Volume 17, Number 6 **Printed ISSN: 1078-4950**
PDF ISSN: 1532-5822

JOURNAL OF THE INTERNATIONAL ACADEMY FOR CASE STUDIES

Instructors' Notes

Editors

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

The *Journal of the International Academy for Case Studies* is owned and published by the DreamCatchers Group, LLC. Editorial content is under the control of the Allied Academies, Inc., a non-profit association of scholars, whose purpose is to support and encourage research and the sharing and exchange of ideas and insights throughout the world.

The *Journal of the International Academy for Case Studies* is owned and published by the DreamCatchers Group, LLC, PO Box 1708, Arden, NC 28704, USA. Those interested in communicating with the *Journal,* should contact the Executive Director of the Allied Academies at info@.alliedacademies.org.

EDITORIAL BOARD MEMBERS

EDITORIAL BOARD MEMBERS

EDITORIAL BOARD MEMBERS

EDITORIAL BOARD MEMBERS

TABLE OF CONTENTS

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 instructors' notes contained in this volume have been double blind refereed, simultaneously with their respective cases. The cases were published in a separate issue of the *JIACS*. The acceptance rate for manuscripts in this issue, 25%, conforms to our editorial policies

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 upper-level 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. She agreed to Shaw's terms and conditions (see Exhibits). 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.

RECOMMENDATIONS FOR TEACHING APPROACHES

We use this case in conjunction with Lesikar, Flatley, and Rentz's *Business Communications* (11th edition) after classroom coverage of bad news and persuasive messages, and following a three-day workshop in interpersonal skills training. This case enhances student understanding of the effective writing strategies in composing a complex message that is thorough and tactful, concrete and behavioral, yet clear and concise. Ideally, it must also maintain goodwill between the parties involved, especially in circumstances where it is feasible to resolve a conflict without getting into litigation. Students are further instructed that *how* a request is made—rather than the *nature* of the request-- often determines the success or failure of the response. In addition, this multi-disciplinary case can promote discussions in business law as students examine the legal ramifications of contract law and consider such issues as bailment, fraud, fiduciary duty, and breach of contract.

Although most strategies for bad news messages advocate using only the indirect order in these types of messages, the writing strategy for this scenario involves using both the indirect and direct approaches in writing an escalating series of bad news messages and further emphasizes the use of rational and/or emotional appeals to persuade. This case further lends itself well to strategic considerations involved in handling or making requests and draws on techniques from Blakeman, Keeling, Pierce, and Carkhuff's *Interpersonal Skills for Correctional Management*.

Students are encouraged to begin their series of letters with a mild (polite) request for reasonable action. It is generally preferable if direct confrontations are avoided. Mild requests are often quite effective in getting a desired result and allows the Consignor room to move to a stronger position later. Should the Consignee decline to respond to this initial request, however, he then places himself in the undesirable position of having caused the further escalation of the disagreement and deterioration of the business relationship.

DISCUSSION QUESTIONS AND WRITING ASSIGNMENTS

Preliminary Questions

1. Before beginning the first letter in the series, students are asked to consider the elements of the relationship between Alan Shaw (the Consignee) and Marilyn McKenzie (the Consignor) in this case. How does this "relatedness" determine the effectiveness of communication between all parties? Their "relatedness" is primarily governed by the oral and written terms agreed upon prior to the sale. Students must review those terms before writing the initial letter; the buffer paragraph would ideally mention those terms of payment previously agreed upon by both parties.
2. What two things should business writers keep in mind when making a request? Be concrete and specific. Be behavioral.
3. What impact may other external factors have had on the Consignee's ability to pay his Consignor? Intentional fraud, financial difficulties, checks from buyers that may not have cleared.

Writing Assignments

<u>Bad News Letter—Mild Request.</u> For the mild request, the student would use the classic or textbook pattern for bad news messages in composing the letter to the Consignee (Alan Shaw). Such letters typically begin with a buffer paragraph, after which follows the bad news (indirect approach). The buffer is a negotiation technique that sets up a positive tone. Buffers can voice agreement or express appreciation. In this case, for example, students might begin with the contractual obligations that both parties initially agreed upon. In the second paragraph, the bad news is the Consignor's (Marilyn McKenzie's) request for payment. The request must be specific and should detail what she specifically wants the Consignee to do and when. The actual request at this stage might look something like this: Would you please [request] because [reason]? Or: I would appreciate it if you would [request] because [reason]. Use of mild language is emphasized in this letter. Students should also be encouraged to include an appropriately written goodwill ending for this letter which will contribute to a positive outcome.

<u>Bad News Letter—Moderate Request.</u> After receiving no response from the Consignee, the Consignor is now free to move to a stronger, more direct request for action. Although the second letter must still communicate Marilyn McKenzie's request for payment, it must also document Alan Shaw's non- response and perhaps also the consequences the Consignor faces due to the lack of timely payment. The students are encouraged to depart from the typical indirect approach of bad news letters and begin directly with bad news--the request for payment. Again the request should be specific and should detail specifically what the Consignor wants the Consignee to do and when. In addition, students must pay particular attention to strengthening word choice and constructing shorter sentences, both of which add emphasis to the overall message. The actual request at this second stage might look

something like this: I want you to [request] because [reason]. Again, students should be encouraged to include an appropriately written goodwill ending for this letter that will contribute to a positive outcome.

Bad News Letter—Strong Request. After again receiving no response from the Consignee, the Consignor can now move to an even stronger request for action. The third and final letter must again communicate Marilyn McKenzie's request for payment. It must also document the Consignor's lack of response and perhaps also the consequences the Consignor faces due to the lack of timely payment. Additionally, the Consignor can now detail to the Consignee the consequences of his not responding to this final request. The students will begin directly with bad news--the request for payment. Again the request should be specific and should detail specifically what the Consignor wants the Consignee to do and when. In addition, documentation of the Consignee's inactions must be detailed using concrete and specific language and dates. Again, students must pay particular attention to strengthening word choice and constructing shorter sentences yet again, both of which add emphasis to the overall message. The actual request at this second stage might look something like this: I want you to [request] because [reason]; if you do not comply with this request, you will force me to [consequential action]. Students should also include a deadline for the Consignee to response, after which the Consignor may threaten to take (legal) action. Students should include a terse and brief goodwill ending for this letter that contributes to a positive outcome.

NOTE: Escalating letters written by students collaboratively create additional opportunities for lively discussion regarding the wording, adaptation, and organization of each message.

Post Discussion Questions

1. In what ways could the Consignee have been more responsive to the Consignor's request for payment in the earlier stages of their relationship? He could have returned calls in a timely manner. He could have been completely open and transparent about his inability to pay. He could have established a schedule of payments as he was able.
2. The Consignor's series of letters to the Consignee is complex in that it needs to be thorough and tactful, yet clear. Ideally, it must also maintain goodwill between the parties involved, as both the Consignor and the Consignee have an interest in seeing a positive outcome. Specify the reasons why both parties would desire a positive outcome (where they work together to accomplish the goal) as opposed to legal action (where they are forced to resolve the issue). What writing strategy accomplishes the former? What writing strategy accomplishes the latter? Some of the more practical considerations will involve saving legal fees and engendering bad relations. Writing strategies may involve using the indirect or direct approaches in writing bad news messages.
3. Play the role of communications consultant to Wind River Farms. In a memo report to the Consignee (Wind River Farms), make recommendations to help Alan Shaw stay in touch with his consignors and the buyers. Explain your recommendations. Recommendations should be based on the principles of effective non-verbal, verbal, and written communication.
4. Does the arrangement between Marilyn and Alan constitute a bailment? Why or why not? No. In a bailment, the property is returned to the owner at the end of the bailment agreement.
5. By virtue of Alan's agreement to sell Marilyn's horses on her behalf, what type of relationship is created between them and what duties does Alan have to Marilyn as a result? An agency relationship is created. Alan has fiduciary duties to Marilyn which include the duty of performance, the duty to notify Marilyn of any matters that concern the subject matter of the agency, the duty of loyalty, the duty of obedience, and the duty of accounting.
6. Does Alan's returned check create a cause of action for Marilyn and if so, what law applies? Yes, Marilyn can sue Alan on the returned check. The Uniform Commercial Code provides a remedy.
7. If Marilyn wants to sue Alan for fraud, what will she have to prove? What will be the likely result? Marilyn will have to show that (1) Alan misrepresented material facts knowing that they were false or made them with reckless disregard for the truth, (2) Alan intended for her to rely on the misrepresentation, (3) she justifiably relied on the misrepresentation, and (4) she suffered damages as a result of the reliance. Here,

Marilyn will have a difficult time proving the first two elements of fraud. Not all breach of contract claims give rise to fraud claims, and the facts do not indicate that Alan had fraudulent intent.

8. In Texas where are contractor liens against real property filed? In Texas, contractor liens against real property are filed in the county in which the real property is located.
9. What happens if Shaw does not pay McKenzie? How will he proceed? If McKenzie is not paid by Shaw, he will have to proceed with obtaining a judicial lien from the Court. She will achieve this by suing Shaw in court and obtaining a judgment. Once the judgment has been obtained, McKenzie will have the judge issue a Writ of Attachment. A Writ of Attachment allows the plaintiff, McKenzie, to send an officer of the court to seize any non-exempt property to satisfy the debt.

ADDITIONAL EXHIBITS

Three exhibits are included with this case to help students understand the contractual obligations of both the Consignor and Consignee: Online Flyer/Advertisement; Terms and Conditions of Sale; and Consignment Auction Entry Form.

EPILOGUE

The Consignor, Marilyn McKenzie, wrote a series of three escalating request letters which documented Alan Shaw's delaying tactics and inactions, and her requests for payment. The final letter, which threatened legal action, finally prompted Shaw to call McKenzie. Rather than risking another lost or insufficient check, Marilyn requested that Shaw make a wire transfer of the funds he owed her by a mutually acceptable deadline. If the funds were not received by that deadline, she would then pursue legal means to collect the money owed to her. Although Shaw wire-transferred the money from the sale of the horses ($2,400.00), he neglected to refund McKenzie the $25.00 debit incurred to her account as a result of his first bad check. She decided that the amount was not enough to justify pursuing the issue further, and forgave Shaw that debt.

EXHIBITS

Wind River Farms Miniature Horse
Consignment Auction

Saturday, April 30, 2006

Horses Preview at 9:30 A.M.
Auction Starts at 11:00 A.M.
See list of Horses Consigned HERE
The Pinemont Equestrian Center – Expo Center
7564 Smithfield Road
Pinemont, Texas

Consignment Fee $250.00 per horse/Commission Fee 10%
Consignment Deadline: February 5, 2006

Please find below .pdf Forms for Consignment to this Sale
Please download and print all forms to have complete information.
Flyer
Terms of Sale
Entry Form

For More Information
sales@windriverfarms.com
www.windriverfarms.com

WIND RIVER FARMS FIRST ANNUAL CONSIGNMENT SALE

Terms and Conditions

- All horses offered at this auction are offered in accordance with the laws of the State of Texas. Texas laws shall govern all transactions.
- Every horse offered in this sale will be sold "As Is" without any implied warranty or condition. Right of recourse MUST be directed to the horse owner and not Wind River.
- Every effort has been made to ascertain correct information, and to print the same in the Sale Catalog and website; however, neither the Auctioneer nor Wind River assumes or accepts responsibility for errors, omissions, or misstatements. Announcements made at the time of the Auction will take precedence over material in catalog or website.
- This auction sale is an auction "with reserve." The owners shall have the right to establish a reserve price under which the horse will not be sold. Prior to the Auctioneer's accepting the highest bid, the sealed reserve shall be opened, and if the highest bid is not equal to or does not exceed the reserve price, then the highest bidder will be advised by Auctioneer of the reserve price and will be offered the opportunity to purchase horse for the reserve. If highest bidder chooses NOT to meet the reserve, then any qualified bidder may bid reserve price and auction shall continue.
- Horses shall be sold to the highest bidder, subject to Sellers' reserve. The successful bidder, submitting the highest bid, shall forthwith acknowledge such bid by presenting his/her bidder number to the auctioneer immediately following the Auctioneer's acceptance of such bid. In the event of any dispute, the Auctioneer shall have the sole authority and right to settle the dispute, and his decision will be final and binding to all parties. Bids received after the fall of the hammer are NOT a basis for dispute. The Auctioneer reserves the right to reject any and all bids.
- Wind River or the Auctioneer is not responsible for the integrity of any bid made and shall not be held responsible.
- Horses consigned to this sale are the sole responsibility of the owner until sold. Seller is responsible for the care, health, and loss of horse until sold. Upon the Auctioneer's acceptance of bid, buyer shall take responsibility and risk of loss of the horse.
- All horses must vacate premises by 10:00 p.m. Saturday, April 30, 2006. Failure to vacate will obligate buyer to pay all costs associated with board and transportation.
- Buyer agrees to issue payment through the auction cashier within one hour following the conclusion of this auction. Upon buyer's making satisfactory settlement for the horses purchased, a paid delivery receipt will be issued by the auction clerk to the buyer, so that buyer may take possession of the horse(s) for which settlement has been made. This paid delivery receipt must be presented to the barn Security for release of horse(s). Sales Management will prohibit removal of any horse without this receipt.
- Buyer or buyer's designated representative shall take possession, care, custody, and control of any horse(s) purchased immediately following buyer's receiving a paid delivery receipt.
- Buyer agrees to hold Wind River Sales Management, or the Auctioneer harmless from all loss, costs and expense having to do with or rising from illness, injury, or death of any horse offered or purchased, any loss or damage to property and injury to persons, including death, caused by the buyer, buyer's agents, representatives or employees, or by the horse(s) following buyer's purchase of the horse(s).
- Notwithstanding delivery of the horse purchased to buyer, Wind River/Auction Management will retain all registration papers and transfers until payments have been verified (i.e., checks have cleared buyer's bank, etc.). Upon verification of payment, registration papers, along with properly executed transfer of ownership reports, and any other pertinent documents related to the horse purchased shall be prepared and mailed to buyer.
- Settlement by buyer, or buyer's representatives, shall be made to the Wind River Auction Cashier only. Payment made to anyone other than the designated cashier shall not be considered as settlement. Settlement for full purchase price on each horse purchased shall be in the form of U.S. currency, certified check, or approved personal check, which has been approved in advance by Sale Management/Wind River. ALL BUYERS AND PROSPECTIVE BUYERS MUST ESTABLISH BUYER IDENTIFICATION PRIOR TO SALE.
- Buyers who fail in any respect whatsoever to pay for horse(s), as provided in the Conditions of Sale and/or settlement procedures, shall be declared in default. Any horse, for which full and complete settlement is not made, may be resold without notice to the buyer, the cost of resale to be borne by the buyer. In the event of a resale, based on buyer's failure to complete settlement, buyer shall be obligated to pay Sale Management/Wind River all expenses incurred in resale, together with any deficiency in the price obtained in the sale. Sale Management/Wind River and/or owner shall have the right to bring suit against a defaulting buyer, in which event buyer shall be responsible for all costs, attorney fees, expenses, and losses incurred by executing a bid acknowledgement.
- The Wind River Sales Management does not act as agent for either seller or buyer, but merely provides an environment in order to permit the binding together of an agreement between seller and buyer for the purpose of sale/purchase transactions. Any and all representations concerning the horses presented are those of the seller, and no action shall lie against Sale Management/Wind River related to or arising by reason of such representation.
- All horses consigned to this sale are required to have a current negative Coggins report dated within twelve (12) months from date of sale and a Health Certificate dated within 30 days of sale.
- Horses may arrive at The Pinemont Equestrian Center on Friday, April 29, 2006 from 10:00 A.M. until 10:00 P.M. Security will be provided Friday night, April 29, 2006. All horses will be checked in and numbered upon arrival. Health Certificates MUST accompany horse. Any sick horse will be refused. Horses must vacate premises by 10:00 P.M. on Saturday, April 30, 2006.
- All horses must be registered AMHA. No horse will be sold on a registration application unless it is a nursing foal sold with its dam.
- All registration papers and related transfer, breeding reports, Coggins report must accompany consignment fee of $250.00 per horse. Consignors will pay a 10% sales commission per horse to Sales Management/Wind River upon the sale of a horse. Consignors will be assessed a $25.00 Pass Out fee per horse not sold. Consignment deadline is January 20, 2006.

- Good pictures are encouraged to be posted on website and to be published in sales catalog. Clipping horses for sale is HIGHLY encouraged.
- Sellers will be paid after funds clear bank, usually within 10 days. Horses bought and sold will be handled in two separate transactions.
- All persons who attend this Auction do so at their own risk. Sales Management/Wind River will not assume any responsibility or liability for the loss, or injury to horses, people, theft or mysterious disappearance, sickness, improper handling, war, terrorism, or an Act of God.

CREDIT APPROVAL FOR PERSONAL CHECKS MUST BE MADE IN ADVANCE BY CALLING WIND RIVER: (555) 555-5555.

Wind River Farms Miniature Horse
Consignment Auction Entry Form

IN ADDITION TO THE TERMS & CONDITIONS OF SALE, THESE TERMS WILL ALSO APPLY.

1. All horses consigned to this auction will be required to have a negative Coggins report dated within 12 months of auction date, and a separate Health Certificate dated within 30 days of auction.
2. Horses will be checked in and numbered on Friday April 29, 2006 from 10:00 A.M. until 10:00 P.M. All horses MUST vacate the premises by 10:00 P.M. Saturday April 30, 2006. If any arrangements need to be made, please contact Wind River prior to sale.
3. Security will be provided on Friday night, April 29, 2006.
4. No straw or hay is allowed as bedding. You may NOT bring shavings onto The Pinemont Equestrian Center property. Shavings MUST be purchased through Sale Management/Wind River and are provided by The Pinemont Equestrian Center. Shavings are $7.97 per bag (7.5 cu ft) and a minimum of 1 bag per stall.
5. Each horse consigned must have a halter and lead rope for the buyer. If you fail to provide the halter and lead rope, we will provide one for you and deduct the cost from the sale of the horse.
6. You are encouraged to provide good quality photos to be used in the catalog and website.
7. Ring handlers will be provided
8. No alley trading allowed. All sales transactions must be handled through the Sales Management/Wind River. Once checked in, all horses must pass through the ring before receiving check out papers.
9. Consigned horses will be excused due to illness or injury with a veterinary statement. There is no penalty fee; however, consignment fees will not be refunded. No substitutions accepted.
10. Consigner agrees not to dispose of consigned horse by private sale. Consignor will be accessed a penalty of $100.00 if consigned horse is sold or scratched prior to passing through the auction on Saturday, April 30, 2006.
11. Mares represented as "vet checked in foal" must have a signed document dated within 90 days of this auction from a veterinarian stating such. All other mares must be stated as open, or pasture exposed.
12. A consignment fee of $250.00 per horse must accompany this entry form. There will be a 10% commission fee charged on all horses sold. Pass Out fee is $25.00 on no sales. Any horse sold outside the auction right on equestrian center property will pay a 10% commission fee to the Sales Management/Wind River.
13. Original registration papers, as well as all pertinent signed ownership transfer papers, and breeders certificates and Negative Coggins report dated within 12 months of sale date MUST BE submitted with this Entry Form with all fees due.
14. All horses consigned to this sale must be AMHA registered. Only nursing foals sold with their dams, may be sold on registration application.

PLEASE COMPLETE THIS FORM:

NUMBER OF BAGS OF SHAVINGS (MINIMUM 1 PER STALL) __________x $7.97 = $_____________
NUMBER OF ENTRIES _______x $250.00 = $____________
Horse's Name____AMHA#______________________
DOB________________Height_______________Sex__________Color__________________________
Notes:____
Horse's Name____AMHA#______________________
DOB________________Height_______________Sex__________Color__________________________
Notes:____
Horse's Name____AMHA#______________________
DOB________________Height_______________Sex__________Color__________________________
Notes:____
Owner____Date_____________________
Address___________________________________City_________________State_______Zip___________
Phone #______________________________E-mail____
I have read and understand the Terms & Conditions of Sale and the Entry Form Terms of this auction. My signature is proof that I have read and accept the terms and conditions of this contract. The information I have supplied of this entry form is true and correct to the best of my knowledge.

Owner's Signature____Date____________________

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

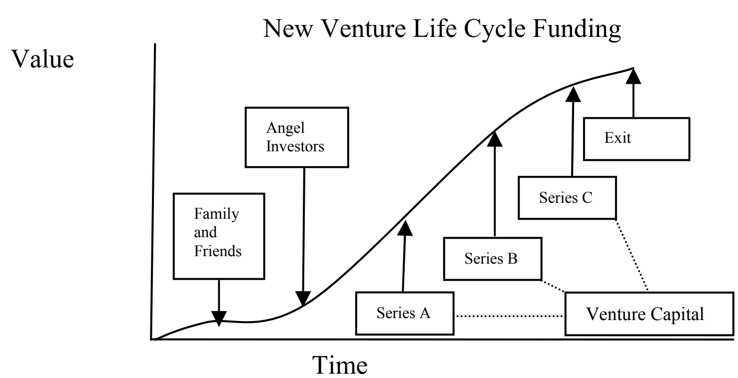
This entrepreneurial finance negotiation case was written to be used in both undergraduate and graduate courses. The rigor and depth of material may be adjusted to reflect the skill and background of the student audience. However, the issues are meaningful and relevant to the learning experience of both 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.

INSTRUCTOR'S NOTES
CASE ISSUES

The two major categories of emphasis in the case are entrepreneurial finance and negotiations. Within the entrepreneurial finance category, the case covers the professional funding phase of a venture's life cycle, the structure and implications of the professional funding term sheet and, within the context of the term sheet, the valuation of a private company. Within the negotiation category, the case covers the goals of the entrepreneur and venture capital in coming to an agreement on the funding transaction, and the negotiating approach each takes in achieving those goals.

Entrepreneurial Finance.

The New Venture Life Cycle. This case puts the student at the stage of the new venture life cycle during which the entrepreneur requires significant funding and attempts to acquire that funding from professional investors. The diagram below shows the funding sources available to the entrepreneur at the various stages of venture development (Gompers and Lerner, 2004; Parker, 2006). Initially, the venture is funded by the entrepreneur and, potentially, family and friends. These funds are not large amounts and are used to provide cash in the initial stages of the venture. However, to progress up the value curve, infusions of cash are needed. Yet, in the early stage of the life cycle, the risk/return tradeoff is not favorable enough for venture capitalists. The entrepreneur may be able to secure interim funding from angel investors (Sohl and Sommer, 2006), who are individuals who have high net worth and invest their own money into ventures they believe have the potential for value creation (Holaday, Meltzer and McCormick. 2003; Metrick, 2006). If the venture continues to grow and has the potential for significant value creation, venture capitalists will be the professional investors of choice (Reid, 2003; Shepherd, 1999).



The ultimate goal of all investors, especially professional investors, is to reach a level of value creation of the venture where an exit is possible (Bartlett, 2005; Smith, D.G., 2005; Smith, G., 2005). That exit can be in the form of an IPO (Halloran et al., 1983), an acquisition of the venture by another company or a buyout of the investors by the management team (Berg and Gottschalg, 2005; Wright et al., 2001). This exit provides liquidity to investors for their share of the value created by the venture.

Students should realize that the case is positioned at the Series A round of funding, which is where the first venture capitalist invests. The term sheet agreement that the students will be negotiating establishes the details of the cash-for-equity Series A Preferred Stock transaction.

Valuation. The valuation of the venture is a key negotiating issue and the starting point in the term sheet negotiation. The earnings multiplier and discounted free cash flow methods are widely-used in the private equity and other financial industries to value both private and public companies.

The earnings multiplier model is attractive in its simplicity, yet still embodies the subjectivity of valuation that others methodologies possess. The equation for the company value (V) using the earnings multiplier method is:

$V = EBITDA_{TTM}$ x Multiple

where $EBITDA_{TTM}$ = the company's "representative" earnings before interest, taxes, depreciation, and amortization during the last (trailing) twelve months,

Multiple = a number applied to the EBITDA of the company and representing the growth and risk attributes of the company.

Each of the variables used in the earnings multiple method has a subjective or "reasonableness" factor. The $EBITDA_{TTM}$ variable can be the actual EBITDA for the trailing twelve months of operations of the company. However, if those twelve months are not representative of the ability of the company to generate EBITDA under normal conditions, then the use of the actual EBITDA during that period would not be reasonable. For example, if a regular customer placing a large annual order at the end of the twelve-month period delays that order so that it falls outside that period and reduces the earnings of the company for the period, a decision would have to be made as to whether it would be reasonable to include that order to make the twelve month period one representative of the normal course of business.

Another example would be the CEO/Founder receiving compensation that is either more or less than the market-based compensation had the company hired a CEO from the outside. An adjustment to that expense line item to reflect the market-based compensation would be reasonable and would impact the $EBITDA_{TTM}$ variable used in the valuation. Therefore, the income statement should be analyzed to determine whether the trailing twelve months of revenues, costs, and expenses are representative of a normal operating year for the company, with adjustments made for any abnormalities.

The multiplier also has a subjective nature and the selection of that multiplier should be 1) made with care, and 2) based on empirical supporting data. Care should be taken due to the sensitivity of the valuation to the multiplier used. Empirical data can support the selection of a multiplier by providing market-based validity.

Financial metrics for FantasyNet and a sample of companies comparable to FantasyNet are shown in Exhibits C through G in the case. One of the issues confronting the valuator is the degree to which the data (individual or aggregate) compares to the company being valued. The closer the comparable company or group, the more appropriate the multiplier. Furthermore, comparable industry multiples can also be used to provide insights into deriving a company EBITDA multiple.

Also, the table below presents the key financial metrics for the comparable companies. Students will need to use their judgment in assessing an appropriate earnings multiple to use in valuing FantasyNet. They will need to compare the FantasyNet financial position as well as its performance, both past and projected, to the three comparable companies. The transactional data shows a multiple range of 5-7 and will likely establish that range as reasonable, although students may present a case for FantasyNet warranting an earnings multiple outside the range.

Those students in the FantasyNet founder role will want to use a multiple at the higher end of the range as it will result in giving up less equity for the CRV $8 million investment. Students in the venture capitalist role will likely estimate at the lower end of the reasonable range so that they receive a higher percentage of equity ownership for their investment.

	Current - 2009			
Key Financial Ratios	**FantasyNet**	**Jobai**	**Tarmac**	**Triptic**
Current Ratio	14.07	17.25	0.00	26.19
Quick Ratio	13.14	16.23	0.00	25.77
Cash Ratio	9.81	13.92	0.00	22.95
Total Asset Turnover	0.93	0.71	0.00	0.53
Average Collection Period	0.25	0.18	0.00	0.20
Gross Profit Margin	95.0%	88.0%	0.0%	97.0%
Operating Profit Margin	41.9%	37.7%	0.0%	52.9%
Net Profit Margin	27.1%	24.3%	0.0%	34.2%
Debt/Equity Ratio	0.00	0.00	0.00	0.00
Leverage Ratio	1.08	1.06	0.00	1.04
Tax Burden Ratio	0.65	0.65	0.00	0.65
Interest Burden Ratio	0.99	0.99	0.00	0.99
Interest Coverage Ratio	176.18	172.66	0.00	157.40
Return on Equity (ROE)	64.8%	48.8%	0.0%	35.5%
Return on Assets (ROA)	39.1%	26.8%	0.0%	28.0%
Revenue Growth – 2005-09 (Geometric Mean)	47.9%	67.9%	70.2%	60.6%
Revenue Growth – 2009-14 (Geometric Mean)	45.0%	42.9%	35.0%	30.0%
Net Income Growth – 2005-09 (Geometric Mean)	33.6%	57.1%	58.8%	57.8%
Net Income Growth – 2009-14 (Geometric Mean)	43.6%	48.7%	36.6%	30.5%
Free Cash Flow Growth – 2005-09 (Geometric Mean)	12.7%	42.9%	42.6%	41.8%
Free Cash Flow Growth – 2009-14 (Geometric Mean)	45.5%	48.1%	33.4%	30.1%
Earnings Multiple Used in Valuation	TBD	7	5	6

The term sheet Ann presented to Tim represented a pre-money valuation of $16,830,000 for FantasyNet based upon an EBITDA multiple of 5 which is at the low end of the range.

$$V_{2009} = \text{EBITDA}_{2009} \times \text{Multiple}_{2009} = \$3{,}366{,}000 \times 5 = \$16{,}830{,}000$$

Using a multiple of 7 at the high end of the range, the result of the valuation would be:

$V_{2009} = EBITDA_{2009}$ x $Multiple_{2009}$ = \$3,366,000 x 7 = \$23,562,000

Students will likely be determining values between those points using the EBITDA multiple method. However, some may also use the discounted free cash flow method which has both advantages and disadvantages over the EBITDA multiple method. On the advantage side, it provides a more complete look at the real financial benefit (free cash flow) to the shareholders of the company. On the disadvantage side, it requires subjective projections of cash flow indefinitely into the future.

The equation for the company value (V) using the Discounted Free Cash Flow valuation model is:

$$V = FCF_1 / (1 + RR)^1 + FCF_2 / (1 + RR)^2 + \ldots.. + TV_n / (1 + RR)^n$$

where FCF is defined as Free Cash Flow and is Cash from Operating Activities minus Net Capital Expenditures and

$FCF_1 = FCF_L (1 + g_1)$ = Free Cash Flow in period 1

$FCF_2 = FCF_L (1 + g_2)$ = Free Cash Flow in period 2

FCF_L = "launch" free cash flow, the annual FCF that most reasonably represents the company's current ability to generate FCF under normal conditions,

RR = Required Rate of Return by CRV for their investment in FantasyNet

$TV_n = EBITDA_{TTMn}$ x $M_{EBITDAn}$ = Terminal value, the cash proceeds received upon an exit event in period n using the TTM EBITDA and multiplier relevant for Period n.

If students value FantasyNet using the discounted free cash flow method, they can use the free cash flows projections found in Exhibit C. The discount rate (VC required rate of return) is subjective and is normally in the 40% to 50% range. The terminal value in the discounted FCF model requires the student to 1) individually calculate the present values of the annual free cash flows for the projection period and 2) value the company at a future time (year) using the EBITDA multiple method in the final year of that projection period and 3) calculate the present value of that terminal value.

As an example, for the projection period 2010-2014 and with all values in \$000's, cash flow for the period 2010-2013 are \$2,354, \$2,968, \$4,310, \$6,258, respectively. For the final year, 2014, of the projection period, EBITDA is \$18,672. If an EBITDA multiple of 7 is used, the terminal value is \$130,704.

$TV_{2014} = EBITDA_{2014}$ x $Multiple_{2014}$ = \$18,672 x 7 = \$130,704

Using these figures in the discounted free cash flow equation above with a discount rate of 50%, the pre-money value of the company is $22,614 million.

NEGOTIATING TECHNIQUE AND STRATEGY

The case provides the instructor with an experiential learning model in which students enter the minds of an entrepreneur raising professional equity financing from a venture capitalist (VC) and of a venture capitalist investing in the entrepreneurial company. Students will recognize that venture capitalist negotiate term sheets many times as an integral part of their business model, but entrepreneurs negotiate a term sheet only a few time during the entire life-cycle of their company. Therefore, the negotiating skill sets of the parties involved are normally at different levels, with VC's at a much higher level. However, serial entrepreneurs gain the experience through funding multiple ventures to bring their negotiating skill level for this type of transaction to a high level.

For instructors using the case in a negotiations course, the normal course reading assignments and class instruction that focuses on negotiating skills and strategy will be sufficient for students to engage in the negotiations aspects of this case. Additional reading drawn from the references below will provide the necessary background information for students to understand the entrepreneurial finance aspects of the case. For instructors using the case in a business course (finance case course or entrepreneurial finance course) that does not focus on negotiating skills, the students will concentrate more on the business issues in the case and use their intuitive skills in negotiating (Norton and Tenenbaum, 1992).

Learning Objectives

This case involves four learning objectives:

1. Application of Negotiating Skills and Strategy. Students will be able to use the term sheet as the vehicle through which they can develop negotiation objectives, create a negotiation strategy to achieve those objectives, and apply their negotiating skill in a realistic and important negotiation setting.
2. The Role of Venture Capital in the New Venture Life Cycle. Students will understand the role venture capitalist play in the success of a new venture. The objective of most entrepreneurial ventures is to achieve high levels of growth in both revenues and earnings, and growth needs to be financed either internally through retained cash flow or externally through an infusion of new investor cash in a transaction that exchanges investor cash for company ownership equity. The venture capital business model is designed to provide that cash to propel the venture up the value curve shown above with the expectation of within 5-7 years having some exit event. Students will understand why the outside funding is needed and the source of those funds.
3. The Structure of a Venture Capital Transaction Term Sheet. The cash-for-equity transaction term sheet can be a complex one for the entrepreneur who is new to the

funding process. The term sheet has new terms that apply to entrepreneurial finance and relate to every aspect of ownership rights of all investors. After experiencing the case, the students will understand the structure of the term sheet and the ownership rights affected by each provision.

4. The Implications on Ownership Rights of the Provisions of the Term Sheet. Each provision of the term sheet has implication for ownership rights for both the preferred and common stockholders, the latter usually being the founder(s) of the company. Through this case, the students will learn those implications and be able to evaluate whether a negotiated agreement on each provision is either investor-friendly, company friendly, or middle-of-the-road.

CLASS LOGISTICS/TIME MANAGEMENT

This case is designed to be a two-person (Tim and Ann) or four-person (Tim, Connie, Ann, Jeff) negotiation and can be implemented as a discussion-based or experiential learning exercise.

Discussion-Based Approach

As a discussion-based exercise, the case can be completed in an 80-minute class or extended to a 160-minute class. In either case, students should have read the case and any supplementary reading assignments in advance of the class.

- 80-Minute Class. In an 80-minute class utilizing the discussion-based approach, the professor can lead the class through all or a subset of the discussion questions, or divide the class into two groups – one taking responsibility for the point of view of Tim Bayliss (FantasyNet founder), the other of Ann Davenport (VC). As the mindset and objective of each party to the transaction is very significant, students should be instructed to try to understand the motivations of an entrepreneur selling shares to a new investor and a venture capitalist putting money at risk in an entrepreneurial venture.

- 160-Minute Class. For a 160-minute course, the professor can use the same approach, but with the extra time can have students break into groups to develop what they believe would be the best approach for Ann and Tim, whichever point of view they are assigned. This additional time will allow more focus on the implications of each of the provisions of the term sheet and the strategies to achieve them.

Two 80-Minute Classes or Two Parts of one 160-Minute Class

- 80-Minute Class/Session One**.** One class structure that has worked is for the first 80-minute class (or first half of a 160-minute class) to be devoted to an in-class discussion of the role of venture capital in new venture growth as well as the provisions included in term sheets and how they can be written as investor-friendly, company-friendly, or middle-of-the-road. Part of that first class also could be devoted to students working in teams to develop what they believe are the best approaches for Tim and Ann to take in the negotiation.

- 80-Minute Class/Session Two**.** During the second 80-minute class (or second half of a 160-minute class), the professor can conduct an in-class discussion of the negotiating strategy students think would be best for Ann and Tim, the important term sheet provisions to be negotiated, the relative values each should place on those issues, the concession s they may think might be appropriate, and the goals they are attempting to achieve in the final term sheet agreement.

