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JOURNAL OF THE INTERNATIONAL ACADEMY FOR CASE STUDIES

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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 are 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 Executive Director of the Allied Academies: info@alliedacademies.org.

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

TURNING UP THE HEAT ON WIND RIVER FARMS

Lucia S. Sigmar, Sam Houston State University
Laura L. Sullivan, Sam Houston State University

CASE DESCRIPTION

Making and handling requests, a skill used in higher-level communications strategies, often determine the success or failure of human interaction. The primary subject matter for this case concerns the development of an escalating communications strategy (mild, moderate, and strong) for a scenario where expectations have diverged between a Consignor and Consignee concerning prior verbal and written agreements. Secondary legal issues include the ethical obligations of Consignees to their Consignors, the basics of contract law, bailment, fraud, fiduciary duty, and breach of contract. This case was designed for use in an undergraduate business communications course and can be taught in conjunction with a business law course. The various communication or legal aspects emphasized in this case could be taught in three 1-hour sessions. Each assignment is expected to require approximately 2 hours of outside preparation by students.

CASE SYNOPSIS

Wind River's owner, Alan Shaw, a miniature horse breeder, initiated Wind River Farms' First Annual Consignment Sale as a way to help small farms market their registered horses in East Texas. Marilyn McKenzie thought the consignment sale would make an ideal venue for the sale of five of her horses. Despite ideal weather on the day of the sale, the event was poorly attended, and Marilyn sold only two of the five horses that day. When Marilyn did not receive payment for her livestock within the ten-day period following the sale, she repeatedly attempted to contact Shaw by phone, and left messages asking him to contact her regarding payment for the two horses she had sold at the sale. When Shaw finally answered her call, he expressed surprise that she had not yet received his check and assured her that he would get another one in the mail to her the very next day. Shaw's next check was refused for payment due to insufficient funds, and Marilyn's account was debited $25.00 by her bank because funds were not collected. Again, after several unsuccessful attempts to contact Alan, Marilyn documented her complaint in a letter sent via certified mail, with return receipt requested. Although the return receipt indicated that Shaw had received the letter, Marilyn still received no reply. At this point, Marilyn feels further compelled to document Shaw's evasive conduct with respect to paying her, to hold him to the terms of their initial agreement, and to document the deterioration of their business relationship for possible legal action.

INTRODUCTION

Wind River's owner, Alan Shaw, a miniature horse breeder, initiated Wind River Farms' First Annual Consignment Sale as a way to help small farms market their registered horses in East Texas. Shaw required a non-refundable consignment fee of $250.00 per horse, and promised construction of a marketing website and a sales catalog to be distributed prior to the sale. Shaw also specified a commission fee of 10%, along with an additional $40.00 fee for shavings. The shavings would be delivered to the Pinemont Equestrian Center the day before the sale on Saturday, April 30, 2005. Marilyn McKenzie thought the consignment sale would make an ideal venue for the sale of five of her horses, and agreed to Shaw's terms and conditions (attached). She sent her completed entry form, fees, and promotional photos of her horses to Shaw by the specified February 5 deadline.

Shaw assured Marilyn that the event would be well-promoted in the industry and within the state. He was presently working with a website designer and graphic artist who was coordinating the production of the marketing materials for the sale. They hoped to have the website completed and the sales catalogs distributed by mid- March at the latest. Shaw would also secure the facility, hire an auctioneer, and handle all marketing efforts and sales transactions. Consignors would provide registration and transfer papers to Wind River Farms; after the buyer's checks had cleared, registration papers would be sent to the new owners, and the proceeds would be sent to the Consigners. Marilyn was optimistic that, with comprehensive advertising efforts to members of various horse associations, the sale would attract not only other horse breeders but other persons interested in owning quality miniature horses for show and pet.

When Marilyn arrived at Pinemont on the Friday evening prior to the sale, she unloaded her horses and bedded them down for the night. She arrived at the Equestrian Center at 7:00 a.m. the next morning to care for her horses and field questions from buyers. The sales preview began officially at 9:30 a.m., but Marilyn began to be somewhat concerned at the obvious lack of buyers in the barn at that time. Shaw confided to Marilyn that he had encountered some delays in the production of the marketing materials. They were distributed almost a month behind schedule—just two weeks prior to the sale. Shaw quickly excused himself to complete last-minute arrangements for the auction which was scheduled to begin at 11:00 a.m.. Marilyn sold two of her five horses that day, and refused the sale of the other three horses since the reserve price was not met.

When Marilyn did not receive payment for her livestock within the ten-day period following the sale, she attempted to contact Alan by telephone, and left a message asking him to contact her regarding payment for the two horses she had sold at the sale. Her concerns escalated when repeated phone calls to Alan over the next few weeks were not returned. When Shaw finally answered her call, he expressed surprise that she had not yet received his check and assured her that he would get another one in the mail to her the very next day.

Marilyn received the $2,400.00 check on July 15 and immediately deposited it into her farm account. The following day, Shaw's check was refused for payment due to insufficient funds, and Marilyn's account was debited $25.00 by her bank because funds were not collected.

Again, after several unsuccessful attempts to contact Alan that day, Marilyn documented her request in the form of a mildly worded letter sent certified mail, with return receipt requested. Although the return receipt indicated that Alan had received the letter, Marilyn still received no reply from Shaw Marilyn then sent another, more moderately worded letter which reiterated her initial request for payment and detailed reasons, again sent certified, return receipt requested. When she again received no response, Marilyn's strongly worded letter documented Alan's evasive conduct with respect to paying her, held Alan to the terms of their initial agreement, and documented the deterioration of their business relationship for possible legal action.

FANTASYNET VENTURE CAPITAL TERM SHEET NEGOTIATION

Dennis Zocco, University of San Diego

CASE DESCRIPTION

In this New Venture Finance case, Tim Bayliss, founder, CEO, and sole shareholder of FantasyNet, has received a term sheet from Ann Davenport, a General Partner in the venture capital firm of Chestnut Ridge Ventures (CRV), for an investment of $8 million in his company. Tim had never seen a term sheet before and felt he needed advice in evaluating that document in preparation for his upcoming negotiation with Ann. Tim engaged the services of his accounting firm to advise him on the implications of the provisions in the term sheet and to assist in the negotiation. That engagement resulted in a memorandum to Tim that included explanations and recommendations for each element of the term sheet. Tim planned to use those recommendations as a basis for his negotiation with Ann to reach agreement on CRV's investment in FantasyNet.

Keywords: Financing, Venture, Entrepreneurship, Governance, Valuation, Equity

CASE SYNOPSIS

This entrepreneurial finance negotiation case was written to be used in both undergraduate and graduate courses. The rigor and depth of material may be adjusted to reflect the skill and background of the student audience. However, the issues are meaningful and relevant to the learning experience of both undergraduates and graduates. This case primarily is designed to be used in 1) a case course in Entrepreneurial Finance or Entrepreneurship or 2) as a supplemental exercise in a non-case course in Finance or Private Equity, or 3) in a negotiations course in a business or law school. It is an experiential learning exercise based on the application of sound integrative negotiating techniques. If the case is used in a finance course, students will negotiate using their instinctive negotiating skills. The instructor can assign one or more of the following readings on basic negotiating skills: Bartlett, 1999; Landstroem et al., 1998. A short primer on negotiating technique also is included in the PowerPoint Slides Section of this Teaching Note. If the case is used in a negotiations course, the instructor can assign the following venture finance basic understanding readings from the list of references: Bartlett, 1995; Berlin, 1998; Pearce and Barnes, 2006; Smith and Smith, 2000; Zider, 2000. Students who have had a fundamentals course in finance will be able to understand the valuation elements of this case.

General Information

Tim Bayliss, founder and sole owner of FantasyNet, Inc., entered negotiations with Ann Davenport, a General Partner at Chestnut Ridge Ventures (CRV), without ever seeing a term sheet. The last three weeks have been a crash course in venture capital financing with much of it an exciting learning experience. Tim's journey to the term sheet negotiation started one afternoon when he was at his booth at the Online Social Networking Conference in Miami. Ann had been walking the aisles, watching the internet-based products being displayed and speaking to the entrepreneurs displaying their sites. Ann thought several looked promising, but when she arrived at Tim's exhibit, she became very interested in his product and his company, which surprised her. The product was FantasyNet, an online social networking site that focused on players participating in the various world-wide fantasy sports leagues.

Ann knew nothing about fantasy sports except that most of the men in her life – her boyfriend, her two brothers, her brother-in-law, and many of her associates at CRV – were passionately involved in it. Even her sister had both a baseball and football fantasy team. Family reunions inevitably turned into a fantasy sports conversation, often heated. Some members of her firm never scheduled travel during a "draft week." One of those members, Jeff Engler, a Research Associate, has experience and knowledge in the online space. She asked him to be part of the team that would evaluate FantasyNet as a potential investment.

Ann was equally interested in the founder of FantasyNet. Tim Bayliss earned a Master of Engineering in Electrical Engineering and Computer Science from MIT's famous five-year Course 6 program and then, after a three-year stint with Microsoft, earned an MBA from Harvard. He worked for McKinsey for several years after Harvard, consulting for firms such as Google and Facebook. While at McKinsey he found the consulting he did for companies frustrating, as he guided his client companies so far and then had to leave for another assignment just as the fun was beginning in carrying out his recommendations and experiencing the results. He decided to leave McKinsey and the consulting business in early-2005 and had offers from many of his client companies as well as several venture capitalists who were investors in those companies. His decision as to which side of the table was right for him was a difficult one. On one side of the table, venture capitalists select companies to which they provide funding and then sit back and watch to see if their investment was successful. On the other side, entrepreneurs accept funding in exchange for an ownership stake in their company and then do their best to make their company a success. He made his decision quickly. He wanted to be an entrepreneur, to recognize a business opportunity and then develop a business to address that opportunity. He had found his passion and his challenge.

Tim knew that venture capitalists prefer to invest in scalable companies in high growth industries run by competent leaders and managers. His advanced education in computer science gave him the background and knowledge to take advantage of opportunities in the software field. His research pointed him to several internet-based niches, the hottest of which was social networking. Sites (with start dates) such as Match (1993), Ryze (2001), MySpace (2003), Fickr (2004), and Facebook (2004) as well as the more niche-specific new startups Jobai, Tarmac, and Triptic (*All are actual sites except for Jobai, Tarmac, and Triptic, which are fictitious and added in order to provide comparable financial performance metrics to FantasyNet.*) were successfully building their member base. Tim knew that behaviorally, these sites were satisfying a real need of people to communicate with friends, old and new, and link with others of similar interests. He wondered which interests were yet to be addressed and would those untapped interests provide enough participants around which to build a viable business.

Then one evening he stopped for dinner at one of the sports bars near his home and discovered that most of the space was taken by a fantasy football draft, with nearly 300 attendees making draft picks from large television screens throughout the bar. He spoke with many of the participants and found that, without exception, they all possessed passion, excitement, and intensity directed toward a common goal – drafting a winning football team. Several different fantasy leagues were represented, but everyone was living the fantasy of being a real team owner and general manager. He was told that the intensity grew as each season progressed.

When he arrived home, he immediately searched for fantasy league social networking sites and found a few, but they were crude. Over the next few days, he spent every waking hour doing research on fantasy sports, learning all he could about what drives so many people to passionate participation. As the days progressed his excitement grew, and at the end of his fourth day of research, he had decided on his new venture. He quickly developed a sense of urgency, however, as he imagined there were other entrepreneurs with the same idea. He believed that quick execution was the key, and he started on his new venture the next day and had FantasyNet up and running in one month. One of the first decisions he made was to ask his close friend and mentor, Ray Katrinak, a retired, successful serial entrepreneur, to serve with him on a two-person Board of Directors for FantasyNet.

Ann was impressed with the story of Tim's journey to his new venture. Given his education and work experience with McKinsey, he could have chosen a very lucrative and safe career path, but he chose to follow his passion. She also liked the fact that at no time in their initial conversations did he once mention that he was in it to get rich. She felt that his real goal was to prove to himself that he could make his business idea a success, and to her that was a big positive for an entrepreneur.

Ann and Tim exchanged business cards at the trade show and a few weeks later, Ann called Tim to ask him to lunch so they could talk more. He was pleased to hear from her and invited her to his company in the Brighton neighborhood of Boston prior to lunch. His company was located in a renovated warehouse with no offices, just cubicles with programmers clustered by function. Now four years into operations, FantasyNet had twenty-six employees, most of them programmers. Tim had a cubicle just like everyone else. Ann liked the frugal nature of Tim's entrepreneurship, using each dollar wisely to create value in his company. She was sure he would have the same respect for investors' dollars.

Prior to arriving for lunch, Jeff had updated Ann on the world of fantasy sports. Fantasy sports leagues exist for every organized sport, from professional and college football and basketball to baseball, golf, hockey, and NASCAR. The industry is also international, with fantasy soccer and cricket leagues popular in Europe. According to the Fantasy Sports Trade Association, 29.9 million people age 12 and above in the U.S. and Canada play fantasy sports, up 54 percent from 19.4 million a year before. Growth in people playing fantasy sports has grown at a 33 percent rate since the early 90s. A recent study showed 22 percent of U.S. adult males 18 to 49 years old with Internet access play fantasy sports. The financial impact of the industry is substantial. Consumers spend $800 million annually on fantasy sports-related products, with an additional $3-$4 billion on media products related to the activity. After their meeting, Ann invited Jeff to accompany her to lunch with the owner of FantasyNet the next day.

The Lunch Meeting

At lunch, Tim learned that Ann had grown up in a neighboring Drexel Hill suburb of Philadelphia, the city where he spent his childhood. She received her MBA from Wharton and then been part of the management team at several startup software companies that went public during the late 1990's before the crash. CRV had been an investor in two of the companies she had worked for and the firm hired her five years ago and made her a partner last year.

He also learned that Jeff had grown up in the entrepreneurial hotbed of Menlo Park, California. His father was a successful entrepreneur, now retired. Jeff received his business degree from Stanford and had his idea for his first company before he graduated. He followed in his father's footsteps as a successful entrepreneur, starting two companies in the internet space, one providing the infrastructure for online sporting event reservations and the other one of the first online social networking sites for music professionals. Both companies were sold at the height of their success, providing a substantial return on investment for Jeff and the investors in those companies. CRV was an investor in his second company. The CRV partners recognized the vision and entrepreneurial insights that Jeff possessed and asked him to join the firm immediately upon the sale of his second company. Tim saw many common traits and experiences he had with Jeff and was glad that Ann had included him in their lunch.

At that lunch, Ann told Tim that CRV was interested in making an investment in his company and asked how much he felt was needed to grow revenue and earnings in the 40-50% range and to integrate a mobile platform so that network members can join leagues, draft and trade players, and monitor the performance of their players, teams, and league standings from their cell phone. Tim replied that to achieve revenue and earnings growth and site capability expansion of that nature his company would need $8 million. Ann said that upon a successful due diligence and agreement by both parties on the terms of such an investment, CRV would be willing to invest $8 million in FantasyNet with a target date for the investment of February 15,

2010. They agreed that due diligence would start immediately, with Jeff heading the due diligence team. Tim promised to open his company to CRV's due diligence team.

Due Diligence and the Term Sheet

CRV found that in 2009, FantasyNet had captured 1.6 million of the 29.9 million people who play fantasy sports. Revenue from sports league memberships, fantasy sports-related purchases commissions, and advertising totaled \$6.474 million. Earnings before interest, taxes, depreciation, and amortization (EBITDA) were \$3.366 million and net income totaled \$2,175 million. The 33.6% net profit margin and the scalability of the company in a growing industry made FantasyNet an attractive investment for CRV.

Ann drew up the firm's standard term sheet (Exhibit A). To determine the share price and CRV's equity stake in FantasyNet, she used a pre-money valuation of \$16.830 million and a post-money valuation of \$24.830 million. At that post-money valuation, the \$8 million investment by CRV would result in a 32.22 percent ownership interest. Currently, two million common shares are outstanding with Tim the sole owner. Therefore, CRV would be buying 950,683 Series A Preferred shares at \$8.415 per share, diluting Tim's ownership from 100% to 67.78%.

Tim had never seen a term sheet before Ann had given it to him two weeks after their initial lunch. She explained to him that it will likely be a confusing and somewhat formidable document on first reading, but that she would be willing to spend time with him explaining each paragraph so that he would be comfortable signing it. Tim thanked her for the term sheet and asked that he have a week to study it before they discussed it. She agreed and they made arrangements for their next meeting.

That evening, Tim read through the term sheet, understanding some parts but not all. He decided that he needed professional counsel. The accounting firm he used for normal accounting services has a consulting division that specializes in private company financing. Tim arranged a phone conversation with Connie Sayler, an experienced associate in that area. Connie agreed to look at the term sheet and provide comments on the terms of CRV's investment in FantasyNet. Two days later, Tim received Connie's memorandum (Exhibit B).

During the week prior to meeting with Ann, Tim spent considerable time thinking about having CRV as an investor. They were a prestigious venture capital firm, with many successful companies in their portfolio. He believed they could offer him more than just the \$8 million investment. He was certain they could provide business networking and executive search opportunities as well as valuable advice on key business decisions. Yet he wanted to be careful that he did not give preferred share terms so investor-friendly that it would hinder the future growth potential and funding opportunities.

The Term Sheet Memorandum

In addition to studying Connie's comments, he did his own research on the concepts he found in the terms sheets, such as liquidity preference, redemption, anti-dilution provisions, exclusivity, and more. He wanted to be well-prepared to negotiate terms that would result in a term sheet of value to both FantasyNet and CRV and also that would allow him flexibility to grow his company.

Tim discussed the upcoming negotiation with Connie. He told her that since an agreement on some form of the term sheet would represent an ongoing ownership relationship with CRV, he would like to set the tone for that relationship and be open with Ann concerning the comments made by Connie on the term sheet. In fact, he decided ask Connie to assist him in the negotiations and also to show Connie's memorandum to Ann so that there would be no confusion regarding his bargaining positions. Connie agreed and told Tim that she looked forward to assisting him in the negotiation. Tim told her that he was enthusiastic about the funding but that there would have to be some give-and-take with CRV on the terms of the terms sheet for the investment to make sense.

When Ann received a copy of Connie's memorandum from Tim, she knew that the negotiations were going to be very interesting. Most entrepreneurs enter the negotiations with incomplete knowledge of the implications to them of each of the provisions of the term sheet. That presents somewhat of a dilemma for her in that it is the entrepreneur's responsibility to be aware of those implications, but Ann was never comfortable with coming to an agreement on the term sheet if the entrepreneur does not have a complete understanding of the terms. So she always does her best to explain each paragraph to them. Even so, her responsibility to the investors in her firm is to make the best deal possible for each investment. In those negotiations, she is faced with the task of balancing those interests.

However, in the upcoming negotiation on the FantasyNet term sheet, Connie Sayler's memorandum indicated to Ann that Tim understood the term sheet and the issues that were going to be on the table in the negotiations. She was thankful for that even though she anticipated that the negotiation will be rigorous. She felt that having Jeff as a partner in the negotiation would be valuable to her since Jeff had been involved from the beginning of the process, had established a working relationship with Tim throughout the due diligence process, and previously had participated in term sheet negotiations from both sides of the table.

Both parties have a strategy session planned after which they anticipate a productive term sheet negotiation.

EXHIBIT A.

FANTASYNET / CHESTNUT RIDGE VENTURES TERM SHEET
Memorandum of Terms for Private Placement of Equity Securities

Chestnut Ridge Ventures ("Investor") is pleased to indicate its willingness, subject to the terms and conditions of this term sheet to purchase up to $8 million of Series A Preferred Stock to be issued by FantasyNet (the "Company").

New Securities Offered: Newly issued convertible, redeemable preferred stock ("Preferred Stock"). At any time at the option of the holders of a majority of the Preferred Stock, the Preferred Stock will convert into 32.22% of the fully-diluted common equivalent ownership of the Company, subject to the conversion and anti-dilution provisions below.

Total Amount Raised: $8 million

Number of Shares: 950,683

Purchase Price per Share: $8.415

Post-Financing Capitalization: The fully-diluted pro-forma capitalization table immediately following the closing shall be as follows:

	Shares Outstanding	% Ownership
Founder (Common Stock): Tim Bayliss	2,000,000	67.78%
Investor (Preferred Stock): Chestnut Ridge Ventures	950,683	32.22%
Total Common Equivalent:	2,950,683	100.00%

Use of Proceeds: The proceeds to the Company will be used to: (i) fund up to $8 million for working capital purposes and (ii) pay the fees and expenses associated with the transaction.

Dividends: The holders of the Series A Preferred shall be entitled to receive cumulative dividends in preference to any dividend on the Common Stock at the rate of 15 percent of the Original Purchase Price annually, compounded monthly. The holders of Series A Preferred also shall be entitled to participate pro rata in any dividends paid on the Common Stock on an as-converted basis.

Liquidation Preference: Upon (i) a sale of all or substantially all the assets of the Company (an "Asset Sale"), (ii) a merger or consolidation of the Company with or into any other entity, in which the combined owners of Common and Series A Preferred shareholders of the Company immediately prior to such merger or consolidation, own less than 50% of the voting power after such merger or consolidation (a "Merger") or (iii) a liquidation, dissolution or winding down of the business (a "Liquidity Event"), holders of the Series A Preferred shares will receive, in preference to holders of all Common shares, an amount equal to two times (2X) the original purchase price plus any accrued or declared but unpaid dividends. After the payment of the Liquidation Preference to the holders of the Series A Preferred, the remaining assets shall be distributed ratably to the holders of the Common Stock and the Series A Preferred on a common equivalent basis.

Redemption: At the election of the holders of at least a majority of the Series A Preferred stockholders, the Company shall redeem the Series A Preferred Stock at three times (3X) the investment amount plus any accrued or declared but unpaid dividends upon the first to occur of (a) a Liquidity Event (as defined above); or (b) the fifth anniversary of the investment.

Anti-dilution Provision: The Series A Preferred shares will have anti-dilution protection on a full-ratchet basis to prevent dilution in the event the Company issues shares of any type at a purchase price less than the applicable conversion price for Series A Preferred shares in effect. The conversion price will also be subject to proportional adjustment for stock splits, stock dividends, recapitalizations, and the like.

Conversion: The holders of the Series A Preferred shall have the right to convert the Series A Preferred, at any time, into shares of Common Stock. The initial conversion rate shall be 1:1, subject to adjustment as provided below.

Automatic Conversion: The Series A Preferred shall be automatically converted into Common Stock, at the then applicable conversion price, (i) in the event that the holders of at least two thirds of the outstanding Series A Preferred consent to such conversion or (ii) upon the closing of a firmly underwritten public offering of shares of Common Stock of the Company at a per share price not less than seven (7) times the Original Purchase Price per share and for a total offering with net proceeds to the Company of not less than $140 million (a "Qualified IPO").

Voting Rights: The Series A Preferred will vote together with the Common Stock and not as a separate class except as specifically provided herein or as otherwise required by law. Each share of Series A Preferred shall have a number of votes equal to the number of shares of Common Stock then issuable upon conversion of such share of Series A Preferred.

Protective Provisions: For as long as any shares of Series A Preferred remain outstanding, consent of the holders of at least a majority of the Series A Preferred shall be required for any action, whether directly or through any merger, recapitalization or similar event, that (i) alters or changes the rights, preferences or privileges of the Series A Preferred, (ii) increases or decreases the authorized number of shares of Common or Preferred Stock, (iii) creates (by reclassification or otherwise) any new class or series of shares having rights, preferences or privileges senior to or on a parity with the Series A Preferred, (iv) results in the redemption or repurchase of any shares of Common Stock (other than pursuant to equity incentive agreements with service providers giving the Company the right to repurchase shares upon the termination of services), (v) results in any merger, other corporate reorganization, sale of control, or any transaction in which all or substantially all of the assets of the Company are sold, (vi) amends or waives any provision of the Company's Certificate of Incorporation or Bylaws, (vii) increases or decreases the authorized size of the Company's Board of Directors, or (viii) results in the payment or declaration of any dividend on any shares of Common or Preferred Stock, or (ix) issuance of debt in excess of $100,000."

Registration Rights: The holders of Preferred Stock will be entitled to one demand registration. Once the Company is eligible to register its securities for sale on Form S-3, the holders of Preferred Stock will have rights to two registrations per year on Form S-3, provided that such registrations will not be for less than $250,000. After the initial public offering, the holders of Preferred Stock will have unlimited piggyback registration rights if the Company effects a registration of shares for its own account or the account of another person. The Company will bear the expenses of such demand, S-3 and piggyback registrations, other than the underwriters' commission.

Board of Directors. The size of the Company's Board of Directors will initially be set at a maximum of three members elected as follows: (i) one director by the Preferred Stock, (ii) one director by the Company, and (iii) the remaining director will be mutually agreed upon by the Preferred Stock and the common stockholders. The Company will reimburse non-employee directors for all out-of-pocket expenses incurred in attending board and committee meetings, as well as provide customary compensation including a right to receive options and similar equity interests on the same basis as directors elected by the company. Furthermore, upon any failure of the Company to redeem the Preferred Stock or pay debts when due, or upon the acceleration of any debt, the majority of the holders of the Preferred Stock will be entitled to designate additional members of the Board such that the designees of the holders of the Preferred Stock constitute a majority of the Board.

Information Rights: The Company will provide to the Investor audited annual financial statements, audited by an accounting firm of selected by Investor, and unaudited quarterly financial statements. In addition, the Company will furnish the Investor with monthly and quarterly financial statements and will provide a copy of the Company's annual operating plan within 30 days prior to the beginning of the fiscal year. In addition, the Company will make available, without limitation, all internal management documents, reports of operations, reports of adverse developments, copies of any management letters, communications with shareholders or directors and press releases and registration statements as well as access to all senior managers as requested by holders of Series A Preferred Stock. Each Investor shall also be entitled to inspection and visitation rights once per quarter.

Right of First Refusal: Investors shall have the right in the event the Company proposes to offer equity securities to any person (other than securities issued pursuant to employee benefit plans or pursuant to acquisitions) to purchase on a pro rata basis all or any portion of such shares. Any securities not subscribed for by an eligible Investor may be offered to other parties on terms no less favorable to the Company for a period of sixty (60) days. Such right of first refusal will terminate upon a Qualified IPO.

Co-sale Agreement: The shares of the Company's securities held by the principal stockholders will be made subject to a co-sale agreement so that such stockholders may not transfer, sell, or exchange their stock unless each holder of Preferred Stock has the opportunity to participate in such transfer on a pro-rata basis.

Bring Along Right: If an unaffiliated third party makes a bona fide offer for all or substantially all of the stock or assets of the Company for a purchase price that is not less than $50 million and the majority of holders of the Preferred Stock desire to sell, the remaining stockholders will have 15 days to match the offer and, failing their ability to do so (with financing in place), they will sell their shares on the same terms and conditions or vote with the holders of the Preferred Stock to sell the assets of the Company.

Stock Vesting: All stock and stock equivalents issued after the Closing to employees, directors, consultants and other service providers will be subject to vesting provisions below unless different vesting is approved by the majority (including at least one director designated by the Investors) consent of the Board of Directors (the "Required Approval"): 25% to vest at the end of the first year following such issuance, with the remaining 75% to vest monthly over the next three years. In the event of a merger, consolidation, sale of assets or other change of control of the Company and should an Employee be terminated without cause within one year after such event, such person shall be entitled to one year of additional vesting. Other than the foregoing, there shall be no accelerated vesting in any event.

Closing Fee: Three percent (3%) of invested funds to Investor at closing.

Expenses: The Company will bear the fees and expenses of the Investor and of the Company incurred in connection with this transaction at the closing. The Company shall provide the Investor with a non-refundable retainer of $35,000 to begin drafting legal documentation and commence due diligence.

Exclusivity: For a period of 90 days after the execution of this term sheet, the Company and each principal stockholder of the Company (i) will deal exclusively with the Investor in connection with the issue or sale of any equity or debt securities or assets of the Company or any merger or consolidation involving the Company, (ii) will not solicit, or engage others to solicit, offers for the purchase or acquisition of any equity or debt securities or assets of the Company or for any merger or consolidation involving the Company, (iii) will not negotiate with or enter into any agreements or understandings with respect to any such transaction and (iv) will inform the Investor of any such solicitation or offer and the terms thereof.

Publicity: Any press release or other public statement issued by any party relating to this letter or the transactions contemplated will be approved in advance by all parties and will contain appropriate references to each such party who desires such references. In addition, the Company shall not use the Investor's name in any manner, context or format (including, reference on or links to websites, press releases, etc.) without the prior review and approval of Investor.

Non-Binding: This is neither an offer nor a binding commitment, other than as set forth under the headings "Expenses", "Exclusivity", and "Publicity." A binding commitment will only be made pursuant to the execution of a definitive purchase agreement and related documents mutually acceptable to all parties.

Tim Bayliss, Chief Executive Officer Date
FantasyNet

Ann Davenport, Managing Partner Date
Chestnut Ridge Ventures

EXHIBIT B.

Accounting Firm Consulting Memorandum on FantasyNet / Chestnut Ridge Ventures Term Sheet

To: Tim Bayliss
From: Connie Sayler, Venture Financing Consultant
RE: FantasyNet / Chestnut Ridge Ventures Term Sheet Comments

In response to your request for comments on the Chestnut Ridge Ventures (CRV) term sheet presented to you, please see below. My comments are to be used only to provide insights into the meaning and potential impact of the noted paragraphs and are not to be considered legal advice in preparing the final version of the term sheet. Paragraphs not addressed in the comments below are standard and will require no or very little negotiation. Please note that some of the provisions are standard, so don't waste too much time in trying to keep them out. A better strategy is to 1) negotiate those provisions that have a potential adverse impact on how the company is managed as well as the value maintained by common stockholders and 2) successfully manage the company so that any provisions adverse to the common stockholder (you) won't be invoked. Please be aware that the term sheet is a non-binding document except for the provisions noted in the "Non-Binding" paragraph.

Valuation: The initial segment of the term sheet concerns the pricing of the shares bought by CRV with their $8 million investment. The valuation of any private or public company is subjective. Publicly-traded companies have an exchange-based value that may or may not provide a reasonable value of the company. Shares of publicly-traded companies are traded throughout any day the market is open, so the share prices can be seen as the market constantly shifts its value-perception of the company. However, shares of private companies such as FantasyNet are not traded publicly, so the only time a share price is determined is when a transaction like the CRV purchase of preferred shares takes place. At that time, an agreement is made on the value of the company which determines the share price. That valuation is the most critical element to be negotiated. If an agreement cannot be made on an appropriate valuation for the transaction, there is no need to negotiate the remaining provisions of the term sheet.

As the term sheet shows, CRV is purchasing 950,683 preferred shares at $8.415 per share for 32.22% of the company. To understand how CRV determined these figures, two forms of the FantasyNet valuation are in play – pre-money valuation and post-money valuation. Pre-money valuation is the value of FantasyNet before the investment is made. Post-money valuation is simply the pre-money valuation plus the amount invested. There are several methods to determine pre-money valuation, and the one most often used is the EBITDA (Earnings before Interest, Taxes, Depreciation, and Amortization) multiple method.

To find the EBITDA multiple CRV used to value FantasyNet, we need to perform a few calculations. Since CRV used 2009 as the latest twelve-month period for which an actual EBITDA exists, we can use that 2009 EBITDA of $3,366,000 as the basis for the valuation applicable to the CRV term sheet. As CRV is valuing the shares at $8.415 and we are initially calculating the pre-money valuation (without the CRV investment), we can find the pre-money valuation as the product of the share price ($8.415) and the number of shares outstanding (2,000,000) before the investment.

(Eq. 1) Pre-money Valuation = Share price x Shares outstanding before investment
= $8.415 x 2,000,000 shares
= $16,830,000.

Therefore, the EBITDA Multiple can be found using the following equation:

(Eq. 2) EBITDA Multiple = Pre-money Valuation / EBITDA
= $16,830,000 / $3,366,000
= 5

The EBITDA multiple embodies the expected future financial and value-creation performance of the company. Higher expectations of future performance would justify a higher multiple. From the information we have concerning investment transactions within the last six months in the social networking space, we have found a range of 5 to 7 for EBITDA multiples used to determine pre-money valuations. Financial metrics for FantasyNet and a sample of companies comparable to FantasyNet are shown below in Exhibits C through G.

The EBITDA multiple of 5 that CRV used is at the lower end of the range. Agreement on the appropriate multiple in valuing FantasyNet will be a major point to negotiate, as a higher multiple would increase the pre-money valuation and therefore result in CRV paying a higher price for FantasyNet preferred shares and receiving a lower percentage of the company for their $8 million investment.

Post-money valuation is the pre-money valuation plus the investment amount:

(Eq. 3) Post-money Valuation = Pre-Money Valuation + Investment Amount
= $16,830,000 + $8,000,000
= $24,830,000

The percentage of the company purchased with that $8 million investment is found by dividing the investment by the post-money valuation:

(Eq. 4) Percent of company purchased by CRV = Investment / Post-money valuation
= $8,000,000 / $24,830,000 = .3222
= 32.22%

Of course, this means that you, as sole common stockholder, own the remaining 67.78% of the company.

To determine the number of preferred shares purchased by CRV with their $8 million investment, we can use the following equation:

(Eq. 5) Shares purchased by CRV = [CRV ownership in decimal / (1 – CRV ownership in decimal)] x Shares outstanding before investment
= [.3222 / (1-.3222)] x 2,000,000 = 950,683 shares

Dividends: Dividends in a term sheet are called "juice" to the deal. The reason CRV is investing in your company is to get a minimum of 10X return on their investment and ideally a 50X return. If a 50X return happens, and it does only in a small number of deals, the dividend return will only increase return slightly. For example, on the $8 million investment in FantasyNet, let's assume CRV gets what they want, a 50X return on their investment in five years. CRV will receive $400 million (50 x $8 million). Assuming no compounding, monthly or otherwise, a 15% annual dividend on $8 million is $1.2 million per year, or $6.0 million accumulated over five years (if the preferred stock is cumulative) and added to the $400 million brings it to $406 million. Not a very significant dividend addition. Just a bit of juice.

However, the dividend gains are significant to CRV when the liquidity event results in much lower value. Say it is only 2X the initial investment, or $16 million. The five year's worth of dividends of $6 million then would take it to $22 million. Even though a 2X return over five years is nothing to brag about, adding $6 million to a gain of $16 million helps quite a bit.

My advice: 15% dividend is at the high end of the 5%-15% range when dividends are included in the deal. No dividend is best, but if you feel you need to give them a dividend-paying preferred, keep it at the low end of the range. And scrap the compounding. Also, the last sentence of the paragraph is moot as you won't be paying a dividend to your common stockholders. Negotiate it out if you can.

Liquidation Preference: This is a critical provision. There are two parts to it, corresponding to the two sentences in the paragraph. The first "very long" sentence is the preference part. It states that the Series A Preferred shareholders get "preference" on a liquidity event in that they will receive twice (2X) their original investment plus any unpaid dividends off the top of any proceeds to the company from the liquidity event and before the common shareholders get any proceeds. CRV will require the "preference." The 2X element is negotiable. 1X is more favorable, especially given they want their Preferred shares to be participating, as explained below. For a few years starting in 2001, the X multiple in term sheets rose above the standard 1X to account for the increased risk perceived in VC investments, but investors are now requiring solid businesses in which to invest, so 1X has returned in most term sheets. CRV will likely have another view on this. Also, the payment of unpaid dividends depends on whether you can negotiate the Series A Preferred to be non-dividend shares.

The second (last) sentence makes the preferred shares "participating." Participating means that after the investor gets their preferred payback (2X or 1X) of their original investment plus dividends, they "participate" with the common shareholders (you) on the existing "as converted" basis. You have a few options on the participate element of the paragraph. First, and my recommended approach, is to try to negotiate it out completely. It represents an economic advantage to the investor that is not the original intent of their investment, which is to share the risk on a preferred and protected basis. Here's an example of how "participation" works. CRV makes their $8 million investment based on a $16.830 million pre-money valuation. CRV gets 32.22% ownership. If the company is sold for $30 million, CRV receives their $8 million first (the preference) and then 32.22% of the remaining $22 million (the participate), or $7.088 million. Therefore, CRV receives a total of $15.088 million, or 50.3% of the $30 million sale proceeds, not the original 32.22% ownership share.

The impact of participation is decreased at higher liquidity event values. Say the company was sold for $100 million. CRV would get their $8 million first, and then 32.22% of the remaining $92 million, or $29.642 million, for a total of $37.642 million, or 37.64% of the $100 million sale proceeds. Not as dramatic of an increase from the original 32.22% ownership as the sale at a lower price, but still a difference of $5.422 million going to CRV instead of to you. Of course, I didn't even consider the accumulated dividends the investor gets, which makes the "participate" even more investor-friendly. This is "full participation" and a significant economic advantage to the investor.

An alternative is to "cap the participate." This means that the investor can participate after their return of their investment but only up to a certain cap level, say 2X or 3X the original investment. A sample term sheet "cap" provision would read: "After the payment of the Liquidation Preference to the holders of the Series A Preferred, the remaining assets shall be distributed ratably to the holders of the Common Stock and the Series A Preferred on a common equivalent basis, provided that the holders of Series A Preferred will stop participating once they have received a total liquidation amount per share equal to X times the Original Purchase Price, plus any declared but unpaid dividends. Thereafter, the remaining assets shall be distributed ratably to the holders of the Common Stock."

In this "capped" participation, the X times the Original Purchase Price includes the Liquidation Preference amount, not just the participating amount. "X' is normally 2 or 3 when this "capped" participation is included and the actual multiple would be a result of the negotiation.

My recommendation: I doubt if any investor would agree to remove the "liquidation preference" part, but try to keep these "participate" clauses out completely and go with the non-participation.

Redemption: To understand the redemption provision, you must understand that VCs raise money for their current fund (typical size: $150-200 million) from investors (institutions, college endowment funds, wealthy individuals) for a period of 8 to 10 years (sometimes as short as 5 years), at which time the VCs must "wind down" the fund (pay back the investors their original investment plus any gains). There is a high probability that some of the companies in which the VC invested from the fund are in a state of "living dead", that is, strong enough to keep going but not strong enough for a liquidity event. The VC has a problem if the money is stuck in the company with no way to get it out when the fund's term is up. So the VCs invented the redemption provision to manage that risk. This provision gives them the right to require the company to pay back the initial investment plus any accrued but unpaid dividends. Of course, the company needs to have an adequate cash balance to honor the redemption. If not, the VC really has a problem – they have a right to the money, but it's not available because the value created in some fund companies is not liquid. If the VC believes there is a good chance that a liquidity event is imminent, they won't invoke the redemption as they will rather roll the dice on the liquidity event.

It will probably be a deal-breaker if you insist on it not being in the term sheet, but there are elements of the provision that you can negotiate to make it more favorable. Keep the redemption date as far in the future as possible. String out the payments so that the company does not have a huge cash requirement at any one time. Redemption at more than 1X the investment amount is taking this provision beyond redemption and into an accelerated return. Negotiate to a redemption of just the investment amount (1X) plus dividends, if the Series A stays as a dividend stock. And do your best to keep out any clause that triggers an adverse-change redemption which allows an option to redeem whenever a majority of the Series A Preferred stockholders vote that the company has experienced a material adverse change associated in any way with its business operations or prospects. They could vote anything a "material adverse-change" in the company. CRV will likely present reasons why this is a critical risk-management provision.

Anti-dilution Provision: Be very careful with this provision. The anti-dilution provision is in a term sheet to protect CRV from excess-dilution caused by a subsequent round of financing taking place at a lower share price than their Series A price. Here's how this works:

CRV is buying their Series A Preferred shares at $8.415 per share. They are getting 950,683 shares for their $8 million investment. Initially their conversion rate is 1:1. Now assume that the Series B Preferred is sold at $7 per share. The the size of investment in the B round is not relevant for a full ratchet anti-dilution, as presented in the term sheet. At $7 per share, the Series B funding would be a down round. With full ratchet protection, the Series A investors have the right to reprice their entire investment at the lower Series B price, no matter how many shares were sold to the Series B investor. At the adjusted Series A price ($7 per share), on conversion to common the Series A investor would have a right to 1.143 million shares of common ($8/$7 = 1.143). They would not immediately receive additional Series A Preferred shares, but their conversion rate would change from 1:1 to 1.143:1. The Series A investors expect dilution of their percentage ownership to occur as additional rounds of financing takes place. They also may expect preferred shares to be sold in subsequent rounds of financing at successively higher prices. However, a lower Series B share price means more shares issued per dollar invested than the Series A round, diluting Series A investor ownership more than had there been an up-round. So they want to be protected from this.

Now let's look at a more serious case, one in which you can get "burned out" of your venture. Assume that FantasyNet hits hard times over the next year, maybe there's a strike in a key sports league or a national crisis in which professional sports stops for a while and revenues dry up for FantasyNet on a short-term basis. You need $500,000 in cash to survive this period and no one except CRV will invest in the Series B round. They will only invest at $4.00 per share, less than half of what they paid for their Series A shares. For their $500,000 investment, they will receive 125,000 Series B shares. First we can look at the situation without an anti-dilution provision. Your dilution is minimal since the funding amount is small and the number of new shares (125,000) represents only 4.1% of the 3,075,683 oustanding shares after the B round (2,950,683+125,000 shares). Your ownership percentage is diluted minimally from 67.78% to 65.0%. CRV now owns both Series A and B shares, with their A share ownership at 32.22% and their B share ownership at 4.1%.

However, with full ratchet anti-dilution protection, CRV has a right to a conversion price adjustment on all of their Series A shares due to the Series B down round. As explained above, they will have the right to value their $8 million Series A investment at $4.00 per share instead of the original $8.415 per share, which would mean that their Series A investment would buy 2 million shares instead of 950,683 shares. On an as-converted basis, CRV would then own 2 million "A" shares and 125,000 "B" shares. Total outstanding shares would be CRV's 2 million "A" shares, their 125,000 "B" shares, and your 2,000,000 common shares, or 4,125,000 shares on an as converted basis. CRV's would now own 51.5% of the company. Your ownership is diluted to 48.5%.

