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JOURNAL OF THE INTERNATIONAL ACADEMY FOR CASE STUDIES

Instructors' Notes

Editors

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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.

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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

BC FROZEN FOODS LIMITED: CHALLENGES AND CHANGE[1]

Seena Shah, University of La Verne
Issam A. Ghazzawi, University of La Verne

CASE DEESCRIPTION

This case highlights the importance of change and responding to environmental challenges via creating effective business strategy that helps organizations to be more sustainable. While the needed strategy (s) must insure a continued focus on the organization's core competencies, it also must insure that the organization has to continue creating value to its customers.

This case has a difficulty level of three and up, appropriate for junior level and beyond. The case is designed to be taught in two class hours in an entrepreneurship, strategic management, management, or marketing management course. It is expected to require about three hours of outside preparation for students, consisting mainly of reading the case and familiarizing themselves with the business environment in Western Canada as well as with some knowledge of the agriculture and frozen food industry.

CASE SYNOPSIS

The food processing industry has undergone massive changes due to economic, social and political influences. As a result, many companies in the food processing business were forced out of business as the economic climate became more intense and global competitors emerged on the scene. BC Frozen Foods is one such company that has felt the crunch of a changing environment. The primary challenges facing the company were increased local competition, labor shortages, weather, and economic conditions. This has led the company to rethink and develop new approaches to tackle threats to its viability. The results were major changes to its operations to adjust to the intense environment. The company has implemented an approach whereby it has begun diversifying its product line.

INSTRUCTOR'S NOTE

CASE ISSUES AND SUBJECTS

This case serves as an educational tool for discussing and understanding the subject of organizational environment and corporate strategies in dealing with environmental challenges of business. It is also intended to further engage students in understanding the topics of organizational core competencies and value creation.

INTENDED COURSES AND LEVELS

This case is intended for advanced undergraduate or graduate courses and designed to be taught in two class hours in an entrepreneurship, strategic management, management, or marketing management course. It is intended for class study application of concepts learned in the classroom. Therefore, this case has a difficulty level of three and up, appropriate for junior level and beyond.

CASE OBJECTIVES

The core pedagogical objective of the case is to help provide an applied, hands-on format for students to increase their understanding of the topics organizational environment, corporate strategies, organizational core competencies, and the value creation model.

Answers to the questions in the case will derive from what students have learned from theories and concepts.

This case requires students to conduct an in depth analysis of organizational growth strategies, environmental scanning, the marketing mix, and the usage of SWOT analyses. This case may be used as a learning tool during any portion of the course to emphasize key issues in an introductory business curriculum.

More specifically, the factual background of this case affords students an opportunity to hold a detailed discussion on the marketing strategy of the company. BC Frozen Foods is a great example of a company that must adjust to changing forces in the market place; both globally and locally.

SUGGESTED CLASSROOM APPROACHES TO THE CASE

INTRODUCTION OF THE CASE IN THE CLASS

It is recommended that the instructor introduce the script at least a week before the class discussions (duration from 30 minutes-one hour) and assign the questions derived from the case. Doing so ensures that the students have read and understood the issues of the case. While this case could be done on an individual basis, the authors found it most effective to create case study groups and request formal group answers to the case questions. If it is to be done in a group environment, please refer to groups' formation and report and presentation for more teaching instructions.

Individually or as a five-member group, students will be asked to discuss and answer the case questions. A PowerPoint presentation and a written report of 2-3 pages should address the case questions.

Based on the authors' experience, requiring a formal response to the questions to help students enhance their written communication skills is a good approach. Please note that this formal write-up of the case requires the instructor to read and grade the students' work more critically. Because of the nature of this case study, it is suggested that the class be divided evenly into groups of up to five students per group. The students will respond to the questions as a group.

Finally, instructors should have enough copies of the script with its instructions to distribute to students at least a week before the class discussions.

Answers to the questions in the case will derive from what students learned from the course concepts, text book and outside reading material. The case is expected to be completed and presented for class discussions.

FORMING GROUPS

At least a week before the class discussions, students will be encouraged to network and get to know fellow students in order for them to decide with whom they want to team. Allow 10-15 minutes towards the end of the class meeting to submit group members' names. Initially, students need to form a group of up to five students to conduct this required study.

PROCESS

Each group will start working on this case after the instructor introduces the subjects of corporate strategies, organizational environmental, organizational core competencies, and the value creation model.

Students are expected to develop and build their responses (as a group) on their acquired knowledge. It is recommended that the instructor address and clarify case questions ahead of time with the class.

USE OF POWER POINT AND AUDIOVISUALS

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

GROUP REPORT AND PRESENTATION

Each group is required to write at least a 2-3 page report (12 point font, double-spaced and using the APA writing style). One report is needed for each group. Each group is also required to prepare a 10-15 minute power point presentation explaining its answers. Students are required to use the chapters assigned for the course. To support their responses and enhance their report, students must include outside references such as books, journals, newspapers, internet information, or a direct interview as resources for the case answers (in case of an interview, they need to include the interview questions as an appendix of the report).

RECOMMENDED OUTLINE

The structure of the written report is critical. In the first part of the case write-up, students should provide salient points of the case before proceeding to answering the case questions.
In the second part of the case write-up, students present their answers and recommendations. Instructors need to encourage them to be comprehensive in their answers, and make sure that answers are in line with the previous ones so that it fits together and moves logically from one to the next.

STARTING THE CLASS DISCUSSION

Before engaging in a class case discussion and presentations, it is recommended to stress to the students that they might be disagreeing with the points that are being made by other students and that this disagreement is healthy and should not be taken personally. A reminder is helpful. This clarification and reminder ensures that the disagreements/discussions remain open and inviting and do not turn into personal matters.

CONTENT AND GRADING

Students' answers and presentations should clearly and concisely demonstrate their knowledge and comprehension of the subject concepts learned in the class, as well as the individual or the group's ability to apply knowledge learned in class and through research (synthesize, analyze, and evaluate his/her/their work). Students will be graded based on the following criteria: (a) The use of innovative and creative ideas, (b) the application of concepts learned in the class, and (c) the use of outside research to support the case.

It is recommended that this case study constitute 5-10% of the student's participation grade.

CASE RESEARCH METHODOLOGY

This research is based on un published "primary" data and interviews obtained by the authors from BC Frozen Foods, Ltd. executives.

DISCUSSION QUESTIONS

1. Has BC Frozen Foods lost its competitive advantage? How may it increase it's market share?
2. How are the product offerings at BC Frozen Foods different from those of its competition?
3. Discuss BC Frozen Foods challenges. How can these challenges be overcome?
4. Conduct a SWOT analysis of BC Frozen Foods.
5. Create a list of marketing goals and improvements for BC Frozen Foods Business Strategies.

POSSIBLE ANSWERS TO DISCUSSION QUESTIONS

NOTE: The following answers provide only guidelines that are designed to assist in the case analysis process and engage students in critical thinking. These guidelines are not intended to be rigid. Therefore, each question is intended to raise issues that will be helpful in analyzing and resolving the case.

Students must be reminded that their answers to the case discussion questions should be well reasoned and supported with evidence/research when applicable. Although there is not one best answer to the discussion questions, some answers might be more appropriate than others.

Accordingly, students should be told that simplistic answers to complex questions, situations, or problems such as in our case will never be "good" answers.

1. *Has BC Frozen Foods lost its competitive advantage? How it responded to its challenges?*

The new trend that emerged in the 90's was for farmers to process their own fresh market produce. This practice over-saturated the fresh market. The effect of this practice hit the food processing industry across the board. It was the first sign of many that indicated that long term survival in the food processing industry would require diversification of product lines so that "not all the eggs were in one basket". This practice by farmers, compounded with labor issues, variable weather in the North West (that can adversely affect a growing season), and a changing global economy, places BC Frozen Foods outside of its comfort zone. While many companies were forced to either shut down or down size, BC Frozen Foods took a more progressive approach and heavily invested into new infrastructure to develop new lines. This allowed for the company to maintain its competitive advantage and helped increase its market share, but not substantially because some of its competitors have had broader product lines for years and maintain a strong loyal clientele. For example, Lucerne is owned by Safeway. Safeway will continue to acquire its fruits and vegetables from its own subsidiary as long as it's in business.

BC Frozen Foods responded to its challenges via diversifying its product line. Over the last 10 years, the company has developed a green bean line and opened a door to an entirely new market. Additionally, the company has acquired 7 large harvesters to get local farmers on board to process the beans. The new bean line was able to provide vegetables for the company's custom repacking line; offering a bigger variety to customers.

Experimenting with other produce foreign to North American markets was also another avenue the company explored with some short term success. It imported Keenu Oranges from Pakistan. This type of orange has a unique taste from those grown in North America. Oranges have a longer shelf life before they spoil (most will not spoil during the 3 weeks it took to ship the oranges from Pakistan to Canada). The major benefit of importing Keenus was that there was no processing involved. All the company had to do was store the Keenus in its coolers until they were ready to be sold. This venture proved to be very profitable. A large British Columbia grocery chain liked the oranges and preparations were made to import these oranges to Canada for the fresh market. Immediately, the Keenu Oranges were a success as the grocery chain began stocking Keenus in its produce aisles.

While the company had decent gains from the Keenu business, it has had to lower its prices due to increased competition.

Finally, importing other products such as bananas, mangos, and pineapples and others kept company's custom repack line operating year round..

2. *How are the product offerings at BC Frozen Foods different from those of its competition?*

While students' answers may vary, there are several aspects that differentiate BC Frozen Foods from other food processors. First and foremost are its IQF (Individual Quick Freeze) capabilities. None of the local berry producers or smaller operations has IQF capabilities. The IQF is an intricate part of production at BC Frozen Foods and allows for the company to freeze top grade produce and later repack that produce.

BC Frozen Foods also has a diverse repack line that only a handful of other producers offer. The company is able to use its own locally grown and processed fruits and vegetables in conjunction with foreign produce to offer an expansive line.

3. *Discuss BC Frozen Foods challenges. How can these challenges be overcome?*

There are several challenges facing BC Frozen Foods. Four problems outlines in this case study are labor, weather, economy, and competition. There is a shortage of labor to fill position in the food processing and growing business in Canada. This has led to the Canadian government permitting BC companies to hire seasonal workers from Mexico and the Caribbean. Although the hired help have proven to be good workers, the cost of hiring foreign workers increases production costs.

Other challenges include over-saturation in local markets with farmers flooding the fresh market. This compounded with variables such as weather make operating in this environment more difficult and unpredictable. A very rainy or dry season can destroy crops, adversely affecting processors and growers alike.

Finally, the case study also outlines a problem with the high Canadian dollar. In recent years, the Canadian dollar has been on par and sometimes higher than the US dollar. This makes American companies less inclined to take advantage of Canadian goods because the usual good value based on currency exchange is not there.

BC Frozen Foods should continue to expand its product line so that it is not heavily dependent on the ups and downs of the local berry market in British Columbia. Moreover, by offering other produce, its expansive product line will open up more doors to new opportunities with new companies and food brokers. Lastly, a high Canadian dollar can be positive for the companies if it is purchasing foreign produce for its custom repack line. This allows for the company to get great value for foreign produce that is not native to British Columbia.