Experiential Learning Approach

In this approach, which works best in two 80-minute classes or one 160-minute class, groups of two or four students are selected. Either one or two of the students in each group take the role of either Tim or Ann or a Tim/Connie team and Ann/Jeff team. It usually works best to have student teams of two as they will have a better opportunity to discuss strategy and learn from each other.

Class/Session One

At the beginning of the class, the instructor should ask the students if they have any technical or definitional questions. Students should be pre-warned to not ask any questions in a form that would reveal any possible negotiating strategy they might have now or develop in the future. In answering questions before the entire class, the instructor must take care to not reveal any of the motivations or potential goals of any party. As a safeguard to revealing strategy, the group having the Ann role can be separated from the group having the Tim role. The instructor can then respond to questions from each respective group separately.
After questions are answered, each group of the two negotiators may be given a private space (a breakout room, student lounge, separate area in a classroom) to discuss their negotiating goals and strategy. The deliverable from that session is a set of issues and goals to be used as a reference document in the upcoming negotiation.

Class/Session Two

During the second 80-minute class or after a break slightly before the mid-point of the 160-minute class, the negotiation between the students or student teams taking the roles of Ann and Tim takes place. This will be a lively negotiation, as there are several critical issues involved that will not be easily resolved. At least 60 minutes should be allotted for this face-to-face negotiation and 20 minutes for the debriefing. An alternative to the debriefing immediately after the negotiation is to have the students complete the Debriefing and Self Assessment Report shown at the end of this teaching note. Have the students be prepared to hand in the briefing report at the beginning of the next class, at which time a portion of that class time can be taken for the debriefing. This approach will provide more time for the actual negotiation.

SUGGESTED TEACHING DISCUSSION/ASSIGNMENT QUESTIONS

1. What are the overall objectives of the FantasyNet founder, Tim Bayliss, in the term sheet negotiation?

Tim has several general objectives in the negotiation. They are to i) come to agreement on a reasonable but optimistic valuation of FantasyNet so that he can receive the $8 million investment from CRV while minimizing the equity he needs to relinquish for the funding, ii) maintain as much control of the company as possible, and iii) minimize the loss-of-control effects on him, as the founder and CEO, of any adverse turn of events in the performance of the company. Tim will have more specific objectives related to each paragraph of the term sheet and based on the explanations and recommendations contained in Connie's memorandum. He would like to negotiate each paragraph to be as "company-friendly" as possible while still maintaining a positive relationship with CRV since they will be owners along with him in FantasyNet.

2. What are the overall objectives of CRV and, in particular, Ann Davenport, in the term sheet negotiation? (Kaplan and Strömberg, 2004)

Ann also has several general objectives in addition to the more specific objectives related to each term sheet paragraph. They are to i) maximize the return on CRV's investment in FantasyNet through maximizing the proceeds to CRV resulting from an exit event, ii) provide downside-protection under conditions of adverse FantasyNet performance in the future, iii) maintain enough control over the activities of the company that could affect their preferred ownership position.

To achieve these general objectives, Ann will be negotiating each paragraph to be as "investor-friendly" as possible while maintaining a positive and cooperative relationship with Tim.

CRV also realizes that the term sheet needs to take into account two important factors. The term sheet can't be so investor-friendly as to de-motivate Tim in creating value for owners. If Tim believes that the terms of the investment result in most of his efforts going to the benefit of CRV, then his motivation may be sub-optimal.

CRV needs to consider the likelihood that FantasyNet will need additional rounds of financing in its journey to an exit event. Therefore, the term sheet can't have provisions in it so favorable to maintaining the preferred status of holders of Series A Preferred over holders of common stock *and* holders of subsequent issues of Preferred Series B and C and beyond. In fact, most VC's are willing to renegotiate some of the terms of their issue when new rounds of investments are made.

3. Which party seems to have the most leverage in the negotiation?

Leverage is as much a matter of perception as it is reality. Both parties have a need that the other can fulfill. FantasyNet would like to grow faster, be more competitive, and progress more quickly to an exit event for Tim. However, he needs more cash funding to accomplish those goals. CRV has the cash. On the other hand, CRV has a funds commitment from it investors to be used to invest in promising, high potential, value-creating private companies. CRV is constantly searching for those companies, and FantasyNet appears to satisfy those conditions.

Leverage comes into play when each side considers its alternatives to reaching an agreement with each other. FantasyNet will not go out of business, but without funding will grow slower and may lose competitive advantage and be vulnerable to new, better financed entrants into the online fantasy sports niche industry. There is no indication that FantasyNet has alternative funding opportunities although Tim has not actively searched for them. So FantasyNet is not desperate for cash, but sees the CRV funding opportunity as being advantageous.

CRV likely is considering investment in other private companies. However, the fact that they have presented a term sheet to FantasyNet indicates they are very interested in funding the company's growth and participating as an owner. If an agreement cannot be reached on the term sheet, CRV will lose the opportunity but likely will not be adversely affected. However, if their position on term sheets is so restrictive that they continually fail to come to agreements on term sheets negotiations, then the firm will be adversely affected in not using investor money as investors had anticipated.

Overall, it appears that CRV holds an edge in leverage although FantasyNet does hold some leverage as the type of company that, if successful as is anticipated, can contribute to the success of CRV. Normally venture capitalists hold superior leverage in these types of negotiations. If multiple VC's are vying for the same investment, the leverage will likely shift to the entrepreneur.

4. **Does CRV want to eventually gain control (majority ownership position or Board control) of FantasyNet?**

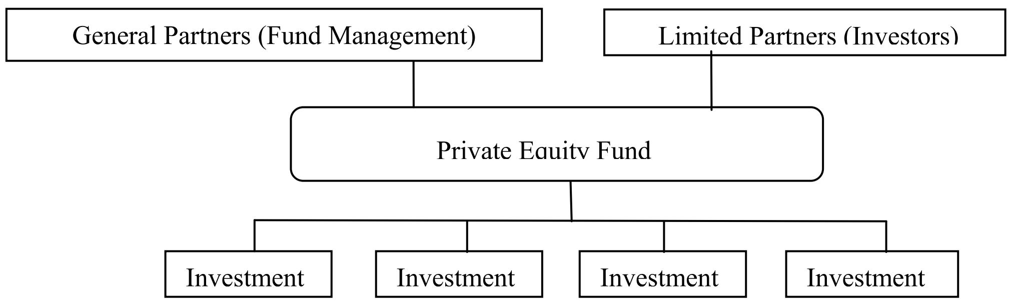
Under normal conditions, CRV wants to be a minority investor in FantasyNet without having the responsibilities that majority control brings with it. CRV invests in companies with strong management that has the ability to create value for all owners. CRV is satisfied with maintaining their minority equity stake as long as management's performance increases the value of that stake. However, under conditions of pre-specified adverse performance, CRV could negotiate into the term sheet provisions to take control of the management and board. (Hellmann, 1998)

5. **How is a venture capital firm organized?**

Venture capital firms are a type of private equity firm in that they take equity stakes in private companies, that is, companies not publicly-traded on any exchange. In recent times, the general term, private equity, has become directed toward those firms that take equity stakes later in the life cycle of the venture usually at a higher percentage ownership (often a controlling ownership) than venture capital firms.

Venture capital firms are normally comprised of general partners who manage the firm and make investment decisions and limited partners who are the investors committing investment funds to the VC firm. Chestnut Ridge Ventures (CRV) operates as a typical private equity firm (see Figure 1 for the organization structure), raising money from accredited investors (limited partners), as defined by Rule 505 of Regulation D of the Securities Act of 1933 (http://www.sec.gov/answers/accred.htm), for the purpose of purchasing equity ownership (investing) in private companies that have high value-creation potential and a high probability of an exit event, such as an IPO or acquisition. Limited partner investors in a venture capital fund may include large U.S. and international corporate pension funds, U.S. state pension funds, university endowments and foundations, and wealthy individuals. General partners may also be invested.

Venture Cap Firm Organizational Structure



The investment strategy of a venture capital firm is to invest long-term equity capital to support the strategic and financial objectives of outstanding management teams operating businesses with 1) providing a demonstrable opportunity to significantly enhance a company's value and 2) possessing defensible positions in change-intensive environments. VC's typically invest in early- to mid-stage growing companies. Target markets are characterized by attractive fundamentals, an abundance of relevant market segments, modest capital requirements, low cost of goods sold and high barriers to entry and switching costs. In 2009, the average VC deal size was between $6 million and $7 million. Before investing, venture capitalists conduct a rigorous due diligence process, including a review of management capabilities, products, competitors, industry dynamics, financial performance, and business strategies. Investment criteria include achievable and sustainable cash flow, a steady and high-growth revenue and earnings history, strong brands, powerful intellectual property, highly skilled work forces, proven management teams with equity interests in their companies, and well-developed business strategies.

6. Why do entrepreneurs access the VC industry for investment funds?

VC firms have the funds to finance the growth that entrepreneurs are trying to achieve. Their business model is to invest in private companies unavailable for investment purposes to the general public. Also, the entrepreneur needs a larger funding amount than is available from friends and family or even angel investors. In addition to providing a cash investment, VC's also can provide networking opportunities, executive search assistance, and general business advice. (Christofidis and Debande, 2001)

7. Why do VC's want to invest in private companies?

The investors who commit capital to the VC firm are looking for a higher return than they typically can find in the stock market and investing in private companies have the potential for that higher return. VC firms are established to provide those investors with the means to participate in the ownership of preferred equity stakes in private companies. The compensation to VC firms is usually on a "2 and 20" basis. The VC firm charges a 2% (of funds invested) management fee and take 20% of the realized capital gains of the fund. (Davila, Foster and Gupta, 2003)

8. What types of securities do VC's receive in exchange for their investment?

VC firms will only invest in a company if they receive an ownership stake with preferred rights superior to those of common stockholders. The securities they receive are preferred shares and can take any of four forms:

- Convertible Preferred: This type of preferred allows the investor the option, upon an exit event such as an IPO, acquisition by another company, or possibly a management buyout of the investors, to either a) redeem their initial investment plus any accrued dividends if dividends are associated with the issue and then not share in the proceeds of the exit event, or b) convert the preferred shares (at a pre-determined conversion rate) into common shares and participate with the other common shareholders on a pro-rata basis in the proceeds of the exit event.
- Redeemable Preferred: These issues give the holders of redeemable preferred shares the right to redeem their initial investment plus and accrued dividend on a pre-determined scheduled basis but no right to share in the exit event proceeds after that redemption. Without some rights to receive common shares and participate on any proceeds from an exit event, private equity firms likely would not agree to receive this type of preferred issue in exchange for their investment.
- Participating Convertible Preferred: This type of preferred gives the holder the right to redeem the original investment plus accrued dividends and, after that redemption takes place, also participate with other common shareholders on a pro-rata basis in the proceeds of the exit event.
- Participating Convertible Preferred with CAP: This issue is the same as the Participating Convertible Preferred issue except that it places a cap (X times original investment) on the proceeds of the participation (with common shareholders and after redemption) component.

9. Why are the Preferred Shares received by CRV referred to as "Series A" shares?

They are the shares issued in the first, or A, round of professional funding. The second round shares would be Series B shares, the third Series C shares, and so forth.

10. What purpose do term sheets serve?

Term sheets describe the characteristics of the investment. They are legally non-binding documents but represent the agreement struck between the entrepreneur and VC on the preferred security resulting from the cash-for-equity transaction. After the term sheet is signed by both parties, further due diligence is conducted by the VC to determine whether the VC wants to finalize the transaction. (Bienz et al., 2006)

11. What is the difference between pre-money valuation and post-money valuation?

- Pre-money valuation is the valuation of the company before the VC investment is made. This valuation is subjective as it is a forward-looking determination based on the projection of future company performance. There are numerous valuation approaches but the two most often used and most widely-accepted are the earnings multiple and discounted free cash flow approaches.
- Post-money valuation is the pre-money valuation plus the VC investment in the transaction. For example, in this case, Ann and Tim have agreed on a pre-money valuation of the company of $16.830 million. That is what they believe is a current fair value of FantasyNet. With the $8 million that CRV is going to invest in FantasyNet, the post-money valuation is $24.830 million.

12. How is the CRV ownership percentage, number of shares issued, and price per share determined?

CRV's $8 million investment is 32.22% of the post-money valuation, which determines CRV's ownership percentage of one-third of the outstanding shares. Since Tim had issued himself 2 million shares for a 100% ownership when the company was founded, he needs to issue another 950,683 shares going to CRV. After the new shares are issued, there are 2,950,683 shares outstanding.

CRV is investing $8 million so the per-share price is $8.415 per share ($8 million investment/950,683 shares received).

13. What is a "cap table"?

A "cap table" is a table showing the post-financing capitalization, that is, the post-financing owners of the company and the number of shares they own and the percentage of outstanding shares that they own. The following is the cap table for FantasyNet after CRV's investment:

	Shares Outstanding	% Ownership
Founder (Common Stock): Tim Bayliss	2,000,000	67.78%
Investor (Preferred Stock): CRV	950,683	32.22%
Total Common Equivalent:	2,950,683	100.0%

14. What does "common equivalent" mean?

This is a term used to indicate the number of shares of common stock into which a preferred stock issue could be converted. At the time of investment, the conversion ratio is 1:1, that is, for each share of preferred stock CRV holds, it could be converted into common shares under the conditions set forth in the term sheet. The 1:1 conversion is specified in the term sheet paragraph "Conversion".

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?

CRV is not expecting to receive a cash dividend payment of $1,200,000 (15% of the initial investment of $8 million) each year as FantasyNet will need those funds to further finance their growth. However, each year's dividend will accumulate (the cumulative feature of the dividend) until the exit event at which time all accumulated dividends will be distributed to CRV.

16. What would constitute an exit event?

As specified in the "Liquidity Preference" paragraph of the term sheet, an exit event is defined as (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"),

17. What is a "liquidity preference"?

As specified in the "Liquidity Preference" paragraph of the term sheet, the holders (CRV) of the Series A Preferred Shares have preference over the common shareholders in distribution of funds resulting from an exit event. As stated in that paragraph, "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."

18. Under what conditions would the conversion of preferred shares to common shares take place?

Those conditions are specified in the term sheet paragraph labeled, Automatic Conversion. They are (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").

19. What is a redemption? How does it benefit CRV?

Redemption allows CRV to require FantasyNet to pay back CRV's initial investment (or a multiple of the initial investment) and any unpaid, accumulated dividends. Assume the Series A Preferred shares have a 10% cumulative annual dividend. Those dividends accumulate at $800,000 per year (10% of the $8 million investment). The term sheet will specify a redemption date. On or any time after that date, CRV can invoke its redemption right. Of course, FantasyNet would need to have the cash to pay the redemption. If it does not have the cash, CRV could require the company to liquidate assets or borrow the money or acquire the cash by some other means.

Redemption benefits CRV in that it provides a means to exit the investment with some return if the CRV believes that a normal exit event is not imminent. On redemption, CRV relinquishes their ownership position and any subsequent rights to value creation in the future.

20. What is an "anti-dilution" provision? What forms can it take? What are the implications of each form on Tim and on CRV?

The anti-dilution provision protects CRV from excessive dilution of their ownership if new preferred shares are issued in subsequent rounds of financing at a price less than the price that CRV paid for their preferred shares. These rounds of lower price are called "down rounds."

In the event of a down round, the anti-dilution provision gives CRV the right to revalue the purchase price of their shares based on the lower price of the newly issued shares. This lower price will result in a modification of the conversion ratio (preferred shares to common shares) applicable to CRV's Series A Preferred issue.

There are two forms of anti-dilution – full ratchet and weighted-average. The full ratchet approach revalues all of the CRV "A" shares based on the lower issue price of the new "B" shares regardless of the relative sizes of the "A" and "B" round fundings while the weighted-average approach takes into account the relative size of a "B" round as compared to CRV's "A" round.

The full ratchet approach is more favorable to CRV in that is allows all Series A shares to be repriced even if the subsequent round is of a smaller size. The weighted-average approach is more favorable to Tim in that the revaluation of the Series A shares reflects the relative impact on Series A dilution based on the sizes of the Series A and subsequent round funding amounts.

21. How are the voting rights of CRV determined?

Here is where the "on an as-converted basis" terminology takes effect. If the conversion ratio has remained at 1:1, that is, no anti-dilution provision revaluation based on a down round, then CRV would have one vote per (Series A Preferred) share owned and initially issued, with that vote being equivalent to a vote per share of common stock owned by Tim.

If the conversion ratio had been modified to reflect a down round revaluation, for example, to 1.25:1, then CRV would have 1.25 votes per preferred share owned in contrast to the one vote per common share owned by Tim.

22. What is the purpose of protective provisions and what forms can they take?

Protective provisions give holders of preferred shares the ability to block certain company actions that may have an adverse impact on preferred stockholders.
Actions that can be blocked include change of the corporate charter, issuance of new common or preferred shares or redemption of such shares, preferred characteristics of new preferred shares, change in board composition, issuance of new debt, etc.

VC's like to include as many protective provisions as possible to reduce their risk and protect their preferred position over other investors. Companies want to minimize the protective provisions as they could severely restrict the ability to manage the company for the benefit of all owners. Some balance of interests is necessary in coming to an agreement on the protective provisions to be included in the term sheet.

23. What is the purpose of the Registration Rights provision?

This is a provision that takes effect in the event of an IPO. It normally is not a significant part of the negotiation between the VC and entrepreneur in that, in the event of an IPO, the investment banker engaged will control the rights of all investor parties so that all interests are protected.

24. Does a VC require representation on the company board? If so, why and what is the extent of the representation?

A VC will require at least one seat on the board (Rosenstein et al., 1993). If the investment represents a minority ownership position, then the VC will likely settle for a minority position on the board. The purpose of that representation is to participate in the process of board decision-making. A term sheet can have provisions that will result in an investor group taking control of the board under certain adverse conditions, such as a default on a loan or certain pre-determined performance milestones not being reached.

Tim would like a board that has a common purpose and vision for the company. This is one of the reasons why the entrepreneur needs to conduct due diligence on the VC in order to make sure that the VC's and entrepreneur's interests are aligned and that the VC will be supportive of management in driving the company's business model forward. That is not to say that Tim wants a board that will just rubber-stamp anything he wants to do. Board members can be very valuable in their contributions to development and implementation of strategy.

Entrepreneurs should be wary of having a board that is too large. Too many diverse opinions may slow the progress of the company.

25. What protections do the "Right of First Refusal" and "Co-sale Agreement" provision give to CRV?

Jointly these provisions prevent Tim from selling shares without CRV being allowed to purchase the shares or participate in the sale of the shares in order to maintain their ownership percentage. CRV has the right to not participate in any subsequent funding rounds.

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?

Vesting is the securing of ownership of shares according to a pre-determined schedule. The rationale for vesting of common shares is to ensure that the owners of those common shares, (top management) stay with the company and contribute to the value creation for all investors. A typical vesting provision is a four-year vesting schedule with a one-year 'cliff' and monthly vesting thereafter. This means that ownership of the first 25% of the common shares won't be "vested" until one year after the investment closes (the "cliff"), and the remainder vested in equal monthly 'installments' over the next three years. There will also be a provision for some type of accelerated vesting in the event of termination of the employee without cause or an exit event and a relinquishing of vesting rights in the event of termination with cause.

CRV is proposing to Tim a vesting schedule in which 25% of his common shares will 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 Tim be terminated without cause within one year after such event, he will be entitled to one year of additional vesting. Other than the foregoing, no accelerated vesting will take place.

27. What is the purpose of a closing fee?

Some VC's include this provision and give the reason that it covers their contribution to the company in addition to providing cash. It can either be payable upon closing or spread out over a number years. The fee would result in Tim receiving $150,000 less than the CRV investment of $8 million.

28. What is the rationale for FantasyNet i) paying not only FantasyNet 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?

This is a very CRV-favorable provision in the term sheet as it puts the burden of the expenses of the transaction on FantasyNet. It is, however, a part of the business model of VC's and part of the costs of raising money. It is likely going to be in a term sheet from any VC, but represents essentially a blank check written to a VC to cover their expenses. Reputable VC's do not take advantage of this provision, but it could be onerous on the cash position of the company. The $35,000 is negotiable and should be set at a reasonable level. The entrepreneur can try to set a cap on VC expenses.

29. What purpose does the exclusivity provision serve? Is it weighted more to the favor of FantasyNet or CRV? Why?

The exclusivity provision protects CRV from putting the time and effort into due diligence and, during that time, have Tim continue to shop around for alternative funding opportunities. CRV needs to have an exclusive right to invest in FantasyNet while their due diligence is in progress.

The time frame of exclusivity is normally the expected time allocated to due diligence. In the case of the FantasyNet term sheet, it is for a period of 90 days after the execution of the term sheet. During that time, Tim (i) must deal exclusively with CRV in connection with the funding, (ii) will not solicit, or engage others to solicit, offers for the purchase or acquisition of any equity or debt securities or assets of FantasyNet or for any merger or consolidation involving FantasyNet, (iii) will not negotiate with or enter into any agreements or understandings with respect to any such transaction and (iv) will inform CRV of any such solicitation or offer and the terms thereof.

30. Is the term sheet a binding document?

Partially. The only provisions that are binding are the "Expenses", "Exclusivity", and "Publicity" provisions. However, the term sheet initially presented by CRV to Tim is one that is open for negotiation regarding the provision it contains. When that negotiation is complete and both parties agree on a form of the term sheet to move forward with, then even though that term sheet is not legally binding (except for those three provisions), the trust between Tim and CRV would be impaired if either party, without reason, came back to the negotiating table proposing a change in one or more provisions.

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?

A successful due diligence by CRV, which will include an audit of the company's financial statements, will trigger the term sheet being given to legal counsel to develop the following legally-binding documents:

- Stock Purchase Agreement
- Certificate Of Incorporation
- Investor Rights Agreement
- Voting Agreement
- Right of First Refusal and Co-Sale Agreement
- Management Rights Letter
- Indemnification Agreement

POWERPOINT SLIDES

The PowerPoint outline below combines elements of the two major issues of the case: Entrepreneurial Finance and Negotiations. The finance portion focuses on the term sheet and its implications on the two parties involved: the entrepreneur and venture capitalist. Wilmerding (2006) provides a detailed primer on term sheets, indicating investor-favorable, middle-of-the-road, and company-favorable versions of all term sheet paragraphs. Pearce and Barnes (2006), Smith and Smith (2003), and Vinturella and Erickson (2004) provide a more complete textbook coverage. The negotiations portion deals with the foundational elements of negotiation as well as an approach to the technique of negotiations. Much of the negotiations material is drawn from Shell (2006) however there are many excellent books on negotiation available if the instructor wants to assign reading material on this subject (Fisher, Ury and Patton, 1991; Lax and Sebenius, 2006; Lewicki et al., 2009; Malhotra and Bazerman, 2007; Raiffa, 1982).

FantasyNet Earnout Negotiation Case Powerpoint Slides

FantasyNet Principals

1. Tim Bayliss
   - Founder, CEO, and sole common stockholder
   - MIT and Harvard graduate
   - Ex-McKinsey consultant
2. Connie Sayler
   - Venture financing consultant from accounting firm
   - Author of Memorandum on FantasyNet / Chestnut Ridge Ventures Term Sheet
3. Ann Davenport
   - General Partner at Chestnut Ridge Ventures (CRV)
   - Wharton graduate
   - Served on management teams of several software startups
   - Principal CRV negotiator
4. Jeff Engler
   - CRV Research Associate

FantasyNet Organizations

- ❖ FantasyNet: Company which runs the FantasyNet site
- ❖ A fantasy sports social networking site
- ❖ Current Membership: 1.6 million
- ❖ Latest Financial Performance (2009):
- ❖ Revenue: $6.474 million
- ❖ Net Income: $2,175 million
- ❖ Net Income Margin: 33.6%

Chestnut Ridge Ventures (CRV)

- ▪ A venture capital firm
- ▪ Interested in investing $8 million in FantasyNet
- ▪ Sees 40-50% growth potential in FantasyNet with integration into a mobile (phone) platform

Fantasy Sports Industry

- National and International
- 29.9 million participants in U.S. and Canada
- 54% growth in 2009 from 2008
- 22 percent of U.S. adult males 18 to 49 years old with Internet access play fantasy sports
- Consumers spend $800 million annually on fantasy sports-related products

Foundations of Negotiations

- ✓ Negotiating Styles
- ✓ Goals and Expectations
- ✓ Authoritative Standards and Norms
- ✓ Relationships
- ✓ The Other Party's Interests
- ✓ Leverage

Negotiating Styles

1. Avoider
   - "I don't want to play."
   - Dislikes interpersonal conflict
   - Dodge situations that might lead to open disagreement
   - Arranges life so that conflict is at a minimum

2. Compromiser
   - Fair-minded; seeks equitable solution

- Will sacrifice some advantage to maintain relationship
- Doesn't relish negotiations, but doesn't shy away
- Looks for fair, obvious, and quick bargaining solutions

3. Accommodator
   - Wants quick solution regardless of self-benefit
   - Solves C/P's problem without guarantee of gain
   - Trusting

4. Competitor
   - Likes to win, may lie to get advantage.
   - Willing to take chances
   - Likes to control neg., opens with ambitious demands, uses threats and ultimatums, may use walk-out to demonstrate commitment to goals.

5. Problem Solver
   - Need for creativity
   - Useful in complex negotiations
   - Seeks to discover underlying problem through
     - candid disclosures,
     - brainstorming,
     - resolution of tough issues using fair standards of division

Your Goals and Expectations

- Objectives we strive toward that are usually beyond the range of our past achievements.
- Give direction; a "stretch" destination
- We are not greatly surprised or disappointed if we fall short.
- Your highest legitimate expectation of what you should achieve.
- Your goals set upper limits.
- You mentally concede anything beyond that goal, so you seldom do better.
- Goals trigger powerful psychological "striving" mechanisms.
- Strengthens commitment
- Set optimistic, justifiable, and realistic goals
- Be specific
- Get committed.
- Carry your goals with you into the negotiation.

Authoritative Standards and Norms

- Authority or norm must have legitimacy and be reasonably accepted by counterpart.
- Provides reasonableness, legitimacy, justification, easier acceptance of your positions by C/P

Relationships

- The Norm of Reciprocity
  - Be trustworthy and reliable
  - Be fair to those who are fair to you
  - Let others know when they have treated you unfairly
- Do what you say
- Stress the benefits of creating mutual trust
- Make your statements honest and accurate
- Have frequent interaction with your counterpart
- Let your counterpart learn about you
- Develop similar goals and objectives
- Build a relationship network

The Other Party's Interests

- Identify the decision maker

- Look for common ground
- Look for differences
- Why might the other side say "no"?
- Search for low-cost options that solve the other party's problems while advancing your goals.

Leverage
- The party with the greater commercial need has the disadvantage
- Self-esteem needs often counts as much as commercial needs
- The more favorable the BATNA, the more favorable the leverage.
- Which party has the most to lose?

The Technique of Successful Negotiating

Prepare
- Mastering the Substance: learning everything there is to know about the negotiation in order to prevent surprises.
- Strategy
  - The overall plan that integrates an organization's major sales targets, policies, and actions into a cohesive whole.
  - Establishes the sales journey to agreement, providing stability, continuity, and direction for tactical behaviors.
- Tactics
  - Short-term, adaptive moves designed to enact and pursue a higher-level strategy.
  - Tactics are used when necessary to keep the strategic journey on course to agreement.

Exchange Information
- Your counterpart is trying to tell you how to make the deal.
- People will not negotiate with you unless they believe you can either help them or hurt them.
- Listening is a strategy
- Information is the capital of negotiations.
- Information is critical in developing strategy.
- Obtaining information on interests, issues, and perceptions
  - Who are your counterparts?
  - Why are they negotiating with you?
  - What issues do they want to negotiate?
  - What is the relative importance of the issues to them?
  - Do they have the authority to commit to an agreement?
- Best Practices
  - Probe first, disclose later.
  - Ask open-ended questions.
  - Search for common ground and areas of departure.
  - Listen; pay attention; let other side know that you value the information they are giving.
  - Test for understanding.
  - Summarize information received.

Opening and Making Concessions
- Integrative Bargaining
- Objective: Create and claim value through "Issues Trading"
- Often "Package Bargaining"
- Requires more skill than haggling, but not less competitive.
- Maintain goals.
- Norm of Reciprocity: permeates every stage of negotiations
- "If…then" method of trading issues ensures that you never make a concession without linking it to a reciprocal concession from counterpart.
- Make big concessions on your "little" issues and little concessions on your "big" issues.

Closing and Gaining Agreement
- Closing is the process of integrating all previous agreements on issues into one comprehensive agreement that creates value for both sides.

- Closing the agreement is the end of one journey and the beginning of another.
- A hurdle-assessment (trial close) is simply a check to see how many hurdles are still standing.
- The close is complete when you have removed all hurdles.
- Assess Progress Toward Agreement
    - *Is there anything (else) that you need to know in order to make this investment?*
    - *Is there anything (else) that is (making you hesitant in) (holding you back from) making this investment?*
- The greater the effort and time investment you and your counterpart have made in the negotiation process, the greater the motivation to get a return from that investment by coming to an agreement.

Assess Performance and Build Knowledge Foundation
- Each negotiation is different.
- You will perform strategically and tactically sub-optimally in many negotiations.
- Critically self-assess your performance.
- What did you do wrong? What did you do right?
- Maintain a journal, noting mistakes and remedies for improvement for next time.

The New Venture Life Cycle
- Seed Stage
- Startup Stage
- Professional Funding Stages (Series A, B, …)
- Exit Stage
- Maturation Stage

Capital Providers – Professional Funding Stages
- Strategic Partners
- Venture Capitalists
- Private Equity

Types of Securities VC's Receive in Exchange for their Investment
- Convertible Preferred
- Redeemable Preferred
- Participating Convertible Preferred
- Participating Convertible Preferred with CAP

The Term Sheet
- The non-binding agreement on terms of the exchange of company's equity (in form of preferred stock) for cash.
- Triggers significant, time-consuming, and costly due diligence
- Changes owner composition of company

Private Company Valuation
- Subjective – based on assumptions of future performance
- Comparables may be difficult to research
- Pre-money valuation used in term sheet to determine
    - Equity percentage purchased
    - Price per share purchased by VC
    - Number of shares purchased by VC
- Post-money valuation – Pre-money valuation + Investment

EBITDA Multiple Method
- Simple in application
- Much embodied in single number – multiple
- EBITDA may need to be normalized to reflect "normal" trailing twelve months
- V = EBITDA x Multiple

Discounted Free Cash Flow (FCF) Method
- More rigorous in using actual FCF projections
- Terminal Value still requires use of EBITDA Multiple method

- Need to determine discount rate
- $V = FCF_1 / (1 + RR)^1 + FCF_2 / (1 + RR)^2 + \ldots + TV_n / (1 + RR)^n$

The Capitalization Table
- a table showing the post-financing capitalization
- the cap table for FantasyNet after CRV's "A" round investment:

	Shares Outstanding	% Ownership
Founder (Common Stock): Tim Bayliss	2,000,000	67.78%
Investor (Preferred Stock): CRV	950,683	32.22%
Total Common Equivalent:	2,950,683	100.0%

Series "A" Preferred Share Dividends
- "A" refers to first round of professional funding
- "B" would be second round, "C" third, and so on
- Shares do not have to be dividend-paying
- If they are, can be
  - Cumulative – if not paid, accumulate to pay at a later date
  - Preferential – over any dividends paid to common stockholders
  - Compounded – monthly or annually or not compounded
  - Rate determines annual obligation (15% of $8 million investment = $1.2 million dividend)

Events Triggering Liquidation Preference
- Asset Sale
- Merger or Consolidation where FantasyNet owners own less than 50% of new company
- Liquidity Event (liquidation, dissolution, or winding down of business)

Liquidation Preference
- Preferential right to proceeds on Liquidation Events
- VC's may receive X times original purchase price plus accrued or declared but unpaid dividends
- VC's may also be able to "participate" in sharing of remaining assets depending upon type of Preferred shares purchased

Redemption
- Provides the VC the right to redeem original investment (or X times original investment) on or after some future date
- Included in nearly all term sheets

Anti-dilution Provisions
- Invoked on a "down round"
- Full Ratchet
  - Most investor favorable
  - Disregards relative size of "down round" investment
- Weighted-Average Approach
  - More company favorable
  - Considers the relative size of "down round" investment compared to prior round investment
- Term sheet does not have to have an anti-dilution provision, but VC will want it included

Conversion Rate
- Initially set at 1:1
- Will change if anti-dilution provision is invoked
- Determined by dividing original purchase price by lower down-round price

Automatic Conversion
- Preferred shares will be converted to common shares
- On vote of Preferred shareholders, or
- An IPO of a pre-determined size

Protective Provisions

- Designated actions that would require approval of Preferred shareholders
  - Changes the rights, preferences or privileges of the Series A Preferred
  - Increases or decreases the authorized number of shares of Common or Preferred Stock
  - 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
  - Results in the redemption or repurchase of any shares of Common Stock
  - 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
  - Amends or waives any provision of the Company's Certificate of Incorporation or Bylaws
  - Increases or decreases the authorized size of the Company's Board of Directors
  - Results in the payment or declaration of any dividend on any shares of Common or Preferred Stock
  - Issuance of debt in excess of $100,000

Board of Directors

- Established through negotiations
- Smaller board is better
- VC's will initially not want a majority position on the board if they take a minority equity position in the company
- VC's want representation to stay informed and to voice their opinion
- Term sheet may include change in board representation upon the occurrence of some adverse event

Right of First Refusal (RFR) and Co-Sale Agreement (CSA)

- Jointly prevents a founder or major stockholder from selling or transferring shares without the company or investors from participating in the sale to maintain the pro-rata ownership percentage.
- Investors may or may not choose to participate

Bring-Along Right

- In the event of an acquisition offer of a pre-determined size, Preferred stockholders can force reluctant common stockholders from preventing the acquisition.
- Dissenting stockholders will have a period of time to match offer.

Stock Vesting

- Establishes a schedule for affected parties to gain ownership of shares over time and according to a schedule
- Affected parties may include:
  - Employees (including the founder)
  - Directors
  - Consultants
  - Other service providers
- Accelerated vesting can take effect on
- Merger, consolidation or sale of assets
- Termination of employee without cause

Exclusivity

- VC wants no "shopping around" for alternative funding sources during due diligence
- Prevents any potential acquisition during exclusivity period
- Normally ends after 30 days following conclusion of audit during post-term sheet due diligence

FantasyNet
Debriefing and Self-Assessment Report

Negotiation Case: ____

Name: ____

Other Team Member(s) Name(s): ____

Please provide your insights into the following questions regarding your negotiation. The objective of this debriefing report is to analyze the negotiation from various perspectives. The objective is not to provide merely a description of negotiation. Your responsibility is to provide insights into the negotiation experience from the initial preparation through to the final decision to either come to an agreement or leave the negotiation without an agreement. Be efficient with your writing. Quality is much more important than quantity.