A more favorable anti-dilution provision for you would be a weighted-average approach which takes into account the relative size of a subsequent round as compared to the Series A round. Here's how it works. The original Series A price is adjusted, not directly to the Series B price as it would under full ratchet, but based on the ratio of the number of outstanding shares had the new Series B financing taken place at the Series A price to the number of outstanding shares given the actual Series B financing without any Series A adjustment. After the CRV Series A funding took place but before the Series B funding, there were 2,950,683 shares outstanding - 2 million common shares owned by you and 950,683 Series A Preferred shares owned by CRV. In the example above, a $500,000 Series B funding takes place at $4.00 with 125,000 "B" shares issued. Under the weighted-average approach, the new conversion price for Series A, made possible by their anti-dilution protection, would be calculated in the following way:

New Conversion Price = Current Conversion Price X

[(Shares outstanding prior to new funding + New shares issued based on current "A" conversion price) / (Shares outstanding prior to new funding + New shares issued based on new funding price)]

= $8.415 x [(2,950,683 + 59,418) / (2,950,683 + 125,000)] = $8.415 x .9787 = $8.2356

This results in a revaluation of the Series A Preferred shares based on the new conversion price. The conversion rate would change to 1.022, found by $8.415 / $8.2356.

Thus, the number of shares of common issued upon conversion of Series A is now:

950,683 shares x 1.022 = 971,598 shares

Your dilution under the weighted-average approach would be to 64.6% (2 million shares/3.096,598 shares) as compared to 48.5% under full ratchet. Less dilution for you happens because the relative size of the Series B funding in addition to the down-round price is taken into account in the weighted-average approach whereas in full ratchet only the down-round price was considered. My recommendation: negotiate to remove the full ratchet provision and replace it with a weighted-average one.

Also, I would suggest adding "carve out" provisions that allow you to sell future shares to certain individuals or groups of individuals without triggering the anti-dilution protection. The carve-out language might be "… other than shares (i) reserved as employee shares described under the Company's option pool,, (ii) shares issued for consideration other than cash pursuant to a merger, consolidation, acquisition, or similar business combination approved by the Board; (iii) shares issued pursuant to any equipment loan or leasing arrangement, real property leasing arrangement or debt financing from a bank or similar financial institution approved by the Board; and (iv) shares with respect to which the holders of a majority of the outstanding Series A Preferred waive their anti-dilution rights) at a purchase price less than the applicable conversion price."

Carve-outs (i-iii) are pretty standard. Carve-out (iv) is being put into many term sheets and protects common investors from the dilution effects of a down round if the majority (but not all) of the holders of Series A Preferred shares decides to fund a Series B round at a lower valuation. Assume a minority of holders of Series A Preferred shares don't participate in funding the "B" round, counting on the anti-dilution protection to maintain their valuation thereby further diluting everyone else. Carve-out (iv) will prevent this by giving those majority investors the right to void the anti-dilution protection for all Series A Preferred share holders, whether they participate or not. Language for carve-out (iv) is "This anti-dilution protection is subject to a play-or-lose provision that provides that adjustments will be made to the Series A Conversion Rate only if the Series A holder participates in such dilutive offering to the extent of its pro rata equity interest in the Preferred. Any investor who does not participate in a future financing forfeits the benefits of dilution protection." You can include either 1) for all future rounds of financing or 2) only for that financing round. Of course, if you only have one owner of Series A Preferred shares, they will either fund a future round or not, so the clause would be moot.

Conversion: This simply states that every share of Preferred stock can be converted on a liquidity event to one share of common stock. Also, it establishes the ratio that pertains to Preferred stockholder voting on an "as converted basis', that is, one Preferred share has the same vote as one Common share. This is standard in all term sheets and acceptable. Note that this conversion relationship could change if the anti-dilution provision is in effect on a down-round.

Automatic Conversion: This paragraph may seem benign, but there are three important variables that will influence its impact on you. Clause (i) regarding the voting threshold is moot because CRV is the only investor. However clause (ii) has two landmines regarding a potential IPO - the thresholds of seven times (7X) the original Series A Purchase Price and of $140 million net proceeds to the Company. You want these thresholds to be a low as possible to maintain flexibility in having an IPO while CRV is going to want these as high as possible to maintain control of when and at what price an IPO will take place. Seven times the original Series A price and $140 million proceeds seem high given your Series A post-money valuation of $24.830 million. Also, you want to make sure that all series of investors (A, B, C….) have the same thresholds in the Automatic Conversion to avoid the possibility that one Series group of investors with very high thresholds can prevent an IPO that the other investors think would be in the best interests of all investors. This may mean that you will have to go to some previous investors and renegotiate these thresholds, but it will be worth it.

Voting Rights: Just descriptive of who can vote. This is standard. Acceptable.

Protective Provisions: These provisions often are hotly negotiated as they represent veto rights for the holders of Series A Preferred shares. Ideally, you would not want the investor to have any veto rights. Their position will be that these are just rights that will not necessarily and likely not, be exercised. But I think you should choose your battles here. (i), (iv), (vi) and (ix) seem okay.

The real problem with the other provisions is the restriction on your ability to raise money in subsequent rounds. (ii) is fine only because you have lots of authorized shares that are currently unissued and available to issue in later rounds. If that were not the case, you would have to get the investor's permission to increase the authorized shares, and they could veto it which means you would have no shares to issue for a future round of financing. (iii) means that the investors have the right to insist that any new Preferred shares sold to new investors must have subordinated rights, preferences, and privileges to the Series A investor's shares. That would make it extremely difficult for you to attract new investors after this round as they would have a subordinated position to the Series A investors. (v) gives the investor the right to block a liquidity event for any reason. Their interests are for a liquidity event and the concern on their part is that the company could be sold either prematurely or at a price that would not provide them with their desired return on investment. You can address this by putting a cap on their veto by adding at the end of that provision "in which the Investor's proceeds would be less than [X] times the initial investment." You can negotiate the X number. (vii) inhibits your ability to provide new investors with seats on the Board, and new investors very likely will require that. This can be addressed by adding at the end of that provision "with the exception of increasing the number of directors comprising the Board of Directors by at the minimum one (1) for each subsequent round of financing in excess of Y million dollars." Again, you negotiate the Y number. (viii) also may inhibit your ability to issue dividend-paying Preferred shares to subsequent investors. You really don't want to have dividends associated with any Preferred issues, but you may need funding in the future and a new investor may require dividends to be included with their Preferred shares. So it would be advantageous to you to have that flexibility without the Series A investors able to veto it.

Registration Rights: No need to spend any time on this one. If and when an IPO takes place, the investment banking firm handling the IPO will decide how the deal is going to be structured regardless of what this paragraph states.

Board of Directors: Board representation can be a contentious issue and potentially create major problems for you in the future in the event that the company underperforms or the VC has an objective of taking control of the company or at least putting a person of their choosing in control. Currently, your board is comprised of you and Ray Katrinak. CRV may want to replace Ray with someone who is not aligned so closely with you. However, they will only own 32.22% of the company, so a minority board representation for CRV is reasonable. They will likely argue that they need some control to protect the way their $8 million is used. I recommend that you do your best to keep Ray as the third person on the Board and let them have the other seat. Also, there is no need to pay them as Directors. I would recommend against the last sentence allowing them to take control of the Board as it would likely have to be renegotiated away when additional funding rounds take place.

Information Rights: No significant issues here, although I would have the Board decide on the accounting firm doing the annual audit in order to maintain control of that cost. Providing monthly financial statements is slightly overkill. Quarterly should suffice. Also, just as a formality I would add as the last sentence: "These provisions shall terminate upon a Qualified IPO."

Right of First Refusal: This gives Preferred stockholders the right of first refusal to purchase enough shares in any proposed subsequent stock offering to maintain their existing percentage ownership. This means that any new investors may have previous investors entering again in the new round. Complicates subsequent funding only slightly.

Co-sale Agreement: This is standard. Not much chance of excluding this. Acceptable.

Bring Along Right: Acceptable.

Stock Vesting: You can negotiate on the percentages. The first 25% is considered the "cliff" and you can negotiate that higher or even vest 25% immediately with an additional 25% as a cliff, then the remaining 50% to vest monthly over the next 24 months. Although your Board member, Ray Katrinak, does not have ownership in the company, assume he invested $500,000 at an early stage. He should not and likely would not be subject to this vesting provision as he actually bought his shares with a $500,000 investment, so he would be considered an investor. But CRV will argue that you are subject to vesting based on the fact that your common shares ownership is based on sweat equity and not hard dollars. Try to negotiate stock vesting out of the agreement. CRV will want it in to keep you motivated to stay with the company.

Closing Fee: Try very hard to negotiate this out of the term sheet. You are likely going to be paying their expenses. CRV may justify these fees as their compensation for providing networking and management consulting services as part of their ownership, but you will have to present an alternative position that as owners they have an interest in providing those benefits to contribute to the increase in the value of their equity stake in FantasyNet. If you can't exclude a closing fee, at least structure a payment schedule extending over several years.

Expenses: Watch out for this one. As written in the term sheet, you are writing a blank check. Negotiate some cap on company-paid closing expenses. Should be about $30,000-$50,000. Okay for the company to pay expenses at closing of deal, but only upon closing. Non-refundable retainer of any amount is over-the-top and would mean that you are paying their expenses even if they back out.

Exclusivity: Ninety days is too long. This deal should get done in much less time or one of the parties is not committed. Make it 45 days or 30 days renewable on mutual and written agreement by both Company and Investor.

The longer the time you are tied to exclusivity, the more difficult it may be for you to raise financing elsewhere if this deal is not made.

Publicity: They want to control the manner in which this transaction is presented to the public. Acceptable.

Non-Binding: Note that the "Expenses", "Exclusivity", and "Publicity" sections of the term sheet are not binding, so you will be legally bound to honor those paragraphs as negotiated. Also, if the due diligence performed subsequent to the signing of this term sheet results in the decision to go forward with the CRV investment, the following are the legal and binding documents to which this paragraph refers: Stock Purchase Agreement, Certificate of Incorporation, Investor Rights Agreement, Voting Agreement, Right of First Refusal and Co-Sale Agreement, Management Rights Letter, and Indemnification Agreement. For samples of these documents, see http://www.nvca.org/index.php?option=com_content&view=article&id=108&Itemid=136.

Good luck with your negotiations!

EXHIBIT C. COMPARABLE FINANCIAL METRICS

	Current - 2009			
Key Financial Metrics	FantasyNet	Jobai	Tarmac	Triptic
Current Ratio	16.76	17.25	28.29	26.19
Quick Ratio	15.68	16.23	27.36	25.77
Cash Ratio	11.83	13.92	25.27	22.95
Total Asset Turnover	0.90	0.71	0.41	0.53
Average Collection Period	0.25	0.18	0.18	0.20
Gross Profit Margin	95.0%	88.0%	88.0%	97.0%
Operating Profit Margin	51.9%	37.7%	38.8%	52.9%
Net Profit Margin	33.6%	24.3%	25.0%	34.2%
Debt/Equity Ratio	0.00	0.00	0.00	0.00
Leverage Ratio	1.06	1.06	1.04	1.04
Tax Burden Ratio	0.65	0.65	0.65	0.65
Interest Burden Ratio	1.00	0.99	0.99	0.99
Interest Coverage Ratio	218.22	172.66	110.93	157.40
Return on Equity (ROE)	62.2%	48.8%	27.3%	35.5%
Return on Assets (ROA)	47.0%	26.8%	15.9%	28.0%
Earnings Multiple Used in Valuation	TBD	7	5	6
Growth Rates (Geometric Means)				
Revenue – 2005-09	47.9%	67.9%	70.2%	60.6%
Revenue – 2009-14	45.0%	42.9%	35.0%	30.0%
Net Income – 2005-09	41.0%	57.1%	58.8%	57.8%
Net Income – 2009-14	40.8%	48.7%	36.6%	30.5%
Free Cash Flow – 2005-09	27.9%	42.9%	42.6%	41.8%
Free Cash Flow – 2009-14	42.4%	48.1%	33.4%	30.1%

Metrics Definitions: Current Ratio = Current Assets/Current Liabilities; Quick Ratio = (Cash and Marketable Securities + Receivables)/Current Liabilities; Cash Ratio = Cash and Marketable Securities/Current Liabilities; Total Asset Turnover = Net Sales/Total Assets; Average Collection Period = Net Sales/Accounts Receivable; Gross Profit Margin = (Net Sales – Cost of Goods Sold)/Net Sales; Operating Profit Margin = EBIT/Net Sales; Net Profit Margin = Net Profit/Net Sales; Debt/Equity Ratio = Long-term Debt/Stockholders' Equity; Leverage Ratio = 1+ (Debt/Equity); Tax Burden Ratio = Net Profit/Pretax Profit; Interest Burden Ratio = (EBIT-Interest Expense)/EBIT; Interest Coverage Ratio = EBIT/Interest Expense; Return on Equity (ROE) = Tax Burden Ratio x Interest Burden Ratio x Operating Margin x Total Asset Turnover x Leverage Ratio; Return on Assets (ROA) = Operating Profit x Total Asset Turnover

EXHIBIT D. FANTASYNET KEY FINANCIAL METRICS

(all dollar values in $000)

Key Income Statement Values	2005(a)	2006(a)	2007(a)	2008(a)	2009(a)	2010(p)	2011(p)	2012(p)	2013(p)	2014(p)
Net Sales (NS)	1,354	2,261	3,256	4,624	6,474	9,387	13,611	19,735	28,616	41,493
NS Annual Growth - Geometric		67.0%	55.1%	50.6%	47.9%	45.0%	45.0%	45.0%	45.0%	45.0%
NS Annual Growth – Average		67.0%	44.0%	42.0%	40.0%	45.0%	45.0%	45.0%	45.0%	45.0%
Gross Profit	1,313	2,216	3,159	4,439	6,150	8,917	12,930	18,749	27,185	39,419
Gross Profit Margin	97.0%	98.0%	97.0%	96.0%	95.0%	95.0%	95.0%	95.0%	95.0%	95.0%
EBITDA	853	1,459	1,876	2,483	3,366	4,224	6,125	8,881	12,877	18,672
Net Income (NI)	550	942	1,212	1,605	2,175	2,727	3,954	5,734	8,316	12,059
NI Annual Growth-Geometric Mean		71.3%	48.5%	42.9%	41.0%	25.3%	34.8%	38.1%	39.8%	40.8%
NI Annual Growth-Average		71.3%	28.7%	32.4%	35.6%	25.3%	45.0%	45.0%	45.0%	45.0%
Net Profit Margin	40.6%	41.6%	37.2%	34.7%	33.6%	29.0%	29.1%	29.1%	29.1%	29.1%
Key Balance Sheet Values										
Cash and marketable securities	411	1,170	2,049	3,390	4,980	15,392	18,436	22,856	29,274	38,591
Property, plant, and equipment	68	74	86	94	104	135	175	228	296	385
Long-Term Debt	0	0	0	0	0	0	0	0	0	0
Key Free Cash Flow Values										
Cash provided by operations		753	889	1,332	1,567	2,390	3,015	4,371	6,338	9,190
Gross investments in tangible fixed		(10)	(15)	(12)	(14)	(36)	(47)	(62)	(80)	(104)
Free Cash Flow (FCF)		743	874	1,319	1,553	2,354	2,968	4,310	6,258	9,086
FCF Annual Growth - Geometric			17.7%	33.3%	27.9%	51.5%	38.2%	40.5%	41.7%	42.4%
FCF Annual Growth - Average			17.7%	50.9%	17.7%	51.5%	26.1%	45.2%	45.2%	45.2%

EXHIBIT E. JOBAI KEY FINANCIAL METRICS

(all dollar values in $000)

Key Income Statement Values	2005(a)	2006(a)	2007(a)	2008(a)	2009(a)	2010(p)	2011(p)	2012(p)	2013(p)	2014(p)
Net Sales (NS)	$1,540	$2,879	$4,808	$7,886	$12,223	$18,334	$26,585	$37,219	$52,106	$72,949
NS Annual Growth - Geometric		87.0%	76.7%	72.4%	67.9%	50.0%	47.5%	44.9%	43.7%	42.9%
NS Annual Growth - Average		87.0%	67.0%	64.0%	55.0%	50.0%	45.0%	40.0%	40.0%	40.0%
Gross Profit	$1,324	$2,534	$4,376	$7,176	$10,756	$16,684	$24,192	$33,869	$47,417	$66,383
Gross Profit Margin	86.0%	88.0%	91.0%	91.0%	88.0%	91.0%	91.0%	91.0%	91.0%	91.0%
EBIT	$821	$1,333	$2,680	$4,303	$4,630	$8,434	$12,229	$17,121	$23,969	$33,556
Net Income (NI)	$489	$818	$1,686	$2,791	$2,975	$5,419	$7,862	$11,012	$15,424	$21,600
NI Annual Growth-Geometric		67.4%	85.7%	78.7%	57.1%	82.2%	62.6%	54.7%	50.9%	48.7%
NI Annual Growth-Average		67.4%	106.0%	65.5%	6.6%	82.2%	45.1%	40.1%	40.1%	40.0%
Net Profit Margin	31.7%	28.4%	35.1%	35.4%	24.3%	29.6%	29.6%	29.6%	29.6%	29.6%
Key Balance Sheet Values										
Cash and marketable securities	$946	$1,645	$2,646	$10,860	$13,296	$17,459	$23,665	$32,557	$45,053	$62,605
Property, plant, and equipment	$108	$162	$272	$543	$674	$849	$1,018	$1,222	$1,467	$1,760
Long-Term Debt	$500	$500	$500	($6)	($6)	($6)	($6)	($6)	($6)	($6)
Key Free Cash Flow Values										
Cash provided by operations		$633	$1,065	$2,030	$2,547	$4,109	$6,210	$8,879	$12,427	$17,394
Gross investments in tangible fixed		($60)	($121)	($293)	($157)	($209)	($210)	($253)	($303)	($364)
Free Cash Flow (FCF)		$573	$944	$1,737	$2,390	$3,900	$6,000	$8,627	$12,124	$17,030
FCF Annual Growth - Geometric			64.8%	74.1%	61.0%	63.2%	58.4%	53.4%	50.1%	48.1%
FCF Annual Growth – Average										

Jobai is the leading innovator in online recruitment and job placement. Jobai takes online job markets to an advanced social networking level by integrating the recruitment activities of companies and job search activities of individuals with other online social networking platforms such as Facebook, MySpace, and Twitter. Jobai also provides an iphone app to provide instant mobile phone notification of job opportunities. Received funding of $7 million in 2008 at a pre-money valuation EBITDA multiple of 7.

EXHIBIT F. TARMAC KEY FINANCIAL METRICS (ALL DOLLAR VALUES IN $000)

Key Income Statement Values	2005(a	2006(a	2007(a	2008(a	2009(a	2010(	2011(	2012(	2013(	2014(
Net Sales (NS)	$606	$1,285	$2,416	$3,770	$5,089	$6,870	$9,275	$12,52	$16,90	$22,82
NS Annual Growth - Geometric	0.0%	112.0	99.6%	83.9%	70.2%	35.0%	35.0%	35.0%	35.0%	35.0%
NS Annual Growth - Average	0.0%	112.0	88.0%	56.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%
Gross Profit	$521	$1,131	$2,199	$3,430	$4,478	$6,252	$8,440	$11,39	$15,38	$20,76
Gross Profit Margin	86.0%	88.0%	91.0%	91.0%	88.0%	91.0%	91.0%	91.0%	91.0%	91.0%
EBIT	$321	$593	$1,345	$1,565	$1,976	$2,814	$3,799	$5,130	$6,926	$9,351
Net Income (NI)	$200	$387	$868	$1,012	$1,273	$1,820	$2,457	$3,317	$4,479	$6,047
NI Annual Growth-Geometric Mean	0.0%	93.4%	108.4	71.6%	58.8%	43.0%	38.9%	37.6%	37.0%	36.6%
NI Annual Growth-Average	0.0%	93.4%	124.4	16.5%	25.8%	43.0%	35.0%	35.0%	35.0%	35.0%
Net Profit Margin	33.0%	30.1%	35.9%	26.8%	25.0%	26.5%	26.5%	26.5%	26.5%	26.5%
Key Balance Sheet Values										
Cash and marketable securities	$371	$612	$9,156	$9,860	$11,07	$12,50	$14,51	$17,22	$20,88	$25,82
Property, plant, and equipment	$42	$48	$54	$60	$68	$76	$85	$96	$107	$120
Long-Term Debt	$100	$0	$0	$0	$0	$0	$0	$0	$0	$0
Key Free Cash Flow Values										
Cash provided by operations		$285	$522	$713	$1,158	$1,466	$1,981	$2,674	$3,610	$4,873
Gross investments in tangible fixed		($7)	($8)	($9)	($11)	($11)	($13)	($14)	($16)	($18)
Free Cash Flow (FCF)		$278	$514	$704	$1,148	$1,455	$1,969	$2,660	$3,594	$4,856
FCF Annual Growth – Geometric			85.2%	59.3%	60.5%	26.8%	31.0%	32.3%	33.0%	33.4%
FCF Annual Growth – Average										

Tarmac provides a mobile-based platform to share and discover restaurants, coffeehouses, nightlife hotspots, retail malls, historic landmarks, notable architecture, theme and community parks, museums and more at any location the user visits. Users can share their experiences through Tarmac with their Facebook and Twitter friends. The platform saves each user's experiences to provide a time-based itinerary of past events to share with friends or others visiting the same locations. Received funding of $8 million in 2007 at a pre-money valuation EBITDA multiple of 5.

EXHIBIT G. TRIPTIC KEY FINANCIAL METRICS (ALL DOLLAR VALUES IN $000)

Key Income Statement Values	2005(a)	2006(a)	2007(a)	2008(a)	2009(a)	2010(p)	2011(p)	2012(p)	2013(p)	2014(p)
Net Sales (NS)	$859	$1,512	$2,632	$4,079	$5,711	$7,424	$9,651	$12,54	$16,31	$21,20
NS Annual Growth - Geometric		76.0%	75.0%	68.1%	60.6%	30.0%	30.0%	30.0%	30.0%	30.0%
NS Annual Growth - Average		76.0%	74.0%	55.0%	40.0%	30.0%	30.0%	30.0%	30.0%	30.0%
Gross Profit	$816	$1,452	$2,526	$3,957	$5,539	$7,127	$9,265	$12,04	$15,65	$20,35
Gross Profit Margin	95.0%	96.0%	96.0%	97.0%	97.0%	96.0%	96.0%	96.0%	96.0%	96.0%
EBIT	$486	$873	$1,469	$2,238	$3,020	$4,001	$5,203	$6,765	$8,796	$11,43
Net Income (NI)	$314	$565	$949	$1,449	$1,951	$2,587	$3,364	$4,374	$5,688	$7,395
NI Annual Growth-Geometric Mean		79.7%	73.7%	66.4%	57.8%	32.6%	31.3%	30.9%	30.7%	30.5%
NI Annual Growth-Average		79.7%	67.9%	52.7%	34.6%	32.6%	30.0%	30.0%	30.0%	30.0%
Net Profit Margin	36.6%	37.4%	36.0%	35.5%	34.2%	34.9%	34.9%	34.9%	34.9%	34.9%
Key Balance Sheet Values										
Cash and marketable securities	$74	$670	$1,487	$7,478	$9,306	$11,69	$14,70	$18,62	$23,73	$30,37
Property, plant, and equipment	$103	$114	$128	$141	$164	$188	$216	$249	$286	$329
Long-Term Debt	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Key Free Cash Flow Values										
Cash provided by operations		$450	$794	$1,010	$1,785	$2,411	$3,004	$3,905	$5,076	$6,598
Gross investments in tangible fixed		($16)	($19)	($18)	($29)	($32)	($37)	($42)	($49)	($56)
Free Cash Flow (FCF)		$434	$776	$991	$1,756	$2,378	$2,967	$3,862	$5,027	$6,542
FCF Annual Growth - Geometric			78.7%	51.1%	59.3%	35.5%	30.0%	30.1%	30.1%	30.1%
FCF Annual Growth – Average										

Triptic is a leading online and mobile-based social networking site for travelers. The site allows members to create itineraries, post short messages as their trip progresses to different destinations. Itineraries can be make public or shared privately with friends. Triptic allows uploading of pictures directly from cell phones for friends to see. Local advertisers can directly target travelers in the immediate locality. Received funding of $5 million in 2008 at a pre-money valuation EBITDA multiple of 6.

QUESTIONS

1. What are the overall objectives of the FantasyNet founder, Tim Bayliss, in the term sheet negotiation?
2. What are the overall objectives of CRV and, in particular, Ann Davenport, in the term sheet negotiation?
3. Which party seems to have the most leverage in the negotiation?
4. Does CRV want to eventually gain control (majority ownership position) of FantasyNet?
5. How is a venture capital firm organized?
6. Why do entrepreneurs access the VC industry for investment funds?
7. Why do VC's want to invest in private companies?
8. What type of securities do VC's receive in exchange for their investment?
9. Why are the Preferred Shares received by CRV referred to as "Series A" shares?
10. What purpose do term sheets serve?
11. What is the difference between pre-money valuation and post-money valuation?
12. How is the CRV ownership percentage, number of shares issued, and price per share determined?
13. What is a "cap table"?
14. What does "common equivalent" mean?
15. If the Preferred Shares that CRV is receiving pays an annual 10% cumulative dividend, under what conditions would CRV actually receive the annual dividends?
16. What would constitute a liquidity event?
17. What is a "liquidity preference"?
18. Under what conditions would the conversion of preferred shares to common shares take place?
19. What is a redemption? How does it benefit CRV?
20. What is an "anti-dilution" provision? What forms can it take? What are the implications of each form on Tim and on CRV?
21. How are the voting rights of CRV determined?
22. What is the purpose of protective provisions and what forms can they take?
23. What is the purpose of the Registration Rights provision?
24. Does a VC require representation on the company board? If so, why and what is the extent of the representation?
25. What protections do the "Right of First Refusal" and "Co-sale Agreement" provision give to CRV?
26. What is vesting? Why would a founder of a company have to relinquish actual ownership of his/her original common shares and then have to stay with the company for certain time to get them back just because the company took in VC funding? What is the vesting provision that CRV is proposing in the term sheet?
27. What is the purpose of a closing fee?
28. What is the rationale for FantasyNet i) paying not only their expenses but also CRV's expenses involved in the transaction and ii) giving CRV a non-refundable $35,000 to begin drafting legal documentation and commence due diligence?
29. What purpose does the exclusivity provision serve? Is it weighted more to the favor of FantasyNet or CRV? Why?
30. Is the term sheet a binding document?
31. If the term sheet is not legally-binding, what other documents provide the legal standing for the CRV investment in FantasyNet and what triggers their creation?

RAIN DANCE PROPERTY SOLUTIONS, INC.

Linda Pickthorne Fletcher, University of Tennessee at Chattanooga
Marilyn M. Helms, Dalton State College
Marilyn Willis, University of Tennessee at Chattanooga

CASE DESCRIPTION

When Porter Raulston, the CEO of Rain Dance Irrigation and Lighting Company, met with Jack Hatcher, the principal partner in Hatcher-Deerfield, Inc., a consulting firm specializing in organizational planning, development and governance, he was interested in a new venture. Hatcher's idea was to combine Raulston's business with two other businesses – landscaping and construction – to form a new entity to serve as a one-stop shop for the homeowner. Their new company, Rain Dance Property Solutions, would merge the three companies and entrepreneurs and could even result in a template for future franchising in other markets beyond Chattanooga, TN. The case explores the merger process as well as strategic planning, mission statement development and goal setting for the new entity.

CASE SYNOPSIS

The primary subject matter of this case concerns issues faced when merging three entrepreneurial companies. Secondary issues examined include ways to value merging companies, issues in combining operations, employees, and managers into one entity, and personality issues involved in such an endeavor with traditional entrepreneur/owners. The case has a difficulty level of three and four – appropriate for junior and senior-level undergraduate students. The case is designed to be taught in one class period and is expected to require one to two hours of outside preparation by students.

INTRODUCTION

In May, 2006, Porter Raulston, the CEO of Rain Dance Irrigation and Lighting Company, made an appointment with Jack Hatcher, the principal partner in Hatcher-Deerfield, Inc., a consulting firm specializing in organizational planning, development and governance. Raulston and Hatcher had been acquaintances for many years and Hatcher had been a long-time client of Raulston's company, the state's largest residential and commercial sprinkler system and outdoor environmental lighting enterprise.

When scheduling the appointment, with Hatcher, Raulston indicated he was searching for a new entrepreneurial venture and needed help identifying, formulating, and implementing that idea. Raulston did not know precisely what he had in mind for a "new entrepreneurial venture," but he had maximized the financial potential of his current business and was interested in making changes. In his early fifties, Raulston was a personable, low-key individual who had started his business over twenty years ago. His primary role had always been external, focusing on sales and customer relations. Raulston relied on his employees to oversee the operations of the company while he provided only cursory oversight activities.

Ralston had come to the right person. Hatcher, in his late forties, was the epitome of a successful entrepreneur. Before starting his own business, he worked in a variety of industries to gain practical business experience, ultimately holding key management positions in the Jack Eckerd Corporation, the Chicago Tribune Company, and Salem Carpet Mills, Inc. With a background that included both staff and line positions and many intrapreneurial accomplishments for his former employers, Hatcher opened his own consulting firm in 1999 focusing on organizational development products. His firm's stated purpose not withstanding, Hatcher took advantage of his entrepreneurial skills by starting more than a dozen new ventures that ultimately were profitably harvested.

During their May, 2006 meeting, Hatcher helped Raulston develop an in-depth analysis of his business in terms of potential opportunities. During the next few months, which were typically during his busy season Raulston had little time to do more than review the information and strategies that resulted from his conversation with Hatcher.

In September, 2006, completely independent of his conversations with Hatcher, Raulston received a telephone call from Ed Britton. Britton, also in his early fifties, was the founder of River City Lawn and Landscaping, Inc., a commercial landscaping and exterior maintenance company. Britton had been Raulston's vendor on numerous projects and the two were well acquainted both personally and professionally. In addition to his landscaping company, Britton created www.ChattanoogaHasBids.com, an Internet based site connecting qualified exterior maintenance contractors to a list of potential customers in the local Chattanooga, TN area. He had a number of customers in the more affluent Lookout Mountain community. Prior to his current business, Britton had started several companies that provided a variety of maintenance-related services. All had experienced limited success and were of a short-term nature. In addition, all were primarily "virtual" operations that relied heavily on subcontractors. Other than a minimum amount of capital equipment, these "virtual" businesses required almost no physical infrastructure.

Britton came straight to the point. He wanted their companies to merge to create a comprehensive one-stop residential and commercial lawn care and landscaping service. Britton's proposal echoed one of the entrepreneurial strategies Hatcher had previously suggested to Raulston. The two decided Hatcher was the logical resource to help them develop their new enterprise. The first meeting was in October 2006, followed by three monthly meetings during October, November and December focusing on designing the new venture.

The Concept

Based on the independent comments of all three principals, their first few meetings were only relatively productive. Their conclusion: "we were all over the place." Raulston and Britton had difficulty envisioning a business that extended beyond their current functions. They were accustomed to limited seasonal activities. Hatcher's vision was far more comprehensive as he continued to stress the importance of a portfolio business model offering high-end homeowners and selected commercial property managers a package of connected products to provide one-stop shopping for the property owner. Hatcher was convinced that the one-stop shopping concept would be successful only by adding construction services to their product mix. He envisioned that property maintenance would include not only routine items but also renovation and expansion. Hatcher thought the addition would be a key service for homeowners who wanted a consultation regarding their home's structural issues just like commercial property received. For their high-end customers, these services would free them from the day-to-day rigors of home maintenance. Their consulting idea for homeowner maintenance would be like the services a financial planner provides to customers in managing their investment portfolio.

As the three continued to unsuccessfully debate the exact nature of their enterprise, they did manage to agree on its name: Rain Dance Property Solutions, Inc. This decision—a variation of the name of Raulston's existing business--was designed to capitalize on the latter's reputation and name recognition.

Despite Ralston's and Britton's lack of enthusiasm for his entrepreneurial concept, Hatcher decided to pursue his idea. In November 2006, Hatcher privately initiated an informal conversation with Stuart Bickley, the owner and founder of Bickley Construction Company. In his late thirties, Bickley had experimented with a variety of occupations. Bickley had worked in his father-in-law's retail business, several marketing jobs and finally a temporary stint in the finance office for the then-Governor of Tennessee. Then Bickley started his construction firm believing he had found his niche.

At the time Hatcher approached him, Bickley was involved in a major remodeling project on Hatcher's residence. This provided Hatcher with ample opportunity to discuss the Rain Dance venture idea with Bickley. Their conversations convinced Hatcher that Bickley could supply the missing operational piece needed to make the new company succeed. In addition, Hatcher believed Bickley could bring a needed leadership role to the new business.

After talking to Raulston and Britton, the two agreed Bickley should be invited to the next meeting in early December to explore the possibility of his joining the venture. At this point, Raulston had been named President and Britton had the title of Vice President of Sales for Rain Dance. Raulston's office assistant, Casey Adcock, began attending the meetings to provide administrative support.

For the first meeting with Bickley, Hatcher had prepared a lengthy agenda. There was much to be decided. As President, Raulston presided over the meeting but it was evident he had difficulty conducting a structured business meeting. Once again, much was discussed but little was accomplished. Despite the unproductive, frustrating meeting, Bickley was impressed with the potential of the Rain Dance concept. In subsequent private meetings with Hatcher, Bickley agreed the new company faced two challenges -- finding the right person to market Rain Dance and finding the right person (i.e., President) to direct the launch of the enterprise. Both believed these two problems could be resolved and Bickley agreed to add his construction business to the Rain Dance venture. Hatcher was confident he had conceived an idea that not only would be financially successful but would also continuously grow into an entrepreneurial venture of wide-spread importance.

By general consensus, Hatcher was asked to run future meetings. The four began meeting two to three times each week throughout December 2006 to meet their goal of officially organizing Rain Dance by January 1, 2007.

THE MERGER

Each of the four principals brought something to the table. In general, Raulston, Britton and Bickley had business experience, but only in their specialized niche areas. None had ventured beyond their areas of expertise, either in terms of new and unrelated businesses or expanding the scope of their current enterprise. Initially, Hatcher's role was as a consultant, but his involvement in the organizational and governance process became more extensive, all agreed he should become a minority owner.

Raulston's contribution to the merger was liquid assets and a strong base of loyal clients. He had been in business for over twenty years. The company had 700 residential customers under contract with a database of an additional 1,200 former and/or occasional clients. Twenty licensed and experienced employees would be available to support the broader activities of the new company, especially during the landscaping off-season. In addition, Raulston anticipated he would be able to contribute income of about $70,000 from prepaid contracts to offset their initial operating expenses. Rain Dance would incur deferred liabilities associated with this income as well as other financial obligations of Raulston's current business. Raulston assured his new partners his debt was minimal.

Britton's strength was his experience in commercial landscaping and exterior property maintenance along with some of the area's largest commercial accounts. His company had a very limited infrastructure because he relied exclusively on subcontractors to service his customers. Britton's contribution primarily would be capital equipment. His relationship with the numerous vendors was a secondary, although intangible, benefit.

Bickley's position as the owner of a custom design and remodeling firm was the strongest of the four principals. With a valuation of $1.3 million, his company was debt-free and profitable. His employees were all long term, seasoned individuals who were supported by a fully stocked central warehouse and shop facility. Bickley was in the midst of his busiest and most profitable fiscal year since he started his company. In contrast to the traditional seasonal construction industry model, he scheduled exterior work for the summer and fall months and interior work for the winter and spring. Far from being seasonal, there was a continual, year-round demand for his services. A twelve to eighteen month waiting period to begin a new project was not unusual, and the length of the waiting period continued to grow. Bickley's contribution from his current business activities would be $40,000 to $50,000 a month.

All the information was verbally provided by each principal. At this point, an extended or external review of each individual and their company as a form of due diligence was not even considered. Relying on this information, the four decided to tentatively allocate ownership of the company as follows: Bickley (40 percent), Raulston (25 percent), Britton (25 percent) and Hatcher (10 percent). The final percentages would be determined after the merger was completed.

Implementing the Merger

With the concept of the merger agreed upon, Rain Dance Property Solutions was incorporated in January 2007 as a Subchapter S company in Tennessee. The specific details of the merger, however, had not been resolved. Numerous issues had to be addressed such as: defining the exact scope of the new company's operations/services; reconciling and combining the accounting records of the three businesses; determining the per share value of the stock; finalizing the ownership percentage of the four principals; formalizing the officers of the new organization--and their responsibilities; and developing and implementing a strategic plan with goals, objectives, and outcome measurements for the new company.

The group decided to tackle two issues simultaneously the development of a strategic plan and assessment of the potential financial condition of the new company. Hatcher led the strategic planning process, which resulted in the following mission statement (see Exhibit 1) and four key objectives for Rain Dance, as shown in Exhibit 2. Each objective was supported by strategies (i.e., action plans).

Exhibit 1
Rain Dance Property Solutions Mission Statement 2007

Rain Dance Property Solutions *is the premier one-source provider of all maintenance and construction services to both home and commercial property owners.*

Our trained staff is licensed, insured, and independently skill-certified.

We are an employee-owned corporation that fully guarantees customer satisfaction.

Exhibit 2
Rain Dance Property Solutions Key Objectives 2007

1. Define and Create New Rain Dance Organizational Structure
2. Execute Marketing Plan to Assure New Sales
3. Establish Operations-Side Protocols
4. Attract Investors

Raulston volunteered to combine the financial records of the three companies. His office assistant had been using an accounting software program in his business and had the time to devote to the project since the winter months were his company's off season. Unfortunately, during their numerous meetings in December 2006 and January2007, Raulston did not demonstrate a sense of urgency for completing the accounting analysis. More to the point, Raulston had not gained even the most fundamental financial or accounting experience from his own business. Every aspect of those functions had been left to his office staff. Consequently, he had no understanding of the scope or the purpose of the assignments. It was clearly beyond the capabilities of the Rain Dance accounting software program.

Raulston, as President of Rain Dance, had failed to comprehend his responsibilities, further compounding the situation. Raulston had the responsibility of assuring the combined enterprises simultaneously maintain their individual businesses, introduce and transition their employees to the functions of the combined companies, and generate the type of new business envisioned for Rain Dance.

This combined lack of understanding became increasingly apparent during the group's meetings. Subsequently, several of the principals privately observed that the meetings were more of a "Management 101" exercise rather than policy-driven discussions. Frustrations increased and the meetings became untenable. By the end of February 2007, little progress had been made on the financial analysis of the merging companies and none had been made on the other issues. As the owners later concluded, not all of the participants had started with a clear idea of what to do and how to do it. Moreover, only Bickley and Hatcher had prior experience with many of the key issues to be resolved.

In the words of one of the owners, Hatcher "had an epiphany" for solving the stalemate: change the roster of officers. After a brief discussion, all four agreed that Bickley's obvious strengths and experience made him the logical choice to become president of Rain Dance. Hatcher attempted to limit Raulston's role to that of secretary. Unfortunately, he was unable to convince the other principals that the job of Chief Financial Officer should be assigned to someone external with substantial experience in the field. Despite his efforts, Hatcher realized that the other principals were equally deficient in financial analysis skills and did not understand the potential problems that Raulston could create. He acquiesced to Raulston's role and privately decided that he would monitor Raulston's activities. Thus, Raulston, the former President, would assume the position of secretary and chief financial officer. Britton would be the vice president of operations and Hatcher would hold the general title of vice-president. The principals hoped these changes would allow the company to move forward more quickly.

Resolving the Issues

The next priority for the company was financial. The accounting records of the three companies had to be consolidated and the value of the new company had to be established. Rain Dance's stock had to be apportioned among the owners and the share value of that stock had to be calculated.

The company's charter authorized 25,000 shares of Corporate Treasury Stock and allowed for the initial issuance of 10,000 shares to the four principals. For tax purposes, the initial stock distribution to the founders would be determined by their individual aggregate contributions in creating Rain Dance Property Solutions, Inc. The remaining 15,000 of unissued shares would be retained by the Corporate Treasury for future sale or acquisition, an event that would dilute the percent of initial ownership of the principals. The charter further provided for an annual revaluation of the stock.

The partner's prior experience with Raulston's attempts to assemble the financial data and consolidate the accounting records of the three merged companies prompted the decision to retain a CPA with experience in the construction and related service industries. The accountant's task was to review the books of the three companies as of December 31, 2006, to create an accounting basis for the new company, and suggest a formula for stock allocation among the owners.

In the meantime, and without waiting for the accountant's report, Hatcher suggested to the principals that they should devise a method for establishing -- on a preliminary basis—(1) the value of Rain Dance and (2) the per-share price of the stock. Hatcher believed that this would result in a more realistic (i.e. higher) valuation of the venture than that calculated by an accountant. He recommended using an ad hoc approach based on two factors. The first was the combined total of the aggregate sales of the three combined companies as of December 31, 2006 ($1,620,000). The second was the projected gross profit ($1,750,000) of the new venture at the end of its first year of operation (December 31, 2007). The latter had been calculated by Hatcher and essentially was an optimistic and "best case scenario." No one questioned the use of the two different measures to determine the company's value. They further did not question that the projected gross profits for 2007 - - the supposed result of their synergic merger—was based on little more than a hypothetical conclusion. The combined total of the two factors ($3,370,000) was divided by the number of shares to be issued (10,000). The resulting per share value was $337.

The accountant's report to the owners revealed Raulston had significantly understated his company's total debt which included unpaid balances on credit cards and other unsecured obligations that were to be transferred to Rain Dance. There were no corresponding assets linked to these outstanding liabilities. As a result, the allocation of the initial stock issue would have to be reconsidered or future shareholder distributions would need to be modified. The owners agreed to a reallocation of the stock. The formula recommended by the CPA for redistributing the initial stock allocation included the following criteria: cash flow, goodwill, options, contracts, and capital. The dollar amount in each category would be calculated from the financial records of each of the three companies and assigned a weighting factor based on the importance of each category. The application of the criteria to the existing companies would determine the revised allocation of the initial stock issue. The principals were charged with the task of defining each of the five criteria and the factor by which each would be weighted.

The process resulted in the following stock distribution of Rain Dance Property Solutions, Inc.: Bickley (48 percent), Britton (24 percent), Raulston (18 percent) and Hatcher (10 percent). The reallocation of ownership was accompanied by a change in responsibilities. Bickley continued in his role of President. Raulston would supervise his former office assistant, Casey Adcock, who would perform administrative and accounting functions for the new company. In addition, Raulston would make sales calls to potential customers. Finally, Raulston would determine the cost of Rain Dance services provided to its clients.

