nor does it seem to be convenient to him.

Option 3

Compensate Tony Martinez financially and cancel the third station project. GGI argued against this option, under the firm certainty that there was nothing to compensate for, given that the cancellation of the project was due to its null profitability. GGI believed there was no possible business rationale to justify compensation in this case. Tony Martinez was willing to accept a monetary compensation in the context of a friendly cancellation of the agreement.

Option 4

Build the third station. Janet would take care of the civil engineering and construction works for the station, and GGI would install the equipments and provide the brand and image. In addition, GGI would write off the mortgages for the first two stations, already in operation. This option, proposed by Martinez, became the most attractive to both parties. Janet was to afford the construction costs (approximately $150,000), while GGI would write off the first two mortgages, provide the equipment, all the brand image elements, and in addition to all this, would provide a small discount in the price of gasoline sold to Janet, equivalent to $150,000, in 15 years, with no interest. This was the final agreement reached by both parties. Janet got the third station, with an additional compensation (the write-off of the mortgages). GGI, in turn, was not forced to make cash disbursements, wholly in line with the corporate policy that had set strong limitations.

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).

INSTRUCTORS' NOTES

Decision Focus

The decision focus of this case is: Will Mohawk be able to maintain its rapid acquisition rate of 19 firms in 13 years and continue its consolidation of the carpet and floorcovering industry while maintaining financial success?

With the summer 2005 acquisition of Unilin, a Belgian-based laminate floor covering manufacturer, Mohawk created a larger presence in the laminate flooring market along with an expanded range of flooring products and a larger European customer base. While the acquisition, valued at $2.6 billion, surprised local carpet competitors in the Northwest Georgia area, where Mohawk as well as most of the industry is clustered, analysts were upbeat about Mohawk's future. Unilin had 2004 revenues of $1 billion and employed more than 2,400 people in Europe and the U.S. The Unilin acquisition came just three years after Mohawk bought Dal-Tile, the largest U.S. ceramic tile maker. 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*).

Main Features of the Case

Students are asked to analyze the company's financial history to determine if avenues for growth through acquisitions are still available. The case provides insights into strategic and managerial issues and includes market and financial information on Mohawk with general information on the industry and Mohawk's main competitor, Shaw Industries, Inc. The financial analysis provides insight into how the operations, profitability, and capital structure of Mohawk has changed due to the most recent acquisitions.

The case study was developed from extensive use of secondary research from readings, articles, the company's annual reports, web sites, and reports from trade organizations in the carpet and floorcovering industry as well as interviews and personal experience working with the industry.

TEACHING APPROACH AND PLAN

This case is designed to meet multiple objectives. For example, it can be used as a case exercise for students with limited knowledge of financial analysis, as one would encounter in a principles of finance course. In an extended coverage format, as described below, the case can be used in advanced classes including strategic management or a capstone financial analysis course where students would be challenged to link business strategy to financial performance. While the case can be adapted by the instructor to fit a wide range of teaching applications, these two primary formats are presented. They include: (1) a one-class session format focusing primarily on financial analysis, and (2) a two-class session format extending the financial analysis and linking strategy to financial performance.

Teaching Plan for a Single (50 or 75 Minute) Class Session

Class Time

The case works well as a single class session exercise following an introductory chapter or instructional session on financial ratio analysis.

Students

Students should be assigned the case for homework and asked to compute the assigned ratios for class discussion. This assignment is consistent with financial statement analyses for the principles of finance course where students have limited background in financial analysis or for use as an introductory review exercise for an intermediate-level finance course for college juniors and seniors. The case could also be used as an effective training exercise on financial statement analysis and ratio computation for non-financial students in continuing education or other similar training courses.

Student Preparation/Assignment Questions

1. Prepare graphical highlights of Mohawk's financial performance and discuss changes over time. (While it is not imperative for students to use a computerized spreadsheet, (e.g. Excel), students should be encouraged to do so.)
2. Prepare common size financial statements and discuss any significant changes over time. (See Exhibits 1 and 2).
3. Calculate liquidity, leverage, asset management, and profitability and market value ratios. Show major trends graphically and describe strengths and weaknesses.

Program Goals and Learning Objectives

The single session format of ratio analysis and discussion supports the educational program goals of functional area knowledge in finance, introductory analysis of business conditions, financial ratio analysis, and limited critical thinking and decision-making.

A single in-class session would focus on the learning objectives of:

- preparing standardized financial statements for comparison purposes
- computing and interpreting common financial ratios to better understand the determinants of Mohawk's profitability and growth, and
- discussing the strengths and weaknesses of financial statement analysis.

Teaching Plan

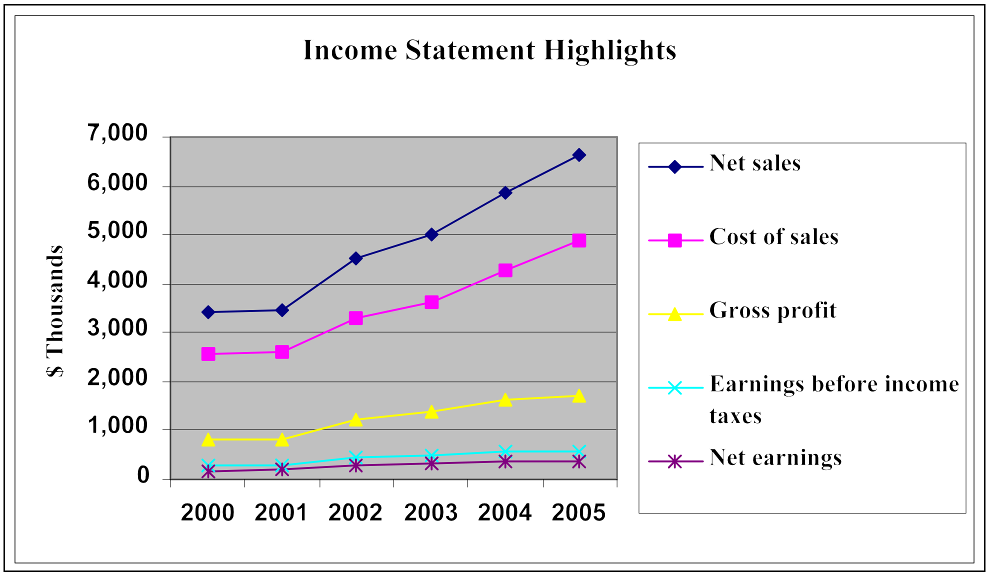
Student preparation of the financial ratios for homework would support the in-class activities of reviewing the ratio analysis computation and checking answers. The professor may want to divide the class into small groups of four or five students to review their answers and computations. It is important for students to attempt the preparation of common size financial statements and attempt the ratio computation. This will lessen the in-class time spent on data computation and allow more time for discussion of the meaning of the ratios as well as a review of financial trends and discussion of the company's financial strengths and weaknesses.

The answers to homework questions/problems are presented below. The instructor should have students address each of the assigned questions. It is suggested that the instructor address each question sequentially so as to move from a broad view of financial and operational performance to the key issues of capital structure and sources of financing and their impact on growth and earnings.

Solutions to Assignment Questions

Mohawk continues a strategy of rapid expansion through internal growth and acquisitions. Assess Mohawk's financial performance and present your case as to whether Mohawk can continue their pace of successful financial performance given the recent acquisitions. (While it is not imperative for students to use a computerized spreadsheet (e.g. Excel), students should be encouraged to do so.)

1. Prepare graphical highlights of Mohawk's financial performance and discuss changes over time.



Mohawk has continued its rapid rate of expansion since 2000 increasing sales from $3.4 billion in 2000 to $6.6 billion in 2005 for an average annual growth rate of 19%. After tax net earnings have increased as well from $163 million in 2000 to $358 million in 2005 for an annual average growth rate of 24%.

An "A" student should recognize the primary financial indicators and contrast them over time. The student should focus on whether increases in sales due to acquisitions result in consistent increases in earnings thus creating value to stockholders. If diversion should occur, the student should note that further analysis of operational efficiency or capital structure changes would be in order.

2. Prepare common size financial statements and discuss any significant changes over time. (See Exhibits 1 and 2.)

A review of the Common Size Income Statement shows operating consistency over time. Even with Mohawk's rapid rate of growth, gross profits have maintained very consistent growth ranging from 24.17% to 27.88% of sales. Earnings before income taxes have ranged from 7.86% to 9.82% of sales with net earnings ranging from 4.78% to 6.27% of sales. Interest expense has increased relative to sales since 2001 but is still consistent over time.

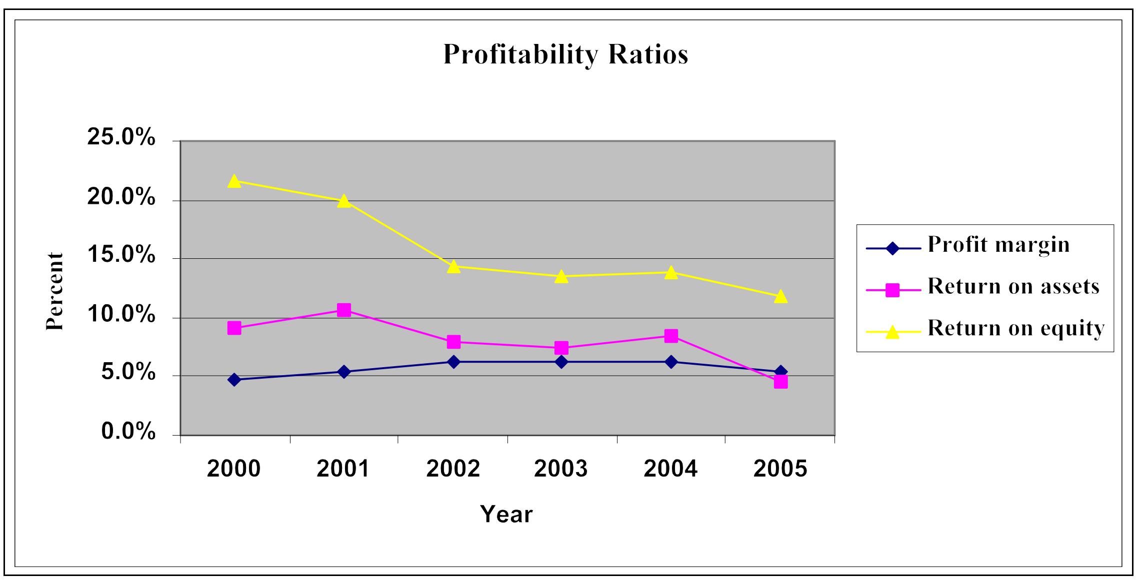
Mohawk's acquisition of Unilin has added more fixed assets to the balance sheet which resulted in a general decline in current assets relative to all assets. Other notable changes include an increase in long-term debt and a reduction of retained earnings. These changes suggest the recent acquisitions were financed with a combination of debt and retained earnings. Also notable is the increase of intangible assets on the balance sheet. Total intangibles including goodwill, trade names, and other intangible assets have increased from 6.26% of total assets in 2000 to 47.50% of total assets in 2005.

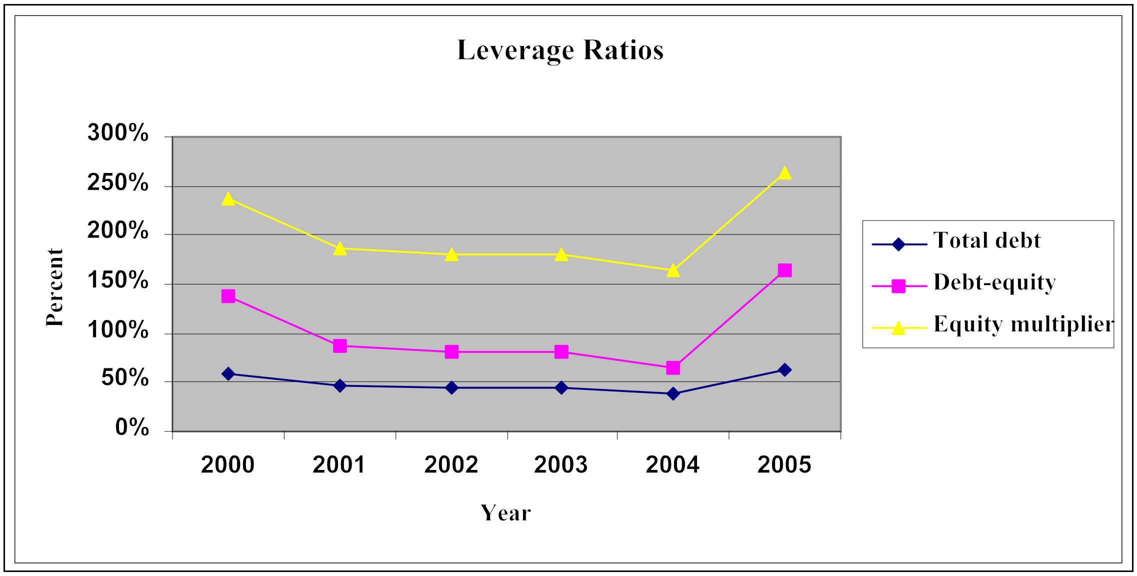
An "A" student should recognize that the company has been able to maintain its growth strategy without detrimental impacts on its cost structure or earnings. The student, however, should focus on changes in the balance sheet. Increases in long-term debt, reductions in retained earnings, and an increase in less marketable intangible assets could lead to financial distress during industry downturns.

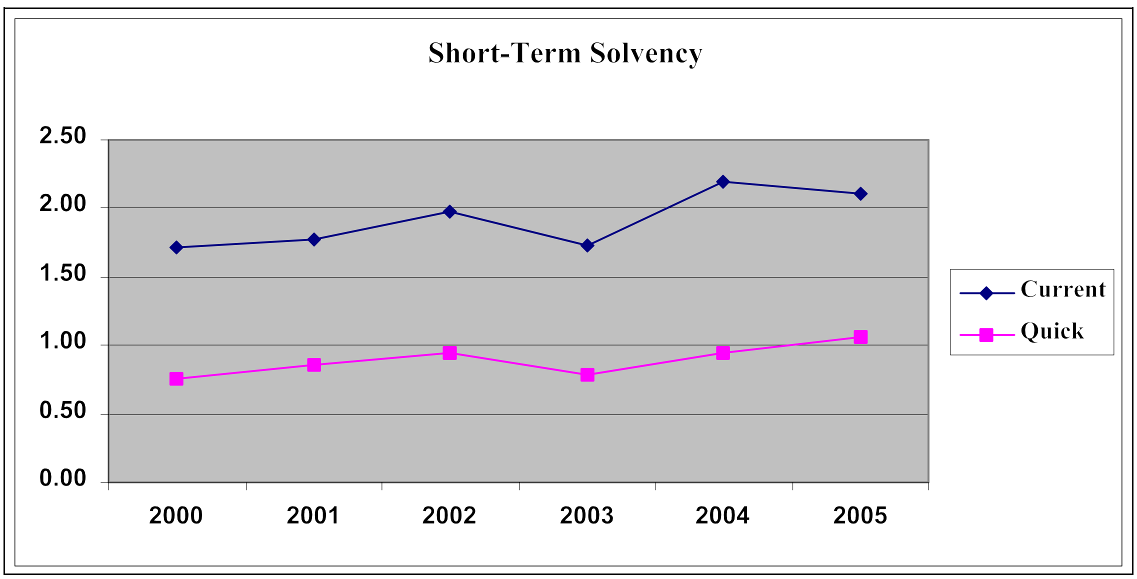
3. Calculate liquidity, leverage, asset management, and profitability and market value ratios. Show major trends graphically and describe strengths and weaknesses.

	RATIO ANALYSIS					
	2005	2004	2003	2002	2001	2000
	LIQUIDITY RATIOS, SHORT-TERM SOLVENCY					
Current	2.10	2.19	1.73	1.97	1.77	1.71
Quick	1.06	0.94	0.79	0.94	0.86	0.75
Cash	0.12					
	LEVERAGE RATIOS, LONG-TERM SOLVENCY					
Total debt	0.62	0.39	0.45	0.45	0.46	0.58
Debt-equity	1.64	0.65	0.81	0.81	0.86	1.38
Equity multiplier	2.64	1.65	1.81	1.81	1.86	2.38
Times interest earned	8.34	10.81	8.79	6.43	9.78	7.03
	ASSET MANAGEMENT, TURNOVER RATIOS					

	RATIO ANALYSIS					
	2005	2004	2003	2002	2001	2000
Inventory turnover	4.20	4.18	4.33	4.84	4.92	4.49
Days in inventory	86.98	87.23	84.27	75.40	74.23	81.25
Receivables turnover	7.80	8.90	8.72	9.02	8.51	9.49
Days in receivables	46.79	41.01	41.87	40.45	42.89	38.47
Total asset turnover	0.83	1.34	1.20	1.26	1.95	1.90
Capital intensity	1.21	0.75	0.83	0.80	0.51	0.53
	PROFITABILITY MEASURES					
Profit margin	0.05	0.06	0.06	0.06	0.05	0.05
Return on assets	0.04	0.08	0.07	0.08	0.11	0.09
Return on equity	0.12	0.14	0.13	0.14	0.20	0.22
	MARKET VALUE RATIOS					
Earnings per share	5.35	5.53	4.68	4.46	3.60	3.02
Price-earning, PE	16.25	16.51	15.07	12.76	15.25	7.75
Book value per share	44.75	39.47	34.23	30.57	17.85	13.90
Market-to-book	1.94	2.31	2.06	1.86	3.07	1.69
Stock price	86.98	91.25	70.54	56.95	54.88	23.44
Dividend payout	0	0	0	0	0	0
Retention ratio	1	1	1	1	1	1







The financial ratio analysis reveals consistent financial performance in the areas of short-term solvency and asset management. Profitability measures, while lower than the level of profitability of the pre-2001 recession, are generally consistent. The return on assets has been trending down as a result of the recent acquisitions; however, return on equity has remained steady even with increasing debt levels. One notable change is the increase in financial leverage due to the increase in long-term debt. Debt relative to assets and debt relative to equity has increased significantly.