How did you prepare for the negotiation? What goals did you set? How did you prioritize your goals? How did you attempt to understand the interests of your counterpart(s) and to anticipate their strategy?

What was your initial strategy going into the negotiation and did you alter your strategy at any time during the negotiation?

What were the critical moments in the negotiation during which you feel the negotiation was at one or more critical points, that is, points where it appeared that the parties were at an impasse on one or more issues and/or the relationship seemed to be going in the wrong direction and/or an agreement was not going to happen. How did you handle those critical moments?

How would you assess your performance in the following areas?

Achieving your negotiation objectives

Implementing your strategy

Achieving your own personal negotiating performance goals (for example, approaching the negotiation from a value-creation perspective, listening to your counterpart, understanding your counterpart's interests, being less competitive, maintaining focus, advantageously framing your positions, building a good relationship, negotiating ethically)

Crafting an agreement that has value to you or not agreeing to an agreement that you feel does not provide you with a better situation than one without an agreement.

How would you assess your personal performance as a negotiator? What areas did you recognize that you can improve upon? Were there areas of performance that you feel you had an improved performance?

REFERENCES

Bartlett, J. W. (1999). Negotiating the best valuation and terms for early-stage investment. *The Journal of Private Equity, 2*(3), 7-14.

Bartlett, J. W. (1995). *Equity finance: Venture capital, buyouts, restructurings and reorganizations.* New York: John Wiley & Sons.

Berg, A., & Gottschalg, O. (2005). Understanding value generation in buyouts. *Journal of Restructuring Finance, 1*(2), 1-29.

Berlin, M. (1998). That thing venture capitalists do. *Business Review,* January/February, Federal Reserve Bank of Philadelphia, 15-26.

Bienz, C., Hirsch, J., Street, H., de la Reforma, P. P., & de Santa Fe, C. L. (2006). The dynamics of venture capital contracts. *CFS Working Paper no. 2006/11*, Frankfurt.

Christofidis, C., & Debande, O. (2001). Financing innovative firms through venture capital. Luxembourg: European Investment Bank Sector Papers.

Davila, A., Foster, G., & Gupta, M. (2003). Venture capital financing and the growth of startup firms. *Journal of Business Venturing, 18*(6), 689-708.

Fisher, R., Ury, W., & Patton, B. (1991). *Getting to yes: Negotiating agreement without giving in.* New York: Houghton-Mifflin.

Gompers, P. A., & Lerner, J. (2004). *The venture capital cycle.* Cambridge: The MIT Press.

Halloran, M. J., Benton, L. F., Lovejoy, J. R., Kearney, K. L., & Gunderson, R. V. (1983). *Venture capital & public offering negotiation.* New York: Harcourt Brace Jovanovich.

Hellmann, T. (1998). The allocation of control rights in venture capital contracts. *Rand Journal of Economics, 29*(1), 57-76.

Holaday, J. W., Meltzer, S. L., & McCormick, J. T. (2003). Strategies for attracting angel investors. *Journal of Commercial Biotechnology, 9*(2), 129-133.

Kaplan, S. N., & Strömberg, P. (2004). Characteristics, contracts, and actions: Evidence from venture capitalist analyses. *Journal of Finance, 59*(5), 2177-2210.

Landstroem, H., Manigart, S., Mason, C., & Sapienza, H. (1998). Contracts between entrepreneurs and investors: Terms and negotiation processes. *Frontiers of Entrepreneurship Research, 1998*, 571-585.

Lax, D. & Sebenius, J. (2006). *3-D Negotiations*. Boston: Harvard Business School Press.

Lewicki, R., Lewicki, R. J., Saunders, D. M., & Barry, B. (2009). *Negotiation*. Burr Ridge, IL.: Irwin.

Malhotra, D. & Bazerman, M. (2007). *Negotiating Genius*. Boston: Harvard Business School Press.

Metrick, A. (2006). *Venture capital and the finance of innovation*. New York: John Wiley & Sons.

Norton, E., & Tenenbaum, B. H. (1992). Factors affecting the structure of US venture capital deals. *Journal of Small Business Management, 30*(3), 20-29.

Parker, S. C. (2006). *The life cycle of entrepreneurial ventures*. NewYork: Springer.

Pearce, R., & Barnes, S. (2006). *Raising venture capital*. New York: John Wiley & Sons.

Raiffa, H. (1982). *The art and science of negotiation*. Cambridge: Harvard University.

Reid, G. C. (2003). *Venture capital investment: An agency analysis of practice*. New York: Routledge.

Rosenstein, J., Bruno, A. V., Bygrave, W. D., & Taylor, N. T. (1993). The CEO, venture capitalists, and the board. *Journal of Business Venturing, 8*(2), 99-113.

Shell, G. R. (2006). *Bargaining for Advantage*. New York: Penguin.

Shepherd, D. A. (1999). Venture capitalists' assessment of new venture survival. *Management Science, 45*(5), 621-632.

Smith, D. G. (2005). The exit structure of venture capital. *UCLA Law Review, 53*, 315-348.
Smith, G. (2005). *Control and exit in venture capital relationships*. Berkeley: University of California.

Smith, R. L., & Smith, J. K. (2000). *Entrepreneurial finance.* New York: John Wiley & Sons.

Sohl, J. E., & Sommer, B. (2006). Angel investing: Changing strategies during volatile times. *Journal of Entrepreneurial Finance and Business Ventures, 11*(2), 27-47.

Vinturella, J. B., & Erickson, S. M. (2004). *Raising Entrepreneurial Capital*. Burlington, MA: Elsevior.

Wilmerding, A. (2006). *Term sheets & valuations: A line by line look at the intricacies of term sheets & valuations.* Boston: Aspatore.

Wright, M., Hoskisson, R. E., Busenitz, L. W., & Dial, J. (2001). Finance and management buyouts: Agency versus entrepreneurship perspectives. *Venture Capital, 3*(3), 239-261.

Zider, B. (2000). How venture capital works. *IEEE Engineering Management Review, 28*(2), 96-103.

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

Synergy is when the whole is greater than the sum of the individual parts. Synergy in business requires imagination, creativity and innovation. Rain Dance Property Solutions, Inc. evolved from such a process. This case presents entrepreneurship and synergy at work and the problems that arise when the original entrepreneurial concept is ignored in the implementation process.

This case covers entrepreneurship, new venture creation, and the implementation of entrepreneurial concepts. The case further illustrated the need for conducting proper due diligence and having a strong leadership team in a merged, in an entrepreneurial venture.

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.

INSTRUCTOR'S NOTES

This case is appropriate for an undergraduate class in entrepreneurship or small business management. The case can be used in a number of ways: as a take home exam using assigned questions; as homework case for analysis and subsequent class discussion; as a team assignment for role playing the views of the partners, or used for in-class discussion particularly for problem identification and brainstorming of solutions. The case also works well following the discussion of entrepreneurial characteristics. The case can be used early in the course as an introduction to the process of entrepreneurship and to illustrate the issues involved in a new combined start-up.

This case has been successfully used in an innovation/creativity class. This case generates a great deal of interest by students in a number of business majors. It demonstrates the need for well-though out strategy and its implementation and thus is of interest to students in principles of management courses as well as strategic management, particularly at the undergraduate level. The case highlights marketing, accounting, and financial differences and it further allows students the opportunity to “fix the problem” with innovative ideas.

The *Epilogue* at the end of the Instructor’s Notes can be used as a follow up for discussion and to update students on the current status of Rain Dance.

Learning Objectives

- To introduce students to the various stages of the entrepreneurial life cycle, particularly focusing on making a good innovation or idea successful.
- To explore partnership and agreements and discuss challenges with selecting an entrepreneurial team and challenges in implementing the idea when multiple entrepreneurs are involved.
- To review the difficulties in implementing the plan and why planning seems to often take priority over day-to-day activities.
- To critique the value proposition of Rain Dance and explore the backgrounds and the aspirations of the individuals involved.

Questions for In-Class Discussion:

1. **Was the idea of a “one-stop” shop for home maintenance a good idea?**

Yes, this is especially appealing to customers with high income levels who value their free time over cost. The emphasis is on service, quality work, and maintenance-free residences, each of which is important to higher-income homeowners. In addition, the demographics findings indicated there are a large number of potential customers within the immediate area. The state itself has other pockets of high-income areas that are ideal for franchising the venture. Contiguous states at the borders also are well-established with prosperous communities that also would be targets for franchise operations.

2. **What are the advantages and disadvantages of combining the concept of multiple businesses into one?**

Assuming the merger is successful, advantages include: (1) improved coordination of services for clients with multiple services being available with “only one p[hone call”; (2) the opportunity to market additional services to a client when making a specific service call (3) greater potential market for services due simply to the combining of customer lists of each of the individual businesses (there was little duplication of clients between the three businesses; and (4) cost savings in employees that overlap in functions (reduction in personnel costs) as well as overhead savings for the individual businesses, especially after the physical consolidation of the three ventures; and (5) the opportunity to expand the variety of services even into other areas as a result of the synergistic effect of the combination (i.e., not only remodeling services but aesthetic indoor and outdoor design/decorating).

Disadvantages of a successful merger include: (1) coordination of administrative functions; (2) possible downsizing of operations with adverse effects in long-term employees who are displaced; (3) difficulty in cross-training existing employees; (4) inability or problems in imposing new rules and restrictions on current employees; and (5) possible loss of control by previous entrepreneurial owners.

3. **Discuss the characteristics of entrepreneurs that both support and limit such a business combination.**

Characteristics of entrepreneurship and entrepreneurs that could impact the business, both in terms of support and limitations, include: (1) the need of the entrepreneur (in this case, Hatcher) to be in control of all aspects of the business, either directly or indirectly by supervising functions delegated to other individuals; (2) the need for organized efforts to implement and manage the venture; (3) the failure to recognize functional deficiencies especially in the areas of marketing, accounting, and finance; (4) tenacity and perseverance; (5) an understanding of the concept of, an need for competitive advantages; (6) the ability to anticipate and quickly react to market opportunities and changes; (7) detailed planning both before and after the business has been set-up; and (8) conscious innovation and creativity.

Assigned Questions and Solutions:

1. **Is there a potential market for the services of Rain Dance?**

To get a better understanding or their target market, students should review on-line demographics of the Chattanooga, TN area and of Lookout Mountain, in particular. The following data was from the Chattanooga Hamilton County's Chamber of Commerce. The Lookout Mountain community of Chattanooga's population was 1,881 individuals in 2006 living in 836 homes: 791 occupied; 723 owners occupied; and 68 renter occupied. Since there are such a large number of homeowners there are lots of prospective clientele who could be looking for permanent work such as renovations, landscaping and other services Rain Dance has to offer.

The estimated median household income in 2006 was $105,100 with 62.35% of households making $75,000 or more and 21.16% making $200,000 or more. The estimated median house/condo value is $447,800, with most homes ranging from $200,000 to $1 million. Sixty-five percent of Lookout Mountain residents have lived in the same house for at least five years. Thirty-nine percent of houses were built in 1939 or earlier, eighty-four percent were built in the 1970's or earlier and only 4.5% of houses were built from 1990 on. This means that the majority of houses on Lookout Mountain are at the point where maintenance, renovation and updating are necessary.

This is a prime market for Rain Dance to reach and help get their business up and going. One of Rain Dance's most influential types of advertising could be word of mouth. When people see and hear about Rain Dance's many services, they will want to give them. Communities like Lookout Mountain, however, do not allow billboards, sign advertisements in yards, or other marketing materials. Rain Dance must use on-vehicle marketing and find other methods to reach this potentially lucrative audience.

2. Is the business a good idea? Support your answer.

Yes, the business has great potential, especially for affluent homeowners. Positive points include: name recognition; an understanding of the challenges (identifying the right person to market and the person to launch the enterprise); the existence of an experienced, licensed and independently skill-certified staff; and an established client base. It must, however, be operated as a consolidated entity to capitalize on the idea and to provide the array of services it has marketed to the community. In addition, there must be a systematic effort to engage in innovative and creative activities and anticipate consumer needs and new markets.

3. What mistakes were made that could have been avoided?

- Management should have been hired from the outside rather than relying on the talents of the principals
- Due diligence was not exercised in the valuation of contributed assets and incurred liabilities
- Each business should have undergone an independent business appraisal prior to merging
- Details of organization and implementation were unresolved for too long a period of time
- The strategic plans developed were not carried through in company implementation and company operations
- A statement of the financial position (a beginning balance sheet) of the newly formed company was not developed
- Overall, the financial projections were based on unsubstantiated and realistic methods and the principals never sought professional financial advice. For example the basis of the valuation of the stock was made without the report from the CPA. In addition, the method of valuation - combined total aggregate sales and project gross profit -- was unrealistic and implied that there was equity in the new company that did not exist. Moreover, the per-share stock valuation was indefensible, especially in light of the undisclosed debt.

4. What are the limitations of having multiple partners?

The key limitations are lack of control and the need for an organizational structure that may dilute the role and authority of some of the partners. For example, they cannot all be CEOs and this may be a difficult transition for some or most entrepreneurs. In addition, as the business grows or changes, some partners may not be able or willing to adjust to these events, thus impeding the adoption of new ideas and/or the need to eliminate or change existing activities. A disgruntled partner can be destructive and can lead to a forced or voluntary buy-out.

5. Would a looser supply chain or referral program be preferable to linking the companies together?

Rain Dance will find that their largest competitors will be small companies that appeal to home and property owners simply because the potential customer may not need everything that Rain Dance is offering. Customers could include plumbers, landscaping firms, electrical contractors and remodeling firms, heating and air conditioning firms, and other property maintenance firms. However, Rain Dance does provide extended financing, while most other companies will not, which could be a large deciding factor for many homeowners.

6. Could joint marketing or promotions achieve the same objective?

Possible joint marketing or promotions could achieve the same objective but customers would not just be interviewing or finding out about one company but multiple companies. This combination offers ease of service for the customer.

Marketing is also easier in the combined firms with possible cost savings from the elimination of duplicative services and negotiated lower pricing for promotional materials.

7. How is the formation different from traditional entrepreneurial start-ups? Are these differences advantages?

The only entrepreneur was Hatcher. The three remaining principals did not understand the concept of entrepreneurship. The purpose of the business was clearly delineated and a detailed strategy was developed. Without Hatcher's involvement, there was no entrepreneur to oversee the vision and objectives of Rain Dance. This was contrary to an entrepreneurial principle that the entrepreneur must be the driving force of the operational aspects of the venture.

In addition, there was no due diligence indicated prior to and during the start-up by any of the principles. These start-up differences were a major disadvantage to the success of the business and in effect, prevented Rain Dance from achieving its entrepreneurial objectives.

8. What are the opportunities and threats of combining businesses in general? What about these three in particular?

In general and for the three specific companies, opportunities include cost savings broader market appeal and the ability to reach a unique market niche. The threats are the difficulties in merging three existing businesses as well as reaching agreement between three entrepreneurs about the structure, mission, and strategy of the new company. Even with the help of a management consultant, the transition was difficult. Often it may be easier for one owner to buy out the other businesses while retaining some of the skilled employees to reach successful operations in a faster time frame. Other threats include failure to successfully execute the merger, and loss of personalized serviced provided by a smaller, single business.

9. Do you agree with their mission statement and key objectives for 2007? 2008?

Students should note that while short and succinct, the mission and objectives for 2007 seem appropriate for the ideas and vision discussed by the owners. Students should also note that few changes were made to either document between 2007 and 2008, at least few material changes. One issue that "A" students should note is the continued emphasis on planning and creating missing statements seems to be preventing action toward the successful merger of the companies.

10. Prioritize the SWOT analysis variables provided. Are some issues in the wrong category? Discuss.

Students should note the large number of weaknesses the company is facing. The top strengths seem to be their current customers and the combination of companies. Since the case discusses the issues with the combination of the companies, it appears the second strength is not entirely true and may be more of a weakness. For weaknesses, it seems the top two issues are lack of a CEO or appropriate leadership and role definition and the fact the organization structure is incomplete. With effective leadership in place with the authority and responsibility to put appropriate individual in key positions, many of the marketing, accounting, and financial issues could be quickly resolved. For opportunities, the aging houses in the Chattanooga and Lookout Mountain area in particular, seem to be a good opportunity along with an aging population that may not have the time or skills for home maintenance. As for threats, the ease of entry of more cohesive competitors is a threat but probably the key threat is the economy and the declining housing market. However, when economic conditions improve, there should be opportunities to perfume maintenance on houses and other properties that have deferred these services.

11. What should their new marketing strategy be?

It is important to effectively market the new combined company. First they should merge the customer list of the three former entities and develop a letter of introduction and promotional brochure listing the new expanded list of services and mail these to current customer. Employees should receive sales training and pricing information so they can cross sell additional services to existing customers.

Next the firm must begin a complete marketing and promotional campaign to spread the work about their services in traditional locations including yellow page advertising, newspapers, billboards, and advertisements on their service vehicles. Since word-of-mouth is critical, calling on neighbors and asking for customer referrals is important as is a web-site and more emerging marketing forms including a Face book page and various blogs discussing maintenance and landscaping and perhaps even a Twitter page with recurring seasonal "tweets" to customers as a reminder for upcoming services. Working with home shows, booths at trade shows, and soliciting builders and realtors for referrals is also recommended.

12. Will Rain Dance survive? Why?

Recommend innovative strategies to resolve the problems facing Rain Dance.

Students should brainstorm possible team meetings, face-to-face interaction, and ways to resolve the problems with the partners and the structure. Students may want to role play the meeting and decisions to resolve the issues.

Discuss the objectives of each of the partners. Why is there conflict? What skills/abilities/traits, etc. is the team lacking?

Students should do a strengths/weakness analysis on the partners and discuss what they bring to the leadership team.

The short answer is "yes" Rain Dance will survive, especially in the current form. It basically is operating as two separate companies under one roof. Bickley (contract side) is very strong and can subsidize the irrigation division if necessary. The irrigation side is stable but probably will not grow because of the absence of an effective marketing plan.

13. Is this business one that could be franchised?

Yes, this company could be franchised. Hatcher had described every step of the "how to" organize such a business. Strategic plans, objectives, and operational strategies had been developed in great detail. The lack of an actual business to demonstrate the potential success of the idea, however, would be a major disadvantage for future franchising success.

EPILOGUE

Faculty may want to share and discuss the following epilogue with students after thoroughly analyzing the case.

Hatcher had personally bought the building he located in late 2007. Rain Dance finally moved into the new space in January 2008. The purchase was made with the understanding that Hatcher would lease space in the facility to Rain Dance as well as to other businesses. The lease also included a provision that required all the principles of the company to develop the property, i.e., find other leases for the facility. The lease was executed and is still in effect. To date, no other tenants are in the building.

By January 2009, Hatcher had exhausted his patience and decided not to continue acting as a consultant for Rain Dance. The two remaining principals were financially unable to buy out his minority interest in the company so he was still linked to it in terms of his stock ownership. In addition, the potential of the building had not been developed. Hatcher is attempting to separate the ownership of the building from the stock ownership and develop the property on his own.

To date, although there has been substantial interest expressed in the building because of its location, the current market for real estate, particularly commercial real estate, is soft. Hatcher is convinced there is great potential in developing the property or selling it.

As of early 2010, Rain Dance continues to be profitable – i.e., salaries and other expenses were being paid. The owners, however, have yet to receive any dividends from the company. From the beginning of the discussions about the new Rain Dance concept, Hatcher envisioned a strategy for “harvesting” the results of the entrepreneurial venture. With that end in mind, he created and documented a detailed record of the process for establishing and operating duplicate businesses. He intended to franchise Rain Dance Property Solutions, Inc. Despite his inability to fully implement the original idea, he has pursued the franchise concept. To date, he has several interested investors and he is continuing to explore the franchise possibility.

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

David A. Bradbard, Winthrop University
D. Keith Robbins, Winthrop University
Charles Alvis, Winthrop University

CASE DESCRIPTON

The primary subject matter of this case concerns (1) managerial responsibilities with respect to planning, budgeting, and controlling and (2) managerial decision making with the assistance of a decision support system. Secondary issues examined include the use of Excel spreadsheets to construct two-variable data tables and engage in sensitivity analysis. The case has a difficulty level of: appropriate for junior level or senior level management or finance courses. The case is designed to be taught in one 75-minute class and is expected to require two hours of outside preparation by students.

CASE SYNOPSIS

The organizational setting for the case is a moderately sized public university with a total enrollment of 6,500 students. The major players are the Vice President of Finance (Percy Bradshaw) and the Director of Academic Computing and User Support (Gerald Radner). It is early summer and Percy is attempting to finalize the university's budget for the coming academic year. His task is complex for several reasons. First, the state legislature has not completed deliberations with respect to allocations of funds for the coming year. Second, there was a budget shortfall in the current fiscal year that was covered by the university's reserve funds. The university president has stated this cannot happen again.

Percy must present the president with a draft of the budget and he is feeling overwhelmed. Fortunately at this crucial decision time, Percy has a chance meeting with Gerald. As a result of this meeting, Gerald offers to show Percy several tools from Excel that might make Percy's task easier.

Percy needs a way to present the budget so it can quickly be revised as the situation changes. In the case, Percy explains the major variables related to expenses and revenue. Based on this discussion, Gerald shows Percy a way to systematically vary tuition revenues to examine the effect of this variable on the budget.

As state support for universities has declined, most state schools have responded by increasing tuition to offset the diminished funds from the state. Public state universities generally enroll both in-state and out-of-state students. Usually, state universities charge in-state students a lower tuition rate than out-of-state students. The higher tuition paid by out-of-state students provides an incentive for schools to enroll more out-of-state students.

INSTRUCTOR'S NOTES

CASE GUIDELINES

This case is intended for a principles of management or finance course required in most undergraduate business curricula. Students should quickly warm to discussions of such sensitive issues as tuition price increases, student user fees, tuition price discrimination (e.g., like airline seats if you polled five students in a classroom you'd find that no two pay the same tuition), net present value estimates for college education, faculty salaries, and faculty student ratios or class sizes. Students and their parents confront these issues on a year-to-year and semester-to-semester basis. Many students are incurring debt as a means to invest in their financial future. Two areas where the case is relevant include: (1) managerial responsibilities with respect to planning, budgeting, and controlling and (2) managerial decision making with the assistance of a decision support system (i.e., a spreadsheet set up for what-if analysis). The case can be assigned as soon as these topics have been covered.

With respect to area one, the objective of the case is to put students on the managerial spot where they can experience the difficulties of planning, budgeting, and decision-making in a real life situation with which they are relatively familiar. Regarding area two, the objective is to show students effective spreadsheet techniques (i.e., what-if analysis) that can be used for planning, budgeting, and decision-making situations. By using what-if analysis, students can systematically change the input variables to determine the effects on the output variables.

TEACHING APPROACHES

This case was assigned for use in a 75-minute class. The case and the questions (see below) should be assigned prior to the class. In the beginning of the class, students share their responses to the case questions. Instructors may find the anecdotes contained in Appendix A useful for this portion of the class. Approximately 30-35 minutes would be devoted to this activity. Individual student responses to the questions should be collected and graded.

The remaining class time would then be used to discuss the various spreadsheet models. The instructor may use the spreadsheet models in different ways depending on the class's experience level with Excel. For some classes with little experience, the instructor may want to distribute the spreadsheet models and let students experiment with changes in selected variables. For more experienced students, the instructor may ask students to build additional data tables. Should the instructor be interested in providing students with instruction related to data tables, the material in Appendix B will prove useful.

ASSIGNMENT QUESTIONS AND ANSWERS

1. Other than raising tuition or increasing enrollment identify other strategies for the university to increase its revenue stream.

Answer: State appropriations, contracts and grants, and other are the possible areas where the university can increase revenues. With respect to state appropriations, the university can try to persuade state legislators to increase support for higher education. This is an excellent approach for universities if they can convince state legislators of the value of higher education. The difficulty of this approach is that it often requires cooperation of other state universities in order to be effective. More than likely this activity is a long-term rather than short-term solution.

This part of the question provides an opportunity to discuss some of the politics of state supported universities within your state. The best students should be able to bring recent history about state funding of higher education into their answer.

Contracts and fees that the university receives from outsourcers that provide dining services, housing management, or managing the bookstore should be reviewed to determine if the university can save money in this area. Alternately, if the university is not outsourcing these services, then this alternative should be examined.

Contracts for these services are usually multi-year contracts so if the university is already under contract not much can be done. However, for schools not under contract or renegotiating contracts, there is a potential for savings. Depending on the universities situation, this could be either a long-term or short-term solution.

For contracts and grants relating to faculty research, the university can encourage faculty to seek outside contracts and grants. If faculty are successful, these activities can provide monies for new equipment, laboratories, etc. In addition, contracts and grants provide financial support for faculty and students. Unless the university has already developed a successful support system for faculty to pursue contracts and grants, this is a long-term strategy because it takes time to develop the support infrastructure and it takes time for faculty to develop the necessary grant application skills. The university may also have to change the reward structure to encourage faculty to pursue contract and grant applications. If the university can develop a history of successfully competing for contracts and grants, it can lead to an important selling point for attracting faculty and students.

In smaller public institutions students may not have much of an understanding of how contracts and grants work. The instructor may have to discuss how this process works.

With respect to the category other, this will vary from institution to institution.

For some universities, increasing the size of endowed funds is a way to increase revenue. Capital fund drives also serve a similar purpose. For many smaller state institutions this is not a significant part of the revenue stream. The use of endowed funds is a point that brighter students may raise.

2. Consider the university's expenses; identify strategies that the university can pursue that will reduce expenses. For each strategy, discuss whether it is a short- or long-term strategy. For each strategy, discuss the pros and cons.

Answer: The expense variables in the model include: faculty salaries, staff salaries, faculty fringe benefits, staff fringe benefits, services and supplies, and utilities.

Regarding faculty salaries, the most dramatic way universities have reduced this expenditure is to eliminate faculty positions (likewise for staff positions). Reducing the number of course sections or increasing class sizes can also reduce expenditures for faculty salaries.

Other cost-savings can be achieved by leaving vacant positions unfilled (or fill them with part-time faculty) or discontinuing low-demand programs.

With respect to reducing expenditures for faculty salaries (short of eliminating faculty positions), universities have limitations for the following reasons: (a) for new faculty, salaries are often determined by discipline and market condition (e.g., supply and demand). This is also true with respect to veteran faculty and (b) in many states, faculty are considered state employees. Where this is the case the state legislature may mandate a salary increase for all state employees and the university must comply. (c) At universities that have unionized faculty, salaries are determined by collective bargaining between the faculty union and the university. (d) As mentioned above, some economies can be achieved by increasing class sizes or faculty workload. For example faculty could teach four courses per semester rather than three. These strategies have limits due to accreditation standards and/or availability of large classrooms. Further, increasing class sizes may be inconsistent with the university's image. For example, a big part of some universities attractiveness is small classes. (e) As mentioned above, hiring part-time or non-tenure track faculty is a viable strategy for reducing faculty salaries, but there are limits on this approach due to accreditation standards.

For staff salaries, some of the same issues mentioned for faculty apply. For example, some staff are considered state employees, some staff positions are effected by market conditions (e.g., director of computing), and unionization. Most staff positions are related to supporting some part of the university community whether it is students, faculty, alumni, prospective students, parents, or the surrounding community. The Internet provides a universal way to achieve economies by empowering members of the university community to do things on their own. For example, students can use the Internet to pay bills, register for courses, access library facilities, or purchase transcripts. Similar activities apply for the other members of the community. Use of the Internet enables staff to service more constituents without increasing staff size. Further, costs are reduced due to less handling of paper and reduction of errors.

Outsourcing some staff functions is also a potential way to economize on staff salaries. Many universities outsource food preparation and dormitory management. For secretarial staff that supports faculty and administration, there may be some economies by pooling secretarial support rather than assigning full-time secretaries to small academic units.

With respect to fringe benefits for faculty and staff, this is another area where public universities have little control. Benefits such as retirement, health insurance, and life insurance are often determined at the state level. Since most university employees are considered state employees, there is little the university can do to control the costs of these benefits.

For services and supplies, the university should take the following steps: Contracts with outsourcers should be periodically reviewed to determine if the university is paying competitive prices for these services. For supplies, the university should consider centralized ordering policies to take advantage of bulk discounts, long-term contracts with suppliers, or join a consortium with other universities to increase their bargaining power.

Utility costs can be lowered by improving the energy efficiency of buildings and facilities. For new construction, this should be a major design consideration. For older structures, the potential energy savings must be weighed against the costs of improving energy efficiency of these structures. With respect to telecommunication services, in most areas there is intense competition in this industry. The university may be able to benefit from this competition.

3. Describe factors that raise a university's costs and contribute to tuition increases.

Answer: In public universities, tuition has never covered the entire costs of instruction. Most of the short-fall has been made up through state support for public universities. In recent years, public universities have been caught in a vice; enrollments have been increasing but state support has been decreasing. Universities have responded by raising tuition.

Increases in enrollment not only increase costs for instruction, but also increase the cost for student support services.

Universities have also had to use financial resources to stay abreast of new technologies. Schools must constantly upgrade laboratories and information technology to assure that their facilities are compatible with the outside world.

There are many costs that are uncontrolled mentioned earlier such as the cost of energy and health insurance for faculty and staff.

4. Why does the tuition revenue not equate to the number of students times the stated tuition price for in-state plus out-of-state students at Winegar University?

Answer: As described in the case, 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?

5. Since out-of-state students pay more tuition than in-state students, discuss the pros and cons of increasing out-of-state enrollments.

Answer: Since out-of-state students pay more tuition, an attractive option for many schools is to increase out-of-state enrollment. If the university has a good academic reputation, the school may be able to attract high achieving students. Because these students are from out-of-state, they automatically increase the diversity of the student body. Since admission standards for out-of-state students can be higher than the comparative standards for in-state students, the out-of-state students can raise the academic standards of the institution.

This strategy generally causes no problems if the university has the capacity to absorb these students. However, if out-of-state students are displacing in-state students, this will usually cause problems for the university. State legislators and parents of prospective in-state students are not likely to be in favor of increasing out-of-state enrollments at the expense of in-state students.

6. Discuss strategies and policies that your university employs to increase revenues and decrease expenses.

Answer: There is no universal answer to this question as it will vary from school to school. This is a good opportunity to determine how aware students are of university policies.

EPILOGUE

The university that served as the basis for background and budgetary information for the Winegar University case actually experienced a worse than expected worst case scenario. The state general assembly held an emergency session in October 2008 due to the fact that state revenue projections had vastly underestimated the rate of flow of taxes and fees into state coffers. That meant the legislators had to revise the appropriations that had been given each state agency for the fiscal year that began July 1, 2008, and ended June 30, 2009.

The legislature decided to cut public higher education institutions up to 15 percent. At "Winegar" the actual cut was \$3.4 million equal to 14.8 percent of the entire state funding. The university's initial response was to cut its spending by \$3.2 million and to cover the remaining \$215,000 shortfall via a mid-year student assessment fee of \$50.

Two months later the budgetary downward spiral had yet to subside and the state ordered an additional 7 percent cut to the university's state appropriation. This resulted in the university imposing a nine-day furlough plan to compensate for the budgetary shortfall. The furlough covered all university personnel and resulted in a savings of nearly \$200,000 per furlough day (it should be interesting to see how students respond to the notion of student fee increases and/or faculty furlough days). Faculty furlough days were to be taken on non-teaching days so as to be as minimally disruptive as possible.

The additional 7 percent (\$1.6 million) cut comes on top of the \$3.4 million cut from Winegar's state appropriation by the legislature in October and the \$735,000 reduction to its annual appropriation level that took effect last July 1. Therefore for fiscal year 2008-2009, the actual state appropriation was \$5,735,000 below the previous year's level or nearly twice as severe as the forecasted worst case scenario.

REFERENCES

American Association of University Professors (2004). Don't blame faculty for high tuition: The annual report on the economic status of the profession 2003-04. Retrieved from http://www.aaup.org/surveys/04z/zrep.htm

Christian Science Monitor (2003). Costs soar at public universities. Retrieved from http://moneycentral.msn.com/content/CollegeandFamily/P57654.asp

Magrath, P. C. (2003) NASULGC statement on college costs. Retrieved from http://www.nasulgc.org/Public%20Affairs/Collegecosts10-15.pdf

Parsons, J., Oja, D., Ageloff, R. & Carey, P. (2010). *New perspectives on Microsoft Excel 2007, Comprehensive*. Thomson Course Technology:Boston, MA.

Winston, W. L. (2004). *Microsoft Excel data analysis and business modeling*. Microsoft Press: Redmond, WA.

APPENDIX A: ANECDOTAL COMMENTS THAT SUPPORT THE RESPONSES FOR ASSIGNMENT QUESTIONS 1-3

The following quotes and anecdotes come from the Christian Science Monitor (2003)

"Since 1993-94… average tuition and fees have risen 47% ($1,506) at four year public colleges and universities…" (p. 1)

"Over a lifetime, the gap in earnings between those with a high school diploma and a B.A. or higher exceeds $1,000,000, the College Board reports." (p. 2)

"… the average yearly cost to attend a four-year public institution is 71% of the annual income of a family in the bottom economic fifth of Americans, …" (p. 2)

The following quotes and anecdotes come from a statement presented by C. Peter Magrath (2003) while he was president of the National Association of State Universities and Land-Grant Colleges (NASULGC) Land-Grant Colleges.

"The Department of Education estimated in 2002 in *Projections of Education Statistics to 2012* that enrollment in degree-granting postsecondary institutions would increase more than 15 percent between 1999-2000 and 2011-2012." (p. 2)

"The share of states' general fund spending devoted to higher education dropped from 14.6% in fiscal 1990 to 12.7% in fiscal 2002, according to the National Association of State Budget Officers." (p 2)

"In a 1999 NASULGC study, members reported spending an average of about 5% of their operating budgets on information-technology expenditures – a category of spending that exploded during the past decade. They reported that they typically had to patch that funding together from a variety of sources since few federal or state programs provide direct support for such expenditures." (p. 2)

"According to data from the Education Department's National Center for Education Statistics, on average, NASULGC institutions received 14.4% of their current funds revenue from tuition in 1990-91 and 18% from tuition a decade later in 2000-2001. State appropriations made up 34. 7% of the revenues in 1990-91 and 29.3% of revenues in 2000-01." (p. 2)

"The University of Virginia estimates that it has saved almost $2.9 million by burning 89% coal, instead of gas, in its main heating plant, and saved $2.7 million form using central plants to chill water rather than doing this in individual buildings." (p. 3)

"Many institutions have modernized their lighting systems for considerable savings. The University of Virginia calculates total savings of $818,000 from lighting upgrades." (p. 3)

"Many institutions have saved considerable money through improving purchasing systems or joining purchasing consortia. The University of Michigan spearheaded formation of the Michigan Life Sciences Purchasing

Consortium, covering itself and three other institutions …. The consortium successfully negotiated contracts with four of the biggest suppliers of life-science materials …. resulting in savings for Michigan of about $95,000 in fiscal 2002 and savings of $550,000 for the other institutions." (p. 4)

"The University of Missouri estimates that about $6 million will be saved through a variety of consolidated standardized procurement and purchasing services, including use of an insurance consortium." (p. 4)

"Many institutions have upgraded administrative and financial systems to use electronic rather than paper systems to save processing costs,...For example, Oakland [University] estimates that it saves $50,000 a ear in paper and staff time by having its accounting department send monthly financial reports to campus departments electronically rather than sending paper copies.".. (p. 4)

"A great many universities have contracted with private companies to save money on items including food services, book stores, custodial services, and vehicle maintenance. The University of North Carolina at Chapel Hill outsourced operation of an inn on campus, which now is generating rent payments of more than $1.5 million annually." (p. 4)

"Institutions also closed low-demand programs and reallocated funds to upgrade the quality of high-demand programs. For example, the Pennsylvania State University will save $464,000 by closing a mineral economics program and merging its business logistics program with its management science and information systems program." (p. 4)

"The University of Binghamton-SUNY eliminated its MBA in the Arts program to free funds for other programs. The University of Mississippi eliminated several masters programs, including its Master of Fine Arts in Theater Arts program so as to focus resources on undergraduate programs, including its Bachelor of Fine Arts." (p. 4)

The following quotes and anecdotes come from *The Annual Report on the Economic Status of the Profession 2003-04* (American Association of University Professors [AAUP], 2004).