Britton was placed in charge of all landscaping and lawn functions. He now supervised both his and Raulston's employees and all related subcontractors as well as coordinated the combined functions of two former businesses. Bickley would continue his operation independently of Raulston and Britton. Hatcher's role had evolved into one of management oversight. Much of his effort was spent in keeping Bickley, Brittan and Raulston focused on three essential goals: (1) the "mastery of skills", i.e., developing a base of skilled workers and subcontractors to deliver the company's services, (2) the integration of all employees into a unified work force and (3) the creation and implementation of an effective marketing plan.

By July 31, 2007, six months after the company's organization, there were both encouraging results and obvious problems to resolve. The new venture had $1.5 million in sales and expectations were that sales would double to $3 million by the end of 2007. Net profit for the first six months was approximately $100,000. That figure would have been larger if not for the amortization of a major portion of the debt assumed by the company and the one time start-up expenses incurred by the new venture. Hatcher estimated for the same time period and assuming the three companies had not merged, they would have generated a total of $900,000 in sales and $60,000 in profit. It was clear to the principals the synergistic effect of simply combining the three organizations into one entity had created higher levels of income. But more than synergy would be needed to attain and fulfill the potential of the venture.

Along with the positive financial results, there remained several potentially debilitating problems. Since its inception, Rain Dance had parceled its operations between the three separate locations. The scattered logistics resulted in a lack of coordination of resources, the inability to cross-train employees in the services offered by the company and the unnecessary expense of maintaining duplicate facilities.

In addition to these obstacles, Hatcher had become aware of a more serious situation that could undermine the fundamental concept of Rain Dance. Once again, the problem involved Raulston. For many years, his company was the "only game in town." Without competition, Raulston was able to succeed with little regard to how he ran his operation. His casual management style, which reflected this competitive advantage, could be seen in his employees.

The fact the new company demanded discipline and additional expertise of all its employees had created problems for Britton in managing the employees and building a multi-skilled work force. Compounding this was Raulston's attitude toward his new responsibilities, which included making eight to ten sales calls a day. Rarely was he in the office and he regularly cancelled or rescheduled appointments that had been arranged for him. Even more problematic, Raulston's oversight of the financial affairs of the new company had, at best, been cursory. Accounts Receivable had been allowed to grow to unacceptable levels and other routine accounting records reflected numerous inconsistencies.

Hatcher was increasingly concerned about Rain Dance's apparent stagnation. He began to meet with the other three, both individually and jointly. Of the three, Bickley appeared to be the only one to grasp the basis of Hatcher's concerns. Despite his efforts, little was done between July and December 2007 to achieve the original objectives of the venture. Hatcher had devoted as much time as possible to the company. He was now in the position of having to spend more time with Rain Dance, to the detriment of his own responsibilities with his consulting firm. By the end of 2007, Rain Dance had recorded only a marginal profit. The income was not attributed to a consolidated venture but rather the three (theoretically) combined units continuing to operate as separate entities. While profitable, this approach defeated the entrepreneurial purpose of the merger. Hatcher decided there still was the potential for success. He would try once again to put the company on the originally conceived track.

At Hatcher's strong urging, the Rain Dance principals agreed to participate in a second strategic planning process. The purpose would be to establish the company's direction for 2008 and identify and solve the venture's long-standing problems. Hatcher led the discussion. A new Mission Statement and revised Key Objectives were developed (see attached Exhibit 3 and 4). The group also prepared a series of "Statements" that (1) assessed the present state (2007) of Rain Dance, (2) described the desired state for 2008, and (3) presented a SWOT – Strengths-Weaknesses-Opportunities-Threats analysis (see attached Exhibits 5, 6, and 7).

The New Rain Dance

The Mission Statement was changed, but the key objectives for 2008 were not materially different from those for 2007. The additional series of "Statements" largely mirrored the initial 2007 goals and objectives for the company. As the strategic planning meeting continued, Hatcher began to wonder whether the other three principals understood or even wanted an entrepreneurial venture. He thought they might perhaps simply prefer the status quo of separate businesses units functioning under one legal structure. But for Hatcher, the status quo was unacceptable. He decided that 2008 would be a pivotal year.

For Britton, 2008 also proved to be a pivotal year. He had become frustrated with his role in Rain Dance. The "commercial services" portion of the business had been eliminated by the 2008 Mission Statement, thus reducing a major part of Britton's responsibilities. His second primary function of supervising the employees and subcontractors could not be carried out because of the lack of physical consolidation of the company. Britton decided to leave Rain Dance, selling his interest in the venture to the three remaining principals. Hatcher redoubled his efforts to find a location for the physical consolidation of all Rain Dance operations. In the latter half of 2007 he located a building that he thought was ideal for this purpose. All agreed on the site but, the move to the new facility still had not been made in July 2008, after fifteen months of discussing it. Numerous other issues continued unresolved. In short, little of either the 2007 or 2008 strategic plan had been implemented.

From his perspective, and despite the continuing marginal profitability of Rain Dance, Hatcher could no longer ignore the situation and his ever-increasing time commitment. How could he extricate himself from Rain Dance without forfeiting his investment? Was it still possible to salvage some aspect of the Rain Dance concept through some other entrepreneurial effort? Hatcher was determined to quickly resolve his dilemma

Questions for Students:

1. Is there a potential market for the services of Rain Dance?
2. Is the business a good idea? Support your answer.
3. What mistakes were made that could have been avoided?
4. What are the limitations of having multiple partners?
5. Would a looser supply chain or referral program be preferable to linking the companies together?
6. Could joint marketing or promotions achieve the same objective?
7. How is the formation different from traditional entrepreneurial start-ups? Are these differences advantages?
8. What are the opportunities and threats of combining businesses in general? What about these three in particular?
9. Do you agree with their mission statement and key objectives for 2007? 2008?
10. Prioritize the SWOT analysis variables provided. Are some issues in the wrong category? Discuss.
11. What should their new marketing strategy be?
12. Will Rain Dance survive? Why?
13. Is this business one that could be franchised?

Exhibit 1
Rain Dance Property Solutions Mission Statement 2007

Rain Dance Property Solutions *is the premier one-source provider of all maintenance and construction services to both home and commercial property owners.*

Our trained staff is licensed, insured, and independently skill-certified.

We are an employee-owned corporation that fully guarantees customer satisfaction.

Exhibit 2
Rain Dance Property Solutions Key Objectives 2007

1. Define and Create New Rain Dance Organizational Structure
2. Execute Marketing Plan to Assure New Sales
3. Establish Operations-Side Protocols
4. Attract Investors

Exhibit 3
Rain Dance Property Solutions Mission Statement – Revised 2008

Rain Dance is the first and only provider of comprehensive property maintenance for the affluent homeowner, replacing the traditional multiple contractor nightmare.

Our limited, member-only approach guarantees quality care for your most valued investment, performed by certified experts.

Exhibit 4

Rain Dance Property Solutions Key Objectives – Revised 2008

1. Become Fully Consolidated
2. Market and Sell Home Contracts
3. Refine Organizational Model

Exhibit 5
Rain Dance 2007 Present State *
(Including Values)

1. On track with good product
2. Creating our market
3. Ground floor opportunity but bugs not all worked out
4. Unique product with a large market that will guarantee sales
5. Much talent is in place – systems are being perfected and documented to manage delivery as we sell and grow
6. Several key openings – Irrigation Leader, Construction Superintendent, Commission Sales Manager
7. Bad labor hiring model
8. Homeless, awaiting new building
9. No training, employee manual
10. Three companies are financially consolidated and transitioned into one accounting system
11. We are consolidating
12. Pricing structure too low
13. Customer relations are not polished, penetration not explored
14. Too many "one-service" customers
15. Need better, consistent internal communications
16. No CEO

* unranked/brainstormed

Exhibit 6
Rain Dance 2008 Desired State *
(Including Values)

1. Focus <u>all our efforts</u> on strategic initiatives: a) consolidation, b)contract sales, c) accountability
2. Be a marketing-driven company
3. Clear replicating processes that we all follow
4. Installed into corporate headquarters
5. Long-term, dependable revenue
6. Clear-cut role and job for Britton
7. Clear-cut organization for irrigation (Raulston's role)
8. 250 signed accounts on contract
9. At least 50% toward our New Business Plan goal
10. Study cost-side reduction
11. Control assets and their security (parts, tools, inventory)
12. Process documentation in "manual" format
13. Effective and efficient system to allocate labor to job
14. More responsible and prioritized C.F.O. role
15. Bill in real time
16. Increase our prices
17. Better regulate cash flow
18. Sales function that assures perpetual and predictable revenue
19. Accurate sales budget for 2008
20. Two carefully selected new partners
21. Proactive business, not reactive. Be embarrassed by emergencies!

* unranked/brainstormed

Exhibit 7
Rain Dance 2007 SWOT Analysis

Strengths 1. **The one and only company offering this product** 2. **Effective combination of experienced and successful entrepreneurs** 3. **Strategically-planned company** 4. **Documenting our entire processes** 5. **Almost debt-free** 6. **Have a corporate headquarters identified** 7. **Have 650 contracted irrigation customers and 1,300 book customers, not yet called upon** 8. **Immediate acceptance of contract product** 9. **Name recognition/logo** 10. **Loan worthiness (credit)** 11. **Solid vendor relationships** 12. **Business is consolidated – technically** 13. **Increasing clarity of mission, purpose and accountability of partners** 14. **Record sales for combined companies**	**Weaknesses** 1. **Margin too low (under priced and not good cost controls)** 2. **Customer follow-up is poor** 3. **Organizational flow is ill-defined** 4. **Process documentation is incomplete** 5. **Standard operating procedures are not fully developed** 6. **Policy manual needs revision** 7. **Need balanced personnel to fill gaps in abilities** 8. **Equipment is outdated** 9. **Training (subcontractor/employee/new hire) and cross training need development** 10. **No sub-contractor manual** 11. **Inventory/equipment controls need to be in place** 12. **Marketing plan/materials needs development** 13. **Sales team/training to be identified** 14. **Winter projects (investments) to balance work flow** 15. **Sales order entry/fulfillment system incomplete** 16. **Need financial controls** 17. **No CEO placed to execute the Strategic Plan** 18. **Success stories not gathered** 19. **We all wear too many hats – defined role absence** 20. **Britton's role** 21. **"One-service" customers vs. recurrent-service customers** 22. **Lack of communication from partners to company** 23. **Contract plan not exercised** 24. **We are cash poor**
Opportunities 1. **Housing market depressed, encourages remodeling** 2. **Boomers-aging population** 3. **Lack of competition (our product)** 4. **Manpower availability** 5. **Virgin market** 6. **Aging houses – Chattanooga area** 7. **Availability of acquisitions, due to revising building economy** 8. **Broad Street location 9both visibility and real estate opportunity)** 9. **Success stories (marketing, newspaper story, visibility)** 10. **Available capital/investors** 11. **Franchise opportunity**	**Threats** 1. **Bunker mentality** 2. **No barriers to entry for competitor copy-cats** 3. **Concept protection, in general** 4. **Housing market declining** 5. **Dependence upon key personnel**

BALANCING THE STATE COLLEGE BUDGET: WHY MUST TUITION INCREASE AND BY HOW MUCH?

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ABSTRACT

Winegar University confronts the increasingly hostile budgetary environment presented by the most significant economic recession since the great depression. State assisted universities have limited means of compensating for decreased state and federal funding. Underlying the harsh budgeting environment are complexities such as tuition pricing and price discrimination, elasticity of tuition pricing, admissions acceptance standards, and faculty to student ratio.

This case presents instructors a rich setting to demonstrate how spreadsheets can assist managers with respect to their planning, budgeting, and decision-making responsibilities. The specific spreadsheet skills covered involve the construction of one- and two-dimensional data tables. By using this case, instructors are enriching students' analytic skills within a context with which they should be intimately familiar. The case will illuminate the utility of spreadsheet tools in support of fundamental management decision making activities.

INTRODUCTION

Exam time is here, or so it seemed, as Percy Bradshaw prepared to enter the Board of Trustees Conference Room at Winegar University. This year July 15 had been selected as the date for the annual skewering. The event never failed to create butterflies as Percy braced himself for the litany of questions – perhaps it was an exam – that were sure to bombard him once inside the room. The examiners were the Board Members and President of Winegar and Percy had been relentlessly playing their predictable queries over in his mind as the moment of truth approached:

Will we have to raise tuition again this year?
Why?
By how much?
Will it cost us students?
What if we don't – worst and best case scenarios?
What are our alternatives to raising tuition?

Percy knew his answers would dramatically affect the pocketbooks and future prospects for thousands of Winegar University (Winegar University is a fictitious institution. However, all budget variable values are based on factual historical data) stakeholders. Not just students and prospective students, but faculty, staff, and the local business and employment community as well. For Percy Bradshaw was Winegar's Vice President, Finance, and hence responsible for assimilating revenue and cost estimates amidst increasingly pessimistic state revenue projections into budgetary recommendations for the President and Board of Trustees. What a moving target – mused Percy. Oh well, guess that's why I'm paid the big bucks – yeah right! - were Percy's final rueful thoughts as he crossed on through to the other side.

SUMMER: THE SEASON OF BUDGETARY UNREST

Earlier that summer, as in each of summers past, the Office of the Controller (more specifically Percy Bradshaw) monitored the state revenue projections and budget proposals emanating from the legislature in the state capital. As in each of his previous summers Percy had that sinking sense of déjà vu – eleventh hour haranguing between the state Senate and House of Representatives over the amount of money budgeted for higher education was preventing him once again from finalizing a budget for the coming academic year. The University President was anxiously awaiting the budget so he could present it to the Board of Trustees for final approval. This meant, with the beginning of fall classes only 12 weeks away, the University could not present prospective students or their parents with their tuition tariff. The tuition charges to a large extent determine the number of students enrolling and thus determine the major revenue stream that would support the university's operations. Percy rued the recurring unpleasantness of summer – the season of uncertainty that complicated an already complex budgeting process. So, Percy decided he would do what he always did; attempt to prepare budgets based on various scenarios that would result from a number of interrelated factors.

His analysis this year would be further complicated by the fact the university's expenses exceeded revenues by $4.5 million in the previous year. This loss was largely due to an unprecedented 5 percent rescission (each state university was required to give back to the state; in Winegar's case nearly $1 million) of state funds. While last year's deficit was covered by using the University's reserve funds, Winegar's President clearly stated using the reserve funds is not an option for the next academic year. Further evidence the President was gun shy from the previous years' rescission of allocated funds was his request for budgets under three scenarios: worst case (five percent below last year's post rescission funding), best case (pre-rescission funding level) and most likely (same allocation as last year with the rescission).

THE CONTEXT OF BUDGETING AT PUBLIC (STATE ASSISTED) INSTITUTIONS OF HIGHER LEARNING

Institutions such as Winegar have seen their level of state funding drop precipitously in recent years. This has been reflected in the obsolescent "state funded" descriptor being replaced with the more accurate "state assisted" college or university. As shown in Figure 1, Winegar's level of assistance has fallen from 44 to 20 percent over the past 16 years. The dollar allocation is essentially the same now as it was in 1990 despite nearly two decades of increases in operating costs.

The key tool for offsetting adverse financial effects from reduced state allocations has been tuition pricing. Chief Financial Officers at public colleges have responded by becoming more sophisticated in the establishment of tuition rates. It is the most basic revenue enhancing option (Bryan & Whipple, 1995). The primary objective is to set tuition at a rate that retains current students, attracts new students, and provides revenue dollars sufficient to cover costs under the most pessimistic budgeting scenario.

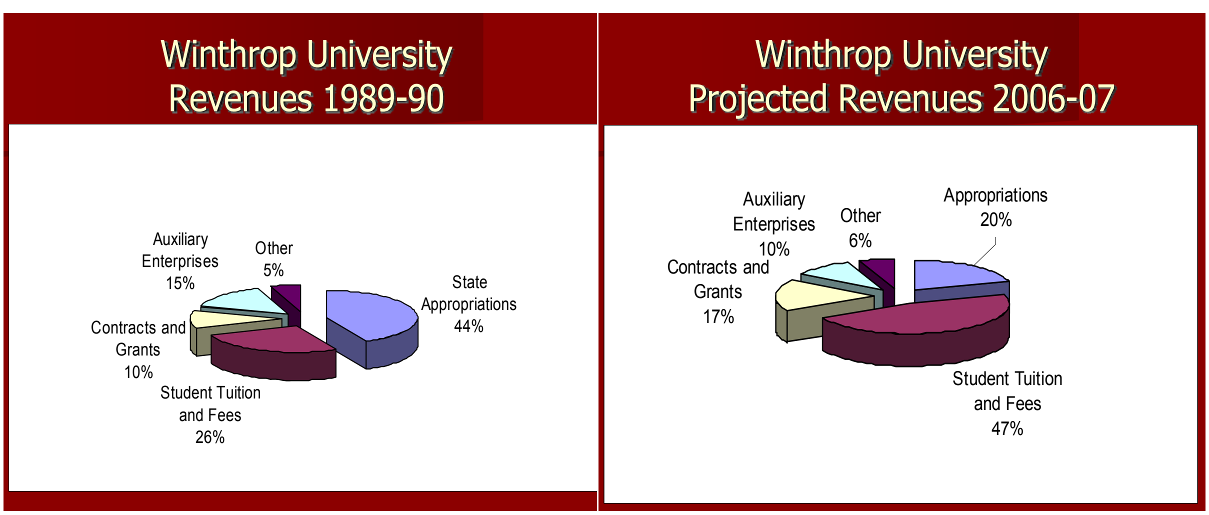
Percy's situation is illustrative of the fact state budgeting for higher education hinges on a complex set of issues and stakeholder tradeoffs (Hannon, 2005). The primary drivers of university budgets have been well documented however the interplay and dynamics remain a mystifying dance among present choices and future options (Bryan & Whipple, 1995).

DATA TABLES TO THE RESCUE

As Percy Bradshaw sat scratching his head in early June, Gerald Radner, Winegar University's Director of Academic Computing and User Support, popped into Percy's office to update his computer's software applications.

"Why so glum Percy?" Gerald asked. "You look like someone just ran over your dog."

Figure 1. A comparison of Winegar's sources of revenue for the academic years1989-90 and 2007-2008.



"I wish" Percy replied. "I never liked dogs. No, the President wants me to give him a draft of the budget, but there are so many uncertainties it will probably have to be completely reformulated after the members of the legislature finish their budget debate. This time of year is a real pain in my back!"

"Have you tried some of the decision support tools available in current spreadsheets?" Gerald asked. "They could allow you to quickly revise your budget as the major issues are resolved over the coming months. They would also allow you to present your preliminary budget based on a variety of possible scenarios."

"I'd be willing to give it a shot" said Percy. "Will you test drive me through it?"
So Percy and Gerald set up a meeting. Percy was asked to prepare a list of major variables that affect his budget forecast and to provide initial values and ranges for each variable that could change.

Underpinning Percy's budget scenarios was the university's primary strategic objectives for the next 5-10 years (shown in Figure 2).

***Figure 2.* Winegar's strategic objectives for the next 5-10 years.**

1. Retain and recruit faculty and staff who will continue to offer national caliber education (operationalized as providing average annual salary increases of at least 3 percent).
2. Increase enrollment from 6,400 to a student body of 8,000-8,500 students with an average incoming SAT score of 1,100 by increasing admissions to 1,500 per year.
3. Increase the proportion of out-of-state enrollments from 15 (current) to 25 percent.

Percy would have to integrate these objectives into his budgeting scenarios; in essence they provide constraints or limits to his range of budgeting options.

BUDGET FORECAST VARIABLES

In order to prepare a budget forecast, Percy explained there were three types of variables that must be considered. The first type of variable concerns basic variables such as size of faculty, size of staff, number of in-state students, number of out-of-state students, etc. The second type of variable concerns sources of revenue for the university (e.g., state assistance and tuition). The third type of variable concerns the major expenses for the university (e.g., salaries, utilities, etc.). These variables are largely dependent on environmental context best described by Layzell and Lydden (1990):

Interrelated historical, political, economic, and demographic factors. Historical factors include state resident's traditional values and preferences regarding higher education as well as the state government's historical involvement in governance of higher education …Political factors include the structure of higher education, gubernatorial influence, legislative influence, and interest groups' and citizens' influences. Economic factors include a state's general economic condition, state tax capacity, and availability of state revenues. Demographic factors include the level and composition of a state's population, enrollment in higher education, and student participation rates in higher education (pp. 1-2).

Five variables particularly important for budgeting decisions are: the amount of state appropriations; enrollment numbers and tuition fees for in-state students; and enrollment numbers and tuition fees for out-of-state students. Before Percy built any model budgets, he decided to look at the last 10 years of (a) state appropriations to Winegar University and (b) data relating to enrollments and tuition fees.

Table 1 displays 10 years of state appropriation data for Winegar University and all higher education in the state. The data show that the overall allocation as a percent of total state revenues has continued to decline. The other noteworthy aspect of the trend data is that within the overall secular decline in funding, there is pro-cyclicality associated with state economic health.

In the most recent year (2007-08), the state legislature provided about 20 percent of the university's base. This figure has been as high as 44 percent in 1989-90 (see Figure 1), but the data in Table 1 show that over the past decade the proportion of the university's budget from state appropriations has steadily fallen. Additional reasons for pessimism regarding an increase in state support may be found in the fact peer public universities have seen their "state assistance" shrink as low as 8 percent (Glenny, 1979).

The most recent year allocation (2007-08) was $19,963,000 (about $20 million). The rescission took back 5 percent (about $1 million). Therefore the base allocation for the most recent year was about $19 million. The best case estimate for the coming year's allocation would be a 5 percent increase up to $21 million. Worst case would be another 5 percent decrease beyond the rescission or $18 million. The most likely estimate would be $20 million.

Table 1
Ten year history of state appropriations for Winegar University and all state higher education

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Winegar($K)	$19,142	$19,947	$20,844	$21,854	$23,428	$25,404	$24,477	$21,900	$19,539	$19,963
% Change	3.78%	4.21%	4.50%	4.85%	7.20%	8.43%	-3.65%	-10.53%	-10.78%	2.17%
Rescission	0%	0%	0%	0%	0%	2%	3%	4%	2%	5%
Colleges & Universities as % of State Revenue	14.4	14.2	14	14.9	14.8	14.6	13.7	12.9	12.4	11.6
State Appropriation for All Education($M)	1,921	2,029	2,154	2,299	2,559	2,729	2,789	2,595	2,374	2,549
All Education as % of State Revenue($M)	46.5	46.4	46.1	50.1	51.8	51.1	51.1	50.1	49.3	48.8
Total State Revenue($M)	4,133	4,377	4,675	4,588	4,944	5,341	5,458	5,180	4,812	5,222

Student tuition contributions to the budget are a function of the number of students that enroll in August, and the tuition rate set for the academic year. Tuition schedules are set once the legislative appropriation has been finalized. Tuition rates for in-state and out-of-state students for the last ten years are shown in Table 2. In the face of dwindling state appropriations, Winegar has increased tuition in the range of 13-15 percent for each of the past three years. Percy recognizes tuition increases affect the number of enrollees, though demand for Winegar degrees has exhibited remarkable inelasticity over the period of the tuition increases.

Table 2
A ten year history of Winegar's student enrollment, tuition, and fees

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
# Students	4,416	4,340	4,610	4,649	4,838	5,056	5,161	5,213	5,187	6,292
# In State	3,823	3,775	4,023	4,066	4,196	4,374	4,421	4,514	4,483	5,322
% In State	87%	87%	87%	87%	87%	87%	86%	87%	86%	85%
# Out of State	593	565	587	583	642	682	740	699	704	970
% Out of State	13%	13%	13%	13%	13%	13%	14%	13%	14%	15%
In State Fees	$4,032	$4,126	$4,262	$4,868	$5,600	$6,652	$7,816	$8,756	$9,500	$10,210
% Change	2%	2%	3%	14%	15%	19%	17%	12%	8%	7%
Out of State Fees	$7,046	$7,250	$7,434	$7,680	$8,756	$10,310	$12,258	$14,410	$16,150	$17,564
% Change	2%	3%	3%	3%	14%	18%	19%	18%	12%	9%

Despite this historical inelasticity, Percy's intuition and research suggest once tuition price increases reach a certain threshold, there is a significant decrease in student enrollments (Bryan & Whipple, 1995). Thus, Percy must be careful not to overprice tuition and chase off current students unable to afford Winegar's higher price tag. Percy has researched tuition pricing models and demand curves for similar sized universities and has developed estimates of student enrollment retention at different levels of tuition price for both in-state and out-of-state students. These estimates are displayed in Table 3.

Table 3
Proportion of students retained and projected future enrollments at various tuition levels

In-State			Out-of-State			
Tuition	Proportion Retained	Projected Enrollment	Tuition	Proportion Retained	Projected Enrollment	Total
$10,210	100.00%	5,722	$17,564	100.00%	1070	6,792
$10,710	95.30%	5,453	$18,564	93.30%	998	6,451
$11,210	85.90%	4,915	$19,564	83.60%	895	5,810
$11,710	62.50%	3,576	$20,564	74.80%	800	4,377
$12,210	39.10%	2,237	$21,564	53.60%	574	2,811

Note. Contents of this table were adapted from Bryan and Whipple (1995).

The table shows Percy expects a moderate drop in demand for tuition increases of less than 10 percent but more excessive increases begin to significantly cut into retention. So according to Percy's research, there is price elasticity of demand for college tuition that would place limits on the ability to use increased tuition pricing as a means to offset decreased state funding and increased operating costs. These estimates apply to continuation rates for current students only. Percy thinks the diminished ability to admit the targeted 1,500 new freshmen due to elasticity can be offset by the relaxation of admission criteria – though this would be considered a short term or emergency type response that would not significantly affect the overall academic quality of the student body.

The determination of student tuition revenue would seem to be the result of the following calculation: [Total Tuition Revenues = (number of in-state-students * in-state-tuition) + (number of out-of state-students * out-of- state tuition)]. In reality, this calculation is considerably more complicated.

There are several additional factors university budgeters must take into consideration when projecting student tuition revenue. These factors include: the number of (1) full scholarships, (2) partial scholarships, (3) out-of-state tuition waivers or reciprocity agreements, and (4) work study programs. As a result of these factors, many students receive a tuition discount of some form and the university nets far less than full tuition for each student.

The line item student tuition revenue in the university's budget includes (1) revenues from students paying the full cost of tuition, (2) Pell Grants, (3) endowed scholarship annual interest income, and (4) athletic program earnings. The latter three revenue sources can fluctuate widely and add complexity to the budgeting process. For example, with a significant down-turn in the economy, there will be little or no annual investment interest income to be used to fund scholarships. This shortage will have to be encumbered elsewhere in the budget.

Similarly, the amount of monies needed to fund scholarships and out-of-state tuition waivers is also a moving target. Some of the factors influencing the funds needed for scholarships and tuition waivers would typically include: (1) How many high achieving students with strong SAT scores are to be given a scholarship in order to attract them to the institution? (2) How many athletic scholarships are required to support the institution's athletic goals? (3) How many of the students provided with tuition waivers or scholarships will be out-of-state students? (4) What is the expected increase in student enrollment for both in-state and out-of-state students? The answers to these four questions are supplied to the budget preparers by the Admissions Office and the Athletic Department.

Most often in an effort to be conservative in preparing the budget, the procedure is to budget the tuition revenues in full and then to itemize related off-set expenses in full on the expense side of the budget. Conservative accounting practice would typically prohibit netting of revenues with related expenses for fear the netting would hide or distort the budget picture. An example of not netting related items on the revenue section of the budget would be the amount of scholarship interest income would be included as revenues and then under the expense section of the budget the cost of scholarships will be budgeted as a separate line item expense. These two amounts are not necessarily dollar for dollar matches. A similar situation typically exists in relation to athletes. Athletic program revenue would be included as a separate line item in the revenue section of the budget and the cost of scholarships and tuition waivers for athletes would be budgeted as a separate line item in the expense section of the budget.

Basic Variables

Percy's scenario development begins by setting starting values for the following basic variables: number of in-state students, number of out-of-state students, in-state tuition, out-of-state tuition, and state assistance. Additional basic variables incorporated into the model include number of full-time faculty, number of full-time staff, average faculty salary, average staff salary, and the percentage of salaries for faculty and staff that goes for fringe benefits such as health insurance and retirement.

To simplify the model building process and still make it reflective of current numbers, necessitated the following simplifications: (1) all students pay the same, albeit discounted (discounted from full tuition to account for the absorption of expenses for full scholarships, partial scholarships, Pell grants, out of state tuition waivers or reciprocity agreements, and work study programs as described earlier), tuition, (2) the university's operating budget for 2007-2008 was $100,000,000, (3) the ratio of out-of-state tuition to in-state-tuition in 2007-2008 was maintained at 1.72 (i.e., 17, 564/10,210), and (4) tuition revenues account for 47 percent of the university's 2007-08 operating budget. To satisfy these conditions, reductions were made to full tuition fees for in-state- and out-of-state students to $6,724 and $11, 562, respectively. These numbers were formulated based on maintaining the 1.72 ratio and the revenue from in-state and out-of-state tuition is 47 percent of the operating budget. Using the average tuition price yields $47,000,268 of tuition revenue.

These variables along with the initial values Percy will use are displayed in Table 4. The values for in-state and out-of-state tuition include all student fees, room, and board for one year (two semesters) as well as tuition.

Revenue Source Variables

As with all state assisted universities, primary revenue source composition for Winegar University's budget are traditionally from state legislature appropriations, student tuition, auxiliary sources of revenue, contracts and grants, and other sources of revenue (see Figure 1).

Table 4
Basic variables and their initial values

Basic Variables	Initial Values
NumInStateStudents	5,322
NumOutOfStateStudents	970
InStateTuition	$6,724
OutOfStateTuition	$11,562
NumOfFaculty	340
NumOfStaff	800
AverageFacultySalary	$65,883
AverageStaffSalary	$45,000
FringePercent	25%

The latter three require some explanation. Auxiliary operation sources of revenues include housing, food services, and health care fees. Food services and health care have been outsourced and the fees for these services have been set according to the terms of the licensing agreement. Housing fees are based on the features and comforts of the dormitory and the operating costs.

Contracts for the bookstore, vending services, user fees for the athletic coliseum and other campus facilities are generally multi-year and not subject to change on an annual basis. Some facilities are subject to short term lease for private events (e.g., weddings, festivals, seminars, religious services, etc.) and usage is on a fee basis. Grants are awarded to faculty and administration by governmental, private sector, and not-for-profit organizations and foundations for directed research. A portion of these funds go to the university to cover university overhead and facilities use.

The *other* category of revenue consists of proceeds from summer instructional camps held on campus and conducted by university athletic coaches in various sports such as basketball, football, tennis, soccer, baseball, and golf. Additional *other* revenues are generated by vending sales and health center proceeds for treatments and medical supplies including prescription drugs.

Therefore, the major revenue variables are state appropriations from the legislature, tuition revenue based on enrollment, contracts and grants, auxiliary operations, and other. Revenue variables along with their estimated values are presented in Table 5.

Table 5
Revenue source variables and their initial values

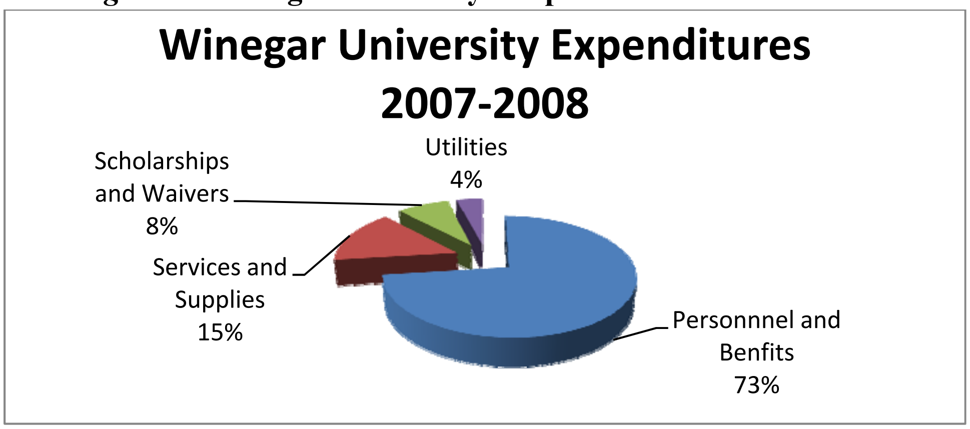
Revenue Variables	Initial Values
InStateTuitionRev	$35,785,128 (5,322* 6,724)
OutOfStateTuitionRev	$11,215,140 (970 * $11,562)
StateAppropriations	$20,000,000 (.20 * 100,000,000)
ContractsAndGrants	$17,000,000 (.17* 100,000,000)
AuxiliaryOperations	$10,000,000 (.10* 100,000,000)
Other	$ 6,000,000 (.06* 100,000,000)

Percy's determination of the initial values for the variables in Table 5 is based on the following reasoning. For the most recent year the university's operating budget was $100, 000,000. The revenue from student fees is the sum of the revenues from in-state and out-of-state students. Each of these calculations is the product of the number of students and the respective tuition rate. Based on the values from Table 4, student fees generated $47,000,268 in revenue. State appropriations, contracts and grants, auxiliary operations, and other account for 20, 17, 10, and 6 percent of the total operating budget, respectively, using the 2007-2008 percentages from Figure 1.

Expense Variables

The major categories of expenditures for Winegar University are shown in Figure 2. The variables in this category include personnel and benefits (faculty and staff salaries, faculty and staff fringe benefits), service and supplies, scholarships and waivers, and utility costs. The personnel cost for faculty is the product of the number of faculty by the average faculty salary found in Table 4. The amount for faculty fringe benefits is the product of the fringe benefit percentage in Table 4 and the total amount of faculty salary. The calculations for staff salaries and fringe benefits are calculated in the same manner.

Figure 2. **Winegar University's expenditures for 2007-2008.**



The service and supplies variable includes all of the costs incurred through outsourcing food preparation and dormitory management. In addition, it also includes the cost of all supplies such as office supplies, physical plant supplies, ground maintenance supplies, etc. Scholarships and waivers include the costs of providing these discounts for students. The utility variable includes the cost of all utilities including electric, telecommunication, water and sewer, and gas. Based on the 2007-2008 budget year, these expenses represent 15, 8, and 4 percent of the total operating budget as shown in Figure 2. The initial values for the expenditure variables are shown in Table 6.

Table 6
Expense variables and their initial values

Expense Variables	Initial values
FacultySalary	$22,400,220 (340* 65,883)
StaffSalary	$36,000,000 (800* 45,000)
FacultyFringeBenefits	$5,600,055 (.25* 22,400,220)
StaffFringeBenefits	$9,000,000 (.25* 36,000,000)
Total Personnel Costs	$73,000,275
ServiceAndSupplies	$15,000,000 (.15* 100,000,000)
ScholarshipsAndWaivers	$8,000,000 (.08* 100,000,000)
Utilities	$4,000,000 (.04* 100,000,000)

ANALYSES

With the variable information at hand, Gerald decided that the data table tools from Excel would be most useful to Percy in preparing his budget recommendations for the Board. Before instructing Percy in the use of these tools, Gerald built the spreadsheet shown in Table 7. This part of the spreadsheet serves as the mathematical model for all subsequent calculations. The column labeled "Formulas" displays the formulas used in the model. For purposes of this paper, a mathematical model consists of input variables, equations, and output variables. If one substitutes specific values of the input variables into equations, the results yield values for the output variables. For example, the output variable InStateTuitionRev is determined by the equation: InStateTuitionRev = NumInStateStudents*InStateTuition.

Table 7 The mathematical model section of the initial spreadsheet

Basic Variables	Initial Values	Formulas
NumInStateStudents	5,322	5322
NumOutOfStateStudents	970	970
InStateTuition	$6,724	6724
OutOfStateTuition	$11,562	11562
NumOfFaculty	340	340
NumOfStaff	800	800
AverageFacultySalary	$65,883	65883
AverageStaffSalary	$45,000	45000
FringePercent	25%	0.25
RecsisionPercent	5%	0.05
Revenue Variables		
OperatingExpenses2008	$100,000,000	100000000
InStateTuitionRev	$35,785, 128	=B2*B4
OutOfStateTuitionRev	$11,215,140	=B3*B5
StateAppropriations	$19,000,000	=20000000*(1-B11)
ContractAndGrants	$17,000,000	=0.17*B13
AuxiliaryOperations	$10,000,000	=0.1*B13
Other	$6,000,000	=0.06*B13
TotalRevenue	$100,000,000	=SUM(B14:B19)
Expense Variables		
FacultySalary	$22,400,220	=B6*B8
StaffSalary	$36,000,000	=B7*B9
FacultyFringeBenefits	$5,600,055	=B10*B22
StaffFringeBenefits	$9,000,000	=B23*B10
ServiceAndSupplies	$15,000,000	=0.15*B13
ScholarshipsAndWaivers	$8,000,000	=0.08*B13
Utilities	$4,000,000	=0.04*B13
TotalExpenses	$100,000,000	=SUM(B22:B28)
Surplus/Deficit	($1,000,007)	=B20-B19

One-Variable and Two-Variable Data Tables

Before Gerald demonstrates a two-variable data table, he shows Percy how to develop a one-variable data table. For this analysis, Gerald built two one-variable data tables. The first analysis varied in-state-tuition from $6,274 to $8,024 and looked at the effects on total revenue and the surplus/deficit under the assumption state appropriations remained at 20 percent of the operating budget of $100 million. The second analysis varied tuition in the same manner and assumed state appropriations were reduced by five percent. The outcomes of these analyses are displayed in Appendix A.

Percy's real interest is to determine the impact on the budget when both the InStateTuition and OutOfStateTuition variables are varied simultaneously. Gerald explains this can be done by using a two-variable data table. For this type of analysis, Excel enables you to simultaneously vary two input variables and examine the impact on exactly one output variable. For the two-variable data table, Percy suggests that in-state tuition be varied in the same way it was done in the one-variable data table while out-of-state tuition is varied from $11,562 to $12,162 in increments of $100. The output variable for this analysis is the Surplus/Deficit (see Table 8).

Results in Table 8 using the mathematical model from Table 7, demonstrate there are multiple combinations of tuition increases for in-state and out-of-state tuition yielding a surplus. Assuming state support remains at the 2007-2008 level with no rescission, there is no need to raise either in-state or out-of-state tuition rates. To verify the calculations in Table 8, assume out-of-state tuition is $11,762 and in-state tuition is $7,124, then the Surplus/Deficit variable calculation is shown in the box below:

Operating expenses are set at $100,000,000.
*InStateTuitionRev and OutOfStateTuitionRev generate $49,323,068. The latter figure results from the sum of the InStateTuitionRev = 7,124*5,322=37,913,928 and*
*OutofStateTuitionRev = 11,762*970= 11,409,140*
The remaining revenues in Table 8 remain the same so that the total revenue is 102,323,068. The expense variables do not change so
Surplus/Deficit = 102,323,018 – 100,000,275
= 2,322,793 as shown in Table 8.

Table 8 Results of varying both in-state and out-of-state tuition on the surplus/deficit with no reduction in state support or change in enrollments

		OutofState Tuition			
InState	$11,562	$11,662	$11,762	$11,862	$12,062
$6,724	($7)	$96,993	$193,993	$290,993	$484,993
$6,824	$532,193	$629,193	$726,193	$823,193	$1,017,193
$6,924	$1,064,393	$1,161,393	$1,258,393	$1,355,393	$1,549,393
$7,024	$1,596,593	$1,693,593	$1,790,593	$1,887,593	$2,081,593
$7,124	$2,128,793	$2,225,793	$2,322,793	$2,419,793	$2,613,793
$7,224	$2,660,993	$2,757,993	$2,854,993	$2,951,993	$3,145,993
$7,324	$3,193,193	$3,290,193	$3,387,193	$3,484,193	$3,678,193
$7,424	$3,725,393	$3,822,393	$3,919,393	$4,016,393	$4,210,393
$7,524	$4,257,593	$4,354,593	$4,451,593	$4,548,593	$4,742,593
$7,624	$4,789,793	$4,886,793	$4,983,793	$5,080,793	$5,274,793
$7,724	$5,321,993	$5,418,993	$5,515,993	$5,612,993	$5,806,993

The results from Table 8 prompted Percy to ask "What would be the effect of increasing out-of-state enrollment and also increasing out-of-state tuition?" Percy suggested varying out-of-state enrollments from 970 to 1,570 in increments of 100 while varying out-of-state tuition from $11,562 to $12,562 in increments of $100. The results in Table 9 show it is not necessary to initiate these measures yet. It should be noted that an enrollment increase of 400-500 students would require additional faculty. It is difficult to estimate the exact number of faculty, because it will depend on what majors the students choose. However, if the university wants to maintain an 18:1 student faculty ratio, then a crude estimate of new faculty would be between 23 and 29. This ratio is important because the university prides itself on a low student faculty ratio, and the ratio is used in all of the university's promotional material.

In Table 10 in-state enrollment and in-state tuition remain fixed, and out-of-state enrollment and out-of state tuition are varied under the assumption of a 5 percent rescission. Table 10 shows that a modest increase in out-of-state enrollment and out-of-state tuition would be enough to cover a five percent reduction in state appropriations.

Table 9

Surplus/deficit results by varying out-of-state enrollment and out-of-state tuition with no rescission

Results of varying Out Of State Students and Out Of State Tuition with state appropriations at 20 percent of the operating budget (no rescission).

	Num Out Of State Students				
Out Of State Tuition	970	1,070	1,270	1,370	1,470
$11,562	$2,128,793	$3,284,993	$5,597,393	$6,753,593	$7,909,793
$11,662	$2,225,793	$3,391,993	$5,724,393	$6,890,593	$8,056,793
$11,762	$2,322,793	$3,498,993	$5,851,393	$7,027,593	$8,203,793
$11,862	$2,419,793	$3,605,993	$5,978,393	$7,164,593	$8,350,793
$11,962	$2,516,793	$3,712,993	$6,105,393	$7,301,593	$8,497,793
$12,062	$2,613,793	$3,819,993	$6,232,393	$7,438,593	$8,644,793
$12,162	$2,710,793	$3,926,993	$6,359,393	$7,575,593	$8,791,793
$12,262	$2,807,793	$4,033,993	$6,486,393	$7,712,593	$8,938,793
$12,362	$2,904,793	$4,140,993	$6,613,393	$7,849,593	$9,085,793
$12,462	$3,001,793	$4,247,993	$6,740,393	$7,986,593	$9,232,793
$12,562	$3,098,793	$4,354,993	$6,867,393	$8,123,593	$9,379,793

Table 10

Surplus/deficit results by varying out-of-state enrollment and out-of-state tuition with a five percent rescission

Results of varying Num Of State Students and Out Of State Tuition with a 5 percent reduction in state appropriations.