4. *Conduct a SWOT analysis of BC Frozen Foods.*

SWOT Analysis			
Strengths	Weaknesses	Opportunities	Threats
IQF Capabilities	Shortage of local labor	Ability to expand product line and gain more clients with Custom Repack Line	Economy/High Canadian dollar; making business in Canada less affordable
High Production Capacity	Increased Cost of Production with Foreign Seasonal Workers	Expand sales of House Brand products	Increased global competition
Expansive Product Line	Increased local competition	Import produce not available in market (e.g. Keenu Oranges)	Increased local competition
Good Location in Central Fraser Valley	Variable weather for local produce		
BC grown produce is a superior produce rich in flavor			

5. *Create a list of Organizational goals and improvements for BC Frozen Foods Business Strategies.*

Organizational Goals	Improvements and Business Strategies
Increase sales of House Brand products	Establish more contacts with grocers to carry House Brand on their shelves.
Explore more ways to diversify products to attract new clientele	Implement necessary infrastructure to expand product line.
Have a strong presence in British Columbia	Import dried fruit for local distribution (especially Dates) from the US and other countries.*
Dealing with increased foreign workers costs and change in weather condition	Outsource crops through strategic partnerships with farmers in Mexico to be processed and packaged at BC Frozen Food plant.* BC Frozen Foods could provide its products' specifications and import it accordingly. No need to manage or operate a farmland in Mexico. Accordingly, BC Frozen Foods will offer job opportunities to Mexican labor in their own country (Mexico).
* Additionally, students could be also asked to investigate how the North American Free Trade Agreement (NAFTA) might help BC Frozen Foods import Mexican crops and export packaged food.	

AUTHOR'S NOTE

[1]*This case was prepared by Issam Ghazzawi and Seena Shah of the University of La Verne as a basis for class discussion, rather than to illustrate either effective or ineffective handling of a management situation. The case is based on primary data and information provided by BC Frozen Foods Limited. The case has benefited by incisive comments from Sue Caple of the University of La Verne.*

CASH PROBLEMS AT CAPE CHEMICAL

David A. Kunz, Southeast Missouri State University
Benjamin L. Dow III, Southeast Missouri State University

CASE DESCRIPTION

The primary subject matter of this case concerns managing a firm's cash flow. Case requires students to evaluate a number of proposed alternatives to address a projected cash short fall as well as develop additional courses of action. The case requires students to have an introductory knowledge of general business issues thus the case has a difficulty level of three (junior level) or higher. The case is designed to be taught in one class session of approximately 1.25 hours and is expected to require 1-2 hours of preparation time from the students.

CASE SYNOPSIS

Cape Chemical is a regional distributor of liquid and dry chemicals. Revenues and profits have grown steadily. The sales growth has required the acquisition of additional fixed assets and current assets. Financing the additional assets has placed a strain on the firm's ability to raise capital. While the company ended last year with a healthy cash balance, there were many occasions during the year that it was necessary to obtain short-term bank loans in order to keep the company operating. As part of the firm's annual planning process, the finance and accounting staff prepare a projected income statement and balance sheet for the coming year. This year, Kathy Ford, the company's chief financial officer, directed David Bush, the firm's budget analyst, to also develop a monthly cash budget in an effort to identify potential cash flow problems. The cash budget indicated that the company would need additional cash during the third quarter of approximately $2,000,000. The company's board of directors had previously established a target capital structure of 50% debt and 50% equity and the projected 2012 ending balance sheet indicates the company will be very close to the target. Cape Chemicals' primary bank also incorporated the target capital structure into its loan covenants. Loan covenants require a quarterly compliance report. Increasing the firm's bank debt, even for a short period of time, is not an option Ford wants to consider. Other alternatives for covering the projected cash shortfall must be evaluated.

INSTRUCTORS' NOTE

CASE OVERVIEW

Cape Chemical is a regional distributor of liquid and dry chemicals, headquartered in Cape Girardeau, Missouri. The company, founded by Ann Stewart, has been serving southeast Missouri, southern Illinois, northeast Arkansas, western Kentucky and northwest Tennessee for over a decade and has a reputation as a reliable supplier of industrial chemicals. Growth has been steady with sales and profits have been growing. The sales growth has required the acquisition of additional fixed assets and current assets. Financing the additional assets placed a strain on the firm's ability to raise capital. There were many occasions during the prior year that it was necessary to obtain short-term bank loans in order to keep the company operating. To improve the firm's ability to manage its cash flow, Kathy Ford, the company's chief financial officer, directed David Bush, the firm's budget analyst, to also develop a monthly cash budget.

The cash budget indicated that the company would need additional cash (additional financing) during the third quarter (July, August and September) of approximately $2,000,000.

Ford reviewed the cash budget with Stewart. The company's board of directors had previously established a target capital structure of 50% debt and 50% equity and the projected 2012 ending balance sheet indicates the company will be very close to the target. Cape Chemical's primary bank also incorporated the target capital structure into its loan covenants. Loan covenants require quarterly compliance report. Ford and Stewart are reluctant to increase the firm's bank borrowing even for a short period of time. Alternatives considered were:

1) Reduce inventory levels.
2) Collect accounts receivables faster.
3) Delay capital expenditures scheduled for the first half of the year to the second half.
4) Delay paying finance charges or tax payments.
5) Slow payments to vendors (accounts payable).

Income Statements and Balance Sheets for Cape Chemical (historic and projected) are provided in Appendix 1. Cape Chemical and selected industry average ratios are provided in Appendix 2.

CASE USE

This case may be used in a number of business courses and may be particularly appropriate for accounting and finance courses. Students are asked to evaluate the alternatives considered by Ford and Stewart to handle the cash shortfall. The case requires students to use ratio analysis to evaluate alternative courses of action.

DISCUSSION QUESTIONS

1) *Assume you are Kathy Ford. Prepare the report evaluating the alternatives and a recommended course of action. Use ratio analysis to support your evaluations and recommendation.*

Increasing Cape Chemical's bank debt was not considered an option since the company's loan agreement included a covenant require a debt ratio of less than 50%.

To effectively evaluate the other options, student must calculate the firm's historic and projected ratios using the financial statements provided as well as the industry average ratios.

1. Reduce inventory levels. Ford thought this option had merit. Ford noted the firm had an ongoing program to systematically review inventory levels of all items and levels were slowly being reduced, but she thought more could be done to reduce inventory. Stewart agreed that some reduction was possible but was concerned that additional inventory reductions could negatively impact sales. Stewart stated "I don't want to jeopardize sales by not carrying enough inventory."

	2009 Actual	2010 Actual	2011 Actual	2012 Projected	2011 Industry Average
Inventory turnover (times)*	5.42	5.74	5.81	6.20	5.50
Days Invested in Inventory (365 days)**	67.34	63.59	62.82	58.87	66.36

* Cost of goods sold//inventory
** 365/inventory turnover

Ratios indicate the firm is currently turning its inventory almost 6 times a year or is carrying about 63 days of inventory and the plan for next year already includes increasing the inventory turns and reducing the investment in inventory to about 59 days. The days investment in inventory ratios for 2010, 2011 and projected 2012 are also below the industry average of 66 days. The three-year trend confirms the statement of Ford that inventory levels are slowly decreasing. The company's ratios also indicate that Cape Chemical is turning its inventory more frequently than the industry average. While reducing inventory levels may be possible, the firm does appear to have an effective inventory control system in place. To cover the necessary $2,000,000 short fall, the firm would need to reduce its days invested in inventory to 51 days. Reducing inventories to this level would be difficult without jeopardizing sales (something Stewart wants to avoid). Reducing inventories will probably not solve the company's cash flow shortfall but inventory reduction should be an ongoing company priority.

Another point against this alternative is that changing a firm's inventory policy will have long-term ramifications and the projected cash shortfall is for only three months.

2. Collect accounts receivables faster. Cape Chemical's selling terms are net 30. Ford thought it might be possible to increase credit standards and collection effort, but it could not be accomplished without a major confrontation with the sales staff. The sales force already feels that they are losing sales because of a conservative approach to granting credit and an overly aggressive collection effort. Stewart was reluctant to increase credit standards but felt the credit department could increase its collection effort on accounts that were habitually late in paying invoices

	2009 Actual	2010 Actual	2011 Actual	2012 Projected	2011 Industry Average
Average Collection Period (365 days)***	47.84	46.26	44.98	39.45	47.15

***365/(sales/accounts receivables)

Ratios indicate Cape Chemical is doing a good job of systematically reducing the time it takes to collect its receivables. Selling terms are net 30 and projected average collection period or days sales outstanding for 2011 is 45 days continuing a positive downward trend. The 2011 average collection period is also well below the industry average of 47 days. The plan for next year calls for an additional reduction to 39 days. As with the suggestion of reducing inventory levels, this option does not appear to be a likely alternative. Reducing receivables would most likely jeopardize sales and the sales staff is already unhappy with the firm's credit standards and collection efforts. As with inventory, reducing receivables should be an ongoing company priority.

Changing a firm's credit policy and collection effort will have a long-term impact on sales while the projected cash shortfall is for only three months.

3. <u>Delay capital expenditures</u>. Capital projects of approximately $2,750,000 are planned for 2012, $400,000 for the first quarter, $1,000,000 for the second quarter, $1,000,000 for the third quarter and $350,000 for the fourth quarter. Stewart opposed this option stating, "Projected revenues are dependent upon new product lines and these lines requires investment in new equipment". Ford agreed that some projects could not be delayed, but thought some replacement projects and other expenditures such as replacing a portion of the warehouse roof, replacing selected vehicles and purchasing new office computers scheduled for the first half of the year could be delayed to the second half or longer. This would require increasing maintenance on those pieces of equipment originally scheduled for replacement and maybe a temporary roof patch for the warehouse but should not disrupt operations and sales.

Although Stewart did not like this option, this alternative should be given serious consideration. Not all projects are directly related to sales activity or cost reductions, and there is a high likelihood that some projects may be able to be postponed for a few months without serious consequences to the firm's projected results.

This option also had the advantage of not requiring a major change in the firm's current asset investment (accounts receivables and inventories) policy. This alternative would provide a short-term solution to a short-term problem. A problem with this option as with others is delaying some projects will not provide the necessary cash to cover the projected $2,000,000 short fall.

4. <u>Delay paying finance charges or tax payments</u>. The case states that Ford thought delaying payments to the bank could be arranged but she was reluctant to approach the bank about rescheduling payments. She felt that approaching the bank could cause the bank to be concerned about the firm's ability to manage its cash. The case provides

limited information regarding Cape Chemical's relationship with its bank or banks but the case did indicate that the Board and the banks were concerned with the firm's debt ratio.

	2009 Actual	2010 Actual	2011 Actual	2012 Projected	2011 Industry Average
Debt Ratio	54.72%	53.06%	49.72%	48.74%	51.79%

Ford's reluctance to approach the bank may be an indication that the bank may also be concerned with the firm's increasing debt ratio. In either case, this may not be an area that would solve the firm's problem. Total projected interest expense for 2012 is slightly over $559,000. The case does not indicate if principal payments are to be made during the year, but the projected ending balance sheet for 2012 indicates a small increase in long-term debt. In either case, this does not appear an alternative that would solve the firm's problem.

Both Ford and Stewart agreed that delaying tax payments was not an option that should be pursued at this time. Delaying tax payments is <u>never</u> a good idea.

5. <u>Slow payments to vendors (accounts payable)</u>. During the early years of operation the company was not always able to pay its vendors according to terms. The delayed payments resulted in some vendors threatening to stop extending credit. This never happened but the lack of vendor credit would have caused substantial problems. Since that period, a concerted effort has been made to avoid late payments to vendors. Ford thought slowing vendor payment for a few months was possible. She thought it was unlikely vendors would notice a change in Cape Chemical's payment pattern. Stewart was skeptical. She did not want a repeat of earlier vendor problems.