"The rate of increase in the consumer Price Index between December 2002 and December 2003 was 1.9 percent, a smaller increase than the previous year's 2.4 percent. Given that average faculty salaries increased by only 2.1 percent, the real increase in average faculty salaries this year was extremely small: .02 percent." (p. 23)

"The data collected for the AAUP's salary survey are for full-time instructional faculty. In recent years, however, a growing share of faculty have been employed in contingent positions -- part- or full-time non-tenure-track appointments." (p. 24)

"The cost to colleges and universities of the medical and dental insurance they provided to their faculty members averaged 8.1 percent of faculty salaries in 2003-04. The comparable percentage for 2002-03 was 7.6; five years ago, in 1998-99, the percentage was 6.2." (p. 24)

"… colleges and universities often claim that faculty salary increases are among the major reasons that tuition persistently increases an average of 2.0 to 3.5 percentage points more each year than the rate of inflation. This past year's experience suggests that this argument does not always hold. As has been noted, tuition and fees rose by an average of 6.0 percent at private four-year colleges and universities between 2002-03 and 2003-04 and by 14.1 percent during the same period at public two- and four-year institutions. … however, that average faculty salaries at private four-year institutions rose by approximately 3 percent this past year, and average faculty salaries at most public two- and four-year institutions rose by less than 2 percent." (p. 29)

"Annual rates of increase in faculty salaries between 1990-91 and 2002-03 were again substantially less than the annual rates of increases in average tuition and fees." (p.30)

"The bottom line is that although faculty and staff salary increases obviously contribute to increases in tuition, other factors have played more important roles during the last quarter century. These factors include the escalating costs of benefits for all employees, reductions in state support of public institutions, growing institutional financial-aid costs, expansion of the science and research infrastructure at research universities, and the increasing costs of information technology." (p. 30)

APPENDIX B: DATA TABLES

A significant feature of spreadsheets is they permit users to vary the values of one variable and observe how these variations affect the values of other variables. Such activity is called “what-if” analysis. What-if analysis is enabled in Excel through one- and two-variable data tables. Data tables are a way to organize and display the results of multiple what-if analyses. Excel supports two kinds of data tables: one-variable and two-variable.

One-Variable Data Tables

Data tables enable users to examine the relationships between input variables and output variables in a mathematical model. In Figure 1, a simple mathematical model appears that involves the relationship among the variables interest rate, term, loan amount, and total payments. The monthly payment is calculated by using the PMT function from Excel. The total payments variable is the product of the monthly payment and the term.

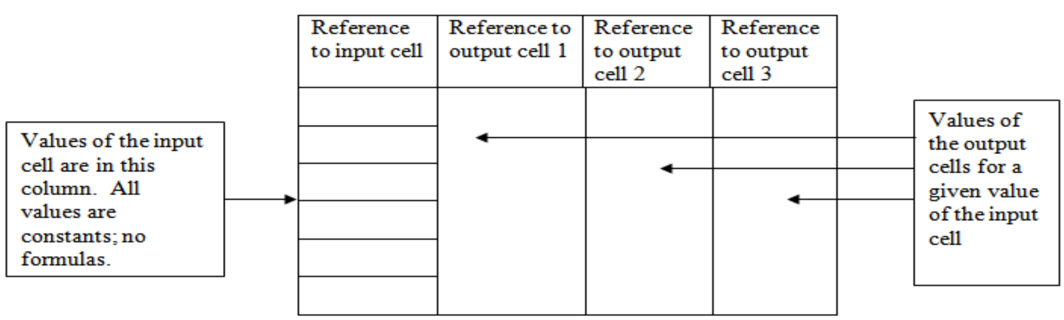
Data tables involve two important types of cells: input cells and output cells. An input cell contains a variable you want to vary, and an output cell contains a variable you want to examine under the variations of the input cell. Consider the mathematical model in Figure 1 where the values for the monthly payment and total payments are calculated based on the values of the interest rate, term, and loan amount. In this example, the variables in cells B3-B5 are all possible input cells while variables in cells B6-B7 are possible output cells. In the text that follows, we will develop a one-variable data table where the value of the interest rate cell (input cell) is varied to determine its impact on the monthly payment and total payment cells (output cells). This example enables users to determine how variations in the interest rate effect the monthly and total payments.

***Figure 1.* Car loan analysis with formulas.**

	A	B	Formulas used in column B
2	Car Loan Analysis		
3	Interest Rate	4.50%	0.045
4	Term (months)	60	60
5	Loan amount	$15,000	15000
6	Monthly payment	$279.65	=PMT(B3/12,B4,B5)*(-1)
7	Total payments	$16,779	=B6*B4

The general procedure for building a one-variable data table is to build a spreadsheet with the structure shown in Figure 2. In this structure, the upper left corner cell contains a reference to an input cell. The cells to the immediate right contain cell references to cells containing the output variables. As the diagram suggests, there can be more than one output variable in this type of analysis. The column immediately under the reference to the input cell will contain the possible values of the input variable.

***Figure 2.* General format for a one-variable data table.**



For the car loan analysis, a one-variable data table would look like Figure 3. Once you have the spreadsheet in the form of Figure 3, select the rectangular range D3:E14. Next click on the Data option on the top line of the Excel screen, then click on What-if- analysis, and finally click on Data Table.

***Figure 3.* Set up for a one-variable data table.**

	A	B	C	D	E
2	Car Loan Analysis				
3	Interest Rate	4.50%		=B3	=B6
4	Term (months)	60		.040	
5	Loan amount	$15,000		.041	
6	Monthly payment	$279.65		.042	
7	Total payments	$16,779		.043	
8				.044	
9				.045	
10				.046	
11				.047	
12				.048	
13				.049	
14				.050	

After this final click, you will see the Data Table window in Figure 4. Since the input variable is varied in a column, you fill in the Column input cell. For this example, the entry would be "=B3". When you click on OK, you are instructing Excel to substitute each value listed in the range D4:D14 into the input cell B3, and place the corresponding result(s) for the output variable(s) in the appropriate column(s) in the data table. Once you click on OK you will see the results shown in Figure 5.

***Figure 4.* The Data Table window for what-if analysis .**

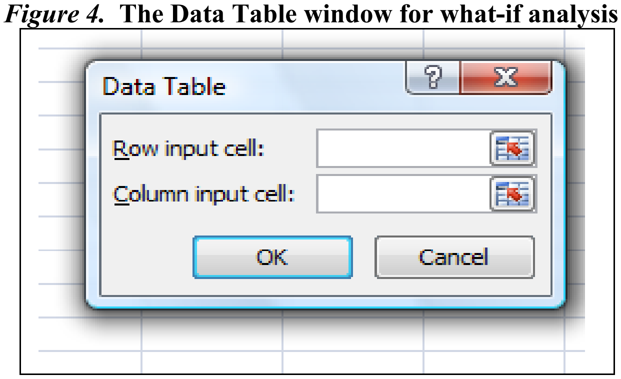


***Figure 5.* Results for the one-variable data table.**

	A	B	C	D	E
2	Car Loan Analysis				
3	Interest Rate	4.50%		4.50%	$279.65
4	Term (months)	60		4.00%	$276.25
5	Loan amount	$15,000		4.10%	$276.93
6	Monthly payment	$279.65		4.20%	$277.60
7	Total payments	$16,779		4.30%	$278.28
8				4.40%	$278.96
9				4.50%	$279.65
10				4.60%	$280.33
11				4.70%	$281.01
12				4.80%	$281.70
13				4.90%	$282.38
14				5.00%	$283.07

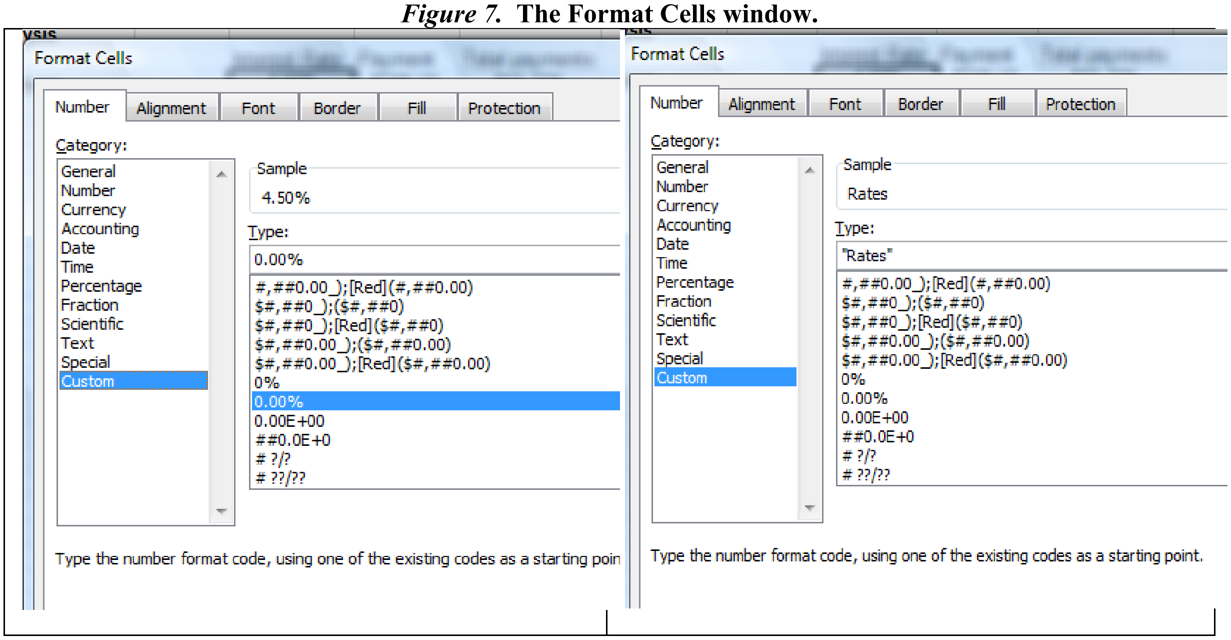
One-variable data tables can have more than one output variables for a single input variable. Specifically, you could also examine how the total payments over the life of the loan vary as the interest rate varies. This is done by adding another cell reference to the output cell B7 as shown in cell F3 of Figure 6. Next you would select the rectangle defined by the range D3:F14. The remaining steps are identical to the previous example.

***Figure 6.* Set up for a one-variable data table with two output variables.**

	A	B	C	D	E	F
2	Car Loan Analysis					
3	Interest Rate	4.50%		=B3	=B6	=B7
4	Term (months)	60		.040		
5	Loan amount	$15,000		.041		
6	Monthly payment	$279.65		.042		
7	Total payments	$16,779		.043		
8				.044		
9				.045		
10				.046		
11				.047		
12				.048		
13				.049		
14				.050		

The appearance of the data table in Figure 5 can be improved if the entries for cells D3 and E3 are customized in the following manner. In particular, the data table would read better if the labels "Rates" and "Payments" were displayed in cells D3 and E3, respectively. This can be done by selecting cell D3 and clicking on Number/Format/Cells. The Format Cells dialog box appears in the left side of Figure 7. Click the Number tab and click Custom in the Category list box. Delete the contents of the Type box. Enter "Rates" in the Type box as shown in the right side of Figure 7, then click on the OK button. The label "Rates" will display as the column heading, but the underlying formula is used in all calculations. In a similar manner, cell E3 can be formatted to display the word "Payments."

***Figure 7.* The Format Cells window.**



Two-Variable Data Tables

Excel also permits data tables where you can simultaneously vary two input variables and observe the effects on a single output variable. For example, in the car loan analysis, you might want to simultaneously vary the interest rate and the terms of the loan to see the effect on the monthly payment. The general format of the two-variable data table is shown in Figure 8.

***Figure 8.* Structure of the Two-Variable Data Table.**	
Cell reference for the output cell.	Values of the first input cell (no formulas). These are the values for the row input cell.
Values of the second input cell (no formulas). These are the values of the column input cell.	This part of the table contains values of the result cell when various combinations of values for the first and second input cells are used in the model.

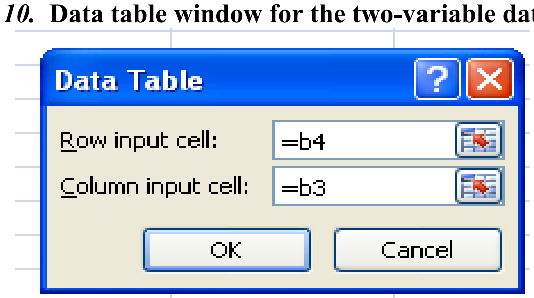
For the car loan analysis, we might want to vary interest rates from 4% to 5% in increments of .01%, and at the same time vary the terms of the loan from one to five years (i.e., 12 to 60 months in increments of 12). The starting layout of the spreadsheet appears in Figure 9.

***Figure 9.* Starting layout for the two-variable data table.**

	A	B	C	D	E	F	G	H	I
2	Car Loan Analysis								
3	Interest Rate	4.50%		=B6	12	24	36	48	60
4	Term (months)	60		.040					
5	Loan amount	$15,000		.041					
6	Monthly payment	$279.65		.042					
7	Total payments	$16,779		.043					
8				.044					
9				.045					
10				.046					
11				.047					
12				.048					
13				.049					
14				.050					

Once you have the spreadsheet in the form of Figure 9, select the rectangular range D3:I14. Next click on the Data option on the top line of the Excel screen, then click on What-if- analysis, and finally click on Data Table. The data window shown in Figure 4 will appear and it should be completed as shown in Figure 10. By filling out this window, you are requesting Excel to systematically substitute pairs of values in the ranges E3:I3 and D4:D14 for B4 and B3, respectively. As each pair is substituted in the model a new value for the monthly payment is calculated and placed in the data table. In other word, you are asking Excel to try all possible combinations of values for ranges specified for the input variables and place the corresponding value of the output variable in the data table.

***Figure 10.* Data table window for the two-variable data table.**



The results for the two-variable data table are shown in Figure 11. Note that the cell in the upper left corner was formatted to display the column heading "Rates."

***Figure 11.* Result for the two-variable data table.**

		Terms			
Rates	12	24	36	48	60
4.00%	$1,277	$651	$443	$339	$276
4.10%	$1,278	$652	$444	$339	$277
4.20%	$1,279	$653	$444	$340	$278
4.30%	$1,279	$653	$445	$341	$278
4.40%	$1,280	$654	$446	$341	$279
4.50%	$1,281	$655	$446	$342	$280
4.60%	$1,281	$655	$447	$343	$280
4.70%	$1,282	$656	$448	$343	$281
4.80%	$1,283	$657	$448	$344	$282
4.90%	$1,283	$657	$449	$345	$282
5.00%	$1,284	$658	$450	$345	$283

Additional material on one- and two-variable data tables is available in books that specialize in Excel (e.g., Oja, D., Parsons, J, Carey, P., & Ageloff, R., 2010; Winston, 2004).

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

Jennifer D. Oyler, Texas A & M University of Commerce
Mildred Golden Pryor, Texas A & M University of Commerce
Stephanie S. Pane Haden, Texas A & M University of Commerce

CASE 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.

CASE 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.

INSTRUCTOR'S NOTES

Intended Audience and Case Objectives

This case is most appropriate for use in the human resource management (HR) course at the undergraduate or graduate level. The teaching objectives of this case are to:
* Introduce students to U.S. legal standards on sexual harassment and the role of the Equal Employment Opportunity Commission (EEOC), and
* Understand the role of organizational culture and how culture can communicate tolerance of sexual harassment.

HYPOTHETICAL TEACHING PLAN

Sexual Harassment Lecture

Before using this case for classroom discussion, the instructor should provide a lecture on Title VII of the Civil Rights Act of 1964 and explicitly focus on the content and meaning of Title VII in relation to sexual harassment. In addition, the instructor should explain the importance of the Equal Employment Opportunity Commission (EEOC) and how the EEOC issues guidelines on the prevention of sexual harassment. Further, the instructor may briefly explain how to determine sexual harassment liability. In order to provide more detailed information on EEOC guidelines and determination of sexual harassment liability, the instructor is referred to Appendixes 1, 2, and 3 in the case.

To complement student's understanding of sexual harassment law, the instructor should discuss several important sexual harassment cases. For example, a landmark case includes *Meritor Savings Bank v. Vinson* in which the Supreme Court determined that sexual harassment was a form of gender discrimination in employment and was a direct violation of Title VII. In addition, an interesting sexual harassment case to discuss in class is *Jenson v. Eveleth Taconite*, as this hostile work environment case was the first sexual harassment case to be certified as a class action lawsuit. To clearly illustrate this case, the instructor could also use the movie *North Country* as a supplemental instructional tool. In addition, the instructor can discuss a quid pro quo case such as *Bryson v. Chicago State University* and a hostile work environment case such as *Harris v. Forklift Systems*. Additional sexual harassment cases that could be reviewed include a coworker harassment case such as *Blakely v. Continental Airlines* and supervisor harassment cases such as *Burlington Industries Inc. v. Ellerth* and *Faragher v. City of Boca Raton*. The latter two cases are very important cases because they set the reasonable care standard that determines employer liability for sexual harassment. In essence, the major components of reasonable care include: establishing a sexual harassment policy, training all employees on the policy, clearly communicating the policy to all employees on a regular basis, and having clear procedures for reporting behavior that allows employees to have access to management other than their supervisors.

As an alternative to the instructor solely lecturing on this subject, an interesting approach may include a cooperative effort with history and legal faculty at your university or college.

Specifically, one of the authors involved with this case has invited a Civil Rights historian and Civil Rights attorney as guest speakers to the class. Each speaker usually takes 15-20 minutes of class time followed by a 10-15 minute question and answer session with students. In this lecture, the historian typically focuses on the events leading up to and surrounding the enactment of the Civil Rights Act of 1964. Next, the attorney highlights the implications from the previously mentioned sexual harassment cases and additional federal statutes such as the Civil Rights Act of 1964 and the Civil Rights Act of 1991.

Organizational Culture Lecture

The instructor should also provide a brief overview of organizational culture. A definition of culture and discussion regarding some of the various types of culture should be included. After the various types of culture are addressed, the students can be asked to determine the type of culture that appears to be prevalent at Laocoön. Additionally, the instructor should devote specific attention to the ways in which a strong organizational culture can act as a barrier to certain company initiatives; in this particular case, as a barrier to change and to diversity. Most texts on organizational behavior (e.g. Bowditch & Buono, Robbins & Judge, 2009) or diversity management (Bell, 2007) should help with this portion of the lecture. The deeply embedded culture at Laocoön could be a major obstacle to the quality and excellence changes that Averil is trying to initiate at the company. The strong culture, originated and sustained by the dominant male workforce at Laocoön, is most likely making it difficult for female employees to be accepted and respected, and is therefore a barrier to diversity.

SUGGESTED DISCUSSION QUESTIONS

The following discussion questions should be provided to students as advanced assignments and to facilitate classroom discussion of the case.

1. **Did Averil suffer sexual harassment from William Prewett? If so, is Laocoön Aeronautics Corporation liable for the sexual harassment?**

Students should begin their initial research at the following EEOC websites: http://www.eeoc.gov/types/sexual_harassment.html and http://www.eeoc.gov/facts/fs-sex.html. The first EEOC website clearly defines sexual harassment and provides statistics on EEOC sexual harassment claims, while the second EEOC website provides additional facts about sexual harassment. Students should only use the EEOC as an Internet source, but other Internet sources such as Wikipedia and Law Guru are strictly forbidden. Finally, students may use books, lecture notes, and additional references from electronic library databases such as ABI/Inform to supplement their responses.

Evaluation of Sexual Harassment and Employer Liability

The first step in the evaluation of sexual harassment is for students to determine whether or not Averil experienced the EEOC definition of sexual harassment: "unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature" (2009, para. 2). On at least three separate occasions, William Prewett made unwelcome sexual advances and innuendos towards Averil Hughes. During the first incident at the Twisted Olive, William blatantly made sexual advances and comments towards Averil. In response to William's advances, Averil first suggested that William was drunk and then she abruptly left William at the bar. The second incident occurred in William's office in which William invited Averil to his office under the guise of discussing the Organizational Excellence program. Again, William made sexual advances towards Averil and invited her to a local hotel for drinks and sex. At this point, Averil vehemently details her disgust to him and clearly explains that his propositions were inappropriate. On the third occasion, William explained to Averil that he would like to discuss the Organizational Excellence program over drinks and dinner one night after work. Also, he invited her to his lake house for a quality sexual experience. Based on these set of circumstances, students should ascertain that sexual harassment has occurred.

Most students will recognize that a hostile environment exists. Specifically, William targeted Averil with his sexual comments, and his behavior was offensive to her. Obviously, William has aided in the creation of the hostile environment, but the hostile environment proliferates throughout the organization. Specifically, Averil not only experiences this hostile environment with her boss, but also she deals with offensive working conditions when she attends executive sexual harassment training. Specifically, many of the executives make lewd and degrading comments about female employees during this training.

Astute students will recognize quid pro quo harassment is also evident in this case. Quid pro quo sexual harassment was experienced by Averil when William refused to participate in the Organizational Excellence initiative unless Averil agreed to dinner and drinks one night after work. Although Averil never succumbed to sex with William nor did she suffer tangible employment action, in the eyes of the Supreme Court (e.g. *Burlington Industries Inc. v. Ellerth*), sexual harassment has occurred. Specifically, the nonparticipation of William's division in the Organizational Excellence program could be construed as a tangible threat to Averil's employee benefits. Specifically, Averil's pay raises and promotional opportunities are directly linked to her successful completion of performance objectives. Although this situation is not discussed specifically in the case, we can determine the Organizational Excellence initiative is a key component of Averil's job.

Although Averil suffered tangible employee action in the eyes of the courts, Laocoön Aeronautics Corporation has an affirmative defense because the company has exercised reasonable care. Specifically, the company has established a well-defined sexual harassment policy, the policy is communicated throughout the organization, all employees are involved in annual sexual harassment training, and a clear open-door policy is in place. Because the employer has preemptively tried to prohibit sexual harassment, Laocoön cannot be held liable for William's sexual harassment. It is important to note that some top-notch graduate students might argue that reasonable care was not established by Laocoön. Specifically, if human resources was aware of executive and manager behavior during the annual sexual harassment training and did not take corrective action, the company could potentially be held liable for sexual harassment.

2. **Describe the organizational culture at Laocoön Aeronautics Corporation. How could it be improved?**

To assist students with this question, the instructor should also suggest that students read the following articles that provide potential solutions to preventing sexual harassment in the workplace.

* Bell, M.P., Quick, J.C., & Cycyota, C.S. (2002). Assessment and prevention of sexual harassment of employees: An applied guide to creating healthy organizations. *International Journal of Selection and Assessment. 10*, 160-167.
* Daniel, T.A. (2003). Developing a "culture of compliance" to prevent sexual harassment. *Employment Relations Today*, *30*, 33-42.

For this question, students should give examples of organizational characteristics that support Laocoön's culture. From the previous question, students will recognize that Laocoön's human resource and legal departments had developed a formal sexual harassment policy, provided clear procedures for the complaint process, clearly communicated the policy throughout the organization, and required annual sexual harassment training for executives, managers, supervisors, and employees. However, students will question why sexual harassment still occurred in this organization given that the company tried to implement several preventive steps to curb harassment. At this point, the instructor must emphasize that Laocoön did not make changes to the organizational culture, top management was not committed to the prevention of sexual harassment, and the job context was clearly skewed in favor of males and nontraditional jobs. Organizational researchers have suggested that this combination of organizational characteristics results in an unhealthy, organizational culture that supports sexual harassment (Bell, Quick, & Cycyota, 2002). In sum, most students will come to understand that the sexual harassment policy was in great conflict with the culture at Laocoön.

To illustrate these pitfalls at Laocoön, the instructor should remind the students that it was apparent from the case that Laocoön had done little to change the culture of the organization even after the implementation of the sexual harassment policy and other preventive measures. Specifically, many of the male executives and managers joked about the content of the sexual harassment training courses and suggested that the training helped them learn to how get away with harassment at higher levels in the organization. Even worse was the fact that many of the managers would sign into training, sit at the back of the room, and leave training before it was completed. This type of blatant disregard for sexual harassment training was apparent in the top levels of the organization, as Tony Zi admitted that he was one of the executives who made snide remarks about the training.

The question that surfaces is why did personnel from the Human Resources Department do nothing about the behavior of these executives and managers? Why was attention and correction to their negative behaviors not pursued? The most obvious answer was that Laocoön's culture was inherently strong and shielded by a male-dominated bureaucracy that superficially implemented sexual harassment policies in response to changing legal requirements in the external environment. In fact, if human resources were aware of the behavior by executives and managers during the training sessions, they simply reinforced negative behaviors and existing norms embedded in Laocoön's organizational culture.

Students will also recognize that Tony, the Executive Vice President of Business Development and Operations, was obviously fearful of confrontation with William because he believed that William was his best Vice President and his best friend. Further complicating the matter was the fact that other managers at Laocoön were just as guilty of sexual harassment as William. For years, executives and managers at Laocoön had not only permitted violations of sexual harassment, but they had also personally violated the procedures against sexual harassment. Therefore, the macho work environment would be considered hostile to females, and the unhealthy organizational culture would be perceived as one that nurtures sexual harassment.

Laocoön must develop a strong and collective stance against sexual harassment. Most students will suggest that the top management team must buy into the sexual harassment policy and demonstrate their commitment towards the enforcement of the policy. In effect, the top management team must clearly illustrate their support for a zero-tolerance attitude towards sexual harassment. By demonstrating their commitment, top management sets the tone for the entire organization. Further, some students may suggest that executives, managers, supervisors, or employees that deviate from the policy should be terminated. To complement this policy, the organization must continue to offer regular sexual harassment training to all executives, managers, supervisors, and employees at Laocoön. In addition, Daniel (2003) suggests that an employer can demonstrate commitment to keeping an organization free of sexual harassment by also using "…comprehensive policy development, broad policy dissemination to all employees, multiple complaint resolution alternatives, quick and thorough investigations, prompt corrective action, counseling and assistance for victims, and frequent and mandatory training for both employees and supervisors" (p. 36). Finally, the EEOC (2008) suggests that prevention of sexual harassment is the most important tool in the workplace by providing clear communication that sexual harassment is not acceptable in tandem with a sexual harassment policy and an effective grievance system.

3. **What would you do if you were Tony? Why?**

To assist students with this question, the instructor should suggest that students use the following EEOC guidelines to develop their response. Students should pay specific attention to the section on *First Prong of Affirmative Defense: Employer's Duty to Exercise Reasonable Care*.

* Equal Employment Opportunity Commission. (1999, June 21). *Enforcement guidance: Vicarious employer liability for unlawful harassment by supervisors*. Retrieved March 5, 2009, from http://www.eeoc.gov/policy/docs/harassment.html#VC

According to the EEOC enforcement guidelines (1999), Tony should assure Averil that her complaint will remain confidential to the extent the anonymity does not interfere with the investigation. Next, Tony should report the incident immediately to human resources. Then, Laocoön's human resources department should locate an individual who is well-trained in interviewing witnesses and who has no control over the investigation to conduct an unbiased

investigation of the alleged situation(s). In the meantime, human resources must ensure that the parties do not come into contact with each other during the investigation. Thus, human resources must either transfer the plaintiff to another position or place the plaintiff on non-disciplinary leave to ensure further potential harassment does not occur. Laocoön, Tony, and human resources must be very careful to avoid any form of perceived or actual retaliation towards the complainant because tangible employment action results in employer negligence. After the interview process commences, and the evidence supports the complainant allegations of harassment, Laocoön should take corrective action. On the other hand, if evidence did not support the complainant's allegations of harassment, preventive measures such as training and monitoring should take place. In line with the EEOC Enforcement Guidelines for appropriate correction action (1999), corrective action includes:
* "Oral or written warning or reprimand,
*Transfer or reassignment,
* Demotion,
* Reduction of wages,
* Suspension,
* Discharge,
* Training or counseling of harasser to ensure that s/he understands why his or her conduct violated the employer's anti-harassment policy, and
* Monitoring of harasser to ensure that harassment stops" (para. 7).

REFERENCES

Bell, M.P. (2007). *Diversity in organizations*. Mason, OH: Cengage.

Bell, M.P., Quick, J.C., & Cycyota, C.S. (2002). Assessment and prevention of sexual harassment of employees: An applied guide to creating healthy organizations. *International Journal of Selection and Assessment. 10*, 160-167.

Blakely v. Continental Airlines, 751 A.2d 538 (N.J. Sup. Ct. 2000).

Bowditch, J.L, & Buono, A.F. (2007). *A primer on organizational behavior* (7th ed.). John Wiley and Sons: Hoboken, NJ.

Bryson v. Chicago State University, 96 F.3d 912, 915 (7th Cir. 1996).

Burlington Industries v. Ellerth, 118 S. Ct. 2257 (1998).

Civil Rights Act, 42 U.S.C.A. § 2000e *et seq*. (1964).

Civil Rights Act, 42 U.S.C.A. § 1981 (1991).

Daniel, T.A. (2003). Developing a "culture of compliance" to prevent sexual harassment. *Employment Relations Today*, *30*, 33-42.

Equal Employment Opportunity Commission. (1999, June 21). *Enforcement guidance: Vicarious employer liability for unlawful harassment by supervisors*. Retrieved March 5, 2009, from http://www.eeoc.gov/policy/docs/harassment.html#VC

Equal Employment Opportunity Commission. (2008, March 4). *Sexual harassment*. Retrieved March 5, 2009, from http://eeoc.gov/types/sexual_harassment.html

Equal Employment Opportunity Commission. (2009, March 11). Sexual harassment. Retrieved September 21, 2009, from http://www.eeoc.gov/types/sexual_harassment.html

Farragher v. City of Boca Raton, 118 S. Ct. 2275 (1998).

Harris v. Forklift Systems, 510 U.S. 17, 23 (1993).

Jenson v. Eveleth Taconite Co., 130 F.3d 1287 (8th Cir. 1997).

Meritor Savings Bank v. Vinson, 477 U.S. 57 (1986).

Robbins, S. P., & Judge, T. A. (2009). *Organizational behavior* (13th ed.). Upper Saddle River, NJ: Pearson Prentice Hall.

The United States Equal Employment Opportunity Commission. (2002, June 17). *Facts about sexual harassment*. Retrieved March 5, 2009, from http://www.eeoc.gov/facts/fs-sex.html

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.

TZEN BOUTIQUE JEWELRY: BRAND BUILDING FOR A SMALL BUSINESS

Jeanny Y. Liu, University of La Verne

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.

In July of 2009, entrepreneur Julie Liu decided to leave her hedge fund manager position and concentrate on building a retail jewelry business. Pursuing what she has been passionate about since childhood, she began to start a retail jewelry store in the metropolitan area of Chicago. Ultimately, Liu has ambitions to distribute her creations nationally but first she needed to establish a clear brand position and strategic focus. Liu and her publicist, Victoria Haubergh, will have to determine the unique position for the new TZEN Boutique brand that would allow the brand to compete and differentiate itself from other jewelry companies. As a small business with limited resources, Liu and Haubergh must be creative and develop a marketing strategy that is effective but realistic.

Starting a business during a recession presents both opportunities and challenges. However, there are numerous challenges and hurdles to start any new businesses especially during a recession. The start of a specialty jewelry designer retail store needs to devise a well planned business strategy to succeed in a competitive landscape dominated by well established brand names. Managing customer loyalty and satisfaction become more important with each purchase and contact with the customers. Satisfying the customer involves making a personal connection during the selling process attempting to fulfill the unique needs of its customers and offering them a memorable consumption experience.

INSTRUCTOR'S NOTES

CASE GOALS AND OBJECTIVES

The goal of this case is to examine the importance of branding for businesses and to develop a plan on a limited budget..

While the case depicts some interesting information regarding the structure and competitive environment of the retail jewelry industry, the primary goal of the case is to discuss the importance of business positioning and the need to establish and cultivate its brand name in a competitive market. Luxury brand businesses face unique challenges. For example, one of the issues facing TZEN is how to launch the brand without undermining the Mia Pezzi brand. Furthremore, how can a small business build a luxury brand in a highly competitive industry during a recession? Additionally, the branding strategy needs to be sustainable over the long term and not be reactive to the current business environment.

"TZEN Boutique Jewelry" may be used in an undergraduate senior level Marketing Management course or an entrepreneurial course and seeks to serve the following opportunities:

i. to discuss the issues and challenges of businesses that attempt to build a luxury brand

ii. to acquire a basic understanding of the opportunities for small businesses in the jewelry industry

iii. to consider the evolution of jewelry as an expression of individuality and rise of identity brands as a counter to standardization

iv. to understand the importance of brand positioning in a luxury market and the components of luxury brands

v. to examine and consider potential strategies to penetrate the luxury market

RECOMMENDATION FOR TEACHING APPROACHES

Instructor might consider commence the discussion by focusing on the general issues regarding the concept of luxury brands such as how is luxury brand perceived by consumers, what are some success factors seen in luxury brands, and does the term luxury solely defined in terms of higher price?

Within the case, the instructor can focus on the key issues to encourage in-depth discussions to assist the business with more specific brand building issues; 1) assist Victoria with designing a campaign and promotional mix to reach the target markets; and 2) develop promotional messages that appeal to the new generation of customers. The important issue for discussion is that reaching the luxury target segments require an understanding of the luxury segment and the underlying motives and perception of those consumers. Students participating in this discussion should be required to identify various segments within the luxury market and understand how each segment behaves differently in order to design an effective campaign.

In the final hour of the discussion, instructors can divide students into groups and create an ad campaign details the essential message and promotional components that would resonate with the target segments of the luxury target market. Additionally, students can focus on creating a niche and a distinct positioning by forming perceptual maps and positioning statements.

ASSIGNMENT QUESTIONS

1. Describe the consumers of luxury brands. How does the consumption of luxury brand make people feel?

2. What are the factors that can be used to stimulate prospective customers' desire to own a luxury product/brand? What processes can be suggested to shorten their decision making process?