Out Of State Tuition	970	1,070	1,270	1,370	1,470
$11,562	($1,000,007)	$156,193	$2,468,593	$3,624,793	$4,780,993
$11,662	($903,007)	$263,193	$2,595,593	$3,761,793	$4,927,993
$11,762	($806,007)	$370,193	$2,722,593	$3,898,793	$5,074,993
$11,862	($709,007)	$477,193	$2,849,593	$4,035,793	$5,221,993
$11,962	($612,007)	$584,193	$2,976,593	$4,172,793	$5,368,993
$12,062	($515,007)	$691,193	$3,103,593	$4,309,793	$5,515,993
$12,162	($418,007)	$798,193	$3,230,593	$4,446,793	$5,662,993
$12,262	($321,007)	$905,193	$3,357,593	$4,583,793	$5,809,993
$12,362	($224,007)	$1,012,193	$3,484,593	$4,720,793	$5,956,993
$12,462	($127,007)	$1,119,193	$3,611,593	$4,857,793	$6,103,993
$12,562	($30,007)	$1,226,193	$3,738,593	$4,994,793	$6,250,993

Additional Analyses

Percy was quite pleased with the results of the data tables. He remarked, "Now that I have a good feel for how enrollment and tuition variables impact our budget, I'd like to examine three different scenarios where I can look at changing more than two input variables. The design of this spreadsheet is presented in Table 11. Percy named these scenarios "Worst Case", "Most Likely", and "Best Case." The initial values for the scenarios and the results are shown in Table 12. For each scenario, Percy wanted to see what would happen to the surplus/deficit variable if any of eight different input variables changed over a three year period. Equipped with this powerful tool and his estimated variable values, Percy is now able to compose his budget presentations for the President.

Table 11
The spreadsheet formulas for a three year scenario model

		After 1 year	After 2 years
Num In State Students	5322	=B2+$B$34	=D2+$B$34
Num Out Of State Students	970	=B3+$B$35	=D3+$B$35
In State Tuition	6724	=B4+$B$32*B4	=D4+D4*$B$32
Out Of State Tuition	11562	=B5+B5*$B$33	=D5+D5*$B$33
Num Of Faculty	340	=B6	=D6
Num Of Staff	800	=$B$7	=$B$7
Average Faculty Salary	65883	=(1+$B$37)*$B$8	=(1+$B$37)*D8
Average Staff Salary	45000	=(1+$B$37)*$B$9	=(1+$B$37)*D9
Fringe Percent	0.25		
Rescission Percent	-0.05		
Revenue Variables			
OperatingExpenses2008	100000000	=(1+$B$36)*$B$13	=(1+$B$36)*D13
In State Tuition Rev	=B2*B4	=D2*D4	=E2*E4
Out Of State Tuition Rev	=B3*B5	=D3*D5	=E3*E5
State Appropriations	=20000000*(1+B11)	=(1+$B$38)*B16	=(1+$B38)*D16
Contract And Grants	=0.17*B13	=$B$17	=$B$17
Auxiliary Operations	=0.1*B13	=$B$18	=$B$18
Other	=0.06*B13	=$B$19	=$B$19
Total Revenue	=SUM(B14:B19)	=SUM(D14:D19)	=SUM(E14:E19)
Expense Variables			
Faculty Salary	=B6*B8	=D6*D8	=E6*E8
Staff Salary	=B7*B9	=D7*D9	=E7*E9
Faculty Fringe Benefits	=B10*B22	=$B$10*D22	=$B$10*E22
Staff Fringe Benefits	=B23*B10	=$B$10*D23	=$B$10*E23
Service And Supplies	=0.15*B13	=(1+$B$39)*$B$26	=(1+$B$39)*D26
Scholarships And Waivers	=0.08*B13	=$B$27	=$B$27
Utilities	=0.04*B13	=$B$28	=$B$28
Total Expenses	=SUM(B22:B28)	=SUM(D22:D28)	=SUM(E22:E28)
Surplus/Deficit	=B20-B29	=D20-D29	=E20-E29
Variables that Change	**Rate of Change**	**Variables that Change**	**Rate of Change**
In State Tuition	0.03	Change In Operating	0.02
Out Of State Tuition	0.03	Faculty Salary Increase	0.02
In State Enrollment	200	State Appropriation Change	-0.05
Out Of State Enrollment	30	Service And Supplies	0.03

Table 12
A summary of the three scenarios including the rates of change for the variables and the results for the surplus/deficit variable

Scenario Summary	Worst Case	Most Likely	Best Case
Assumptions			
In State Tuition	N/C	+3%	+2%
Out Of State Tuition	N/C	+3%	+3%
In State Enrollment	N/C	200	250
Out Of State Enrollment	N/C	30	60
Change In Operating Expenses	+3%	+2%	N/C
Faculty Staff Salary Increase	+3%	2%	+2%
State Appropriation Change	-10%	-5%	N/C
Service And Supplies Change	+5%	+3%	+2%
Results for the Surplus/Deficit variable			
After one year	($5,840,015)	($707,595)	$721,296
After two years	($10,593,224)	($263,538)	$2,543,263
After three years	($15,282,478)	$334,774	$4,469,766

Note. The spreadsheets for the three scenarios are shown in Appendix B.

CONCLUSION

As Percy entered the room, armed with his laptop and his analyses in hand, he felt more confident of his ability to respond to Board Member challenges. In addition to the prepared scenarios and his responses to the obvious tuition questions presented at the outset of the case, Percy had prepared and rehearsed responses to several other anticipated questions.

- What are the major assumptions upon which you base your most likely scenario and on which scenarios are you more or less confident?
- Where should we set our in-state and out-of-state tuition to insure we will not have to tap into the emergency fund?
- Under your recommended tuition pricing, how many out-of-state and in-state students will not be able to afford to continue next semester?
- How critical to your budget is increasing the ratio of in-state to out-of-state students?
- If the state freezes salaries for the coming year for all (faculty and staff) employees, what would be your new recommendation regarding tuition pricing?

Equipped with his analysis of the budgeting environment, rehearsed responses, and his new tool, Percy felt confident he will be able to quickly respond to the President and other Board Members' questions regarding components of the recommended budget for the coming academic year at Winegar. He will pass his exam. Will you?

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APPENDIX A: ONE-VARIABLE DATA TABLES

The one-variable data tables enable Percy to systematically vary one input variable and observe the effect on several output variables. For example, the left side of Table 1 shows the results of varying the input variable InStateTuition from $6,724 to $8,024 in increments of $100 on the output variables TotalRevenue and Surplus/Deficit (TotalRevenue-TotalExpenses). The left side of Table 1 shows the budget is fine as long as the state provides 20 percent of operating expenses. However, the right side of Table 1 shows that if the state reduces their support from $20 million to $19 million (i.e., a 5 percent reduction), the university faces shortfalls that must be remedied by increasing in-state tuition by at least $200 per student to yield a surplus.

Table 1
One-variable data tables showing the effects of increasing In State Tuition under no rescission and a 5 percent rescission

State appropriations at 20 percent of the operating budget			State appropriations reduced by 5 percent		
InStateTuition	TotalRevenue	Surplus/Deficit	InStateTuition	TotalRevenue	Surplus/Deficit
$6,724	$100,000,268	($7)	$6,724	$99,000,268	($1,000,007)
$6,824	$100,532,468	$532,193	$6,824	$99,532,468	($467,807)
$6,924	$101,064,668	$1,064,393	$6,924	$100,064,668	$64,393
$7,024	$101,596,868	$1,596,593	$7,024	$100,596,868	$596,593
$7,124	$102,129,068	$2,128,793	$7,124	$101,129,068	$1,128,793
$7,224	$102,661,268	$2,660,993	$7,224	$101,661,268	$1,660,993
$7,324	$103,193,468	$3,193,193	$7,324	$102,193,468	$2,193,193
$7,424	$103,725,668	$3,725,393	$7,424	$102,725,668	$2,725,393
$7,524	$104,257,868	$4,257,593	$7,524	$103,257,868	$3,257,593
$7,624	$104,790,068	$4,789,793	$7,624	$103,790,068	$3,789,793
$7,724	$105,322,268	$5,321,993	$7,724	$104,322,268	$4,321,993
$7,824	$105,854,468	$5,854,193	$7,824	$104,854,468	$4,854,193
$7,924	$106,386,668	$6,386,393	$7,924	$105,386,668	$5,386,393
$8,024	$106,918,868	$6,918,593	$8,024	$105,918,868	$5,918,593

APPENDIX B: SPREADSHEETS FOR THE THREE-YEAR PROJECTIONS

Table 1				
A spreadsheet for a three-year period under the "worst case" scenario		After 1 year	After 2 years	After 3 years
Num In State Students	5,322	5,322	5,322	5,322
Num Out Of State Students	970	970	970	970
In State Tuition	$6,724	$6,724	$6,724	$6,724
Out Of State Tuition	$11,562	$11,562	$11,562	$11,562
Num Of Faculty	340	340	340	340
Num Of Staff	800	800	800	800
Average Faculty Salary	$65,883	$67,859	$69,895	$71,992
Average Staff Salary	$45,000	$46,350	$47,741	$49,173
Fringe Percent	25%			
Rescission Percent	-5%			
Revenue Variables				
OperatingExpenses2008	$100,000,000	$103,000,000	$106,090,000	$109,272,700
In State Tuition Rev	$35,785,128	$35,785,128	$35,785,128	$35,785,128
Out Of State Tuition Rev	$11,215,140	$11,215,140	$11,215,140	$11,215,140
State Appropriations	$19,000,000	$17,100,000	$15,390,000	$13,851,000
Contract And Grants	$17,000,000	$17,000,000	$17,000,000	$17,000,000
Auxiliary Operations	$10,000,000	$10,000,000	$10,000,000	$10,000,000
Other	$6,000,000	$6,000,000	$6,000,000	$6,000,000
Total Revenue	$99,000,268	$97,100,268	$95,390,268	$93,851,268
Expense Variables				
Faculty Salary	$22,400,220	$23,072,227	$23,764,393	$24,477,325
Staff Salary	$36,000,000	$37,080,000	$38,192,400	$39,338,172
Faculty Fringe Benefits	$5,600,055	$5,768,057	$5,941,098	$6,119,331
Staff Fringe Benefits	$9,000,000	$9,270,000	$9,548,100	$9,834,543
Service And Supplies	$15,000,000	$15,750,000	$16,537,500	$17,364,375
Scholarships And Waivers	$8,000,000	$8,000,000	$8,000,000	$8,000,000
Utilities	$4,000,000	$4,000,000	$4,000,000	$4,000,000
Total Expenses	$100,000,275	$102,940,283	$105,983,492	$109,133,746
Surplus/Deficit	($1,000,007)	($5,840,015)	($10,593,224)	($15,282,478)
Variables that Change	Change			
In State Tuition	0			
Out Of State Tuition	0			
In State Enrollment	0			
Out Of State Enrollment	0			
Change In Operating Expenses	3.00%			
Faculty Staff Salary Increase	3.00%			
State Appropriation Change	-10.00%			
Service And Supplies Change	5.00%			

Table 2				
A spreadsheet for a three-year period under the "most likely" scenario		**After 1 year**	**After 2 years**	**After 3 years**
Num In State Students	5,322	5,522	5,722	5,922
Num Out Of State Students	970	1000	1030	1060
In State Tuition	$6,724	$6,926	$7,133	$7,347
Out Of State Tuition	$11,562	$11,909	$12,266	$12,634
Num Of Faculty	340	340	340	340
Num Of Staff	800	800	800	800
Average Faculty Salary	$65,883	$67,201	$68,545	$69,916
Average Staff Salary	$45,000	$45,900	$46,818	$47,754
Fringe Percent	25%			
Rescission Percent	-5%			
Revenue Variables				
OperatingExpenses2008	$100,000,000	$102,000,000	$104,040,000	$106,120,800
In State Tuition Rev	$35,785,128	$38,243,826	$40,817,839	$43,511,873
Out Of State Tuition Rev	$11,215,140	$11,908,860	$12,634,110	$13,392,156
State Appropriations	$19,000,000	$18,050,000	$17,147,500	$16,290,125
Contract And Grants	$17,000,000	$17,000,000	$17,000,000	$17,000,000
Auxiliary Operations	$10,000,000	$10,000,000	$10,000,000	$10,000,000
Other	$6,000,000	$6,000,000	$6,000,000	$6,000,000
Total Revenue	$99,000,268	$101,202,686	$103,599,449	$106,194,155
Expense Variables				
Faculty Salary	$22,400,220	$22,848,224	$23,305,189	$23,771,293
Staff Salary	$36,000,000	$36,720,000	$37,454,400	$38,203,488
Faculty Fringe Benefits	$5,600,055	$5,712,056	$5,826,297	$5,942,823
Staff Fringe Benefits	$9,000,000	$9,180,000	$9,363,600	$9,550,872
Service And Supplies	$15,000,000	$15,450,000	$15,913,500	$16,390,905
Scholarships And Waivers	$8,000,000	$8,000,000	$8,000,000	$8,000,000
Utilities	$4,000,000	$4,000,000	$4,000,000	$4,000,000
Total Expenses	$100,000,275	$101,910,281	$103,862,986	$105,859,381
Surplus/Deficit	($1,000,007)	($707,595)	($263,538)	$334,774
Variables that Change	Change			
In State Tuition	3.00%			
Out Of State Tuition	3.00%			
In State Enrollment	200			
Out Of State Enrollment	30			
Change In Operating Expenses	2.00%			
Faculty Staff Salary Increase	2.00%			
State Appropriation Change	-5.00%			
Service And Supplies Change	3.00%			

Table 3				
A spreadsheet for a three-year period under the "Best case" scenario		**After 1 year**	**After 2 years**	**After 3 years**
Num In State Students	5,322	5,572	5,822	6,072
Num Out Of State Students	970	1030	1090	1150
In State Tuition	$6,724	$6,858	$6,996	$7,136
Out Of State Tuition	$11,562	$11,909	$12,266	$12,634
Num Of Faculty	340	340	340	340
Num Of Staff	800	800	800	800
Average Faculty Salary	$65,883	$67,201	$68,545	$69,916
Average Staff Salary	$45,000	$45,900	$46,818	$47,754
Fringe Percent	25%			
Rescission Percent	-5%			
Revenue Variables				
OperatingExpenses2008	$100,000,000	$100,000,000	$100,000,000	$100,000,000
In State Tuition Rev	$35,785,128	$38,215,451	$40,728,672	$43,327,136
Out Of State Tuition Rev	$11,215,140	$12,266,126	$13,370,077	$14,529,226
State Appropriations	$19,000,000	$19,000,000	$19,000,000	$19,000,000
Contract And Grants	$17,000,000	$17,000,000	$17,000,000	$17,000,000
Auxiliary Operations	$10,000,000	$10,000,000	$10,000,000	$10,000,000
Other	$6,000,000	$6,000,000	$6,000,000	$6,000,000
Total Revenue	$99,000,268	$102,481,576	$106,098,749	$109,856,362
Expense Variables				
Faculty Salary	$22,400,220	$22,848,224	$23,305,189	$23,771,293
Staff Salary	$36,000,000	$36,720,000	$37,454,400	$38,203,488
Faculty Fringe Benefits	$5,600,055	$5,712,056	$5,826,297	$5,942,823
Staff Fringe Benefits	$9,000,000	$9,180,000	$9,363,600	$9,550,872
Service And Supplies	$15,000,000	$15,300,000	$15,606,000	$15,918,120
Scholarships And Waivers	$8,000,000	$8,000,000	$8,000,000	$8,000,000
Utilities	$4,000,000	$4,000,000	$4,000,000	$4,000,000
Total Expenses	$100,000,275	$101,760,281	$103,555,486	$105,386,596
Surplus/Deficit	($1,000,007)	$721,296	$2,543,263	$4,469,766
Variables that Change	Change			
In State Tuition	3.00%			
Out Of State Tuition	3.00%			
In State Enrollment	200			
Out Of State Enrollment	30			
Change In Operating Expenses	2.00%			
Faculty Staff Salary Increase	2.00%			
State Appropriation Change	-5.00%			
Service And Supplies Change	3.00%			

THE GOOD OL' BOY SYSTEM: ALIVE AND WELL AT LAOCOÖN AERONAUTICS CORPORATION

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DESCRIPTION

The purpose of this case is to present a dilemma regarding the actions that should be taken in response to incidences of sexual harassment at Laocoön Aeronautics Corporation. Averil Hughes, a high-ranking and well-respected director on the executive leadership team at Laocoön, is offended by the sexual propositions and innuendos made to her by her direct supervisor, William Prewett. Her boss's behavior not only incites an array of negative emotions within her, but she believes that by not appeasing Prewett's sexual advances her job performance and future at the company could be compromised. Averil eventually reports the harassment to William's direct supervisor, Tony Zi. The case concludes with Tony contemplating how he should handle this complicated and delicate situation.

SYNOPSIS

This cutting-edge, dilemma case examines sexual harassment from the lens of a female executive in the gender-biased, U.S. defense industry. The uniqueness of this case is that while more females are moving into male-dominated organizations in this industry, very few cases have examined sexual harassment within these organizations. The majority of the case focuses on Averil Hughes' meteoric rise from employee to the executive ranks within Laocoön Aeronautics Corporation and chronicles events that led to her filing a sexual harassment claim against her boss and Vice-President of Military Aerospace and Electronic Systems, William Prewett. In addition, the case provides a broad overview of the U.S Defense Industry and detailed insight into the organizational culture at Laocoön Aeronautics Corporation. The case concludes with Averil reporting the sexual harassment claim to William's boss, Tony Zi, the Executive Vice-President of Business Development and Operations. Tony Zi is faced with a difficult decision- how to legally manage a sexual harassment claim that involves his best friend, William Prewett, and one of his star hires, Averil Hughes.

INTRODUCTION

Averil Hughes intently gazed out her office window, as the sun slowly set over the Colorado River and back into Shepherd Mountain. To Averil, this moment was the favorite part of her work day especially given the events of the past few months. Although Averil had worked for Laocoön Aeronautics Corporation for almost 12 years, she had never faced such a difficult sell of the Organizational Excellence Program. William Prewett, Vice-President of Military Aerospace and Electronic Systems, vehemently refused to participate in the program that was headed up by Averil. To Averil's surprise, William had recently appointed her as the lead Six Sigma expert for the Odysseus Group. Averil was thrilled with this opportunity because she was the first Director of Divisional Quality and Excellence to be appointed with an above security clearance. Typically, these types of appointments were reserved for the Senior Vice-President of Organizational Quality and Excellence. Further, Averil believed that her appointment would serve as the perfect stepping stone to entice William to participate in the Organizational Excellence Program. As Averil continued to watch the final rays of light peer through her window, she took a deep breath and thought about her meteoric rise to fame at Laocoön Aeronautics Corporation.

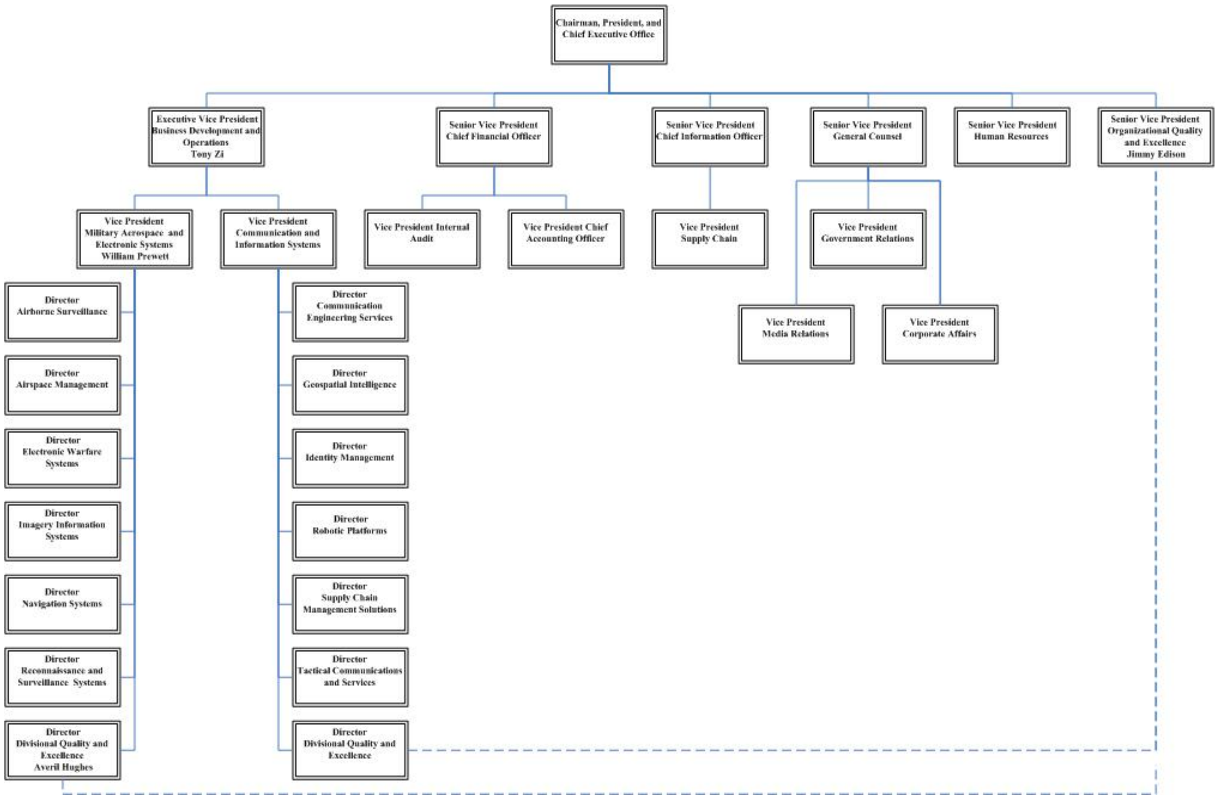
Averil had graduated at the top of her MBA class from The Pamplin College of Business at Virginia Tech and was heavily recruited by multiple Fortune 100 companies. Rather than take an immediate position with one of these companies, Averil opted for a prestigious internship with Quality Management guru, Joseph Juran, in New York City. Through this internship, she spent two years learning the fine techniques that comprised quality analysis and planning. At the end of her internship, Averil interviewed with five Fortune 100 companies and again received several offers of employment. Eventually, Averil decided upon a Supervisory Quality Assurance Specialist position with Laocoön Aeronautics Corporation, a Fortune 100 Company with more than 5,000 employees, so that she could help to implement Total Quality Management (TQM) processes and principles throughout the organization. Averil quickly rose through the ranks at Laocoön because she was not afraid to question old principles and practices within the organization and because she was one of the few females in the executive leadership ranks for Laocoön Aeronautics Corporation. Within two years, she became certified as a Master Black Belt and was moved into a Lead Quality Assurance Specialist position. Eventually, she was promoted to Director of Divisional Quality and Excellence for the Military Aerospace and Electronics Division at Laocoön Aeronautics Corporation.

THE U.S AEROSPACE AND DEFENSE INDUSTRY AND LAOCOÖN AERONAUTICS CORPORATION[2]

The Cold War with the Soviet Union resulted in an unprecedented buildup of conventional and nuclear weapons and laid the foundation for the U.S. Aerospace and Defense

Industry. Military defense contractors emerged in the 1950s and 1960s to bid on contracts and to supply the Department of Defense (DoD) with a steady stream of proven weapon systems. Laocoön Aeronautics Corporation was created during this period to provide research, development, testing, and evaluation of aerospace systems. Aerospace systems encompass manned and unmanned aircraft, laser systems, and microelectronics. Like many other competitors in this industry, Laocoön eventually diversified beyond aerospace systems into electronic systems and information systems. In the Aerospace and Defense industry, electronic systems include advanced electronic technologies that support American and foreign national security and non-defense applications. Meanwhile, information systems typically provide advanced enterprise solutions to civilians, commercial, intelligence, and military customers.

FIGURE 1
LAOCOÖN TECHNOLOGIES CORPORATION ORGANIZATIONAL STRUCTURE



As the Aerospace and Defense industry experienced dramatic budget cuts towards the end of President Reagan's tenure in office, successful defense contractors responded by becoming agile competitors. Laocoön's strategies were aimed at diversifying into nondefense related industries and implementing TQM. The later strategy was congruent with DoD requirements for defense contractors to implement a TQM program before the end of 1992. In response, Laocoön had undergone a fundamental restructuring that involved moving the Director of Divisional Quality and Excellence from under the supervision of the Senior Vice-President of Human Resources to its own executive position as Senior Vice-President of Organizational Quality and Excellence (See Figure 1). In this executive position, the Senior Vice-President of Organizational Quality and Excellence was given a department that consisted of two Directors of Divisional Quality and Excellence for each business operational division in the company. These directors reported directly to the Senior Vice-President of Organizational Quality and Excellence and to the Vice-President of the respective operational division.

Averil Hughes was one of two Divisional Quality and Excellence directors. She reported directly to Jimmy Edison, Senior Vice-President of Organizational Excellence and Quality, and William Prewett, Vice-President of Military Aerospace and Electronic Systems, who in turn reported directly to the Executive Vice President of Business Development and Operations, Tony Zi. The corporate headquarters for Laocoön Aeronautics Corporation was located in Baltimore, Maryland. So, Averil only meet with Jimmy Edison four times per year. Meanwhile, the Military Aerospace and Electronic Systems Division was located in Austin, Texas. Both Averil Hughes and William Prewett were based out of Austin, Texas. Meanwhile, Tony Zi divided his time between Austin, Dallas (Communication and Information Systems Division), and Baltimore.

ORGANIZATIONAL CULTURE AT LAOCOÖN AERONAUTICS CORPORATION

The organizational culture at Laocoön Aeronautics Corporation resembled the male-dominated culture of many other firms in the U.S. Aerospace and Defense industry. Executive indulgences in alcohol combined with professional escorts at lavish corporate outings and executives looking the other way when ethical violations occurred was the norm at Laocoön. Throughout the lower ranks of the company, extramarital affairs were prevalent as office romances blossomed while coworkers turned their heads to avoid the situation. Of the few women who dared to break the gender barrier at Laocoön, most suffered unwelcome sexual comments and lewd jokes on a daily basis. In fact, Laocoön's culture was one where sexual harassment of women had been tolerated. The culture was so perverse that most women were too scared to make complaints when they were harassed.

Over the 12 years that Averil had been employed at Laocoön, the human resource department had required members of the executive team, managers, supervisors, and employees to attend annual sexual harassment training. The purpose of the training was to educate all employees about sexual harassment and to help employees understand their rights to work in a harassment free environment. However, each time Averil had attended one of the annual training sessions for executives she could overhear many of her male colleagues joking about the training.

"Just because I tell my secretary that she is hot and that she could get a raise if she dressed in a shorter skirt doesn't mean a thing."

"My secretary loves for me tell her she looks good. Hell, if weren't for me, she would be working at the local Wal-Mart."

"Which flavor of the month is William sleeping with these days- the dumb blonde or the feisty brunette?"

Typically the room would erupt into a loud roar of laughter. Everyone had heard the scandalous stories about William Prewett and his frequent sex capades with the female employees at Laocoön.

Averil had also noticed that sometimes the male executives signed the attendance form and sat in the back of the room just so that they could leave the training after it began. The prevailing belief of many male executives at Laocoön Aeronautics Corporation was that sexual harassment training did not apply to them.

At the direction of the CEO, the Senior Vice-President of Human Resources, in coordination with the Senior Vice-President and General Counsel, had developed a formal sexual harassment policy. This policy was outlined in annual sexual harassment training and was also posted in writing on bulletin boards next to the executive and employee bathrooms. Specifically, the sexual harassment policy outlined the formal complaint process which included instructions on how to report complaints, when to bypass supervisors if they were involved in the harassment, assured employees of anonymity and prohibited retaliation when a complaint was filed, guaranteed a prompt and thorough investigation of the complaint, and provided procedures for disciplinary actions for the harasser if found guilty. To complement the annual sexual harassment training and policy, the Senior Vice-President of Human Resources sent out annual-mails that clearly stated that Laocoön Aeronautics Corporation was a workplace free of sexual harassment and that any form of sexual harassment would not be tolerated.

WILLIAM PREWETT- A WOLF IN SHEEP'S CLOTHING

William Prewett, the Vice-President of Military Aerospace and Electronics Division and one of Averil's managers, had seemed like a great boss. He allowed his directors to set their own work schedules as long as they completed all assigned work according to Laocoön's strict timelines. He also negotiated with Laocoön to provide his directors with plush office suites that had great views of the Colorado River. William even scheduled a monthly golf game with his directors at Deep Creek Country Club followed by a dinner at Ruth Chris Steakhouse. To top off these perks, William had recently appointed Averil to serve as the Six Sigma Specialist on the Odysseus Group.

April 2007

Laocoön Aeronautics Corporation had been awarded a $1 billion dollar contract to develop and eventually manufacturer a laser-guided weapon system for the DoD. Naturally, William was elected to serve as head of the Odysseus Group. The Odysseus Group was operating under strict deadlines and required above top secret security clearances as outlined by the DoD. So, the Odysseus Group began to work past the traditional work hours of 5:00p and well into the night. Soon, William began to cater dinner for the late night work sessions. After one of these late night sessions, William asked Averil to head down to the Warehouse District with him to have a few drinks and unwind from the day. Averil thought that it sounded like fun and so she met William for drinks at the Twisted Olive.

After a couple of pomegranate martinis, Averil was ready to leave, but William insisted that she stay while he ordered one more drink. Averil obliged and seized the opportunity to discuss some of the organizational change initiatives that she wanted to see accomplished. After all, she had been desperately trying to get William on board with the rest of the organization for the new Organizational Excellence Program for quite some time.

William stopped her before she got too far by saying, "Has anyone ever told you that you look like Jennifer Garner? Since we are away from work, I just have to tell you that I have been watching you for awhile now. You are so damn attractive…"

Averil, sensing that William was approaching his limit of alcohol intake for the evening, quickly explained: "William, it's time to go buddy. You have drunk way too much this evening."

William, in response, argued, "No, no baby… It's you that I want, no more drinks…Let's go back to my place."

Without hesitation, Averil got up from the table, waved good-bye to William, and quickly darted out door. On the way home from the bar, Averil just shook her head in dismay and partially dismissed William's actions because he had been drinking way too much.

Since Laocoön Aeronautics Corporation was a private defense contractor and comprised of mostly engineers and scientists, Averil found herself in a mostly male-dominated world. For the Odysseus Group and in the Military Aerospace and Electronic Systems division, Averil was the lone female among the executive leadership ranks. While there were female engineers and research scientists, and even a few female supervisors, she was the only female executive at all of the divisional meetings. Nevertheless, Averil enjoyed working for Laocoön and rightfully so. Not only had she moved up quickly in the executive ranks, but also she was comfortable working for an organization that did not have many female employees. In Averil's opinion, she had grown up with all brothers, so working with men was no big deal to her.

May 2007

Several weeks after the martini incident, Averil was excited when William asked her during an Odysseus Group session to schedule a meeting with him to discuss the Organizational Excellence Program. For months, Averil had been pleading with William to implement the organizational change initiatives established by the CEO and the Senior Vice-President of Organizational Quality and Excellence. Averil thought that her new Quality Assurance specialist, Adam Bartol, should go with her in order to learn how to interact and work with William Prewett.

As they entered his office, William snapped at Averil in a coy manner and said, "Why is he here? I didn't invite him to my office!"

Immediately, Averil asked Adam to wait for her in the outer office with William's secretary. As Adam left William's office, William yelled in a demanding tone, "Shut the door son and don't come back until you're invited!"

With a strange look, Averil asked William, "What's up with your crappy attitude? I thought that today would be an excellent time for you to meet Adam and to let him sit in on our meeting. We really need to begin implementing the organizational change initiatives established by our executive team."

William suddenly stopped her and said, "Organizational change initiatives are not the most important things to me today."

A bit frustrated, Averil asked, "Then what is?"

William replied, "You know, sexual things. Why don't we leave work early and head over to The Café at Four Seasons? Then, if we drink too much, we can just stay at the hotel."

As Averil immediately stood up to leave, she said, "Let me know if and when you want to start managing your division instead of acting like an idiot. You may proposition other women in this organization, but you will not proposition me again! Your comments today and when we were at the Twisted Olive are highly inappropriate!"

Averil was boiling over with anger. Her first reaction was to slap William Prewett from Austin to El Paso. Here she was, almost 40 years old, managing a department comprised of quality engineers and assurance specialists, and William had just treated her like she worked in a brothel.

Adam had no clue why his boss was walking so fast in those Jimmy Choo shoes or why she looked so angry. She had not stayed too long in William's office, but Adam had heard all the rumors about William and his infinite sex capades. Adam's imagination ran wild about what happened in William's office, and he quickly decided that he would not like working with William.

Averil contemplated telling the Executive Vice-President of Business Development and Operations and William Prewett's boss, Tony Zi, about her encounters with William, but she decided against it. After all, she loved working for Laocoön Aeronautics Corporation and did not want to create unnecessary issues for the company. She forced herself to suppress the feelings of anger, anxiety, and shame that were overwhelming her. While she knew in her heart that she had done nothing to encourage this inappropriate behavior on the part of her boss, her mind began to fill with doubts about the possibility that she somehow gave him the wrong impression. She even began to question the motives behind her rapid rise through the ranks in the organization. While her credentials and stellar performance were more than enough to undeniably justify her promotion through the company, she wondered whether her gender and appearance may have also been factors. All of these doubts were starting to take a toll on Averil's confidence, self-esteem, and motivation.

Early June 2007

Throughout early June, Averil continued to work on design processes with the Odysseus Group. William seemed to return to his normal self and became the good boss that Averil remembered. However, he still avoided the Organizational Excellence Program and consequently his division was lagging behind on the organizational change initiatives.

Shortly thereafter, William talked to Averil after an Odysseus Group session and suggested that they needed to meet to discuss productivity management and things like "production environments, motivation and reward systems, and the impact of technology."

William went on to suggest that Averil should come to his lake house for the weekend because he could guarantee her a "quality experience."

Averil was so frustrated and degraded because she knew that William was not talking about managing production activities. His blatant sexual innuendos made her realize that he had no intention of treating her with respect as a colleague, and he did not appear to be at all concerned about legalities.

Averil knew that something had to be done. She could not allow William to continue his sexual advances. Not only had William invited her to his vacation home on Lake Austin for a weekend of debauchery, but also he had propositioned her for sex and made inappropriate comments on at least two separate occasions. To top things off, he refused to participate in the organizational excellence initiative that was headed up by Averil unless she agreed to drinks and dinner one night after work. Although Averil had grown up with two brothers and was accustomed to them and their friends talking about women; she had never experienced a situation where a man, and for that much a boss, had blatantly forced himself on her.

REPORTING THE CLAIM TO TONY ZI – FRIEND OR FOE?

Late June 2007

Averil scheduled a meeting with Tony Zi, Executive Vice-President of Business Development and Operations, who had been with Laocoön Aeronautics Corporation for 25 years. During the meeting, Tony was obviously concerned about Averil, yet he was also worried about losing William as a Divisional Vice-President.

Tony asked, "What do you want the company to do? William is one of our best Vice-Presidents."

In response, Averil demanded, "I either want him fired or he needs to be demoted with a drastic reduction in his salary. End of story… no exceptions. I want everyone in this company to get the message that sexual harassment is not tolerated!"

Tony suggested to Averil, "Why don't I just move you to the Communications and Information Systems Division? I'll make sure that William gets additional training and understands that his behavior is not appropriate."

Averil snapped back at Tony, "Do what you want to do, but he will never change. He'll do this again!"

Averil left wondering what Tony would do and how many females had been victims of William's sexual harassment but had suffered in silence.

If an investigation revealed that William Prewett was guilty of sexual harassment, Tony knew that the company had several options. First, William could be relieved of his supervisory status and demoted from Vice-President of Military Aerospace and Electronic Systems back to his original position of electrical engineer. Second, William's salary could be docked by 10-20%, he would be forced to attend a professional treatment program, and he would keep his current position. Third, William could be permanently terminated from Laocoön.

Tony agonized over how to handle the situation. Tony and William had both started at Laocoön Aeronautics Corporation at the same time as engineers in Airborne Surveillance. Further complicating the situation was the fact that Tony and William were fraternity brothers from their college days at The University of Texas, and they had maintained their friendship for almost 30 years. At the same time, Tony knew that additional members of executive leadership team were just as guilty of sexual harassment as William was. In fact, Laocoön's culture was one where sexual harassment of this type had been tolerated. Over the years that Tony had been employed at Laocoön and before he became the Senior Vice-President of Human Resources, Tony had also attended the sexual harassment training and had joked with the other guys about the training. He even had bragged to his colleagues that members of the executive leadership team were in attendance so that they could learn how to harass at a higher level.

Now Tony found himself wondering if what the Senior Vice-President of Human Resources had preached was really true. Tony wondered if this type of behavior really did demoralize employees. Also, he contemplated whether there had be declines in job satisfaction and more psychological distress in female employees at Laocoön Aeronautics Corporation because of the proliferation of sexual harassment. He knew that if William was demoted this would only be the beginning of having to address this type of behavior at Laocoön. He also wondered who would be the next Vice-President or Director that would need to be disciplined because of inappropriate behavior. In the old days, helping William survive would not have been a problem; but now, legally, such behavior could not be tolerated.

Tony was also very concerned about Averil. She was a superstar member of the executive leadership team. She was highly respected by her peers and was an intelligent, self-motivated leader. More importantly, Tony was responsible for hiring Averil; and he had a great deal of respect for her. Maybe Averil would be satisfied if Laocoön simply moved her to Director of Divisional Quality and Excellence for the Communication and Information Systems Division. As he was preparing to leave the office for the day, Tony was sure of one thing – there was no possible way that he would sleep tonight if he did not make a decision about William and Averil.

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ENDNOTES

1 This case is based upon actual events in an existing organization, but all names of actual persons and the organization are disguised for purposes of anonymity. Also, an earlier version of this case was presented at the 2009 Southwest Case Research Association Meeting in Oklahoma City, OK.

2 The U.S. Department of Labor also refers to the U.S. Aerospace and Defense Industry as the Aerospace Products and Parts Manufacturing Industry.

APPENDIX 1
U.S. SEXUAL HARASSMENT LAW AND THE EQUAL EMPLOYMENT OPPORTUNITY COMMISSION (EEOC)

Sexual harassment is a form of gender discrimination that is prohibited by Title VII of the Civil Rights Act of 1964. Title VII applies to employers that have 15 or more employees and includes state and federal governments, labor organizations, and employment agencies. The EEOC has defined sexual harassment as consisting of "unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature" (EEOC, 2009, para.2). The EEOC guidelines outline two forms of sexual harassment: quid pro quo and hostile work environment. Quid pro quo harassment occurs when sexual harassment is made explicitly or implicitly as a term or condition of employment or is used as the basis for employment decisions. The second form of sexual harassment, a hostile work environment, interferes with the individual's work and/or creates an offensive and intimidating work environment. This form of sexual harassment manifests when a victim is subjected to unwanted and pervasive sexual comments, innuendos, touching, or conduct of a sexual nature.

The United States EEOC was created by the Kennedy administration to primarily enforce Title VII of the Civil Rights Act of 1964. While the EEOC became officially active on July 2, 1965, the EEOC did not initially have power to enforce the statute until the introduction of the Equal Employment Opportunity Act of 1972. Because Title VII did not officially prohibit sexual harassment, the U.S. Supreme Court held in the 1986 case of *Meritor Savings Bank v. Vinson* that sexual harassment is a form of gender discrimination in employment and is a direct violation of Title VII. In 1993, the Supreme Court, in its decision of *Harris v. Forklift Systems, Inc.*, ruled that psychological harm is not a requirement for a sexual harassment claim.

APPENDIX 2
SEXUAL HARASSMENT LIABILITY DETERMINATION

In response to the increasing number of sexual harassment claims in the 1980s, Congress amended Title VII to allow victims to recover damages under federal law. Then, in June 1998, the Supreme Court issued two opinions that interpreted Title VII and its applicability to sexual harassment claims. These opinions were based on *Burlington Industries Inc. v. Ellerth* and *Faragher v. City of Boca Raton*. The Supreme Court agreed that sexual harassment is a form of gender discrimination in employment and represents a direct violation of Title VII. As such, the employer is liable for sexual harassment by employees and supervisors, the burden of sexual harassment prevention falls upon the employer, and the employer must respond promptly when sexual harassment occurs. First, if the employee suffers tangible employment actions because of sexual harassment, the employer will be found liable for damages (Laabs, 1998). Tangible employment actions include termination, salary reduction, and poor work assignments. Second, even if the employee does not suffer tangible employment actions and if the company has no affirmative defense, the employer will be found liable (Laabs, 1998). Affirmative defense examines the extent to which 1) the employer exercises reasonable care and 2) the plaintiff employee takes advantage of corrective actions provided by the employer (Daniel, 2003). Reasonable care includes establishing a sexual harassment policy, training all employees and managers on avoiding sexual harassment, and investigating and taking action when complaints are presented (Laabs, 1998). Further, the plaintiff employee must actively take part in employer corrective opportunities. If the company fails to meet both components of the affirmative defense, the company will be held liable for damages (Daniel, 2003).

APPENDIX 3
SEXUAL HARASSMENT IN THE WORKPLACE: STATISTICS IN THE UNITED STATES

Rates of Incidence across all Occupations and Organizations

According to a meta-analysis based on more than 86,000 respondents (Ilies, Hauserman, Schwochau, & Stibal, 2003), at least 24% of women report being sexual harassed at work and 58% report experiencing some form of harassing behaviors. The difference in estimates is most likely attributable to women being hesitant to label negative experiences as sexual harassment at work.

Numbers of Women in Nontraditional Occupations and Industries: The Case of the Aerospace and Defense Industry

The number of working women entering into nontraditional occupations is steadily rising in the United States.[a] In the U.S. Aerospace and Defense Industry, 21.9% of the workers were female in 2007 (U.S. Department of Labor, 2008). Further, of occupations that require a bachelor's degree or higher in this industry, 11.5% of engineers were women (U.S. Department of Labor, 2009).