An “A” student would calculate the key financial ratios in each major category and then focus on at least two categories that present positive and negative trends. The student should also note the rate of growth is being absorbed with little negative impact on operations. However, he should note that the change in the firm’s capital structure to include more debt has impacted the firm’s long-term solvency and profitability.

Teaching Plan for a Double (100 or 150 Minutes) Session

Class Time

A two-session sequence or a 2.5 hours class would include the ratio analysis previously discussed above but would add additional coverage of the strategic implications of the mergers and acquisitions and discuss more forward-looking strategies for Mohawk, Inc

Students

The two-session format is designed for students that have more advanced financial analysis and strategic management skills. The case would be appropriate for senior level finance majors, managerial finance courses, a strategic management course, or a continuing education professional improvement workshop. The ratio analysis computations would be a review for these more advanced students or professionals.

Student Preparation/Assignment Questions

1. Prepare graphical highlights of Mohawk’s financial performance and discuss changes over time. (While it is not imperative for students to use a computerized spreadsheet (e.g. Excel), students should be encouraged to do so.)
2. Prepare common size financial statements and discuss any significant changes over time. (See Exhibits 1 and 2).
3. Calculate liquidity, leverage, asset management, and profitability and market value ratios. Show major trends graphically and describe strengths and weaknesses.
4. Use the DuPont Identity framework to decompose Mohawk’s Return on Equity and discuss any changes in operating efficiency, asset use, and financial leverage over time. (See Ross, Westerfield, Jordan, 2007, pp. 60-63.

5. What are Mohawk's internal and sustainable growth rates and earnings per share? How have they changed and why?
6. Discuss growth issues or challenges in a mature company and/or industry.
7. Discuss both the financial and non-financial issues associated with merging companies.
8. Consider the interplay of strategic alternatives, financial outcomes, and implications of possible continued mergers and acquisitions for the industry.

Program Goals and Learning Objectives

The double session format of ratio analysis, discussion, and coverage of the strategic issues of mergers and acquisitions asks students to move beyond the computation of financial ratios and discuss their implications. This longer format can also support student learning through report preparation, graphical presentation of data, oral presentation of analysis, and the use of spreadsheet software (Excel ®, for example) in the financial and/or strategic analysis. Students can be assigned the eight questions above to consider in a report. In addition, team presentations of the findings and conclusions will provide practice with oral communication skills and teamwork.

In addition to the single session learning objectives of:

- preparing standardized financial statements for comparison purposes
- computing and interpreting common financial ratios to better understand the determinants of Mohawk's profitability and growth, and
- discussing the strengths and weaknesses of financial statement analysis.

The double session would add additional focus on the learning objectives of:

- using the DuPont Identity framework to decompose Mohawk's Return on Equity and discussing any changes in operating efficiency, asset use, and financial leverage over time. (See Ross, Westerfield, Jordan, 2007, pp. 60-63.
- determining Mohawk's internal and sustainable growth rates and earnings per share? How have they changed and why?
- recognizing growth issues in a mature company and industry,
- identifying financial and non-financial issues associated with merging companies, and
- determining the interplay of strategic alternatives, financial outcomes, and implications of possible continued mergers and acquisitions for the industry.

Teaching Plan

The teaching plan for the first session of the double session format should be consistent with the one session format. Again, it is recommended that the class begin with a brief introduction to the floorcovering industry and its history. Students should prepare the assigned questions prior to class and then, as a group, address the case questions in class.

The case analysis could also be conducted as a take-home or in-class examination of the financial and market data with strategic issues. The analysis would include a review of major industry players to understand the parallel changes at Shaw Industries, Inc. (http://www.shawfloors.com) who has also grown through a number of acquisitions. Consolidation of the industry should be discussed as well as consolidation of the retail outlets (now largely limited to big-box home improvement retailers). A discussion of the lifecycle of manufacturing companies and their maturity strategies could also be addressed in the second session.

Solutions to Assigned Questions

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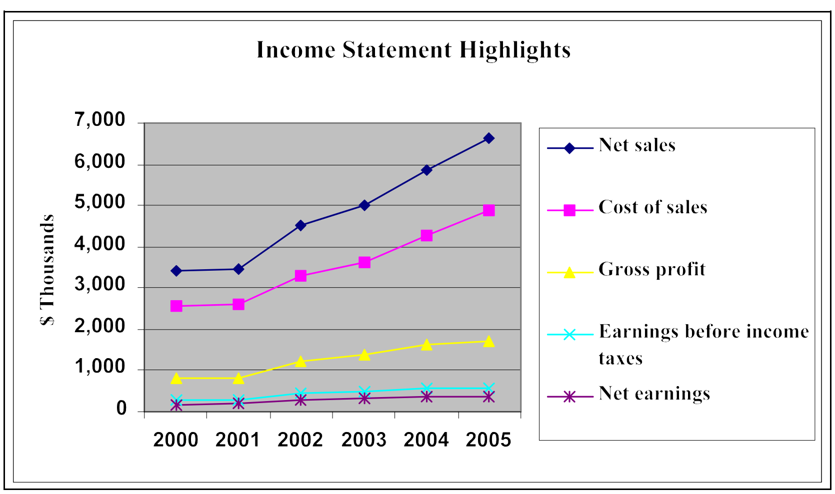

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	PROFITABILITY MEASURES					
Profit margin	0.05	0.06	0.06	0.06	0.05	0.05
Return on assets	0.04	0.08	0.07	0.08	0.11	0.09
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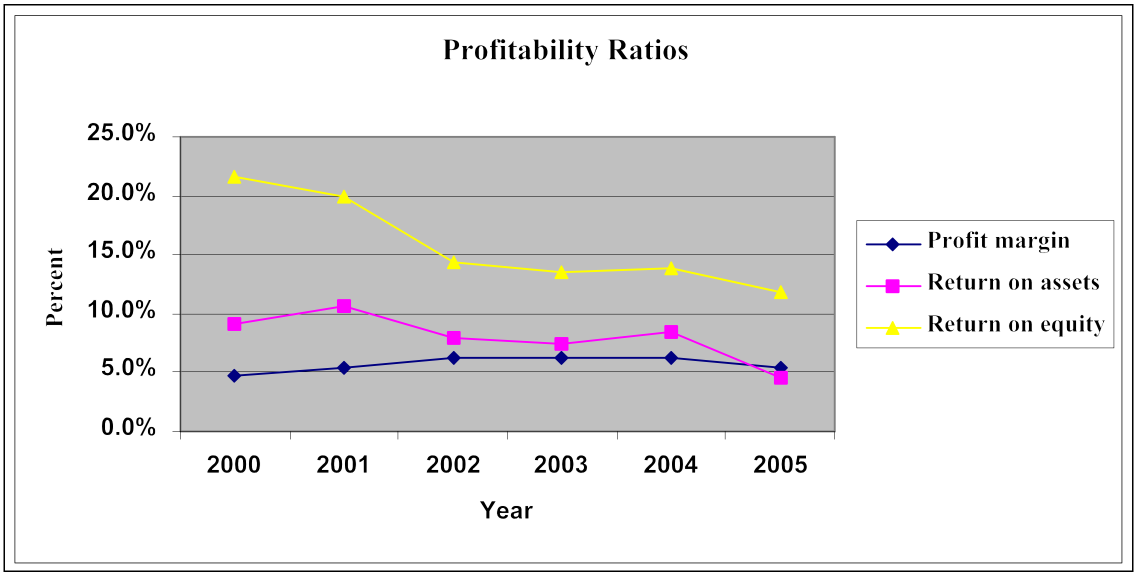
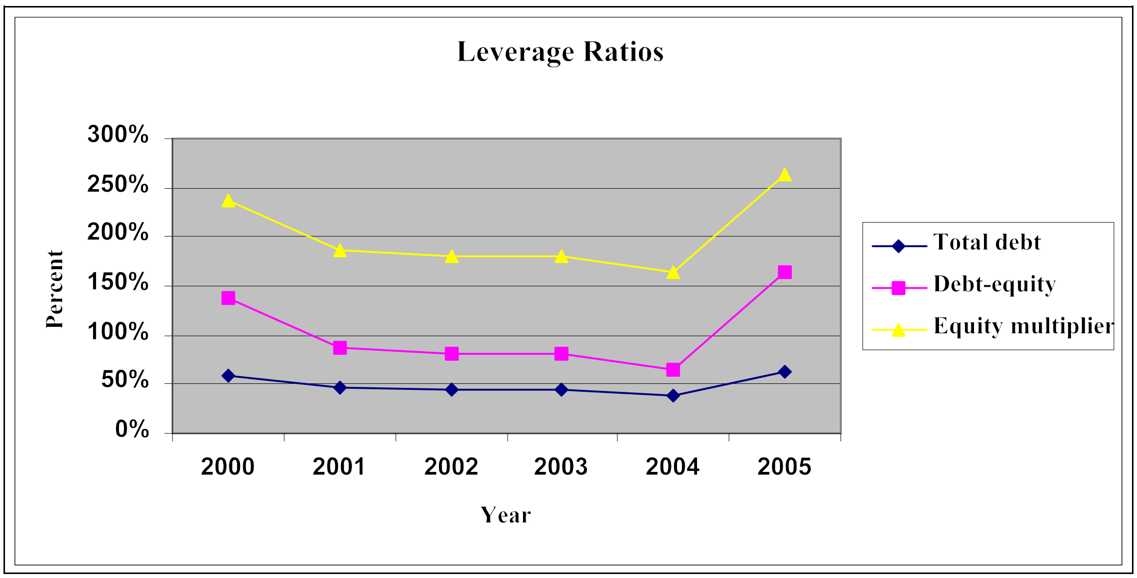
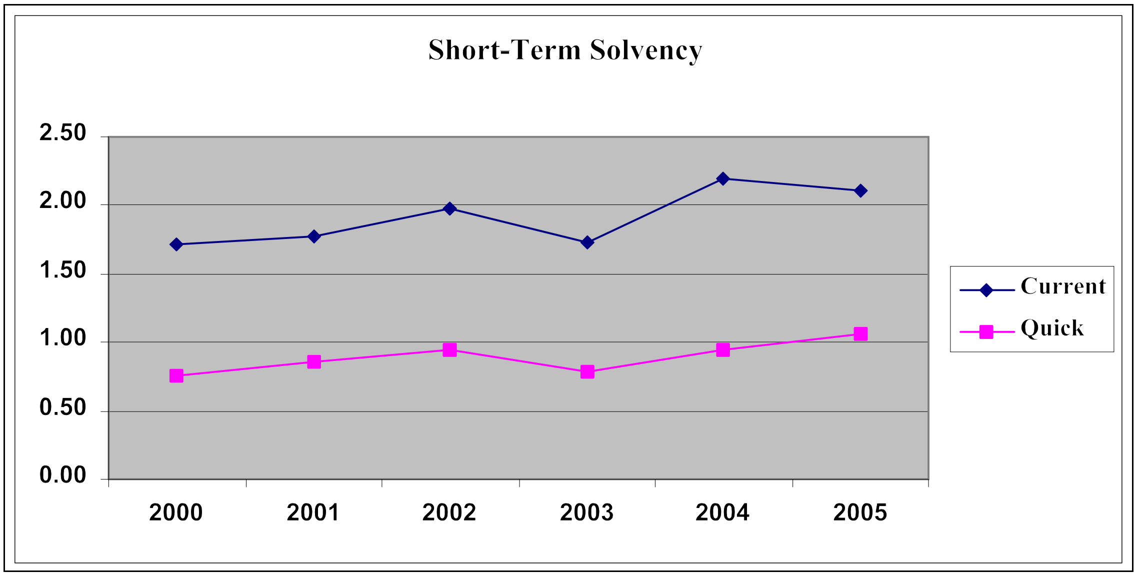

Profitability Ratios
25.0%
20.0%
15.0%
10.0%
5.0%
0.0%
Percent
2000
2001
2002
2003
2004
2005
Year
Profit margin
Return on assets
Return on equity


Leverage Ratios
300%
250%
200%
150%
100%
50%
0%
Percent
2000
2001
2002
2003
2004
2005
Year
Total debt
Debt-equity
Equity multiplier



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4. **Use the DuPont Identity framework to decompose Mohawk’s Return on Equity and discuss any changes in operating efficiency, asset use, and financial leverage over time. (See Ross, Westerfield, Jordan, 2007, pp. 60-63) Is this a text that anyone using this case would be expected to use?**

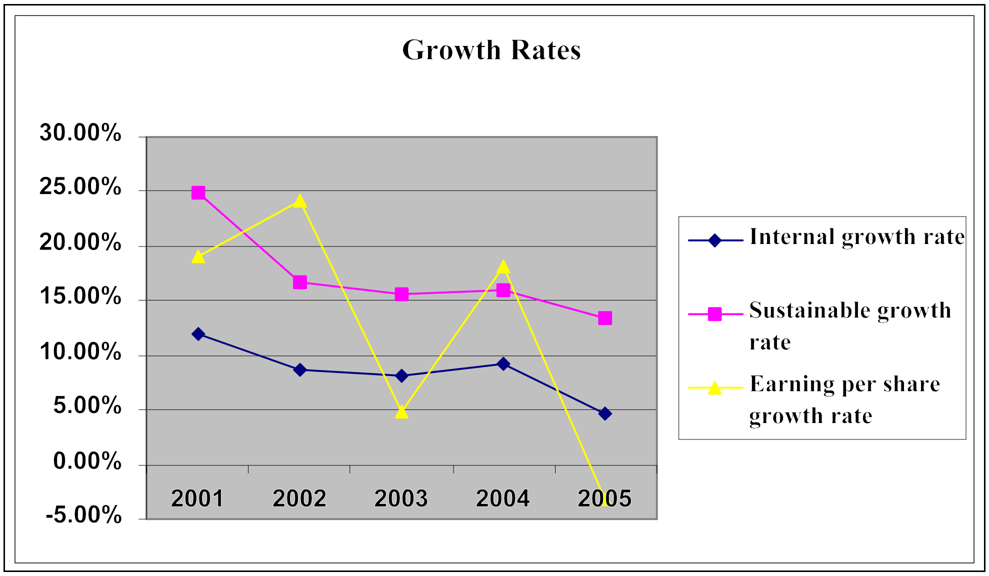
DuPont Identity						
	2005	2004	2003	2002	2001	2000
Profit margin	0.05	0.06	0.06	0.06	0.05	0.05
Asset turnover	0.83	1.34	1.20	1.26	1.95	1.90
Equity multiplier	2.64	1.65	1.81	1.81	1.86	2.38
Return on equity	0.12	0.14	0.13	0.14	0.20	0.22

Return on equity has remained consistent since 2002 ranging from 12% to 14%. However, Mohawk's operations and capital structure has changed considerably due to their acquisitions of non-carpet flooring. Since 2001, Mohawk's asset turnover has declined from 1.95 in 2001 to 0.83 in 2005, which suggests their latest acquisitions are more capital intensive. In addition, the equity multiplier has increased from 1.86 in 2001 to 2.64 in 2005 and suggests its use of long-term debt to finance its acquisitions has changed its capital structure. This increased use or leverage continues to reward stockholders; but, it could subject the company to financial distress during market down-turns.

An "A" student should be able to break down the DuPont Identity into its relevant parts (ratios) and discuss changes in the operational efficiency, asset use efficiency, and financial leverage of the firm over time. Most notable is the asset turnover and changes in the firm's financial leverage.

5. What are Mohawk's internal and sustainable growth rates and earnings per share? How have they changed and why?

	2005	**2004**	**2003**	**2002**	**2001**	**2000**
Internal growth rate	4.69%	9.14%	8.05%	8.59%	11.94%	9.96%
Sustainable growth rate	13.42%	16.04%	15.60%	16.75%	24.82%	27.48%
Earning per share growth rate	-3.19%	18.08%	4.86%	24.09%	18.98%	N/A



Mohawk does not pay dividends to stockholders. This 100% retention rate has allowed a combination of retained earnings and debt to finance acquisitions. Therefore, both the internal and sustainable growth rates have been declining. This suggests Mohawk's growth may be slowing to a more sustainable level. This is also evident by the 21.27 % decline in the growth rate of earnings per share from 2004 to 2005.

An "A" student should be able to calculate the market value ratios and be able to convert them into internal and sustainable growth rates and explain how they have changed. The student should note the firm's dividend payout and/or retention policy and how that has fostered growth over time. The student should be able to discuss the determinants of growth and their effect on the internal and sustainable growth rates. (see Ross, et.al. 2007, pp. 64-66)

For example:

- Profit margin: An increase in profit margin will increase the firm's ability to generate funds internally thereby increasing its sustainable growth rate.
- Total asset turnover: An increase in the firm's total asset turnover increases the sales for each dollar of assets. This increases the firm's need for new assets as sales grow thereby increasing the sustainable growth rate.
- Financial policy: An increase in the firm's debt-equity ratio increases the firm's financial leverage thereby increasing the sustainable growth rate.

- Dividend policy: A decrease in the percentage paid out as dividends increases the retention thereby increasing both the internal and sustainable growth rates.