	2009 Actual	2010 Actual	2011 Actual	2012 Projected	2011 Industry Average
AP Deferral Period (days)****	43.42	41.12	38.52	36.21	43.56

****Accounts payables/(cost of goods sold/365)

The company's current accounts payable deferral period is 39 days and the projected 2012 deferral period is 36 days, compared to an industry average of 43 days.

To cover the necessary $2,000,000 shortfall, the firm would need to increase its AP Deferral Period to approximately 43 days. Ford thought slowing vendor payment by 7 days for a few months was possible. She thought it was unlikely the vendors would notice a change in Cape Chemical's payment pattern. Temporarily delaying payments to 43 days would the advantage of not requiring a major change in the firm's current asset investment policy and have no impact on sales. This alternative would provide a short-term solution to a short-term problem.

Another option not mentioned in the case and associated with accounts payable is to meet with key vendors and request extended payments terms for 3-4 months. This would allow the firm to handle its short-term cash problem without delaying payments and risking irritating the firm's suppliers.

Recommendation: The first option would be to delay those capital expenditures that will have minimal impact on sales and operating expenses, but this action alone may not provide the cash necessary to bridge the shortfall. The second option would be to approach selected suppliers to request temporary extended credit terms. As mentioned previously, this approach would allow the firm to handle its short-term cash problem without delaying payments and risking irritating the firm's suppliers.

An argument could be made to temporarily slow the payments of vendor invoices without asking for extended credit terms. This alternative would risk upsetting vendors, but, based on comments from Ford, the risk would be small.

Changing the firms inventory or credit management policies would not be an attractive solution because the change would have a long-term impact on the firm's sales. Cape Chemical is facing a short-term problem. However, efforts should continue to reduce inventory and receivables balances.

It may be that the cash shortfall is addressed using a combination of actions, delaying selected capital expenditures, delaying vendor payments, reducing inventory levels and accelerating collections.

2) *Would your recommendation change if the projected cash shortfall was for six or nine rather than three months?*

If the projected shortfall was for six or nine months rather than three months, the recommended course of action could change, but probably not much. Delaying capital expenditures would still be an option but given the time period of the shortfall (six to nine months), it would essentially be delaying some projects for most of the year. Suppliers would be less likely to agree to extended credit terms for six to nine months than three months.

Slowing payments without permission from vendors would become a more viable option. As stated previously, to cover the necessary $2,000,000 shortfall, the firm would need to increase its AP Deferral Period to approximately 43 days. This would match the industry average. Ford thought it was unlikely the vendors would notice a change in Cape Chemical's payment pattern. She is probably correct. Delaying payments to 43 days would have the advantage of not requiring a major change in the firm's current asset investment policy and have no impact on sales. This alternative would provide a short-term solution to a short-term problem.

In addition to the first two recommendations, a combination of actions, delaying selected capital expenditures, delaying vendor payments, reducing inventory levels and accelerating collections may be the best approach to addressing the cash shortfall.

Appendix 1

Cape Chemical				**Projected**	**Ind./ Avg.**
Income Statement ($000)	**2009**	**2010**	**2011**	**2012**	**2011**
For the Year Ended December 31	**$**	**$**	**$**	**$**	**$**
Sales revenue	83,200,000	89,600,000	94,300,000	108,900,000	117,400,000
Less: Cost of goods sold	74,505,600	79,878,400	83,596,950	96,703,200	104,474,260
Gross profits	8,694,400	9,721,600	10,703,050	12,196,800	12,925,740
Less: Operating expenses					
Selling expense	3,078,400	3,404,800	3,489,100	3,974,850	4,343,800
General and administrative expenses	1,414,400	1,702,400	1,744,550	1,960,200	1,995,800
Depreciation expense	1,264,640	1,361,920	1,716,260	1,655,280	1,784,480
Total operating expense	5,757,440	6,469,120	6,949,910	7,590,330	8,124,080
Operating profits	2,936,960	3,252,480	3,753,140	4,606,470	4,801,660
Less: Interest expense	487,720	533,600	529,300	559,111	686,195
Net profits before taxes	2,449,240	2,718,880	3,223,840	4,047,359	4,115,465
Less: Taxes (rate = 30%)	734,772	815,664	967,152	1,214,208	1,234,640
Net profits after taxes	1,714,468	1,903,216	2,256,688	2,833,151	2,880,825
Dividends	734,772	815,664	967,152	1,214,208	1,646,186
Balance Sheet ($000)	**2009**	**2010**	**2011**	**Projected**	**Ind./Avg.**
As of December 31	**$**	**$**	**$**	**2012**	**2011**
				$	**$**
Assets					
Current assets					
Cash	499,200	448,000	471,500	544,500	704,400
Accounts receivable	11,055,342	11,512,986	11,781,041	11,934,247	15,374,575
Inventory	13,746,421	13,916,098	14,388,460	15,597,290	18,995,320
Total current assets	25,300,963	25,877,084	26,641,001	28,076,037	35,074,295
Gross fixed assets	10,100,480	12,113,920	13,503,760	16,258,770	18,161,780
Less: Accumulated depreciation	4,583,000	5,944,920	7,661,180	9,316,460	10,111,982
Net fixed assets	5,517,480	6,169,000	5,842,580	6,942,310	8,049,798
Total assets	30,818,443	32,046,084	32,483,581	35,018,347	43,124,093
Liabilities and Stockholders' Equity					
Current liabilities					
Accounts payable	8,863,105	8,998,904	8,822,341	9,593,487	12,468,216
Notes payable	1,300,000	1,400,000	1,000,000	1,000,000	1,774,867
Accruals	1,190,338	804,628	429,152	415,828	1,190,001
Total current liabilities	11,353,443	11,203,532	10,251,493	11,009,315	15,433,084
Long-term debts	5,510,000	5,800,000	5,900,000	6,058,000	6,901,163
Total liabilities	16,863,443	17,003,532	16,151,493	17,067,315	22,334,247
Stockholders' equity					
Common stock (at par)	5,500,000	5,500,000	5,500,000	5,500,000	7,104,176
Retained earnings	8,455,000	9,542,552	10,832,088	12,451,032	13,685,670
Total stockholders' equity	13,955,000	15,042,552	16,332,088	17,951,032	20,789,846
Total liabilities and stockholders' equity	30,818,443	32,046,084	32,483,581	35,018,347	43,124,093

Appendix 2

Cape Chemical

Ratio	**Actual 2009**	**Actual 2010**	**Actual 2011**	**Projected 2012**	**Industry Average 2011**
Current ratio	2.23	2.31	2.60	2.55	2.27
Quick ratio	1.02	1.07	1.20	1.13	1.04
Inventory turnover (times)	5.42	5.74	5.81	6.20	5.50
Days Invested in Inventory (365)	67.34	63.59	62.82	58.87	66.36
Average collection period (365 days)	47.84	46.26	44.98	39.45	47.15
Fixed (net) asset turnover (times)	15.08	14.52	16.14	15.69	14.58
Total asset turnover (times)	2.70	2.80	2.90	3.11	2.72
AP deferral period (days)	43.42	41.12	38.52	36.21	43.56
Debt ratio	54.72%	53.06%	49.72%	48.74%	51.79%
Times interest earned ratio	6.02	6.10	7.09	8.24	7.00
Gross profit margin	10.45%	10.85%	11.35%	11.20%	11.01%
Net profit margin	2.06%	2.12%	2.39%	2.60%	2.45%
Return on total assets (ROA)	5.56%	5.94%	6.95%	8.09%	6.68%
Return on equity (ROE)	12.29%	12.65%	13.82%	15.78%	13.86%

TRANSFORMATION FROM WITHIN: THE CDBG CASE

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CASE DESCRIPTION

This case is designed for the study of leadership and organizational change within a unit of a larger organization. As such it provides an important learning experience for students who are already managers or who aspire to that level of responsibility. The primary learning opportunities address building a vision at the unit level, restructuring for success, overcoming resistance to change internally and across other units of a larger corporation, building support with powerful sponsors, and the importance of communication and persistence where authority is limited. The case has a difficulty level appropriate for undergraduate seniors and graduate students, and is designed for courses addressing organizational change, leading change, and leading teams. It can be covered in a one hour class. Preparation for the case is expected to require 3-4 hours.

CASE SYNOPSIS

The case begins with the recognition by a senior vice-president that the inadequacies of a seemingly insignificant compliance unit could jeopardize the overall growth strategy of BOKF, a large regional bank holding company. Paula Bryant-Ellis agrees to take on the transformation of the CRA department into a modern Community Development Banking Group (CDBG) that will contribute to the overall strategy of BOKF, the parent banking company. The case covers the first two years of significant organizational change, with emphasis on creating a vision, restructuring the organization, and shared leadership at the unit level. For the first three months, Bryant-Ellis is learning the existing, inefficient and archaic process while she studies benchmark banking groups to crystallize a vision for the future and an initial direction for the group. Early in this process, she brings new leadership into the unit. The case chronicles the new leadership team's approach to transforming the basic functions of the group, while concurrently managing the old processes until the new ones are operable. The challenge is complicated by substantial resistance to change by executives in powerful operating divisions affected by the compliance responsibilities of the CDBG. Communication and collaboration across organizational silos and the role of powerful sponsors are key elements of the transformation. The case ends with a summary of "early wins" for the unit, and a list of challenges its leaders will face over the next few years.

INSTRUCTORS' NOTES

DISCUSSION POINTS

1. Students can be asked to share their experiences about stagnation and inertia in their own work group or department. What are the reasons that some organizations tend to stagnate or decline in effectiveness? What impact did corporate, group and/or middle management have in the students' experiences.

2. Describe and discuss the forces for and against change at the beginning of the case (Lewin, 1974). Identify the major change actions taken by key players in the case, and the results of their actions. To what extent were the actions effective in reducing resistance to change within CDBG and in interactions with other operating units in BOKF?

3. One model of successful turnarounds (Gabarro, 1987) identifies five key steps in the process. Identify and analyze the actions of the key players in the case relative to each step. The analysis should address the effectiveness of the actions taken. The five steps are:
   a. Diagnose underlying causes.
   b. Take initial corrective actions even before the diagnosis is complete or a strategy has been developed.
   c. Create and communicate a sense of urgency.
   d. Articulate a mission and shared purpose to provide direction internally and externally (e.g., operating divisions and subsidiaries of BOKF). (Note: in this case, the mission is not formally stated; however, students should identify the main thrust of Bryant-Ellis' vision and overall direction for CDBG.)
   e. Create early successes.

4. Identify the major challenges and issues remaining for the leadership team at the end of the case. Provide three solid recommendations for sustaining the momentum for change, providing adequate support for why you selected these particular recommendations.

CASE ANALYSIS OVERVIEW

This setting of this case allows students to integrate their own experiences. Their experiences provide relevant background relative to the situation facing Paula Bryant-Ellis and the newly hired team leaders. This initial discussion encourages students to synthesize their own experiences and set up the more detailed review of forces for/against change in analyzing underlying in a structured review of the case.

Discussion points 3 and 4 require students to analyze the case based on two models of implementing change. The first model deals with Gabarro's five steps to that guide actions where the organization faces a dramatic change. Students will identify actions consistent with this model, and differences as well. The second model highlights the importance of addressing hardware and software issues in effectively leading change. The two models complement each other in addressing change from different perspectives and provide breadth to the students' understanding of the dynamics of effective change.