Adverse Outcomes in Male-Dominated Jobs and Organizations

Women in nontraditional, male-dominated occupations experience adverse working conditions, such as isolation, segregation, and withholding of training opportunities, and more sexual harassment as compared to women in more traditional occupations (Berdahl, 2007; Fitzgerald, Drasgow, Hulin, Gelfand, & Magley, 1997; Glomb, Munson, Hulin, Bergman, & Drasgow, 1999; Gruber, 1998; Gutek, Cohen, & Konrad, 1990; Mansfield et al., 1991).

[a] Nontraditional occupations are those for which women comprise less than 25% of the total employed.

TZEN BOUTIQUE JEWELRY: BRAND BUILDING FOR A SMALL BUSINESS

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CASE DESCRIPTION

The primary subject matter of this case concerns the challenges of establishing a brand within the jewelry industry where appropriate positioning of the business and establishing a credible brand are the main emphasis for new business entrants. Secondary issues examined include: understanding luxury consumer segment, consumer behavior, and creating an integrated marketing and communications plan. The case has a difficulty level appropriate for senior and graduate level. This case is designed to be taught in two (2) class hour or as a mini group research project and is expected to require at least of three (3) hours of outside preparation by students.

CASE SYNOPSIS

In July 2009, Mia Pezzi started a new silver jewelry line: TZEN Boutique. The TZEN line was created in response to the recessionary market and consumer demand in a high-income, metropolitan area of Chicago. This new silver line focuses on quality sterling silver jewelry that uses quality semi-precious stones and unique designs. As a newly launched jewelry line, TZEN was looking to build its brand name and establish its business positioning in a highly fragmented and competitive market. There are numerous challenges and hurdles to starting a new business especially during an economic downturn, however, there are also opportunities for specialty retailers to gain market share. Consumers are more discerning and apt to engage in research prior to making a purchase decision. This provides new businesses with enormous opportunities to enter the market and fulfill demand that the traditional retailers do not meet.

INTRODUCTION

At the end of July 2009, Victoria Haubergh, a marketing consultant and a freelance PR specialist, was preparing to present her plan and recommendations for the management of an emerging jewelry brand, TZEN Boutique, at Mia Pezzi's Chicago, Northbrook office. Victoria had been tasked to determine the entry strategy for its first advertising campaign in the Chicago area. She had spent the last few months researching and analyzing the jewelry industry and started to promote the new brand with other emerging artisan brands in Chicago. TZEN Boutique's intent was to build and establish a meaningful brand connection with jewelry consumers in Chicago. If successful, TZEN would look to a national expansion program within the next 5 to 10 years.

BACKGROUND AND HISTORY OF MIA PEZZI AND TZEN BOUTIQUE

With a desire for unique design and an interest in jewelry, Julie Liu, a 27-year-old Chicago GSB, MBA graduate and a former hedge fund manager, decided to start her own jewelry company. Liu grew up playing with rare gemstones while most girls were playing with dolls. The daughter of a ship's captain who traveled the world in cargo ships, Liu would gaze at the variety of colorful "rocks" her dad would bring home to her mom from these trips. Little did she know, these were not ordinary rocks, they were magic rocks that always made her mom happy (Liu, personal communication, January, 14 2010).

A lover of art and jewelry, Liu began playing around with gemstone pieces her father had in his collection. She had an eye for combining colors with designs that were simple, yet impactful. Soon, her friends began asking her to design jewelry pieces. Despite a successful career in finance, she realized that in her heart she had always wanted to start a company. Liu in 2008 launched her first collection, Mia Pezzi (Liu, personal communication, January, 14 2010).

The formal Mia Pezzi collection features one-of-a-kind jewelry using diamonds, gold, rare stones, high quality precious gemstones and pearls. Liu's initial focus was to attract a small clientele with an appreciation for one of a kind jewelry. Customers of Mia Pezzi are mainly women between the ages of 45 to 60 years of age and high household income. They appreciate exclusive and luxury brand names, and are willing to pay a premium for bold designs and quality jewelry to express their sense of individuality. The line took off immediately. It continues to grow through word of mouth, personal referrals and satisfied customers in the Chicago area.

Noticing the need for a more affordable and accessible collection to capture a wider market segment, Liu decided to start a new line featuring silver and semi-precious stones. The idea of TZEN is to offer whimsical and fun luxury jewelry while still using high quality gemstones. TZEN features diamond cut crystal rings, multi-colored sapphire earrings, pearl and dangling bracelets and multi-colored tourmaline necklaces. Additionally, the brand attempts to inspire a sense of lush, fashion, uniqueness, and exclusivity in its customers. According to Liu:

> *"TZEN Boutique is inspired by fashionable women around the globe. Lush colors, vibrant designs and most importantly, fashion forward designs with a tint of classics. Each piece is carefully crafted and designed by our artisans in solid precious metals and rare gemstones. We want women to feel their own presence being magnified with jewelry that lends a statement (Liu, personal communication, January, 14 2010)."*

TZEN's jewelry line uses organic designs and bold colors that represent the brightness and the energy of the sunset (TZEN means sunset in the Chinese language). The collection has bold designs that accentuate the colorful semi-precious gemstones. All the pieces are set in fine sterling silver or 18K gold overlay. The pieces are fun, playful, and suitable for everyday work or classic evening engagements. To maintain its brand exclusivity, most pieces are limited in production with no more than 50 pieces per style. The line targets women with a focus to provide them a sense of luxury, self-expressive individualism, and self-worth through the everyday wear of earrings, bracelets, necklaces, rings, and pearls. The prices for these products range from $100 to $1,200 with a median price of $500 (Tzen Boutique, 2010).

The Mia Pezzi jewelry line is very different from TZEN in that 99 percent of Mia Pezzi pieces are one of a kind and set in solid 18K gold or platinum. Mia Pezzi also uses precious and rare gemstones of the highest quality. Each design is carefully crafted and can take more than three months to perfect. These statement pieces are meant to be pieces of art. The style of the brand also showcases big bold colors with intricate details. The prices for these products range from $2,500 to $10,000 with a median price of $4,500 (Mia Pezzi, 2010).

Liu opened up her first boutique in July of 2009 in the North Shore neighborhood of Chicago and featured both her Mia Pezzi and TZEN collections. Currently, TZEN is distributed in Chicago at local boutiques, online, and at local trunk shows. Mia Pezzi is only distributed at the TZEN Store, located at the Northbrook Court Mall in Northbrook, IL. The Northbrook Court Mall is a luxury mall with brand stores like Ralph Lauren, Louis Vuitton, Max Mara, Burberry, etc.

Prior to starting Mia Pezzi, Liu did not have any experience in retail nor jewelry making. In school, her focus was in finance. Despite these challenges, Liu pressed forward and launched her first retail store and hired Victoria to help her market her jewelry line.

FLAGSHIP STORE IN CHICAGO

In designing the flagship store, Liu acquired the help of an interior designer. The store is located in the in Northbrook Court Mall, 20 miles north of downtown Chicago. The mall is a luxury mall carrying a number of upscale name brand stores (Exhibit H). In the end, Liu decided on an organic concept, focusing on raw elegance but with a vibrant twist to stimulate a sense of lush fashion, using bold colors such as brown, orange, red, and gold. It is also designed to be roomy enough to host parties and private cocktail events, with wide aisles and comfortable chairs (Exhibit J).

Based on the 2000 Census data, the population of the Northbrook area (zip code 60062) is 40,392 with women making about half the population at 20,889. TZEN's target market of 30-45 year old women is 20 percent and Mia Pezzi's target market of 45-60 is 23 percent of the total female population. Within the female segment, ages 35-44, 68 percent have bachelor or higher degree, and from 45-65, the percentage of women with at least a bachelor degree is 60 percent.

In addition, 64.7 percent of the females ages 15 years and over are married with a median family household income of $106,020 (U.S. Census Bureau, 2000).

MARKET CHARACTERISTICS

The overall jewelry industry has been in slow decline with a negative growth rate of -4.8% in 2009 down from -0.5% in 2005 (IBIS Word Inc, 2009). The U.S. jewelry market has more than 22,500 stores and $60 billion in sales revenue in 2008 (IBIS Word Inc, 2009). Three major players are expected to account for 20.4% of the market share in U.S. with no single merchant owning more than 9% of the market. The three major companies are: Signet Jewelers Limited (which own the brands Kay Jewelers and Jared), Zale Corporation, and Tiffany & Co. According to research, 53 percent of the market is owned by 50 companies while the other 47 percent are owned by the remaining 22,500 jewelry retailers (IBIS Word Inc, 2009).

The critical issue facing the jewelry industry is the 2008-2009 recession and corresponding high unemployment. The jewelry industry is sensitive to economic factors and subject to consumers' disposable and discretionary income. With increasing unemployment, the market is suffering with a pessimistic outlook for 2010. Since the start of recession in 2008, the demand of jewelry has been on a consistent decline, evidenced by store closures and poor financial performance.

COMPETITION

The jewelry industry is highly competitive and extremely fragmented due to low barriers to entry. The major two categories of jewelers are traditional and fashion forward retailers.

Traditional Retail Jewelers :

Tiffany & Co. currently holds 4.1 percent of the market share in U.S. (IBIS Word Inc, 2009). A highly recognizable brand, it is a jewelry (87 percent of its net sales from jewelry) and specialty retailer (website) with approximately 70 stores in the US and 185 worldwide. It also has an online store, catalog sales, and business-to-business accounts (IBIS Word Inc, 2009). For its fiscal year end 2008, Tiffany saw its overall revenues decline by 3 percent to $2.86 billion, with most of the decline coming from the United States, 14 percent (Tiffany & Co., 2010; Tiffany & Co. Annual Report, 2009). This was due to the economic downturn as consumers were more conservative and cautious with their discretionary spending. Both middle-income and high income consumers were postponing purchases or looking for cheaper alternatives.

Zale Corporation current holds 7.6 percent of the market share in the industry (IBIS World Inc, 2009). It was founded more than 80 years ago and has 1247 stores and kiosks in the U.S. and Canada under the names of Zales, Zales Outlet, Gordon's, Peoples (Canada), Mappins

(Canada) and Piercing Pagoda (Zale Annual Report, 2009). In the US, Zale's fine jewelry business (Zales, Zales Outlet, and Gordon's) had $1.28 billion in revenue for fiscal year 2009, down from $1.55 billion for fiscal year 2008 (Zale Annual Report, 2009). The company filed for bankruptcy in 1993 and emerged from bankruptcy with fewer stores. According to the company's annual report, the strategic focus for Zale is to concentrate on costs, working capital management and real estate (stores) management. As a result, the company closed 218 stores and kiosks in fiscal year 2009, after closing 106 in 2008 (Zale Annual Report, 2009).

Signet Jewelers Limited current holds 8.7 percent of the market share in the industry (IBIS World Inc, 2009). The company has 1,394 stores in the US under the name of Kay Jewelers and Jared The Galleria of Jewelry (Signet Jewelers Annual Report, 2009). Signet is the largest specialty retail jeweler in the U.S. with $2.53 billion in sales for fiscal 2009, down from $2.71 billion for fiscal 2008 (Signet Jewelers Annual Report, 2009). According to the company's own annual report for 2009, the biggest risk facing Signet in the US are: consumer confidence, the ability to extend credit to its customers and aggressive discounting by competitors (Signet Jewelers Annual Report, 2009).

Fashion Forward Designer Retail Jewelers :

David Yurman (Yurman Design, Inc.) is an American based private company established in 1980 and is popular with the premium fashion forward jewelry segment. They are known for the cable jewelry pieces that are made using silver sterling ropes. The company offers a diversified business portfolio selling luxury fashion for women, men and kids, including fragrances, eyewear collection, watches, bracelets, money clips, and key chains, at price range from $145 to $20,000. Its products are sold through its own name brand David Yurman retail boutiques, specialty jewelry shops, as well as high-end department stores such as Bloomingdale's, Neiman Marcus, Saks Fifth Avenue, and Nordstrom (Hoovers, 2010).

Me & Ro, established in 1991, is a New York based fashion forward retail jeweler that has become popular when celebrities such as Julia Roberts, Charlize Theron, Sheryl Crow and others began wearing the line (Me & Ro, 2010). The Company offers a diversified product portfolio a slight market differentiation in the satin finish sterling silver, 10 and 18 karat gold, platinum, and precious stones such as brown diamonds, rubies, multi colored sapphires, and rare stones. Me & Ro attempts to appeal to a niche segment of sophisticated and classic jewelry designs, expressing themes of strength, love, karma characters and symbols. Its products are distributed nationally under its own name brand retail boutiques, high-end department stores, and through its online store. There are 4 boutiques nationwide in New York, Los Angeles, Miami, and Chicago (Me & Ro, 2010).

In addition to the competition from these national brands, TZEN Boutique also faces threats from local competitors like the small privately owned jewelry stores in the surrounding local area as well as luxury and fashion retailers inside the mall that carry their own lines of fashion accessories. Examples include Louis Vuitton, Coach, BCBGMAXAZRIA, MaxMara, and more (Exhibit H & I).

EMERGING CONSUMER BEHAVIOR IN JEWELRY RETAILING

According to industry report, jewelry purchases are greatest between the ages of 45 to 54, followed by the younger consumer segment between the ages of 20 to 30 (IBIS World, Inc., 2009). With as the Baby Boomer generation ages, the age group 45 to 64 is expected to increase its jewelry spending. Specifically, medium to high income households are the most prolific consumers of jewelry and watch products.

According to Liu, the target market for Mia Pezzi is women 45 to 60 with household incomes of over $350k annually and who own homes over $1million. As for TZEN, the age demographics are lowered to 30 to 45 with household annual income of over $150,000. While age and income are important characteristics of profiling potential customers, an important shared characteristic is individual self expression through the use of uniquely designed jewelry. This creates an opportunity for TZEN to target consumers focusing a lifestyle concept rather than as a form of security investment.

There are a number of trends indicate market opportunities for TZEN: 1) Increase in the number of women in the workforce. American women are highly educated, working professionals, and entering the workforce in greater number than 40 years ago. 2) While still earning less than men, women's wages are increasing at a faster rate as the gender pay differences narrow. Boston Consulting Group estimates that women control $4.3 trillion (or 73%) of the $5.9 trillion in consumer spending in the U.S. 3) According to emarketer.com (2008), online sales will continue to grow to an estimated $183.9 billion by 2012. Furthermore, it is expected that 14 percent of jewelry sales will move online by 2010. In the first quarter of 2008, Amazon.com saw their retail diamond sales increased more than 100% and they are continually adding more styles to its site. 4) Online retailing and research furthers the concept uniqueness and personalization at the expense of the one-size-fits-all. Consumers want something unique and different, which will allow them to express their individual style. 5) The traditional value of jewelry as currency, like gold, has slowly evolved and shifted to a more lifestyle brand. This concept will lead a higher demand in lifestyle brands with unique designs focusing on enhancing the hedonic value.

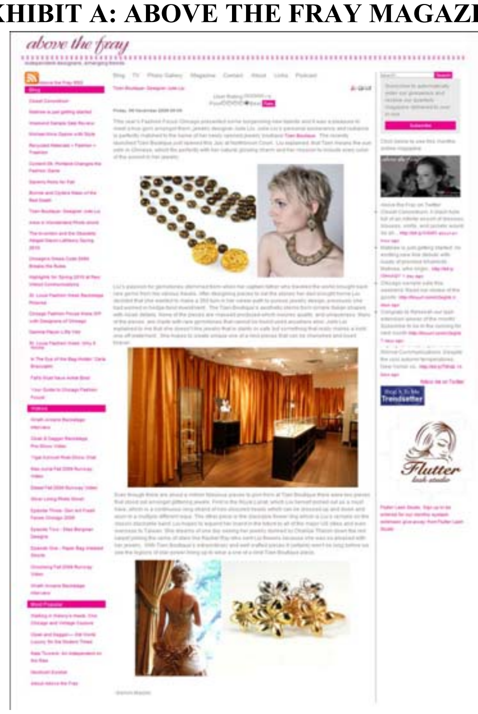
The economic recession has reduced consumer spending and luxury product consumption. In addition, consumers' behavior have changed to a longer decision making process which allows consumers to spend more time shopping around and look for brand substitutes. Based on a report by McKinsey, 46 percent of consumers who switched to a cheaper brand during the economic downturn claimed that they performed better than expected, and the large majority claimed that the performance was much better than expected. As a result, a growing number of consumers indicated that it was not worth the money for the premium brand that they ordinarily preferred. This is somewhat positive news for new emerging brands and entrepreneurs. While the U.S. consumers have curtailed their discretionary expenditures in responding to the recession, they are more careful in product selection and taking longer decision making process before they act. This will allow consumer more time shopping on the market and potentially break away from the premium brands that they are loyal to.

PREPARING AN ADVERTISING CAMPAIGN

With a limited budget and intense competition, Victoria knew that she would have to use focused and creative strategies to design her advertising campaign. In order to design an effective campaign, Victoria will have to address the following challenges:

1. Determine the appropriate entry strategy for TZEN to launch its brand into the community;
2. Identify the target consumer segments;
3. Select the appropriate promotional mix;
4. Design a creative advertising and PR plan that communicates TZEN Boutique's positioning and captures the attention of its target consumers;
5. Select the goal, time frame, and duration for the promotional campaign;
6. Execute with a small budget.

EXHIBIT A: ABOVE THE FRAY MAGAZINE



Source: TZEN Boutique, 2010

EXHIBIT B

Tzen Boutique Featured in Chicago Style Magazine – A Luxury Magazine

Julie Liu's stackable flower ring.

BAUBLE BUZZ

Twice as Nice

Chicagoan Julie Liu's life has always been about the bling. After all, if diamond rings and sapphire brooches were your toys as a child, then owning two jewelry lines as an adult seems only natural. With a strict "design comes first" policy, her custom creations (everything from earrings to rings) are made to emit exclusivity. The Mia Pezzi line uses 18k gold, diamonds, pearls and precious and semi-precious stones to create luxurious items. The lines' signature Incanto flower ring—made with two diamond-encrusted, hand-shaped gold flowers—can be stacked to create a bouquet effect. To make them unique, all designs are carefully crafted by Liu, who often uses the flawed shape of a diamond to create drama. Liu's less expensive line, TZEN (the Chinese word describing the colors of sunset), specializes in pieces that are always unpredictable, like haystack earrings with strands of wrapped gold overlayed on silver hanging from diamond-cut crystals. No matter which line you love, your baubles will rock. *The first TZEN boutique will open later this month in the Northbrook Court Mall, 312.755.8346, tzenboutique. –M.A.*

The TZEN ring with diamond-cut crystals, $500; the TZEN ring band, $70. bandhere.

Source: TZEN Boutique, 2010

EXHIBIT C

Michigan Avenue Magazine – A Luxury Magazine

Source: TZEN Boutique, 2010

EXHIBIT D

Retail Jewelry Industry Key Statistics in the U.S.

INDUSTRY RATIO	2005	2006	2007	2008	2009	
Average Revenue per Employee	0.17	0.16	0.16	0.16	0.17	$Mil
Wages and Salaries Share of Revenue	16.23	17.34	17.05	16.96	16.53	%

REAL GROWTH	2005	2006	2007	2008	2009	
Industry Revenue	-0.5	-3.1	-1.7	-4.9	-4.8	%
Industry Gross Product	-1.6	1.4	-2.0	-5.7	-6.1	%
Number of Establishments	-0.5	3.7	-1.7	-4.4	-5.7	%
Number of Enterprises	-0.9	3.6	-1.6	-4.6	-4.0	%
Employment	2.3	0.9	-3.6	-4.4	-6.5	%
Total Wages	-3.6	3.5	-3.3	-5.4	-7.2	%

INFLATION ADJUSTED CONSTANT PRICE	2005	2006	2007	2008	2009	
Industry Revenue	32,761	31,750	31,210	29,681	28,256	$Mil
Industry Gross Product	9,183	9,314	9,129	8,607	8,081	$Mil
Number of Establishments	62,178	64,453	63,357	60,549	57,078	Units
Number of Enterprises	52,557	54,446	53,582	51,143	49,087	Units
Employment	195,410	197,225	190,070	181,647	169,806	Units
Total Wages	5,317	5,504	5,322	5,033	4,670	$Mil

Source: IBISWorld Inc., 2009

EXHIBIT E

General Characteristics of the Demographics in the 60062 Zip Code

General Characteristics	Number	Percent	U.S.
Total population	40,392		
Male	19,503	48.3	49.10%
Female	20,889	51.7	50.90%
Median age (years)	44	(X)	35.3
Under 5 years	2,250	5.6	6.80%
18 years and over	30,410	75.3	74.30%
65 years and over	7,837	19.4	12.40%
One race	39,961	98.9	97.60%
White	35,220	87.2	75.10%
Black or African American	283	0.7	12.30%
American Indian and Alaska Native	15	0	0.90%
Asian	4,237	10.5	3.60%
Native Hawaiian and Other Pacific Islander	3	0	0.10%
Some other race	203	0.5	5.50%
Two or more races	431	1.1	2.40%
Hispanic or Latina (of any race)	873	2.2	12.50%
Household population	39,532	97.9	97.20%
Group quarters population	860	2.1	2.80%
Average household size	2.63	(X)	2.59
Average family size	3.04	(X)	3.14
Total housing units	15,445		
Occupied housing units	15,028	97.3	91.00%
Owner-occupied housing units	13,251	88.2	66.20%
Renter-occupied housing units	1,777	11.8	33.80%
Vacant housing units	417	2.7	9.00%

(X) Not applicable. Source: U.S. Census Bureau, 2000

EXHIBIT F

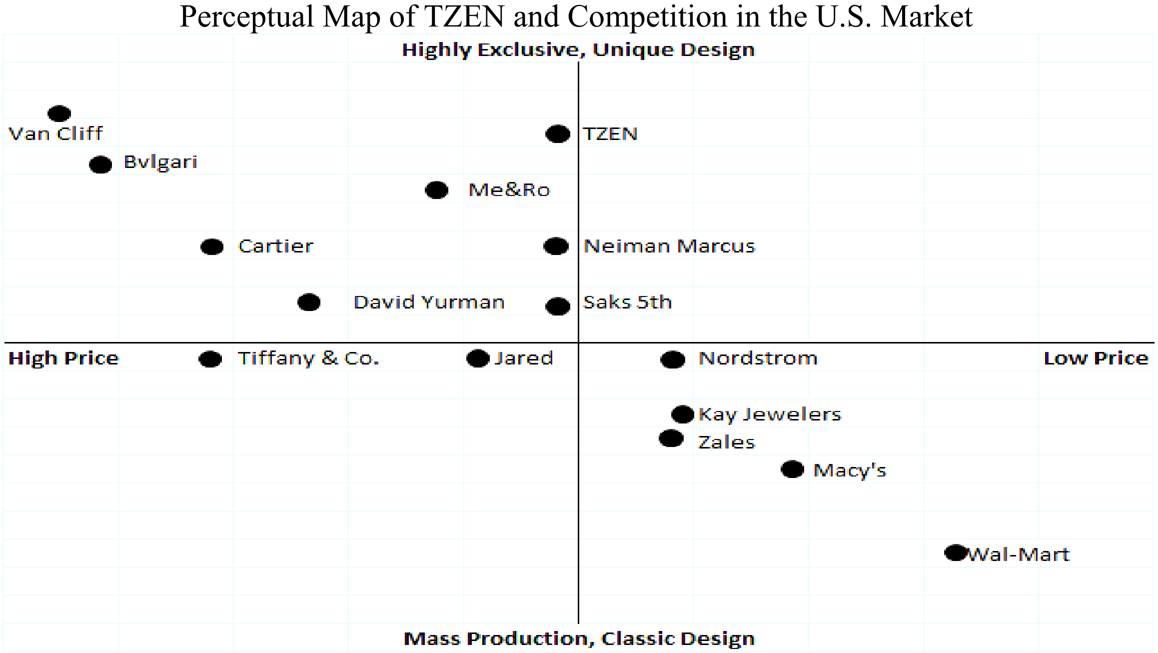
Social, Economic, and Housing Characteristics in the 60062 Zip Code

Social Characteristics	Number	Percent	U.S.
Population 25 years and over	28,509		
High school graduate or higher	27,087	95	80.40%
Bachelor's degree or higher	17,103	60	24.40%
Civilian veterans (civilian population 18 years and over)	3,740	12.3	12.70%
Disability status (population 5 years and over)	4,362	11.7	19.30%
Foreign born	6,999	17.4	11.10%
Male, Now married, except separated (population 15 years and over)	10,899	72.3	56.70%
Female, Now married , except separated (population 15 years and over)	11,021	64.7	52.10%
Speak a language other than English at home (population 5 years and over)	8,744	23	17.90%
Economic Characteristics	**Number**	**Percent**	**U.S.**
In labor force (population 16 years and over)	19,604	62.3	63.90%
Mean travel time to work in minutes (workers 16 years and older)	29	(X)	25.5
Median household income in 1999 (dollars)	89,164	(X)	41994
Median family income in 1999 (dollars)	106,020	(X)	50046
Per capita income in 1999 (dollars)	48,536	(X)	21587
Families below poverty level	154	1.3	9.20%
Individuals below poverty level	894	2.3	12.40%
Housing Characteristics	**Number**	**Percent**	**U.S.**
Single-family owner-occupied homes	11,180		
Median value (dollars)	361,100	(X)	119600
Median of selected monthly owner costs	(X)	(X)	
With a mortgage (dollars)	2,055	(X)	1088
Not mortgaged (dollars)	670	(X)	295
(X) Not applicable.			

Source: U.S. Census Bureau, 2000

EXHIBIT G

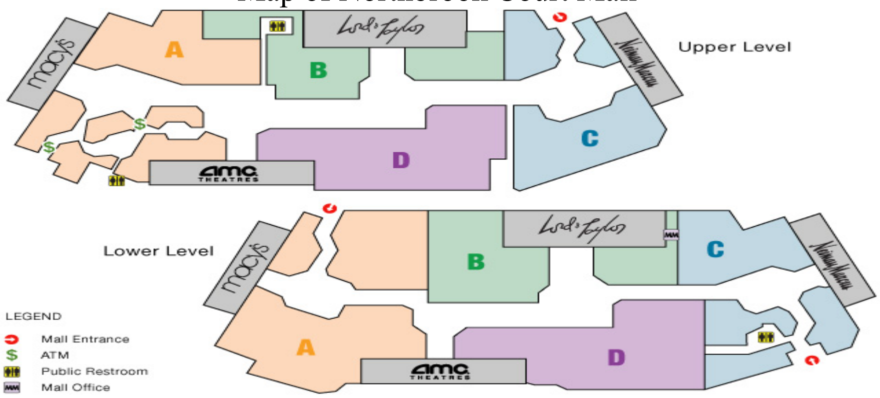
Perceptual Map of TZEN and Competition in the U.S. Market



Source: Casewriter, 2010

EXHIBIT H

Map of Northbrook Court Mall

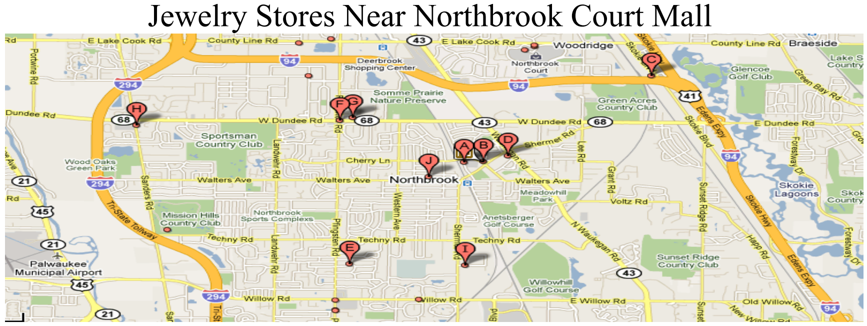


Zone C (Lower Level)	Zone C (Upper Level)
Louis Vuitton	TZEN Boutique
Aritzia	Stuart Witzman
BCBGMAXAZRIA	Coach
MaxMara	J. Crew
Burberry	Lucy
Ralph Lauren	Aveda
Teavana	Stir Crazy
	Soma Intimates

Source: Northbrook Court Mall

EXHIBIT I

Jewelry Stores Near Northbrook Court Mall

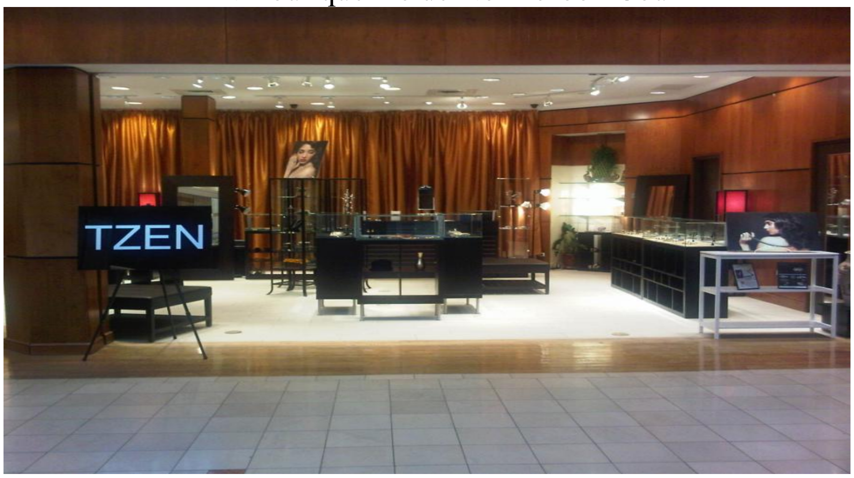


A	Franz Jewelers Ltd	1220 Meadow Road,Northbrook,IL	F	AM Lee Jeweler	2778 Dundee Road,Northbrook,IL
B	Jacqueline's of Northbrook	1163 Church Street,Northbrook,IL	G	Genuine Merchandising	2750 Dundee Road, Northbrook,IL
C	Shelle Jewelers Inc	300 SkokieBoulevard,Northbrook,IL	H	Bien Jewelry Studio	855 Sanders Road, Northbrook,IL
D	Sue's Selections-Charm Shop	1111 Shermer Road,Northbrook,IL	I	Pompeii 3 Jewelry	1966 Raymond Drive,Northbrook,IL
E	Windy City Estate Jewelers	840 Willow Road,Northbrook,IL	J	Kohl's	2201 Center Avenue,Northbrook,IL

Source: Google Maps

EXHIBIT J

TZEN Boutique inside Northbrook Court Mall



Source: TZEN Boutique, 2010

LEADERSHIP CRISIS AT ALGOOD PRESS: A CASE STUDY

John James Cater III Nicholls State University

CASE DESCRIPTION

The primary subject matter of this case is small family business management, specifically developing a strategy for leadership succession in a crisis situation. We also examine shared leadership or family top management teams that involve multiple family members in the top management and ownership of family firms. The case is appropriate for junior and senior level undergraduate courses. The case is designed to be taught in one class hour and is expected to require approximately three hours of outside preparation by students. The events described in this case are based on real world experiences, but all names have been disguised.

CASE SYNOPSIS

Carlton Algood heard the devastating words from his doctor: "With the treatment we currently have available to us, which is among the best in the country, I would say that we are looking at about one year (for you to live)." As a responsible small family business leader, Carlton made plans for Algood Press to survive without him. Carlton laid the groundwork for a management committee, composed of three family members and three non-family managers, to lead the company during his illness. Passing the management and ownership from one generation to the next is a daunting task for small family businesses. Succession is even more difficult when the process is shortened by the illness or death of incumbent family leaders. We trace the story of Algood Press from its beginnings in 1933 through three generations of family owner-managers to the present day. After Carlton's death, the remaining family leaders must decide whether to continue with the management committee, who should become president of the company to replace Carlton, and if they should extend the privilege of stock ownership to other company managers.

INTRODUCTION

Carlton leaned his head back against the wall as he sat awkwardly on the high examination table waiting for Dr. Lee to arrive in patient room number three. He felt uncomfortable wearing the required hospital gown because the air was cool and drafty in the doctor's office. The minutes passed by slowly. In spite of the cool air, Carlton began to perspire, which was also annoying because this made the white paper, which doctors always use to cover examination tables, stick to his legs and hands as he struggled to maintain some semblance of dignity. The test results were in and Carlton feared the worst. He knew that something was wrong because of the headaches and black-outs that had occurred with increasing regularity over the past year. Finally, after what seemed like an eternity to Carlton, he heard someone approach his waiting room and knock softly on the door.

Dr. Lee solemnly opened the door and entered the room. Carlton observed that his doctor, a young man barely forty years-old, seemed grim and hesitant.

"What's the news, doctor? Tell me the truth. There is no need to beat around the bush," Carlton said, getting straight to the point as he always did.

"Mr. Algood, we have run all the tests and double-checked ourselves. There is no way around it. You have a virulent, aggressive form of cancer," explained Dr. Lee.

"Well, I figured something was wrong because of all the headaches and the spells in which I passed out. What is the prognosis? Is there anything that can be done?" asked Carlton.

"Yes sir, we will definitely try everything at our disposal, but I do have to tell you that this cancer is strong and spreads rapidly," replied Dr. Lee.

"I see. I will try to fight it. I still have work to do. But I do need to know, if the treatment fails, how long do you think I have?" questioned Carlton.

"Naturally, that is hard to say because there are many variables involved, but I understand that you do want an answer. With the treatment we currently have available to us, which is among the best in the country, I would say that we are looking at about one year," stated Dr. Lee.

CARLTON MEETS WITH BOBBY

The morning sun peeked above the horizon, splashing vibrant shades of orange and pink and yellow across the sky. Looking out the window of his office, Carlton admired the display of nature and contrasted its beauty with the ugly gray ribbon of man-made highway punctuated by the luminous glow of car headlights. Carlton sat pensively at his desk, mulling over his meeting with young Dr. Lee the previous day and trying to straighten out his thoughts for the coming dialog with his brother, Bobby. It seemed like only yesterday, not forty years ago, that Carlton had graduated from college and started working full-time for Algood Press. Bobby was two years younger then Carlton, but he too joined the family business as soon as he finished his degree at the state university. The office where he now sat was only a few short miles down the gray ribbon of highway from their alma mater.

Carlton's mind wandered back to happier days. He recalled fishing trips with Bobby and their father, Francis. Bobby was great at fishing and working with his hands - anything mechanical suited him. Bobby loved things one could do alone or perhaps with one other person. In contrast, Carlton excelled at team sports like football, basketball, or baseball, anything that involved lots of people, but he had little or no mechanical aptitude. These childhood traits had carried directly over to their days as business leaders at Algood Press. The business relationship between the two brothers was quite clear in that Carlton provided the overall leadership for the firm and managed the office including sales and finances, while Bobby concentrated on the production side of the business, or the actual printing.

"Good morning, brother!" Bobby called out as he strode briskly into Carlton's office. "How are things going? What did you want to see me about today?"

Carlton swiveled about in his desk chair to face Bobby. It was then that Bobby perceived the serious look in Carlton's eyes and he realized that something was amiss.

"Have a seat, Bobby. I have some news to discuss with you," said Carlton. "As you know, I haven't been feeling well lately and I went to visit Dr. Lee yesterday. The news is not good. Brother, I have cancer, a serious cancer."

"No, brother! I can't believe it. You are only 60 years-old," stammered Bobby.

"Yes, it is true. I have felt it coming on for some time now. After all the dancing about and explaining treatment possibilities, Dr. Lee says that I may only have one year left to live."

"We will fight it. You will make it through this. I know you will," said Bobby, fighting back the tears.

"Brother, I will fight the cancer and maybe I will win, but this morning we need to discuss our business and how to maintain the leadership of Algood Press," Carlton stated.

"Brother, you have been the president of Algood Press for over twenty-six years now since our father passed away. The two of us have operated the company, with you as president and me as vice president. To be quite honest with you, my makeup and my background is not suited for being president. I am happy doing what I do. I have always been in production, always handled production. I like it just like that," explained Bobby.

"Well, Bobby, we have talked about this before and I am well aware of your thoughts on the leadership of our company. This is why we brought in Ernie Fisher as a vice president about seven years ago. His background is actually in finance with a degree in accounting. He started in cost accounting, and then moved into marketing. His strength is financial management and marketing, growing the business," remarked Carlton.

"Ernie does a great job. There are really two issues of concern here – one is the management of the company and the other is the ownership of the company. Although it may be somewhat unusual, we can certainly have a non-family member as president of Algood Press and yet maintain control of the company in the family via the ownership of stock and the board of directors," said Bobby. "However, there is another option. We could move your daughter Julie up to the position of president. She is also qualified."

"Yes, we invited Julie on board in 1992 as our controller after she earned her degree at State University and gathered several years of accounting and financial experience. She has worked in that capacity ever since and has done a great job. I know that she understands our financial situation, but she may lack production knowledge," mused Carlton. "Bobby, we have always followed a traditional organizational structure. Our father was president and CEO and everyone else reported to him in a traditional functional structure."

"Yes. Then, since he passed away, you have been president and CEO and everyone else has reported to you in a traditional organizational structure," agreed Bobby.

"I want to set up something different now because I believe that our situation calls for it. Although Ernie and Julie are both qualified to be president, I feel that the company would benefit from the active inclusion of the entire group of top managers in the decision-making process. I want to appoint a management group – an executive committee - to make day to day operational decisions. This committee should start meeting immediately once a week, every week. I want minutes recorded and reported to me. I will stay in the loop as long as possible. The committee should consist of six individuals: you Bobby, Ernie Fisher, Julie, Craig Dickson, who we bought the direct mail business from, our sister Frances Algood, and Stan Hebert, who is our long-time production manager," explained Carlton.

"We will give it a try, Carlton. I am all for it myself," said Bobby.

ALGOOD PRESS BEGINNINGS

C. J. and Irma Landry decided to go into business for themselves in 1922 after working in the printing industry for many years. The Landrys opened a printing company in the center of Capital City and named the business after the city. At first, the Landrys were the only employees of the Capital City Printing Company, but soon the business began to grow and prosper along with the city.

In 1933, the Landrys hired a young apprentice, Francis Algood, who had come to the city from the very small town of Patterson, which is just west of Capital City across the Mississippi River. Francis decided that he did not want to be a farmer, the main occupation in his little home town, and acquired the job with the Landrys although he knew very little about printing. His early lack of printing knowledge did not stop Francis Algood as he quickly learned the business and showed strong management skills. By 1942, Francis bought a half interest in the company and became a partner with the Landrys. Algood's interest in the company continued to rise and the Landrys gradually backed out of the business. In 1949, Francis Algood became president and changed the name of the company to Algood Press, Inc. As the company continued to grow, a larger production facility became necessary. So, under Algood's direction, the business was moved from its original Main Street site to its current location on Highland Road, near the State University, in 1953. Eleven years later, in 1964, Francis completed acquiring the remaining stock of Algood Press, and became the sole owner. Over the years, Francis' brother, Sidney Algood, and his sister, Bernadette, both worked for Algood Press. Sidney was a salesperson for over forty years and Bernadette was the company's bookkeeper. However, their roles in the business were secondary to Francis, who was the CEO and sole owner of Algood Press.

In addition to his involvement in the printing business, Francis Algood became a leader in civic organizations, such as the Kiwanis Club. He set the tone for the company's active participation in community activities. His son, Bobby Algood later described Francis, "He was very, very outgoing, very friendly, very helpful, just a gracious, giving person."

Besides being a warm and friendly gentleman, Francis Algood, possessed the necessary toughness to face a competitive business environment. According to his granddaughter, Julie Algood Piccolo, "Francis had a strong business personality as far as being aggressive about getting things done." Francis was a strong leader and laid an important foundation for the company with his emphasis on technological growth and advancement within the printing industry. Julie Algood Piccolo explains further, "I think our philosophy today is staying on the leading edge of technology and that goes back to his beliefs as well. Since his leadership, we have stayed with the latest and greatest in technology, trying to stay ahead of the curve." A picture of Francis Algood still graces the entrance area of the company's offices, underscoring his contribution to the culture of the company. Beginning in 1949, Francis served as president and owner of Algood Press for over twenty-five years. During this time period, the company grew steadily as the number of employees increased to around seventy.

SECOND GENERATION

The Algood family's involvement in the company continued to grow. In rapid progression, Francis Algood's two sons entered the business. Carlton came into the Algood Press in 1959 and Bobby joined the company the following year. Both sons grew up in and around the business, working there during their high school and college summers. Although Francis Algood did not have the benefit of a college education like many individuals in his generation, the Algoods believed in education. Therefore, both of Francis' sons completed their college degrees before coming to work full-time for Algood Press. Carlton and Bobby admired their father and sought to follow in his footsteps.

In many ways, the second generation of Algoods at Algood Press was an extension of the first generation. For some time, the company continued to operate as it had always done—as a high quality general printing company. According to Stan Hebert, Production Supervisor, Algood Press, "After Francis passed away and Carlton came along, we had a ten or fifteen-year period with the same presses, the same way of doing things. We had some updates, but nothing like the last ten years with the computers." The increasingly heavy workload was divided between Carlton and Bobby. Upon Francis' death in 1975, the ownership of the business passed to his children: Carlton, Bobby, and their sister, Frances P. Algood. Carlton, the older brother, assumed the leadership role as president and CEO of the company. Bobby managed the production processes or printing work of the company. Frances did not take a management role in the family business, but she had a seat on the company board of directors as part owner. Today, she still maintains her role on the board and has an active voice in company decisions.

DIRECT MAIL PRINTING

Another major event at Algood Press in the mid 1990s was the decision to leave the general printing market and focus on the printing of direct mail advertisements. The Algoods realized that they could not continue to operate profitably in the general printing market and they received vital assistance in finding a suitable market niche from the recently hired Ernie Fisher. Ernie had over thirty years of experience with a local printing competitor and had known the Algoods for many years. Ernie led in the decision to acquire Database, Inc., which was in the data processing and direct mail business, but did not do any printing. Craig Dickson, who started Database in the mid 1980s, came to Algood Press along with the company. Craig remarked as follows.

In ’96, Ernie approached me about an acquisition…They bought my company in August of ’96. While he (Carlton) was excited to put up the money and do the acquisition and could see the benefits, it wasn’t his idea. It was Ernie’s idea to change direction like that…Since then, we have transitioned Algood Press to data processing and direct mail, which is probably 80 percent of our sales now.