The two session case asks students to address additional strategic issues associated with a rapidly growing manufacturing firm. While the instructor has latitude to discuss a wide range of issues, the following should assist addressing some of the key strategic issues.

- Recognizing growth issues in a mature company and industry.

In an industry in the mature stage of the lifecycle, further growth through acquisition may be difficult. First, there may be no appropriate targets for acquisition. Secondly, size issues and a maximum efficient scale may be reached. Finally, the cost of growth and difficulties in assimilating additional companies, cultures, and systems may be challenging. The industry is dominated with large industry players like Mohawk Industries, Inc. and Shaw, Inc. The economic structure is an oligopolistic one and the other competitors are niche players that are typically either unprofitable or undesirable for the larger firms. It may be interesting to discover the smaller players and their foci (institutional and commercial accounts, specialty carpets for automobiles, boats, motor homes, and trailers, and high end, mass-customized designer rugs, for example).

An "A" student should be able to discuss some of the benefits and costs associated with continued growth. Growth increases economies of scale by lowering per unit fixed cost. The student should use the financial data to show changes in Mohawk's fixed cost per unit of sales over the six-year period.

- Greater market share would lead to market power and improved product pricing.

Since markets for mature industries grow more slowly, the student should expand on the benefits of growth through acquisitions rather than internal growth. The "A" student should also address growth through vertical integration. The acquisition of suppliers lowers supply chain costs and allows better coordination of supply acquisition and production.

The students should also note some of the difficulties of continued growth including the difficulty of merging different business cultures, overlapping product lines, and the integration of different management information systems.

- Financial and non-financial issues associated with merging companies.

Since internal growth opportunities are limited, an "A" student should begin to focus on the company's capital structure and discuss Mohawk's use of debt as a means of funding acquisitions and the increased financial stress due to elevated debt levels. Even non-financial issues can have financial underpinnings. Mergers made as an attempt to consolidate fragmented markets, broaden product lines, or improve supply chain management can have an impact on operating performance. An "A" student should further the discussion of the asset management financial ratios and discuss any changes over time.

- The interplay of strategic alternatives, financial outcomes, and implications of possible continued mergers and acquisitions for the industry.

An "A" student should note that regardless of the growth avenue, market share growth is the goal. Market share growth encompasses a number of strategies. Further internal growth is through process improvements and leveraging knowledge across all lines supported by real-time information systems. Acquisition is also a means to achieve a strategic goal. Acquisition offers a fast way to gain existing infrastructure including transportation and distribution centers. In other cases, the acquisition of information systems architecture has been sufficient reason to acquire another company. Purchasing sole source suppliers allows firms to have improved supply chain management through an uninterrupted source of raw materials.

An "A" student should again bring in further discussion of Mohawk's internal and sustainable growth rates and address strategic options related to future acquisitions. Firms can reduce financial leverage over time by paying down debt or issuing new equity. While lowering financial exposure, it differs in the timing of acquisitions since internal financing takes place over a longer period of time. The "A" student should stress Mohawk's need to generate free cash flow and use cash for debt repayment before continuing the pace of acquisitions.

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Exhibit 1: Mohawk Industries, Inc. Common Size Income Statement						
	(In percent, except per share data)					
	Years Ended December 31, 2000-2005					
Year	**2005**	**2004**	**2003**	**2002**	**2001**	**2000**
Net sales	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Cost of sales	73.97%	72.44%	72.12%	72.58%	75.83%	75.83%
Gross profit	26.03%	27.56%	27.88%	27.42%	24.17%	24.17%
Selling, general & administrative expenses	16.55%	16.75%	17.04%	15.88%	14.68%	14.86%
Legal settlement	0.00%	0.00%	0.00%	0.00%	0.00%	0.21%
Operating income	9.48%	10.81%	10.84%	11.54%	9.49%	9.11%
Other expense (income):	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Interest expense	1.01%	0.91%	1.11%	1.53%	0.86%	1.12%
Other expense	0.18%	0.17%	0.13%	0.30%	0.23%	0.17%
Other income	-0.12%	-0.08%	-0.16%	-0.09%	-0.05%	-0.04%
Total other expense (income)	1.06%	0.99%	1.07%	1.73%	1.04%	1.25%
Earnings before income taxes	8.41%	9.82%	9.77%	9.81%	8.46%	7.86%
Income taxes	3.00%	3.55%	3.57%	3.52%	2.98%	3.09%
Net earnings	5.41%	6.27%	6.20%	6.29%	5.47%	4.78%

Exhibit 2: Mohawk Industries, Inc. Common Size Balance Sheet
(In thousands, except per share data)

ASSETS	2005	2004	2003	2002	2001	2000
Current assets:						
Cash and cash equivalents	1.68%	0.00%	0.00%	0.00%	0.00%	0.00%
Receivables	10.62%	15.00%	13.77%	13.93%	22.89%	19.99%
Inventories	14.60%	23.12%	19.99%	18.85%	30.05%	32.00%
Prepaid expenses and other assets	1.76%	1.12%	1.03%	1.04%	1.41%	1.50%
Deferred income taxes	0.62%	1.26%	2.02%	2.28%	3.96%	3.70%
Total current assets	29.29%	40.50%	36.82%	36.10%	58.31%	57.19%
Property, plant and equipment, net	22.66%	20.56%	22.07%	23.78%	35.04%	36.21%
Goodwill	32.81%	31.28%	32.87%	35.52%	6.17%	6.26%
Trade-names	7.78%	6.18%	0.00%	0.00%	0.00%	0.00%
Other intangible assets	6.91%	1.14%	7.81%	4.08%	0.00%	0.00%
Other assets	0.55%	0.33%	0.41%	0.52%	0.47%	0.34%
Total Assets	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
LIABILITIES AND STOCKHOLDERS' EQUITY						
Current liabilities:						
Current portion of long-term debt	1.42%	4.35%	5.98%	0.76%	8.95%	12.50%
Accounts payable and accrued expenses	12.49%	14.15%	15.32%	17.52%	23.95%	20.90%
Total current liabilities	13.91%	18.50%	21.30%	18.29%	32.90%	33.40%
Deferred income taxes	7.83%	4.36%	4.41%	4.06%	4.80%	4.22%
Long-term debt, less current portion	39.97%	15.90%	18.34%	22.05%	8.49%	20.35%
Other long-term liabilities	0.40%	0.70%	0.76%	0.48%	0.17%	0.01%
Total Liabilities	62.12%	39.44%	44.81%	44.87%	46.36%	57.98%
Stockholders' equity: (see yearly notes in Annual Reports)						
Common stock	0.00%	0.00%	0.00%	0.00%	0.03%	0.03%
Additional paid-in capital	14.06%	24.04%	24.88%	27.99%	11.15%	10.21%
Retained earnings	28.39%	43.39%	37.03%	34.24%	53.56%	42.25%
Accumulated other comprehensive loss	-0.59%	-0.06%	0.06%	0.03%	-0.16%	0.00%
Less treasury stock	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total stockholders' equity	37.88%	60.56%	55.19%	55.13%	53.64%	42.02%
Total Liabilities and Stockholder Equity	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

TIMKO EXPORT MANAGEMENT COMPANY: THE DYNAMICS OF INTERNATIONAL ENTREPRENEURSHIP

Andrew Thomas, The University of Akron
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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.

INSTRUCTORS' NOTES

Recommendations for Teaching Approaches

The case can be used in undergraduate or graduate small business, entrepreneurship, international business, and strategic management courses. Students should find the case fascinating due to the focus on the motorcycle industry and the international dynamics involved in the startup and growth of a small business doing business throughout the world. Students should have knowledge of international business and currency risks associated with doing business internationally.

This case is especially valuable due to the growth of emerging economies around the world. It gives students an opportunity to see the risks that are associated with going international.

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TEACHING QUESTIONS/PLAN

The following questions were developed to assist students in learning about the various aspects of the case. The assignment of the case and these questions is estimated to take students a minimum of five hours.

1. The owners took a calculated risk when they set up the payment structure for their business. Why did it succeed initially? Why did it ultimately fail?
2. Together, the owners of Timko Export Management Company had the following assets: cash, experience, and education. What didn't they have, which may have prevented their mistakes?
3. What strategies could Timko have put in place to hedge the potentially damaging effects of rapid or drastic currency value fluctuations within international financial markets?
4. Conduct a SWOT analyses of the Timko's position in the motorcycle market in 1992 and 1997. Do any of the 1992 points remain relevant in 1997?
5. In Behaving Badly: Ethical Lessons from ENRON, Denis Collins provides an ethics decision making framework. The full framework consists of six questions, but ultimately an ethical decision comes down to the answers to two questions:

- *Is the action for the greatest good of the greatest number of people affected by it?*
- *Are the motives behind the action based on truthfulness and respect/integrity toward each stakeholder? (You will need to consider all the people affected by the decision.)*

According to Collins, if the answers to both questions are "yes" then taking this action is the <u>most</u> ethical decision. If the answers to both questions are "no" then taking this action is the <u>least</u> ethical decision. If the answers to both questions are mixed, then taking this action is <u>moderately</u> ethical and you may have to consider legal, social, and personal affects.
Discuss each of the following decisions made by the Timko partners in terms of Collins' ethical decision making framework:

(a) Selling motorcycles in Argentina which the Japanese OEM designed, built, and intended for sale in the U.S. market.
(b) Selling motorcycles in Argentina for 200 percent to 300 percent over MSRP.
(c) Salvaging the value of motorcycles intended for customers in Mexico by selling them instead to customers in Africa.
(d) Continuing to incur expenses appropriate for a $127 million business in the face of an economic crisis created by unstable currency valuations.
(e) Establishing a payment structure that required distributors (buyers) to put down only 50 percent of the value of what they purchased.

6. What should Timko do now? Why?

1. The owners took a calculated risk when they set up the payment structure for their business. Why did it succeed initially? Why did it ultimately fail?

The payment structure succeeded initially because of several reasons:

- ♦ Based on previous ventures in South America, Wilson and Richards were flush with cash. Selling product at 200 percent to 300 percent of the MSRP allowed the partners to create enormous cash flow in a short period of time.
- ♦ Either because the Japanese OEM did not know or did not care that Wilson and Richards were selling product meant for the U.S. market in South America, there was no interference in the deal.
- ♦ Coincidentally, the Japanese motorcycle manufacturers had also turned their attention to the manufacture of cars and other electronic products. Apparently, they did not notice demand characteristics in South America and elsewhere around the world. Wilson and Richards were "in the right place at the right time."

- ♦ Stability of the currency in the South American markets combined with a pent up demand (recently unleashed by government policy in South America) for Japanese motorcycles created an engine of demand the partners exploited.

The payment structure ultimately failed because:

- ♦ The currency crisis in Asia choked off the ability of distributors and ultimate retail customers throughout the Timko network to afford the Jaiek motorcycles.
- ♦ Cash flow for Timko dried up when the cash sent to China did not release the bikes necessary to keep the business model going.
- ♦ There was an over-dependence on the sustainability of long cash-to-cash cycle times. Expenses continue to mount during the three to six months that cash is tied up in the next purchase cycle under the unusual payment structure. Unmet obligations put pressure on the partners which they could not meet.

2. Together, the owners of Timko Export Management Company had the following assets: cash, experience, and education. What didn't they have, which may have prevented their mistakes?

Wilson and Richards lacked knowledge of foreign currency markets, the time value of money, and the ability to stay focused on effective business management.

The partners had little interest in or knowledge of international currency markets. Even though they had found an imaginative way out of the collapse of the Mexican peso by shifting sales to another currency, they did not learn from that experience. The broad lesson to be learned was that currency is like any other commodity in that it has value relative to other commodities. Even if they had been savvy enough to put hedge strategies in place to mitigate potential currency fluctuations, they may have missed the difference in the second crisis.

The second crisis involved the currency of their manufacturing partner in China. Labor is paid and materials are procured in local currency, which with the devaluation, meant that cash for the Chinese manufacturer could not cover those additional costs. In 1993 the problem had been on the demand side which could relatively easily be remedied by shifting to currency that was more stable and where demand was roughly equivalent: Africa. In 1997 the currency shift meant that the source of supply would be cut off.

Wilson and Richards also lacked knowledge of the time value of money. When the partners extended themselves to cover 50 percent of the cost of the motorcycles they bought from China, they did not see that for what it was: an interest free loan to their distributors in South America and Africa. Even though they knew demand was high in the selling markets, they assumed distributors would not be willing to put down the full value of the motorcycle 6 months in advance of delivery. They assumed demand needed to be propped up by no-interest loans they provided to their distributors. This assumption never required testing because of the buffer in cash reserves and the partners' lack of understanding that their cash was not working for them in the transactions.

Finally, the partners seem to be unaware of erosions in their own business plan as reflected in their financial statements of the time. These are two men who make decisions based on how much money is in the checkbook today – an ironic result of too much success early on. It might be too much to expect them to assess trends in the financial condition of their business.

At the very time that the business was reaching its zenith in terms of top line sales and bottom line profits, gross margins were eroding significantly. Between 1992 and 1994, gross profit as a percent of sales (gross profit margin) went from 44 percent to 48 percent. But the margin dropped to 41 percent in 1995 and dropped again in 1996 to 38 percent. The cost of travel and offering free use of cash for distributors began to eat away at profits internally. These are fundamental warning signs that executives with less hubris would be paying attention to.

Further, while the increase in sales from 1994 to 1995 is impressive (up 74 percent) the increase in operating expenses over that same period (70 percent) almost entirely offset the revenue generating potential the company was building at the time. Sales were going up but at a high cost.

Finally, once the issue of how serious the financial meltdown in Asia had become, the partners apparently did not take enough cost cutting action to make any significant difference. Sales declined 58 percent from 1996 to 1997 while expenses went down only 4 percent. The partners may have missed the looming crisis, but they had 6 months in 1997 to offset some of their losses by making cuts in operating expenses. Both travel and employee wages went up during the year over the previous year.

3. What strategies could Timko have put in place to hedge the potentially damaging effects of rapid or drastic currency value fluctuations international financial markets?

Timko could have hedged its transaction exposure through the use of various financial contracts. Two of the popular methods are forward market hedging and money market hedging.

Strategy	Transactions	Outcomes
Forward market hedge (the firm sells its foreign currency receivables forward to eliminate foreign exchange exposure	1.Sell foreign currency accounts receivable forward for U.S. dollars at the forward exchange rate. 2.On payment date, receive payment in foreign currency and deliver it to the counter party of the forward contract.	Assured of receiving monies in U.S. dollars on payment due date, future spot exchange becomes irrelevant – eliminating transaction exposure.
Money market hedge	3.Borrow in foreign currency today the discounted sum of the foreign currency receivable in the future. 4.With proceeds, buy U.S. dollars on the spot now. 4.Lend forward U.S. dollars in time to coincide with timing of collection of receivable at current money market rates. 5.On due date of the receivable, collect payment from buyer and pay of foreign currency loan.	Assured of receiving the discounted receivable amount now in U.S. dollars or the full value at the time of the payment; future spot exchange rate becomes irrelevant – eliminating transaction exposure.
Adapted from Madura, Jeff (2003)		

Timko could have billed foreign importers in their own currency, with the exchange rate set at time of shipment. This approach exposes Timko to currency exchange risk rather than credit risk. Timko did try to shift this exposure (currency exchange risk) to the buyer by billing with terms for payment in U.S. dollars (operational hedging). If the currency devaluation occurred before the payment date, the possible collection may become a mute issue. For example, if the home (foreign) currency was devalued by 50%, the devaluation would double the payable (receivable for Timko) of the foreign company, a very substantial increase that few firms could absorb.

Timko could have hedged its transaction exposure through the use of various financial contracts. Some of the popular methods are: (1) forward market hedging, (2) money market hedging, and (3) swap market hedging. (Note: although a possibility, swap market hedging is usually available only to large Multi-National Corporations because of the customization, the timing, and the size of the various contracts). An underlying premise of the above hedging techniques is that there are existing markets for the currencies of interest and thus, can be easily executed by a firm to manage its transaction exposure. However, if a firm is transacting in minor currencies such as the Korean Won or the Thai Bhat, it may be either very costly or impossible to use financial contracts in these currencies (Stetz, Finkle, and O'Neil, 2008).

Aggarwal and Demasky (1997) suggest that various exchange rates are highly correlated. For example, the Yen/Dollar exchange rate is highly correlated with the

Won/Dollar exchange rate. As a result, if Timko wanted to manage its currency exposure, it might want to consider cross-hedging techniques which involve hedging a position in one currency versus another (Madura, 2003). Thus, Timko could sell an amount of Yen forward against the Dollar thereby cross-hedging its Won exposure (equivalent to Timko's Won receivable).

4. Conduct a SWOT analyses of the Timko's position in the motorcycle market in 1992 and 1997. Do any of the 1992 points remain relevant in 1997?