The final discussion point addresses issues and challenges remaining, providing a venue for students to develop their plans for the future.

CASE ANALYSIS

Asking students to share their own experiences associated with stagnation and inertia in organizations provides a personal touch in for building their understanding of the topic. This discussion sets the stage for introducing or reviewing theoretical bases for the situation presented in the case. Lewin (1974) observed that organizations "freeze" their operations and processes to strive for effectiveness and consistency in their operations. Managers seek to ensure consistency and reliability in operations to avoid unauthorized activities and encourage repetitive processes that limit the need for individuals to take initiative or make unnecessary decisions. Organizational activities become more and more routine, leading to institutionalization of those activities, which Hannan and Freeman (1984) term structural inertia. Many individuals seek the safety and routine of such processes, and increase the investment in maintaining the status quo. It is no surprise that many organizations stagnate. What begins as a positive standardization of routines becomes an obstacle to change of any type – even the recognition of the need for change. It follows that the characteristics that lead to stability in organizations and their routines create strong forces that will resist improvements of any type, and will be even more resistant to dramatic change (Amburgey, Kelley & Barnett, 1993).

FORCES FOR AND AGAINST CHANGE

The CRA department had been ignored by senior management for years at the beginning of the case. Is apparent lack of importance had allowed it to drift along without attention. Its operating motto seemed to be "let's just get by". There was no impetus for improvement. The fact that the department manager worked out of the home provides evidence that leadership was not required or expected. A second structural issue is that the organization was very flat, and dispersed across multiple locations. This environment built a culture that focused on paperwork and avoiding an unsatisfactory audit report.

Although the situation in the CRA department was contrary to the stated BOKF commitment to excellence in all operations and a strategic risk, the manager and long term employees in each location would likely resist any change in their routine. This represents the first level of resistance to change for this group. (For an excellent discussion of the impact of change on recipients, see "The Recipients of Change" from Managing Change, by Jick and Peiperl, 2003). A related force against change would likely be the limitations of skills by the existing work group to do anything beyond purely administrative work. At the same time, only these employees would have working knowledge of the regulations, an important resource for the department.

Perhaps a more difficult force against change exists in the divisions and subsidiaries with which CRA relied upon for access and collaboration. It appears that these organizations had little respect for this backwater compliance group who had little positive impact on their operations and simply increased the workload without contributing anything of substance. The new CDBG team would have to overcome the stigma associated with this lack of respect for the old CRA department. As importantly, attempts to develop a collaborative process could be seen as interference, and develop into turf wars with multiple organizations.

At the beginning of the case, Steve Bradshaw is initiates the change for the CRA department by seeking out Paula Bryant-Ellis, and clearly laying out the challenge and the expectations. Paula then enlists well-respected current and former BOKF managers to help turn the organization around. Three levels of management provide complementary forces for change.

Cassandra, A.J., and Gale develop the specific tactics and implement them. They are working day-to-day with employees inside the CDBG, addressing improvements in processes and structure, encouraging development of new skills, and building their own knowledge base. Eventually additional talent is recruited to bolster the capabilities of the organization and drive the internal transformation. The case shows that substantial improvements have been made by the leadership team in less than two years. The organization is staffed up to start producing results. By the end of the case, all procedures are documented and revised, the automation program is substantially complete and the new approach to investment and lending is starting to produce a more profitable portfolio. It is clear that new blood, a stronger organization and centralization have been critical for the internal transformation.

On the other hand, there is little evidence that existing employees have bought into the new approach. The lack of commentary about changes in attitude by existing employees is a sign that the efforts of the leadership team have been in replacement rather than employee development. This observation provides a good opportunity to discuss the tradeoffs between replacement and development for employees who may lack both skills and initiative. At the same time, the existing employees are the only ones with detailed knowledge of the regs and the existing approach that must be partially retained as the new leadership gains expertise and confidence.

The leadership team is also critical in the one-on-one interactions with the divisions and subsidiaries that are the focus of the CRA and HMDA compliance. They are given substantial autonomy in addressing compliance issues with other BOKF organizations. The rapport they establish with peers would be critical to acceptance if not true collaboration.

Paula's role as a force for change is to provide overall direction to the leadership team and to provide critical support in interactions with the divisions and subsidiaries. Her first three months of intensive doing and learning provided the foundation to provide effective direction and support for her new leadership team. Communicating the vision was the important first step – develop one of the top community development groups in the country, be recognized through the achievement of outstanding ratings in all compliance audits, and contribute to the growth and profitability of BOKF. According to the case, Paula joined and provided leadership in the initial meetings with divisions and subsidiaries when addressing compliance processes/issues or in beginning audits. In the problem situation where one of the division president's refused to cooperate, Paula interceded and took the lead in reporting the situation to corporate executives.

The support of Steve Bradshaw was also an important force for change. Not only did he recognize the need for dramatic change, but communicated that need and the positive results of the CDBG to the highest levels of BOKF, including the board of directors. This support is absolutely critical for a group like CDBG which has no internal power base. One of the crucial elements of successful change organizations is to "establish a powerful guiding coalition" (Kotter, 2007). Power and influence are critical issues for any team involved in a transformation process. Toes will be stepped on. Executives will defend their turf. People are busy with their priorities. Organizations that seek to create change must have powerful sponsors for multiple reasons. Just getting the attention of others is difficult, and it is even harder to develop a collaborative relationship. And eventually any change agent will have to overcome the serious resistor who will not cooperate without coercion.

The increased focus of the external regulators was also an important force for change. It is doubtful that the corporation's commitment to excellence would have been sufficient to create the urgency needed within BOKF and forced the change in leadership of the CDBG. The warnings from government regulators provided the external force to drive interest at top management levels, and encourage Steve Bradshaw to beef up the leadership of the group.

KEY STEPS IN EFFECTIVE TURNAROUNDS

Step 1: Diagnosis

The initial diagnosis was evident in Steve Bradshaw's evaluation of the situation and the decision to recruit a proven manager. The poor reputation of the CRA was well known in the overall corporation, and the fact that the manager worked out of the home was added information. Although the case did not specifically address Steve's evaluation in detail, it is obvious that his interaction with CRA personnel would not be positive. As importantly, recognition of the strategic risk was a critical piece of information that drove his decision.

Paula's diagnostic job had to be in greater depth. It was not enough to recognize that the department was "broken"; she had to decide what it would take to fix it. There were three important aspects in her diagnosis. First, she already knew what it meant to contribute to the community through her recent stint at the XXXX Project. Second, was her knowledge of the other organizations in BOKF, and how she would have to approach collaborative efforts with them. The third was her hard work in the first three months to learn the regs and study banking groups that had achieved excellence in community development banking operations. This was critical in her early decisions to bring in new talent and organize the group around compliance, lending and investment activities.

Steps 2 & 3: Initial Corrective Actions; Create a Sense of Urgency

In this case, these steps are clearly related, and are best addressed together. Number one was to recruit proven leadership for the organization, and work with each leader to develop a plan of action in their area of responsibility. Each leader was strong enough to develop and implement the key aspects of their own area. All would be expected to continue to learn on the job and through interaction with outside experts, but taking action and responsibility from the start. The first two leaders joined within a few months. The third joined at the end of 2004, but would have been recruited even earlier based on the footnote in the case, where Paula Bryant-Ellis indicated that she moved too slowly in the lending area.

Another early action was for Paula to start writing procedures on her own. The fact that the regulators identified this weakness made it a critical action. A.J. and Cassandra jumped into this process as soon as they joined the group. Again, this was done while working on active audits.

Communication was quickly identified as crucial, and was built around the vision Paula had developed in the first few months. The communication of that vision and even the early actions was critical at multiple levels. Within the group it provided overall objectives and motivation for the new leadership team. At the executive level, it created a sense of direction consistent with the strategic needs of the overall corporation.

It is clear from the case that the team had to attack the problems in multiple areas and create new systems and procedures as quickly as possible. Not only was it crucial for in addressing eminent deficiencies in compliance, but also reflects the urgency in which successful changes must be pursued. Momentum is critical for continuing to receive support, especially in transformational change.

Step 4: Articulate a Mission and Shared Purpose

Although the Gabarro model (1987) places this action in step 4, mission and purpose was developed early in the change process. Although not a formal vision statement, the direction enunciated in the case and noted in step 2/3 reflected both the overall expectations of Steve Bradford and the broad vision that drove Bryant Ellis to take the position in the first place. The initial idea of that vision matured in the early months she spent studying benchmark banking groups, and diagnosing the problems that existed. That vision was to develop one of the top community development groups in the country, be recognized through the achievement of outstanding ratings in all compliance audits, and contribute to the growth and profitability of BOKF. This theme was articulated internally, was included in presentations to top management, and became part of the message communicated by the leadership team to the divisions and subsidiaries.

Step 5: Create Early Successes

This was a difficult issue for the newly restructured CDBG leadership team. It had taken years to build up the archaic compliance process, and much had to be done simply to set the foundation for improvement. As noted above the first priorities were talent/structure, writing procedures and automating processes. By addressing this foundation, the team made it possible to achieve some critical successes with the first 18 months. The most notable are:

- Automate a substantial number of processes/systems;
- Move the losing portfolio back to the originating organizations;
- Demonstrate senior management support in a crisis situation; and
- Achieve the first outstanding audit rating.

MAJOR CHALLENGES/ISSUES

At the end of the case the leadership team is facing a number of challenges, including:

- CDBG lacked real cooperation with some of the divisions and subsidiaries. This created extra work and frustration. Although progress had been made it was still a struggle.
- Although some senior executives were supportive of the general thrust of the group, division management was only at the level of acceptance, and still resisted process improvements that seemed like more work to their people. The team would continue to have to push for change and collaboration without the authority to force any actions on their own.
- Knowledge and skills still were needed. The team leaders would have to upgrade their knowledge of financial instruments and community development strategies that supported compliance and built profitability for BOKF.
- The group had yet to make it into the black in profitability. This problem was made more difficult because many of the financial instruments required several years before the payoff was realized in profitability – this would require patience and additional forbearance by senior management who was expecting a profitable operation.
- MAKE A NOTE TO ADD THE NEED TO COMPLETE OTHER AUDITS IN THE CHALLENGES.

As noted in the case: "The bottom line is that two years of hard work and a great deal of positive change only positioned the team for long term success, it did not guarantee it."

RECOMMENDATIONS

After the initial set of actions taken to drive change, it is critical to consolidate improvements, build on new knowledge and reassess objectives and expectations for the future. The following recommendations address these opportunities and issues:

1. The team must continue to focus on the upcoming audits in multiple locations. Achieving an outstanding rating in one of the subsidiaries increases expectations at the top level of the organization, whose support continues to be critical. Outstanding rating also provide a highly visible results of the efforts exerted by the CDBG organization and the operations and subsidiaries that collaborate in the process. The leadership team

should review the process utilized in the successful audit, retaining the most effective changes, and improving upon areas of weaknesses. The team should continue to develop the collaborative efforts, focusing on subsidiaries targeted for audits. Reinforcing top management support with continued focus on

2. The CDBG leadership team should consolidate their successes by developing a strategic plan that documents the mission, vision and strategic objectives of the CDBG as a communication tool for senior executives, and as a roadmap for success internally. This will provide the basis for longer term thinking. This is critical in documenting and communicating the long term benefits of investments that will not pay off in the short-term. The roadmap will keep the leadership team focused on the most important actions in the intermediate term. The three year plan will highlight the potential for profitability in lending and investment departments.