The company has maintained a competitive advantage in the data processing and direct mail niche by investing heavily in technologically advanced equipment. Algood Press was the first company in its region of the country to have a multi-color printing press, one of the first to employ computerized type-setting, and the first in Capital City to have UV ink presses. In 1999, the firm purchased the Sanden Web Press in order to process large quantity printing orders and in 2002, a four-color Halm Jet Envelope Press was added to process full color envelopes quickly.

THIRD GENERATION

Although the family still controls the ownership of Franklin Press, the daily management of the company is done by a committee. Before he passed away, Carlton set up the management committee to operate the company. This management committee consists of family members – Bobby Algood, Julie Algood Piccolo, and Frances Algood, in an advisory capacity, and non-family members: Vice President Ernie Fisher, Vice President of Digital Printing Craig Dickson, and Production Supervisor Stan Hebert. According to Stan Hebert, “It was kind of a weird thing when it happened because we didn’t know what he was doing or why he was doing it. I was honored to be asked to be on the committee.” Rather then leave the company in a weak management position, Carlton started the management committee in motion. There was no committee prior to Carlton’s illness, but approximately two years before his death, he formed the group and called the committee together to meet once a week to make operational decisions.

The management committee developed a strategic plan while Carlton was alive. Ernie Fisher commented as follows.

We have stuck to the plan, which was to move into the direct mail with variable data area. When I came here this was a general printing company, award-winning, successful. We acquired Database shortly after I came here to get into the mailing with variable data part of the business. We felt that printing was becoming a commodity and that we needed a niche, so that we could set ourselves apart. It has been successful for us. Now, we are probably 80 percent direct mail and 20 percent commercial. We have changed the nature of the business almost 180 degrees in 10 years.

The family still possesses the ability to transfer the business from one generation to the next. Of Carlton Algood's six children, only one has entered the business, Julie Algood Piccolo. While Carlton had six children, Bobby Algood had four, three daughters and a son. None of the daughters were interested in coming into the business. Richard, the third child and only son, graduated from high school and decided to come straight to work for Algood Press, rather than to attend college. Attaining a college degree is often a prerequisite for attaining a top management position in a small family business (Lambrecht, 2005). He has worked in deliveries, shipping, and receiving, but has spent most of his time in the press room doing production. After running the presses for about ten years, Richard moved up to the position of Press Room Supervisor five years ago. Richard is quite content with a role he describes as "hands-on." He enjoys the demands of the physical aspects of printing and the use of advanced technology, but shows little or no desire to advance in the management of the company.

FAMILY BUSINESS RESEARCH

Succession continues to be the leading topic in family business studies (Sharma, Chrisman, & Chua, 1996; Dyer & Sanchez, 1998). The succession process involves the passing of leadership from one family member to another in family firms when the individuals belong to different generations (Sharma, Chrisman, Pablo, & Chua, 2001). Researchers have suggested that the person most responsible for the continuity of the family business is the founder or incumbent leader (Barnes & Hershon, 1989). Approximately, 86 percent of family firm leaders expect their businesses to continue on to the next generation in the family (Mass Mutual, Kennesaw State, & Family Firm Institute, 2007). Research shows that only 30 percent of all family firms successfully complete the succession from the first generation to the second and that this percentage holds for successions from the second to third generation and beyond (Lansberg, 1988; Handler, 1994; Shanker & Astrachan, 1996).

Passing the family business to a generation involving the leadership of multiple family members is becoming a common practice (Cater & Justis, 2010). The trends toward team management, in which several family members are involved in the management of the firm, and multiple family members share ownership have been recognized as among the most significant changes occurring in family businesses (Aronoff, 1998).

One of the most significant problems facing family businesses is the lack of capable and willing successors (Lansberg, 1988). Qualified family members may hesitate to join a family firm for several reasons (Covin, 1994). Some do not want the stress and pressure involved with working with family members. Others simply have different occupational interests. There may be concerns about the fairness of the decision making process, the abilities of co-workers, high turnover among non-family employees, resistance to change, or the fairness of compensation and workload.

Even when there is an available, qualified successor, more challenges may arise. New family members may enter the firm and fail to understand the sacrifices that the founder made. These new family members may also expect to enter the firm at the top without making sacrifices of their own (Hoy & Verser, 1994). Feelings of entitlement on the part of the younger generation may emerge. Selfishness and lack of concern for other parties often reigns in family businesses. Lack of forgiveness for mistakes on all sides and lack of appreciation, recognition, and love may be major family obstacles to succession (Hubler & Kaye, 1999).

Successors must be willing and fully committed to the succession process (Barach & Ganitsky, 1995). Successors must demonstrate the necessary skills, performance, and experience for leading the firm (Barach, Ganitsky, Carson, & Doochin, 1988). Successors need a thorough training regimen to acquire firm specific knowledge and to develop their capabilities (Morris, Williams, Allen, & Avila, 1997). In the best situations, successors receive counsel and instruction from mentors, which may begin informally around family dinners and gatherings (Dyer, 1986). Chrisman, Chua, and Sharma (1998) found that the most important attributes for successors were integrity and commitment to the business as opposed to gender or birth order. Foster (1995) proposed four key components for developing leadership among successors: knowledge of the industry, technical skills, influence skills, and self-awareness.

THE FAMILY STOCKHOLDERS' DECISION

Bobby caught the scent of fresh polish from the gleaming long maple conference table as he motioned for Estelle Algood (Carlton's widow) and Frances Algood (his sister) to have a seat in the swivel chairs on both sides of the table in the company conference room. He opened the meeting, "Thank you both for coming today. We have all seen this day coming for over a year now, but that does not make things easier. Estelle and Frances, you know that I share your grief for the loss of your husband and our brother. It has been two weeks since Carlton's funeral and now we must address some important issues for Algood Press. We are the company stockholders as Carlton's interest has passed to Estelle. As I see it, we need to discuss our current situation in leadership at Algood Press.

"Bobby, from my vantage point as an advisor, the management committee has operated splendidly for the past two years," Frances offered.

"I wonder about that. How can you operate with six people making a decision? Doesn't that slow things down?" asked Estelle. "What do you do when there is a tie – three to three?"

"We operate by consensus. If we do not agree, we cannot move on. With the group, we have more brain power than one person. We have made decisions as a group that none of us would have made individually. Somehow, we talk things through. Amongst the six people, several of us are very conservative and a couple of us are more risk oriented. We just kind of reach a happy medium," explained Bobby.

"From a family point of view, it is a little disconcerting to have outsiders making important decisions in our company," ruminated Estelle.

"Remember, we still control the board of directors as family stock holders and we can step in and correct issues as they appear," remarked Bobby.

"Bobby, there is a lot to be said for having a strong leader in a business. Francis, our father, and Carlton, our brother, both led this company with a firm hand and a strict manner. You are the logical person to step up now, Bobby," Estelle asserted.

"I have been over this topic many times before with Carlton. I do not want to be the president. I have concentrated on the production side of the business, while Carlton did the marketing and sales end of it. So, that has been my background – manufacturing and running the production part. I don't see myself in the leadership role," Bobby replied.

"Okay, Bobby, I understand what you are saying. This leaves Ernie and Julie as the front-runners for president," said Estelle. "I do like the idea of having a woman as president. Julie does a great job as our financial leader and she has been with the company since 1992. Also, she is a family member and we know that we can count on her as a direct blood descendant of Francis, her grandfather, and Carlton, her father."

"Yes, I understand that point of view and I agree that Julie should be president of Algood Press at some point. Presently, she has two young children who take up a great deal of her time. Ernie is 63 years-old and will decide to retire fairly soon. Then, it may be Julie's time to become president," countered Bobby. "In my opinion, Ernie has done a great job for Algood Press by changing our focus from a general printing company to the direct mail niche and leading the acquisition of Database. Also, I think that we should reward Ernie with some stock ownership in the company."

"I am concerned about keeping control in the family," stated Estelle.

"I agree that we should offer some stock ownership to Ernie. We need to retain him in our company. At the same time, Craig Dickson is vital to our company because of his direct mail expertise. He should have some ownership as well," added Frances.

"I do not mean to slight Julie. She is also a valuable asset to our company. If you are willing to give Ernie and Craig some stock ownership, I believe that Julie should have that opportunity as well," Bobby replied. "As I see it, we need to decide on three major items at Algood Press. Should we continue with the management committee? Who should be president? And who should own stock in the company?"

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"LOSS OF VALUE" FOR EXCESSIVE ABSENTEEISM: A CASE STUDY

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CASE DESCRIPTION

The primary subject matter of this case is arbitration in a company with a powerful union. Other issues include absenteeism, FMLA, documentation, arbitrators' decisions, "Loss of value" letters, and Last Chance letters. The case has a difficulty level of being appropriate for senior level or first year graduate classes. The case is prepared for two hours of instruction and discussion. The students should receive the case earlier and be prepared to discuss the ramifications of the case together with the instructor.

CASE SYNOPSIS

This case involves an employee with an extended history of frequent and protracted absences over his employment of 17 years. When the company finally terminated him after going through all the options available to them, the union representing him filed a grievance which progressed thorough the steps of the plant grievance procedure to arbitration. This case is exciting as it is based on first-hand knowledge of the situation. Students will have a sense of immediacy upon reading the case. It gives a perspective seldom available to undergraduate students in the meaning of "Loss of Value" and how such a case must be approached by management. It involves interesting exerts from previous Arbitrators' decisions, along with views of such cases from Authors Elkouri & Elkouri. The case involves interesting testimony during the arbitration hearing by both the grievant and his Union Representative as both give their perspectives on the case to the Arbitrator. This case also has serious implications during the negotiations of a Collective Bargaining Agreement between the parties during the sale of the plant to a new owner. Finally, there is a surprising caveat seldom experienced following an arbitrator's binding opinion and decision to both the Company and the Union.

INTRODUCTION

This paper, written as a case study, investigates whether a manufacturing plant in a small mid-western town was justified in terminating the employment of an employee with seventeen (17) years of service in 2005 following the issuance of a "Loss of Value" letter of notification for what the employer considered excessive absenteeism. The "Loss of Value" letter had been given to the employee in early fall of 2004, prior to the events leading to his ultimate termination.

The employee, represented by a Local Union of the United Steelworkers of America, filed a grievance which went before an Arbitrator, insisting that the employer had violated the spirit and intent of their Collective Bargaining Agreement (CBA), along with previous arbitration decisions at the facility, by unjustly terminating the employee. The Union specifically argued the section of the CBA regarding "Disciplinary Action" and claimed the employee should have been administered a "Last Chance" letter in lieu of discharge.

The Employer attempted to show the grievant's absenteeism had been unacceptable, not only during the past five (5) years of his employment, but throughout his career at the facility. The employee's absences from work for various reasons during the period from 2000 through 2004 had resulted in his being issued the "Loss of Value" letter. This letter communicated that he must correct is attendance problem or be subject to disciplinary action, up to and including discharge. The Employer further argued that the series of events leading to additional absences from work during 2005, coupled with his long history of absenteeism and lack of effort to correct his problems justified the decision for termination.

"LOSS OF VALUE"

"Loss of Value" is a common labor relations term utilized through the years by Employers when the evidence indicates that employees are absent from their workplace to the extent that they are no longer of any value to the employer as an employee. The period of time usually used in the process of establishing the burden of proof of "Loss of Value" is the attendance record for the most recent five (5) year period prior to the disciplinary action being taken. In many cases, the final decision maker (Arbitrator, Umpire, or Mediator) will examine the percentages of unexcused absences for each year during this period to see if they meet or exceed a total of 20%. In this case, the employer took the position that "Loss of Value" was when an employee had compiled an absentee record such that the person becomes practically useless as an employee. At this time, it is proper to consider the entire record, including all absences and other aspects of the record including factory injuries, time spent on light duty, and other disciplinary action as it relates to the value of an employee. The Union vehemently opposed this definition due to the fact that it would include absences that are normally covered by the Family Medical Leave Act (FMLA). The Union argued that in previous cases at this facility, FMLA absences were not included in the "Loss of Value" calculation and the Employer had been unsuccessful in any attempt to include such FMLA absences as part of the employee's absentee record. In fact, this Union had prevailed in getting their grievances sustained and the employee returned to work regarding the termination of an employee for any reason for the previous fifteen (15) years.

BACKGROUND AND HISTORY

As previously noted the employee in this case, was hired on July 28, 1988 and had a total of seventeen years of service with this employer at the time of his termination for "Loss of Value" on July 12, 2005. The employee's absentee record during his employment period from July 28, 1988 to July 13, 2005 is summarized as follows:

Employee Absentee Record	
Year	**Total Days Absent**
1988	2
1989	2
1990	4
1991	37
1992	39
1993	11
1994	38
1995	43
1996	44
1997	24
1998	36
1999	8
2000	24
2001	22
2002	62
2003	34
2004	17
2005 (Thru 7/12/05)	3

The above absences are in addition to the following approved Family Medical Leave Act (FMLA) representing days not available for work:

Employee Absentee Record	
Year	**FMLA Total Days**
2002	61
2003	18
2004	69
2005 YTD	37

Further, the employee's claims of both occupational and non-occupational injuries and illnesses had been many and varied throughout his employment. In addition to his above absences from work, he had been provided extensive light duty (276 days) for various reasons throughout his employment.

As a result of the employee's absentee record for the years of 2000 through 2004, and following the required numerous steps in the grievance procedure for excessive absenteeism, a meeting was held on October 26, 2004 regarding his attendance with the appropriate Union and

Management officials present. The result of this meeting was a "Loss of Value' letter for absenteeism being placed on the employee's record.

During this meeting the employee's Business Center Manager (BCM) noted the following percentages of work days absent from the year 2000 to 2004 YTD:

Percentages of work days absent from the year 2000 to 2004 YTD	
2004 YTD (10/20/04)	15% work days absent (including light duty days)
2003	22% work days absent (including light duty days)
2002	38% work days absent
2001	17% work days absent
2000	13% work days absent

Following a "Report off sick" on March 3, 2005, the employee experienced additional absentee problems due to health related issues with difficulty breathing. These problems resulted in a "Report off sick" on June 27, 2005 and a "Clock in late" on June 28, 2005. These absences led to a meeting on July 1, 2005 to discuss these last two absences and his overall attendance record. The meeting concluded with the employee being placed on a 48 hour investigative period as required by the Collective Bargaining Agreement (CBA). On July 12, 2005, a follow-up disposition meeting was held regarding the employee's attendance and "Loss of Value" status. This meeting concluded with the employee being notified that his absences were unacceptable in accordance with his "Loss of Value" letter and that his employment was terminated. A grievance was filed that same day which progressed through the steps of the grievance procedure and was heard before the arbitrator on August 31, 2005.

DISCUSSION

The Company's position at the arbitration hearing was that the employee's absentee record for most of his 17 years of employment history clearly had been unsatisfactory. It had consisted of both long and short term absences spread out over many years. As a result, neither his employer nor his fellow employees could count on him from an attendance standpoint. From the year 2000 through October 26, 2004, the employee had been absent 159 days out of a total of 866 work days for an 18.4 % absentee percentage. Accordingly, after years of attempting to correct his absentee problems, management reached the point where he was determined to be of no value to the Company. Of further significance, when his approved FMLA leave is included in this five (5) year period, he was not available for work 307 days out of the total 866 work days for a 35.5 % unavailable for work percentage.

The Company defined "Loss of Value" at the arbitration hearing as when an employee has compiled an absentee record such that the person becomes practically useless as an employee; at which time it is proper to consider the entire record, including all absences and other aspects of the record including factory injuries, time spent on light duty, and other disciplinary action as it relates to the value of an employee.

The Company argued it was justified in placing this employee on notice with the "Loss of Value" letter dated October 26, 2004 which communicated in part as follows:

"Regular reliable attendance is a responsibility of all employees. Your attendance record was reviewed in its entirety with you, and it was determined to be unsatisfactory. It is your responsibility to correct your attendance problem immediately. Failure on your part to correct you attendance problem may subject you to further disciplinary action, up to and including discharge."

The Company pointed out at the hearing that the employee was asked to "correct your attendance problem immediately." The letter did not ask him to simply improve over his past unsatisfactory attendance. The second step answer by the BCM to the grievance filed by the Union following the issuance of his "Loss of Value" letter also clearly communicated how serious his absenteeism had become by stating in part as follows:

"After reviewing the grievant's record, it is hard to dispute that the grievant places an undue burden on the Company to cover him due to his unavailability to perform his assigned job on a regular basis. Loss of Value recognizes those employees who miss such a large amount of work that they no longer have a value to the Company. Clearly, this employee cannot be relied on for regular attendance and the Loss of Value letter issued was appropriate."

Arbitrator Fred Kindig had previously addressed the principle of a Company issuing letters to employees regarding excessive absenteeism which could eventually lead to discharge for loss of value. His words from Arbitration Decision FEK-222 are well- know and have been quoted by numerous arbitrators as follows:

"Absence is defined as a state of being away or not being present. Therefore, if an employee is not present when expected to be present at work, said employee is absent; whether voluntarily or involuntarily, excused or unexcused, controllable or uncontrollable, avoidable or unavoidable. Arbitrators generally agree that one of an employee's obligations is regular attendance and that no company can tolerate situations where absenteeism is excessive. In fact, a point may be reached where an employee has compiled an absentee record such that the person becomes practically useless as an employee; at which time it is proper to consider the entire record, including all absences and other aspects of the record, and to discharge said employee if lesser discipline fails to correct the unsatisfactory behaviour of the individual.

The principle is also well established that where an employee has been absent from work on many occasions over a period of time for varying injuries and/or illnesses, as to indicate unfitness for industrial employment, a company may finally terminate said employee, not for offenses, for injury and illness are not offenses, but simply because the employee is not only of no value to the company's operations, but is actually a hindrance. Such cases are difficult to handle. The company has the right and the obligation to make an employee aware of a record that is considered unsatisfactory to the company, and should take appropriate action accordingly when it appears to be necessary to convince the employee of the unsatisfactory behaviour. In this connection, one of the problems is the proper timing of the appropriate action; as there is just as much danger in waiting too long as there is in taking action too soon."

The Company argued that it was justified in terminating the employment of the subject employee on July 12, 2005 following the contractually required 48 hour investigative period by concluding that his last absences were unacceptable in accordance with his "Loss of Value" letter. Following his "Report off sick" on March 3, 2005, along with his absence from work on June 27, 2005 and his late clock in on June 28, 2005, it became apparent that this employee would continue to experience additional absentee problems for various health related issues as his previous history had proven.

Arbitrator Anthony Sinicropi had addressed a similar situation in a prior arbitration case at this same mid-western manufacturing facility in 1995 when he upheld the discharge of an employee and stated the following in his decision:

"Arbitrators Wagner and Gunderman have specifically addressed the discharge of 'loss of value' employees at this plant. In Case No. 84.7, for example, Arbitrator Gundermann noted that 'if an employe has an uncontrollable absence due to injury or illness, conditions beyond the employe's control, it is doubtful that either counseling or discipline would have any effect on the employe's attendance, as the underlying cause of the absence is beyond his control. Arbitrator Gundermann also noted in Case No. 84.7 that:

'It is generally recognized that if an employee's uncontrollable absences reach the point where the employee cannot be available for work on a regular basis, and there is no expectation that the cause(s) of the absences can be eliminated, the employer has a right to terminate the employee.

Likewise, in Case No. 77-3, Arbitrator Wagner upheld the discharge of an employee for excessive absenteeism under the following facts:

'In Case 76.1, the Umpire also had before him a termination for excessive absenteeism. In that case the Umpire noted that different approaches were appropriate for absenteeism growing out of employee indifference to his job and that caused by physical disabilities that prevented an employee from fulfilling his job duties. He went on to observe that in the former case the corrective discipline approach was appropriate but in the latter it was not useful but 'instead a systematic and careful medical evaluation must be made' to support a termination. The Union contends that the latter approach should have been followed in the present case if the Company's corrective disciplinary policy was not required. The Umpire believes the facts in the cases are basically different. In 76.1 the grievant had a record of mixed reasons for his absences – indifference and a back disability. The Company terminated him under the corrective discipline policy it customarily applied in its regular absentee control program; however, the Umpire determined that under the circumstances that prevailed, the medical excuses that the grievant advanced for his absences should not have been ignored but should have been 'systematically and carefully evaluated' to determine whether they provided justification for the grievant's absence. In the Umpire's judgment the situation that prevails in the present case is fundamentally different. Here the grievant's absence at the time of termination was not triggered by a particular absence that it considered unjustifiable because it had no medical support but because the grievant had once again been unable to provide the services the Company needed. Although it would have been useful if the Company had insisted upon a detailed and complete medical prognosis of the grievant's prospects before terminating him, the Umpire cannot conclude that in the light of the grievant's repeated and extended absences for a variety of very different illnesses and disabilities that the termination for his physical inability to perform his job was procedurally faulty that it was arbitrary or without cause. On the contrary, the entire record discloses that the Company was burdened heavily by production losses and by medical and sickness benefit costs for which it received no employee services. Therefore, especially in the light of the February 1977 notice, the termination was proper.'

Applying the principles outlined in the above-referenced cases to the facts presented in the instant grievance, the undersigned finds that the Company has met its initial burden of proof to show that the Grievant's absenteeism rate was excessive and warranted disciplinary action. It is undisputed that during the last seven years of his employment with the Company, the Grievant was only able to work his regular job assignment approximately 23% of his scheduled work days. His rate of absenteeism was not only excessive, but was continuing in nature. The Grievant missed work as a result of an appendectomy, assorted strains, and injuries to both shoulders and wrists. Although these injuries may have been caused by reasons outside of the Grievant's control, and were documented as such by his doctor, the fact remains that the Grievant was absent from work and the Company had to repeatedly make arrangements to cover his regular work assignments. These arrangements imposed hardships on the Grievant's co-workers, created financial costs for the Company and, as demonstrated by the record evidence, reached an unacceptable point.

As to the appropriateness of the discharge penalty, the Grievant was given specific notice by the Company's 'loss of value' letter about the consequences of his inability to maintain an acceptable level of attendance. The Grievant failed to meet the conditions of that letter. Because the reasons for the Grievant's absences were largely uncontrollable, strict adherence to the principles of progressive discipline by the Company was not required. The medical evidence introduced by both parties fails to offer any definitive proof that the Grievant's physical inability to perform his regularly assigned job duties will improve or that the Grievant will no longer miss extended periods of work in the future. There is also no evidence in this case to show that the Grievant was unfairly singled out for discharge. In short, there is no evidence of any other employee whose absenteeism rate compared with that of the Grievant and who was not discharged. Under these factual circumstances, the Arbitrator must conclude that the Grievant's discharge was appropriate."

In June, 2005, the subject employee had filed an accident report for heat exhaustion resulting in light duty work and was later absent from work for claims of chest pains. In his letter dated July 11, 2005, the plant physician had noted the following at the conclusion of his evaluation:

"I have come to the conclusion, I find no evidence of this being related to a heat related illness based on the description of his physician, the available laboratory work and the patient's own history."

Even the employee's own personal physician noted in her June 22, 2005 report the following information:

"The patient presents here today with a general achiness all over, throughout his extremities and extreme fatigue as well as some lightheadedness. He does not describe specific chest pain with any radiation. He also complains of extreme fatigue. He states that he has been at work over the past couple of days, and there is no air conditioning, and he has felt drained, particularly yesterday when he got home from work when he began having this all over achiness and continued to feel generalized myalgias and pain over the day. He denies any other symptoms. ASSESSMENT: Myalgias."

Comments provided in a letter dated July 27, 2005 by yet another physician from a nearby mid-western town following the employee's discharge were most interesting and are noted as follows in part:

"Apparently the question had been raised as to whether or not he is suitable for factory work in light of his medical situation. I wanted to clarify that issue. He has suffered from intermittent abdominal pain and pancreatitis in the past. He has also dealt with functional abdominal pain exacerbated by anxiety. He also suffers from mild asthma from which, despite working for years at the plant, he has only suffered one or two mild flares of the asthma despite all the fumes and hot environment…..He has followed a pattern of intermittent absences from work, which have affected his attendance pattern."

The husband and wife authors Elkouri & Elkouri had also previously addressed "Excessive Absences" in their Fifth Edition of "How Arbitration Works" by noting as follows:

"The right to terminate employees for excessive absences, even where they are due to illness, is generally recognized by arbitrators. However, no simple rule exists for determining whether absences are in fact, 'excessive.' In this regard, Arbitrator Edwin R. Teple explained:

'At some point the employer must be able to terminate the services of an employee who is unable to work more than part time, for whatever reason. Efficiency and the ability to compete can hardly be maintained if employees cannot be depended upon to report for work with reasonable regularity. Other arbitrators have so found, and this Arbitrator has upheld terminations in several appropriate cases involving frequent and extended absences due to illness.'

In another statement, Arbitrator Marlin M. Volz explained that:

'Illness, injury, or other incapacitation by forces beyond the control of the employee are mitigating circumstances, excuse reasonable periods of absence, and are important factors in determining whether absences are excessive. However, if an employee has demonstrated over a long period of time an inability due to chronic bad health or proneness to injury to maintain an acceptable attendance record, an employer is justified in terminating the relationship, particularly where it has sought through counseling and warnings to obtain an improvement in attendance.'

The Company concluded their argument in this case by noting that the history of the subject employee clearly demonstrated over a significant period of time a great number of injuries and illnesses, both occupational and non-occupational, that he had not maintained an acceptable attendance record and this employer was justified in terminating the employment relationship.

The Union's case at the arbitration hearing centered on the Company's use of the employee's FMLA absences in justifying his termination. The Union argued vehemently that the Company had violated this federal statute and that all references to his Company approved FMLA absences should be struck from the record. Previous arbitration decisions were noted by the Union where approved FMLA absences were not allowed to justify discipline and this case was quite similar in nature. With the illegal inclusion of these FMLA absences, the Company had failed to establish the required "just cause" and to consider the mitigating factors which failed to justify discharge.

The Union also argued that the Company was merely out to make an example of this employee and had even refused to agree to a "Last Chance" letter following his "Loss of Value" letter and prior to termination. The Union noted that a "Last Chance" agreement letter had been a standard practice between the parties for the past 15 years rather than administering discharge. Termination of his employment was nothing more than the Company creating "economic capital punishment" for this individual which did not "fit his crime." The Union further contends that the grievant had corrected his attendance record noting that in the year of 2003, just prior to the "Last Chance" letter, he was absence only 34 days, and those absences led to his "Lost of Value" letter. The Union noted at the time of discharge, termination was not justifiable based upon the grievant's attendance record over the past ten (10) months. The Union noted that although the grievant did experience two absences from work after the issuance of his Loss of Value letter in October, 2004, he had clearly demonstrated a strong desire to make himself available to work as evidenced by the fact that he reported for work immediately following hi discharge from the hospital on June 28, 2005. In addition, the Union argued that the Company had failed to conduct systematic and careful evaluations to determine whether or not the grievant's medical conditions were likely to improve prior to deciding to terminate his employment.

As in many discharge cases, the tables began to turn when the Union put the grievant on the witness stand. This employee, regardless of how well coached by the Union, never lacked in his verbal enthusiasm and efforts to describe his medical condition and how he had been mistreated by management and his peers on the job. While testifying on his own behalf, the grievant explained that his primary medical issue had been pancreatitis, a condition he had suffered from for the past five years. He stated that he thought this condition was now under control because he had not had to seek medical treatment for it since June, 2005. This testimony, however, appeared to be contradicted by a medical report from his physician dated February 3, 2005, and submitted by the Union as evidence at the arbitration hearing. This medical report read as follows:

"I am writing at the request of my patient to clarify his family medical leave paperwork. He suffers from abdominal pain syndrome that is a chronic medical condition. It is likely related to a splenic nerve irritation syndrome after pancreatitis and stint placement. He also deals with an element of irritable bowel syndrome, which is worsened with anxiety. He has required intermittent office visits and will likely require these for the foreseeable future. A splenic nerve injection is being contemplated, and we are researching a provider that can pursue that option for him. I wanted to clarify what was meant by the answer to the question concerning incapacity. I simply meant that he was cleared to return to full duty without restrictions at this point in time. That is not to say that his condition has resolved or that we cannot expect periodic visits to the physician being required in the future. I attempted to convey that by stating his condition will likely last 10 years. I feel that he has made a good faith effort to report to work when he is able.

In summary, he does have a chronic condition, which will require periodic physician visits as provided under the Family Medical Leave Act. I hope these comments are useful."

The grievant's comments with respect to his absences of June 27-28, 2005, which triggered his termination, included his explanation of his going to the emergency room for chest pain and being admitted for evaluation. On the next day, June 28, a stress test, along with other tests, were administered, after which he was released to return to work either that day or the next and he chose to go to work that day to prove that he was conscientious about his job. In regards to his March 3, 2005 absence, the grievant claimed the absence was not recorded correctly because he called in for FMLA that day and was told he was granted eight hours of leave. He stated he was never told otherwise until the meeting with management on July 11, 2005, at which time he was told that the March 3 absence was being counted against him as an absence.

Further comments by the grievant while on the stand were many and varied, ranging from conflicts involving hostility and abusive language that he had with his co-workers such as how the Company had failed to stop his fellow employees from harassing him by "staring at him" while he worked at his machine. He also described an incident involving his peers placing grease on his jacket which was transferred to his van seats when he entered his vehicle at the end of his shift. When he reported the incident to the Company and requested reimbursement of $150 for having his van seats cleaned of the grease, his request had fallen on deaf ears. In summary, the employee blamed his discharge on being disliked by many of his fellow employees and management in general.

The Union Vice-President also testified at the hearing on behalf of the grievant. He testified that he had been active in Union affairs for twenty-four years and had been involved in several cases involving employees who had been discharged for "Loss of Value." The Union VP was of the opinion that some of those employees were treated "differently" or more leniently than the grievant but failed to provide any facts or circumstances surrounding the referenced previous cases. His testimony focused on the history of the loss of value procedure applied at this plant and the characteristics that distinguished it from similar procedures at other plants. Based upon the above noted Martin Wagner Case No. 1.76 as noted in part above, the VP concluded that the crux of this dispute is whether the evidence showed that the grievant had corrected his attendance record to the point that discharge was inappropriate and unreasonable.

THE DECISION

The grievance was denied by the Arbitrator. In denying this grievance, the Arbitrator noted the following conclusions in his opinion:

First, the grievant had received ample notification that his attendance record was unsatisfactory and that failure to correct his attendance problem immediately would result in termination. Accordingly, ample warning of the consequences had been provided by management. Second, there was no prognosis for improvement in the grievant's record based upon the fact that his absenteeism continued for a wide variety of reasons in 2005, after he received his loss of value letter. It was undisputed that the grievant had been absent for a total of forty days, which represented 41% of the workdays available to him in 2005. Third, keeping an employee on the employment roll who has displayed such cavalier regard to his responsibility for regular attendance does a disservice to the vast majority of employees who do care about their jobs and who do make a conscientious effort to maintain regular attendance. Finally, the Union's claim that the Company has not made a thorough evaluation of the grievant's medical condition in their decision to terminate his employment was completely undermined by the medical evidence in the file which clearly demonstrated this was a matter that was clearly taken into account by the Company.

An Unexpected Turn of Events

Needless to say, this arbitration decision did not set well with a Local Union who had not lost a termination case in the past 10 years. It caught them totally by surprise, and having a future opportunity to redeem themselves was always on their minds. This opportunity came when the plant was sold to a new owner for an even $1 million dollars. Thus, when intense negotiations over a new Collective Bargaining Agreement with the upcoming new owner of the plant occurred during late December, 2005, the reinstatement of the subject grievant was a union proposal in order to complete the deal. When the background of the case and an objection was voiced by the plant Human Resource Manager, the new owner's attorney spoke quite frankly as to the expected outcome when he said, "Listen this new owner (name) wants this plant more than a 16 year old boy wants sex for the first time, trust me the reinstatement of the subject grievant (name) will not stand in the way of this deal". Accordingly, the grievant's reinstatement became a small part of a very big deal for the new plant owners.

THE FINAL CAVEAT

After the signing of the new CBA, plant management reluctantly contacted the terminated ex-employee and scheduled a meeting for reinstatement. The individual came to the plant Employment Office as scheduled and as the Employment Manager explained the results of the negotiations and his reinstatement process, the ex-employee suddenly bolted unexpectedly for the door and ran to the gatehouse. The BCM Manager, who had initially terminated his employment and who was present for the reinstatement that day, quickly pursued knowing that he should not fail his new owner and management team. When finally stopped at the plant gatehouse, the ex-employee told his BCM that he had no desire to work at this facility and planned to pursue other interests he had recently initiated. Thus, we all learned something that had been suspected for quite some time: "The Local Union, a new owner, and even the old management team cannot make an individual work that has a lack of desire to do so in the end."

RICHARD BRANSON AND VIRGIN, INC.

Todd A. Finkle, Gonzaga University

CASE DESCRIPTION

This case focuses primarily on entrepreneurship and the problems facing entrepreneurs in today's volatile economic environment. The case is appropriate for courses in entrepreneurship, small business management, and strategic management. The case examines the life of Richard Branson and Virgin, Inc. and has a difficulty level two. It is appropriate for freshmen and sophomores. It can be taught in a 75 minute course period and the case preparation time is approximately two hours.

CASE SYNOPSIS

Richard Branson built a billion dollar company based on numerous entrepreneurial endeavors, however he was facing one of the most difficult times in his career. The global economic crisis had a significant negative impact on his companies' revenues and earnings. Virgin, Inc. was down 40%. The world was stuck in the worst economic crisis since the 1930's. The Dow Jones Industrial Average (DJIA) had collapsed 55% from 2007 to 2009 and the banking system was on the verge of collapse. Yet, Branson was optimistic because he was thinking about what opportunities lay ahead. He had five billion dollars in cash and needed to determine what strategies he must utilize to manage and grow his firm through this chaos.

INTRODUCTION

Sir Richard Branson was pontificating as he was flying in his hot air balloon trip from England to the United States. He had built a billion dollar company based on numerous entrepreneurial endeavors since his youth. As he reminisced about his life, he thought diligently about the dire economic situation the world was facing in March, 2009. The global economic crisis had a significant negative impact on his companies' revenues and earnings, they were down 40%. Furthermore, a lack of consumer spending and a new all-time low in consumer confidence were all having negative impacts on his businesses.

Virgin was trying to determine how they were going to navigate during the worst recession the United States had seen since the Great Depression.[1] The Dow Jones Industrial Average (DJIA) had collapsed 55% from 2007 to 2009 and the banking system was on the verge of collapse. The stock market had not collapsed like this since the Great Depression when the stock market fell by 89% from 1930 to 1932.

Yet, Branson was optimistic because he was thinking about what opportunities lay ahead. He had five billion dollars in cash and needed to determine what strategies he must utilize to manage and grow his firm through this chaos.

RICHARD BRANSON

Born in England on July 18, 1950, Sir Richard Branson's mother was a stewardess, father was a lawyer, and grandfather was a judge. Branson remembers his childhood with his two younger sisters as happy. His parents encouraged independence.

Branson's confidence in his ability to analyze a situation and make it work was evident early. Although he was a mediocre student, Branson insisted that he could run the school he attended more effectively and efficiently than the headmaster. One aspect of the school that Branson thought he could improve was the creation and enactment of school rules. Branson insisted that one rule he could improve was, "*Allow all sixth-formers [final year students] to drink two pints of beer a day.*"[2]

The lessons that Branson learned and his personality traits were fundamental to his business success. Branson's mother, Eve, focused on challenging her children so they could enhance their confidence, growth, and development. According to Branson, "*I remember that my parents continually set challenges for us. My mother was determined to make us independent.*"[3] Branson's mother was raised in a family that encouraged women to strive to live more than just a domestic existence. She had drive and determination and wanted to instill this in her children. By the age of 27, Branson's mother was married to Ted Branson (Richard's father), was a dancer, and was performing in local London theaters. When Eve met Ted she was employed as a stewardess for an airline that made trips to and from South America.

Branson attributed a lot of his creativity and initiative to his parents' upbringing. When he was four years old, Branson's mother demanded that he find his way back home after dropping him off in a remote location a few miles away in a field. Branson also recalled that his mother told him to ride his bike 50 miles to another town and then find his way home. Her purpose was to increase Branson's stamina and overall sense of direction. Eventually Branson began to embrace challenges that were set out for him. He saw them as opportunities to overcome weaknesses and conquer a small part of the world.

Branson's parents also encouraged him to think freely and voice his opinion. Branson was aware of his mother's passions; generating work for her children and creating ways to make money. Branson learned a great deal from his parents by watching them work hard. Branson's parents instilled the values of putting people first and the importance of teamwork. This fundamental value of understanding the importance of teamwork influenced Branson's appreciation and development of the culture at his future company, Virgin.

There was no television in Branson's house while growing up. His parents viewed watching television as a waste of time. The children were encouraged to use their time productively to improve themselves and their lives. Branson and his siblings were taught that shyness was frowned upon and that they should learn to be able to converse effectively in a social setting. Branson's business fever may have been ignited by his mother's propensity to create ways to raise money when family funds were running low.

Branson's father was an attorney and his grandfather, Sir George Branson, was a highly respected and reputable court judge. Branson's father was much less dominant in trying to mold his children's future habits. His personality was more laid back.

Schoolwork presented a significant challenge for Branson. Branson was dyslexic, nearsighted, and unable to read at age eight. His undiagnosed sight problem hindered his school success. Branson attended a boarding school, the Stowe School, as a teen. He was not a good student and dropped out of school by the age of 16. Branson stated that the headmaster told him that he would either be a millionaire or end up in prison.

Branson struggled academically through his school years, yet excelled in competitive sports, and was able to overcome most obstacles. Overcoming dyslexia and learning how to cope with this condition had a significant impact on Branson's approach from a business perspective. According to Branson, "*Perhaps my early problem with dyslexia made me more intuitive: When someone sent me a written proposal, rather than dwelling on detailed facts and figures, I found that my imagination grasps and expands on what I read.*" [4]

Branson had the ability to see the broader vision; the bigger picture beyond the specific details. This assisted him greatly when it came to business creativity.

Branson was an entrepreneur from a very young age. He embarked upon numerous business ventures, such as selling Christmas trees and breeding budgerigars, a small breed of parakeet. Although he was not financially successful, he discovered a love for doing business. This love would never die.

Branson took an early departure from school and engaged in his first successful business venture, *Student* magazine. The magazine was geared towards 16-25 year olds; a category that Branson believed was underserved in the marketplace. The magazine was successful and at its high point had a circulation of up to one hundred thousand issues. By age 20 he had been the subject of a television documentary highlighting his *Student* magazine.

In 1970, Branson and his friend, Nick Powell, created a mail order venture focusing on the record industry. After this, they opened their first record store in London on Oxford Street. Branson started a recording studio and record label called Virgin Records in 1972. His first major signing was Mike Oldfield who wrote the soundtrack to "The Exorcist" called *Tubular Bells*. The album was on the UK music charts for almost five years. As Branson's reputation increased so did the quality of the acts he worked with which included: Genesis, Simple Minds, The Rolling Stones, Peter Gabriel, and The Sex Pistols.

Branson also had his share of disappointments. One of the most serious infractions was selling records illegally that were meant for export. He did not pay taxes, which led him in jail. Branson's parents came to his rescue by posting a pretty hefty bail by mortgaging their home.

Charges against Branson were eventually dropped after he agreed to reimburse the state for the taxes that he should have paid.

The scrape with the law was one of many life lessons learned by Branson on his way to the top. Many of these incidents would shape the way he thought, felt and dealt with friends, foes, and the establishment.

Branson was known as one who rose to the top and remained there by being his own person. He instilled a belief in those around him that would carry them wherever they went. Branson was anti-establishment, light hearted, and creative. At times Branson was labeled as a hippie entrepreneur for the way he lived his life and ran his businesses. Even though Branson had made millions of dollars for himself and others, material possessions did not drive him. Being successful and enjoying what he did was much more important.

In 1999, Sir (a form of knighthood by British Royalty) was added to the beginning of Branson's name to recognize his contribution to service through entrepreneurship. His knighthood was another tribute to all that Branson had accomplished and contributed to the United Kingdom and the world.

Branson was also adventuresome. He was the first to attempt to travel across the world in both hot air balloons and sail boats. Not only was he the first to travel across the Atlantic and Pacific, but he set a record pace in doing this. He also made attempts at speed records in an amphibious vehicle. These activities were criticized by some as being reckless and childish. Branson was putting his life in danger along with the viability of the Virgin Group. With the criticism that Branson received, he also received massive amounts of free publicity for himself and Virgin.

VIRGIN

Branson's first profitable venture was called *Student* magazine, which was launched on January 26, 1968. The magazine's articles focused on "sex, rock music, interviews with terrorists, and proposals for educational reform."[5] The magazine was started as a hobby for Branson to dabble in during his down time. He solicited the help of other students to make up his staff. Branson ran the magazine without paying salaries to his aides. In exchange for their services, he provided them with room and board.

Branson then diversified into the mail order record business after four years of guiding his magazine. The mail order business was an expansion of the magazine, but it focused as a musical distribution outlet. Branson decided that the magazine had served its purpose and that he needed to move on to bigger and better things. Branson used his last print issue of *Student* to advertise his new venture of selling records. His start began with seizing the opportunity of attaining a stock of records from a discounter. With this purchase he was able to fulfill the demand created by the magazine's advertisements. Branson was also able to flip these records for a profit by selling them to music retailers less expensively than most middlemen.

Branson soon realized that he needed someone to keep track of the funds, regulations and other procedures necessary for smooth business operations. To fulfill this need he recruited a longtime friend, Nik Powell. In exchange for Powell's commitment to help grow Virgin and keep it on the right track Branson offered him a 40% share of the company. Powell brought the business expertise that was needed to run the day-to-day activities. Branson was more of the creative, idealistic part of the team. The two worked very well together.

Branson then opened a physical brick and mortar record store on Oxford Street in London in 1971. The existence of the mail order business was being threatened by a nationwide postal strike. Without mail carriers to deliver records there was no means for customers to acquire Virgin's product. So he opened a retail store.

Virgin then vertically integrated backwards by expanding into record publishing – establishing a recording studio and signed major bands like the Sex Pistols. The first huge step for Virgin was signing Mike Oldfield who went on to release of the classic album, *Tubular Bells, the* Soundtrack to The Exorcist. Oldfield released this album in 1973 under the Virgin Record label. Oldfield had been rejected by many other labels only to fall into the lap of Virgin. *Tubular Bells* would sell over five million albums worldwide and lift Virgin Records into a notable player in the music industry.