SWOT Elements	1992	1997
Strengths	♦ Management experience in international trade ♦ Management fluency in Spanish ♦ Ready cash brought to the partnership from previous ventures ♦ Vision to take advantage of market opportunities in narrow niches	♦ Management experience in international trade
Weaknesses	♦ Lack of appreciation of the critical role international currency plays in ventures like TimkoLong cycle cash flow drains in the procurement and delivery cycle of the business ♦ Lack of basic financial management ability and paying attention to the nuts and bolts of running a business ♦ Lack of a coherent business plan	ack of basic financial management ability and paying attention to the nuts and bolts of running a business ♦ Lack of focus on international financial market shifts and trends ♦ Management hubris and lack of ability to learn from previous failures ♦ Long cycle cash flow drains in the procurement and delivery cycle of the business ♦ Lack of a coherent business plan

SWOT Elements	1992	1997
Opportunities	Pent up demand in Argentina for high-end Japanese motorcycles ♦ Easing of government restrictions on imports ♦ Lack of an existing Argentine dealership network ♦ Easy availability of Japanese motorcycles in the U.S. dealer network ♦ No enforcement by Japanese motorcycle OEMs on the re-selling of motorcycles intended for the American market ♦ Growing worldwide demand for low-end motorcycles used as a primary means of transport in developing countries ♦ The existence of motorcycle manufacturing companies in China ♦ Relative economic stability in Latin American markets ♦ The exit of Japanese motorcycle manufacturing companies from the low-end market	♦ Growing worldwide demand for low-end motorcycles used as a primary means of transport in developing countries ♦ The existence of motorcycle manufacturing companies in China
Threats	♦ The low-end market is largely in developing countries with less stable currencies ♦ The manufacturer of motorcycles Timko would sell was also located in a developing country surrounded by other countries with unstable currencies	♦ The low-end market is largely in developing countries with less stable currencies

5. In Behaving Badly: Ethical Lessons from ENRON, Denis Collins provides an ethics decision making framework. The full framework consists of six questions, but ultimately an ethical decision comes down to the answers to two questions:

a. ***Is the action for the greatest good of the greatest number of people affected by it?***

b. Are the motives behind the action based on truthfulness and respect/integrity toward each stakeholder? (you will need to consider all the people affected by the decision)

According to Collins, if the answers to both questions are "yes" then taking this action is the most ethical decision. If the answers to both questions are "no" then taking this action is the least ethical decision. If the answers to both questions are mixed, then

taking this action is <u>moderately</u> ethical and you may have to consider legal, social, and personal affects.

Discuss each of the following decisions made by the Timko partners in terms of Collins' ethical decision making framework:

(a) Selling motorcycles in Argentina which the Japanese OEM designed, built, and intended for sale in the U.S. market.

The people affected by this decision include Timko, Argentine distributors, Argentine retail customers, and the Japanese OEM.

Clearly, Timko and the Argentine distributors benefited from this decision. Argentine retail customers got the motorcycles they demanded, but at prices beyond what those who were able to pay for a trip to the United States they often paid.

The Japanese OEM, however does not benefit from this decision. Basically, Timko cut out its trading partner's ability to access Argentine markets by taking motorcycles the OEM expected to sell in the U.S. for one price and reselling them in another market at a premium which the OEM did not enjoy. Even if the selling agreement with the Japanese manufacturer did not strictly prohibit further export of its bikes, Timko had an ethical responsibility to inform their trading partner as to what they planned to do. The obvious reason why Wilson and Richards did not make their intent known to the OEM was to keep the OEM from reaping any portion of the gain found in Argentina. Their motive was untruthful. This is not an ethical decision.

(b) Selling motorcycles in Argentina for 200 percent to 300 percent over MSRP.

The people affected by this action are the same as in (a) above and the ethical issues are an extension of the discussion in (a) above. Retail customers able to get to the U.S. were paying 30 percent to 40 percent over MSRP. By delivering the bikes directly to Argentina, Timko served a market that could not afford to travel to the U.S. Clearly, again, the distributors in Argentina and Timko benefited from this decision. The Japanese OEM did not benefit. Because the answer to question 1 is clearly no and the answer to question 2 may be disputed, this is a more unethical than ethical decision.

(c) Salvaging the value of motorcycles intended for customers in Mexico by selling them instead to customers in Africa.

The people involved in this action include Timko, the Chinese manufacturer, the distributors and retail customers in Mexico, and the distributors and retail customers in Africa.

The people in Africa got access to additional bikes beyond what they would have access to otherwise. Clearly, they benefit. The distributors and retail customers in Mexico, however, had a right to those bikes (they had put down at least 50 percent of the value with the order). The fact that the value of the peso declined did not mean they gave up their legal right to the bikes. Employees at Timko benefited because the company did not have to take a loss on the value of the bikes intended for Mexican customers. The Chinese manufacturer was not effected one way or the other since the bikes had already been sold to Timko.

This action is not in the greatest interest of all those involved (particularly Mexican customers) and was done without respect for the impact on Mexican customers. This is clearly an unethical decision.

(d) Continuing to incur expenses appropriate for a $127 million business in the face of an economic crisis created by unstable currency valuations.

The most significant group of people affected by this decision are the employees of Timko, though to the extent Timko's value chain (from suppliers to customers) is effected by the failure of the company, others are marginally involved.

The decision that Wilson and Richards made to continue to incur expenses may have been made in a desperate attempt to salvage the business model they had created. To the extent that is true, the answer to both questions is likely to be yes – Wilson and Richards attempted to preserve the business and the jobs of the greatest number of their employees.

However, the partners knew that there was a crisis in June 1997. There is no indication they significantly slowed their cash outlays during the last six months of that fiscal year. By the end of 1997 they were spending at a rate much more appropriate for a $100 million business than a $50 million business. Perhaps there is no ethical lapse here, but this is certainly an indication of bad judgment and poor business management sense.

(e) Establishing a payment structure that required distributors (buyers) to put down only 50 percent of the value of what they purchased.

The people affected by this decision include the Chinese manufacturer, Timko and its employees, and distributors. Retail customers are buffered from this decision by their transactional relationship with distributors.

Clearly, the distribution businesses benefit from this decision. They can order merchandise with half the risk of a regular deal. To the extent that the partners' belief of the need to fill the distribution pipeline was dependent on this kind of payment structure, Wilson and Richards were probably acting in the best interests of their company and its employees. After all, Timko took all the risk in this deal. There does not seem to be any lack of truth or integrity in the decision. Again, this is more of a bad business decision than one lacking an ethical basis.

6. What should Timko do now? Why?

As the Asian Flu of 1997 spread across all of Timko's customer base, the partners were confronted with what to do next. Unlike 1995, when they saved their business by entering the African market, there were no worlds left to conquer. The company, while still viable, was severely wounded by this second currency blow. Fear, uncertainty, and doubt within the company and amongst the partners were on the rise. Given the current state, options were few.

After carefully analyzing their precarious financial situation, the partners took stock of what they had, beyond the cost ratios and balance sheets. It occurred to them that the most valuable part of their business was in fact the relationships they enjoyed with their distributors around the world. Many of their customers were incredibly wealthy and some of the richest persons in their country. It was these relationships which had sustained the business through the good and bad times.

Initially, their Chinese manufacturing partner had little knowledge of who the local distributors were. The Chinese built the units for Timko and let them handle the rest. Timko also kept the Chinese at an arm's length when it came to the local markets. However, as the business evolved, the Chinese began to express more and more of an interest in the distributors.

In the midst of this second crisis, the partners began to formulate an exit strategy of the company, in which they would sell their interest to the Chinese, while continuing to export the Japanese motorcycles from Los Angeles. They calculated that their removal from the value chain would enable the Chinese to sell directly to the distributors at a lower price – and, therefore, lower the risk exposure in the market.

In early 1999, the partners traveled to China and began discussions about a buy-out. The Chinese were receptive and within a year the deal was done.

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EPILOGUE

The partners, faced with their second foreign currency crisis in less than two years, became more and more melancholy as time went by. They had made millions of dollars between them. Despite the current downturn in Southeast Asia and the threat to their business, the partners were not as stressed out as they might have been. Much of this was due to some big changes in each of their personal lives. Richards was going through his second divorce, a very difficult and ugly one. Wilson, who at this time was traveling more than 250 days per year, was exhausted. He was feeling increasingly detached from his wife and young son and his health was not very good. He decided to move to the Midwest to be closer to his family.

Without much debate and fanfare, the partners decided to wait out the "Asian Flu". They sat on the inventory, believing that the markets would eventually correct themselves. And they did. By mid-1999, orders from around the world began to flood in once again.

Beat-up and tired, the partners lacked the earlier enthusiasm to seize the initiative. Instead, they began talks with their Chinese partner to discuss a buy-out. Over the next six months, the negotiations intensified, and, by early 2000, a deal was reached. The partners cashed out and each went their separate ways. Richards remained in Southern California and continued operating his successful dealerships. Wilson did move to the Midwest, where he started a successful home-based management consulting firm, helping companies who want to take their firms global. Both partners walked away with enough money to gain them financial security for life.

AUTHORS' NOTE

The case is based on an actual company that was started and sold by one of the co-authors. All of the information is based on the facts as they actually happened, except for some of the financial information.

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.

INSTRUCTORS' NOTES

Recommendations for Teaching Approaches

The goal of this case is for Keels to develop a marketing plan that best matches customer demographics with magazine reader demographics by product line and increases the effectiveness of Cycle World's marketing budget. Students play the role of a media planner for Keels. This case is an integrated situation where technology (i.e., Excel) helps to provide an efficient solution for a marketing application using statistics. Specifically, it shows (1) descriptive statistics can be informative, but also has limits, (2) that some simple Excel features can help develop a better solution, (3) the importance of critical thinking when the problem is not well structured, which usually is the case in the real business world, (4) how business concepts (e.g., cost/benefit analysis) can impact the final managerial decision.

To illustrate the usefulness of descriptive statistics and critical thinking we recommend a four-stage solution process to this case. First, students develop a solution to the case without any statistical analysis. Second, students compute descriptive statistics for Cycle World's customers and have the opportunity to reconsider their original solution. However, this decision is likely to be based on one primary criterion (e.g., salary or fitness level) and depends on the student's individual preference. Third, students develop a solution while considering several criteria simultaneously. Fourth, students develop a solution that best matches customer demographics with magazine demographics and cost/benefit analysis is performed to offer a final managerial decision with a higher monetary value.

SOLUTIONS

Stage 1: Intuitive Solutions without Statistical Analysis

To solve the problem without any statistical analysis, students will only use magazine name information provided by Lance. Specifically, students have to search for magazines by their names; and only those magazines that have names related to cycling or sports get picked. This leads to the following magazine selection: Cycle time, Outdoor Fun, Runner's World, Sporting World, Sports Line, Today's Cyclist and Who's Hot Sports, as listed in Figure 1.

Figure 1: Magazine List

Magazine	Age	%Male	Education	Salary	Level
Cycle Time	29	65	BA	60	5
Outdoor Fun	27	55	HS/BA	30	3
Runners' World	43	70	BA	38	5
Sporting World	28	52	HS/BA	31	4
Sports Line	35	76	HS	28	4
Today's Cyclist	25	10	HS	22	2
Who's Hot Sports	25	80	HS	22	3

Because Cycle World asks to select two magazines per product line: novice, intermediate and advanced, students will drop one magazine from further consideration, most likely again based upon magazine's name. Once the six magazines are decided, students may assign them to three product lines based on salary or fitness level information. For example, if we drop Who's Hot Sports from further consideration and if salary is considered an important factor to influence customer's purchasing decision among the three product lines, *Cycle Time* and *Runner's World* will be selected for novice product line, *Outdoor Fun* and *Sporting World* for intermediate and *Sports Line* and *Today's Cyclist* for advanced.

Note that student's selection of target magazines may vary depending on personal preference. However, the major drawback of this solution is that it is subjective and does not utilize any of the demographic information.

Stage 2: Solutions Using Descriptive Statistics with Excel

From the previous stage, students should see the needs of statistical analysis in order to understand customer better. In this stage, we introduce simple descriptive statistics: sample mean, standard deviation and proportion, and discuss their use in analyzing customer demographics.

First, we study customer demographics by product line using mean and standard deviation. Second, we show that the pivot table feature in Excel can compute both statistics by product line and automatically provides a side-by-side comparison among the three. Moreover, using pivot table here eliminates the need of manually typing functions such as *"average"* and *"stdev."* Figure 2 shows the results of pivot table and Appendix I shows how to obtain such a pivot table.

Figure 2: Pivot Table for Characteristics of Customers

	Product		
Data	Novice	Intermediate	Advanced
Average of Age	28.6	29.4	29.2
StdDev of Age	7.3	6.8	7.0
Average of Education	3.5	3.6	4.2
Average of Income	$30,700	$32,967	$50,103
StdDev of Income	$7,963	$7,727	$14,947
Average of Times/wk	3.0	2.9	4.4
Average of Miles/wk	88.0	83.3	168.5
Average of Fitness	3.0	2.8	4.7
Number of Customers	80	61	39
% of Sample	44%	34%	22%

Notice that Figure 2 does not contain the variable "Gender." This gives us an opportunity to introduce and discuss differences between quantitative and qualitative variables. Third, we show that pivot table in Excel can compute percentages for qualitative variables. Figure 3 shows the percentages of male and female customers by product line. Without pivot table, students will have to manually count the number of male and female customers for each product line (or use *"count"* function along with some simple filtering for each product line) and then calculate respective percentages.

Figure 3: Pivot Table for Percentages of Male and Female Customers

Count of Gender	Product			
Gender	Novice	Intermediate	Advanced	Grand Total
male	55.00%	50.82%	79.49%	58.89%
female	45.00%	49.18%	20.51%	41.11%
Grand Total	100.00%	100.00%	100.00%	100.00%

At this point, students comment on customer demographics by product line using the information in Figures 2 and 3. They should observe that the novice and intermediate product lines have similar demographics. Thus, combining these two product lines for advertising purposes will increase the effectiveness of Cycle World's advertising budget. This shows the usefulness of statistical analysis in reducing expenses.

Now our target is to find two common magazines for the combined novice and intermediate product lines, and two magazines for advanced product line. For illustration purposes, our following presentation focuses on novice and intermediate product lines only. From Figures 2 and 3, the key statistics we use in our search are: (1) average age is between 28 and 30, (2) average salary is between $30,000 and $33,000, (3) average fitness level is between 2.5 and 3, (4) average education is between 3 and 4, and (5) the percentage of male customers is between 50% and 55%.

Using "age" as the primary criterion leads to magazines in Figure 4. When applying the secondary criterion of "salary," the target magazines reduce to those in Figure 5. Notice that the only magazine that satisfies all 5 criteria is *Family Living*. Figures 4 and 5 are created using the *AutoFilter* feature in Excel. Appendix III shows how to use the *Autofilter* feature.

Figure 4: Magazines with "Age" between 28 and 30.

Magazine	Age	%Male	Education	Salary	Level
Bus World	30	70	BA	50	4
Creative projects	28	20	HS/BA	32	4
Cycle Time	29	65	BA	60	5
Family Living	30	55	HS/BA	31	3
parent's Digest	28	50	HS/BA	29	2
Software Review	28	60	BA	48	4
Sporting World	28	52	HS/BA	31	4
Who' Hot Movies	29	45	HS/BA	29	2
Woman's World Today	28	10	BA	34	3

Figure 5: Magazines with "Age" between 28 and 30 and "Salary" between 30 and 33.

Magazine	Age	%Male	Education	Salary	Level
Creative projects	28	20	HS/BA	32	4
Family Living	30	55	HS/BA	31	3
Sporting World	28	52	HS/BA	31	4

This solution is better than Stage 1 because it uses customer information. However, it does not use the variability information, i.e., standard deviation, for any of the variables involved. Moreover, this solution procedure is quite subjective. For instance, the average ages for novice and intermediate bicycles are 28.6 and 29.4, respectively. Thus, we arbitrarily set our search criterion for "Age" to be between 28 and 30. In next stage, we use standard deviation to create search ranges, which greatly reduces the subjectiveness of the solution.

Stage 3: A Better Solution Using Descriptive Statistics, Search Intervals & Excel

In the first step of this stage, we develop search ranges using means and standard deviations. Although using customer demographic means helps us conclude that two of the product lines have similar demographics, they are less useful in helping find magazine matches in a subjective manner. Thus, we create ranges for variables: age, income, education level, fitness level and percentage of male customers. Intervals within one standard deviation are used for applicable variables, as shown in Figure 6. We should also note to students that one can always widen (narrow) the range to obtain more (fewer) matches.

Figure 6: Search Ranges for the Novice and Intermediate Product Lines			
Variable	**Average**	**Standard Deviation**	**The Search Range**
Age	28.6	7.3	29±7=[22,36]
Income	30,700	7,963	31,000±8,000=[23,000, 39,000]
Education	3.5	N/A	Higher than high school
Fitness	3.0	N/A	2 or 3
% Male	55%	5%*	55%±5%=[50%,60%]
*The standard deviation is calculated as the square root of *p(1-p)/n*.			

Since information on "Average times per week" and "Average miles per week" is not available for magazines, we drop them from further analysis. The main idea of creating ranges for the variables is for students to understand that using a range makes use of its mean and its variability.

We use a similar process to create ranges for the advanced product line as shown in Figure 7. Note that to determine the search range for "% of Male," using the mean and standard deviation from the customer demographics leads to interval [77%, 83%]. However, looking at the magazine data, the maximum "% of Male" for all magazines is only 69%, thus using [77%, 83%] will not produce any matching results. Alternatively, we set the lower limit of the search range to be the 95th percentile of "% of Male" for all magazines, 65%, and the upper limit to be the maximum, 70%.

In the second step of stage 3, we find target magazines for the combined product lines (novice and intermediate) by using the search ranges in Figure 6 and Excel's *advanced data filtering*. Excel's *advanced data filtering* allows users to define some criteria and then it searches a database looking for records that meet the user defined criteria. First, as shown in Figure 8, we enter variable names in cell range H7:P7, then lower and upper limits in cell range H8:P8. For instance, the range for age is between 22 and 36. Thus, we type Age in Cells H7 and I7, and define the lower limit in cell H8 as ">=22" and the upper limit in cell I8 as "<=36." We use a similar process for other variables. The criterion for Education in Figure 6 is "higher than HS," and is defined as "<>HS" in Figure 8 because it is of string type. Using "<>HS" includes all BA or BA related education levels. Finally, we name range H7:P8 as "SearchRangeNI" to simplify future reference. Figure 8 shows the entire search criteria for all variables.