3. Discuss TZEN's business position in comparison to the other players in the market. Identify other opportunities available for TZEN.

4. TZEN offers a unique and creative jewelry line and needs an integrated marketing mix to reach its target market. Develop a marketing approach and strategy to assist TZEN with building its brand image, create buzz, and gain credibility.

RECOMMENDED ASSIGNMENT ANSWERS

QUESTION 1 :*Describe the consumers of luxury brands. How does the consumption of luxury brand make people feel?*

The consumption of luxury brands is often viewed as a signal of status and wealth. Price, which often acts as a cue for judging quality, plays an important factor in determining consumers' perceived brand value of the product offering. Other subjective benefits such as unique designs, beauty, country-of-origin, packaging, and technical superiority, all play an important role in consumers' overall evaluation of the brand. Such prestige seeking consumers are more likely to pay a premium to satisfy their emotional driven desires.

Research indicates that prestige products are infrequently purchased, require a higher level of interest and knowledge, and strongly relate to the person self-concept (Vigneron & Johnson, 1999). An individual's social interactions and/or aspirations and motivations play a significant part in shaping consumption preferences for a certain brand or product. According to Vigneron & Johnson (1999), consumers of luxury brands can be divided into five categories:

1. The Veblen (Perceived Conspicuous Value). Veblen suggests that people consume conspicuous products to signal wealth, power, and status. Consumers in this segment would consider using or displaying highly visible prestige brands in public. Price is an important driver to consumers in this segment.
2. The Snobs (Perceived Uniqueness Value). The snob effect refers to consumptions made to satisfy an emotional and personal motive such as for individuals to express a "need for uniqueness". Snobs are most likely to purchase limited number of production items and reject product when it is seen to be consumed by the general mass of people. Rare items, limited production and supply are important drivers to consumers in this segment.
3. The Bandwagon (Perceived Social Value). The bandwagon segment refers to individuals' desire to conform to a prestige group through the possession of prestige brands. The consumption is served as a symbolic marker of group members or reference groups to match social standards.
4. The Hedonic Effect (Perceived Emotional Value). The hedonic effect refers to an individual's purchase decision based on non-cognitive and unconscious motives. Emotional value has been recognized as an essential characteristics associated with luxury products consumption. There is a long history of promoting emotional responses in potential consumers by luxury car makers.
5. The Perfectionism (Perceived Quality Value). Perfectionism refers to luxury consumption that connotes an underlining superiority and function of the product. Premium brands are expected to demonstrate evidence of greater quality and superior features or functions. For example, consumers may wear luxury brand clothes because they are confident in the judgment of fashion and/or style of the designer.

QUESTION 2 : ***What are the factors that can be used to stimulate prospective customers' desire to own a luxury product/brand? What processes can be suggested to shorten their decision making process?***

The consumption of luxury brands has been described as a manifestation of conspicuous consumption. For the most part, it is a reflection of our identity (or multiple identities) and the world of culture. In an article by Holt (2008), he stated that, "*Iconic brands are built by cultural activists*." While many companies strive to create an iconic brand, most of them were organized to act as cultural reactionaries, responding to the emerging cultural opportunities (Holt, 2008). In order to systematically build iconic brands, companies must reinvent marketing functions, assemble cultural knowledge at large, and strategize according to cultural branding principles (Holt, 2008). For additional reading please refer to the cultural brand management process developed by the author.

To increase the prospective customers' desire to own, the relationship among brand awareness, production, distribution, and emotional factors must be carefully managed.

1. Brand awareness. In order to gain consumer trust and confidence, successful jewelry retailers must have a high level of awareness in the market. Consumers are less likely to purchase a high value piece of jewelry from an unknown and unfamiliar source. Establishing and building a well recognized brand name should be one of the main focuses in the overall business strategy.

2. Inventory control and production. Jewelry retailers have to become more skilled at predicting fashion trends, managing inventory, and adapting production to cater to the market demand. The concept of rarity and scarcity may also help to increase the perception of the brand and consumers' desire to own.
3. Proximity to populated locations. Retailers should seek areas that will expose them to a high volume of traffic and high income individuals. The retail store must be located in areas that have high foot traffic and wealthy tourists.
4. Sensory enriched store layout and product presentation. Retail is detail. Create sensory activated stimuli, which appeal to all the senses to enhance the consumers' perception. Focus on the details of the store layout, store display, music, smell, shopping flow, customer service, and on the employees' attitude of the brand and customer. All of these factors must be carefully executed in order to create a total shopping experience.

QUESTION 3 : ***Discuss TZEN's business position in comparison to the other players in the market. Identify other opportunities available for TZEN.***

Business Positioning: TZEN is positioned in the category of high price, high exclusivity and unique appeal. Its competitive advantage is offering unique designed jewelry pieces in limited quality, providing a sense of rarity. This competitive advantage should be clearly communicated in every aspect of contact with the customers: in store experience, media outlets, endorsements, private events, public relations, web sites, customer service, etc. For a perceptual map and sample of PR announcements, please refer to Exhibits A, B, C, & E in the case.

SWOT Analysis:

Location of factor	**TYPE OF FACTORS**	
	Favorable	**Unfavorable**
Internal	Strengths: Unique & individualized product line No mass production –exclusivity Limited pieces per style High quality of gemstones Boutique setting-make feel customers exclusive Quality service Good boutique location Distribution in four different retail stores Repeated customers Public Relation	Weaknesses: New company Low brand loyalty No brand awareness Limited market target Limited selection on-line Only silver jewelry sold on-line Low inventory turnover No mass production-can be additional income stream
External	Opportunities: Expand Nationally/ Internationally Introduce man line Introduce kids jewelry line Wider selection on-line Target younger generation Appraisal Jewelry cleaning	Threats: Competition Economic downturn Jewelry Imports over 80% of the total US market Jewelry industry is a seasonal Gold / silver price fluctuation

QUESTION 4: ***TZEN offers a unique and creative jewelry line and needs an integrated marketing mix to reach its target market. Develop a marketing approach and strategy to assist TZEN with building its brand image, create buzz, and gain credibility.***

If TZEN aspires to become a well-recognized national brand in the next 5 to 10 years, more exposure to the market is a must. The company should consider distribution of its line through specialty boutiques located in fashion forward, high-income, dense, highly populated areas such as New York, Los Angeles, Las Vegas, Dallas, and San Francisco. To increase awareness to its target markets, TZEN can consider forming strategic alliances with select high end retailers. An example would be contacting the buyers for Neiman Marcus or Saks Fifth Avenue to distribute products through these retailers. In order to protect its exclusivity and maintain its unique design, TZEN should consider creating special designs for distribution exclusively through these upscale department stores. Additionally, the company should perfect is branding strategy and market penetration in a specific region before launching nationally.
Messages to prospective consumers should focus on specific product attributes. Sample attributes:

Product Quality	**Beauty**	**Exclusivity**	**Sophistication**
Excellence of the product Handmade Attention to detail Production integrity	Uniqueness Design Creativity Sensuality	Perceived scarcity Rarity Limited production	Classic Sophisticated Credible Never out of fashion

Marketing and Brand Building Strategies :

Target the appropriate market. TZEN needs to identify the appropriate target markets, select the viable markets that are easier to reach, and increase the awareness of the product to those target segments. One strategy that TZEN can consider is to use the power of the opinion leaders influential in the targeted market to help spread information and to advocate the brand. Opinion leaders can play an important role in leading social preferences. They spread information, influence decisions, create buzz, and help generate new product ideas

Compose the brand identity. Create a compelling story for the brand to facilitate its communication to the target audience. Look for opportunities for that will heighten consumers' emotions and increase consumers' perception and favorable attitude of the brand. The brand identity must be fully integrated: logos, visual imagery, brand statements, packaging and presentation must be consistent to connect the brand identity with its users in a meaningful way.

Foster brand communities. Harley Davidson is one of the class examples that developed a strong community-based phenomenon. The 'HOG' brotherhood of riders offered Harley a strong and loyal core customer base when compared to the other motorcycle manufacturers. To reinforce this concept, TZEN must solidify the connection with its customers, identify if its customer base can be cultivated to be a customer community and plan outreach events to foster community development. A key constituent group is TZEN's employees. As the front line of communication with customers, employees are key ambassadors and advocates of the product. Focusing on employees will assist TZEN in building and nurturing a stronger connection with potential customers, even if they decide to leave the company.

Continue reinvent the identity. It is important to continuously reinvent its brand identity and foster strong connections with communities that might represent a potential cultural revolution. TZEN should actively communicate and solicit feedback from the customers. There are many Web 2.0 tools that are available which may allow TZEN to get closer to the customers and to deliver the needs of the customers better. In such instances, the brand stays current and relevant catering to the changing tastes in consumers.

REFERENCES

Besty Bohlen, Steve Carlotti, and Liz Mihas (December, 2009). How the recession has changed US consumer behavior, McKinsey Quarterly, Issue December 2009. Retrieved from https://www.mckinseyquarterly.com/How_the_recession_has_changed_US_consumer_behavior_2477

Beverland, M. (2004). Uncovering "theories-in-use": Building luxury wine brands. *European Journal of Marketing, 38*(3), 446-466. doi:10.1108/030905604105186

Dubois, B. and Czellar, S. (2002), "Prestige brands or luxury brands? An exploratory inquiry on consumer perceptions", Marketing in a Changing World: Scope, Opportunities and Challenges: Proceedings of the 31st EMAC Conference, University of Minho, Portugal, 28-31 May.

I Phau and G Prendergast. (2000). Consuming luxury brands: The relevance of the 'rarity principle. *Journal of Brand Management, 8*(2), 122. doi:10.1057/palgrave.bm.2540013

IBIS World Inc. (2009, October), Jewelry Stores*: in the US 44831*. Retrieved November 19, 2009, from MarketLine database.

Grau, Jeffrey. (December 16, 2008). Retail E-Commerce: Record-Setting Declines. Retrieved from http://www.emarketer.com/Article.aspx?R=1006813

Hoovers. (2010). *Company information for Yurman Design, Inc.* Retrieved February 16, 2010, from Hoovers database.

Ken Gassman. (2008). IDEX Online Research: State of the Jewelry Industry - 2008 Jewelry Demand. Retrieved on December 01st, 2009, from website: http://www.idexonline.com/portal_FullNews.asp?id=29448

Me & Ro. (2010). Retrieved February 17, 2010 http://www.meandrojewelry.com/a_bio.aspx

Morris B. Holbrooke and Elizabeth C. Hirschman. (1982). The experiential aspects of consumption: Consumer fantasies, feelings, and fun. *Journal of Consumer Research (Pre-1986), 9*(2), 132.

Signet Jewelers Limited. (2009). *Annual Report*. Retrieved February 12, 2009, from http://www.signetjewelers.com/sj/uploads/dlibrary/documents/Form20F2008.pdf

Tiffany & Co. (2010). Retrieved February 12, 2009, from http://investor.tiffany.com/index.cfm

Tiffany & Co. (2009). *Annual Report.* Retrieved February 12, 2009, from http://www.shareholder.com/visitors/dynamicdoc/document.cfm?documentid=2545&companyid=TIF&page=1&pin=&language=EN&resizethree=yes&scale=100

TZEN Boutique. (2010). *Press*. Retrieved from http://www.shoptzen.com/category-s/150.htm United States Census Bureau. *American Fact Finder* [Fact Sheet of Zip Code Tabulation Area 60062]. Retrieved January 27, 2010, from http://factfinder.census.gov

Vigneron, F., & Johnson, L. W. (2004). Measuring perceptions of brand luxury. *Journal of Brand Management, 11*(6), 484-506.

Zale Corporation. (2009) *Annual Report.* Retrieved February 12, 2009, from http://www.shareholder.com/visitors/dynamicdoc/document.cfm?documentid=2545&companyid=TIF&page=1&pin=&language=EN&resizethree=yes&scale=100]

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.

INSTRUCTOR'S NOTES
INTRODUCTION

This case portrays a small family business weathering the storm of the death of its president and CEO. Although Carlton Algood's death from cancer was premature at age 62, he did have almost two years to prepare the leadership of Algood Press to carry on without him. Recognizing that no one single successor stood out as a clear leader in the company, Carlton formed a management committee, composed of family members and non-family managers. The management committee had the advantage of his presence for two years as the individuals involved learned to manage by consensus.

The purpose of this study is to aid students in their understanding of the complexities of leadership succession in small family businesses. Students should recognize that family business owners typically sacrifice their own immediate gratification for wealth to invest in the long-term welfare of their family. Successors also invest their time in the family business and give up alternative careers. Behavioral aspects of the succession process and management decision-making are emphasized.

METHODOLOGY

The author performed in-depth qualitative interviews with the key actors in the case after the death of Carlton Algood. These tape-recorded interviews were semi-structured in nature and conducted individually. The author transcribed approximately six hours of interviews, which totaled fifty-nine pages of transcripts. The respondents answered numerous follow up questions via telephone and e-mail. The author provided the respondents with an initial case history including all information used in the case. The respondents verified this information. The author also gathered newspaper and magazine articles, advertisements, company catalogs, and other documents.

TEACHING APPROACH

The case's focus on succession issues in a small family business makes it appropriate for use in Entrepreneurship or Small Business Management courses at the undergraduate level. In the case, we describe the decisions facing a group of family business leaders following the death of the company's president and CEO. The case serves as an appropriate companion exercise in Entrepreneurship or Small Business textbooks, especially in chapters dealing with family business issues or leadership challenges. It is recommended that the case be assigned after the class covers the family business or leadership chapter as an illustration of the issues involved in leadership succession. Each student should individually prepare written answers for the discussion questions attached to this Instructor's Note before the next class meeting. During this class period, the instructor should first introduce the case and lead a general discussion of the facts of the situation. The instructor should apply principles from the textbook to the case. Then, the instructor may place the students in small groups and assign different roles or vantage points for discussion, such as the small business owners, involved family members, and leading non-family managers.

CASE OVERVIEW

The case begins as Carlton Algood receives the news from his doctor that Carlton has cancer that is life-threatening. Carlton meets with his brother, Bobby, the next day to make plans for the leadership of Algood Press. Carlton suggests that they form a management committee of six individuals – three family members and three non-family managers - to make the day-to-day operational decisions for the company. The committee is charged to inform Carlton of all decisions and he agrees to assist the committee as much as his health allows.

The narrative then describes the history of Algood Press from its beginning in 1922 under the ownership of the C. J. and Irma Landry as Capital City Press. The Algood family involvement started in 1933 with the hiring of Francis Algood as an apprentice. Francis quickly learned the printing business and by 1942 bought a half-interest in the company from the Landrys. In 1949, Francis became president of the company and changed the name to Algood Press. The company continued to grow and moved to a new larger facility in 1953. Francis completed a buy-out of all the Landrys' stock in 1964. During this time, Francis became a community leader involved in many civic, service, and church organizations.

Francis' two sons, Carlton and Bobby Algood, joined the family firm in 1959 and 1960 respectively after completing their college degrees. Following their natural inclinations, Carlton worked in marketing and finance, while Bobby preferred production activities. After Francis' death in 1975, the ownership of the company passed to Carlton, Bobby, and their sister Frances Algood. Carlton became president and CEO, while Bobby became Vice President of Production and Frances served as an active board member.

For the next fifteen years under the second generation leadership, the company operated as a general printing business. Carlton followed his father as a dedicated community leader and worked on marketing and financial issues for the company, while Bobby devoted his time to production or printing activities. In the 1990s, the Algoods recognized changes in the printing industry and began to seek a niche in the market, rather than continue in general printing. They brought in Ernie Fisher, a top manager from a rival printing company in the city. Ernie led in the acquisition of Database, a company that specialized in data processing and the direct mail business, but did not do any printing. Over a few years, this acquisition resulted in a broad change in the company from general printing to an eighty percent focus on direct mail printing.
Sparked by the change in strategy, Algood Press enjoyed several years of steady growth. At this point, Carlton discovered that he was very ill with cancer and made the decision to develop a management committee. Over approximately two years, the management committee learned to operate the company as conservative individuals and those more inclined to take risks worked together to reach a consensus on decisions. As his health allowed, Carlton advised the management committee until his death.

The case closes as the current stockholders - Bobby Algood, his sister Frances Algood, and Estelle Algood, Carlton's widow - meet to discuss the future leadership of the company. Important issues include whether or not to continue with the management committee, who should succeed Carlton as president of the company, and should stock ownership be extended to include some members of the management committee.

LEARNING OBJECTIVES

- Through analysis of this case, students will be expected to:
- Assess the impact of groups on decision making in the leadership of small businesses.
- Evaluate the characteristics successors need in a family business.
- Examine the role of non-family managers in a family business.
- Analyze alternatives and make a clear decision in the process of leadership succession.
- Recognize the affect of stock ownership on key individuals in a small business.

DISCUSSION QUESTIONS

Should the stockholders of Algood Press allow the management committee to continue as the day-to-day decision-making group for the company? Why or why not?

The majority of evidence presented in the case supports the continuation of the management committee. Carlton Algood believed that the change in organizational structure would benefit the company by acquiring greater input from the entire top management team. While Carlton considered both Ernie Fisher and Julie Algood Piccolo qualified for the job of president, perhaps neither of them was ready to manage the company on their own.

In the case, Frances Algood characterized the management committee's performance as splendid. On the negative side, Estelle Algood pointed out the flaws of slower decision-making and possible stalemate, which are inherent in group decision-making. Bobby Algood countered with the observations that the group had made higher quality decisions than individuals alone would have made and that the group was willing to work toward a consensus. If the stockholders chose to dissolve the management committee, they should also consider the possible adverse affect of a reduction in power on the five individuals in the management committee not chosen as president. Therefore, in this situation, it is probably better to continue with a management practice that is working.

Should the stockholders of Algood Press consider Richard Algood, Bobby's son, for inclusion in the management committee? Explain your answer.

Richard Algood, the son of Vice President Bobby Algood, joined the company straight out of high school and has worked in production for fifteen years. At present, he is the Press Room Supervisor. Richard has not been included in the management committee, nor is there any mention of him as a possible successor or candidate to be president. At Algood Press, the second and third generation owners and managers have all attained a college degree. This has served as a signal of their interest in top management (Lambrecht, 2005), while Richard has only a high school degree. Richard has not shown a desire to participate in the top management of the firm and has not participated in the succession process (Barach & Ganitsky, 1995). He has not demonstrated the necessary skills, nor has he acquired the management experience to be a successful successor (Barach, Ganitsky, Carson, & Doochin, 1988). Finally, he does not possess the influence skills and self-awareness needed to develop leadership (Foster, 1995). Therefore, there is little or no reason for the stockholders of Algood press to consider Richard for inclusion in the management committee.

Argue the case that Ernie Fisher should become president of Algood Press.

There is strong evidence in favor of Ernie Fisher as the next president of Algood Press. Early in the case in his meeting with Bobby, Carlton states that Ernie was hired with the thought in mind that Bobby did not want to become president and that Ernie could fill that position. Carlton also says that Ernie's background in finance and marketing is suitable. Ernie had over thirty years of experience with another local printing company and had known the Algoods for many years. Soon after Ernie was hired at Algood Press, he led the company's acquisition of Database. This was the key for entry into the direct mail printing segment of the market. Ernie has worked at Algood Press for ten years and has earned the trust of the stockholders and managers of the company.

Provide evidence that Julie Algood Piccolo should become president of Algood Press.

Julie Algood Piccolo is the most qualified third generation family leader to become president of Algood Press. Starting with the company in 1992, Julie has acquired extensive financial knowledge and experience. The only other third generation family member in the company, Richard Algood, does not possess the qualifications or the desire to lead Algood Press. The granddaughter of Francis and the daughter of Carlton, Julie has earned the respect and confidence of the second generation stockholders of the company. Julie is committed to the company and the succession process (Barach & Ganitsky, 1995) and possesses integrity (Chrisman, Chua, & Sharma, 1998). As a family member, it can be implied that she received counsel and instruction informally from her father and uncle at family gatherings (Dyer, 1986). Julie is a viable choice to become president of Algood Press.

Clearly state your recommendation that Ernie Fisher or Julie Algood Piccolo should become president of Algood Press. Explain your choice.

Students often have trouble giving a definite answer to a question, perhaps for fear of being incorrect. The purpose of this question is to elicit a definite response with a supporting line of reasoning. In questions three and four above, students should have stated the case for naming Ernie president and the case for Julie as president. While there is evidence to support both candidates, the case for Ernie is slightly stronger. His experience in the printing industry is greater than Julie's – forty years compared to thirteen. As noted in the case, Ernie possesses knowledge and skill in finance and marketing, while Julie's expertise is primarily in finance alone. Perhaps, most importantly, Ernie led the company in the acquisition of Database, Inc. This was a very significant event for Algood Press because it has resulted in a major change from general printing to focusing on the specialty of direct mail printing. While the choice of Julie as president is a good one, the choice of Ernie is better at this time. Julie would be the logical choice to follow Ernie as president upon his retirement.

Should the stockholders of Algood Press offer the right of stock ownership to Ernie Fisher, Craig Dickson, or Julie Algood Piccolo? Explain your choice.

One way to promote longer tenure among managers is to offer them some form of stock ownership in the company. Publicly held companies frequently offer stock options or direct stock ownership tied to provisions of executive tenure, such as golden hand cuffs. For Algood Press, one way to pacify managers or family members who are not chosen as president is to offer those individuals stock ownership in the company. Ernie Fisher contributed greatly to the company's change of strategic direction. Craig Dickson formerly owned Database, Inc. and currently is very valuable to Algood Press because of his direct mail knowledge. Julie Algood Piccolo is the most qualified third generation family member for leadership in the company. Algood Press would be well served to maintain the services of all three individuals. The cost of giving up some percentage of the company stock to each of the three may be far less than losing them as managers. In order to continue the succession process, the three second generation stockholders (Bobby, Estelle, and Francis Algood) should pass on some stock ownership although at this time it may not be necessary to give up a controlling interest in the company.

EPILOGUE

The case ended as the three second generation stockholders met to consider the relative merits of the management committee, who should be the next president of Algood Press, and who should own stock in the company.

The management committee is still in operation at Algood Press and continues to be a key to the success of the company. Since the formation of the management committee, a sense of cooperation has prevailed among the members of the committee and personal egos have been sublimated. The arrangement has been positive and harmonious according to Craig Dickson, "I can't remember, but the biggest argument we have had is whether to renew our NFL tickets or not." While this is probably an overstatement, the group has worked together as a team to produce a higher quality of decision-making than they could have as individuals. "We have made decisions as a group that none of us would have made individually by somehow talking things through among the six people," remarked Julie Algood Piccolo.

Ernie Fisher had been in the position of vice president since coming over to Algood Press, but he was not a family member. A controversy developed over whether Julie Algood Piccolo, the most qualified family member, or Ernie Fisher should receive the promotion to president of the company. Julie remarked, "So, we went back and forth between me and Ernie as president. It took about a year to make that decision among the family and stockholders. I guess the compromise was naming Ernie as president and me as chairman of the board. Ernie and I work closely together." As the president, Ernie Fisher leads the management committee, but he respects the fact that Algood Press is a family business and before any major decisions are made, the committee meets for discussion. Julie Algood Piccolo remains in her financial leadership position, serves on the management committee, and now acts as chairman of the board.

In addition to the decision to name Ernie Fisher as president, the board of directors chose to extend stock ownership privileges to Ernie Fisher, Craig Dickson, and Julie Algood Piccolo. While Ernie Fisher oversees the operations of the business as president, he now owns fifteen percent of the company stock. Craig Dickson, Vice President of Digital Printing and a non-family manager, also owns fifteen percent of the company's stock. This accounts for a total of thirty percent of the company ownership in non-family hands. The remaining seventy percent of the stock is owned by family members Estelle Algood, Bobby Algood, Frances Algood, and Julie Algood Piccolo. Estelle owns the largest portion at twenty-one percent while the other three own about fifteen percent each.

Ernie Fisher summed up the situation at Algood Press, “We strive to have a consensus with the management committee and board of directors. Fortunately, since Carlton died, we have not had a problem reaching a consensus. I think the reason is that we have a strategic plan. I think that the most important thing for a family business is to agree on what your plan is and what your goals are.”

REFERENCES

Barach, J. A., & Ganitsky, J. B. 1995. Successful succession in family business. Family Business Review, 8(2), 131-155.

Barach, J. A., Ganitsky, J. B., Carson, J. A., & Doochin, B. A. 1988. Entry of the next generation: Strategic challenge for family business. Journal of Small Business Management, 26(2): 49-57.

Chrisman, J. J., Chua, J. H., & Sharma, P. 1998. Important attributes of successors in family businesses: An exploratory study. Family Business Review, 11(1): 19-34.

Dyer, W. G. 1986. Cultural change in family firms: Anticipating and managing business and family transitions. San Francisco: Jossey-Bass.

Foster, A. T. 1995. Developing leadership in the successor generation. Family Business Review, 8(3): 201-209.

Lambrecht, J. 2005. Multigenerational transition in family businesses: A new explanatory model. Family Business Review, 18(4): 267-282.

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

E. Hill Mayfield, Jacksonville State University
Patricia C. Borstorff, Jacksonville State University

CASE DESCRIPTION

The primary subject matter of this case is arbitration in a company with a powerful union. Other issues include absenteeism, FMLA, documentation, arbitrator's 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 naturally 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 on 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 at the time of 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.

INSTRUCTOR'S NOTES

Recommendations for Teaching Approaches

The students should be assigned the case and have read and studied the concepts prior to coming to class. In class, the students and instructor can summarize the case and offer what they believe to be the important concepts in the case. Each of the following questions can be discussed. This case offers students the opportunity to be a part of a real arbitration case and discover the challenges faced by management when they face a powerful and experienced union.

Questions:

1. Would a "Last Chance" letter been an appropriate response for this employer?
2. How powerful is the Arbitrator? Can he/she render a final judgment?
3. Why do companies resort to arbitration?
4. Why do unions resort to arbitration?
5. Under what situations are employees allowed to take FMLA leave? What are "qualifying events" which entitles an employee to take FMLA leave?
6. How is an arbitrator chosen?
7. What is 'light duty' and who determines that?
8. What are the most effective ways for providing a Company Position or Union Position during an Arbitration hearing?
9. What is Collective Bargaining?
10. Why have labor and management tended to treat each other as adversaries in the U.S. labor relations system?
11. What, in your opinion, is the most significant impact of a union on the management of Human Resources? Explain.
12. Portray yourself as the Arbitrator, how would you have ruled in this case? Please provide all of your reasons which support your opinion in this matter.
13. What is the issue in the above disciplinary case involving the termination of this employee?
14. What are the seven tests or questions for "Just Cause" which management must address in employee terminations?

Answers for Questions:

1. Possibly, particularly in cases involving an employee whose previous actions had shown more effort to improve his or her attendance record. However, in this particular case we have an employee of 17 years who had been provided numerous opportunities to correct his attendance and had not been successful. Not only had management given up in their efforts to provide an additional opportunity to correct the situation, but also his co-workers or peers had recognized management's previous efforts and the individual's refusal to respond which had began to have a motivation effect with them.

2. As most CBA's indicate, the Arbitrator has sole discretion in issuing an answer that is binding on both the Company and the Union. It is the final and binding judgment, unless the parties agree, at a future date, to negotiate other terms and conditions regarding the matter.

3. Companies resort to arbitration to resolve a grievance which cannot be otherwise settled during the agreed to steps of the grievance procedure. A grievance process normally includes: a first step hearing (either oral or written) and Company answer usually by the

grievant's supervisor; a second step hearing (written) and Company answer, usually by the Department Manager; a third step hearing and Company answer, usually by the Human Resource Manager; a three- and-a-half step, known as grievance "screening" prior to Arbitration, and the final Arbitration step.

4. Unions resort to arbitration to resolve a grievance they have been unsuccessful in resolving during the steps of the grievance procedure also. However, often times there are political motives depending on their relationship with the grievant, along with their efforts to send a message to the Company, show their strength to the membership, and present a problem within the facility that could be a future negotiation issue.

5. An employee is entitled to FMLA leave if the following requirements apply:
    - The employee works for a covered employer (i.e., a government agency or a private company with at least fifty employees)
    - The employee worked for that employer for least twelve months prior to taking leave.
    - The employee worked at least 1250 hours during the twelve months prior to taking leave.
    - The employer has at least fifty employees at the employee's work site or within a seventy-five-mile radius of that work site.
    - The employee experiences a "qualifying event" and provides timely notification of the need for a leave to the employer.
    - "Qualifying events" under the FMLA include:
    - Birth of a son or daughter of the employee
    - Placement of a son or daughter with the employee by adoption or foster care
    - Serious health condition of an employee's spouse, son, daughter, or parent
    - Serious health condition of an employee that makes him unable to perform the functions of his job
    - Serious injury or illness of a service member that is incurred while on active duty
    - Any "qualifying exigency" arising out of the fact that a family member is in the National Guard or Reserves and is or soon will be placed on active duty

6 Arbitrators are chosen based upon the procedure provided by the parties CBA. However, if several arbitrators are provided by the CBA, the Union President and the HR Manager or their designed representatives use what is known as the "striking method" whereas each of the parties will strike on arbitrator off the list until only one arbitrator is remaining.

7 "Light duty" is most commonly referred to as "modified work duties" which consist of work duties being revised to "match" or "fit" the temporary work limitations provided by an employee's physician. Most employers will provide "modified work" or "light duty" for a specified period of time. "Temporary medical restrictions" (TMR's) should

not be confused with "Permanent work restrictions" (PMR's) which limit the employee from performing work outside the specified PMR's on a permanent basis which can lead to a "reasonable accommodation" determination under the Americans with Disabilities Act.

8 The most effective way as viewed by Arbitrators to present a parties position in a contract interpretation case is to reference past practice and past applications of the contractual provisions being challenged, along with presenting prior arbitrator's decisions which support your parties' position. In disciplinary cases, such as this one, you would present the above arguments, and the reasons proving "just cause" if you are the Company representative or the reasons why "just cause" has not been met, if you are the Union representative.

9 Under a collective bargaining system, union and management negotiate with each other to develop work rules, pay, and other benefits. The product of collective bargaining is a labor contract or agreement that spells out the conditions of employment and work rules that affect employees in the bargaining unit represented by the union. U.S. labor laws view labor and management as natural adversaries who will disagree over the distribution of the firm's profits and resources. For this reason, rules have been put in place so that the pie is distributed peacefully in most cases. Managers are more likely to develop work rules and HRM policies based on efficiency and productivity. But, when a union is in the picture, work rules and policies must reflect the employees' preferences as well. Employees have preferences related to staffing, employee development, compensation, and employee relations. The labor contract gives employees specific rights. The employees, through the collective bargaining process, have a voice in the development of work rules that affect their jobs.

10 Labor and management tend to treat each other as adversaries because of their origins and their different missions. Labor unions see their mission as gaining better benefits and pay for their members regardless of the company's economic situation. Companies have viewed their mission as maximizing shareholder wealth, and keeping labor cost as low as possible to help boost profits.

11 The most significant impact of a union on the management of human resources is its influence in shaping HRM policies. In the absence of a union, the company may develop all HRM policies based on efficiency. However, when a union enters the picture, management must develop HRM policies that reflect consideration for the preferences of workers who are represented by a union. A union's strong preferences for higher wages, COLAs, job security, the ability to express dissatisfaction with administrative actions, and having a voice in the development of work rules that affect their jobs get injected into the equation along with the employer's preferences.

12 Students should either grant or deny the grievance and give their opinion in detail justifying their decision.

13 The issue in this case was whether the Company was justified in terminating the employment of an employee with seventeen (17) years of seniority following the issuance of a "Loss of Value" letter for excessive absenteeism.

14 If the answer is "no" to one or more of the following questions, just cause for termination is not present or is seriously weakened.

I. Notice. Did the employer give to the employee forewarning or foreknowledge of the possible or probable consequences of the employee's disciplinary conduct?
II. Reasonable rule or order. Was the employer's rule or managerial order reasonably related to (a) orderly, efficient, and safe operation of the employer's business, and (b) performance that the employer might properly expect of the employee?
III. Investigation. Did the employer, before administering the discipline to an employee, make an effort to discover whether the employee did in fact violate or disobey a rule or order of management?
IV. Fair investigation. Was the employer's investigation conducted in a fair and objective manner?
V. Proof. At the investigation, did the decision maker possess substantial evidence or proof that the employee was guilty as charged?
VI. Equal treatment. Has the employer applied its rules, orders, and penalties even-handedly and without discrimination to all employees?
VII. Penalty. Was the degree of discipline administered by the employer in a particular case reasonably related to the seriousness of the employee's proven offense?

If the answers to the above questions are YES, then additional questions are considered in determining the degree of penalty:

I. Are there any due process procedural violations of the employee's rights, such as failure to give notice of charges, not allowing the employee to face his or her accusers, or lack of counsel?
II. Are there any mitigating circumstances, such as a record of long term service with the employer or fault on the part of management which may result in a penalty less than termination, such as reinstatement without back pay?

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

Virgin, Inc. was one of the most innovative companies in the world. The company's success can be traced to founder, Richard Branson. The case traces the roots of Branson's family and the major influences on his life that contributed to the success and growth of Virgin.
The case follows the various stages of Branson's entrepreneurial ventures (e.g., magazine, record company, record studio and label, airline and various other ventures) through 2009. Branson's keys to success are also examined. The case ends with the current problems that face Virgin in 2009.

INSTRUCTOR'S NOTES
RECOMMENDATIONS FOR TEACHING APPROACHES

Students will find the case very interesting because most of them will have heard of Virgin, Inc. Students will combine the facts presented in the case with their own perceptions and experiences of Virgin. The case makes valuable contributions related to the historical background of one of the most successful companies in the world. Furthermore, the case examines Richard Branson and takes students through the process of starting an enterprise. The following questions are recommended for discussion.

Questions

1) Discuss the background and personality of Richard Branson.
2) What did Branson do to make Virgin so successful? What grade would you give Branson as an entrepreneur?
3) Perform a SWOT analysis on Virgin
4) Discuss the history of Virgin from startup until today. What strategies did Branson and Virgin employ to grow their business?
5) What were the major problems and/or opportunities facing Virgin, Inc. in 2009?
6) What recommendations would you make to Richard Branson? Why?

Questions and Answers

1) Discuss the background and personality of Richard Branson.

Born in England in 1950, Richard Branson's mother was a stewardess, father a lawyer, and grandfather was a judge. Branson had two sisters and recalls that his childhood was happy. His parents emphasized independence. Due to Branson's dyslexia and his near-sightedness, he was a poor student.

Branson dropped out of boarding school at 16. When he was asked about this, he responded, *"I was so happy to get out of school. So was the headmaster. He told me as I was leaving; Richard you will end up in prison or a millionaire."*

Branson's lessons and personal traits, which were developed during his childhood, contributed enormously to his success.

Branson's mother, Eve, was focused on challenging her children to them with their confidence, growth, and development. Branson stated, *"I remember that my parents continually set challenges for us. My mother was determined to make us independent."* Eve had been 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, when she married Ted Branson, Richard's father, Eve had already trained as a dancer and performed in London theaters. When Eve met Ted she was employed as a stewardess for an airline that made trips to and from South America.