Virgin also signed the Sex Pistols. Virgin's propensity to walk landscapes that were too risqué for other more conservative labels was becoming legendary. The Sex Pistols were known drug users and lived obscene lifestyles. Virgin Records then expanded internationally and went on to sign Phil Collins, Simple Minds and Culture Club, which was headlined by another very controversial character, Boy George.

VIRGIN ATLANTIC AIRWAYS

In 1984, Virgin began implementing an unrelated diversification strategy with startups in the airline industry, Virgin Atlantic Airways and Virgin Cargo. The airline business was very capital intensive, competitive, and volatile. There was stiff competition, financial demands, and uncertainty in the industry. Though many stop signs presented themselves, Branson thoughts this was an opportunity. Branson playfully joked about the extreme risk of investing in an airline by saying "*The quickest way to become a millionaire is to be a billionaire and buy an airline*."[6]

Branson knew that there was a place for them in the airline industry; they just had to find it. He witnessed poor customer service and unpredictable, high pricing. He worked tirelessly to make his idea a successful reality. He brought in experience and intuitiveness in order to implement his vision. After getting through all the red tape, brainstorming, and preparation it was finally time to start the engine. In what would become known as typical Branson style, Branson dressed up as a World War I airman during the official launch of Virgin Airlines.

Management

Branson poured his heart, energy, time and capital into his airline. At this point Virgin Airlines was the only limb of the Virgin enterprise to receive a significant piece of Branson's personal attention. The day-to-day leadership responsibilities in the other Virgin companies had been handed over to loyal Virgin executives that Branson learned to trust. This was a common pattern for Branson; to create and learn a new part of his conglomerate and then hand the reigns over to a trusted member of the Virgin family to lead to the top.

Branson frequently gave the leaders of each division a share of the company that they ran. This practice provided extra incentives for the leaders to increase the bottom line. Branson often commented that he enjoyed making millionaires out of the people that worked for Virgin through this practice. After delegating the leadership roles to others in the company Branson would then have time on his hand for seeking out new ventures and planning publicity opportunities for Virgin.

The airline was a bit different than the other parts of the organization. Branson grew a personal tie to it partly because it was such a challenging endeavor. Effort by Branson to accelerate the success of the airline along with government regulations on airline pricing and unfair competition thrust Virgin Airlines into a threat amongst UK competitors.

Going Public

In 1985, privately owned Virgin Group went public. This gave Branson an uncomfortable feeling. Branson did not like giving up the control of his company. Though he was apprehensive about the move, Branson knew the benefits of being able to raise a tremendous amount of capital. The influx of investor money created many options for Virgin. The public offering was successful but not as successful as expected. After the company went public there was much discord between Virgin, Branson, and market analysts. Branson did not possess the type of leadership style that appealed to the conservative, traditional critics. After only two years on the public market, Branson bought the outstanding shares and brought Virgin Group back under private ownership.

Strategic Maneuvers

Though Virgin Airlines had become relatively successful and was pretty steady in the short term, Branson knew that in order to create long term stability the airline needed new investment capital. This situation caused Branson to make a decision that had no right solution. In order to raise the capital needed to keep the airline competitive, Branson had to sell his greatest asset, Virgin Records. Virgin Records was the crown jewel of the Virgin family and it was what made Virgin a household name. At that time (the early 1990's) Virgin was the world's biggest independently owned record company.

After much thought and steady negotiation the deal finally was made. Virgin Records was sold for $1 billion in 1992 to Bertelsmann and Thorn EMI. To this day Branson talks of his disappointment of having to make the decision to sell Virgin Records. He knew in his heart that it was the right business move for what he wanted to accomplish, but it still hurt him to let go of something that he had created and grown. In a way it seemed like Branson was proud of himself for being able to think with his head and not with his emotions. In his own words he has said that "*Too many entrepreneurs have gone down because they were not prepared to cash in their chips at the right time*."[7]

The cash raised through the sale of Virgin Records helped spawn new Virgin entities along with the expansion of Virgin Airlines. New innovations on the airline included: onboard masseurs, fashion shows, and tailors.

Over time, Virgin Group continued to embark upon numerous acquisitions and joint ventures which added more companies under the Virgin umbrella still with a non-related diversification strategy. Examples of this include the launching for Virgin Brides and Virgin Trains in 1996 and more recently the launching of Virgin Galactic (2004) and Virgin Fuel (2007). Additionally, the firm divested businesses such as selling Virgin Music Group in 1992 to Thorn EMI and Virgin closing its clothing company in 2000. For a list of Virgin's companies see Exhibit 1.

Even though Virgin was operating as a conglomerate with businesses in multiple industries with little in common except for the Virgin Brand, it was apparent that some related diversification occurred within subgroups, which are categorized in Exhibit 2.

While one can argue that these categories are indicative of non-related diversification, it was evident that Virgin was already recognizing particular industries/markets where it could expand and leverage its success.

VIRGIN IN 2009

Virgin's strengths included the following: (1) Strong brand equity: The Virgin brand name was not only associated with Richard Branson, but also embodied a rebellious, anti-corporate image; (2) Entrepreneurial leadership: Richard Branson was continuously looking to engage in new opportunities and considering new ventures, (3) Non-related companies: The Virgin Group consisted of over 200 individual, non-related companies. These companies operated on a standalone basis which allowed the underperformance of one company not to affect the collective group; (4) Strong Corporate Culture: The Virgin Group had a competitive advantage that cannot be replicated, its corporate culture. Virgin's employees were high performing, fun, high energy people that were continually thinking outside the box and looking to innovate; (5) Decentralized Organizational Structure: The flat organizational structure allowed for the firm to be flexible and responsive to market conditions.

The company also had several weaknesses including: (1) It was difficult for the market to identify core businesses/products of the Virgin Group: The initial brand of the Virgin Group, served as an antithesis to corporate bureaucracy; it was no longer consistent with some of its businesses such as Virgin Credit Cards; (2) There was poor financial performance of some of the individual businesses; (3) Some of Virgin's unsuccessful business ventures affected the brand negatively; (4) Brand recognition was most prominent in the United Kingdom; (5) The Virgin brand is heavily dependent on Branson's identity in the marketplace; (6) Virgin's businesses can be considered market players, but not recognized market leaders

Virgin had several opportunities and threats. Opportunities were: (1) The Virgin Group could leverage synergies between businesses; (2) International expansion: The Virgin Group can identify companies that can increase market potential through expansion into international markets; (3) Identify core businesses and focus on market growth in those particular sectors. Threats to the company included: (1) Brand licensing creates the potential for negative impact to the brand; (2) Maintaining the Virgin culture as Virgin acquires more companies; (3) Brand dilution in the marketplace: With the Virgin brand attached to so many companies, the potential exists for the brand to have less meaning to consumers; (4) The retirement of Richard Branson: The concern was whether or not the brand will maintain its market value without Branson to personally launch new companies, and (5) The international economic crisis will significantly impact the performance of numerous Virgin companies as consumers pull back their discretionary spending in categories such as electronics and travel.

In 2009, Virgin was reportedly still looking to expand to new territories. Unnamed sources claimed that Virgin had placed a bid to purchase a race car team (Honda Formula One).[8] No one associated with Virgin would comment on these claims but in a related move Virgin entered into a partnership to sponsor another race team in March of 2009.

With the world economy depleting in the last two years Virgin's businesses have seen down times. In the second half of 2007, Virgin America, a U.S. version of Virgin Airlines, "lost $227 million in its first 12 months of operation, far more than expected."[9] In April 2009 allegations were made that Virgin America was breaking the law because the company was not at least 75% American owned, which was a violation of U.S. regulations.[10] This situation was created when Virgin America's American investors sold off their share of the company to an unnamed party. The sale was undoubtedly because of the poor financial performance of Virgin America. Though Virgin American was not performing as Branson and Virgin hoped it would Branson still believed that there was opportunity in the U.S. Market.

Financial troubles are also hampering other parts of the Virgin Group such as Virgin Blue (an airline that operates primarily in Australia). The financial troubles for Virgin Blue have resulted in salary and pay cuts along with hiring freezes. With such a large portion of Virgin consisting of airline travel businesses, times were tough. All airlines, not just Virgin, had been struggling for at least the previous 24 months.

Also relevant in 2009 was Virgin Mobile. Virgin Mobile was started in 1999 and originated in the United Kingdom. The Company was primarily known and had been successful promoting its prepaid cellular phone services. Virgin Mobile also offered traditional services in the U.S. to select customers. During 2009 Virgin Mobile operated in seven different countries. Virgin Mobile had been especially successful in Canada for the four years previous to 2009.

In 2009 Branson was also looking to continue to expand Virgin Rails, Virgin's train service operation in the UK; begin an e-banking venture to complement its financial services division; and had collected "$40 million in deposits from would-be space tourists"[11] from future Virgin Galactic customers.

BRANSON'S KEYS TO SUCCESS

"*Life is short; one has to make the most of it. Thus, do things that you like. If your work and your hobby are the same, you will work long hours because you are motivated.*"[12] Branson enjoyed doing many things which was one reason why he had been successful in so many areas.
In Britain, Branson was known by his countrymen to be either one of two things: the country's best known businessman who walks on water, or a ruthless, wily entrepreneur who was always trying to get over on his rivals and skated on thin ice. Branson's real talent was his ability to inspire loyalty from people. He was known as a global entrepreneur who loved adventure.
Branson had faith in his people and respected their ideas. He was not afraid to give credit to someone else even when it made that person look smarter than him. Branson realized that multiple perspectives and sources are an asset to the leader of an organization and not a threat.

Some of the success of Richard Branson and Virgin were related to the personality of Branson. He never gave up and was willing to take on hefty amounts of risk. Virgin had a strong brand recognition image and was in almost every industry imaginable. Even though most of the Virgin companies were not making huge profits, Virgin and Branson's keys to success included global brand recognition, an entrepreneurial focus, an adventurous leader, and the ability to take on challenges and risks.

Multiple factors influenced the combined success of Branson and The Virgin Group. The most significant of those factors was Branson himself, his willingness to take risks and embrace his entrepreneurial spirit. Branson was successful in creating an identity with Virgin that appealed to a specific target market and he has been able to build upon that brand as he expanded Virgin.

Some of the key characteristics that described Branson included: self- motivator, aggressive, risk-taker, financially organized, excellent negotiator, creative, flexible, very competitive, proactive, hardworking, and charismatic. Branson always networked with talented and important people.

Branson attributed much of his success to the people around him. Branson made it a priority to maintain a close, family-like organization. He believed that if the company was run by quality people who are treated well, then success was right around the corner. Every year Branson celebrated his employees with a party at his home. The employees were invited to celebrate the success that Branson attributed to the team. Branson has been known to point out that the preferred pecking order in terms of importance was employees or associates first; customers were second; and shareholders were third. Branson created an atmosphere in his business that promoted casualness and fun. He wanted people to have a good time at work as if they were immersed in a hobby. Branson was not known for paying large salaries and was not ashamed of this. He felt that truly enjoying your work made up for a few extra dollars.

Another business practice that Branson utilized was creating new businesses as opposed to buying existing ones. By expanding in this manner, it allowed employees to get in on the ground floor and learn about the business more intimately. This manner also provided a sense of ownership to employees knowing that they helped give birth, nurture, and grow the new entity. By building on this idea, Branson felt that he encouraged the production of quality products and/or services within the company. He emphasized that quality over quantity was the goal.

Another one of Branson's personality traits was the art of giving. His charitable ways created even more popularity amongst his many fans. Branson gave multiple donations to such causes as AID research, political publications to educate the masses, and rescue efforts for those affected by the first Gulf War. Branson made a bid to run the national lottery of Britain but was not successful. Part of his plan was to donate all the profits derived from the lottery to charity.

THE FUTURE OF BRANSON & VIRGIN

The major issue confronting Virgin in 2009 was how to survive and grow in the current economic crisis. The firm needed to identify its core competencies and determine what direction it wanted to go. Another problem confronting Virgin in 2009 was the impending retirement of Branson, from both an external and internal perspective. Externally, Branson and the Virgin brand are considered synonymous. However, what will happen when Branson is no longer the leader? Internally, the concern was who will be the leader and can they maintain the culture of Virgin.

Branson touched down his hot air balloon in upstate New York. His trip was finally over. He had enough time to ruminate about what his next moves were going to be for his company. Branson's entrepreneurial instincts had him excited about the future. He was anxious to get back to England and talk about his next moves with his top management team.

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Exhibit 1: The History of Virgin	
1968	First issue of *Student* magazine, January 26.
1970	Start of Virgin mail order operation.
1971	First Virgin record shop opens in Oxford Street, London.
1972	Virgin recording studio opens at The Manor near Oxford, England.
1983	Virgin Vision (forerunner of Virgin Communications) formed to distribute films and videos and to operate in television and radio broadcasting.
	Vanson Developments formed as real-estate development company.
	Virgin Games (computer games software publisher) launched.
	Virgin Group's combined pre-tax profit climbs to £2.0 million on turnover of just under £50 million.
1984	Virgin Atlantic Airways and Virgin Cargo launched.
	First hotel investment (Deya, Mallorca).
	Virgin Vision launches The Music Channel, a 24-hour satellite-delivered music station and releases its first feature film *1984* with Richard Burton and John Hurt.
1985	Private placement of 7% Convertible Stock completed with 25 English and Scottish institutions.
	Virgin wins Business Enterprise Award for company of the year.
	Virgin Vision extends film and video distribution internationally.
	Virgin Holidays formed.
1986	Virgin Group, comprising the Music, Retail & Property, and Communications divisions, floated on London Stock Exchange. 35% of equity sold to 87,000 shareholders.
	Airline, clubs, holidays, and aviation services remain part of the privately owned Voyager Group.
1987	Virgin Records subsidiaries in US and Japan launched.
	British Satellite Broadcasting (Virgin a minority partner) awarded satellite broadcasting license. (Virgin sells its shareholding in 1988.)
	Virgin acquires Mastertronics Group, which distributed Sega video games in Europe.
	Virgin Airship & Balloon Company launched to provide aerial marketing services.
1988	Recording studios opened in Barnes, London.
	New international record label, Virgin, launched.
	Virgin Broadcasting formed to further develop Virgin's radio and TV interests.
	Virgin Hotels formed.
	Virgin Megastores opened in Sydney, Paris, and Glasgow.
	Branson takes Virgin private with £248 million bid for outstanding shares.
1989	Virgin Music Group sells 25% stake to Fujisankei Communications for $150 million.
	Virgin Vision (video distribution) sold to MCEG of Los Angeles for $83 million.

Exhibit 1: The History of Virgin	
1990	Virgin Retail Group and Marui form joint venture company to operate Megastores in Japan.
	Virgin Lightships formed to develop helium airships for advertising.
1991	W. H. Allen plc acquired. Merged with Virgin Books to form Virgin Publishing.
	Sale of Virgin Mastertronic to Sega. Remaining part of the business becomes Virgin Games.
	Virgin Retail Group forms 50:50 joint venture with W. H. Smith to develop UK retail business.
1992	Sale of Virgin Music Group to Thorn EMI plc.
	Joint venture with Blockbuster to own and develop Megastores in Europe, Australia and US.
	UK Radio Authority grants Virgin Communications and TV-AM plc the license for Britain's first national commercial rock station (Virgin 1215AM goes on the air in April 1993).
	Virgin acquires Euro-Magnetic Products, a specialist in the personal computer consumable market.
	Vintage Airtours established to fly Orlando–Florida Keys in vintage DC-3s.
1993	Virgin Games floated as Virgin Interactive Entertainment plc with Hasbro and
	Blockbuster taking minority equity stakes.
	Virgin Euromagnetics launches a range of personal computers.
1994	Virgin Cola Company formed as joint venture with Cott Corp.
	Agreement with W. Grant to launch Virgin Vodka.
	Virgin acquires Our Price retail music chain, owned 75% by W. H. Smith, 25% by Virgin.
	Virgin Retail Group forms joint ventures to develop Megastores in Hong Kong and S. Korea.
	Virgin City Jet service launched between Dublin and London City Airport.
1995	Virgin Direct Personal Financial Service is launched as a joint venture with Norwich Union (whose stake is later acquired by Australian Mutual Provident).
	Acquisition of MGM Cinemas, UK's biggest movie theater chain, to create VirginCinemas.
1996	Virgin Travel Group acquires Euro-Belgian Airlines to form Virgin Express.
	V2 record label and music publishing company formed.
	London & Continental Railways (in which Virgin is a major shareholder) wins a £3bn contract to build the Channel Tunnel Rail Link and operate Eurostar rail services.
1997	Virgin Rail wins bid to operate the InterCity West Coast and is awarded the 15-year rail franchise.
	Virgin Net, an Internet Service Provider, formed with NTL.
	Branson acquires a 15% stake in the London Broncos rugby league team.
	Victory Corporation, a joint venture with Rory McCarthy, launches the Virgin Clothing and Virgin Vie toiletry products.
	Majority share in Virgin Radio sold to Chris Evans' Ginger Media Group.
	Virgin Bride, a chain of wedding retailers, formed.
	Virgin One telephone bank account and "one-stop integrated financial service" launched in collaboration with Royal Bank of Scotland.
1998	Virgin Entertainment acquires W. H. Smith's 75% stake in Virgin/Our Price.
	Virgin Cola launches in the US.
1999	Virgin sells its UK cinema chain to UGC for £215 million.
	Virgin launches mobile phone service in joint venture with Deutsche Telecom's Oneto-One (November).
	49% of Virgin Atlantic sold to Singapore Airlines for £600 million.
	Restructuring and re-launch of loss-making Our Price record stores.
2000	Virgin Mobile launches US wireless phone service in joint venture with Sprint and announces plan to expand into Europe, Africa and South-East Asia. Virgin Mobile Australia (a joint venture with Cable & Wireless) begins service in October.
	Virgin Net, Virgin's portal and ISP venture, closes its content division.
	Virgin announces the closing of its clothing company (February).
	Virgin Cars, online sales of new cars, launched.
	Virgin and Bear Stearns set up Lynx New Media, a $130 million Internet-focused venture capital fund.
	Inaugural flight of Virgin Blue, Virgin's low-cost Australian airline (August).
	Branson knighted by the Queen.
	Virgin fails to win franchise to run Britain's government-owned National Lottery.

Exhibit 1: The History of Virgin	
2001	50% of Virgin Blue sold to Patrick Corporation for A$138.
	Virgin expands into Singapore and SE Asia with joint ventures with local companies in radio stations, cosmetic retailing, and wireless phone services.
	Virgin.net merges its ISP and portal businesses.
	16 French Virgin Megastores sold to Lagardere Media for 150 million Euros.
2002	Virgin Bikes (UK) launched. Offers direct sale of new motorcycles at discount prices.
	Virgin Mobile offers wireless telecom services in the US.
2003	Virgin Blue initial public offering; Virgin retains 25% of equity.
2004	50% stake of Virgin Money repurchased from AMP for £90 million.
	Virgin Digital launched. Offers online music store and digital music download capabilities.
	Virgin launches Virgin Galactic
2005	Virgin Active UK acquires Holmes Place
2006	Virgin Fuel is launched
2007	Virgin Health Bank is introduced
	Virgin Media is launched
	Virgin America is launched
2008	Virgin Holidays + Hip Hotels created to provide style conscious travelers the best in travel.
	Virgin Healthcare opens their first centers.
Source: http://www.virgin.com/Companies.aspx# accessed December 26, 2009.	

Exhibit 2:			
Travel & Tourism		**Leisure & Pleasure**	
Virgin Holidays	Virgin Trains	Virgin Games	The Virgin Voucher
Virgin Vacations	Virgin Charter	V Festival	Virgin Comics
Virgin Holiday Cruises	Virgin Blue	Virgin Experience Days	
Virgin Limousines	Virgin Atlantic	**Social & Environment**	
Virgin Balloon Flights	Virgin America	Virgin Green Fund	Virgin Earth
Virgin Limited Edition	Virgin Galactic	Virgin Unite	
Blue Holidays	Virgin Nigeria	**Media & Telecommunications**	
Virgin Limobike		Virgin Media	Virgin Broadband
Finance & Money		Virgin 1	Virgin Mobile
Virgin Money		Virgin Radio	
Health		**Shopping**	
Virgin Spa	Virgin Life Care	Virgin Books	Virgin Digital
Virgin Active	Virgin Healthcare	Virgin Vie at Home	Virgin Wines
Virgin Health Bank		Virgin Megastore	Virgin Drinks
Source: Source: www.virgin.com accessed October 13, 2009.			

MIA MOTORS: THE ARRIVAL OF A FOREIGN MULTINATIONAL FIRM INTO THE U.S. AUTOMOBILE MARKET.

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Jin-Gil Jeong, Howard University

CASE DESCRIPTION

The primary subject matter of this case concerns the entry of a Korean multinational firm into the U.S. Automobile market and the development of an enormous management challenge to not only coexist but to prosper in an industry with the hope for future growth in a market dominated by large multinational firms who also have similar aspirations of growth, profit and success in a turbulent market. The issue of international capital funding, that is obtaining the required implementation and operational funding to begin U.S. operations away from its home country, along with pricing of the firm's domestic and foreign public offerings, and possible use of American Depository Receipts (ADRs) to acquire the needed funding are central themes for the case evaluator and student. Further, the determination of appropriate methods for acquiring the necessary funding, while managing foreign exchange (forex) risk and the handling of SEC Rule 144A and other security choices, have significant impact on the success of the firm and are integral to the case. How should the automobile industry, the prudent American consumer and the American stock market accommodate this new Korean firm who must face major competitors, virtual giants in the U.S. auto world, specifically, the big three: Ford, GM and Chrysler? The case has a difficulty level of three, appropriate for first year graduate level. The case has both current and historical applicability for MBA students concentrating in corporate finance, international financial management, or multinational corporate entrepreneurial relations and serves as a pedagogically sound tool for applied market strategy by foreign multinational firms who similarly seek entry into and funding in the U.S. economy. It includes elements of the valuation processes used by American analysts and investors to determine the investment potential of those multinational manufacturing and service firms. The case is designed to be taught in three class hours and is expected to require 6-8 hours of outside preparation by students. Mia Motors is a fictitious firm and much of the company information provided in the case is included to enhance the case focus and present a pedagogical model with a range of international issues including the use of international corporate financing with ADRs and other financing methods by a firm who may have subsidiaries branching into foreign country operations while maintaining close direct support and supervision by parent firms from their countries of origin. The exercise of and use of international financial theory and concepts provide the basis for much of Mia's management strategy in addition to its entrepreneurial efforts within the case. Thus, any similarities noted between Mia Motors and other international firms are purely coincidental.

CASE SYNOPSIS

This case affords students an opportunity -- from both strategic and financial points of view -- to evaluate Mia Motors' decision to expand its operations outside Korea to the U.S.; to provide or obtain the funding necessary to establish and continue operations in U.S. public markets while simultaneously maintaining home country relationships and further consideration of expanding its assembly and manufacturing operations world-wide from a growth perspective. The approach of the case hinges on the analysis of two key areas: 1) the internal decisions made by the home office of Mia Motors located in Korea to assist its international subsidiary to obtain operational funding to enhance the unit's successful U.S. market entry and to better enable the operational rigors faced by the firm in a market composed of major players in the industry (Ford, General Motors and Chrysler and others) and 2) the effect and influence of multinational banking firms in providing the necessary operating capital for similar firms like Mia Motors, who may also be entering fully-integrated industries with a primary product. The product in the case is simply known as ""A Foreign" Car trade category which is widely known and accepted now. Of primary concern throughout is how firms attempt to become major players in international markets and go public (domestically and internationally) and how one should analyze and evaluate the offering instruments used by these firms and determination of the funding instrument price when the forces of international markets and other foreign firms are involved. Further, a peripheral issue is the impact of capital restructuring -- the design of the firm's debt and equity claims (or equivalents) with an emphasis on changes in and additions to its international clientele and investors, how does a foreign firm compete for capital funds with both domestic and foreign competition for those scarce dollars, and what is the real potential for failure in new markets by firms with limited operating history. All data elements and statements were derived from researcher-designed and public financial data. Mia Motors represents a fictitious firm, and although its financials may resemble others in the international automobile industry, it is purely coincidental. No private or insider information was provided or extracted from company files or other such cases.

INTRODUCTION

In August 2003, the Board of Directors of Mia Motors Incorporated faced the decision threshold concerning several issues facing the "coming to America plan" for the firm including: (1) how does this firm survive in an international automobile industry market where it is but a small dot on the industry horizon, (2) which international market would best "fit" the mission and direction of the firm; and (3) how would the firm fund its domestic and international plans, and in that vein, could the Korean offices of its long-term financial partner, J.P. Morgan Chase, be called upon for assistance with funding sources available to satisfy its needs. As the firm was deliberating the issues, several pertinent factors conclusively indicated that it must expand its operations to a more profitable area. Mia had historically made several foreign direct investments in the U.S., South America, Europe and China. These corporate decisions were based upon 1) a strategic motive of mitigating its operating exposure evident in unexpected changes in exchange rates, and 2) a financial motive, to enhance its profitability by diversifying its operational markets and monetary sourcing. The first of several internal Korean issues affecting the firm's decision noted by Mia's expansion planners was that the price of domestic land was prohibitively expensive. Thus, it would make sense for the firm to go outside of Korea to obtain access to more reasonably priced or free sources for construction of its assembly plant. Next, the domestic regulation in Korea for expansion of assembly plant operations was extremely difficult to overcome at the current period and showed very little chance of changing in the near term. Finally, within Korea, the firm had to deal with labor unions which would present the real potential for much higher contract costs, increased labor costs and other union-specific elements, reducing the profits derived from operations. The choice for movement to the U.S. was also affected by the firm's determination that land prices in the U.S. were reasonable, if not free, that local and federal governments there were very business friendly, and that labor costs were low because it would be hiring non-union employees in its U.S. plant. (Alvis, 2009)

COMPANY BACKGROUND

James ("Jim") Cheng is the firm's founder, Chairman of the Board, and CEO of Mia Motors International. After earning his BS in mechanical engineering from Korea University, in Seoul, he worked with various firms in the industry for several years, during which time the idea for Mia as an international firm began to develop. He later enrolled in Stanford University where he earned his MBA in business and marketing. While at Stanford he worked with the university's Small Business Development Center where he continued developing his ideas, establishing a home business in Korea, and, then, once the homeland business was stabilized, transforming a fledgling subsidiary of the firm into an international auto firm that could compete with Hyundai, Mitsubishi and other more reputable firms that were also implementing their own marketing plans or already moving internationally into European markets while attempting to fully extended themselves into the U.S. auto market. Jim Cheng was fully aware of and subscribed to the sound Confucian beliefs of hierarchy and respect for elders that would enable his firm to provide the speed and efficiency necessary to succeed internationally. At first, all manufacturing for both the domestic and international markets would be done in Korea. Mia, unlike other international firms, did not at this point have assembly plants in the U.S. Thus, Mr. Cheng desired to fulfill his dream by initially establishing assembly plants in the U.S. and then moving forward with the full development of manufacturing, assembly, and sales activities within the U.S.

Mia Motors was incorporated in May 1995 by Jim Cheng upon his graduation from Stanford. Ten years previously, the South Korean government formulated a plan to enhance development and manufacturing for Korean firms. Hyundai, Daewoo, and SSangyong took advantages of the legislation and applied funding and technology into their corporate infrastructure. Mia submitted its plan in January 1995 for the formulation of a new plant with a capacity of producing 50,000 cars each year (with 300,000 units to be produced in 2000), with expansion of up to 15 subsidiary firms in 5 countries for assembly and/or foreign manufacturing and sales.

- 5 firms in Japan and Italy for car design and development
- 2 firms in Japan and the UK for stamping equipment

- 3 firms in the UK and Germany for casting and forging equipment
- 3 firms in Japan and the UK for engine production and development
- 2 firms in the U.S. and the UK for auto parts, assembly and final production.

Initially, in 1995, the firm's primary activities included developing, producing, marketing, and sales of its smaller sized cars. The production of small, gas-efficient automobiles was done in conjunction with other manufacturers such as the co-production with the British Leyland Motor Corp and Hyundai for car parts and Mitsubishi for the engines. Two years later, in 1997, Mia established its Japanese and UK subsidiaries. This move began the real expansion into the international markets and paved the way for its ultimate move into the U.S. market. The European and Japanese operations also allowed Mia to introduce its new K-3 EVO hybrid sports car for the younger, environmentally-conscious, upscale consumers, which could provide the impetus for the firm's U.S. operations when and if the firm matured to that level. As the gas and oil crisis in the western world became more significant, the company believed that its product would be increasingly used by Asian and European consumers, and perhaps ultimately by individuals in the U.S.

Coincidentally, in 1997, the Asian financial crisis caused the firm to retreat from much of its expansion, but, with its public funding, funds raised from various company ventures, and some of Mr. Cheng's own funds, along with funds from family, friends and even one of his college professors, Mia Motors was able to continue toward its quest. He next expanded the firm's management team of very talented individuals that were committed to the firm's vision to include managers of R&D/production, marketing, and finance. The Board was composed of some of the early investors in the firm, including one of Jim's professors, representatives of a local venture capital firm, and Jim.

Jim viewed the firm's core competencies, i.e., its ability to efficiently design and produce high quality, reasonably priced, fuel-efficient, well-constructed automobiles would help it to continue to survive and prosper. By the end of 1999, the firm had stabilized and begun to benefit from synergies in its research and manufacturing. With the confidence in its product and its growth from dependency on and dependability of its product in domestic and international markets, the firm found itself better prepared to expand into further international markets.

THE TARGET MARKET & STRATEGY

The firm's primary customers since inception had been the environmentally-conscious drivers of small, gas-efficient vehicles in the Korean market. That approach would not change for the U.S. market because of the spiraling cost of oil, gasoline and their derivatives and would allow the firm to afford investment, R & D and growth to enhance the firm's business operations. Since the consumer was not required to depend totally on the dealers for support for their car, and because of its modular design and easy consumer-maintenance, the firm offered large cost-savings to its customers. In addition, in each of its selected markets, the company provided customers with a promise to have servicing completed within two hours. Customer satisfaction was therefore maximized because service and repair delays were minimized, generating higher return purchases from those same customers. So Mia Motors' core values of providing its customers significant cost savings, optimal revenue flow, and predictability are to be included in the firm's predictive future growth and firm value.

In Japanese and European markets, the firm provided the products and services through local assembly and service centers. It is believed that this would work well in U.S. markets such as New York, Atlanta, and San Francisco, and, although these markets may be difficult for the firm to penetrate, they were on the firm's marketing and production wish list.

To accelerate acceptance of its products and services and to further diffuse competitors in the domestic and international marketplace, Mia entered into agreements with other auto firms who maintained facilities for manufacturing and sales within targeted areas. In essence, Mia would share its parts, engines and services in support of such dealerships as Honda, Toyota and rivals like Hyundai and Kia. The acceptance of this joint effort was said to be in line with current business leveraging and collaborative practices, i.e., establishing and expanding markets through the servicing and support of others domestically and internationally. Mia believed that it could continue to increase its market share in this growing US market.

GLOBAL MARKET SHARE; CURRENT AND FUTURE

In 1998, Mia Motors exported almost 50% of its domestic production into overseas markets. Almost 150,000 vehicles were sold in markets from Norway to South Africa, countries as large as China and as small as Trinidad. The U.S. market accounted for nearly 10% of Mia Motor's exports, with Europe and Canada buying much of the remainder. It was somewhat amazing how well the firm's automobile had been accepted by upper and middle-income customers internationally. It is anticipated that, if the firm could move its operations to the U.S. and enhance its access to U.S. consumers, that sales could be doubled or tripled. Foreign assembly plants had grown over the years and production was increasing. Mia had regularly invited staff from foreign assembly plants such as Japan, China, and the UK to Korea to learn the company's advanced engineering technologies and manufacturing systems. This had been used to pave the way for Mia to increase the scale of its assembly operations and prepare the firm for what it hoped to be a move into the U.S. automobile market. One international advantage Mia must explore is that Korea joined the World Trade Organization (WTO) in 1995 and the Organization for Economic Cooperation and Development (OECD) in 1996. This essentially meant that trade barriers for member countries would be non-existent. Conversely, Ford and GM tended to use Korea as important assembly sites for their Asia and exports to Japan, China, and Europe. Thus, the trade barrier issue would be non-existent because of the very stringent standard held by WTO and OECD, basically removing barriers to capital flow and foreign direct investment.

The company had been exploring opportunities in the international marketplace which would better prepare it for operating in the US. In the markets in Africa, Asia, and South America, there were still expansion opportunities, but none that could exceed those available within the U.S. In many of these markets the company could be negatively affected by existing and potential new government controls, laws, and policies such as: (1) pricing, characteristics, and quality of products and service; (2) property ownership and (3) controls on repatriation and currency conversion.

According to Jim, it was critically important for Mia Motors to use governmental assistance and trade barrier advantages to establish its presence in North America, preferably in the U.S., in five of the top EU markets, and in Japan. He was sure that competitors would soon be targeting their markets, and he wanted to be there to welcome them when they arrived. Mia's initial foray into the international markets had been through the use of parts distribution and assembly. However, the goal was to obtain the resources necessary to establish sales offices initially in each of these markets, with regional R&D production facilities to follow. At the same time, Jim heard the beckoning call of full manufacturing and sales in the U.S. automobile market. The firm estimated that to make a successful entry it needed a minimum of $10-$15 million, which would be obtained from public offerings in the host country, in this case the American stock markets.

However, there was a minor problem of compliance with U.S. exchange requirements, which prevented many smaller country firms from accumulating wealth through U.S. markets. How does the firm acquire the capital for the venture when they may be affected by existing and potential stock market government controls, laws, and policies such as: (1) pricing, characteristics, and reliability of the shares; (2) protection of U.S. investors from the firm's exchange products and servicing of Mia's shares, and (3) controls on repatriation and currency conversion. Mr. Cheng contacted his friend Mr. Lee at the Seoul branch of J.P. Morgan Chase's International Unit Subsidiary for assistance in preparing an ADR issue of Mia's shares. Mr. Lee had promised to assist Jim last year when the expansion idea was in its infancy planning stage. Jim was not sure of how this process worked but was fully aware of its return if executed correctly. He assumed that you could assist him in valuing his shares and the ADRs relating to them. Jim remembered the concepts he had been taught while attending college relevant to foreign exchange, including the purchasing power parity, Fisher's Theory of Interest Effect, and interest rate parity theories. He has requested that you use these models when valuing the exchange and equity recommendations.

FINANCIAL INFORMATION

The company revenues were derived from manufacturing, assembly and sales of the firm's K-3 EVO sedan and convertible automobiles. Over the two years ending December 31, 2002, the company earned revenues of $706,000 annually. In their dominant positions, the firm's competitors were able to successfully thwart the competitive efforts of new entrants, and this would possibly be what Mia would experience: that usual access to sales revenues would affect the company's operations. However, plans for overseas expansion were being developed to further penetrate the European and Japanese markets, along with the desired expansion in America. Consolidated financial information is available in Exhibits 1 and 2. Noteworthy was the fact that the company's expenditures were, to a large extent, based on its apparent sales growth and expansion in the future. Revenues and operating results were dependent on the volume of, timing of, and ability to fulfill sales expectations, which proved difficult to predict. The firm would be exposed to foreign currency changes and value adjustments in both outstanding Korean stock prices and U.S. sponsored ADR values. In light of this heavy dependence and the constraints on cash flows which may result, the company might be unable to adjust spending to compensate for any shortfall in revenues, which would severely impact the company's operating position. Moreover, with plans of expansion afoot and other capital ventures, the company may be in need of the flexibility that additional financing could provide. Theoretically, the principal purposes of the ADR issue would not only be to obtain additional financing but also to create a public market for the company's common stock and to facilitate future access to public equity markets. The firm has approached its long-time U.S. financial intermediary and investment bank, J.P. Morgan Chase for support of an issue of seasoned Korean stock which, if they agree to sponsor, can be issued simultaneously in the U.S and listed in the over-the-counter market. Mia’s parent corporation could request the bank to create a market for them and hold the ADRs, but that would not allow them to be listed on any U.S. exchange and could mean a significant price difference to the cash-needy firm.

The decision facing the Board was a tricky one. There were risks associated with international investment of the firm, under-pricing or overpricing the firm’s ADR or stock issue, proper management of the firm’s foreign exchange transactions, and repatriation. Given the high risks associated with the company, the industry and the technology, an overpriced issue would surely result in an under-subscribed offer. Not only would the underwriting team have to absorb these shares and risk eventual damage to its reputation, but the company's need for financing would go unresolved, thereby exposing it to potential downturns in the market and risk of potential decline in operations. An underpriced issue might ensure sale of the company's stock, but J.P. Morgan Chase and associates would be criticized for failing to obtain the maximum value for Mia.

Despite the uncertainty surrounding this expansion to the U.S. auto industry, the country appeared to be ready to accept the firm's type and style of gas-efficient, compact automobile. The use of this type of conveyance appeared to be growing as gas prices increased and supply and demand for gas, oil and petroleum derivatives would be sure to receive more government support. However, there was cause for caution with the controversy surrounding the balancing of the budget and the conflict raging between the White House, the financially-concerned House of Representatives and American public produced by the U.S. inability to create a unified energy policy. As the firm approached issue, the market would hopefully be fairly stable, and perhaps it would be in the best interests of all concerned to act quickly and take full advantage of the market optimism.

In consideration of the appropriate price, the Mia’s underwriters should review comparable initial issues made by companies in the industry. It might be difficult for Mia to secure debt financing with its outlook. The Mia underwriters should also test comparable methods of accurately valuing Mia, its domestic Korean shares, and the potentially sponsored ADRs, through traditionally accepted equity and equity derivative valuation methods. The firm needs $10-15 million in expansion funding which is to support the building and implementation of its Alabama manufacturing operations. Note Mia's planned sales and production breakdown which its senior management feel closely approximates the firm's expansion strategy (See Appendix A)

The firm's Board and Mr. Cheng were busying themselves preparing for their management decision to expand to America, facing the challenge of competing with established firms within the U.S. automobile industry, determining an investment bank access for their needed funding into a potentially unfriendly, possibly economically-depressed industry. Finally, from your forecast of Mia's future growth, what do you think this multinational auto maker should do to ensure a successful transition into the U. S. market? You are being compensated as the firm's international expansion consultant, and your task is to assist them with the analysis necessary to make that decision.

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MIA MOTORS
Breakdown of Annual Production and Sales (units: number of autos sold)

Time line	Major Dev. & Strategy Decision	Annual Production in Domestic & Foreign Units		Annual Sales				
				Domestic	Foreign Market			
		Domestic	Foreign (U.S)	Korea	Japan	China	Europe	U.S.
1995	Mia Motors incorporated. Joined WTO. Small-sized cars specialty.			60,000				
1996	Korea Joins OECD	100,000		65,000				
1997	Established subsidiaries in Japan & UK. Also Asian Financial crisis	150,000	25,000	75,000	5,000		5,000	
1998	Emphasis on synergies of R & Develop. and manufacturing	150,000		75,000 (50%)	5,000	4,000	7,000	
1999		150,000		75,000	5,000	4,000	7,000	
2000-02		150,000	2,000	75,000	5,000	4,000	7,000	
2003-04		150,000	2,000	75,000	5,000	4,000	7,000	1,000
2005	Cap. Budgeting for plant in U.S. & Equity financing	154,000	7,000	77,000	5,000	4,000	7,500	1,000
2006	Approval by State, Federal and County for Alabama Plant	154,000	9,000	77,000	7,700	4,000	7,500	1,000
2007	Production in the U.S.	154,000	10,000	79,000	7,700	4,000	7,500	8,000

PAPER AIRPLANES, INC.: UTILIZING AN IN-CLASS CASE TO DEMYSTIFY PROCESS COSTING

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CASE DESCRIPTION

The primary subject matter of this case is the preparation of a basic process costing report using the weighted-average method. Secondary issues examined include understanding the physical flow of units in a processing environment, the notion of partially completed units, and the understanding of and accounting for equivalent units. The case has a difficulty level of two and is targeted at business students in a sophomore level managerial accounting course and/or MBA students in a graduate managerial accounting course. The case is designed to be taught in 1-2 class hours and is expected to require 1-2 hours of outside review by students following the class. This case is best administered in a class of 10 or more students.

CASE SYNOPSIS

Paper Airplanes, Inc. is a fictitious company organized to produce high-quality paper airplanes using aerodynamically superior paper and highly skilled labor. The company relies exclusively on college students for its labor and management pool. During a one hour class, students will be given an opportunity to "work" for the company by actually producing paper airplanes. Specifically, student volunteers are asked to assume roles as direct laborers, production supervisors, a materials (paper) manager, and, of course, cost accountants (all students). The basic production process is then explained to the class, and student volunteers are given quick training on their roles. Students will also see a few partially completed airplanes from the prior period and will be told that these need to be completed during the upcoming production period. After the training, student laborers will be given just two minutes to actually produce as many airplanes as they can and send (fly) them to the next department. When a production supervisor states that the time is up, the laborers will stop their production immediately. Production supervisors will count completed airplanes (those flown into the classroom), and then all students will assume the role of cost accountants to prepare a weighted-average process costing report. They will need to consider actual production during class and take into account such issues as partially completed airplanes and cost per equivalent unit. This hands-on, visual case is very instructive in its simplicity and ability to actively engage students in learning a challenging topic. Within a short class period, students will have actually participated in a production process and learned all the complexities and difficulties in preparing a basic process costing report.

CASE: PAPER AIRPLANES, INC

To better understand how process costing works, the classroom will be transformed today into a small-scale paper airplane factory. There will be direct materials (paper) and direct labor (student volunteers). Necessarily, there will be some supervisors (more student volunteers). Finally, a legion of cost accountants (students) will round out the participants. We will be looking ONLY at the first of two work-in-process (WIP) departments in the process: assembly. As airplanes are finished being assembled, they are transferred (flown) to the second and final process: painting.

These are fancy paper airplanes. The paper is expensive ($10/sheet), because it is specially designed to be aerodynamically superior. Further, only highly skilled labor is used in the process ($90/minute). Manufacturing overhead costs are applied based on 2 times (200%) direct labor costs.

At the beginning of class, we have three partially completed airplanes that were worked on during the prior period (beginning WIP). Of course, they are 100% complete as to direct materials (paper is the only material); however, they are, on average, only 50% complete as to direct labor and manufacturing overhead. Direct labor cost attached to these is $60.