Figure 7: Search Ranges for the Advanced Product Lines			
Variable	**Average**	**Standard Deviation**	**Search Range**
Age	29.2	7.0	29±7=[22,36]
Income	50,103	14,947	50,000±15,000=[35,000, 65,000]
Education	4.2	N/A	At least bachelor degree
Fitness	4.7	N/A	4 or 5
% Male	80%	3% *	80%±3%=[77%,83%], changed to [65%,70%]
*This is calculated as the square root of *p(1-p)/n*.			

Figure 8: Defining Filtering Criteria for the Novice and Intermediate Product Lines

	A	H	I	J	K	L	M	N	O	P
1	**Magazine**									
3	Fashion Flair	Product								
4	Today's Cyclist	Novice								
5	Country Cookin	Intermediate								
6	Creative projects	Criteria (Novice & Intermediate)								
7	Who Hot Music	Age	Age	%Male	%Male	Education	Salary	Salary	Level	Level
8	CHinese Cooking	>=22	<=36	>=50	<=60	<>HS	>=23	<=39	>=2	<=3

Second, select *Data > Filter > Advanced Filter* in Excel and a window like Figure 9 will appear. Fill out the three ranges: *List range* is where the original database is stored and in our case it is A1:F31, which we name as "MagazineData" previously; *Criteria range* is where the searching criteria is defined and in our case it is range "SearchRangeNI" as defined above; *Copy to* is where Excel will put the results and in our case it is cell H10, which we name as "ResultsNI" previously. Click OK, searching results will show as in Figure 10. Excel finds three magazines: *Parent's Digest*, *Family Living* and *Outdoor Fun*. Likewise, after defining search ranges shown in Figure 11 for the advanced line, Excel finds that *Business World*, *Cycle Time* and *Software Review* are good matches.

Figure 9: Advanced Filter

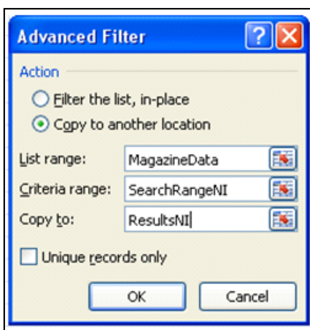


Figure 10: Magazine Search Results: Novice & Intermediate Product Lines

Product								
Novice								
Intermediate								
Criteria (Novice & Intermediate)								
Age	Age	%Male	%Male	Education	Salary	Salary	Level	Level
>=22	<=36	>=50	<=60	<>HS	>=23	<=39	>=2	<=3
Magazine	**Age**	**%Male**	**Education**	**Salary**	**Level**			
Parent's Digest	28	50	HS/BA	29	2			
Family Living	30	55	HS/BA	31	3			
Outdoor Fun	27	55	HS/BA	30	3			

Figure11: Defining Filtering Criteria for the Advance Product Lines

Product							
Advanced							
Criteria (Advanced)							
Age	Age	%Male	%Male	Education	Salary	Salary	Level
>=22	<=36	>=65	<=70	BA	>=35	<=65	>=4
Magazine	**Age**	**%Male**	**Education**	**Salary**	**Level**		
Software Review	28	70	BA	48	4		
Cycle Time	29	65	BA	60	5		
Bus World	30	70	BA	50	4		

To extend class discussion, we perform sensitivity analysis by varying the search ranges. For instance, in the case of the novice and intermediate product lines, one may argue that setting the range for percentage of male customers to be [50%, 60%] could lose sales when female subscribers may initiate a family exercise campaign for their own fitness goals. Therefore, we can expand the search range to [40%, 60%], which leads to inclusion of two additional magazines: Today's Home Video and Who's Hot Movies.

Stage 4: A Best Solution with Cost/Benefit Analysis

This is an advanced solution where students are challenged to further improve their solution from Stage 3, paying special attention to business aspects such as cost/benefit analysis. We recommend using this stage as a group homework assignment to encourage discussions and creativity in a team problem-solving environment.

Because the problem essentially is to select the best magazine outlets for advertising products, it is natural to choose magazines with high circulation volume while keeping the cost as low as possible. We use the "People/$" ratio, i.e., (Circulation Volume/Cost per issue), to represent the number of potential customers for every dollar we spend. For instance, *Cycle Time* has a circulation volume of 790,000 at a rate of $34,500 per issue for a 1/3 page of black and white advertisement. The ratio (790000/34500) is approximately 23 potential customers per dollar spent. Figure 12 shows the comparison on the "People/$" ratio for the six magazines suggested in Stage 3. Notice that even though *Business World* has the highest circulation volume compared to *Cycle Time* and *Software Review*, its "People/$" ratio is the lowest among the three magazines. Additionally, *Outdoor Fun* and *Parent's Digest* have the same ratio although their advertising rates and circulation volumes are quite different.

Figure 12 shows that it is best to choose *Software Review* and *Cycle Time* for the advanced product line. Additionally, it shows that for the novice and intermediate line, however, two alternatives are available as *Outdoor Fun* and *Parent's Digest* tie on the "People/$" ratio. If Cycle World wishes to spend more to reach more potential customers, they may choose *Family Living* and *Parent's Digest*; however, if Cycle World prefers a low cost solution, choosing *Family Living* and *Outdoor Fun* is a good alternative as well.

Figure 12: Circulation Cost Ratios for Six Magazines

Magazine	Ciculation	Ads Price/Issue	People/$
Family Living	1,210,000	$39,400	31
Outdoor Fun	940,000	$35,100	27
Parent's Digest	1,050,000	$38,900	27
Bus World	820,000	$36,900	22
Cycle Time	790,000	$34,500	23
Software Review	750,000	$31,900	24

Keels Recommendation to Cycle World

Acting as a media planner for Keels, students should make the following recommendations to Cycle World: (1) combine the advertising budget for their novice and intermediate product lines and place ads in *Family Living* and *Outdoor Fun* under Plan A, or place ads in *Family Living* and *Parent's Digest* under Plan B and (2) place ads for their advanced product line in *Software Review* and *Cycle Time* under both plans. The total annual advertising expenditure will be $845,400 for Plan A, or $868,200 for Plan B. Both plans cost well below the total budgeted amount $1,500,000, attributing to combining ads for novice and intermediate product lines. If this combination was not adopted, the total advertising costs would have been $1,292,400 and $1,338,000 for Plans A and B, respectively. Thus, the total savings amount to $447,000 and $469,800 for Plans A and B, respectively. Remaining funds can be used to pay for other promotional activities or use elsewhere.

APPENDIX I: FIGURE 2 PIVOT TABLE INSTRUCTIONS

To create the pivot table in Figure 2, first highlight the cell range A2:I181 on the customer spreadsheet, previously named as "CustomerData," as shown in Figure 13; then select *Data > Pivot Table and Pivot Chart Report*. Figure 14 shows step 1 of creating a pivot table. In this step specify that the data is from a Microsoft Excel list and that a pivot table is to be created. Figure 15 shows steps 2 and 3. In Step 2 the cell range of the original database will appear as "CustomerData", click *next*. In Step 3 request to put the pivot table on a new worksheet and click *finish*.

Figure 13: Customer Database Stored in A2:I181 (with some data hidden due to space limit)

	A	B	C	D	E	F	G	H	I
1	Product	Age	Gender	Education	marital	Income	Times/wk	Miles/wk	Fitness
2	1	18	1	3	1	16000	4	120	4
3	1	19	1	3	1	18000	3	80	3
4	1	19	2	3	2	17000	2	70	3
5	1	19	1	2	1	19000	3	90	3
6	1	20	1	3	2	21000	2	50	2
7	1	20	2	3	2	19000	3	70	3
8	1	21	2	3	2	21000	3	80	3
9	1	21	1	3	1	19000	3	90	3
10	1	21	1	3	2	21000	5	150	4
11	1	21	2	3	2	23000	2	90	3
12	1	22	1	3	1	22000	3	90	3
170	3	30	1	5	2	63000	4	160	4
171	3	30	1	5	2	73000	5	150	5
172	3	31	1	4	2	70000	6	260	5
173	3	33	2	4	2	62000	4	200	5
174	3	34	1	4	1	67000	3	150	5
175	3	35	1	4	2	64000	4	360	5
176	3	38	1	5	2	64000	3	150	5
177	3	41	1	5	1	74000	6	200	5
178	3	42	1	4	2	57000	4	200	4
179	3	44	1	4	2	62000	4	160	5
180	3	47	1	4	2	63000	4	120	5
181	3	48	1	4	2	74000	4	180	5

Figure 14: Pivot Table-Step 1

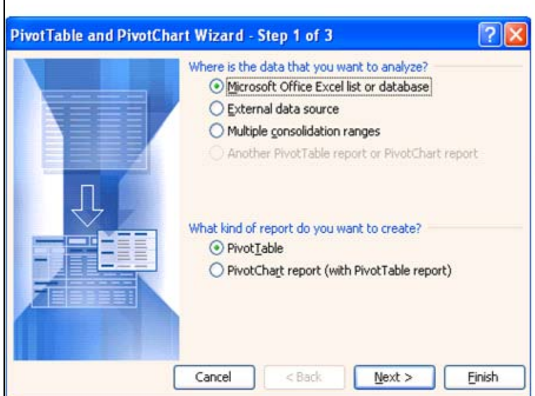
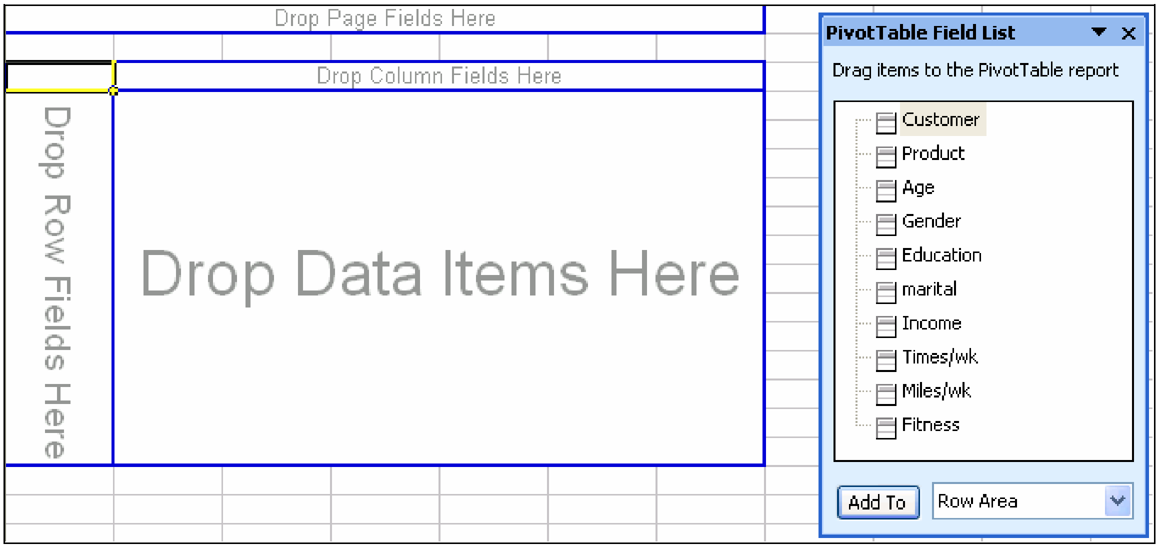


Figure 15: Pivot Table-Steps 2 & 3

After clicking finish in Step 3, a blank pivot table with an associated field list will appear on a new worksheet. Figure 16 shows the blank pivot table and field list.

Figure 16: Blank Pivot Table for Customer Data



To fill-in the blank pivot table, select *Product* from the field list and drag it into the column field area of the pivot table. Next, select the cell with the *Advanced* label, right click, then select *field settings > custom > advanced > descending* and click *OK* two times. Figure 17 shows the pivot table after completing these steps.

To compute the average of the customer ages, select *Age* from the field list and drag it into the data items area of the pivot table. By default, Excel will compute the sum of every variable placed in the data items area. To change the default statistic to average, right click the cell with the label *Sum of Age*, then select *field settings > average > OK*. Figure 18 shows how to calculate average age in the pivot table. To compute the standard deviation of the customer ages, select *Age* from the field list and drag it into the data items area of the pivot table. Again, by default Excel will compute the sum of the customer ages. To change the default statistic to standard deviation, right click the cell with the label *Sum of Age*, then select *field settings > StdDev > OK*. Follow a similar process to compute statistics for the other variables in Figure 2. For example, to compute average education, select *Education* from the field list and drag it into the data items area of the pivot table. Change the default statistic to average by right clicking the cell with the label *Sum of Education*, then select *field settings > average > OK*.

Finally, it is worth mentioning that the last two rows of Figure 2 are the number of customers and percentages of customers for each product line. To compute *number of customers* select *Customer* from the field list and drag it into the data items area of the pivot table. Change the default statistic to *Count* by right clicking the cell with the label *Sum of Count*, then select *field settings > count* and in the *name* field, change the name from *Count of Customer* to *Number of Customers,* and click *OK*. To compute *% of sample*, follow a similar process, that is, select *Customer* from the field list and drag it into the data items area of the pivot table. Change the default statistic to *% of Sample* by right clicking the cell with the label *Sum of Count*, then select *field settings > count > Options* and in the *show data as* area select *% of row*, then in the *name* field change the name from *Count of Customer* to *% of Sample* and click *OK*. Figure 19 shows the result for % of sample.

Figure 17: Dropping Product as a Column Field

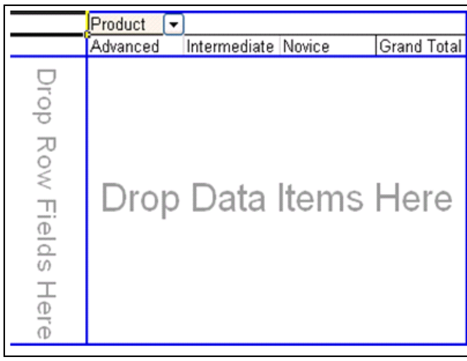


Figure 18: Calculating the Average Customer Age

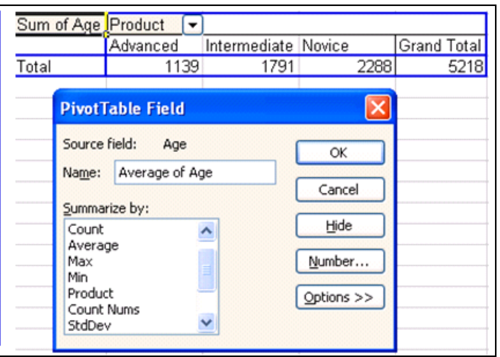
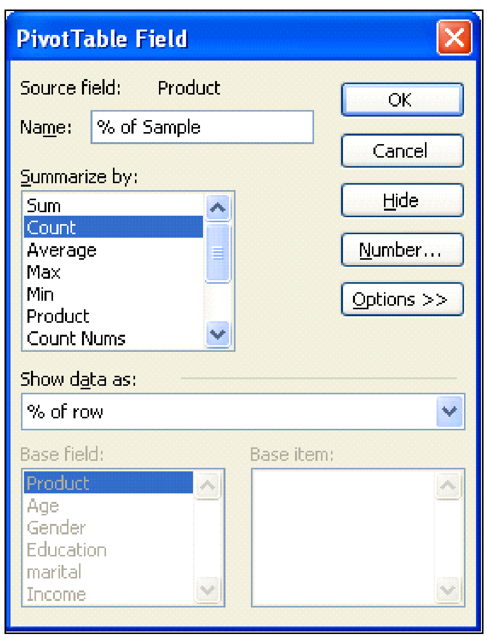


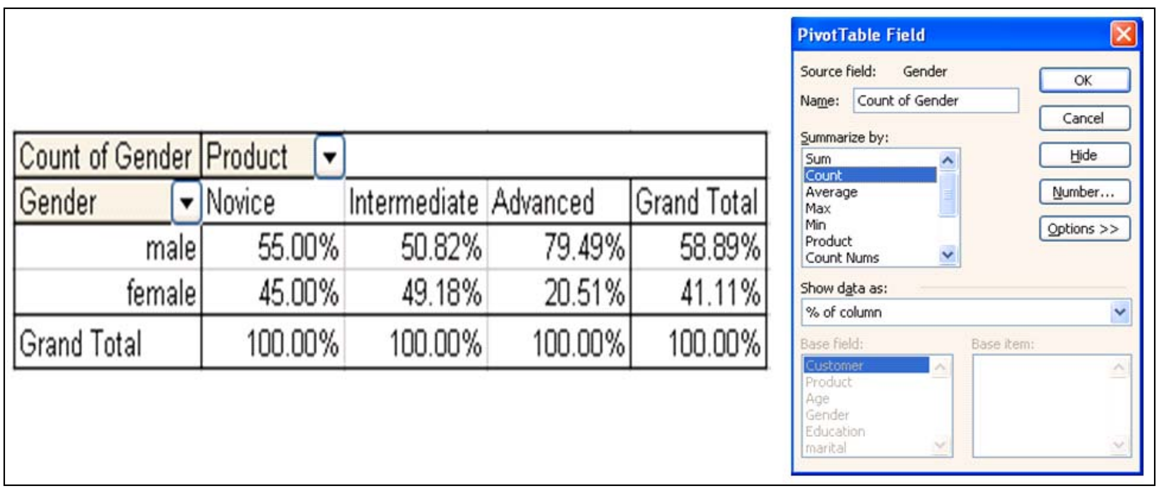
Figure 19: Calculating Percentages of Customers for Each Product Line



APPENDIX II: FIGURE 3 PIVOT TABLE INSTRUCTIONS

First, to compute the pivot table in Figure 3, see the directions contained in the first two paragraphs of appendix I. Second, select *Gender* from the field list and drag it into the row field area of the pivot table. Third, select *Gender* from the field list and drag it into the data items area of the pivot table. Fourth, right click the cell with the label *Sum of Gender*, then select *count > options* and in the *show data as* area select *% of column* and click *OK*. The original database is coded so that 1 is equal to male and 2 is equal to female. To make the pivot table more readable, right click the cell with the 1 label, select *field settings* and in the name area enter *male*, and click *OK*. Note that in order to calculate the percentages of male and female customers for each product line, we drop Product into the column area and "Gender" twice into both the row and data areas. We then reformat the data field "Count of Gender" by right clicking the field, selecting the *field settings* and clicking the *Options* button and specifying "Show Data as % of Column." This process is illustrated in Figure 20.