Branson attributes a lot of his creativity and initiative to his parents' upbringing. When he was four years old, his mother dropped him off in the country a couple of miles away from his home and expected him to find his way back. Branson also recalled his mother telling him to bike to a town 50 miles away. 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. 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 socially. 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, Ted, was an attorney, as was his father. Ted's father, Sir George Branson, went on to be a high court judge and was very respected and reputable. Ted Branson was much less dominant in trying to mold his children's future habits.

Schoolwork presented a significant challenge for Branson. Branson was dyslexic and by age eight, he was still unable to read. An undiagnosed sight problem also hindered Branson's school success. 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 has 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."*

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

In 1970, Branson started a discount records mail order venture with his friend Nick Powell. He then opened a record store on Oxford Street in London. Branson explained, *"I started the "Virgin Records" recording label in 1972. This was my first major success. I was the first person to sign the instrumental artist Mike Oldfield, whose album "Tubular Bells" went on to be the soundtrack for the movie The Exorcist. This was my first big money maker and stayed on the UK music charts for 247 weeks. In the following years, my record label signed top music artists like The Rolling Stones, Genesis, The Sex Pistols, Peter Gabriel, and Simple Minds.*

Branson has also had his share of disappointments and hard knocks. One of the most serious situations Branson got himself into, and eventually out of, involved an overnight stay in jail. Branson decided, against better judgment, to sell records that were meant for export and therefore were exempt from certain taxing requirements. Though this opportunity presented a very attractive profit margin, it was very illegal and eventually Branson was caught. 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 he should have paid.

The scrape with the law was one of many life lessons learned by young Branson. Many of these incidents would shape the way he thinks, feels and deals with friends, foes and the establishment.

As documented later in this writing, Branson's success was unconventional. Branson was known as one who rose to the top and remained there by being his own person and instilling belief in those around him. Branson often represented, consciously or not, anti-establishment; light heartedness and creativity. 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. The "Sir" at the beginning of Branson's name is there because in 1999 he was formally knighted for his service to entrepreneurship. His knighthood was another tribute to all that Branson had accomplished and the admirable reputation he had achieved through his years of contribution to the United Kingdom and the world.

Another facet of Branson's life is his adventure-seeking side. Branson has attempted world record feats in both hot air balloons and sail boats. He has attempted and achieved the record of the first and fastest to cross the Atlantic and Pacific Oceans in a hot air balloon. He has also made attempts at speed records in an amphibious vehicle. These activities by Branson 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 cheap or free publicity for himself and Virgin.

Along with the publicity Branson received for his world record attempts he has also appeared on television and the big screen.

2) What did Branson do to make Virgin so successful? What grade would you give Branson as an entrepreneur?

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."–Richard Branson. Branson enjoyed many things, which is one of the reasons why he has been so successful in so many areas.

People viewed Branson from two conflicting view points. He was known as: (1) the country's best known businessman who walks on water, or (2) a ruthless, wily entrepreneur who was always trying to get over on his rivals and skates on thin ice. But Branson's true talents were in his ability to win over people with his ability to inspire loyalty. Branson developed faith in his employees and respected their ideas. He was not afraid to give credit to someone else even when it may make 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.

Branson's other successes can be attributed to his character and personality. Branson never gave up and was willing to take on huge risks. Virgin had a strong brand name in many industries. Even a large number of Virgin companies were not making a large amount of profits, 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 is 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 has expanded Virgin.

Branson's characteristics included: hardworking, charismatic, excellent negotiator, self-motivator, aggressive, risk-taker, creative, very competitive, flexible, proactive, and financially organized. Branson networked with successful people.

Branson stated that the key factor in his success were his employees and the environment he created within the company. The culture of Virgin was similar to a close, family-like company. Branson's philosophy of success was to hire quality people and reward them.

Branson put employees or associates first; customers second; and shareholders 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 life made up for a few extra dollars here and there.

Another practice or theory that Branson lived by was that a successful business effectively expands by creating new businesses as opposed to buying existing ones. Expanding in this manner allows employees to get in on the ground floor and learn the ins and outs of the business more intimately. This manner also provides a sense of ownership to employees knowing that they helped give birth, nurture and grow the new entity. Branson felt that building from within encouraged the production of quality products and/or services. He emphasizes that quality over quantity is the goal.

One of Branson's personality traits was generosity. 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.

Branson deserves an A for his ability to create one of the most innovative companies in the world.

3) Perform a SWOT analysis on Virgin

Virgin's strengths included the following: (1) Strong brand equity: The Virgin brand name is not only associated with Richard Branson, but also embodies a rebellious, anti-corporate image; (2) Entrepreneurial leadership: Richard Branson is continuously looking to engage in new opportunities and considering new ventures, (3) Non-related companies: The Virgin Group consists of over 200 individual, non-related companies. These companies operate on a standalone basis which allows the underperformance of one company not to affect the collective group; (4) Strong Corporate Culture: The Virgin Group has a competitive advantage that cannot be replicated, its corporate culture. Virgin's employees are high performing, fun, high energy people that are continually thinking outside the box and looking to innovate; (5) Decentralized Organizational Structure: The flat organizational structure allows 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, serving as an antithesis to corporate bureaucracy, is 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 is most predominant in the United Kingdom, does not carry as much significance in international markets; (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 can leverage synergies between businesses: While the various companies operate independently, the companies themselves can potentially capitalize on best practices/competitive advantages that have helped one business become a market leader by applying internally within another organization; (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 is whether or not the brand will maintain its market value without Branson to personally launch new companies. From an internal perspective, one must question from a second tier leadership perspective, whether the entrepreneurial spirit is pervasive enough throughout the organization and its culture for the growth of the organization to be maintained; 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.

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. In April 2009 allegations were made that Virgin America was breaking the law because the company wasn't at least 75% American owned, which is a violation of U.S. regulations. 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 is not performing as Branson and Virgin hoped it would, Branson still believed that there was opportunity in the U.S. Market.

Financial troubles also are hampering other parts of the Virgin Group such as Virgin Blue, which operates predominantly in Australia. The financial trouble for Virgin Blue has resulted in salary and pay cuts along with hiring freezes. With such a large portion of Virgin consisting of airline travel businesses, times are 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 existence in the United Kingdom. The Company is primarily known and has been successful promoting its prepaid cellular phone services. Virgin Mobile also offers traditional services in the U.S. to select customers. During 2009 Virgin Mobile operated in 7 different countries. Virgin Mobile had been especially successful in Canada the four years previous to 2009.

In 2009 Branson was also looking to continue and 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" from future Virgin Galactic customers.

4) Discuss the history of Virgin from startup until today. What strategies did Branson and Virgin employ to grow their business?

It all started with an entrepreneurial venture by Richard Branson, *Student* magazine, which was launched on January 26, 1968. This magazine embodied the essence of what many of Virgin's companies represent; organizations which challenge the status quo and appeal to the younger generation. The magazine's articles focused on sex, rock music, interviews with terrorists, and proposals for educational reform. Branson 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 ventured into the mail order record business after over four years of guiding his magazine. This mail order business can be viewed as a musical distribution expansion of *Student* magazine. 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 magazines advertisements. Branson was also able to flip these records for a profit by selling them to music retailers less expensively than most middle men were at the time.

Business began to pick up and Branson realized the advantages of having 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 Nik's commitment to help grow Virgin and keep it on the right track, Branson offered him a 40% share of the company. Nik brought to the business professionalism and know-how in running a business's day-to-day activities. Branson was sort of the creative, idealistic part of the team. The two worked together very well.

After the beginning and relative success of Branson's mail order business he then expanded structurally to opening a physical brick and mortar location on Oxford Street in London in 1971. This move was more necessary than strategic. 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. The new Virgin retail stores were the answer to the dilemma caused by the postal strike.

Virgin then vertically integrated backwards by expanding into record publishing – established a recording studio and signed major bands, starting with Michael Oldfield and the Sex Pistols. The first huge step was the release of Mike Oldfield's *Tubular Bells*. 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 5 million albums worldwide and lift Virgin Records into a role as a notable player in the music industry.

The signing of the Sex Pistols was a move that embodied Branson's, and now Virgin's, propensity to walk landscapes that were too risqué for other more conservative labels. The Sex Pistols were known drug users, lived obscene lifestyles, and were definitely not your grandmother's kind of artist. Though this reputation preceded them they were a hit while with Virgin and both parties benefited from this alliance. 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.

In 1984, Virgin began trending towards an unrelated diversification strategy with Virgin Atlantic Airways and Virgin Cargo. The airline business was known then, and still is, as very capital intensive, competitive, volatile and not a place for the little guy. Though many stop signs presented themselves, Branson hopped on the opportunity to create a startup airline when an associate of his, Randolph Fields, was searching for someone to grasp onto and fund his idea. Branson knew of the many risks but seen the opportunity as a challenge that not many were willing to embrace. 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*."

Branson knew that there was a place for them in the airline industry; they just had to find it. Branson witnessed very poor customer service and unpredictable, unnecessarily high pricing. Branson worked tirelessly to make this idea a successful reality and brought in experience and intuitiveness in order to get this plane in the air. 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.

During the days when Virgin Airlines was born British Airways was the UK's national carrier. This meant that if Virgin Airlines had a hope of surviving, much less thriving, it would have to gain some type of advantage over the British Airways giant.

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 will give the leaders of each division a share of the company that they are running. This practice is meant to give the extra incentive to the leaders to push a little harder because they have an actual stake in the success of their division of the company. Branson often comments that he enjoys making millionaires out of the people that work 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.

In 1985 privately owned Virgin Group went public, which gave Branson an uncomfortable feeling. Branson didn't like giving up the control that accompanies a privately owned company. Though he was apprehensive about this move Branson knew the benefits of being able to raise a tremendous amount of capital so quickly by floating the company to the public. The influx of investor money seemingly created so many options for Virgin. During the time when the company was public the relationship between Virgin, Branson and market analysts was never stable. 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.

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 decide if he would 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 knows in his heart that it was the right business move for what he wanted to accomplish, but it still hurts to let go of something that he had grown so attached to and had been through so much with. In a way it seems Branson is proud of himself for being able to think with his head and not 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*." For all of Branson's critics that believed that he just lived by the seat of his pants and made rash, unpredictable decisions this one may have surprised even them because it made so much sense.

The cash raised through the sale of Virgin Records helped spawn new Virgin entities along with aiding the growth and expansion of Virgin Airlines. Such innovative injections into the airline experience that were funded by the sale included onboard masseurs, fashion shows and tailors. The creativity of Branson and other brains at Virgin is the only limit to what will come to fruition at Virgin.

Branson employed multiple strategies to help foster Virgin's growth into the conglomerate that it currently stands as today.

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 in case.

Even though Virgin was operating as a conglomerate with businesses in multiple industries with little in common except for the Virgin Brand, it is apparent that some related diversification occurred within subgroups, which are categorized in case Exhibit 2 (e.g., Travel and Tourism, Leisure & Pleasure, Social & Environment, Media & Telecommunications, Finance & Money, Health, and Shopping).

While one can argue that these categories are indicative of non-related diversification, it is evident that Virgin is already recognizing particular industries/markets where it can expand its reach and leverage the success of some of its existing firms.

5) What were the major problems and/or opportunities facing Virgin, Inc. in 2009?

The world was stuck in the worst economic crisis since the Great Depression of the 1930's. 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?

In order to increase its profitability Virgin had to determine how it would compete in this volatile environment.

6) What recommendations would you make to Richard Branson? Why?

The case addresses two problems confronting Virgin in 2009. First, what is the succession plan related to the retirement of Branson and second how will the firm manage itself in this challenging economic environment?

First, it is recommended that Branson set up a succession plan. As part of the plan, Branson should specifically designate who will be taking over for him and what their responsibilities will be. Ideally, Branson should be mentoring this person to make the transition go smoothly.

Second, Branson and his staff need to perform a strategic analysis of Virgin's various business entities. This can be done through the following eight step procedure:

1. Identify the present corporate strategy, which would be unrelated diversification for Virgin. Determine if the strategy is domestic and/or international? Are there any moves to divest the business portfolio or build positions?
2. Construct one or more of the business portfolio matrices (e.g., BCG Matrix) to determine the attractiveness of the business units.
3. Compare long-term attractiveness of the businesses the firm competes within.
4. Compare the competitive strength of the company's business units to see which ones are the strongest.
5. Rank each business according to historical and future profitability.
6. Assess each business unit's compatibility with corporate strategy and determine the value of any strategic-fit relationships.
7. Rank the businesses in terms of priority for new capital investment. Decide what the strategic posture for each business unit should be (e.g. divest, defend, expand, etc.).
8. Craft new strategies to improve overall corporate performance. Change the makeup of the portfolio through acquisitions, divestitures, and improve the coordination among the business units to share costs and skills. Orient future resources into the areas of greatest opportunity.

Improving a diversified company's long-term financial performance entails concentrating company resources on businesses with good to excellent prospects and investing minimally, if at all, in businesses with subpar prospects. Once strategists have performed the first seven steps in the analysis of diversified companies, the final step is crafting a corporate strategy. It is at this stage that a company must decide whether to add businesses, divest, and focus more on its core competencies. Is the company diversified enough? Are the industries attractive? What performance objectives need to be satisfied?

Unfortunately, since Virgin is a private company, we do not have the luxury of having data on the company. Therefore, specific recommendations cannot be made. However, we do recommend that Branson evaluate all of his businesses to determine which ones he wants to keep or divest. Also he needs to determine if any layoffs, downsizing or other corporate strategies need to be done to increase the profitability of Virgin. It's possible that Branson can reinvest in certain areas to increase market share as that is a strategy that Apple does in economic downturns to increase their competitive advantage against their competitors.

MIA MOTORS: THE ARRIVAL OF AN INTERNATIONAL FIRM INTO THE AMERICAN ECONOMY.

William Brent, Howard University
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 industry and the development of their pioneering management challenge to not only exist and prosper but to explore their hopes for corporate growth in a market dominated by large multinational firms. The issue of valuation and use of the firm's public shares is a central focus for the case evaluator and student. Determining methods for exchange rate risk and stock to American Depository Receipt (*ADR) choice to finance expansion plans into foreign ventures (Assembly plant in Alabama) are the themes addressed in the case. How should the automobile industry and the American stock market value this firm's shares as they compete against major competitors who are virtual giants in the U.S. auto world namely, 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 Korean firms and the valuation of the shares for multinational auto designer and manufacturing 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.*

CASE SYNOPSIS

This case affords students an opportunity -- from both a strategic and financial point of view -- to evaluate Mia Motors decision to enter the U.S. to manufacture and sell automobiles and the special international funding and use of ADR public offerings to finance their planned installation and implement operations of their U.S. assembly plant in Alabama. The analysis and discussion basis for the case hinges on the international financing of its capital needs by means of traditional debt and equity-ADRs. The corporate objective of this Korean firm is essentially to establish assembly plants in the U.S and to determine the extent of funding necessary to allow for their successful operations with a product simply known as " Foreign Import" which is widely known and accepted now. All data elements and statements were derived from public Internet data and public financial data, and Mia MOTORS represents a fictitious firm although its financials may resemble others in the international automobile industry. No private or insider information was provided or extracted from other company files or other such cases

INSTRUCTORS' NOTES
PROBLEM STATEMENT

In August 1999, the Board of Directors of Mia Motors Incorporated faced the decision threshold concerning several issues facing its "expanding to America plan" for the firm including: (1) how does this firm survive in an international automobile industry market when it is but a small dot on the industry horizon, (2) which international market would best "fit" the mission and direction of the firm (i.e., further expansion in Europe or an Assembly plant in the U.S.); and (3) how would the firm fund its international plans. First, a consideration is made of what funding sources are available from its parent firm in Korea or, if that is not available, what can be acquired from U.S. exchange markets based on the suggestions of an underwriting team of J. P. Morgan Chase, Inc. and Wachovia Securities, Inc., who would be handling (or provide the sponsoring of an ADR issue) the funding issue. According to Wall Street estimates and CNN News.com, the underwriters have agreed to fully underwrite 300,000 shares of Mia's common stock for ADRs depending on the firm's decision. The underwriters were also granted the option to purchase up to 10,000 additional shares from the company to cover any over-allotments. There were numerous risk factors to consider with respect to an equity issue, including the company's limited U.S. operating history and its rapid emergence into a fairly unstable U.S. auto market, which traditionally has led to share price volatility, and even a hearty "best offer" underwriting. Following an extensive investigation, management had discovered that most entrepreneurial firms had stumbled after an initial period of rapid growth but felt that MIA's development had been relatively successful thus far, especially since its stock had sold well in Korea. But its potential investors would be the ultimate deciders of the fate of the firm. In light of the foregoing, the case reviewer is being asked to assess the value of funding needed ($10-15 millions to begin with) by Mia and determine the appropriate source of that funding, whether it is from Korea or one of Mia's other foreign sources. Finally, with consideration of the strategic and financial needs of a multinational firm and the possibility that Mia's shares can be utilized as collateral for an ADR issue, get Mia listed on an American exchange and allow Mia to avoid most of the restrictive requirements and costs of U.S. regulations. One can consider that the firm will not receive the direct funding of the venture by its parent firm in Korea, and the needed funding must be obtained from a Korean stock issue or by an ADR issue with the support of an American investment bank, namely J.P. Morgan Chase.

ALTERNATIVE SOLUTIONS

Book Value Method

Determine the firm's book value and use that value as a basis for determination of a fair market (offering) price for the firm's shares and determine whether the share-to-ADR conversion will be equal, or disproportional and require additional collateral to support the ADR issue.

Price-to-Earnings Method

Compute the firm's estimated price-to-earnings rate times its estimated EPS and use the figure to determine the ADR price as an acceptable valuation method for price determination,

Free Cash Flow Analysis

Analyze the firm's projected discounted cash flows as a valuation methodology and determinant of the firm's current U.S. market value and an appropriate market clearing price for the ADR issue.

ADR Valuation Process

A number of valuation methods including the enterprise, and market multiples models based on the foreign EBITA and EBITDA cash flows could be attempted. Valuation of Mia's Korean operations will be the most significant element in determining whether the ADRs will be sponsored by the U.S. intermediaries or Mia could present its shares cross-listed, or simply as an unsponsored presentation.

ANALYSIS OF THE ALTERNATIVES AND RECOMMENDATIONS FOR TEACHING APPROACHES

Book Value Method

Determine the firm's book value and use this value to determine a fair market price for the offering. Mia's current book value per share is $74.92. It follows that, if the company issues 100,000 shares, the total book value will be approximately $289 million foreign and domestically. The industry average for 2000 (computed by and cited in the Standard and Poor's industry surveys) produced or yielded a book value per share of $48.18. If the industry average is used, the total value of Mia's shares would be nearly $42.23 million.

In a pure-play analysis, using one of Mia's most formidable competitors as a basis for comparison, Chrysler Corporation's value was determined to be $63.83 per share for the same period. Given Chrysler's established record of somewhat sound performance in the market as one of the larger auto manufacturer, the low share price of $48 is used as a comparative test base for the US-inexperienced Mia. If Chrysler's high market price of $61.125 were used instead, the book-to-market value would be 0.059. Based on this figure, Mia's per share market price for the 1,200,000 shares would be $65.15 per share. Using Chrysler to estimate Mia's market price does produce a rather wide range of prices (between $9.10 and $65.15), thus making the accuracy of the outcome of the method somewhat questionable. Moreover, it is difficult to make relative comparisons of Chrysler and Mia on any level given the vast differences in size, experience, market share, and years of operation. The comparison parameters become quite distended in the process.

If the underwriters choose to use either of these prices to set the price of Mia's ADR or its U.S. equity issue, they will run the risk that the offering would be either under- or over-priced. As noted by Roger Ibbotson, Jody Sindelar, and Jay Ritter in their seminal articles on equity pricing (Chew, 1998), if the price is too low, the issuer's potential to raise the needed capital is undermined and the reputation of the underwriter is damaged. On the other hand, if the price is set too high, the firm and investment bank underwriter as in Mia's case, may incur a loss, because they would have to issue more shares in order to receive the level of funding necessary for the venture.

In most valuation case problems, evidence can be obtained about the capital market's assessment of the company itself. In the case of the equity issue or collateral for the ADR backing (and listing on U.S. Markets), however, the market price or a current assessment of the firm will usually be used as the price available. Further, securities regulations may prevent dissemination of cash-flow forecasts, and, although internal forecasts are possible, they often fall wide of the mark because of market cyclicality or lack of knowledge this particular new firm in the existing business segment. Because of the level of uncertainty that surrounds the international issue, and Mia would be no exception, it would be necessary for the firm and the underwriters to disclose as much information as possible to potential investors about the firm to enhance sales of the issue. This would hopefully allay some of the many concerns about the ADR and the firm and dispel much of the uncertainty that often occurs prior to an international issue.

Price-to-Earnings Method

Compute the firm's price-to-earnings rate (and forecasted EPS) and use it as a valuation methodology and determinant of the firm's market clearing price. The underlying assumption of this method is that the market value of the firm is directly related to the company's share price. The average price-to-earnings ratio for the industry was computed to be 24.2 times. This is applied to Mia's earnings figures to determine the appropriate market value; however, we are unable to apply this method directly because the firm currency translation in 2000 was reported from various sources and current translation was assumed from the firm's statements only. In examining other similar companies that had ADR issues, like Hyundai appears to be a more closely aligned pure-play firm for Mia, including the fact that Hyundai had a recent history of revenue gains at or near the time of its ADR issue. This would have precluded the use of the P/E method valuation for that firm also. The new firms incur heavy losses in order to exploit the market's vast opportunities, but because this firm was not the first such firm to explore the U.S. economy, we have chosen to project cash flows as positive-assuming the firm will be able to reduce its learning curve into the market and gain the trust of the American investor.

The perplexing issue for the managers of Mia will be the decision of go into the market at this moment while entry is favorable from a NAFTE Agreement, and a lower period of regulation for international firms. If the company goes immediately to the market, the credibility of the firm might be a serious concern. Conversely, waiting could also be problematic in that it would keep or not allow the firm to obtain its needed capital and strategically inhibit it from the international market, reduce the firm's growth and U.S. market sales, and cause the firm to lose its potential advantage as a relatively new international entrant and potential competitor to the established U.S. firms. Additionally, with its projected market gains, Mia would demonstrate to its potential investors, customers, and creditors that it had sufficient strength to be taken as a serious market contender. One best means of accomplishing this would be through the issue of the ADR, even if the firm had to accept the deposit of its shares at other American banks

Free Cash Flow Analysis

Analyze the firm's projected discounted cash flows as a valuation methodology and determinant of the firm's current market value and an appropriate market clearing price for its shares or ADRS. The Discounted Cash Flow (DCF) Methodology of stock price determination rests heavily on the forecast of the firm's future cash flow projections. As noted in Case Attachment 1, the firm's revenues increased from $957,000 in December 1998 to $4,606,000 in 2003 (3800% growth rate), which was additionally matched by the firm's operational costs. Forecasting the future growth rate is a requirement of the DCF method, which for Mia was a difficult matter because of its limited U.S. operating history. Although high rates of growth are not uncommon in the automobile industry for growth firms, this rate of growth was rather large to be used in the financial valuation because it would be difficult, at best, for the firm to sustain that growth rate. A forecast of the company's cash flows based on the sustained growth model is presented in Exhibit 1. The forecast was conducted based upon the fact that a pure-play company namely Hyundai had to be chosen from the industry to determine an appropriate (more realistic) growth rate. Consequently, Hyundai's average growth rate of 29.3% was used to forecast Mia's short-term growth rate for a 5-year period of 31.4% . This rate is estimated to remain in duration for 5 years, with a subsequent long-term sustainable rate of 10%. Based on Value-Line's predictions, the market rate of growth is predicted around the Hyundai and other international firms in the U.S. automobile market with a sustained rate of 23% prediction used as a case model for short-term growth. In the long-term, however, a conservative approach was taken for Mia's future growth at 10 percent because of the belief that the large initial growth could not be sustained with the addition of competition, arbitrage of Mia's product mix and other market growth leveling transactions.

Financial cash flows (net income and depreciation) are calculated as a percentage of sales using industry averages. These calculations are displayed in the case solution exhibit 1 and Attachment 1. As a means of forecasting the capital expenditures, the capital expenditures for 2000-03 are projected, Based on the industry average growth rate in capital expenditures, the firm's capital expenditure rate is forecasted at a constant rate of 5.6% (between 2000-2003). This assumption might be understated in light of the firm's expansion plans, and international marketing.

However, as a proxy, Hyundai provides only a partial solution to the problem. Thus, Mia's free cash flows are considered as an adjunct to the above analysis. To accomplish the valuation, the firm's discount rate must be estimated for discounting cash flows to 2003. The firm's cost of equity (capital) is calculated using a Capital Asset Pricing Model (CAPM-WACC combination), producing a rate of 40% (see solution Exhibit 1). A Weighted Average Cost of Capital computation more closely approximates a real world application, 35.94%, considering the international risk-adjusted nature of the rate. [Attachment 1] The CAPM elements assumed are a market return of 22.8%, risk-free rate of 5.57% for 90-day treasury bills, and the beta of 2.0 because of the firm's given high risk characteristics. The WACC elements included a cost of debt equal to a Baa debt offering of 8%, but this is discarded as too low for the firm, and a prime rate of 9% is a better choice. The WACC rate is used to discount the firm's cash flows, producing a present value of the firm of $4,338,631, and a per share value of $36.60 [see Attachment 1]

ADR Valuation

Mia's opportunity for funds in the U.S. can be derived from several sources, since the 1990s foreign firms have traded their shares on several exchanges by cross-listing in various countries. Yankee stock offerings or new direct sales into U.S. public exchanges and large investors were allowed under Section 144A and now the North American Free Trade Agreement (NAFTA, 1994). Other alternatives available to Mia are funding from its parent firm in Korea, and issue of stock in its home country, issue of its shares in U.S. markets, borrowing the funds from a U.S. intermediary and an intermediate transfer of some its stock to a U.S. financial intermediary like J.P. MorganChase where these shares can be converted to ADRs. These securities began trading in 1927. Since their inception, their use is grown astronomically. These rights offer advantages over those available to the firm who issues its shares directly in the foreign exchange. Some of the advantages are;

- -They are denominated in dollars, traded on U.S. stock exchanges and can be purchased through a local broker. Trading directly by the foreign firm requires the investor to set up an account with a broker from the issuing firm's home country, execute currency exchanges for the stock and arrange the shipment of the shares to the investor's custodial account,

- -Dividends are collected by the investor, converted to the investors home currency and handle any tax implications between the U.S. and the foreign country if the shares are purchased and issued directly within the U.S., while ADR investors have dividends collected, currency converted, and payment is completed by the custodian ,

- -ADR trades are cleared in three days like U.S. stock trades, while foreign stock settlement can vary from country to country,

- -ADRs are registered securities (not bearer securities) which provide ownership protection, can be terminated by trade with another investor or returned to the bank depository for cash, and can be sold in multiples of their underlying shares.

FINAL RECOMMENDATIONS

Based on the foregoing discussion, the underwriters should have valued the firm using the discount cash flow method of analysis, potentially a better method for international firm valuation because this method more closely accounts for many of the idiosyncrasies of ADR offering and international firms, while addressing the problem of recognizing the expanding firm's international earnings potential. Additionally, the DCF method lends a greater degree of authenticity to the value derived than other methods employed. The true potential of the firm may be viewed from a rather conservative basis; however, with all other factors present in the case with the company, risk avoidance is the key. Although, the firm might take off following the ADR issue or later experience what most rising stars encounter periodically, i.e., a period of down-turn due to competition with competitors like Chrysler and General Motors.

Moreover, based on the traditional inclination to pricing ADRs, investors should and quite often do carefully evaluate the worth of the growth opportunities that could positively impact the value of the shares upon entry into the market. ADRs are quite often severely underpriced in terms of their real potential, but in the case of Mia, hefty growth should have been considered as a key element to its competitive edge in the market.

REFERENCES

Chew, D. (1998). *The New Corporate Finance: Where Theory Meets Practice, first edition*. New York: Irwin/McGraw-Hill.

Copeland, T. E. and J. F. Weston (1988). *Financial Theory and Corporate Policy, third edition*. Reading, MA: Addison-Wesley, 1988.

Grinblatt, Mark, & Sheridan Titman, Financial Markets and Corporate Strategy, 2nd edition McGraw-Hill, 2002

Moffett, Michael H., Cases in International Finance, Addison-Wesley, (2001).

Rapport, Alfred, Creating Shareholder Value, The Free Press, 1998

Kuemmerle, W. (2005). Case Studies in International Entrepreneurship: Managing and Financing Ventures in the Global Economy, *first edition*, New York: Irwin/McGraw-Hill.

O'Hara, M. (1995). *Market Microstructure Theory*. Cambridge, MA: Blackwell Publishing, Ltd.

Ross, S.A., R.W. Westerfield, and J. F. Jaffe. (2003). *Corporate Finance, fifth edition*. Boston: Times Mirror/Mosby College Publishing.

Standard and Poor's Industry Surveys (2002).

Standard and Poor's Stock Reports (February, 2002).

Value-Line (March, 2003)

ATTACHMENT 1 -Notes
WACC CALCULATIONS
Cost of Equity – Risk Adjusted for International inclusion
The CAPM Model = $R_f + (R_m - R_f)$Beta
where: Beta = 2.0
R_f = 5.57%
R_m = 22.8%
K_e = 5.57 + (22.8- 5.57)2.0
K_e = 40.03
Cost of Debt assumed to be at prime rate of 9%
Weighted Average Cost of Capital (WACC)
$= W_d K_d (1 - T) + W_{ce} K_e$
WACC = 9%(1 - 0.34) 0.12 + 40.03 (0.88) = 0.359392 or 35.94%

ATTACHMENT-2-Notes							
DISCOUNTED CASH FLOW ANALYSIS							
		1998	1999	2000	2001	2002	2003
Free Cash Flow		$957,000	$1,237,000	$2,161,000	$2,360,000	$2,176,000	$ 4,606,000
Discount rate	35.94%	$703,987	$ 669,217	$ 860,227	$ 691,480	$ 684,139	$ 729,861
Total present value			$4,338,911				
Present Value of Cash Flows form 1999 onwards			$4,338,911				
Discounted back to 2003							$195,213,000
Value of Mia = sum of present values							$195,213,000
Market Value per share based on issue of 1,200,000 shares of common stock					$4,338,911.00/1,200,000		$36.16

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

Sara R. Melendy, Gonzaga University
Daniel W. Law, Gonzaga University

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.

INSTRUCTORS' NOTES

Students have frequently expressed frustration and experienced difficulty understanding the complexities of process costing. Whereas the basic idea of a common product (i.e. cereal, canned peas) going through a series of processes to be finished is often readily understood by students, the cost accounting for departments is often challenging to visualize and, therefore, difficult to understand. This case is especially helpful in allowing students to see that materials and/or labor and overhead can be added at various stages of a production process, which in turn relates to a better understanding of the concept of equivalent units. Essentially, the case of Paper Airplanes, Inc. is a hands-on, visual learning exercise that is simple enough to complete in one class period, yet it successfully tackles the complexities of process costing.

The case involves some student volunteers actually producing a product (paper airlines) as if they were workers in a factory setting. Some students will act as direct laborers after some basic training. The materials manager will track and supply paper. One supervisor will track time. At least three production supervisors will count finished planes. They may recruit other helpers as needed. Some discrepancy may exist among the three supervisors regarding the count, but this can be resolved using a recount, average, or some other acceptable approach. This part of the process demonstrates the costs and benefits of utilizing multiple sources of data. The remaining students will assist their peers as cost accountants in the preparation of the process costing report following the production period (just two minutes of class time). Difficult-to-understand concepts such as partially completed units and cost per equivalent unit will be addressed in real time using real products.

Case studies and cooperative student projects provide students with opportunities to actively participate in the learning process by talking, listening, reading, writing and reflecting (Meyers & Jones, 1993). Many researchers argue that greater learning takes place when students are required to make use of multiple senses (Kvam, 2000). This case not only requires students to use many senses; it requires some participation of all students. Related to the topic of process costing in a managerial accounting course, Pariseau & Kezim (2007) found that using case studies in a technical business class had a significant positive impact on the student learning environment.

In preparation for this case, the instructor should introduce process costing by discussing relevant product types and the reasoning behind process costing for these products. Further, the instructor should prepare students by describing the basic process involved to account for the physical flow of units, compute equivalent units and cost per equivalent unit, and complete a process costing report. Students should have a solid understanding of why the report is necessary and its uses (cost control and accounting for costs within departments). A simple example (with or without numbers) using T-accounts, along with accompanying explanations will usually suffice. This explanation could take place in the class period prior to case study or, possibly, at the beginning of the same class period.

Additional preparations include setting up the front part of the room (assembly department) and procuring the necessary materials (paper and partially completed airplanes). The room should be set up so that students can easily view the factory workers as they produce airplanes. A table or grouping of desks is usually sufficient.

Just prior to the beginning the case, the instructor can hand out a copy for students to quickly read. During this time, volunteers will be requested for the factory positions and given some quick training on their jobs. The instructor should monitor the actual production period (2 minutes) and the brief time following (tracking and counting), but students should take care of all the work. When everything is tallied, the instructor will guide the students in setting up and preparing the process costing report.

CASE SOLUTION WORKSHEET FOR INSTRUCTOR

CASE SET UP				
Beginning Work in Process (WIP)		3 Airplanes	% Complete	
Direct Materials (DM)		$30	100%	
Direct Labor (DL)		60	50	
Manufacturing Overhead (MOH)		120	50	
Total		$210		
Costs Added During 2 Minutes	DM: $Q @ $10/sheet (# of sheets from DM manager)			
		DL	540	
		MOH	1080	
		Total (T): $(Q+540+1080)		
Airplanes Completed and Transferred: C		Ending WIP	% Complete	
Partially Completed Airplanes in Ending WIP: E		DM	100%	
		DL	40	
(# of C from Painting Production Supervisors)		MOH	40	
STEP 1: ACCOUNT FOR PHYSICAL FLOW OF UNITS AND EQUIVALENT UNITS				
Beginning Airplanes WIP	3			
+ Airplanes Added into Production	(C+E-3)			
Total Airplanes to Account for	C+E			
		DM	DL	OH
Airplanes Transferred	C	C	C	C
Ending Airplanes WIP	E	E	.4E	.4E
Total Equivalent Units	C+E	C+E	C+.4E	C+.4E
STEP 2: DETERMINE COSTS TO ACCOUNT FOR AND COSTS PER EQUIVALENT UNIT				
Beginning WIP	$210	= $30	$60	$120
Added	T	= Q	540	1080
Total Costs to Account for:	$210+T	= $30 + Q	$600	$1200
Total Equivalent Units		C+E	C+.4E	C+.4E
Cost per Equivalent Unit (CEU)	Total	($30+Q)/(C+E)	$600/(C+.4E)	$1200/(C+.4E)
Variables for CEU:	Z	A	B	C
STEP 3: PREPARE COST RECONCILATION (PROCESS COSTING REPORT)				
		Equivalent Units		
	Costs	DM	DL	MOH
Airplanes Completed and Transferred (M)	$(C*Z)	C	C	C
Ending WIP:				
DM	E*A	E		
DL	.4E*B	.4E		
MOH	.4E*C	.4E		
Total Ending WIP (N)	(E*A)+(.4E*B)+(.4E*C)			
Total Cost Accounted for	(M+N)	(should be equal to $210+T)		

STUDENT FEEDBACK

Both authors have utilized this case in the classroom, and informal student feedback has been very positive. After the case is completed, instructors should take a few minutes and review the case and its solution informally with the class. Student questions and observations should be encouraged. This follows similar recommendations for a less structured discussion of case studies (Amoah & Arundhati, 2009). Such a discussion will be important for the instructor to gauge whether key points of the process are understood.