3. The leadership team should accelerate their own learning priorities and those of their associates. Time should be set aside to investigate financial instruments that will contribute to the profitability of the organizations. Outside experts should be enlisted in the learning process as they provide consulting assistance on specific technique. The leadership team should benchmark one or more high performing community banking organization that does not compete with BOKF. Benchmark studies not only provide ideas to CDBG personnel, but can also build credibility with top management and executives in the operating divisions and the subsidiaries.

(Note that these are three possible actions, but students may address a number of additional ideas, such as: hiring staff with specific knowledge, focusing more specifically on collaborative efforts with divisions and subsidiary managers, paying greater attention to internal culture and motivation, and completing the automation program.)

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LKT PRODUCTS; A FAILED LEAN JOURNEY

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CASE DESCRIPTION

The primary subject matter of this case centers on the approach for successfully implementing Lean Manufacturing in a small manufacturing facility. Secondary issues include: employee motivation, lean change leadership, management commitment, employee cross training, management/employee communication, and sustainability of achieved process improvements. This case is appropriate for junior level. The case is designed to be taught in 1.5 classroom hours and is expected to require 1.5 hours of outside preparation by students. This case study will complement current Operation Management textbooks that address the basic principles and philosophy of lean.

CASE SYNOPIS

Beginning as a basement hobby of founder/president Ronald Jefferson, LKT grew into a world class solid-body guitar case manufacture with 55 employees. LKT made mass-produced guitar cases in the molded-case department and personalized one-of-a-kind guitar cases for musicians in the custom-case department. LKT is indicative of a successful proprietorship micromanaged by its owner whose resistance to change fostered the culture of the company. Not only was implementing lean challenging to shop employees but to Jefferson himself who considered LKT his "baby".

Bryan Ackers was hired by Ronald Jefferson as Plant Manager to assist in running the day-to-day plant operations. Ackers, an experienced practitioner of lean implementation at Hewlett-Packard, envisioned potential improvements from implementing Lean Manufacturing at LKT. Ackers success at Hewlett-Packard was well documented, yet he knew every lean journey begins with different challenges. He was unaware of the tribulations he was about to confront.

Ronald Jefferson, despite his hands-on management style, was not present during initial lean training sessions or the first kaizen event. His absence was evident to senior managers and department operators which led to skepticism and discontent within the process improvement teams. Initially Ackers focused on implementing lean in the molded-case department. Although the improvements were considered successful, operators resisted improvements and gradually returned to their old work habits unable to adapt to the concepts of lean. Not to be dissuaded. Ackers continued to follow his improvement goals in the custom-case production department.

The kaizen improvement event in the custom-case department showed slight improvements. Ackers was troubled by the outcome from custom-case and the deterioration in improvements from the first kaizen in molded-case. Ackers understood lean is learned by doing. Ackers apprehension continued when Jefferson verbalize his displeasure with the lean process. Shortly after, Ackers left the company with a myriad of questions of what he could have done better.

INSTRUCTOR'S NOTES

INTRODUCTION

This case is designed by the case writer to illustrate the intricacy in developing an implementation strategy for lean manufacturing in a small privately owned company with a micro managing owner/founder. In today's business world there is sufficient information on what lean is and more than enough information on how to use lean tools. However, there is little information on how to implement lean thinking at the employee level or how to lead cultural change. Lean implementation is not a recipe with clearly identified process steps but a roadmap offering direction to achieving successful improvement. There is no right way to implement lean.

This case offers Business School students the opportunity to discuss approaches and strategies for successful lean implementation and cultural change. Beyond the understanding of using lean tools, leadership and cultural change present organizational challenges most practitioners don't anticipate. The failure of lean implementation at LKT Products illustrates these concerns; lack of communication, poor planning and training, and non-standardization.

Students with the basic knowledge of lean should respond with constructive analysis and discussion. Students will gain an understanding of the variables encountered during lean implementation and a realization that organizational change includes employee knowledge, understanding, and respect. Effective use of lean tools does not guarantee success.

This case will supplement lean instruction. The case could be assigned as homework with classroom discussion during the subsequent class period. Student teams or study groups, if applicable, will also benefit from their own discussion before review in the classroom.

RECOMMENDATIONS FOR TEACHING APPROACHES

A basic understanding of Operations Management, specifically Lean Manufacturing is required for meaningful case discussion. Several books and articles can be found in the reference section included in the instructor's notes that will assist in understanding the concepts, tools and methodologies of lean. Significant discussion is attainable with an understanding of lean failure attributes of which the following are most relevant:

* *Lean transformation is not a short time program*. It takes two to three years to build significant momentum and achieve noteworthy improvements. Lean tools such as kaizen events provide quick and significant improvements but will slowly deteriorate without identified goals to sustain improvements and change the organizations' culture.

* *Lean is not only about the shop floor*. Lean is not just a production system. Every discipline of the business, from sales to accounting to manufacturing, must embrace the implementation. Competitive advantages will not be achieved if manufacturing can reduce lead time from two months to two weeks if accounting still takes two months to collect payment.

* *Lean is not a recipe; it is more like a road map*. Every company begins its lean journey with different circumstances, factors and constraints. There are no guidelines, sequences, or timing charts that tell you what to do. Each journey is unique in utilizing lean tools, methodologies and concepts. What works in one department, plant or location will not necessarily work in another similar situation.

* *Be prepared for resistance*. When people are confronted with change, they feel threatened and uncomfortable with the unknown. Effort must be given to help employees understand why, what and how. Comprehensive employee training is necessary. People often think lean means layoffs when in reality it's about working smarter to grow the business and preserve jobs. Employees must be assured from senior management that no jobs will be lost from implementing lean.

* *Lean implementation requires leaders not managers*. Managers maintain the current state: making schedules, containing costs, budgeting etc. Leaders move the organization towards an ideal state by transforming employee thinking, constantly teaching lean concepts, communicating to all levels of the organization, and practicing what is being preached. Lean implementation requires leaders not managers.

* *Top management support*. Without top management support lean efforts will not succeed. Gains might be achieved in the short term but long term sustainable improvements will eventually disappear. Top management must be committed to the implementation process including attendance in training and participation in kaizen events.

* *Understanding Lean Change Management.* Sustaining the improvements of lean necessitates understanding several attributes of cultural change. The following are identified to assist in understanding organizational change:

a) Change will reveal past activities which may be threatening, distrustful, filled with promises of improvement, or failures that could have been prevented.

b) Change often results in issues of control such as shifts in power or redistribution of status especially when identifying lean leaders as opposed to managers.

c) Change generates emotional stress on individuals which results in conflict, especially intergroup conflict.

d) Approximately 5% of employees are willing to adopt to change and will be strong supporters of lean. 90% of employees will be open to change and will look toward management for leadership. The remaining 5% will directly oppose change. Those individuals who continue to support past work efforts must be directly addressed.

e) Everyone is different. People are not inherently against change. Employees will do what they perceive is in their best interest. Most people will embrace change provided the change has positive meaning for them.

f) Employees will thrive under creative challenges. They will believe in what they see; action will speak louder than words.

DISCUSSION QUESTIONS

1) *Why were the improvements in Molded-case not sustainable? Why did the department regress to the old way of doing business?*

The root cause for non-sustainability is the confusion or lack of priorities at different levels of the organization. This is compounded by the failure to make someone responsible for continually improving upon the improvements already made. Ackers focused his attention on the next Kaizen event and was not focused on sustaining the changes made in the department. A supervisor who was not trained or familiar with the concepts and methodologies of lean was assigned to supervise the area relying upon old management tools and measurements rather than sustaining and supporting the new concepts of lean.

2) *What tools could Ackers have used to sustain the improvements in Molded-case?*

Periodic auditing of operational processes, for example, cell work flow and inventory scheduling would have exposed problems and contradictions to lean objectives. Ackers needed to identify a trained management member who would periodically visit the Molded-case area to move the department to a higher level of performance and continuous improvement which by default would prevent regression.

3) *Would creating a new organizational structure support successful lean implementation?*

Most organizations, to include LKT, are vertically organized by departments: engineering, production, sales, purchasing, marketing, finance etc. The philosophy of lean is a horizontal flow of value across the organization. Someone needs to be identified to manage and improve the Molded-case value stream from the perspective of the customer. In most organizations no one is responsible for the horizontal flow of value in a product family between departments. A value stream manager needs to be identified for product flow, from concept to launch, from order to product delivery, and from delivery to product life cycle.

4) *What approach should Ackers have used to motivate the Molded-case department employees?*

A representative cross-section of employees from all departments across the value stream should have been included in the training, shop floor data collection, mapping, and kaizen event. The best way to engage people at every level is to involve employees in identifying and correcting problems and allowing employees to solve identified problems. The mapping teams and data collection teams should have been populated by the same employees. Thus everyone would understand the current state and suggest ways to improve it. The teams and employees affected by changes in the process would then have ownership in the improvements resulting in involved, motivated and contributing employees.

5) *Knowing that lean Implementation is a road map and not a recipe, what suggestions would you give Ackers for beginning the lean journey?*

There are several suggestions that would assist Ackers in the implementation process, of major consideration are:

* Senior management, to include Ronald Jefferson. need to discuss and agree on a lean vision. This team also needs to identify a project leader and set objectives.
* Communicate the plan to the entire workforce.
* Identify employees who will be members of the implementation team. A cross section of all departments in the value stream should be represented. This team would include Ronald Jefferson and appropriate senior management.
* Train the implementation team to the concepts, methodologies and tools of lean.
*Select a pilot project. Monitor the pilot for 2-3 months to evaluate, review and learn from your mistakes.
* When satisfied with the outcome of the pilot project, consider another area for implementation.
* Identify a value stream manager.

6) What *influence did Ronald Jefferson's role or lack thereof, have on implementing lean?*

By not participating in training and kaizen events, Jefferson did not "walk the talk". His presence would have demonstrated his commitment to the process. LKT was Jefferson's business, he needed to demonstrate the importance of changing the processes he initially developed through active participation. Consequently, there was skepticism and discontent with management and operators on the shop floor when Jefferson did not become involved.

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WILJAX STUDIO: A 10-YEAR ENTREPRENEURIAL JOURNEY

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CASE SUMMARY

Will Jacks' 10-year journey from his start as a struggling entrepreneur to a seasoned entrepreneur at the cross roads of a career changing decision point are highlighted in this case. This case examines the evolution of an entrepreneur from his days as a journalism graduate student, to start up entrepreneur, to taking on and disentangling with partners and large commercial photography clients. Jacks' story provides insights into a wide array of entrepreneurial struggles, obstacles, defeats and victories.

Case Intended Uses: This case is designed for use in undergraduate Entrepreneurship or Small Business classes.

Learning Objectives

To examine the importance of establishing and cultivating a vision for entrepreneurs.

To identify decision making pitfalls and ways that entrepreneurs can make better decisions.

To understand the challenges of managing relationships with both partnership and customer constituents.

INSTRUCTOR'S NOTE

**This decision-based case was developed based on interviews with Will Jacks, the owner of the firm in question. Disguises have been used to mask some of the names involved.*

SUGGESTED TEACHING PLAN

We suggest using this case following an effective class lecture and student reading of relevant text chapters on Entrepreneurial Vision and or Planning (Questions 1-3) and Business Formation (Questions 9-11). Additional reading from an Organizational Behavior text may be required for a better understanding of Escalation of Commitments (Questions 6-8).