Figure 20: Pivot Table for Percentages of Male and Female Customers



APPENDIX III:
INSTRUCTIONS ON USING AUTOFILTER IN EXCEL FOR FIGURES 4 AND 5

We apply the primary criterion: "Age" to be between 28 and 30, and secondary criterion: "Salary" to be between $30,000 and $33,000, to search for matching magazines. To use the *AutoFilter* feature in Excel, first select the range previously named "MagazineData" that contains all information on magazines including column headings, then go to *Data > Filter > AutoFilter* as shown in Figure 21, and make sure *AutoFilter* is checked. When the *AutoFilter* option is on, a dropdown menu will show for each column header as in Figure 22.

Figure 21: Locating AutoFilter in Excel

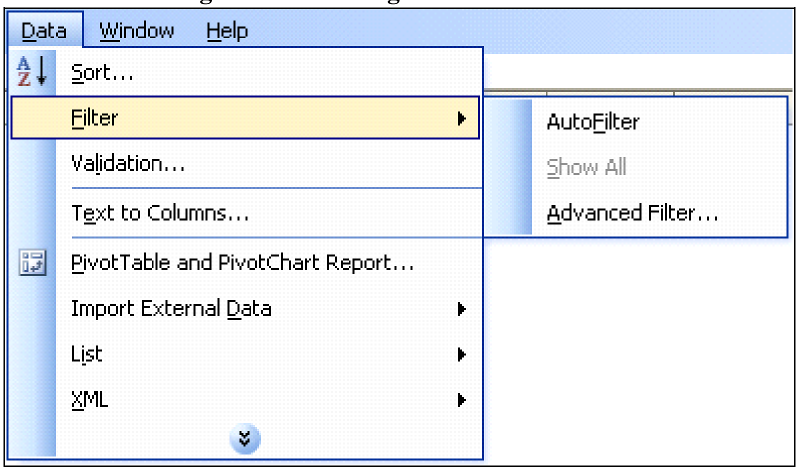
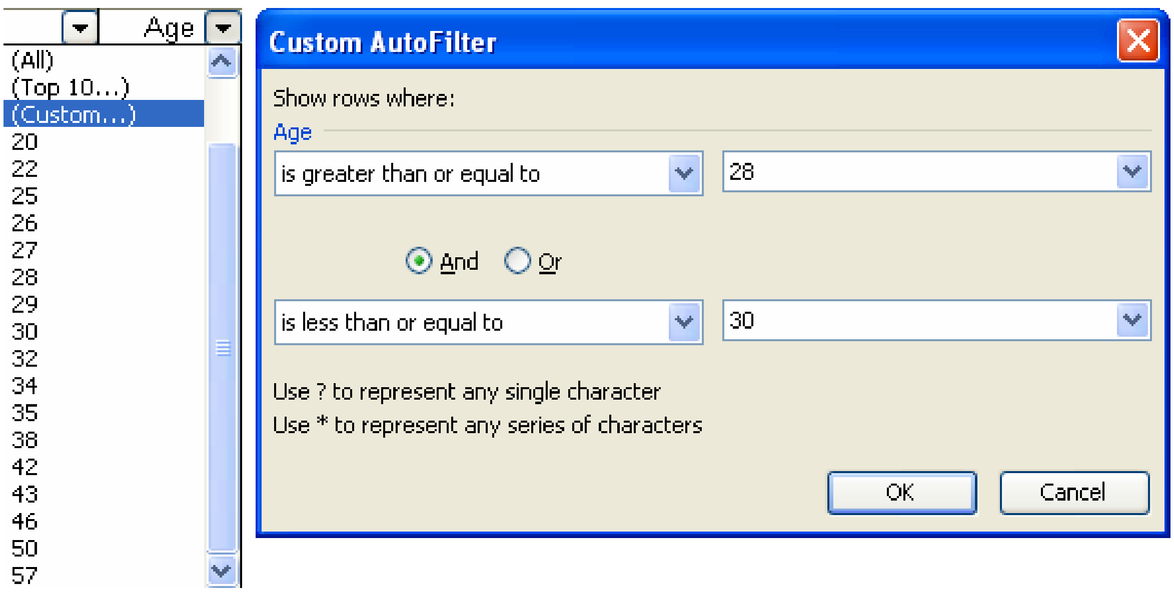


Figure 22: Dropdown Menu On for Each Column Header

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

Next, we input the two criteria for "Age" and "Salary" by clicking on their dropdown menus respectively. To specify the condition that age is between 28 and 30, click on the dropdown menu for "Age", choose *Custom* and enter the criteria as shown in Figure 23. This produces the 9 matching results in Figure 4. To further filter the magazines using the secondary condition on salary, follow a similar process from the dropdown menu for "Salary" with $30,000 and $33,000 as the lower and upper limits, respectively. Consequently, only three magazines as in Figure 5 satisfy both age and salary conditions.

Figure 23: Setting Criterion: Age to be between 28 and 30



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.

INSTRUCTORS' NOTES

Summary

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.

Target Audience and Purpose

This case is written primarily for an undergraduate audience, however, the case could be used in graduate courses as well. The case deals with cross-cultural issues and is appropriate for courses in cross-cultural management, international management, and international business. The case could also be found to be useful for courses in human resource management, and specific area studies. The case is written to show how a management style in one culture isn't necessarily successful in another culture. The case also shows the need for preparation for an international assignment. In particular, the case looks at specific aspects and nuances of Filipino culture.

ANALYSIS

Students are asked to answer four questions at the end of the case. Additional questions could be supplied by the instructor to supplement these four questions as deemed necessary.

1. What mistakes, if any, did Bill make in his management of the plant?

Bill made a number of mistakes in his management of AmeriTech in the Philippines. While an argument could be made to blame the company for sending an employee overseas with too little preparation, Bill did make the following blunders:

a. Failed to do necessary preparation for his assignment. By simply relying on the stories told by his uncle about his war experiences in the Philippines, Bill did not have any understanding and appreciation of Filipino culture. He did not have cultural awareness. This became obvious by the number of mistakes which will be discussed below, including his lack of understanding of the concept of pakikisama. Pakikisama is the Tagalog word for smooth personal relationships, especially in the workplace. It relates to the overall concept of group harmony, and requires some give and take in order to maintain cohesion in a group. It is an important Filipino cultural value.

b. His misinterpretation of the comments made by Millet and his reaction to her. In the Philippines it is not uncommon for people to ask, what may be considered personal questions. This is usually an attempt to get to know the other person better. Filipinos and Filipinas are very social people and like to establish social bonds with others. Whether or not Millet was making advances towards Bill is really unclear in the case, however, it is likely he overreacted to her questioning and teasing behavior. Teasing people, regardless of gender is not uncommon in the Philippines. Terminating her employment sent a strong message to the other employees and caused disharmony within the group. It also made Bill appear to be untrustworthy and unpredictable. In collectivistic societies, how one treats one member of the group could be interpreted as to how one would be treating the entire group.

c. Failure to establish social relations with employees. Similar to the problem with Millet, Bill did not do much to generate a social bond between him and the employees. The workplace is seen as a social institution in the Philippines, and a little sign of appreciation gones a long way towards increasing employee morale and happiness. It is not uncommon for employers to feed employees at times, and to show appreciation by having social outings for employees. Bill failed to understand the importance of these social interactions and his role in the process.

d. Failure to understand pakikisama. Closely related to the issue above, Bill did not understand the "unending chatting" and social interactions that he witnessed, and how important they are for employee morale. While these activities may seem like a waste of time to American managers, they are an important element of Filipino culture, and this part of culture does spill over into the workplace. This is not to say that Bill should expect low levels of productivity from his employees. A better approach would be to support the need for social interaction and to set group based performance goals, with appropriate rewards for the group. Bill needs to change the organizational culture, but he needs to do so slowly.

e. Causing employees to lose face. In Asia the loss of face, or esteem, is very serious. In collectivistic societies, losing face increases stress for those losing face. By calling out the names of the employees who failed to attend one of the meetings, Bill was causing those employees to lose face. Some of the employees may have had legitimate reasons for not attending, such as family responsibilities, which are very important in the Philippines. Not only did the employees lose face through this behavior, Bill himself lost face in the eyes of his employees.

f. Show of anger. In the Philippines, and throughout much of Asia, when someone shows anger, they show a human weakness. A premium is placed on being cool-headed, especially in terms of employee relations. His anger with Miguel, where he criticized him for not understanding profitability, was not only showing anger, but also causing Miguel to lose face as well.

g. The incentive plan. Bill's introduction of a complex incentive plan threatened the employees. Filipino employees, especially when working for a foreign company, expect a degree of job security and certain pay. The plan might also be interpreted as threatening the group's harmony. Such an incentive plan has the tendency to be rejected by group members, because they do not want to be stamped as traitors. The fact that a new program is being introduced by a person who, now is not be trusted, is reason for great concern. The timing of the program was also not ideal. With tensions already running high, additional stress for employees caused many of them to jump ship and find work elsewhere.

h. Not listening to Miguel. Miguel was assigned the task of providing Bill with help in understanding cultural differences. While an argument could be made concerning how well he did his job, Bill appeared not to be too receptive to suggestions, nor did he ask questions. In the Philippines, young subordinates give great deference to superiors, and Miguel may have been hesitant to offer advice, especially when it appeared that Bill wasn't open to this advice.

2. Was it necessary for Bill to change, in any way, in his new assignment in the Philippines? Explain.

A management style that works well in North Carolina may not work well everywhere. Bill needed to make a number of adjustments when he arrived in the Philippines. Many of these can be implied in the above answer. Bill needed to modify his management style to fit the culture. He needed to spend more time with social interactions, and act in a more paternal fashion. He needed to be more patient and accepting of cultural difference. Bill also needed to control his temper. Lastly, while his personal choice of dress may have been welcomed in North Carolina, in the Philippines dress is an important matter. While the case does not provide detail on how Bill appeared, it is important in the Philippines for managers look professional in the workplace. Otherwise Bill can indirectly manage the employees by appointing an influential in-group employee. Bill can use the in-group member to explain and convince the employees of his plans and decisions.

3. What is the significance of the nickname the employees gave to Bill?

Bill did not react well to the nickname given him by employees. In the United States one generally would not appreciate being referred to as a pig. In the Philippines, nicknames are common practice. While it could be that the employees assigned him that name because of his appearance, there could be other reasons for the name as well. A better response would be to laugh the matter off. Bill could in fact have won some favor with the employees by making fun of the fact that he had been given the name. Taking oneself too seriously in the Philippines isn't a good idea.

4. If you were advising Bill, what would you suggest?

While Bill is in trouble in his present assignment, it isn't hopeless. He will need to change his behavior and style of management in order to keep his position. Continuing with present management behavior will only result in continued failure to achieve the desired results. Miguel can be of assistance in helping Bill regain his moral authority in the company. First it will be necessary for Bill to improve his relationship with Miguel. An apology is in order. Bill will need to implement many of the suggestions implied in the previous answers. He will need to focus on rebuilding harmony within the organization. Although Miguel has his own problems with the employees, he is in a better position to reestablish trust. For example, Miguel could organize a social event in which employees are honored with a dinner, and Bill makes an apology to the entire group for his behavior. It is likely he will be given some allowances for cultural missteps by the group, especially if he is sincere in his approach. Bill needs to scrap the incentive system for the time being. His first priority is finding good employees to get the plant up and running at full capacity again. Group-based incentives, social recognition for the entire group, and a softer approach to management will go a long way towards achieving productivity gains. Bill has to realize that cultural values in the Philippines are quite different, and that his approach to managing workers will need to reflect those differences.

LEARNING POINTS

Globalization has increased the internationalization of firms' operation. Many firms in the world have increased their presence in other countries. In order to be successful, global managers should adapt their management styles to fit with the local cultural environment. The cultural environment consists of many factors that can influence an individual's perception and interpretation of many managerial, organizational, or social phenomena. Culture influences how an individual understands, and make sense of the environment.

a. Cultural awareness. Cultural awareness requires more than merely having cultural knowledge. More than sensitivity, cultural awareness leads to better understanding and appreciation of other cultures. Global managers with high cultural awareness are more open and willing to adjust their behaviors and attitudes to local cultural environments. This cultural awareness will facilitate and make the global managers more effective. The cultural awareness becomes more important as the magnitude of cultural differences or the exposure to the local culture increase. The development of cultural awareness requires global managers to have communication skills and cultural empathy.

The case shows that the problems Bill encountered originated from his lack of cultural awareness. Bill did not understand or appreciate how things work in the Philippines. He did not understand the collectivistic and paternalistic culture of the Filipinos. Thus, he failed to understand the importance of pakikisama. As a consequence, Bill misinterpreted the intention of Millets' personal questions and employee's unending chatting. Bill also did not understand how people in collectivistic society feel when they lose face and the consequence of showing anger on group harmony and the development of pakikisama.

b. Fitting performance management to the collectivistic culture. The case shows that Bill failed because he did not adjust his management techniques to fit with the collectivistic culture. He could have been more effective if he had chosen group-based performance enhancement techniques, appointed an in-group leader as his advisor or representative, or immersed himself in the culture.

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.

INSTRUCTORS' NOTES

Case Objectives and Use

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. Through the case, students can meet the following learning objectives.

- ♦ Identify the essential human resources considerations one encounters in small business management.
- ♦ Identify the appropriate steps that should be taken in the recruitment and employment of personnel.
- ♦ Determine constructive human resources actions that must be taken to keep the business operational.
- ♦ Detail the steps to be included in a discipline system appropriate for a small business.
- ♦ Gain insights into the unique human resources challenges facing family-owned and operated businesses.
- ♦ Understand and appreciate the importance of racial/cultural/ethnic sensitivity in relations with employees.

TEACHING PLAN

The case has been taught in a graduate human resources seminar. The approach utilized was to assign the case and questions to teams to review the case and prepare written analyses of the case. The teams were assigned the case at the end of class and presented their analyses the following week. The team presentations were limited to ten minutes; each team was assigned one of the first six questions to present. Following team presentations the entire class was permitted to offer additional comment on questions they did not present, and to jointly answer question seven regarding what else Kelly might have done to better manage the human resources issues in her business. In this way the discussion can be handled in a seventy-five minute class session.

Students were quite able to identify the major human resources issues in the case and were quick to grasp the broader considerations of diversity embedded in the case.

For graduate classes where not as much direction may be needed, question 6 might be dropped and incorporated into a more general question 7.

QUESTIONS AND ANSWERS

1. What are the human resources issues that Kelly faces in this case?

Multiple human resources issues arise as a result of the employees walking out.

a.. Employment-at-will: Texas, like many other states, is an at-will employment state, meaning that employees do not have a right-to-employment other than that granted to employees through contract (and the 26 exceptions to at-will employment provisions, mostly based in civil rights statutes).

b. Job abandonment: Under Texas statutes, an employee who leaves work and fails to return is given three days to appropriately notify the employer with regard to the employee's intentions regarding returning to work. After three days' with no communication, the job is considered abandoned and the employee may be officially terminated.

c. Progressive discipline processes: Lauren's Wardrobe has no established disciplinary procedures, either formal or informal. Implementing a progressive discipline system is one option available to Kelly, if she chooses to extend such rights to her employees.

d. Employee grievance processes: Similarly, no clear procedure is in place for employees to express their concerns to management. While often done informally in such small environments, it would be advantageous for Kelly to establish a clear procedure so that employees understand that management seeks such expressions.

e. The need to have formal policies that clearly outline what benefits are extended to employees: This pertains not only to policy issues, but specifically refers to employee discounts and clothing allowances.

f. Employee selection processes: There is no clear employment process, and their needs to be one.

g. The roles/responsibilities of family in family-owned businesses: Much of Kelly's consternation arises over her relationship with her mother and her mother's interference in the business. Yet, policies are not in place that address family-member rights and prerogatives in the business. These are much needed.

2. What considerations does the legal environment present to Kelly as she seeks to formulate a course of action?

a. Employment-at-will: Texas is an employment-at-will state. However, there are 26 exceptions within the Texas law, most of which incorporate the provisions of Federal laws governing employment. At will employment is defined as "a provision found in many employment contracts which suggest the employee works at the will of the employer, and which the employers insert in order to avoid claims of termination in breach of contract, breach of the covenant of good faith and fair dealing, or discrimination. Inclusion of such a term puts the burden on the discharged employee to show that he or she had reasons to believe the employment was permanent. The employer uses the "at will" provision to claim: We could fire the employee at any time, no matter what the reasons [www.thelawencyclopedia.com]

Citation: In Texas, "absent an express agreement to the contrary, either party in an employment relationship may end the relationship or change the terms and conditions of employment at any time for any reason, or even for no particular reason at all, with or without notice." Exceptions include statutory employment discrimination laws, protected activity, retaliation, voting, as well as military or jury duty. Common law exceptions include public policy and contractual agreements.