Although this after-case discussion is useful for both instructor and student, a more formal, confidential evaluation gleaned from students' perceptions of the case provides further insight and, perhaps, greater evidence as to its efficacy. To this end, the authors prepared a short questionnaire and administered it in class a few days after the case was done and after the students completed homework and an exam relative to this material.

The survey was reviewed by the participating university's Institutional Review Board and approved for the use of human subjects. Students were informed before the survey was administered that their participation was voluntary and that their responses would be kept strictly confidential. No identifying information was collected.

The results of the survey are very promising. All students in attendance (63) participated, and all students responded to each item. Students were evenly split between two sections. Items one through six utilized a Likert-type scale anchored with "strongly agree" and "strongly disagree."

The first three items asked students to respond to the degree of learning they experienced relative to the case and various process costing components. Ninety-seven percent of students at least somewhat agreed that the case helped them learn more about process costing in general with 27% of these marking "strongly agree." Similar sentiments were expressed about the other two items asking about the degree of learning about equivalent unit concepts/computations and process costing reports. At least 90% of students at least somewhat agreed that the case was helpful in learning these technical aspects of process costing with over 30% indicating "strongly agree." These results clearly indicate that students generally believed the case was efficacious in learning the subject matter.

Two other items asked students whether the case was helpful in doing their homework and preparing for the exam. In both cases, at least 88% of students at least somewhat agreed that the case was helpful, and at least one third of all students strongly agreed. The final item asked about the general efficacy of these kinds of in-class activities in learning difficult or technical material in accounting. Here, students overwhelmingly responded in the affirmative with 51% *strongl*y agreeing and 97% at least somewhat agreeing. Again, students clearly felt the exercise was beneficial for study purposes and in learning technical material.

Students were also invited to make written comments on the survey about the case, and virtually all of these were positive as to their experience. A few selected comments are reproduced here:

"I really enjoyed the hands on activity because I am a visual learner."

"I really enjoyed how interactive the case in-class example was. More of these examples would be very helpful!"

"I had not read the chapter coming to class and learned all the material in that class period. That exercise helped tremendously in doing the homework."

"After this exercise, I did not find the material difficult at all."

CONCLUSION

From the comments above and the other feedback received, this in-class case appears to be an effective exercise for students in learning the basics of process costing. This case lends itself to a number of expansion possibilities, should the instructor wish to add complexity. For example, in a large lecture class, the instructor could employ multiple locations in the lecture hall with each representing a different facility producing airplanes. Each location could have its own overhead rate and labor costs could be varied. Three processing reports would need to be generated and consolidated.

Another expansion possibility would be having a "painting" department receive transferred-in planes (and associated costs) and "paint" the planes (using a crayon and a simple design). Students would then prepare a similar solution for this department and get the opportunity to see the entire production process and its accounting from start to finish. Instructors may think of other extensions relative to their students' academic level or course learning objectives.

REFERENCES

Amoah, N. & R. Arundhati (2009). Receivables management: A case study. *Journal of the International Academy for Case Studies*, 15(6).

Kvam, P. (2000). The effect of active learning methods on student retention in engineering statistics. *American Statistician*, 54, 136-140.

Meyers, C. & T. Jones (1993), *Promoting active learning: Strategies for the college classroom.* San Francisco: Jossey-Bass.

Pariseau, S. & B. Kezim (2007), The effect of using case studies in business statistics. *Journal of Education for Business*, Sep/Oct, 27-31.

THE HIPPOCRATIC OATH ON TRIAL

Sarah J. Holt, Southeast Missouri State University
Judy A. Wiles, Southeast Missouri State University

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.

INSTRUCTORS' NOTES

RECOMMENDATIONS FOR TEACHING APPROACHES

This case is especially useful in courses on management topics, such as organizational behavior or leadership. It is also appropriate in a business ethics course or health administration course. It is recommended that students be provided the following discussion questions to answer following their reading of the case. Class discussion should be guided by these questions. The instructor could choose to relate this case to that of a similar medical practice in the local community to help students make the connection to this type of organization and potential dilemma it may face.

For a more experiential approach, a role-playing activity could be created for the meeting between Westgate Surgical's administrator, Susan Smith and the physician, Dr. Goldstein where they discuss how to resolve the case dilemma. The role-playing could be constrained by types of conflict-handing orientations (see answer to question 4 below). One student could portray Susan in a collaborate orientation and another student would portray Dr. Goldstein, indicating typical responses to this type of orientation. Then the orientation for Susan could be changed to competitive with a focus on understanding how the response from Dr. Goldstein (another role-playing student) changes. Each of the five conflict-handling orientations could be role-played.

QUESTIONS FOR DISCUSSION:

1. **What is it about this situation that warrants the immediate attention of the administrator, Susan Smith?**

Answer: The situation can be viewed through the dimensions of the task, the organization and the environment (Hughes, Ginnett & Curphy, 2009). From a task perspective, we would consider the surgeon's personal reputation to be at risk if he became known as a physician writing prescriptions for the addictive pain killer, OxyContin more often than necessary. The task would also include caring for the patient and the need for healing a wound that appeared difficult to heal. The situation from the organization's perspective encompasses concerns about the threats from the patient's father and his disruptive behavior. Furthermore, the potential effect of having a physician on staff that may be considered an "easy source" for OxyContin would be highly detrimental to the organization's reputation. From a broader environmental perspective, we could consider concerns among the community about prescriptions written by physicians for OxyContin and its impact on drug abuse and the selling of OxyContin among drug abusers.

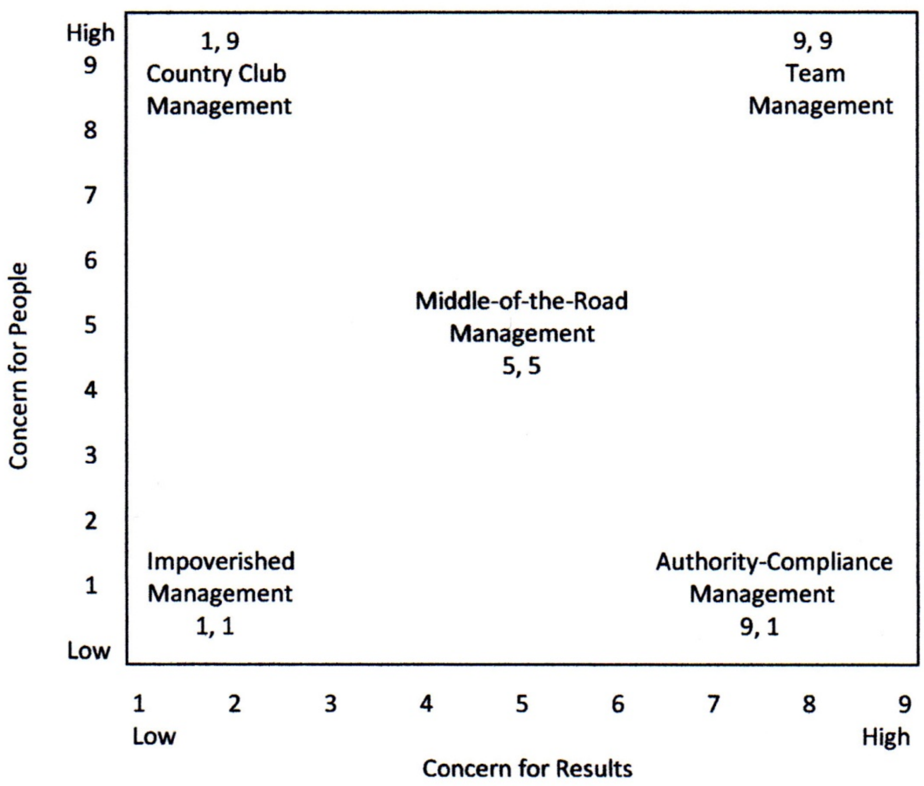
2. **Would you suggest that Susan Smith, the administrator of Westgate Surgical, meet with the physician? If you would, how would you recommend that she handle the meeting?**

Answer: There should be a variety of answers provided to this question and hopefully some debate will ensue. Most students will likely respond that she should meet with the physician based on answers to the above question. In terms of handling the meeting, Susan should be very sensitive to the authority of the physician and his desire to protect the physician-patient relationship. She should be in a listening mode, trying to understand the situation from the physician's point of view since she only has the perspective of her staff at this stage. She should ask the physician how he thinks they should proceed and how she can be of service. Answers could present "what if" scenarios such as what if the physician was threatened by her approach and refused to take any differing action or what if he agreed there was a problem but didn't know what to do? The epilogue below indicates what actually happened in the meeting with the physician.

3. **Identify the leadership style you recommended that the health care administrator use with the meeting with the physician (see prior question).**

Answer: Answers will vary but the style presented in the answer above represents a participative leadership style. Due to the power and authority of the physician and his expertise in dealing with his patient, it would be best to be consultative in tone and solicit his suggestions, concerns and recommendations as part of the decision-making process. Susan has displayed a supportive leadership style in that she appears to be open and approachable by her staff members and concerned about their well-being. Conceptualizations of Leadership Behaviors can be discussed, for example, the classic Leadership Grid which profiles leader behavior on two dimensions: concern for people and concern for production (Blake & McCanse, 1991; Blake & Mouton, 1964). According to this grid, leaders who present behaviors of high concern for people and high concern for results (production), exhibit a team management orientation.

Figure 1



Source: Blake, R.R. & A.A. McCanse (1991). *Leadership Dilemmas—Grid Solutions*. Houston, TX: Gulf.

4. **How should the issues be resolved from a conflict resolution perspective?**

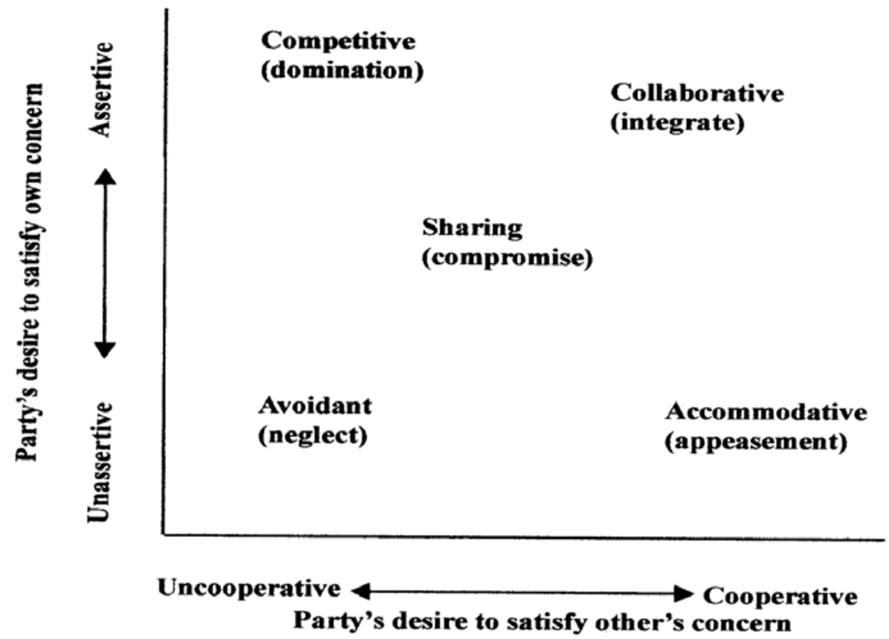
Answer: The issues can be defined as two broad issues: 1) the administrator interfering with the physician/patient relationship and 2) the concern of the administrator for the reputations of the physician and medical clinic. The instructor could use Thomas's (1976) two dimensional scheme to discuss approaches for managing conflict. Thomas described conflict resolution in terms of understanding how cooperative or uncooperative the parties are and how assertive or unassertive they are. This results in five conflict-handling orientations:

- Avoidant (highly uncooperative and highly unassertive): reflects indifference to the concerns of the parties involved.
- Competitive (highly uncooperative and highly assertive): reflects a dominating stance, a desire to achieve one's own ends at the expense of another (a win-lose orientation).
- Sharing (somewhat cooperative and somewhat assertive): represents a compromise between domination and appeasement.
- Accommodative (highly cooperative and highly unassertive): reflects the act of appeasement, giving into someone else's concerns without making an effort to achieve one's own goals.
- Collaborative (highly cooperative and highly assertive): portrays an effort to fully satisfy both parties.

The epilogue indicates that the physician had been operating in an accommodative stance with the patient for some time due to fear for himself and his family. He felt that the patient's hatred for Jews would influence his treatment of the patient. Susan Smith, the administrator approached the meeting with the physician in a collaborating manner. According to Thomas (1977), the collaborative approach is best when the objective is to learn, to merge insights from people with different perspectives, to work through emotions that may impact working relationships, to find an integrative solution when both sets of concerns are too important to be compromised and to gain commitment. The "competitive" approach was most likely used by the administrator when she met with the patient (see epilogue) and informed him the surgeon was unable to prescribe anymore pain medication for him and he would be referred to a pain clinic. According to Thomas (1977), the competing approach to conflict management is best when quick, decisive action is vital, when the issue is important but unpopular actions need implementing, on issues vital to company welfare, and against people who take advantage of noncompetitive behavior (clearly portrayed by the patient and his father in their interactions with medical staff and the physician).

The "avoiding" approach would be appropriate on trivial matters or when more important issues are pressing and when one perceives no chance of satisfying concerns. Avoidance is also appropriate when people need to let their emotions cool down or when others are perceived to be able to resolve the conflict more effectively. Sharing (compromising) is often a backup when collaboration or competition is unsuccessful or there is a desire to lessen the perceived disruption of using assertive modes. It is used when opposing parties have equal power and are committed to mutually exclusive goals (Thomas 1977). Depending on how the answers to the conflicts were presented by students, it may be that conflict resolution choices of Avoiding or Sharing may be justified.

Figure 2



Source: Thomas, K.W. (1976). "Conflict and Conflict Management." In M.D. Dunnette (Ed.), *Handbook of Industrial and Organizational Psychology.* Chicago: Rand McNally.

5. **How does the Hippocratic Oath impact decision-making in this case?**

Answer: The 2,500 years old Hippocratic Oath serves as a professional and ethical code of conduct for physicians. Although some changes and modernization have been made to the oath, it continues to be used as a source of inspiration for a pledge at graduation ceremonies of medical students (O'Reilly, 2006). In this case the Oath or similar ethical codes in the medical profession provide some guidance to the physician for treating the well-being of the patient and for his obligations to fellow human beings. However, he may not have been conscious that his fear of the anti-Semitic attitudes of the patient was resulting in OxyContin addiction and the possible enabling of the patient to sell OxyContin illegally. As the administrator, Susan Smith would be highly respectful of the Oath that physician's take and thus interference between the physician and patient on her part could be considered infringing on this oath. The oath also references special obligations to all fellow human beings. This broader societal view reminds the physician and health care professionals of their obligation to their communities, for example protecting the community from illicit drugs.

6. **What role do the staff members in the physician's office play in uncovering the problem? What conditions in the workplace encourage these behaviors?**

Answer: The staff members played a critical role in bringing to light the potential drug abuse by the patient and his ability to get more drugs from the physician over a longer period of time than normal. They also were willing to share with the administrator the concerns about the threatening behaviors of the father of the patient and the increasing frequency of calls and visits to the physician. The probable addiction of the patient to OxyContin and the potential for this patient to be selling the drug was shared with the administrator. These actions by the staff, using independent, critical thinking skills and a mode of being active rather than passive, represents "exemplary followers" according to Kelley (1992). Leaders that foster the existence of "exemplary followers," (high on independent, critical thinking and high on being actively engaged in work) can be considered essential to organizational success. According to Hughes, Ginnett and Curphy (2009), leadership must be understood as an interaction between the leader, follower and the situation. Followers are often at the level of where issues and problems arise or come to a level of awareness. As in this case, the "followers" (staff) can provide leaders with relevant information so that effective solutions can be implemented. Some "followers" may need training to express ideas and problems to superiors. In this case there is evidence of an organizational culture where "all roles are respected. Rather than creating a hierarchy, the organization strives to be a learning organization." Specific leadership behaviors can encourage exemplary followership such as being team oriented, participative and demonstrate supportiveness. Reference could be made to The Leadership Grid (see answer to question 3 above) which profiles leader behavior on two dimensions: concern for people and concern for production (Blake & Mouton, 1964; Blake & McCanse, 1991).

7. **What sources of power were displayed in this case by the major characters?**

Answer: French and Raven's (1959) well-known five sources of power (expert, referent, coercive, reward and legitimate) could be applied to this case. Expert power, the power of knowledge is most noticeable among Susan Smith and Dr. Goldstein. Referent power relates to the strength of the relationship between the administrator and her staff. This could also play out in interactions between Susan and Dr. Goldstein. If Susan did not have referent power, she would not be able to exert her influence on resolving the issue between the physician and the patient. Legitimate power depends on the person's organizational role. One can clearly identify the official roles within the case and how legitimate power comes into play in the case. The physician can be considered to have legitimate power but it did not work to his advantage with the manipulative nature of the patient and the disdain displayed towards him by the patient's father. Reward power is derived from the perception that one controls desired resources and can influence others because of these "rewards." The physician had reward power in that he could offer prescriptions for OxyContin for his patient. The patient attempted to use reward power with the giving of collector baseball cards, a necklace, and a poem to the physician. Coercive power is the potential to influence others through the application of negative sanctions or removing positive events. In this case the patient's father exhibited the use of threats and intimidation.

According to Hughes, Ginnett and Curphy (2009), effective leaders typically take advantage of all of their sources of power and work to increase these power bases. Furthermore, although leaders in successfully functioning organizations have strong influence over their subordinates, they are also open to being influenced by them. High degrees of reciprocal influence between leaders and followers are distinctive traits of effective organizations (Hughes, Ginnett & Curphy, 2009).

EPILOGUE

At the meeting Dr. Goldstein confessed to Westgate's administrator, Susan Smith that he had been struggling with how to deal with his patient, Mark Jones. He admitted that he had gone out of his way to accommodate Mark because he so feared that his disdain for Mark's hatred for Jews would influence his interactions with Mark. Dr. Goldstein also admitted that he was fearful for his family if he made Mark or his father angry. Susan volunteered to terminate the relationship with the patient by telling him that the surgeon was unable to prescribe anymore pain medication for him and that they would refer him for all further appointments to a pain clinic. That approach was accepted by the surgeon. It was felt that it would protect the surgeon to some degree by avoiding a face-to-face confrontation with the patient. Susan did not feel threatened because Mark, nor the father, had any information about her.

A year later the administrator received a call from a detective from the local police department asking if Mark was a patient of Dr. Goldstein's. Susan informed the detective that he had been a patient but had not been seen by the surgeon for more than one year. The detective stated that Mark had been found in a local motel dead from an overdose and that he had the surgeon's card crumpled in his pocket. Susan explained that Westgate Surgical had suspected that Mark was a drug abuser and had cut the relationship with Dr. Goldstein approximately one year ago. The patient had been referred to a pain clinic but shortly after the referral the pain clinic called Westgate to inform them that Mark did not keep his referral appointment.

REFERENCES

Blake, R.R. & A.A. McCanse (1991). *Leadership Dilemmas—Grid Solutions*. Houston, TX: Gulf.

Blake, R.R. & J.S. Mouton (1964). *The Managerial Grid*. Houston, TX: Gulf.

French, J. & B.H. Raven (1959). "The Bases of Social Power." In D.

Cartwright (Ed.), *Studies of Social Power*. Ann Arbor, MI: Institute for Social Research.

Hughes, R.L., R.C. Ginnett & G.J. Curphy (2009). *Leadership: Enhancing the Lessons of Experience (Sixth Edition)*. New York, NY: McGraw-Hill/Irwin.

Kelley, R. (1992). *The Power of Followership*. New York: Doubleday Currency.

O'Reilly, K.B. (2006). *Only 1 medical school uses classic version of Hippocratic Oath*. (February 20) Retrieved March 12, 2010 from http://www.ama-assn.org/amednews/site/free/prsb0220.htm

Thomas, K.W. (1976). "Conflict and Conflict Management." In M.D. Dunnette (Ed.), *Handbook of Industrial and Organizational Psychology.* Chicago: Rand McNally.

Thomas, K.W. (1977). Toward Multidimensional Values in Teaching: The Example of Conflict Management. *Academy of Management Review*. 2(3), 484-490.

ADDING VALUE AT H & H FINANCIAL SERVICES, LLC

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

CASE DESCRIPTION

The case is a field-based, disguised case which 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" Ms. Sutton 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 Jane managed all of the back office customer and supplier services through her supervisors. Although each supervisor ran a "fun" department Ms. Sutton 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.

INSTRUCTORS' NOTES

Intended Instructional Audience & Placement in Course Instruction

The case was written primarily for an undergraduate class in an organizational behavior since it is written from a new employee's perspective; a student straight out of college looking for but not getting on-the-job "learning" experiences in what is perceived as a closed, incommunicative environment. The case is fairly comprehensive in nature in that it includes several micro and macro organizational issues (leadership style, work motivation, and job design at the micro level as well as organizational structure, culture, and growth at the macro level) that impact individual and organizational performance.

Secondarily, this case could also be utilized in a small business management class since the case talks about the managerial problems a small business experiences as it evolves from a "ma and pa" part-time business through small group operation into a multiple group (departments) organization. Further, since the case clearly addresses issues of employee development and career planning, an instructor teaching human resource management may find the case useful when discussing issues of employee burnout and personnel development.

For students in an undergraduate organizational behavior class, the case should be introduced towards the later part of the semester, preferably at the end of the course, so that students already have the necessary educational background in which to address both micro and macro organization behavior issues. [For example, in Schermerhorn, Hunt and Osborn (2008) students would have needed to have read chapters 5, 6, 11, 12, 16, 17; in Robbins and Judge (2009) chapters 6, 7, 12, 13, 16-18; and in George and Jones (2008) chapters 6-8, 12, 16, 17.]

We suggest that this case serve as an end-of-semester integrative outcomes assessment case (given its length, possibly as a take-home assignment or final examination) which would:

1. Allow students to internalize the course material by experiencing through the protagonist, a recent graduate, how organizational theory does have application to business practices.
2. Allow students to see the interdisciplinary and integrative nature of business problems (even individual problems) when viewed through an organizational behavior perspective.

In an entrepreneurship or small business management class, the case could be introduced as an end of chapter case on managing growth if viewed from the owner's perspective (Roberts et.

al, 2007, chapter 11; Lambing and Kuehl, 2007, chapter 10). We suggest that in this course students might address personnel, leadership, cultural and structural issues that both support and hinder the success of this firm as it continues to expand. What changes can Mr. Blake make in the firm's operation in order to empower workers like Ms. Matthews and take advantage of her drive and desire to learn and progress? What changes does he need to make in his own approach to leadership?

In terms of specific human resource management issues, Ms. Matthews, as the focus of the case, is represented as an employee experiencing burnout who desperately wants to work for a "learning organization." (Senge, 1990) As an end of chapter case on job burnout and career planning (Ivanevich, 2010, chapter 14; Bernardin, 2010, chapter 9), the challenge from an HRM perspective is how to counsel Ms. Matthews given the current organizational structure and culture and then how to specifically address her job and career path within and/or outside of the firm. Students need to question whether Ms. Matthews can grow with the firm as the firm increases its operation and determine whether Ms. Matthews fits the firm's managerial culture and work environment.

Learning Objectives (Organizational Behavior Course)

The overall purpose of this case is to have students examine the growth of a small business (family firm) from two differing perspectives:

1. The more obvious micro perspective – what should Ms. Matthews do given her deflating motivation and inability to grow on the job?
2. The less obvious macro perspective - as a consultant to the small business owner, Mr. Blake, how is Ms. Matthews' situation symbolic of the growing pains experienced by the firm and the need for Mr. Blake to change his leadership style so as to then establish a more learning and communicative work environment?

This case is of particular value to undergraduate students since many of them may be working for a small, family firms and encounter similar work, developmental and career path barriers. Students are asked to probe beyond personalities and the immediacy of the moment and examine the underlying nuances of the posed problem.

Specific student learning objectives include:

1. Applying content theory and process theory to describe Ms. Matthews' work motivation.
2. Demonstrating an understanding of the impact of job design and style of supervision (leadership) on Ms. Matthews' work motivation
3. Developing alternative solutions for Ms. Matthews relative to her ability to remain with H & H based upon the three general options of "exit, voice, and loyalty." (Hirschman, 1970)
4. Analyzing the impact of Mr. Blake's leadership style on organizational culture and structure.
5. Examining the impact of growth on H & H using Greiner's (1972) model of organizational evolution and revolution.

6. Proposing solution strategies for the firm addressing any problems identified in learning objectives 4 and 5.

SUGGESTED QUESTIONS AND ANSWERS

(Teaching strategies for this case are addressed in Teaching Note Appendix A.)

The following questions may be employed by the instructor either as guidelines for case analysis and/or as questions to be distributed to the class in conjunction with the case. This methodology provides the instructor some latitude in terms of how much direction he or she wishes to provide the student and therein allows the instructor to modify the difficulty of the case to fit his or her class's needs. The questions are divided by topic and correspond to the prior learning objectives.

Questions:

1. *Using one content theory and one process theory of work motivation, describe Ms. Matthews' work motivation.*
2. *Discuss what might be the impact of job design and style of supervision (leadership) on Ms. Matthews' work motivation.*
3. *Using the options "exit, voice, and loyalty" (Hirschman, 1970), develop three alternative solutions for Ms. Matthews relative to her ability to remain with H & H.*
4. *What is the impact of Mr. Blake's leadership style on H & H's organizational culture and structure?*
5. *Describe how the growth of H & H (using Greiner's 1972 model of organizational growth) has been both evolutionary and revolutionary.*
6. *Propose solution strategies for the firm addressing any problems identified in questions 4 and 5.*

1. Using One Content Theory and One Process Theory of Work Motivation, Describe Ms. Matthews' Work Motivation.

The purpose of this question is to check students' understanding of what content and process theories of motivation are as well as to understand and then apply one theory from each category to describe Ms. Matthews' work motivation.

The student should first define what motivation is. Motivation *is goal directed, requires sustained effort, and is a need-satisfying process*. Motivated employees exert effort to relieve tension (unsatisfied need); the greater the tension, the greater the effort. If this effort leads to the satisfaction of the need, it reduces tension. Individual needs must be compatible with the organization's goals so that employee effort levels and performance benefit the organization. (George and Jones, 2008) For instance, if an employee is primarily motivated by the fulfillment of social needs, then although great effort is exerted to socialize, the firm's goals are not attained.

The student should then explain in his/her answer what are the differences between process theories of motivation and content theories of motivation. A *content theory* of motivation describes the facts of 'what' drives the person to exert an effort. These theories are considered need theories as they view motivation as a drive to satisfy a need. (Schermerhorn, Hunt and Osborn, 2008) On the other hand, *process theories* attempt to understand how and why people are motivated; the focus being on the behavior rather than the needs of the individual. (Lussier, 2008) A short description of several content and process theories not directly addressed in the TN is in TN Appendix C.

Content Theory: Maslow's Hierarchy of Needs

A popular theory of motivation was developed by the psychologist Abraham Maslow (1954). He believed that within every person was a set of five hierarchical needs. Lower order needs- physiological, safety and social, were concerned with a person's physical survival requirements, freedom from harm, and sense of belongingness. These needs are satisfied externally. Higher order needs, esteem and self actualization, were concerned with the desire to achieve, be respected and fulfill ones fullest potential. These needs are satisfied internally.

According to Maslow, the highest level unsatisfied need motivates behavior. Once a need is satisfied, the next level need becomes the motivator. For example, a student is taking a distance learning management course. The act of taking the course is fulfilling an esteem need - to achieve mastery of new knowledge. If the student becomes very hungry while reading this chapter, they will have trouble concentrating. Instead, they will begin to day dream about what they will eat as soon as they are done reading this screen! The student has dropped out of fulfilling an esteem need because a physiological need (hunger) became unsatisfied. As soon as the students has something to eat, and no longer experiences hunger, she or he will continue to work on an esteem need and finish reading this chapter.

Management's role is to fulfill worker's lower order needs so that they can be motivated by their higher order needs. Physiological needs are satisfied by providing employees with lunch breaks, bathrooms and water fountains. Safety needs are satisfied by clearly marking emergency exits, providing protective equipment and job training. Social needs are fulfilled by organizing company picnics, soft ball teams, and coffee breaks.

Ms. Matthews' on-the-job frustration stems from the fact that she seems to be motivated by esteem needs (has a high need for achievement/learning) and self-actualization needs and yet is not given the opportunity on-the-job to meet those needs. Fulfilling higher order needs such as esteem requires managers to provide higher level training, delegate responsibility and authority in decision making, provide promotions and methods for recognizing employee performance. While self-actualization is thought to be a person's innate inclination to develop their fullest potential, managers can facilitate this process by providing employees the opportunities to learn new skills, mentor others and time to volunteer in community service.

Process Theory: Vroom's Expectancy Theory

Expectancy theory (Vroom, 1964) states that individual effort is a function of the expectation that activity will be followed a performance which leads to receipt of a desired outcome. There are three important relationships that explain the level of effort an employee will expend:

1. ***Expectancy***, the effort-performance linkage - is the probability perceived by the individual that a given amount of effort will lead to a certain level of performance

2. ***Instrumentality***, the performance/reward linkage - is the degree to which the individual believes that performing at a particular level is instrumental in attaining a desired outcome.
3. ***Valence**,* the attractiveness of reward - is the importance the individual places on the outcome or reward that can be achieved from the job. Valence refers to both an individual's goals and needs.

The key to expectancy theory is the understanding that motivation is dependent upon the individual's goal and the linkage between effort and performance, between performance and rewards, and between rewards and individual goal satisfaction. Worker motivation can then be calculated as a function of expectancy, instrumentality, and valence (M=EIV).

Ms. Matthews' motivation waned because while her valence (desire to learn and grow with the firm) remained the same, her expectation and instrumentality dwindled (she perceived that she would not receive opportunities for learning, lower expectations, and she felt that regardless of her performance, the situation was not going to change, lower instrumentality).

2 Discuss What Might be the Impact of Job Design and Style of Supervision (Leadership) on Ms. Matthews' Work Motivation.

The purpose of this question is to check students' understanding of job design and supervision style as well as the student's ability to apply these theories/concepts within a specific business context.

Managers deliberately engage in job design to incorporate the demands of changing environments, the organization's technology, skills and abilities, and individual preferences. When jobs are designed with these intentions, employees are motivated to be productive. Managers can choose to enlarge or enrich jobs. The Job characteristics model (JCM) by Hackman and Oldham (1980) provides a framework for analyzing and designing jobs. A job can be defined according to five core dimensions:

Skill variety, the degree to which a job demands a variety of activities so that an employee can use a number of different skills and talents. *Task identity*, the degree to which a job requires completion of a whole identifiable piece of work. *Task significance*, the degree to which a job has a substantial impact on the lives or work of other people. *Autonomy*, is the degree to which a job provides substantial freedom, independence, and discretion to an individual in scheduling and conducting work. *Feedback*, the degree to which carrying out the work required by a job results in direct and clear information about performance effectiveness. JCM suggests that these dimensions and their interrelationships impact productivity, motivation and job satisfaction. Furthermore that skill variety, task identity and task significance combine to create meaningful work. Autonomy provides the employee with a sense of responsibility and feedback provides knowledge regarding effectiveness.

The motivation process indicates that intrinsic (internal) rewards are obtained when an employee learns (feedback) that he or she has performed well (autonomy) on a task he or she cares about (experiences meaningfulness).The links between the job dimensions and outcomes are moderated by a person's growth need strength. The higher the growth need strength, the more appropriate JCM. Jobs can be scored for motivating potential (MPS). If jobs score high, the model predicts that motivation, performance and satisfaction will be positively affected.

In analyzing Ms. Matthews' job using the five factors of the model, we might derive the following results:

Instructors' Notes - Figure 1 Applying Hackman-Oldham (1980) JCS Model to Case			
Job Characteristics	**Low**	**Medium**	**High**
Skill Variety	**x**		
Task Identity		**x**	
Task Significance	**x**		
Autonomy		**x**	
Feedback	**x**		

Ms. Matthews seems to have very low scores in three of the five factors (specifically skill variety, task significance and feedback) and therefore low work motivation. To increase her job's MPS, the firm could:

- Enlarge the job to increase skill variety and task identity
- Create natural work units to facilitate employee ownership and sense of meaningfulness
- Establish direct relationships between Ms. Matthews and her clients to increase skill variety, autonomy and feedback
- Enrich jobs to increase employee responsibility and control
- Provide feedback as employees engage in their jobs, instead of on an occasional basis.

Style of supervisory (transactional leadership) refers to theories focusing on "what" an effective leader is and how to effectively lead. Leadership is the ability to influence people toward the achievement of a common goal. Douglas McGregor (1960) denoted that leaders possessed two differing assumption about employees and therein lead them accordingly. *Theory X* leaders assume that people are naturally lazy, seek to avoid responsibility, and must be coerced to perform. These types of employees appear to be motivated by lower order needs. Managers lead employees using a reward and punishment system which focuses upon being direct and providing close supervision. *Theory Y* leaders assume the opposite. Employees are viewed as creative, seeking responsibility and are self directed. Operating from higher order needs, managers can get the most from employees by including them in decision-making and giving them challenging jobs.

It seems evident that Ms. Sutton, given her controlling approach (*Theory X*) and inability to share information, assumes that Ms. Matthews is either incapable of handling a more enlarged and/or enriched job and/or is unwilling to accept Ms. Matthews' need for personal growth and development. Regardless of her immediate supervisor's more *Theory Y* approach, Ms. Sutton's leadership style has clearly negatively impacted Ms. Matthews' desire to perform and has forced Ms. Matthews to confront the possibility of resigning from the firm.

3. Using the Options "Exit, Voice, and Loyalty" (Hirschman, 1970), Develop Three Alternative Solutions for Ms. Matthews Relative to her Ability to Remain with H & H.

This question requires students to first define Hirschman's theory of marketplace behavior (this may involve secondary research) and then apply the simple model to help define Ms. Matthews' alternatives to her problem.