The discussion questions also allow students to expand their thinking beyond the nuts and bolts of the case and make application across a broader spectrum of concepts (e.g. vision and decision-making). Senior level undergraduate students will likely have had exposure to the concept of escalation of commitments and junior level students will likely be covering the concept in an organizational behavior or principles of management course. The case also allows the students to place themselves in the place of both Will and the managers of his major client (Questions 12-14).

SUMMARY LIST OF DISCUSSION QUESTIONS

VISION QUESTIONS: 1-3

What role did establishing a vision play in Will Jacks' problems?
How might an entrepreneur go about establishing a vision for his or her business?
What steps are needed to convert a vision into a plan of action?

MANAGEMENT QUESTIONS: 4-8

What were some of Will's questionable decisions in his role of manager?
How might he have come to make better decisions in each of those instances?
Did Will have a problem with escalation of commitments? If so, explain. Could also be phrased: What decision making trap has Will fallen victim to?
What are the hallmark signals of a decision-maker engaging in escalation of commitments?
Why is escalation of commitments an especially troubling phenomenon for entrepreneurs?

PARTNERSHIP QUESTIONS: 9-11

Was Will wise to add the Scotts as partners to his firm?
Based on the information provided in the case what aspects of partnership formation did Will not adequately address / miss manage?
What are some of the challenges associated with bringing in partners to already established firms?

BALLEW FURNITURE / JEFFREY RAY QUESTIONS: 12-14

What evidence from the case suggests that Will should not have been surprised when he was terminated right before he was to start his photo shoot?
Why do you think that Ballew / Jeffrey Ray terminated Will?
Would you have trained your replacement if you were in Will's shoes – why or why not?

VISION QUESTIONS: 1-3

What role did establishing a vision play in Will Jacks' problems?

Will Jacks never fully articulated a vision to direct his decisions with regard to establishing his business. The failure to articulate a vision contributed to his jack-of-all-trades approach to photography while failing to fully develop a specific niche on which to focus for success.

How might an entrepreneur go about establishing a vision for his or her business?

Will Jacks has the eye of an artist. He saw the world and people from a different perspective than others. Entrepreneurs are able to see and envision things in a unique way which enables them to perceive opportunities that others have failed to identify. Jacks needed to use this creative vision in conjunction with the market for photographic services to envision a way that he could provide something unique that was not currently being provided. The failure to realize his unique talents led him into direct competition with Wal-Mart, which was obviously doomed from the start. The financial viability of his business required him to be able to do something that was unique enough that very few would be available to do it and that the skills and knowledge required for it would command a price high enough to make him profitable. His vision statement needs to identify how he can make a unique contribution that others will value enough to command a price that will generate a profit. The initial opportunity created by Ballew Furniture should have served as a springboard and catalyst for Jacks to focus his creative energies. Within his sphere of opportunity there were probably other businesses which would have been interested in paying for display and promotional photography. Jacks' failure to cultivate and develop additional business in this area has lead to his current dilemma, this was because he had not fully formed and stated a vision for his business.

What steps are needed to convert a vision into a plan of action?

Once he has articulated his vision he needs to develop a business plan to help him assess if his vision can be profitable. He needs to know who would be his major competitors and how much they charge for their services. He needs to have a service and product that is unique enough that there is limited competition, this is essential for a very small business such as his.

***A Note Related to Questions 1-3 (Vision Questions)

Early in the case it was noted that Will "did not have a specific vision for what he wanted this business to be." This lack of a clear vision should be explored by the students through the evaluation of a business model. A business model needs to describe how the company intends to create value in the marketplace. The model should include the unique products and services that can be offered that would enable the company to command a revenue stream that would lead to financial success. The business plan must also include the underlying organization of people and the operational infrastructure that they use to accomplish their work. When a business provides a commodity, competition drives the price to an economic breakeven. Will's business cannot compete head on with the Wal-Mart's of the world. An economic profit can only be attained when a company is able to offer a product or service that is unique and therefore not subject to *the same economic pressures prevalent with a commodity. It was noted in the case that Will's "photography work initially spanned the spectrum of possibilities from commercial photography to weddings, school pictures, portraits and artistic photography, along with a food service area making him a jack of all trades master of none." Will needed a vision that would articulate the unique value he can offer the public. His business plan should also identify the market segments he Will target with these unique services. The plan should define the structure of the value chain within the firm required to create an economic profit. The cost structure and profit potential of the offerings envisioned by Will should be examined to determine which ones generate the largest potential net gain to the firm and therefore he needs identify how his business plan will be shaped by the role of suppliers, customers, and third parties in influencing the value of his products and services. Will needs to assess his business model as it relates to the feasible inputs to his product and the external economic forces that affect the price and value of his outputs in order to formulate a plan that has the highest probability of success.*

Further Suggested reading on the role of vision and planning can be found in *Business Model Generation* (2010) by Alexander Osterwalder and Yves Pigneur (John Wiley & Sons).

MANAGEMENT QUESTIONS: 4-8

What were some of Will's questionable decisions in his role of manager?

Will Jacks made several very questionable decisions that indicated that he did not fully assess the competition. He initially opened a coffee shop in conjunction with an artist's photography studio without ever considering what was required to be successful in the food service business, an area where he had no experience whatsoever. There many competitors in his some with economies of scale that he does not have. His next questionable decision, which became obvious to him as well, was the partnership formed with the Scotts. His lack of knowledge in business caused him to assume all the risks in the partnership with the Scotts. He also once again failed to have a vision about how the school photography business would fit with his talents. The most egregious error he made was going into a one-hour photo developing business when Wal-Mart was already in the same business near his location. The five competitive force model developed by Porter clearly warns entrepreneurs of the bargaining power of suppliers. Clearly, he had no ability to compete as a supplier with Wal-Mart and this business was doomed before it ever started.

How might he have come to make better decisions in each of those instances?

In all cases his decisions appear to have been made with very limited knowledge. There is no mention of a feasibility study for the coffee shop. He should have analyzed the market to determine how many competitors he would face and how much rivalry would exist in this market. What would he be able to offer that would give him a competitive advantage?

The partnership with the Scotts was apparently done without assessing the risks he was assuming with the "salaries" for the Scotts. They brought the volume of business he needed to *fully utilize his equipment, but apparently he didn't analyze the cost for his equipment and was under pricing this service.*

He seemed unaware that he could not compete with Wal-Mart on price for a product that is a commodity. One hour photo development is a commodity. His product and Wal-Mart's are identical therefore customers will make decisions based solely on price. Even the most superficial examination of this would lead to the conclusion that he would not be successful.

Did Will have a problem with escalation of commitments? If so, explain. Could also be phrased: What decision making trap has Will fallen victim to?

Will did not have a problem with escalation of commitments. Wills' problem was a failure to properly price the additional work that came from additional commitments or to assess the profitability of the commitment. Escalation of commitments on behalf of his business was the way to grow his business and ultimately increase his income. But his failure to properly estimate the costs associated with those commitments and to properly price them in the market is what created the problem that he has fallen victim to.

***Entrepreneurship and Small Business Courses many not cover Escalation of Commitments or Decision Making traps in-depth as one would in an Organizational Behavior or Principles of Management Class.

The instructor is encouraged to provide outside reading on the concept of Escalation of Commitments such as a chapter on Decision Making from an Organizational Behavior textbook (see Robbins and Judge, *Organizational Behavior*, 14e, 2010). For additional reading on Escalation of Commitments see also Staw, B.M. (1981). The Escalation of Commitment to a Course of Action. *Academy of Management Review*, 577-87.

What are the hallmark signals of a decision-maker engaging in escalation of commitments?

Will's lack of a vision statement caused him to jump at any perceived opportunity, thus escalating his commitments to engage in opportunities which were not going to be successful because he failed to evaluate what was involved in these commitments.

Why is escalation of commitments an especially troubling phenomenon for entrepreneurs?

Entrepreneurs, especially when the business is young and they are on the verge of going bankrupt, will frequently have the phenomenon of grabbing any opportunity that presents itself without fully analyzing the costs involved in that venture and what would be required for it to be successful. Often these additional commitments will carry them away from their particular comparative advantage. The failure of them to identify their comparative advantage in the market place leads to this phenomenon.

PARTNERSHIP QUESTIONS: 9-11

Was Will wise to add the Scotts as partners to his firm?

Adding the Scotts may have been the best decision that Will Jacks made. They brought a large base of business and generated a demand that would offset the cost of his computer and printing needs. His failure was not in adding the Scotts, but it was the structure of the relationship he created with the Scotts that led to the problem. Had he more fully explored the options available to him, he probably could have negotiated a better arrangement whereby the Scotts shared more of the risks and would have been motivated to help him grow the business.

Based on the information provided in the case what aspects of partnership formation did Will not adequately address / mismanage?

Based on the information in the case, it is uncertain exactly what arrangements Will Jacks had with the Scotts. We know, in effect, they drew a salary which insulated them from the problem of the business being profitable. We also are unaware of what incentives were in place to encourage the Scotts to help Will Jacks grow the business. The information provided suggests that the Scotts, being more experienced in running a photography shop, were able to gain advantages for themselves in copying and reproduction of photographs while, in some way, apparently maintaining control of their business. One would assume when the partnership was dissolved he was no longer involved in the photography business done by the Scotts. I am lead to assume that the Scotts went back to or continued to do school photographs, yearbook photographs, and team photographs. So, it appears that the Scotts were in some way able to profit at the expense of Will Jacks' naiveté.

What are some of the challenges associated with bringing in partners to already established firms?

A major challenge for forming a partnership is the lack of knowledge about the business that you're forming with the partnership. Some costs associated with operating a business are hard to identify from the outside and forming a partnership can lead one to a risk of exposure that was not anticipated. Partners share a legal liability and it is very important to understand all aspects of a business before you form a partnership with it. In many cases, the firm with which the partnership is being formed may, for various reasons, hide or disguise certain pieces of information which can often lead to a partnerships which bring liabilities and costs which were not anticipated. Another problem with forming a partnership, especially for a small firm like Will Jacks is the cost of doing the appropriate due diligence needed to decide whether or not to create the partnership. The time and money needed to determine whether a partnership would be profitable or not can be significant, and it can take a considerable period of time to recover this cost if the partnership is formed. If this due diligence leads to a decision not to form the partnership, you have a very significant expense from which there is no opportunity to recover.

BALLEW FURNITURE / JEFFREY RAY QUESTIONS: 12-14

What evidence from the case suggests that Will should not have been surprised when he was terminated right before he was to start his photo shoot?

Will Jacks should not have been surprised that Ballew Furniture was going to terminate his services. This possibility should have been paramount in his mind since he came to the realization that he was pricing his services essentially below his costs and needed to negotiate a new contract. Ballew Furniture was simply aware of the fact that Will Jacks is trying to negotiate a new contract at a substantially higher cost for them. He needed to realize that there is always a threat of substitutes and that when he began to negotiate for a higher contract price that Ballew Furniture would seek out an alternative substitute if possible in order to save money. While Jacks' services and abilities are somewhat unique, clearly there is a substitute available and that possibility should have been paramount in his mind when he began negotiations. He should have been especially careful about this because he had terminated his relationship with the Scotts which meant that he no longer had that base of business to help offset the costs of his operations.

Why do you think that Ballew / Jeffrey Ray terminated Will?