(Texas Workforce Commission. Retrieved on June 27, 2005 at www.twc.state.tx.us/news/efte/wrongful_discharge.html.)

Rights associated with legal concepts of implied contract also impinge upon at-will constructions; in this case, verbal agreements between management and sales personnel.

Citation: "Texas courts have never ruled that handbooks are binding contracts for employment." Texas Workforce Commission. Retrieved on June 27, 2005 at www.twc.state.tx.us/news/efte/termination.html.)

Citation: "The employment-at-will doctrine has been eroded through a series of court rulings that restrict the right of employers to fire workers. Because this is a common law issue, the rules vary from state to state. The trend among the states has been to recognize exceptions to the employment at will doctrine….those expectations include those based on contract theory, public policy, and tort law" (p. 677).

Jentz, G., Miller, R., & Cross, F. (1996). West's business law Alternate Edition, 6th Ed. West Publishing Company; New York.

b. Job abandonment: An employee who is absent for three consecutive days without notification to his employer is considered to have abandoned his job. The employee can initiate separation from his/her employer through job abandonment. If the employee abandons his/her job, the separation can be considered voluntary. In a voluntary termination situation, if the employee makes an unemployment claim, the employee "faces the burden of proving good cause connected with the work for leaving the job."

(Texas Workforce Commission. Retrieved on June 27, 2005 at www.twc.state.tx.us/news/efte/types_of_work_separations.html.)

c. Constructive discharge: Constructive discharge occurs when an employer deliberately seeks to make the working conditions for an employee so undesirable that it forces the employee to quit. If the employee quits, and the court finds that the working conditions were such that a reasonable employee would also quit, the employee is determined to have been constructively discharged. An employee is required to give the employer notice and seek to resolve the issue prior to quitting. "Under the constructive discharge doctrine, an employee's reasonable decision to resign because of unendurable working conditions is assimilated to a formal discharge for remedial purposes." Pennsylvania State Police v. Suders, 542 U.S.; Faragher v. Boca Raton, 524 U.S. 775, 808

d. Applicability of federal laws: As a small business with fewer than 15 employees, Lauren's Wardrobe is exempt from coverage by many of the federal laws governing employment. However, state laws and local ordinances often replicate the substantive provisions of federal laws, and may have differing numbers of employees that trigger their applicability. Beyond this, increasing awareness among employees and the public in general regarding issues of "fairness" suggests that prejudicial conduct within the management of Lauren's Wardrobe may create liability exposure for the enterprise. Finally, even modest growth in employees will trigger federal thresholds. It would be advisable for Kelly to plan accordingly.

e. In-kind compensation: Kelly (and all small business owners must be concerned with in-kind compensation, the providing of goods or services to employees where the fair-market value of these goods are not reflected in their earnings statements filed for tax purposes. Federal tax law does make provision for discounts to employees. The amount of the discount is capped by the gross profit percentage of the business (IRS Publication 15-B (1/2005) Employer's Tax Guide to Fringe Benefits). The law also provides for exceptions where the benefits are provided for the benefit of the employer. In this case, if Kelly required employees to wear styles sold in the store while they were working, this may qualify as a tax-exempt benefit. However, this was not a store requirement.

3. What issues must Kelly address if she decides to allow Yolanda, Estelle, and Carla to return to work on Wednesday?

Kelly must be very cautious in the actions she takes, yet must act decisively. Failure to respond appropriately to the circumstances presented could amplify any liability exposure she faces, especially pertaining to the conduct of her mother and how she responds to her employees who walked off of the job. It would be appropriate for her to immediately consult with her attorney, even if she needs to close the stores for a day to do so. Some of the issues she would want to discuss with her attorney include the following:

a. Kelly will first need to address the issue of job abandonment, which occurred when the workers walked off the job. If the employees do not return within three days, the employees may be terminated for job abandonment. The date of the incident, date of termination, and the events of the day will need to be documented in the event the employees attempt to claim unemployment benefits. As the employees engaged in job abandonment and willful misconduct when they walked out, it is most likely they will not be eligible for unemployment benefits.

b. Kelly must decide what disciplinary action, if any, she would take against each individual, if Kelly determines she would permit any of the employees to return to work. In making the determination, she must adhere to the essential tenets of procedural fairness, beginning with hearing the employees' reasons for the walkout. Her final determination of appropriate action may reflect each employee's past performance history *if there is reasonable documentation to support differential action.* Given the informality of Kelly's approach to managing employment practices, it is unlikely that such documentation exists.

c. Regrettably, Kelly has no formal disciplinary process in place. While Kelly could simply terminate employees for transgressions, an established progressive discipline plan could provide the framework for a more formal disciplinary program that specified what actions to take. With such a process, her first step would be to make contact with each employee to fully investigate the incident. She would then need to determine the intent of the employees with regards to their return to work. If they do intend to return to work, Kelly could allow them to return with the understanding that some form of disciplinary action would be taken. A common progressive disciplinary process includes: an oral warning for the first offense; a written warning for the second offense; a suspension from work without pay after a third offense; and possible termination of employment for a fourth offense. Regardless of her decision as to whether or not to allow the employees to return to work, she must ensure she conducts an investigation and keeps notes of the incident. Kelly will need the notes in the event she needs to take disciplinary action against the employees in the future or defend her actions at a later date.

d. Kelly must acknowledge that employee theft (and family theft) is a notable issue. The installation of security devices may be a partial answer, within limits.

e Finally, Kelly must be prepared to answer the question that is sure to come from the employees, "What are you going to do about your mother?" Here, Kelly has a difficult choice; either she honors her mother and likely loses the employees, or she "reins in" her mother and risks her personal enmity.

4. What steps must Kelly take with regard to her mother? Is there an appropriate role for her mother within the business?

a. Kelly must address the issues pertaining to her mother's behavior in the store. While her mother may not carry a title indicating she is a manager, her relationship with the owner may imply she has authority over the store employees. The mother cannot discuss employee issues with the customers. If she is permitted to continue, it may be interpreted as a situation of constructive discharge. If so, then the employees would be eligible for unemployment compensation as well as civil legal remedies. The employees may also have a legitimate privacy complaint if they can establish that Kelly's mother was talking about individual performance issues with anyone other than management.

b. First, Kelly must get clear in her own mind what she wants and what she perceives as her obligations to her mother. As the major financier for the business, Kelly's mother likely believes that much is owed to her and that she has a financial investment to protect. Her actions may be predicated on this belief. In some way, Kelly may share this belief. Alternatively, Kelly may envision the relationship as an "arm's length" transaction, where her mother provided the financing but, Kelly believed, was to have no direct (or indirect) involvement in the stores. This fundamental issue must be resolved before a preferred course of action emerges. Regardless, Kelly and her mother must have this discussion and, if her mother is to be involved, they need to construct an agreement that officially delimits the scope of authority and job responsibilities of the mother. Potentially, there are several possible roles in the business for Kelly's mother, given her prejudicial attitudes; however, these should not include contact with customers or employees. Possible opportunities might be serving as the bookkeeper or as a buyer.

In small, privately held business, especially, the lines between one's role as an owner and as an employee-manager become blurred. Many well-run family-owned businesses have established handbooks or charters that specifically address the responsibilities and authorities that pertain to each role. Owners are those who have invested capital and generally have responsibility for establishing policy and making financial and capital budgeting decisions above an established threshold. Managers are employed by owners to operate the business and fulfill specific responsibilities for which their talents and abilities qualify them.

5. What issues might Kelly face if she decides to install hidden security cameras?

Organizational climate issues such as privacy, trust, security, and safety may become an issue for employees with the installation of security cameras. Initially, the employees may feel uncomfortable about the cameras being installed. The installation may be perceived as a lack of trust on Kelly's part towards her employees. It may also be viewed as a retaliatory act based upon the comments of Kelly's mother. Prior to installing the security system, Kelly should frame the discussion of the installation in the context of providing for the employees' safety and security. The installation of the cameras would create a safer workplace by providing deterrence to shoplifting and robbery.

The Electronic Communications Privacy Act allows videotaping, however the employees should be made aware of the activity. However taping should not occur in restrooms or dressing rooms. Viewing of the tapes should only be allowed to occur by authorized personnel and the tapes should remain private. (Texas Workforce Commission. Retrieved on June 27, 2005 at www.twc.state.tx.us/news/efte/video_surveillance.html.)

6. Kelly was obviously quite surprised to hear that Yolanda had been terminated from her last three jobs. How might Kelly have constructed her selection process to do a better job of identifying and employing the right people for these sales positions?

The discussion should center on issues pertaining to the selection and hiring of employees and the need for checking references. Going forward, Kelly should implement a formal hiring and selection process.

1. Conduct job analysis
2. Write job description
3. Application process
4. Interview process
5. Check references
6. Conduct a formal background check
7. Extend formal offer

Conduct job analysis: Before hiring anyone else, Kelly should do a thorough job analysis of the sales position to determine the knowledge, skills, and abilities of the person she should hire for this position. Sales aptitude, attitude, customer service orientation, product knowledge, prior sales experience and the importance of being bilingual are all factors that should be considered.

Write job description: Once the job analysis is complete, translate these findings into concrete job requirements and specifications. Be certain to include a section that details the physical requirements of the job, and identify those functions that are essential to the job (for ADA compliance purposes).

Application process: Kelly should have each prospective employee complete an employment application. Applications ought to be accepted at all times, even when an opening does not exist. Having a pool of candidates to draw from will provide her with some degree of security in the event she has a need for a new hire. She can make staffing decisions from a position of strength, rather than being held hostage by employees who may think their unacceptable behavior must be tolerated since their departure would deal a sever blow the stores' ability to operate. In this case, the employees probably knew their actions would create basic operational problems for Kelly. Without a candidate bench to draw from, the employees may have anticipated Kelly would have to ask them to return to work on their terms. A candidate pool will also help to reduce the turnaround time in the event she has unplanned turnover. Kelly would have a sense of security in knowing she has other candidates in the event she does make a planned turn. Maintaining a pool of candidates would reduce future recruitment costs associated with advertising for an open position. The applications will provide her with a work history for each candidate, aiding with future staffing decisions, which may involve identifying individual development needs.

Interview process: Kelly should utilize behavioral interviewing to screen candidates. Understanding that past performance is a good predictor of future performance, behavioral interviewing may have provided hints that there may be issues with Yolanda.

Check references: While Yolanda may have looked like an attractive hire when she was working for the competition, had Kelly conducted a reference check, Yolanda's past work related performance issues might have surfaced. Then, Kelly could have made an informed decision as whether or not to hire Yolanda.

Conduct a formal background check: Since the store employees handle cash, all job offers should be made contingent upon a background check for past criminal activity. Someone with prior legal issues may not be suited for a position handling large sums of money on a daily basis. If Kelly did decide to hire a person with a criminal background, she would at least be aware of the past behavior and could take the necessary steps to monitor that person's performance pertaining to cash handling activities.

7. What additional changes should Kelly make in the immediate future to better manage human resources in her stores?

Gain a clear strategic understanding of her business: The most important issue that Kelly must address is to get a clear strategic understanding of her business and its processes. This is perhaps the fatal flaw for many small business owners. Kelly must understand what market she is in, who her competitors are, who her customers are, the kinds of goods they seek, the price points of her clientele, the types of marketing that attract her clientele, and how she can be profitable within that environment. Once she determines where her businesses are positioned strategically, then she can staff her stores to meet the needs of her customers, hire employees who will be able to sell into those markets, and design jobs and compensation that will attract the sales staff that she needs.

Clearly, the fact that she is located in a community bordering on Mexico makes diversity issues important to her and her business success. Does she seek to cater specifically to the Hispanic community, or does she see this as an after-market? Do her staff and store managers need to be bi-lingual? She must make a strategic choice with regard to the Hispanic market and operate her stores consistent with this vision.

Having said that, there are immediate issues she must address.

Employee grievance processes: There also appears to be an issue associated with the work environment. Some level of animosity exists between Kelly's mother and the other employees. Kelly can address the issue or at least surface issues for discussion by implementing some process to get feedback from her employees. Kelly could implement regularly scheduled meetings with the employees at each store. These sessions could serve as a platform for the employees to vent and provide Kelly with meaningful information about the activities within the store. Had Kelly known about the conflict between her mother and the other employees, she may have been able to resolve the issue before the incident occurred.

Formal employee handbook: Kelly may find it necessary to create a small employee handbook that highlights any special discounts or perks to which employees are entitled. It appears that store policies are not formalized, creating situations of uncertainty and inconsistencies for employees.

Family member's handbook: Kelly also needs to commit to writing the policies that govern the conduct of family members in relationship to the store. It should detail the rights, responsibilities, and obligations, and perquisites of family members, both for those who are employed and those who are not. In addition to the immediate questions raised in this case, such as employee discounts, it should address issues related to qualifying for benefits, access to business cash, personal use of store inventory and other assets, access to business properties during non-business hours, etc. A policy barrier needs to be constructed between the business and the daily routines of family members so that the assets of the business are not seen as personal property, and abused.

Manage Proactively: Many of Kelly's problems emerge do to her lack of being proactive in the management of her business. She needs to be in greater contact with her employees, discussing business issues with them more frequently, and follow through on issues that are of concern to her, such as the clothing smelling of smoke and perfume. Open lines of communication and proactively addressing issues as they arise can resolve many issues before they become problems.

EPILOGUE

In the days following the employee walkout, Kelly met with each of the girls individually. She asked several of the girls to return to work and assured them that she would speak to her mother about her behavior towards the customers and employees. As Kelly expected, her mother was upset after their discussion. Feeling that Kelly had sided with the employees, despite her best intentions, Kelly's mother decided it was best if she was no longer involved in the operation of the business. From that day forward, Kelly's mother never returned to either store.

Nearly a year after the incident, Kelly found herself unable to find the time to manage the two stores. Kelly had failed to realize how much work her mother was actually doing to support the stores. Her mother had been doing all of the bookkeeping, payroll, and monthly inventories. Her mother had also provided a great deal of emotional support to Kelly. The next year Kelly closed Mind's Eye and eventually sold Lauren's Wardrobe to Rosie. Kelly financed the sale of the store to Rosie. Despite her best efforts, Rosie was too young and lacked the business savvy to operate the business. She defaulted on her note to Kelly and was unable to pay her suppliers. Kelly was forced to liquidate the business and used funds from her husband's business to repay the loan she had taken from her mother to open the business.

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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.

INSTRUCTORS' NOTES

Replacement Policy

In this section a vehicle replacement policy (of the most simple type) is suggested for a maintenance operation's fleet. The process considers relevant vehicle age, maintenance cost, opportunity cost of downtime, depreciation, salvage value and the cost of capital. It presents a simple method of determining which vehicle should be replaced.

Basic Cost Calculations

Table 5 indicates the calculation of major maintenance cost by vehicle age. These calculations show that vehicle maintenance costs increases with the age of the vehicle. A slight decline in 1983 and 1986 is due to sample size. There are 23 vehicles from 1989, one from 1983 and two from 1986. Table 6 indicates the average number of major breakdowns by the vehicle age. This makes age the most important variable in determining both the number of major breakdowns and the associated repair costs.

Table 5: Avg. Maintenance Cost per Vehicle 2004-2006 by Year of Make.

Year	Average 3-year Major intenance Cost per Vehicle
1983	$1,553.84
1986	$1,259.48
1989	$1,885.28
1993	$1,338.45
1995	-
2001	$353.42
2003	-
2004	$198.48
2005	-

Table 6: Avg. Breakdowns per Vehicle for Three Year Period (2004-2006) by the Year of Make.

Year of Make	Average Number of Major Breakdowns per Vehicle in 3-years Period
1983	3
1986	4.5
1989	6.83
1993	5.25
1995	-
2001	1
2003	-
2004	0.79
2005	-

Cost Considerations in the Replacement Model

As indicated in the assumptions of the case, several cost considerations are excluded. The replacement policy needs not consider insurance, fuel, taxation, and or parking/garaging, supervision and other incidental cost associated with vehicle maintenance. In this case many of the excluded costs are not charged on the contractors accounts, but paid by the contractor/federal government directly. Thus, this policy will consider only initial purchase cost, cost of capital, major maintenance cost, opportunity cost, and opportunity cost due to catastrophic failure. Note that the all costs are calculated based on the age of the vehicle at the end of three year from now. A three-year period is used as the time period to compare old and new vehicle as new vehicles are amortized over three years by the contractor.

The replacement model could be further expanded by calculating yearly cost over useful life of each vehicle and then calculating the present value of each cash-flow. However, it is required that the model can be used for quick assessment, therefore, tedious yearly assessments are not considered. As another option an instructor can decide the level of complexity desired based on the course level and learning objective.