We need the following six volunteers:

- 3 highly skilled laborers to produce airplanes
- 1 direct materials manager to supply and track paper
- 1 assembly production supervisor to keep track of time
- 3 painting production supervisors to count how many airplanes are transferred (flown) to the painting department

The period to assembly airplanes lasts only two minutes. During that time, the highly skilled laborers will finish the three partially completed airplanes, make as many new airplanes as they can, and transfer (fly) them into the painting department (the middle of the classroom). They will need to requisition paper from the direct materials manager as they need it, and they must stop producing airplanes when the assembly production supervisor calls “times up.” The painting production supervisors will count the assembled airplanes transferred (flown) into the painting department.

After the two-minute production period, the real fun begins. To keep things simple, we will assume that the partially assembled airplanes at the end of the two minutes are, on average, 40% complete. Our task now (as a legion of cost accountants) is to account for the physical flow of airplanes, determine equivalent units in terms of direct materials, direct labor, and manufacturing overhead, compute costs per equivalent unit, and complete a process costing report for the assembly department using the weighted-average method. Remember that our goal for all of this work is to determine how much cost is transferred to the painting department and how much cost remains in the ending WIP of the assembly department.

THE HIPPOCRATIC OATH ON TRIAL

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CASE DESCRIPTION

The primary subject matter of this case concerns health care administration. Secondary issues examined include the code of conduct of physicians and health care professionals, leadership styles, the role of power and conflict resolution strategies. The case has a difficulty level of three (junior level) or higher. The case is designed to be taught in one class hour and is expected to require two hours of preparation time by students.

CASE SYNOPSIS

This case is an example of the testing of a moral code of conduct for a physician and a physician-owned medical practice. Physicians and health care professionals subscribe to the tenets of The Hippocratic Oath or similar codes of ethics for health care providers. In this case a Jewish physician (surgeon) is confronted with the moral obligation of treating a patient who is blatantly anti-Semitic. Moral obligation is further tested as the patient becomes addicted to pain killing drugs as prescribed by the physician. The patient and his father are disruptive in the physician's office and exude threatening behaviors. The medical staff is wondering at what point the father of the patient will move from threats to physical violence. At what point will the patient bring down the reputation of the medical practice and the surgeon because of the patient's addiction to OxyContin which has become a popular street drug.

The health care administrator of the medical practice is loath to come between a physician and his patient. Her role in the medical practice does not typically include interfering with a physician/patient relationship unless the physician is committing an illegal or unethical action—neither of which appeared to be occurring in this case. It is highly unusual for a non-clinical administrator to interject him/herself in a medical matter. However, in this particular situation there were compelling and urgent reasons to meet with the physician to determine the best way to resolve the issue. Discussions of the dilemma can explore leadership styles, the roles of power and conflict resolution and the role of codes of ethical conduct such as the Hippocratic Oath.

THE FIRST "TEST" OF THE OATH

Dr. Michael Goldstein was a general/trauma surgeon in a mid-size town in the Midwest. While on weekend trauma call for St. Mary's Medical Center, he was notified of a three car accident in a town 70 miles away. A severely injured patient was being flown by helicopter to the trauma center that Dr. Goldstein was covering. The patient, Mark Jones had severe abdominal injuries. Dr. Goldstein assembled the surgical trauma team in expectation of the patient's arrival. All was routine.

Upon arrival the patient was assessed by the intake team and the patient was immediately taken to surgery. The patient's condition was critical and the surgery was long and tedious. During the surgery one of the surgical assistants asked the surgeon if he noticed the patient's tattoos. The surgeon affirmed he had noticed the anti-Semitic tattoos: several swastika tattoos, an Aryan Nation tattoo, Posse Comitatus, lightening-bolts with 88 tattooed on both arms, and an eagle over a swastika tattooed across his chest. Most of the patient's body was covered with racist hate symbols. The surgeon commented to his surgical assistant that if the patient knew his heritage and religion he might not want him working on him.

Staying true to the spirit of the Hippocratic Oath, Dr. Goldstein proceeded with operating on the patient while remembering his oath of the special obligation he had to fellow human beings. His primary obligation was the well-being of his patient.

THE CONTINUING TREATMENT OF THE PATIENT

Mark Jones, the critically injured patient survived and was recovering in the hospital in the intensive care unit. When he was moved from the unit to a room on the floor and it was clear that he was stronger, the surgeon broached the topic with him. Dr. Goldstein said, "You must realize that I am Jewish." Mark tried to deflect the topic as if he didn't get the point. Dr. Goldstein never mentioned the issue again. Mark was hospitalized for several weeks but finally progressed to the point of being released from the hospital. He was then scheduled to see Dr. Goldstein in his office for follow-up wound care.

On Mark's first visit to the physician's office, Westgate Surgical, five days after discharge from the hospital, he was accompanied by a very large and intimidating man who presented himself as the patient's father. The father made the staff feel uncomfortable at several points during the visit. For example, in a loud voice the father raised the issue that he was "surprised that such a high and mighty doctor would take Medicaid patients." The staff assured the father that Dr. Goldstein sees Medicaid patients. Then while waiting to see the surgeon, the father complained about the magazines available to read and smirked to the entire waiting room full of patients that "if they mess with me, I'll bring them some real reading material." The father also asked for a restroom and added that "he didn't want to use the one that the doctor used."

When Mark Jones was called back to see Dr. Goldstein, the father accompanied him to the examination room. The difference in the patient's size and the father's size was striking to everyone. Mark was about five feet six inches tall and weighed 137 pounds at 36 years old. On the other hand, the father was about six feet four inches tall and weighted approximately 230 pounds. The father looked to be in his mid-fifties. There was no resemblance between father and son. The father continued his rude behavior with Dr. Goldstein. He questioned the surgeon as to why "the boy" was not well yet and inquired as to what Dr. Goldstein intended to do to get the boy "fixed up." The father described "the boy" as being in such severe pain that neither one of them could sleep—night or day. The angrier the father became, the more subdued Mark became. Mark's behavior toward his father was submissive. When Dr. Goldstein examined Mark he could see that his abdominal wound was not healing well. He cared for the wound, wrote a prescription for pain pills for the patient and told him to come back the next week or sooner if necessary.

At the next office visit, Mark came in alone and told the receptionist that he made his dad stay in the car and he hoped he wouldn't have to wait long because he didn't want his dad to come into the office. The staff made sure that Mark was seen quickly. When Dr. Goldstein entered the examination room the patient immediately apologized for his father's behavior and told the doctor that he wanted to thank him for saving his life. Mark insisted to Dr. Goldstein that he was suffering from severe pain and said that he had used all his pain medication and asked if he could give him something stronger. Dr. Goldstein complied with the request because the abdominal wound still was not healing well. When Dr. Goldstein and Mark discussed the time for the next appointment, Dr. Goldstein remarked that he couldn't see Mark late in the afternoon as he requested because he was taking off work early to take his wife to a professional baseball game.

The weekly visits continued for two months. The abdominal wound still was not healing completely and Mark continued to complain of severe pain. Approximately every other visit Mark's father would join Mark at the appointment. Mark and his father began to act out "good cop, bad cop" scenarios during the visits. The father was aggressive and attempted intimidation but when Mark came alone, he was extremely friendly to the point of asking the doctor personal questions about his wife and children.

At one visit Mark's father began to make accusatory remarks about Dr. Goldstein's ability as a physician. Dr. Goldstein reminded Mark and his father of Mark's injuries and of the progress that he had made toward healing. He ordered medically appropriate testing to try to determine if Mark's inability to heal was due to a deficiency that could be corrected with diet or injections. He told both Mark and his father that it was important for Mark to become healthier in his lifestyle so that he could build his body up so that he could heal. Mark continued trying to ingratiate himself to the doctor and to ask for stronger pain medication. Finally Dr. Goldstein complied by writing him a prescription for OxyContin.

Three days later Mark called in tears saying that he had lost his bottle of OxyContin and that he couldn't stand the pain. The doctor called in another prescription. That incident raised suspicions with Dr. Goldstein's staff. Meanwhile, Mark's efforts to become more personal with the doctor began to seem extreme. Over the weeks that followed, Mark began to bring personal tokens of appreciation to the surgeon. At one visit Mark brought in baseball cards for Dr. Goldstein as a gift because he remembered that the surgeon liked baseball. Dr. Goldstein later learned that two of the cards were collector items and he gave them back to Mark insisting that he could not accept a gift of such value. At another visit Mark brought an inexpensive necklace and asked the surgeon if he would take it to his wife. Dr. Goldstein told Mark that he could not accept gifts of appreciation anymore and explained that he was appreciative of the gestures but that no other gifts would be received. At the next visit Mark presented the surgeon with a poem that he had written for him. Dr. Goldstein thanked Mark for the poem.

Over a period of several months, Mark's abdominal wound continued to display problems with proper healing. During this time calls were made to the office by both Mark and his father for appointments to see the surgeon. Mark's calls were pleading calls and the father's calls were demanding calls. These behaviors together had caused the surgeon's office staff to be cautious of dealings with Mark and his father.

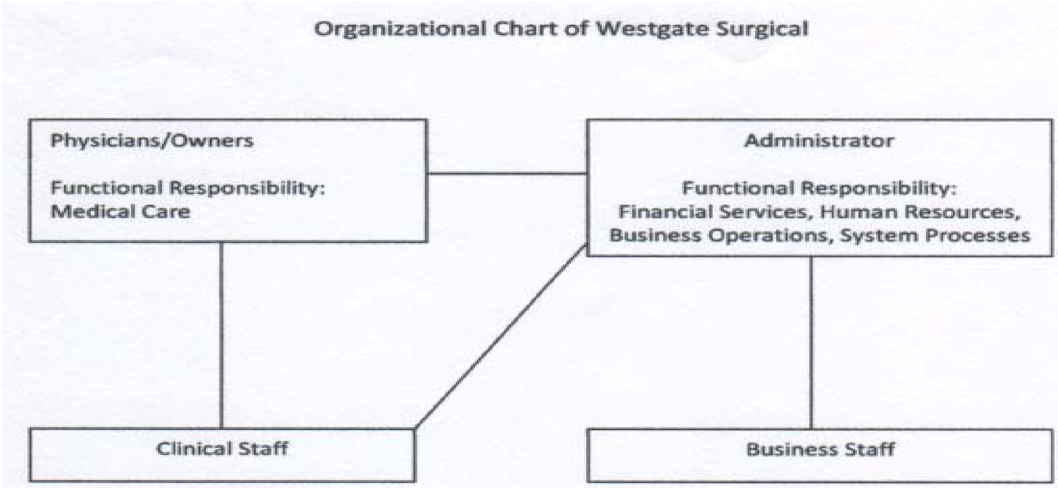
THE MEDICAL PRACTICE'S ADMINISTRATOR AND STAFF

Dr. Goldstein's office, Westgate Surgical is the physician's home base. It is the place where patients who are not in the hospital are seen, where patients are scheduled for surgery and seen in follow-up after surgery. It is where all patient records are housed and where all financial transactions with both insurance carriers and patients are generated and resolved.

At the onset of developing the organization the physician owners of Dr. Goldstein's group made a dedicated effort to hire well trained, high quality staff. For example, the organization employed Registered Nurses to deliver care for patients rather than less well trained persons. Licensed Practical Nurses and clinical staff work under the supervision of Registered Nurses. Likewise, the organization hired an administrator qualified by formal education as well as by professional certification. The administrator, Susan Smith had attained the highest accreditation offered by the American College of Medical Practice Executives. The group's dedication to high quality staff is supported throughout the organization. Personnel working for the group are trained to think of themselves as professionals. They are instructed to think of themselves as an "extension of the physician's arm." All members of the staff (clinical and business) are aware of their role and how it integrally fits into the organizational structure. The organizational culture is such that all roles are respected. Rather than creating a hierarchy, Westgate Surgical strives to be a learning organization. There is an emphasis placed on a shared value by all organizational members that the work done by each individual is equally important to the work done by anyone in the organization. The group lives by the mantra that the whole is bigger than the sum of its parts and each team member sees the vital role they play in the organization.

As the administrator of Westgate, Susan Smith understood the value of having the staff trained to use effective problem-solving techniques and empowered to make decisions. Best practices in the industry suggests that there be an understanding that medical office staff members regularly make decisions using general problem-solving processes in the context of the circumstance at hand (Holt 2009). Staff members are encouraged to examine areas in the organization that may compromise the organization, physicians, staff, or patients and they are encouraged to bring those concerns to light, not in a capricious manner but rather in the spirit of esprit de corps.

Figure 1



THE DILEMMA

Typically surgeons see patients for a short period of time. All major surgery includes 90 days of post operative care in which the patient is seen without charge. That period of time is normally enough time for any issues relating to the surgery to resolve. The numbers of visits from Mark to Dr. Goldstein were extraordinary. The substance and tenor of the visits raised red flags for the staff members to the point that they came to Westgate's administrator, Susan Smith with their concerns. They expressed that they were afraid of the father, that they suspected that Mark was illegally selling the OxyContin prescribed to him on the street and that they were sure that Mark was addicted. These perceptions caught the immediate attention of Susan. Her concern was heightened by the national and regional awareness of OxyContin abuse. Local and regional news media had made reports that OxyContin was accessible on the street in the town where Mark called home. There were reports of patients going to multiple physicians and multiple pharmacies to obtain this highly addictive pain killer and then selling the product on the streets. As Westgate's administrator, Susan felt immediate concern for the reputation of the practice and for the surgeon's personal reputation and standing in the medical community. While the administrator knew the surgeon to be of high quality, both in surgical skills and ethically, she immediately sensed a problem.

An administrator's role in the medical practice includes primarily governance, business/financial, human resources, and information technology management as well as patient care, quality, and risk management systems. The risk management component deals with purchasing liability insurance, corporate compliance, and such but it is not typically directed toward an administrator interfering with a physician/patient relationship unless something the physician is committing is illegal or unethical—neither of which was occurring in this situation. It is highly unusual for an administrator who is a non-clinical person to interject him/herself in a medical matter relating to the way the physician is treating the patient. Under normal circumstances the administrator, Susan Smith, would never have intruded in territory that was not under her purview and thus she struggled with this issue.

Susan elected to address the issues with Dr. Goldstein out of concern for him and the practice and she set up a meeting with him. Susan felt compelled to assist in the resolutions of the conflict but wanted to respect the physician-patient relationship. How should the meeting with Dr. Goldstein be handled?

REFERENCES

Holt, Sarah J. (2009). *Get the Money in the Door*. Englewood, CO: Medical Group Management Association.

ADDING VALUE AT H & H FINANCIAL SERVICES, LLC.[1]

Deepthy Marunninal, Long Island University – Brooklyn Campus
Adva Dinur, Long Island University – Brooklyn Campus
Herbert Sherman, Long Island University – Brooklyn Campus

CASE DESCRIPTION

This field-based, disguised teaching case describes the birth and continued growth of H & H Financial Services, LLC and how that growth has impacted work processes and procedures. The data for this case was gathered through personal experience of the primary author and interviews of co-workers. The case was written primarily for an undergraduate class in organizational behavior although it has applications to courses in small business, human resources, and strategic management.

The case follows a new hire, Debbie Matthews, as she faces the challenge of dealing with what appears to be a dead end job in that she has little opportunity for job enlargement and enrichment. After 11 months of working at H & H Financial and do the same old job with little to no challenge and growth potential, she wonders if it is worth it for her to stay with the company. Complicating factors in her decision include being a single mother, attending graduate school, and a very tough economic job market.

CASE SYNOPSIS

The case begins with a description of Christopher Blake's birth and growth of H & H Financial Services LLC. Mr. Blake, finding that a large corporate financial services firm was more interested in selling product than helping its clients, founded a part-time financial services firm which put people's needs above sales goals. With the growth of his little start-up venture, Mr. Blake left corporate to work full time in his burgeoning business and ended up hiring Jane Sutton (a former office manager in his corporate office) and two recent college graduates. The firm grew, moved into new office space, and was then reorganized by the now "office manager" Jane who created two departments; supplier and customer relations. Each college graduate became supervisor of the department as Mr. Blake also expanded his side of the operation by hiring two new agents who he was personally responsible for training and managing.

The firm continued to grow and moved once again while retaining its "departmentalization by function" organizational structure. Mr. Blake continued to manage the "front office" (client contact) side of the business while Ms. Sutton managed all of the back office customer and supplier services through her supervisors. Although each supervisor ran a "fun" department Jane ran a much more formal operation where "playing" was kept to a minimum.

The case is written from the perspective of the character Debbie Matthews, a recent college graduate who was hired by H & H Financial right out of college. A single mother in graduate school, Ms. Matthews is at first highly elated about the job given her desire to learn everything that she can. Reality sets in though when after two months she finds that all of her questions about how things work in her office are answered by Ms. Sutton in basically the same way; you do not need to know.

At the end of the case Ms. Matthews is wondering whether she should stay with the firm given her flexible schedule and her need to take care of her daughter or whether she should quit and find a job that she can grow with and continue to learn.

INTRODUCTION

"That doesn't concern you" was the response that resonated through the halls; a rejoinder that Debbie Matthews had heard a thousand times from Jane Sutton, the office manager, and was likely to hear again and again. It was around September of 2008 and after working at H&H Financial for 11 months, this was the same retort to all of her inquiries. Ms. Matthews thought to herself "I can't take this anymore! Why is it that none of my questions ever get answered? Why am I not allowed to learn here? What is my value to the company? Why do I still feel like an outsider? Why can't I use and improve my skills? Why? Why? Why?" Ms. Matthews was fuming as she walked out of yet another one of Jane's tiresome monthly office meetings having lost all motivation and feeling completely defeated. She was ready (and not for the first time) to walk out of the front door never to return again; but the decision was not that simple and could not be taken lightly. Money and a very tough job market were important factors that had to be considered when making such a decision as Ms. Matthews was a single mother attending graduate school.

Ms. Matthews also thought about how the firm had evolved from a small one person operation to a small, fast growing business. She questioned her potential for personal growth and development and what role she could possibly play in the firm's expansion. Ms. Matthews was in a serious dilemma; should she stay for the money and hope that things would change or should she go and find a more challenging job? She thought about the firm's current status and its history as told to her over time with the firm by the founder, Mr. Christopher Blake. (See Appendix A for its product line and services.)

IN THE BEGINNING …

H & H Financial was founded in 1997 as a local insurance and investment consulting firm specializing in financial, estate and retirement planning. The owner, Mr. Christopher Blake, age 45, had been working with senior retirees and growing families for over 20 years. The business started as a part-time consulting practice given Mr. Blake's dissatisfaction with his full-time job working for a franchise office affiliated with a large insurance agency. Mr. Blake found that his agency's focus on productivity and "numbers" precluded his ability to provide what he really wanted to do most for his clients; provide them personalized service that they could trust. He wanted his clients to be faces, not names and numbers, and he wanted to offer them the optimal products and services that would best fit their needs, not the "selling needs" of corporate hyping their latest product through their franchises.

Mr. Blake bid his time and learned "the ropes to skip and the ropes to know" about how to run an agency. He obtained several key financial and insurance licenses and professional certifications (i.e. CFP, CFA, CFT, CTEP, etc…) as well as financial product suppliers. When he had developed a large enough private client base (with a growing list of potential clients as well) so that he could make enough to live on, he left his job and reopened H&H as an independent agency to replace his consulting practice.

The firm started with just Mr. Blake operating out of a cheap store front and he was quickly overwhelmed with the "paperwork" side of the business. Mr. Blake was great at selling, knew the product lines in and out, but he was not an expediter nor comfortable with details. Debbie Matthews, from her own interactions with Mr. Blake, easily confirmed this part of his story, if you gave any client paperwork to Mr. Blake it would quickly disappear to "somewhere" in his office and never be seen again.

Mr. Blake's solution was to quickly hire a part-time administrative assistant to handle phone calls, deal with foot traffic (what little there was), and do some light computer work. It was a no-frills operation, except for Mr. Blake's own high end Apple laptop and printer; bag lunches and dinners (except when he met with clients for meals) were the order of the day. Advertisements in the local newspapers, penny savers, and late night spots on the local cable channel kept a slow but steady stream of customers walking into his store and that was all that Mr. Blake needed in order to "work his magic" and develop a customer base.

Times were not easy and Mr. Blake squeaked by on a very limited income. Yet he always looked nostalgically back at those days "in the hole" (his office) and called them "the golden years." Ms. Matthews recalled one conversation with Mr. Blake about the early years of the firm as if it were yesterday. "I was a maverick back then" said Mr. Blake. "A rebel with a cause. I went right from college into a corporate shop, detested it, then rejected it, and decided that I knew better and was going to do it all on my own. I wasn't in it for the money, although I certainly would not have turned it away, but I really wanted to be my own boss, set my own rules, and by doing so deliver real value to the people I served; and I did just that! I could rattle off my client list right off the top of my head, tell you each and every client's needs, and even, in some cases, their birthdays. I might have been broke, working crazy hours, but I was very happy and content."

EARLY SUCCESS LEADS TO GROWTH

Mr. Blake's formula for success quickly caught on and he found that he needed full-time assistance in order to help handle phone calls, process policies, and assist with claims. His office expanded quickly from one part-timer to three full timers who, as he would often say to Ms. Matthews and the other office staff, "buffered him" from the mundane paperwork and day to day office duties. He remained the sole "consultant" providing sales and expert advice and counseling while the staff provided his clients with all of the support they needed in terms of what he called "back office work" (processing bills, claims, questions about policies, etc…). His office staff, consisted of one office staff person from Mr. Blake's old agency (Jane Sutton) and two "raw" college graduates, and for the most part worked independently of Mr. Blake. Although Mr. Blake never gave any of them titles, job descriptions, or formal authority, Ms. Matthews was told by Mr. Blake and her immediate supervisor that it was clear to everyone that Ms. Sutton was the informal leader of the office given her expertise and prior experience in an insurance office.

Ms. Sutton first worked with Mr. Blake to develop office procedures and systems and then worked with the two "rookies" to ensure that the systems were in place in terms of customer/supplier management and accounting. The work was challenging since Mr. Blake hated detailed paperwork and office systems but fun (Ms. Sutton had a background in teacher education and made every task a game) and in sixth months Mr. Blake and Ms. Sutton had ironed out all the major office procedures while the two rookies became fully trained and integrated into the operation. At that point, according to Ms. Matthews' immediate supervisor, Ms. Sutton's leadership faded and all three employees became flexible generalists; part of a self-managed work team. Ms. Matthews thought to herself that that would have been a great time to have joined the firm since she would have had the opportunity to learn all phases of the business. Ms. Matthews wondered, "What had happened to change the work environment?"

Work then was parceled out through volunteerism and cooperation – Ms. Matthews recalled Mr. Blake saying how proud he was that his team at that time operated so well without his input. "I had a well oiled machine and I knew it. This allowed me to focus on what I knew and did best; direct client contact and analysis of their financial needs." Mr. Blake would usually express these sentiments at the then informal monthly meetings; usually over a beer and pizza after hours. Ms. Matthews wondered what it would have been like hanging around with Mr. Blake after hours since this practice was discontinued prior to her joining the firm.

MORE GROWTH, NEW DIGS, MORE PEOPLE

Mr. Blake's old office had an open front area where his three employees worked and a back office where he met with clients. As the business grew, Mr. Blake realized that he would need to bring in new agents (consultants) to help him deal with the increasing flow of customers

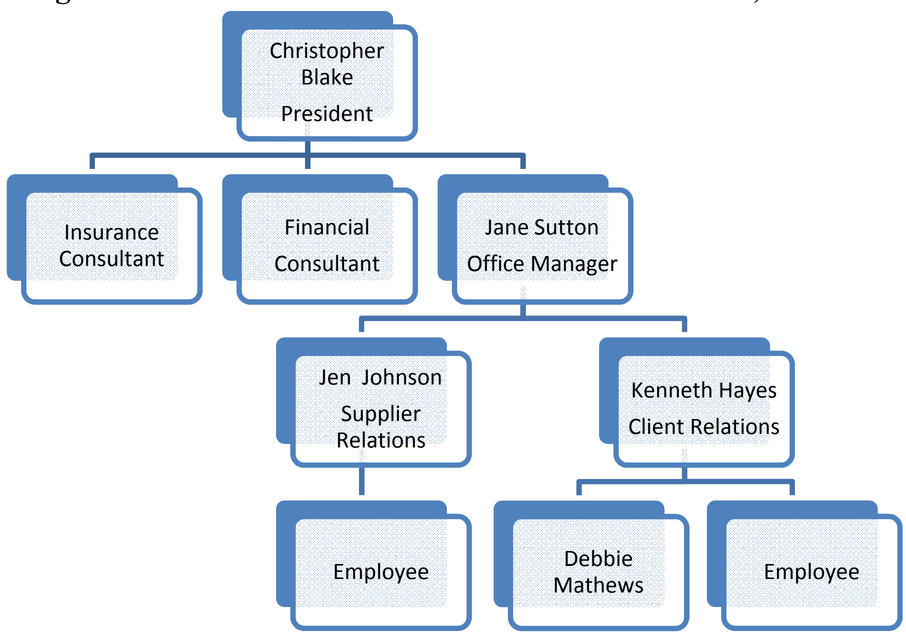
and there was just no place to put them. A search found a newly renovated office complex (an old doctor's office) just a few blocks away which had separate executive offices and a main office area that could seat 6 employees and a small but separate waiting area for his clients.
Mr. Blake and his small team gave a thumb up to the office and quickly settled in. Mr. Blake hired one financial planner and one insurance agent so as to provide more sales and technical expertise to his consulting team. The new associates worked out so well and his business grew so quickly that within a three month period, three new staff people had to be hired (all recent college graduates) to help Ms. Sutton and her old crew manage the additional workload ; Ms. Matthews was one of them.

THE BIRTH OF DEPARTMENTS

Ms. Matthews' supervisor told her when she first came on the job that before the new staff was hired Mr. Blake made Ms. Sutton the office manager while Ms. Sutton made her now "old rookies" each supervisors. Jeffrey Johnson became in charge of supplier relations (dealing with the products and services), and Kenneth Hayes ran client relations; Ms. Matthews' supervisor. (See Figure 1 below, Organizational Structure of H & H Financial Services, Inc.)
Ms. Matthews had heard from Ms. Sutton that this new structure was highly efficient from Ms. Sutton's perspective since it allowed Mr. Johnson and Hayes the time to develop their own expertise and familiarity with their specific focal group. These new department managers would handle the day-to-day work routine of their own department with their new staff while Ms. Sutton served as coordinator and in-house expert; the answer person. This structure also made the assignment and training of new office personnel much easier since each employee was allocated to one of the two departments where their supervisor would then provide them with basic training within the department.

Ms. Matthews learned from Hayes that work flow paralleled the organizational chart. (See Figure 1 "Organizational Structure of H & H Financial Services, Inc.) New clients would be brought in by Mr. Blake or his two consultants and that information would then be sent to Ms. Sutton who would then hand it off to Hayes in charge of client relations. He would then have the information entered into the client database by Ms. Matthews or her coworker. New suppliers (insurance carriers) would go the same route (through Ms. Sutton) but then the work would be allocated to Mr. Johnson who would then hand this off to her subordinate. Once in the database, clients and suppliers would then contact their respective departments in terms of service and informational needs.

Figure 1
Organizational Structure of H & H Financial Services, LLC



Mr. Hayes and Mr. Johnson kept the "fun" atmosphere of the workplace within their departments which Ms. Matthews greatly appreciated. Ms. Sutton however wanted the office to have a more professional demeanor since she felt that H & H was now an "established firm" with expert consultants on staff who also seemed to not appreciate the horseplay of the office workers. For Ms. Sutton maintaining an expert image became everything and therefore she went to great strides to minimize office antics (like wastebasket basketball) and excessive chatter. Mr. Hayes and Mr. Johnson were not happy with the new "rules" but went along with them since most of the time they spent in their own work areas and away from "the back office" where Ms. Sutton stayed and did most of her work. Besides, they knew (although Ms. Matthews found his hard to believe) that underneath that now tough exterior Ms. Sutton was a "buddy" who had given them their first real jobs out of college. However, the change in rules did create tension between the newest employees (including Ms. Matthews) and Ms. Sutton since the new employees' supervisors acted differently around Ms. Sutton while they otherwise maintained a very happy go lucky work environment. Ms. Matthews quickly learned that she could "play" with Mr. Hayes and even Mr. Johnson when Ms. Sutton was away from their work area but she had to be on her best behavior when Ms. Sutton was around or when they went into "management" territory.

Ms. Matthews noted that the old companywide informal monthly meetings with Mr. Blake became formal monthly meetings just with Ms. Sutton and all of her subordinates. Rarely would Mr. Blake or the other agents attend these formal meetings that were run by Jane (they had their own meetings) though everyone would meet quarterly to discuss the firm's overall performance. The monthly meetings without Mr. Blake consisted of discussions of new products, services and/or clients, new procedures, and any outstanding problems that either department could not solve alone. These were open meetings but rarely did anyone but Ms. Matthews raise questions, and these questions were always about work processes and procedures. Everyone else, including the supervisors, only spoke when Ms. Sutton spoke directly to them or asked very general questions about the growth plans of H & H.

Mr. Blake led the quarterly informational meetings which included presentations by the other consultants and Ms. Sutton on the current and future plans for their areas. No one else from the office staff usually spoke at these meetings (even Ms. Matthews) unless specifically asked to do so. Mr. Blake did not go out of his way to engage the office staff since he felt that those actions would usurp Ms. Sutton's authority and legitimacy with her team.

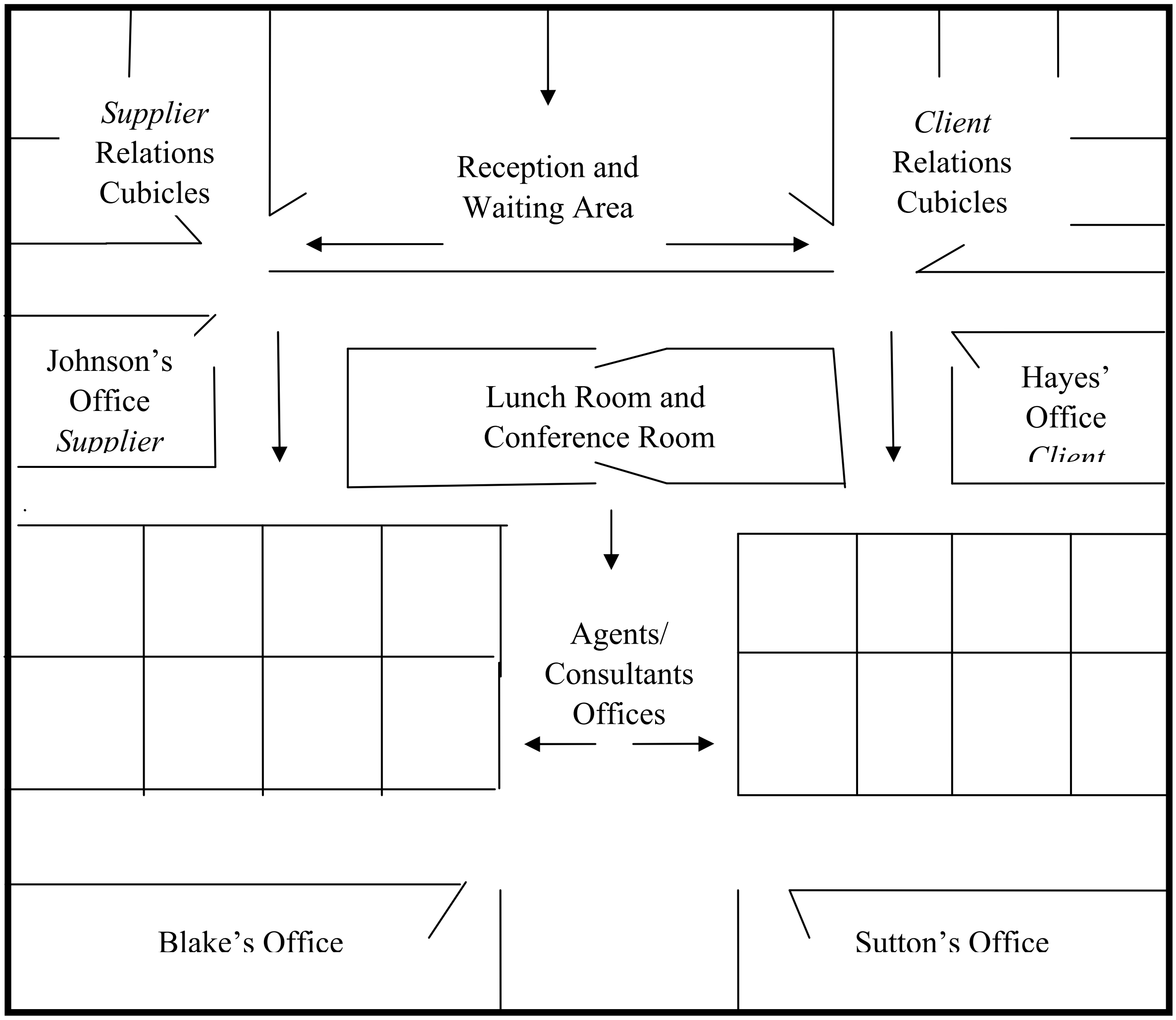
From Ms. Matthews's perspective Mr. Blake was quite happy with Ms. Sutton's new office configuration since it allowed him to once more concentrate on his clients and stay out of the office operations. He could now work with his other specialist consultants to help locate new clients as well as new products and services. This was often voiced by Mr. Blake as a critical operational strategy for continuing to grow the business yet Ms. Matthews questioned how his laissez-faire approach impacted her job and the operation of the office.

ANOTHER MOVE

With sustained success, the organization continued to grow, adding several more consultants and back office staff while keeping the same basic organizational structure and workflow. Mr. Blake once again needed new office space to contain his firm's growing needs and he moved his operation about a mile away to an office complex with larger accommodations where he, each consultant, Ms. Sutton, and her supervisors had their own office space while the other employees worked out of their own cubicles. This new space had several open, unused offices since Mr. Blake wanted to expand his operation to include accounting, tax preparation, and legal services (a paralegal and tax preparer to begin with, perhaps an accountant and a lawyer later on). (See Figure 2, Office Layout of H & H Financial Services, LLC.)

From an operational standpoint, however, nothing changed. Ms. Sutton continued to run all of the office functions and served as a liaison between Mr. Blake and the employees. Ms. Matthews learned at a quarterly meeting that Mr. Blake was focusing even more of his time on the firm's strategic growth and landing "big fish" (corporate clients) – a seeming shift in the firm's basic strategy. Mr. Blake also announced that he was starting to conduct preliminary inquiries as to a possible "number two" who would handle the ever growing functions of finance, accounting and human resource management; a job that Ms. Matthews aspired to after she completed her MBA degree.

FIGURE 2
Office Layout of H & H Financial Services, LLC
Street Entrance



Ms. Matthews noticed that the new large sitting area required the firm to hire a receptionist who then handled "walk-ins" and who would also orient the new clients to all of the services provided by H & H. The receptionist would also, on occasion, administer customer questionnaires that dealt with customer service satisfaction as well as desired additionally services. Ms. Matthews was sorely tempted to take this job because the receptionist reported to Mr. Blake, not Ms. Sutton. She quickly let go of the notion though since she would be devolving in terms of her career and personal development, not growing.

REMINISCING ABOUT HER FIRST FEW MONTHS AT H & H

As frustrated as she had become with the current work environment, Ms. Matthews Matthews affectionately thought back to when she was looking for her first job in New York City and was hired by H & H. As a recent college graduate and single mother, Ms. Matthews was excited when she got the job working for H&H Financial as their assistant case manager in the client relations department. H&H Financial was a small but growing insurance firm of 12 people and Ms. Matthews was happy to see that all of the office employees were around her age. Ms. Matthews was more than delighted to be there so that she could learn as much as she could and expand her knowledge and skills. She quickly and eagerly learned all of her required duties and executed them to the best of her ability. Mr. Hayes was very pleased with her work, highly complementary, and gave Ms. Matthews's more and more demanding work. This fit well with Ms. Matthews's motto which was to continuously learn from mistakes, and to ask questions to improve and expand one's mind and knowledge. As such, Ms. Matthews was always ready and excited to face the challenges that were presented to her.

In her second month with the firm they moved to a much larger office space which bespoke well of the firm's continued growth and success. Ms. Matthews thought that she had real opportunities for advancement and promotion ("as the firm grows, so will I") and thought that she had made an excellent choice in a very tough job market. She was aware of Mr. Blake's preliminary search for an assistant manager and thought that with her MBA in hand (less than a year away) she would be the perfect candidate once she had learned the ins and outs of the business.

The dream however quickly became a nightmare. Ms. Matthews found that after the first few months of working at H&H Financial, her learning curve came to a complete and sudden halt. Ms. Matthews realized that jobs were very compartmentalized and the office manager Jane Sutton did not want the employees to learn anything more than the bare minimum of what their jobs in their own departments required of them - the firm seemed to have a "don't ask, don't tell" policy.

Mr. Hayes was very helpful and supportive about the work in his department, but when Ms. Matthews asked questions about interdepartmental and organizational processes he deflected most of her questions saying "I'm really not sure why we do things this way, check with Ms. Sutton." Ms. Sutton's response to Ms. Matthews's questions was always the same, "I'll tell you what you need to know when you need to know it … just do your job, do it well, and you'll get along fine." Ms. Matthews thought that perhaps with a few more months on the job Ms. Sutton would learn to trust her more; and she couldn't have been more wrong.

During the Ms. Matthews's third monthly office meeting, Ms. Matthews became increasingly irate when her questions were still be answered by Ms. Sutton with "you don't need to know that", or "you will never deal with that situation", or worse "that's not your concern". Ms. Matthews found that these were the answers to even the simplest of questions dealing with the most essential parts of the business outside of her department. This approach made it difficult for Ms. Matthews to properly do her job because she did not see how her job related to the other jobs in the firm.

In summary, Ms. Matthews thought there was a clear lack of communication between the owner, Ms. Sutton, the two supervisors, and the employees and that this created slowdowns and gaps that bottlenecked the flow of the entire work process of the business. She also noticed that not only was her job compromised by this lack of knowledge, but also, in her opinion, everybody else's. All of her questions regarding this matter were not only disregarded by Ms. Sutton but discouraged as well. Ms. Matthews thought that for such a small but fast growing company, the operations would run much smoother if all of the employees were aware and informed about each other's jobs for they were all dependent and interrelated to each other. Overall Ms. Matthews felt that Ms. Sutton was overly controlling and excessively formal even though Mr. Blake was charming, supportive, and quite friendly.

After several attempts to learn more about her job, Ms. Matthews was starting to lose motivation. She felt like a robot that was programmed to do the same thing day in and day out and it was starting to affect the quality of her work. She was surprised and disappointed to learn that she no longer cared about her performance, her job, and the firm. This is when she realized that by staying at H & H she was starting to compromise her work ethic; her values of always striving to achieve and working to the best of one's ability. Ms. Matthews also found out that she was not the only one feeling less motivated and interested. At least two other people who started before her felt the same way but never said anything to their immediate supervisor or Ms. Sutton.

With all this negativity surrounding her work life, the decision to leave was still a difficult one to make. The company had some great employees in her department that made it fun to come to work every day. Since everybody was about the same age, people got along well. Ms. Matthews also liked the relatively laid back environment in the department and the flexibility of hours the job offered, especially considering that she was now in graduate school. However, Ms. Matthews was not sure if that was enough; after 11 months of working at H & H she wondered if it was worth it for her to continue working there. On the one hand, Ms. Matthews knew that she had no future at the company. She was pursuing her MBA and she now knew that that would not make a difference for her future at H & H. Ms. Matthews wondered, "What is the point in spending money and time to get a graduate degree if it is never going to be appreciated or add value to my career at H & H? Should I stay at a place where there was no chance for growth and no value given my curiosity and desire to learn? At the same time, is it a bad decision to try to change jobs right now considering the downturned economic climate, my need for a flexible schedule for graduate school, and my financial responsibilities? Should I stay simply for the money and my flexible schedule?" Ms. Matthews realized that she had an important decision to make and she had to make it soon before she became completely unmotivated.

END NOTES:

1. The name of the firm and the case characters have been disguised at the request of the firm's owner.

Appendix A
H & H Financial Services, Inc. Products and Services

Financial Consultant & Retirement Planning. H & H are independent financial advisors offering financial & retirement planning services on a commission or fee basis. They assist clients in implementing the correct insurance and investment strategies that meet their stated needs and objectives and that stay within the boundaries of their risk profile.

Estate Planning. They offer comprehensive estate planning programs. They will review both investment portfolios and other personal vehicles such as Wills, Trusts, and insurance programs to ensure that a financial plan meets clients' personal and independent objectives. Independent lawyers, tax accountants, and insurance specialists may be involved with this process.

Insurance. As insurance professionals, they offer a full portfolio of high-quality insurance products including life, long-term care, disability and variable products. They assist clients by reviewing their current and future needs and recommending the many ways insurance can provide the protection they need for themselves and their loved ones and the peace of mind they deserve.

Life Insurance. Life insurance provides either a stated sum or a periodic income to a client's designated beneficiaries upon their death. Certain "life events" such as marriage, the birth of a child or a change of jobs trigger the need to buy or add life insurance. Deciding the need for life insurance is the first step. The next step, deciding what kind of life insurance, is where H & H provides assistance. They offer a variety of policies to fit a variety of needs.

Health Insurance. Health Insurance is an important aspect of a client's overall financial and life security. Minimizing the health care expenses associated with illness and accidents for the client and his/her family is easy to do and the client has many options for coverage. Whether the client is an individual looking for personal health coverage, a small business wanting to create a health insurance benefit for employees, or a large corporation, H & H will match the plan to the client's budget and health care needs.

Long-Term Care Insurance. Long-Term Care is the only insurance plan that offers protection from exhausting savings for a long-lasting illness or disability. Half a million Americans fall into poverty while paying for long-term care. Medicare covers a small fraction of long-term care and it is limited to skilled nursing care, which isn't the same as custodial care - the kind of long-term care most people need. Some private health insurance plans cover a month or two of skilled nursing after a hospital stay, but that's all. To qualify for Medicaid, the individual in question must deplete most of his or her assets and contribute nearly all of his or her income to meet the program's poverty requirements. Planning ahead with a Long-Term Care policy can protect a client and his/her family from losing their life savings to pay for needed services if the client becomes chronically ill or infirm.