Will Jacks' termination by Ballew Furniture was probably precipitated by a combination of factors. One already discussed was the fact that he was trying to negotiate a new contract with substantially higher costs for Ballew. Additionally, Ballew had hired a new marketing director and Jacks needed to be aware of the fact the new marketing director would be looking for ways in which he could impact the business directly and clearly bringing in a different photographer would allow the marketing director to put his stamp on the business and, if successful, be able to take the credit for the sales increase that he hoped to bring to Ballew Furniture. The new marketing director should have instantly raised concerns with Will Jacks.

Would you have trained your replacement if you were in Will's shoes – why or why not?

If I were Will Jacks I would have trained my replacement. I would be upset about losing the job and initially would not have wanted to have done this. But I believe the potential good will I could get from training my replacement, which could lead to referrals from Ballew Furniture for display work in the future would far offset any potential gain I might give to this competitor. It appears that display photography is the direction that Will Jacks has chosen to take for his business although he never articulated that in a vision statement. But given that that seems to be his forte I would want to maintain the ability to use Ballew Furniture as a reference for future jobs and I believe that training my replacement would be the best way to ensure that I would get a good recommendation from them for business in the future.

EPILOGUE

Will Jacks did accept the job training his replacement, at a rate of $150 per hour. He took the break from Ballew / Jeffrey Ray as an opportunity to conduct a strategic assessment of his business. He determined that he needed to get out of the processing and printing side of photography. He now focuses his efforts on weddings and other special occasion photography. This freedom of expression allows him to be his most creative. Additionally he is charging for his time and creativity. All of his clients must deal with third party vendors for processing and printing costs. He does occasional commercial work but, only when he has the time. He has converted his building space again. He now has a local potter renting one of his back rooms as a work station. He has also converted much of his personal showroom into a consignment gallery for local artists whereby he is able to collect a percentage of the proceeds of any sale. He has paid off all of his large equipment purchases and is looking forward to many more years of fulfilling his artistic visions.

RAS CONSULTANTS LIMITED

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CASE DESCRIPTION

Ever wished you had a short one-page mini-case which you could bring to class, pass out, and discuss the same day (perhaps as an example of how best to tackle and benefit from case studies) with your students? Alternatively, are you and/or your students interested in a short one-page mini-case which highlights the importance of pricing and the very substantial impact pricing and pricing policies can have on corporate revenues? If your answer to either of the above questions is “yes,” you (and they) may find interesting this true story of the Head of Administration of RAS Consultants Limited, who doubled the amount of revenue her company had expected to generate from an upcoming event by using an “out of the box” approach to pricing a training seminar RAS has organized. This mini-case can be used with students from level 1 up. While the case could be assigned as homework, it can also be distributed and taught during one 50 minute class period. Experience suggests that students are likely to need a minimum of 15-30 minutes to read, analyze, and then develop a solution for the case.

CASE SYNOPSIS

Ms. Bonnie Jones is Head of Administration for RAS Consultants Limited (RCL). Earlier today, her Finance Director requested that Ms. Jones recommend to him a price RCL should charge International Oil Company (IOC) representatives to attend a training session which RCL will be running next month for 10 staff members of the Ministry of Environment. Ms. Jones has already collected information on the incremental costs RCL will incur by adding each additional participant to the seminar; she now needs to decide exactly how she wants to use the information she has collected to generate the recommendation she will make to her Finance Director, regarding the price each IOC representative interested in attending the upcoming seminar should be charged. Discussion of this mini-case will provide students an example of the importance of pricing and the very substantial impact pricing and pricing policies can have on corporate revenues.

INSTRUCTORS’ NOTE

CASE OVERVIEW

This one-page mini-case opens by describing a pricing-related decision situation faced by Ms. Bonnie Jones, Head of Administration for RAS Consultants Limited (RCL). Specifically, Ms. Jones has been asked by her Finance Director to recommend the price which RCL should charge International Oil Company (IOC) representatives who wish to attend a training seminar which RCL is organizing for 10 staff members of the Ministry of Environment. Readers are provided the information Ms. Jones has collected on the incremental costs RCL will incur by adding each additional participant to the seminar; they are now asked to use that information (and any other information they might wish to utilize) to decide what recommendation Ms. Jones will make to her Finance Director, regarding the price which each IOC representative interested in attending the upcoming training seminar should be charged.

As regards lessons and/or information which students should learn from this case, at least three points can be made:

1. Because it is based on a true story, this mini-case provides (for students with little experience in price and/or pricing policy) a very realistic example of the some of the sorts of price and pricing policy-related issues encountered by business decision makers.
2. Discussion of the case exposes students to a systematic way of thinking about price and pricing policy-related issues. Furthermore, references provided at the end of the case provide sources of additional price and pricing policy-related information, for students wishing additional information and/or insight.
3. In the epilogue, students not only learn the price Ms. Jones recommended to her Finance Director and the process she used to develop that recommendation; students also see firsthand the very substantial positive impact on corporate revenues generated by the price which Ms. Jones recommended and the Finance Director approved.

PRESENTATION/DISCUSSION-RELATED ISSUES

The approach the author recommends varies depending on whether the students are in undergraduate or graduate/executive development programs. For graduate/executive development students, the author might ask them to identify information from the case which they believe is critical and then move directly to a discussion of what solution they would recommend. With undergraduates, however, it seems useful to provide substantially more structure to the discussion. For that reason, when teaching the case with undergraduates, the author recommends the following sequence of steps and questions:

A. Solicit from students the details of the case, especially the cost information developed by Ms. Jones. Because this is a one-page mini-case, there is not a lot of additional information available.

B. Ask an individual student or the class as a whole to address a very specific set of questions. The seven questions, together with brief elaborations regarding exactly what information each question is meant to elicit, are as listed below:

1. What is the main problem? While both cases and real-life dilemmas commonly involve multiple issues, it is usually possible to identify one problem or issue which is most important or critical. Here in step #1, the author's objective is that students will identify that one most critical issue or problem.

2. What kind of problem is this? Having identified the most critical problem or issue, here in step #2 the author's objective is that students will categorize the problem or issue into one of the kinds of problems or opportunities which professionals in the field (either

academicians or practitioners) have identified. Within the field of marketing, for example, a few of the kinds of problems and opportunities identified by marketing professionals include market segmentation, targeting, and positioning (STP), new product development, pricing, channels of distribution, logistics, advertising, direct marketing, sales promotion, personal selling, and so on.

3. For this kind of problem, what are the key variables and what expert says so? Knowing the kind of problem or opportunity one faces, one can usually find an expert (again, either an academician or a practitioner) who can recommend what variables are key to understanding and resolving this type of problem. So, the point at this stage of the analysis is to identify both the variables which are key for the particular kind of problem or opportunity faced by the decision maker in the case, and the expert (again, either a researcher or an academician) who says so.

4. What data from the case relate to the variables or steps which the expert believes are key to this kind of problem? Having identified key variables, it is time to go back and see what information available in the case study (or decision situation, if it is a real-world problem or opportunity) relating to the key variables identified in step #3 above.

5. What alternative solutions/recommendations should be considered? At this stage, it is useful to identify at least two alternative solutions to the problem or opportunity. The reason for doing so: Research suggests that decision-makers choosing between alternatives make better decisions than decision makers who identify only one possible solution and then choose that option.

6. What alternative recommendation should the hero(ine) chose, and why? Here at step #6, the task is to choose one of the alternatives from step #5 (above) and then explain why this alternative is the best solution to the problem faced by the decision maker.

7. What negatives are associated with the chosen solution/recommendation but why is the chosen solution still a good one? Even good solutions have drawbacks. Often, a good solution is expensive, in terms or time or money or both. Alternatively, the decision-maker may lack data on variables which the expert believes are key. In either case, the objective at this final stage of the 7 step case solution process is to examine the implications and/or assumptions underlying the chosen solution, and to make sure that these assumptions are reasonable and/or the implications are acceptable.

Having provided a process which students can use to structure their thinking about cases in general, we turn now to asking, one by one, the seven questions in that process, and to providing answers for each as they relate to the RCL case. We start with question #1:

1. What is the main problem? In this mini-case, it seems likely that students will conclude that the main problem Ms. Jones faces is that she must recommend to her Finance Director the price which RCL will charge IOC representatives wishing to attend the upcoming training seminar. The author reinforces the idea that this definition of the main problem seems very reasonable.

2. What kind of problem is this? Instructors should not be surprised if there are many answers to this question. In the end, however, it will not be

surprising if students agree that the kind of problem Ms. Jones faces has to do with pricing. Again, the author reinforces the idea that this is a very reasonable answer.

3. For this kind of problem, what are the key variables and what expert says so? As readers know, for almost any decision problem, the key variables (that is, the elements of the model for a particular problem) will vary somewhat, depending on the expert. Thus it is no surprise that both the number of steps in the pricing process and the recommended action at each step will depend on which expert (Kotler, Nagle, etc.) one consults. In the area of pricing, the author likes very much the model proposed by Morris and Morris (1992); these experts indicate that "the program of action which should guide pricing has four key components: Objectives, strategy, structure, and levels (tactics)." Brief elaborations on each of these components are as indicated below:

   a. Objectives: Morris and Morris (1992) indicate that pricing objectives can be focus on a number of different dimensions; some of those dimensions include long or short run profitability, desired level of market share, desired impact on relations with competitors and/or customers, and so on.
   b. Strategy: Morris and Morris (op. cit.) indicate that " pricing strategies generally fall into one of two groups: cost-based and market-based. . . Of these two groups, cost-based approaches are much more prevalent in business than are market-based approaches. This tendency is one of the great ironies of business, and reflects a general level of naiveté among managers."
   c. Structure: Morris and Morris (op. cit.) indicate that "The pricing structure is concerned with which aspects of each product or service will be priced, how prices will vary for different customers and products and services, and the time and conditions of payment. . . The simplest structure involves charging one standard price, with no discounts or variations, for a product or service."
   d. Levels (tactics): Morris and Morris (op. cit.) indicate that "The day to day management of prices focuses. . . on setting specific price levels and employing periodic tactical pricing moves."

4. What data from the case relate to the variables or steps which the expert believes are key to this kind of problem? Assuming the student presenter does perceive this situation to be a "pricing" problem, they should now highlight data from the case relating to the key variables identified by their expert. As indicated above, the author is using as his experts Morris and Morris (op. cit.); the data from the case relating to the four components of

a pricing program identified by Morris and Morris (op. cit.) are as indicated below:

a. Objectives: The case indicates that the Finance Director believes that RCL's pricing objective should be to maximize the revenue generated from IOC representatives wishing to attend the upcoming training seminar.
b. Strategy: The case indicates identifies the following incremental costs which RCL will incur, for each IOC representative attending the training session; the clear implication is that Ms. Jones expects to use a cost-based approach to developing the price which she will recommend to the Finance Director:
    i. Cost of printed materials which will be supplied to each representative will be approximately $100.
    ii. "Per person, per day" cost which the hotel staging the training session will charge, each day, for each attendee, is $75; this amount covers the use of the room where the training seminar is being held plus things like morning coffee, tea, and pastries; a meal at lunchtime; and coffee, tea, and soft drinks during the afternoon coffee break.
    iii. The cost of the "successful completion of seminar" certificates which will be presented to each participant at the end of the seminar is $25 for each certificate.
    iv. The cost (for the entire 5 days of the seminar, including tips) of the van which will be used to transport participants from their hotels to and from the seminar venue is approximately $2000.
c. Structure: The case provides no information about the structure of prices for various customers. The clear implication is that the simplest structure (the same price, for each and every IOC) is the structure which is most likely to be used.
d. Level (tactics): Because this training seminar is expected to be a one time" event, day-to-day management of the price does not seem relevant to this situation.