Replacement Model:

The replacement model is to compare the cost of maintaining a current fleet vehicle versus the total cost of buying and owing a new vehicle. When the cost of maintaining a current fleet vehicle is more than the cost of owning a new one then the current fleet vehicle should be replaced, i.e.,

Cost of maintaining current fleet vehicle over next three years >=
Cost of buying and maintaining a new vehicle over next three years. (1)

Where,

Current cost of maintaining a current fleet vehicle over three years =
Expected sum of major maintenance cost over three years + Expected sum of opportunity cost over three years + Expected opportunity lost due to catastrophic failure –Present value of salvage value of vehicle three years from now (2)

Current cost of buying and maintaining a new vehicle over next three years=
Purchase cost of vehicle + Cost of capital + Expected sum of major maintenance cost over three years + Expected sum of opportunity cost over three years + Expected opportunity lost due to catastrophic failure – Present value of salvage value of vehicle three years from now (3)

Calculation of Costs

As shown before, the age of vehicle is one of the most important factors in determining the expected cost of maintenance due to major breakdowns. Table 4 provided data for total major maintenance cost over the three year period. The linear regression model can also be used to determine expected total maintenance cost over three years, where the vehicle's age is treated as the independent variable. The vehicle age can be calculated from the year of make of the vehicle and the year of assessment (2007.) The regression equation is given below. The R-squared value is not very high for the model (55%) due to sample characteristics; however the regression model is highly significant (probability ≈ 0)

Expected of sum of major maintenance cost over three year =
*(-$120.30+ $102.80 * Age of the vehicle)* (4)

The expected opportunity lost cost due to major breakdowns can also be calculated based on the age of the vehicle. Table 4 has provided data for total number of major breakdowns over three year period. It is also indicated that that every major breakdown reduces productivity of two repairmen by 50% for 8 hours. That is the opportunity lost cost of each breakdown is:

Opportunity lost cost per breakdown =
50% 2 repairman *8 hours *$40/hour/repairman = $320* (5)

Another linear regression can be used to determine the expected number of breakdowns per three year period. Again, the vehicle age is treated as the independent variable. The regression equation is given below. The R-squared value is not very high for the model (60%) due to characteristics of the sample however; regression model is highly significant (Probability ≈ 0.)

*Expected of number of failures in three year = -0.297 + 0.362 * Age of the vehicle*

Expected opportunity lost cost over next three years =
*$320 * (-0.297 + 0.362 * Age of the vehicle) =*
*(-$95.04 + $115.84 * Age of vehicle)* (6)

The opportunity cost due to catastrophic failure can be calculated based on the probability of a catastrophic failure. A catastrophic failure is defined as vehicle being unserviceable after the failure. It is given that age of vehicles follows a normal distribution with a mean of 16 years and a standard deviation of 1.5 years {N (16, 1.5)}. The cumulative probability of catastrophic failure will rise with the age. The probability can be calculated using Z table or Excel function NORMDIST(x, mean, Standard deviation, cum).

Opportunity lost cost due to catastrophic failure =
*Cum. probability of failure *$1,000 =*
*$1,000 * NORMDIST(AGE,16,1.5,1)* (7)

Furthermore, an investment into a new vehicle will use company's capital for replacement of an existing asset. Once used to buy a vehicle this capital is unavailable to the company. Hence, there will be an opportunity loss as capital is consumed for replacement purposes. A cost of capital and discount rate are provided as 10% per year. It is stated that a vehicle is depreciated over three years using straight line method. The net present value of cost of capital will be 17%, where cost of capital is calculated based on the book value of the vehicle. The cost of capital factor of 17% is calculated using Excel net present value formula, NPV(r, cost of capital each year for three years), i.e., NPV(10%,$1*10%, ($1-$1/3)*10%,($1-$2/3)*10%).

Cost of Capital = 17% Purchase cost of the vehicle* (8)

The replacement model will be as follows once equations 4, 5, 7 and 8 are substituted in the equations 1 and 2.

*[(-$120.30+$102.80 * Age of the current vehicle) + (-$95.04 + $115.84 * Age of current vehicle) + $1,000*NORMDIST(Age of current vehicle,16,1.5,1)- Present value of salvage value of current vehicle three years from now)]>=*

*[Purchase cost + .17*Purchase cost + (-$120.30+$102.80 * Age of the new vehicle) + (-$95.04 + $115.84 * Age of new vehicle) + $1,000*NORMDIST(Age of new vehicle,16,1.5,1)- (Present value of salvage value of new vehicle three years from now)]*

That can be simplified as:

*[$218.64 * Age of the current vehicle + $1,000*NORMDIST (Age of current vehicle, 16,1.5,1)- Present value of salvage value of current vehicle three years from now)]>=*

[1.17 Purchase cost + $218.64 * Age of the new vehicle + $1,000*NORMDIST(Age of new vehicle,16,1.5,1)- (Present value of salvage value of new vehicle three years from now)]* *(9)*

The present value of the salvage price of the vehicle can be obtained from sources like "Kelly Blue-Book (KBB)." Simply using the resell value of the car from KBB based on current vehicle age plus three year will eliminate any discounting requirement. The equation (9) can be automated in the EXCEL or other similar tool without much difficulty

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.

INSTRUCTORS' NOTES

This case is designed to elicit a discussion on the ethics of lending in the subprime market. Real world data is provided to give substance to the discussion. The case is positioned just prior to the melt down in the subprime market. We wanted to avoid an ethics discussion that quickly broke down into a reaction to people losing money and a quick conclusion that it must be unethical.

The case is structured around the question of entering the subprime market in its early form. Initially the market restricted the risk by requiring, usually, a minimum down payment of at least 10 percent. As financial institutions observed this market's profitability, largely resulting from a rising housing market, they increased their risk exposure. This reduction came through lower down payments required and granting secondary subprime loans. With lower down payments and secondary loans, the moral hazard problem increases. With little or no equity in the home, the borrower's incentive to continue making payments is reduced. An interesting discussion topic revolves around how aware the secondary market was of the increase in risk.

Data is provided going back sixteen years. A question that should be address is whether or not the market should have been functioning on a seeming belief that housing prices would continue to rise.

The case includes a number of questions that we believe students should address in developing their conclusions on entering or not entering the subprime market. Suggested answers to these questions follow.

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?**

   a. We can use a simple linear regress ion on the credit data to estimate the credit score likely to lead to being 90 days delinquent on a loan. From excel we get:

   DDelinq = 203.64 – 0.255 CredScore
   (23.18) (18.675) t-stats $R^2 = 0.925$

   b. If we set DDelinq to 90 and solve for the associated credit score we find that a credit score of about 445 is likely to result in being 90 days delinquent on a loan.

c. Since a score of445 yields an expected 90-delinquency, one-half of the of the loans extended to individuals with a score of 445 would be expected to be 90 days or more delinquent. This assumes a normal distribution. We put this question in to make students aware that setting such a low cutoff point could result in one-half of the loans with that credit score defaulting.

d. Ideally we would want information on competitors' decisions in setting our lower limit. Should we set it below the minimum score used by competitors, we would likely get a larger number of lower quality loans and assume greater risk. A higher selected lower limit would reduce risk at the cost of limiting the loans.

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?

Using the housing data and running a multiple regression on Non-performing loans we get:

NONPREF = 1.118 + 0.029 Inflation + 0.0016 LIBOR- 0.0236 HomePriChange
(1.36) (0.073) (1.977) t-stats $R^2 = 0.113$

The only significant evidence is that rising home prices is likely to lead to a reduction in nonperforming loans. It is a suggestion that Mary be concerned over any possible decline in housing prices.

If we look at Home Price Changes, we get:

HomePriChange = 9.771 – 0.155 inflation – 0.759 6-moLIBOR $R^2 = 0.191$
(8.79) (0.699) (3.55) t-stats

The only significant evidence here is that a rise in interest rates is likely to lead to a reduction in home price changes. If the Federal Reserve moves to a higher interest rate regime, this could generate problems in this lending market.

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.

Each loan brings in an additional 2 percent in interest payments. If the loan becomes delinquent, the bank will suffer an interest loss of about $12,000 from the loan. This is nine months interest on a $200,000. Assuming that Mary is correct in assuming that the 10 percent down will protect the principal, one year's payment stream from six loans would maintain the income stream. The question then is how long will the bank actually suffer the loss in income and does the principal have protection. Additional costs could include: repairs to a damaged property, costs to sell the foreclosed property, and maintenance costs during the holding period. Planning for a potential ten percent seems very high and, even with the recovery of most of the loan principal, is likely to place the bank in severe difficulty.

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.**

Selling the loans on the secondary market reduces the bank's risk exposure. This needs to be discussed in the light of also removing the potential higher interest income. On the positive side, the bank would usually earn a service fee for collecting and processing the loan payments.

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.

This case is set in late 2006. Subsequently the mortgage market encountered substantial problems. We expect students not to jump to a conclusion that, since some individuals suffered losses in the market, actions to enter that market must have been unethical.

We expect students to cast their ethical analysis of this situation in some model for ethical decision making, such as Utilitarianism. The relevant stakeholders should be identified and the benefits and costs, short and long term, discussed.

The ethics discussion has two significant components. First, are the customers being lured into a situation that they have little hope of surviving? Second, if the customers are fully informed of potential consequences, should they not be given the opportunity? An interesting point is that, even if five percent of the loans default, 95 percent of the borrowers maintained their payments and it is likely that many actually achieved home ownership.

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.

INSTRUCTORS' NOTES

One of the most important outcomes of any Entrepreneurship class (undergraduate or MBA) is for students to thoroughly understand the business plan process. To accomplish this goal most instructors require students to create a business plan --- either in groups or individually. Generally these plans are worth 30 to 60 percent of the final grade, so they are very important to students and sometimes extremely frustrating. The biggest reason for this student frustration seems to be the enormity and unfamiliarity of the task. Let's not forget, most students have never written a business plan and at first blush it appears to be a limitless task. Consequently, panic generally sets in for the first two weeks --- followed by denial, acceptance, and finally traction.

This case has been prepared to help students create and complete a successful business plan. It is the second of two cases that help students become aware of what they must accomplish at certain milestones during the semester. Most students just see "perfect" completed business plans and generally do not realize that a business plan is a PROCESS. This PROCESS takes lots of time and rewrites. One of the biggest hurdles of the business plan process is receiving and utilizing feedback on work. Students must present enough work for evaluation and feedback. They must provide the reviewer with this material so that he/she can help the student complete a quality plan. For example, we generally require students to turn-in the first-drafts of their plans in Week 10. We read them and offer extensive feedback and return them to the students by Week 11. We will then re-read and provide a light edit for the plans in Week 13 and point out obvious problems (NOTE: ANOTHER CASE ACCOMPANIES THIS CASE. IT HAS BEEN CREATED TO OUTLINE WHAT IS NEEDED IN A FIRST-DRAFT OF A BUSINESS PLAN --- "FIRST-DRAFT OF A BUSINESS PLAN: WHAT SHOULD IT CONTAIN"). Final plans are due in Week 15. We find that this process works best for several reasons --- it gives students the ability to recover from problems and mistakes, the business plans are always better with less student angst, and it eliminates most bad surprises.

The biggest hurdle with this process is the first-draft edit in Week 10. This milestone becomes the critical point in the process. We find that most students who can turn-in a plan that is at least 80% complete and have at least a "B" opportunity will be successful. Students whose first-drafts are either vague outlines or minimal plans generally do not recover for several reasons. First, as reviewers, we cannot edit and give quality feedback on something that is not there. Second, the probability of someone completing a good business plan without some feedback is pretty slim. Third, if students have not worked on the project for the first ten weeks the chances of them finishing it in the final four weeks are not good. The second-draft edit is important because it helps students get over the final hurdle. We usually assign this case in Week 11 --- right after the first-draft edits have been returned. This case reminds students that they only have two weeks to make edits and improvements. If students can make real progress they stand a very good chance of making an "A" or "B" on this project. If they do not make progress it usually spells doom for the project --- because they have missed their last chance for feedback on their plans.

This case is an actual second-draft from a four-member group of undergraduate students. The draft is not perfect, but it allowed us to highlight problems to the students and for them to recover. This second-draft is pretty good. The financials are solid. Yet, there are numerous mistakes and shortcomings with this business plan. What is important to note is that the students have at least "arrived" at the point where they can expect feedback. This group was able to take our feedback and re-work the plan and do well in the class.

Students love to trash this case and the "authors". We can assure you that students will find lots of "stupid things" with the case --- poor writing and grammar, unreasonable assumptions, a vague opportunity, repeating words and ideas, no marketing research, and bad analysis. It is fine to discuss and highlight these shortcomings, but the point to make with students is that they will be expected to deliver a second-draft at least as far along as this case in two weeks. Students tend to become a little more subdued at this news, because although this case has a long way to go, it has most of the critical parts and structure of a business plan. Below we will highlight "some" of the obvious problems with the case (in no particular order). We are sure that you and your students will find many other problems to discuss, but remember it is only a second-draft and the students accomplished the task at hand.

There are four BIG issues and numerous smaller problems with this business plan. It is imperative that the students address the four major issues and then begin the process of handling the smaller problems. The four major issues are:

The lack of "real" marketing research.
The validity of the financial plan.
The lack of detail in the competitive analysis.
The risks and assumptions of the business plan.

While we do not expect students to commission and pay for a marketing research project to support their business plans, we do expect a deeper effort than provided by this group to determine market potential for their business. What the students have done is take national data provided by the Sporting Goods and Manufacturers Association and project those percentages to the counties that will be served by the Paintball Palace. Next, they have projected this potential customer data to determine the number of unique visits the company can expect. Finally, the data on unique visits is utilized to determine revenues.

This "back of the envelope" method of market sizing is a good way to get a general idea of what the market potential of a new business might be, but a savvy investor would require additional supporting information before being satisfied with market potential and sales projections. Therefore, it is imperative that the students provide more backup data to support the market sizing and revenue numbers. If this were an actual business plan, we would recommend that the entrepreneur hire a research company to conduct a telephone survey of potential customers in the area. Another method would be to research paintball equipment sales in the area.

Because these students do not have the money or time to hire an outside company to research local demand for a paintball facility, we suggested that they do some survey research of local high schools and colleges. Additionally, we told them to call local sporting goods stores to interview owners and managers on paintball equipment sales. They collected this data and included it in the final business plan. This data tended to support higher demand in this area for a paintball facility than their projected Census Bureau numbers. And this points out the real problem with the "back of the envelope" method used by many business plan writers. Using national data to project local demand hides many nuances. For example, the local area has a large college population, yet is very rural. This means that these students are looking for activities and paintball could be a great possibility for this group. With this additional information the students were able to justify an increase in demand, revenues and profits for the company.

The second major issue with this business plan is the financing route taken by the students. They clearly state that $470,000 is needed to launch the company. The financials indicate that this much capital is needed to keep the company afloat. The students then state that each partner will contribute $30,000 or a total of $120,000. This is a reasonable assumption --- the students could raise this capital from friends, family, and fools. The real problem lies with the suppliers financing (i.e., providing a loan) for the remaining $350,000. The students' state that the National Paintball Supply, Bauer Compressors, and an "unknown Astro-turf company will provide the debt financing. This is a real stretch. We doubt the validity of this assumption and suggested that the students provide a more reasonable financing method. They eventually decided to offer equity in the company for financing and provide an additional $80,000 in personal capital. This financing plan seemed much more reasonable and it freed up a great deal of cash because interest payments were eliminated. The downside was the students had to give-up part of the company. They decided to offer equity to angel investors, who would require input and substantial ownership rights. The students were made aware of the oldest phrase in the business handbook --- "there is no such thing as a free lunch".

The third major issue was the competitive analysis section of the business plan. While the plan did provide a chart of direct competitors in the area, it did not discuss these competitors in detail. This is a huge mistake. All potential investors in a company want all the details on direct competitors. This chart is nice but inadequate. The students were instructed to provide much greater detail on these competitors. Additionally, the group was instructed to provide information and analysis on indirect competitors such as skiing, hunting, hiking, and other such recreational facilities. Analysis of all direct and indirect competitors provides a much better picture of the recreational facility market in this local area. The students were able to complete this analysis without too much angst and the plan was greatly improved. Luckily there was not a great deal of competition, which added support for a paintball facility.

The final major problem was the incomplete analysis of the risks and assumptions of this business plan. All investors want a fair, balanced, detailed, and complete statement of risks and business assumptions. The limited listing provided by the students was just inadequate. To be fair, they had placed many of their assumptions in their financial statements, but they needed to be placed in the text as well and discussed in detail. The students were able to fix this issue in a matter of days.

The basic structure of this business plan is very good. It is a "canned" structure taken from Jeffrey Timmon's text. There are three or four other "canned" business plan outlines and all of them are excellent. The financials are excellent. The students used a software package created by the Kaufman Foundation called "The New Business Mentor". There are many other software packages for business plan financials. Most are excellent. The remaining problems with this business plan are mostly minor, but still need to be addressed. Below we will list the comments made on the edited business plan:

> *The writing needs to be pumped up, increased, and improved. It is bland in many sections. Make it more confident, aggressive, and optimistic. Tell the truth, but sell the truth. It seems that the sections were written by different students. That is ok, but you need ONE person to edit the complete plan and give it a one-writer voice. Additionally, the flow of the plan needs to be improved.*
>
> *Make sure all of the metric questions are clearly answered (i.e., the questions in the introduction of the case).*
>
> *The financials must be changed because the financing and demand have changed.*
>
> *Stress the lack of recreational facilities in this area. Also include this in your Industry section.*
>
> *Tell us why paintball is so popular --- we do not get-it and we are typical of a potential investor --- old and ignorant.*
>
> *How big can this get in five years? I have no idea?*
>
> *How did you derive your service price? It seems that you just looked at what the competition is charging. It needs more analysis and support.*
>
> *Tell us about your vision for the company.*
>
> *Is your team a strong team? Why? We are not sold.*

That was it for the second edit. The students were shell-shocked. They felt that they had a near perfect "A" plan. But they recovered quickly and because they had specific direction were able to complete the plan in the remaining two weeks. The biggest problem was the additional required marketing research. Most of the other problems were easily handled. The group received a "92" on the final draft. It was a very good group effort. The students worked very hard and the final plan looked very professional.