Hischman (1970) hypothesized that members of an organization have two possible responses when they perceive that the organization is demonstrating a decrease in quality or benefit to them as a member: they can exit (withdraw from the relationship); or, they can voice (attempt to repair or improve the relationship through communication of the complaint, grievance or proposal for change). Economically, employees can choose to quit their unpleasant job, or express their concerns in an effort to improve the situation. The general principle, therefore, is that the greater the availability of exit, the less likely voice will be used. Loyalty comes into play in terms as a mediating variable between exit and voice. For example, when there is strong loyalty to the organization, exit may be reduced, therein forcing the employee to choose between voice and no action whatsoever. This is especially true where options to exit are not appealing (small job market). By understanding the relationship between exit, voice, and loyalty, organizations can craft the means to better address their members' concerns and issues, and thereby effect improvement. Failure to understand these competing pressures can lead to organizational decline and possible failure.

Students may present several differing alternatives based upon their application of the above model (exit, voice, and loyalty). Interestingly enough, Ms. Matthews has thought about just one of the options, exit. Her loyalty, tempered by the job market, will determine whether or not she seriously follows through with her desire to leave. Interestingly enough, nowhere in the case does Ms. Matthews think about her other major option, voice, and therefore whom she should be “voicing” to (her immediate supervisor, Ms. Sutton, or to the owner Mr. Blake, or some combination therein). By limiting her options she, by definition, reduces the possibility of implementing a well-thought out solution strategy.

4. What is the Impact of Mr. Blake’s Leadership Style on H & H’s Organizational Culture and Structure?

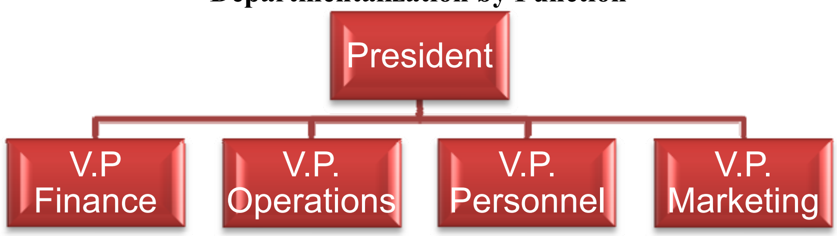
The purpose of this question is to have students shift their attention away from the case’s protagonist (Ms. Matthews) and toward the founder of the firm in order to see if students can determine what might be the root cause of H & H’s growth problems.

Students might note that Mr. Blake’s leadership style emerged as the firm shifted from a small one man operation (where he employed just a part-time assistant) to a full-blown business operation with administrative staff. His leadership style could best be characterized as laissez-faire (he left the back office operation to his key administrator, Ms. Sutton) or, using the Mr. Blake-Mouton grid (1980), a 1,1 manager. He seemed to have little concern for the effectiveness or efficiency of his back office staff and also seemed to have little concern for how people were treated outside of his own area, client consultation. As long as the work of his office got done (and not how well it got done and how well people were treated in the process of getting the work done) and he was free to deal with clients (or train others to do so), he was content to be a “defacto” absentee owner/manager.

The question then addresses the organization’s structure and culture. Organizational structure is the formal framework by which job tasks are divided, grouped, and coordinated. The activities of organizational design are seen in the developing or changing the structure by manipulating six key elements: work specialization, departmentalization, chain of command, span of control, centralization and decentralization, and formalization. The managerial challenge is to design an organizational structure that facilitates effective and efficient work as employees strive to achieve organizational goals in light of the strategy of the firm.

Students should be able to identify the fact that the firm's organizational structure is one of departmentalization by function. *Functional structures* group similar or related occupational specialties together. Economy is achieved through specialization with the firm capitalizing on its internal distinctive competencies. However, the organization risks losing sight of its overall interests as different departments pursue their own goals and accountability is solely at the top. Coordination between departments is difficult since these structures have generalists managing specialists that their competitive advantages get lost in higher levels of administration. See the figure below.

Instructors' Notes - Figure 1
Departmentalization by Function



Under each Vice-President would be more specialized departments. For example, reporting to the V.P. of Marketing could be department heads for market research, product development, advertising and promotion, sales, and distribution.

Mr. Blake's structure is functional since the administrative workers report to Ms. Sutton and her supervisors while agents report directly to Mr. Blake. Students might note that this relationship seems imbalanced in that individual agents have direct access to the President of the firm while administrative assistants like Ms. Matthews do not. Furthermore, although the President in theory oversees the administrative operation of the firm in this structure, it is clear that his leadership style 'overrides' the structure's built-in control mechanism (command and control from the top). In addition, students might note that the President is actually on par if not lower than Ms. Sutton in the hierarchy; Ms. Sutton has two supervisors reporting to her who handle more of the detailed workers while Mr. Blake has all of the agents and Ms. Sutton reporting to him. Since he chooses not to manage Ms. Sutton he has in fact lowered himself to the rank of a supervisor.

This clearly has had an impact on the firm's culture. Organization culture is the system of values, rules, symbols, taboos and rituals that evolve over time. It is the common perception shared by members that identifies how thing get done in the organization. Culture drives expected behaviors internal to the organization as well and those engaged when interacting with the firm's surrounding environment. Understanding an organization's culture helps an employee learn the ropes and discover whether their personality is a good fit.

Organizational cultures are *integrated, differentiated*, or *fragmented*. An integrated or homogenous culture is characterized by consistency, organization-wide consensus, and clarity and this culture reacts to change as a whole as one unit. Differentiated cultures, on the other hand, have conflict and usually have subcultures broken down into those groups in power (the haves, the dominant coalition) and those outside the power structure (the haves not, the minority coalitions). These cultures are inconsistent, have ambiguity in the minority subcultures yet the subcultures have internal consensus. The firm reacts inconsistently to change, with some subcultures embracing it while other parts will resist it, based upon the source of the change. Fragmented cultures are prominent for their heterogeneity, ambiguity and plurality of disconnected subcultures. It is not clear in this structure which subculture runs the firm (power is diffused) and there is certainly not a stable organizational consensus. In this type of culture differences of subcultures are not only tolerated but considered the norm and subcultures will emerge to address organizational crisis when needed.

Mr. Blake's absentee leadership style has allowed Ms. Sutton to set the culture of her portion of the firm; a differentiated culture where Ms. Sutton clearly dictates both the formal and informal rules of her department. Ms. Matthews perceives herself as being unfairly treated and not a part of the dominant coalition (cannot influence the leaders); she therefore felt as if she no longer should stay with the firm.

5. Describe How the Growth of H & H (using Greiner's 1972 Model of Organizational Growth) has been Both Evolutionary and Revolutionary.

This question requires student to first understand the Greiner organizational growth model and then apply the model to the current case situation.

Students should first point out that Greiner (1972) indicated that organizations have evolutionary and revolutionary growth spurts (or cycles) based upon the age of the organization, its size, its evolutionary stage and the growth rate of the industry and therefore a firm's structure evolves over time. Greiner developed a five phase model of organizational growth where evolutionary periods are characterized by a dominant management style and revolutionary periods denoted by a dominant management problem or crisis. The crisis points are directly related to the prior management style with the solution strategy being the next managerial style (organizational phase) followed by a new structure.

Phase 1, *creativity*, signifies the birth of an organization with the focus on creating both a product and a market. The leadership of the company is focused upon technological and/or entrepreneurial ventures and perceives that the main task is making and selling of new products and services. A *leadership crisis* arises as the company grows in that the informal style of leadership is not capable of properly directing the new employees. A more formalized approach that emphasizes operating efficiency and financial controls is needed in order for the organization to survive its first growth spurt.

In phase 2, *direction*, a functional organizational structure replaces the more simple reporting arrangement with the key functional area managers (marketing, manufacturing, R&D, etc.) taking over responsibility and providing expert direction. Simultaneously, more formalized managerial systems are introduced (rules, policies, procedures) with incentives and work standards adopted by the company. A crisis of *autonomy* develops in that, as the company grows and the organization becomes more complex, lower level workers find that they lack the authority to make on-the-spot decisions although they have the expertise and knowledge in which to make an informed judgment. The centralized system developed in phase 2 cannot respond quickly enough to market demands and the organization stalls without another revolution.

Without going into the other phases of the model, it is evident that Mr. Blake demonstrated *creativity* when he introduced his new idea for a firm that was strongly client-driven and service based. Mr. Blake clearly was focused on obtaining and retaining customers through strong value-added products and services and spent his energy on creating a large customer base. His success led to the first leadership crisis; the firm *evolved* from a small, sole proprietorship, to a small business with full-time employees and required a more formalized managerial approach. Mr. Blake created a *revolution* when he fashioned a formal organizational hierarchy and directed Jane to officially become office manager. Her prior management style when she was acting manager was team-oriented, yet, when she became the leader she started to impose *direction* and centralize information flow through her position. Because of this revolutionary change, Ms. Matthews experienced a *crisis of autonomy* in that she lacked the authority to learn about how her job related to other jobs in the firm (did not have access to needed information). She also felt she was denied the ability to learn how to make better informed choices about her tasks and responsibilities. According to Greiner, d*elegation* is the revolutionary change (a decentralized organizational structure such as departmentalization by geography, division, or by product) needed to allow the firm to grow and evolve.

6. Propose Solution Strategies for Addressing any Problems Identified in Questions 4 and 5.

This question challenges students to move from the analysis phase (questions 4 and 5) to the development of theory-driven solution strategies.

Recapping the answers to questions 4 and 5, students should indicate the following:

Mr. Blake's laissez-faire leadership style, which was appropriate when the firm was in its creativity phase (looking for clients), became inappropriate (a misfit so to speak) when the firm evolved into a larger organization with a more formalized structure. A differentiated culture emerged where Jane, given her Theory X leadership style, created what was apparently a dysfunctional culture from Ms. Matthew's perspective for the back office's operations.

According to Greiner, d*elegation* is the revolutionary change (a decentralized organizational structure such as departmentalization by geography, division, or by product) needed to allow the firm to grow and evolve. For delegation to occur within Jane's back office operation several conditions would have to change:

Mr. Blake would have to become cognizant of the fact that Ms. Sutton has filled his lack of active leadership with a leadership style that seems to be stymieing the growth of at least of one his employees. Without Mr. Blake's realization that his organization has an evolutionary problem (that it has outgrown his current leadership style and therein the organizational culture created from it) which requires a "revolutionary" solution, no change can occur.

Mr. Blake, once this realization has occurred, would have to want to become more actively involved in the management of the firm's entire operation. He may attempt some stop-gap structural, cultural, and procedural interventions but without his active engagement in these issues Jane will continue to be able to exert a strong influence on the organization's back office operation.

Mr. Blake would also have to accept the possibility that once he does become more actively involved in the firm's back office operation that Ms. Sutton may exhibit "exit, or voice" behaviors of her own and he therefore must be prepared for her possible resistance to change and loss of power.

Mr. Blake's leadership style needs to change so that he can focus more on back office task performance as well as a concern for people within the back office. This would require that Mr. Blake perform the role of the CEO, as per the organizational chart, and manage both sides of his firm's operation. This may require that he appoint one of his consultants as manager of the consulting unit and that he obtain CEO training while his two managers (including Ms. Sutton) obtain managerial training as well. Once Ms. Sutton and Mr. Blake learn how to properly delegate authority (Ms. Sutton does not delegate; Mr. Blake delegates but does not follow-up on what he has delegated), the back office's culture may change therein producing a more integrated culture for the firm.

An alternative solution would be to form cross functional management teams where client consultants work with back office personnel on a client by client basis and where all personnel are trained in the firm's entire operation. This would highlight the need for personalized customer service and allow greater flexibility in terms of work performance.

AUTHORS' NOTE

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

REFERENCES

Bernardin, H. John (2010). *Human Resource Management* (Fifth Edition). New York: McGraw-Hill Irwin.

Mr. Blake, Robert R. and Jane S. Mouton (1980). *The Grid for Sales Excellence* (Second Edition). New York: McGraw-Hill Book Company.

Bowditch, James L. and Anthony F. Buono (2001). *A Primer on Organizational Behavior* (Fifth Edition). New York: John Wiley and Sons, Inc.

David, F. R. (2005). *Strategic Management: Concepts.* 10th Edition. Upper Saddle River, N.J.: Pearson Prentice Hall.

Dubrin, Andrew J. (2000). *Essentials of Management* (Fifth Edition). New York: South-Western Publishing Company.

George, Jennifer M. and Gareth R. Jones (2008). *Understanding and Managing Organizational Behavior* (5th Edition). Upper Saddle River, NJ: Pearson Prentice Hall.

Gomez-Mejia Luis R. and David B. Balkin (2002). *Management*. New York: McGraw-Hill Irwin.

Greiner, Larry E. (1972). "Evolution and Revolution as Organizations Grow" *Harvard Business Review.* July-August.

Griffin, Ricky W. (2002). *Management* (Seventh Edition). New York: Houghton Mifflin Company.

Hackman, J. R. and G. R. Oldham (1980). *Work Redesign.* Reading, Mass.: Addison-Wesley.

Hirschman, Albert O. (1990). *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States.* Boston, Mass.: Harvard University Press.

Ivanevich, John M. (2009). *Human Resource Management* (Eleventh Edition). New York: McGraw-Hill Irwin.

Lambing, Peggy A. and Charles R. Kuehl (2007). *Entrepreneurship* (Fourth Edition). Upper Saddle River, NJ: Pearson Prentice Hall.

Lundberg, C. C., P. Rainsford, J. P. Shay, and C.A. Young (2001). "Case Writing Reconsidered" *Journal of Management Education* (August) 25, 4, 450-463.

Lussier, Robert N. (2008). *Human Relations In Organizations* (Seventh Edition). New York: McGraw-Hill Irwin.

Lynn, L. E. Jr. (1999). *Teaching & Learning with Cases: A Guidebook.* New York: Seven Bridges Press.

McGregor, Douglas (1960). *The Human Side of Enterprise.* New York: McGraw-Hill Book Company.

Naumes, W. and M. J. Naumes (1999). *The Art & Craft of Case Writing.* Thousand Oaks, Ca.: Sage Publications.

Nelson, Debra L. and James Campbell Quick (2003). *Organizational Behavior: Foundations, Realities, & Challenges* (Fourth Edition). Cincinnati, OH: South-Western College Publishing.

Nicastro, M. L. and D. C. Jones (1994). *Cooperative Learning Guide for Marketing Teaching Tips for Marketing Instructors*. Englewood Cliffs, N.J.: Prentice-Hall, Inc..

Pearce, J. A. II and R. B. Robinson, Jr. (2005). *Strategic Management*: *Formulation, Implementation, and Control*. 9th Edition. New York: McGraw-Hill Irwin.

Robbins, Stephen P. (2001). *Organizational Behavior* (Ninth Edition). Upper Saddle River, N.J.: Prentice-Hall.

Robbins, Stephen P. and Timothy A, Judge (2009). *Organizational Behavior* (Thirteenth Edition). Upper Saddle River, N.J.: Pearson Prentice-Hall.

Roberts, Michael J., William A. Sahlman, Paul W. Marshall, and Richard G. Hamermesh (2007). New York: McGraw-Hill Irwin.

Schermerhorn, John R. Jr., James G. Hunt, and Richard N. Osborn (2008). O*rganizational Behavior* (Tenth Edition). New York: John Wiley & Sons, Inc.

Senge, Peter (1990). *The Fifth Discipline.* New York: Doubleday.

Vroom Victor H. (1964). *Motivation and Work*. New York: Wiley.

APPENDIX A
TEACHING STRATEGIES

Preparing the Student Prior to Case Analysis

There are several approaches, none of which are mutually exclusive, that an instructor may employ in terms of utilizing this case. It is strongly recommended that, regardless of the specific methodology employed, students, prior to reading this case, be exposed to a broad range of material on organizational behavior (leadership, culture, structure, job design, and work motivation) and more specifically Greiner's model of organizational evolution and revolution. This will provide students with the proper background and knowledge base and allow them to acknowledge some of the managerial and systemic issues embedded in the case.

This conceptual framework may be delivered prior to assigning the case by using at least one (1) of the follow methods:

- a short lecture and/or discussion session on the above noted topics.(See Teaching Note Appendix C "Motivation Theory" as a sample student handout.)
- a reading assignment prior to reading the case that covers several of the topics mentioned.
- a short student presentation on each topic.
- a guest lecturer on one of the topics.

Case Method

Although most of the students in a undergraduate business programs may have had some exposure to the case method, it behooves the instructor to provide students with a review of the case method of analysis. In the traditional case method, the student assumes the role of a manager or consultant and, therein, takes a generalist approach to analyzing and solving the problems of an organization. This approach requires students to utilize all of their prior learning in other subject areas, although the focus should be on the current course content. It is strongly suggested that students prepare for the case prior to class discussion, using the following recommendations:

- allow adequate time in preparing the case
- read the case at least twice
- focus on the key issues
- adopt the appropriate time frame. (Pearce and Robinson, Jr., 2005)

The instructor's role in case analysis is one of a facilitator. The instructor: (1) helps to keep the class focused on the key issues; (2) creates a classroom environment that encourages classroom discussion and creativity; (3) bridges "theory to practice" by referring back to key concepts learned in this or prior courses; and (4) challenges students' analyses in order to stimulate further learning and discussion. There are several variations of the aforementioned approach including: written assignments, oral presentations, team assignments, structured case competitions, and supplemental field work. (Nicastro and Jones, 1994).

Regardless of the variation employed, it is recommended that the students' work be evaluated and graded as partial fulfillment of the course's requirements. However, if this case is not employed as a comprehensive case, it is not recommended that this case (and its related assignments) have a large weight or impact on students' overall course standing.

Using Case Questions. Whether or not the instructor assigns questions for students to analyze with the case is usually a matter of educational philosophy and student readiness. Naumes and Naumes, for example, thought that if the questions were embedded in the case that "students will tend to focus only on the issues specifically raised by the questions …". (Naumes and Naumes, 1999). Lynn (1999), on the other hand, noted that the use of assignment questions provided students with more concrete guidance in case preparation and analysis; specifically directing them to consider the decision to be reached.

In deciding whether or not to assign questions, the instructor should first answer the following questions:

1 What is the level of course instruction?
2 What type of case is being taught? (Iceberg, incident, illustrative, head, dialogue, application, data, issue, or prediction – see Lundberg et. al., 2001 for full descriptions.)

3 What is the instructor's preliminary assessment of the students' ability to be self-directed learners?
4 What are the students' previous experiences with case instruction?
5 If the students have already been exposed to the case method, to what types of cases have they been exposed? Case incidents (1-2 page cases with questions)? Short cases (3-8 page cases with and/or without case questions? Comprehensive cases (greater than 8-15 pages) Harvard-style cases (greater than 15 pages)? (David, 2003)
6 What is the instructors preferred method for case instruction? (For example, "sage on the stage", "guide on the side", "student as teacher" (student-lead discussions), "observer and final commentator" (open class discussion with faculty summation, etc.).

Role-Playing (55 minutes)

Role-playing enacts a case and allows students to explore the human, social, and political dynamics of a case situation. This case lends itself quite well to a role playing exercise, since it involves a rather simple situation with only three characters and, therefore, most of the class can actively participate in this exercise.

Prior to role-playing the case part, students should be asked to not only read the case but to also answer the following questions:

1. Who are the key participants in the case? Why?
2. What is the "role" of each of these participants in the organization?
3. What is the dilemma that the characters are facing and/or how can they assist someone else in solving a problem?

The instructor may either go through these questions prior to case enactment or wait for the role playing exercise to be completed in order to use this material to debrief the class.

Step 1: Assignment of Roles & Instructions (5 minutes)

The class should form groups of four to five students with four of the students enacting the key roles in the case (Ms. Matthews, her immediate supervisor, Jane the office manager, and the owner Mr. Blake); with the other student acting as observer. The instructor should pass out a short reminder notice about participants staying within their roles. A brief summary of each role may be handed out to student playing the associated character. (See "Role Play Exercise Character Descriptions" below.)

Step 2: Enactment – Ms. Matthews' resignation (20 minutes)

The student enacting the role of Ms. Matthews' should start the conversation by explaining why she has called this meeting, which is to discuss her future with the firm. The student should be very clear on why Ms. Matthews is raising this issue now BUT not reveal her desire to immediately leave the firm (may be revealed later on as the role play continues) if her situation does not change. The conversation should continue within the time limit, with the observer taking notes as to how the other three students reacted to Ms. Matthews' request and more specifically indicating whether Ms. Matthews quit or was given some sort of accommodation in terms of job enrichment. The students' group decision should be written down on a piece of paper and handed to the instructor when they are completed.

Step 3: Exercise Analysis (20 minutes)

The instructor should allow each observer in the group to report on how the group dealt with Ms. Matthews' request and what the results were (i.e. resignation, job enlargement, job enrichment, etc…). The results can then be amalgamated in table form and the class can then summarize the results. The following questions could be asked by the instructor in leading a debriefing discussion:

- Did the majority of the class agree with on a solution strategy or did Ms. Matthews resign from her position?
- If resignation, why? If a solution was agreed upon, why?
- What were the differing class solutions? How much did they vary by?

- Which solution would seem to best address Ms. Matthews' concerns? Was there an even better solution not presented?
- If groups had more lenient punishments or none at all, what were they and what was their rationale?

Step 4: Debriefing the Exercise (10 minutes)

The instructor should have the class as a whole comment on the results of the role-play and determine with the class their overall sentiment towards the problem. Students should also be given the opportunity to comment on the role-playing exercise as a learning instrument. The instructor might ask the class the following questions:
Did this exercise animate the case? Did students get a "feel" for the issues surrounding Ms. Matthews and her desire for more challenging work?

What were the strengths and weaknesses of the exercise? What changes would they make to the exercise given their experiences with it?

The debriefing session should produce closure for students by connecting the theory and practice of leadership, culture, structure, job design, and work motivation with case specifics and the results of the role-playing exercise.

Role Play Exercise Character Descriptions

This short summary has been developed to facilitate the role playing exercise found after in this TN after the learning objectives. These descriptions go beyond the material in the case (add more detail) and therefore should not be employed as part of a general case discussion. Students should only read their own role description and student observers should not have access to this material.

Christopher Mr. Blake – the owner of H & H. Chris is a hands-off, liaissez-faire manager whose real interest is in customer service and working with his clients. His focus is on business expansion (new products, new services, more agents) and he has little interest in how the back office operates except as it might negatively affect service delivery to his clients and benefits providers. He does not want to know the details as to how things get done as long as they get done. He trusts Jane implicitly with running the back office and thinks she does a splendid job

Jane – the Office Manager. Jane is very loyal to Mr. Blake and rightly so; he took her from a dead end job in a large insurance firm and made her his number two in command (key person). She enjoys the freedom that he gives her to run the office and she is proud that she runs a very tight ship. People know what they are supposed to do and not to do to do their jobs. Jane is confident that this system of doing things (making everyone's task as simple and straightforward as possible; minimizing information overload by keeping everyone's knowledge about the firm's operation to within their own job scope) is the best way to run the firm. She continuously points to the firm's growth as an indication of the firm's success.

Ms. Matthews' supervisor - (use the actual name of the person playing this role). The supervisor is a recent college graduate who is very loyal to the firm and Mr. Blake and who sees his/her future in the successful growth of the firm. Having worked with Jane for a long time, the supervisor has gotten used to her "conversion" from a fun loving coworker to the "hard nosed" boss yet, within his/her own unit, kept the "fun" part of working with people. The supervisor is quite loyal to Jane as well but wishes she would allow people more leeway in carrying out their jobs. The supervisor's biggest hope is that as the firm grows larger, more higher level mangers will be needed and that Mr. Blake will promote those from within the fill those positions.

Ms. Matthews – Ms. Matthews is a high achiever who wants to learn from every experience. She loves challenges and finds solving of highly complex problems irresistible. She thought that in a small firm such as H & H that she would be exposed to every facet of the business and would therefore get a "big picture" of what it takes to run a financial services firm. Instead, she has been placed into a "box" and told that she should only operate within the confines of her job. She is upset, frustrated, and feeling depressed and is wondering what, if anything, can be done to make her job more rewarding. She has called a meeting with her supervisor, Jane, and Mr. Blake as a last ditch effort to salvage her job. If her job is not going to change she is prepared to resign (has already typed up her letter of resignation).

TN APPENDIX C
Motivation Theory

Maslow's Hierarchy of Needs

A popular theory of motivation was developed by the psychologist Abraham Maslow. He believed that within every person was a set of five hierarchical needs. Lower order needs- physiological, safety and social, were concerned with a person's physical survival requirements, freedom from harm, and sense of belongingness. These needs are satisfied externally. Higher order needs, esteem and self actualization, were concerned with the desire to achieve, be respected and fulfill ones fullest potential. These needs are satisfied internally.

According to Maslow, the highest level unsatisfied need motivates behavior. Once a need is satisfied, the next level need becomes the motivator. For example, a student is taking a distance learning management course. The act of taking the course is fulfilling an esteem need - to achieve mastery of new knowledge. If the student becomes very hungry while reading this chapter, they will have trouble concentrating. Instead, they will begin to day dream about what they will eat as soon as they are done reading this screen! The student has dropped out of fulfilling an esteem need because a physiological need (hunger) became unsatisfied. As soon as the students has something to eat, and no longer experiences hunger, she or he will continue to work on an esteem need and finish reading this chapter.

Management's role is to fulfill worker's lower order needs so that they can be motivated by their higher order needs. Physiological needs are satisfied by providing employees with lunch breaks, bathrooms and water fountains. Safety needs are satisfied by clearly marking emergency exits, providing protective equipment and job training. Social needs are fulfilled by organizing company picnics, soft ball teams, and coffee breaks.

Fulfilling higher order needs such as esteem requires managers to provide higher level training, delegate responsibility and authority in decision making, provide promotions and methods for recognizing employee performance. While self-actualization is thought to be a person's innate inclination to develop their fullest potential, managers can facilitate this process by providing employees the opportunities to learn new skills, mentor others and time to volunteer.

McGregor's Theory X and Theory Y

This motivation theory is really a set of assumptions about people's behavior. Theory X assumes that people are naturally lazy, seek to avoid responsibility, and must be coerced to perform. These types of employees appear to be motivated by lower order needs. Manager's control behavior and levels of effort through rewards and punishments. Theory Y assumes the opposite. Employees are viewed as creative, seeking responsibility and are self directed. Operating from higher order needs, manager's can get the most from employee's by including them in decision-making and giving them challenging jobs.

Hertzberg's Motivation-Hygiene Theory

Frederick Hertzberg discovered that work attitudes had two distinct independent dimensions; satisfaction and dissatisfaction. These dimensions are independent because the factors –motivators, that increase employee satisfaction, are different from the factors that contribute to dissatisfaction- called hygiene factors. Motivators are intrinsic, resemble higher order needs and include: the work itself, achievement, recognition, responsibility, advancement, and growth. Hygiene factors are extrinsic, resemble lower order needs, and include supervision, policy, working conditions, relationship with peers, relationships with subordinates, status and personal life. Managers should seek to build motivators into jobs and to eliminate the effects of hygiene factors that tend to cause dissatisfaction. What's significant about the motivation-hygiene theory is the recognition that just because people are not dissatisfied doesn't necessarily mean that they are satisfied. Also, if people aren't satisfied, it doesn't necessarily mean that they are satisfied.

The underlying assumption of this theory is that satisfied workers will be more productive than unsatisfied workers. Thousands of studies on job satisfaction have been conducted to date. The findings are inconclusive.

A common theme among these theories of motivation is the idea that people are driven by lower order and/or higher order needs. It is important for managers to understand the role of need fulfillment in motivation so that they can design tasks, work environments and incentive systems that stimulate workers to perform their best. It is essential that managers provide for lower level needs and recognize that not every employee will be operating at the same need level, or striving to fulfill higher order needs. Although the Need Hierarchy Theory has intuitive appeal, research has not substantiated the notion that all people strive for self-actualization. Another theme in these theories is the shift away from focusing on efficiency and the beginnings of a shift toward the notions of employee effectiveness.

Contemporary Theories of Work Motivation

There are six contemporary theories to be discussed here. The first is a content theory-the 'what' of motivation.

Three-Needs Theory

There are three major motives or needs that characterize employees in work situations:

- **Need for achievement (nAch)**: the drive to excel, to succeed. High nAch people strive for personal achievement rather than the icons of success, seek situations where they can take personal responsibility for finding solutions to problems, prefer rapid and unambiguous performance feedback, and set moderately challenging goals. They perform best when their estimate of success is 50-50.
- **Need for power (nPow)**: the need to make others behave in ways they would not have behaved otherwise. It is the desire to be influential and have impact. High nPow people seek to be in charge and prefer competitive, status-oriented situations.
- **Need for affiliation (nAff)**: the need for friendly and close interpersonal relationships. The desire to be liked and accepted by others finds high nAff people preferring cooperative situations, and prefer relationships requiring a high degree of mutual understanding.

The majority of research has been conducted on nAch. Results indicate that: High nAch individuals are successful in entrepreneurial activities such as running their own businesses or managing autonomous business units and in sales positions. They do not make especially good managers in large organizations. The best managers are individuals with high nPow, and low nAff.

Goal-Setting Theory

Goal-setting theory proposes that specific goals increase performance and that difficult goals, when accepted result in higher performance. Goal specificity acts as an internal stimulus. Thus, students told they need to maintain a "B" average to remain a business major, should perform better than when they are told to maintain a "C" average (easy goal), or to "do their best" (general goal). Further, the student must believe that maintaining a "B" is important (goal acceptance).

Individuals striving to achieve goals that are specific, difficult, and accepted also perform better when feedback is provided to guide behavior. Self-generated feedback- where an employee can monitor his or her own progress- is a more powerful motivator.

This theory also has certain contingency factors. Performance increases when goals are made public, if the person has an internal locus of control, and when goals are set rather than assigned. The higher a person's self-efficacy- belief that he or she can perform the task- , the higher the level of self-confidence and level of motivation. This motivational theory is culturally bound, explaining motivation for North American cultures. In general, goal-setting theory indicates that an individual's purpose directs action, and that hard and specific goals are a powerful motivating force.

Reinforcement Theory

Reinforcement theory suggests that motivation is externally caused. What controls behavior are reinforcers- consequences following actions- that serve to increase the probability of behavior. This theory was is presented as a method for shaping behavior. It also provides insight into motivation. Thus, manager's can influence employee behavior by reinforcing the acts deemed favorable.

Designing Motivating Jobs

Managers can deliberately engage in job design to incorporate the demands of changing environments, the organization's technology, skills and abilities, and individual preferences. When jobs are designed with these intentions, employees are motivated to be productive. Managers can choose to enlarge or enrich jobs.

Job enlargement is the horizontal expansion of jobs, increasing job scope-including different tasks required to complete a job. For instance: A supermarket employee working in the bakery can have his or her job enlarged from packing finished goods to include placing them on shelves, and designing displays. While addressing the lack of diversity in work, enlargement sometimes leaves employees feeling as if they now perform more components of boring jobs.

Job enrichment seeks to increase job depth by vertically expanding the work to include planning and evaluative functions. Employees are empowered to assume some supervisory tasks, increasing their independence and responsibility. For instance: the supermarket employee working in the bakery can determine the number of hard rolls to bake, in addition to packaging and displaying them, can monitor sales reports to prepare ingredient orders and adjust next day baking requirements. To improve performance the supervisor needs to provide feedback on quality and accuracy. Although enrichment can improve the quality of output, research demonstrates mixed results regarding its effectiveness.

Job characteristics model (JCM) provides a framework for analyzing and designing jobs. A job can be defined according to five core dimensions:

- ✓ **Skill variety**, the degree to which a job demands a variety of activities so that an employee can use a number of different skills and talents
- ✓ **Task identity**, the degree to which a job requires completion of a whole identifiable piece of work
- ✓ **Task significance**, the degree to which a job has a substantial impact on the lives or work of other people
- ✓ **Autonomy**, the degree to which a job provides substantial freedom, independence, and discretion to an individual in scheduling and conducting work
- ✓ **Feedback**, the degree to which carrying out the work required by a job results in direct and clear information about performance effectiveness

JCM suggests that these dimensions and their interrelationships impact productivity, motivation and job satisfaction. Skill variety, task identity and task significance combine to create meaningful work. Autonomy provides the employee with a sense of responsibility and feedback provides knowledge regarding effectiveness.

The motivation process indicates that intrinsic (internal) rewards are obtained when an employee learns (feedback) that he or she has performed well (autonomy) on a task he or she cares about (experiences meaningfulness).The links between the job dimensions and outcomes are moderated by a person's growth need strength. The higher the growth needs strength, the more appropriate JCM.

Jobs can be scored for motivating potential (MPS)- If jobs score high, the model predicts that motivation, performance and satisfaction will be positively affected. To increase a job's MPS, managers can:

- ✓ Enlarge jobs to increase skill variety and task identity
- ✓ Create natural work units to facilitate employee ownership and sense of meaningfulness
- ✓ Establish direct relationships between workers and their clients to increase skill variety, autonomy and feedback
- ✓ Enrich jobs to increase employee responsibility and control
- ✓ Provide feedback as employees engage in their jobs, instead of on an occasional basis

Equity Theory

Equity theory proposes that employees perceive what they get from a job situation (outcomes) in relation to what they put into it (inputs) and then compare their inputs-outcomes ratio with the inputs-outcome ratio of relevant (referent) others. A referent can be individuals with similar jobs, organizational policies and procedures or the person's past experiences. The choice of a particular referent is related to the information available and perceived relevance. The foundation of this theory is the belief that people want to be treated fairly.

If an employee perceives the ratio to be equal, then equity exists -he or she perceives that the situation is fair and justice prevails. However if the ratio is unequal, inequity exists and the employee feels either under or over rewarded. This feeling of inequity is similar to perceptual experiences of cognitive dissonance. The person will be motivated to relieve this tension and create a sense of equity or consistency. To create equity employees may:

- ✓ Distort either their own or other's input and outcome
- ✓ Behave in some way to induce others to change their own input of outcomes
- ✓ Behave in some way to change their own input and outcomes
- ✓ Choose a different comparison or referent other
- ✓ Quit their job

Expectancy Theory

Expectancy theory states that individual effort is a function of the expectation that activity will be followed a performance which leads to receipt of a desired outcome. There are three important relationships that explain the level of effort an employee will expend:

- ✓ *Expectancy*, the effort-performance linkage- is the probability perceived by the individual that a given amount of effort will lead to a certain level of performance
- ✓ *Instrumentality*, the performance-reward linkage- is the degree to which the individual believes that performing at a particular level is instrumental in attaining a desired outcome.
- ✓ *Valence,* the attractiveness of reward- is the importance the individual places on the outcome or reward that can be achieved from the job. Valence refers to both an individual's goals and needs.

The key to expectancy theory is understanding the individual's goal- and the linkage between effort and performance, between performance and rewards, and between rewards and individual goal satisfaction. For example: A manager wants her employees to improve the quality of their work. She learns that the employees care about quality (goal) and that many of them would like to extend a holiday weekend to four days (valence of reward). The manager defines the new quality standard as 2 defects per 100,000 units produced (performance level). She provides training in new manufacturing technique and coaches her employees in their early post training work (expectancy -she provided the skills necessary that link effort to performance). When the quality level is achieved, she announces that the labor day holiday will be a four day weekend, with full pay (instrumentality and valence).