5. What alternative recommendations can Ms. Jones identify? As she reviewed her Data, Ms. Jones found herself considering the following three alternatives:

A. A "per representative" price which just covers the incremental costs which RCL will incur; this price would total up to approximately $600 per person ($100 for printed materials, $75 x 5 for the daily hotel charge, $25 for the certificate, and $2000/20 persons for transportation).

B. A "per representative" price which doubles the incremental costs which RCL will incur; this price would total up to approximately $1200, and would ensure that RCL would not only cover its incremental costs but would generate additional revenue as well.
C. Because she does not have much prior experience in pricing, Ms. Jones found herself believing that it might be useful to solicit advice on this situation from a good friend who has been (for many years) a professor of marketing.

6. Which alternative recommendation should Ms. Jones chose, and why? This is where students need to indicate which solution/recommendation they would choose, and why. Because she was concerned that her lack of experience might lead her to make a bad decision, Ms. Jones decided to choose alternative #3, that is, she decided that before making any recommendation, she would try to talk at least briefly with her old friend the marketing professor. To see the recommendation Ms. Jones finally made to the Finance Director and the reasons for that recommendation, please see the section of this case study labeled "Epilogue."

7. What negatives are associated with the chosen solution/recommendation? In case studies and in the real world, there are downsides and/or negative consequences associated with nearly every possible solution and/or recommendation. In this situation, the case indicates that the Finance Director is hoping to receive Ms. Jones' pricing recommendation later today. In other words, the time Ms. Jones has available to her (for the purpose of talking with her friend the marketing professor) is very short.

EPILOGUE

Ms. Jones was able to contact her old friend the marketing professor. In response to Ms. Jones' question about pricing the training seminar to IOC representatives, the marketing professor suggested that Ms. Jones use a market-oriented (rather than a cost-based) approach; specifically, the marketing professor recommended that Ms. Jones look on the internet to see what oil companies tend to pay for seminars to which they send their staff. When Ms. Jones looked, she discovered that seminars attended by oil company personnel tended to be priced at approximately $500 per day. Based on that information, and based on the fact that RCL's upcoming seminar was 5 days long, Ms. Jones recommendation to the Finance Director was that RCL's price to IOC representatives wishing to attend the training seminar should be $2500 per person. The Finance Director approved her recommendation; ultimately, approximately 17 IOC representatives attended the training session and the amount of revenue generated for RCL exceeded $40,000.

It seems very clear that no reasonable cost-based approach to pricing would have generated more than $20,000. It also seems worth noting that the Morris and Morris (op. cit.)

model suggests that there are additional dimensions which Ms. Jones could (if she had been given more time) have considered. For example, regarding structure (that is, key component #3), it seems clear that instead of using a "one price for all" approach, Ms. Jones could have recommended an approach in which any IOC sending more than two or three people would qualify for a discounted price. This might have been a way to further increase both attendance and revenues. In any case, the bottom line here is that by using a systematic approach, and by moving from a cost-based to a market-oriented approach to pricing, Ms. Jones was able to increase very substantially the revenues which the training session generated for her company.

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DIXIE ELECTRONICS AND INDIA: A MATCH MADE IN HEAVEN?

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CASE DESCRIPTION

The primary subject matter of this case is analyzing international markets as possible export or manufacturing locations. This case focuses on a company investigating India as a possible expansion location. The medium sized Alabama Company should consider conducting a market assessment and analysis of India as a potential location to manufacture and export. Secondary issues include environmental scanning, to include cultural, political, legal, financial, and economic issues. The BRICS nations of Brazil, Russia, India, China and South Africa are often considered as great locations by multinational firms although there are substantive issues to consider. The difficulty level is four and five and is suitable for a senior or graduate level international business course. It can be taught in a 90 minute class with two hours of student preparation outside of class. This case could be used with an international trade and foreign investment chapter in International Business, an export chapter in International Management, or an international culture chapter in International Marketing.

CASE SYNOPSIS

Companies are stepping up their efforts to be present in foreign markets. This case centers upon the decision whether to engage in international business. The company must decide if increasing exports and/or manufacturing overseas would be a part of their strategy. If so, they must choose the location and the form of the venture. The vice president of marketing has suggested that Dixie's future success lies in India. However, the company is small and located in a small southern town. The owners and management team are reluctant to enter such an uncertain environment. What they have heard about India is heavy government regulations, oppressive taxation, rampant corruption, deadly terrorism, and massive, unchecked population growth. However, one of the managers mentioned that India's government, in its pursuit to match or surpass China's meteoric rise as a world economic powerhouse, has reinvented itself. None of them have any international experience and, quite frankly, they do not know where to start.

INSTRUCTOR'S NOTES

RECOMMENDATIONS FOR TEACHING APPROACHES

This case helps students appreciate the challenges and opportunities in deciding to enter the international market place. The opportunity to investigate one of the more important nations that comprise BRICS (Brazil, Russia, India, China, and South Africa) countries will be beneficial as they look at the international arena. Allow the students to read the case and then assign the questions. They can use the Internet to find all the answers which are provided below. Students are adept at finding information on the Internet and enjoy the success that this case brings.

We suggest they first investigate the general concept of conducting an international assessment and analysis. Then they should look carefully at India and consider if the necessary factors for success are present in India. The students should answer the following questions:

QUESTIONS

1. What are the advantages of investing in India?

The choice of investing in India for many MNCs is influenced by the comparative advantages that India holds as well as the symbiotic effect it has on the investing MNCs. It makes excellent business sense, since India has the combination of solid economic growth and unlimited strength of human resources. TaNate in concert, these two represent short and long-term growth and profit opportunities that few multinational corporations and investors can find in other markets. India offers dual opportunities, on one hand serving the demands of an increasing Indian market and on the other, using the country as a source of talent, services and products for global clients make it irresistible to many. India's growth has largely been unaffected by the global economic recession in the last three years except for a six month slump starting in 2008 largely because of strong domestic consumption. Industrial production has been rising steadily with most economic forecasters expecting its gross domestic product to continue to grow by over 8 percent.

2. What are the negatives of investing in India?

Corruption is significant in business and government. Terrorism is a factor to consider. Poverty is severe. Regulations continue to restrict the movement of multi-national corporations in India. The tax system is problematic for a foreign company.

3. How important is corruption to conducting business in India?

Corruption influences license approvals, contract awards, and terms of contractual obligations. A 2005 study done by Transparency International (TI) in India found that 55% of the people had firsthand experience of paying bribe or peddling influence to get a job done in a public office. TI estimated that truckers driving across state borders paid over $1 trillion in bribes. Check Transparency International at www.transparencyinternational.com.

4. How significant is terrorism in India and what forms does it take?

Terrorism is a concern to international employees as they have seen and read reports about the Mumbai and New Delhi bombings and Islamic terrorism which is mostly funded from overseas. The three major terrorist trouble areas are home grown insurgents: Communist Terrorism (Maoist version), Islamic Terrorism and the Kashmir Problem. Again, almost all of Islamic terrorism is funded by overseas groups and groups based in Pakistan in particular. More needs to be done by the government in India to prevent terrorist attacks by using effective crisis management and preventive diplomacy, since most of the terrorism against India is instigated from overseas. Terrorism can interfere with MNCs operation for many days.

5. What are the population, poverty levels, and other demographics of India?

India shows an area of 3, 287,263 sq km, a population of 1.19billion and continuing to grow rapidly at a rate of 1.34%.The official national language is Hindi, spoken by 41% of the population, but there are 13 other major languages and a number of smaller languages spoken by 5% of the population. The gross domestic product (GDP) real growth rate is 10.4% (2010) and GDP/capita is $3703 PPP, making it a lower-middle income economy (IMF, 129th in the world.) The economy of India is the ninth largest in the world by nominal GDP and the third largest by purchasing power parity (PPP). The country is one of the G-20 major economies. The rupee is trading at Rs 49.67 to one US Dollar, which is higher than its all-time low of Rs 52.70 as this paper is written.

6. What are some of the trade groups to which India currently belongs?

Greater trade liberalization is happening due to various bilateral and regional trading agreements signed by India. These agreements offer preferential tariff rates and economic cooperation (Trade Agreements, 2011). These regional free trade agreements have the potential of opening up additional markets for a multinational firm setting up shop in India. India views Regional Trading Arrangements as 'building blocks' towards the overall objective of trade liberalization. Hence, it is participating in a number of RTA's which include Free Trade Agreements; Preferential Trade Agreements; and Comprehensive Economic Cooperation Agreements. These agreements are entered into either bilaterally or in a regional grouping. Some of the major one's are: Agreement on South Asia Free Trade Area, Asia-Pacific Trade Agreement, Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation, Bangladesh India Myanmar Sri Lanka and Thailand Technical and Economic Cooperation, India And Singapore Comprehensive Economic Cooperation Agreement, India-Sri Lanka Free Trade Agreement, India-Chile Preferential Trade Agreement, India-Afghanistan Preferential Trade Agreement, India-Bhutan Trade Agreement, India-Nepal Trade Treaty and India-Japan Trade Agreement (*Trade Agreements, Business Knowledge Resources Online, Govt. of India).*

7. How should a company proceed in India?

A corporation's main goal is to maximize share holders revenues while minimizing costs. Therefore, when a business in opened in India, apart from the large domestic market in India, there is also the dual benefit of sourcing from the India operations either labor or products or new designs that will give the multinational company an edge, increase the shareholders revenue and hence make the multinational more competitive in the global market. One alternative may be to explore, in the short term, a joint venture with an Indian firm to get a foot hold in the market and in the medium term set up independent operation. Alternatively, buying out an Indian operation will kick start the multinational corporation's foray in India.

8. What are the different options for setting up a MNC?

Liaison Office Option: RBI permits establishment of a liaison office for representing the MNC in India which can undertake the following activities: Represent the parent company / group companies; Promote export / import from / to India; Promote technical/financial collaborations between parent/group companies and companies in India; and Act as a communication channel between the parent company and Indian companies. Foreign banks can establish Liaison Offices in India only after obtaining approval from the Department of Banking Operations and Development (DBOD).

Branch Office Option: Specific approval from RBI paves the way for establishment of branch office by a MNC. It can undertake export/import of goods, professional services, R&D work, technical collaboration, be the buying/selling agent in India, provide IT services, providing technical support and undertaking business for foreign airlines and shipping companies. RBI also gives general permission for establishing branch/unit in Special Economic Zones (SEZs) to undertake manufacturing and service activities subject to a few restrictions.

Wholly Owned Indian Subsidiary (WOS) Option: Foreign companies can also to set up wholly-owned subsidiary in sectors where 100% foreign direct investment is permitted under the FDI policy.

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MYSTERIOUS BROKEN CROSS-COUNTRY M&A DEAL: BHARTI AIRTEL - MTN

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CASE DESCRIPTION

This management case is designed to explicit the implied connection between business environment, competitive & industry forces, business strategy and negotiations. In a nutshell, it imparts the domain knowledge of inorganic strategies, like joint ventures, mergers and acquisitions (M&A), in order to keep their global presence and brand loyalty in the emerging markets. Lastly, Bharti Airtel – MTN cross-country M&A case helps students to get involve in international investment decisions in the perspective of international business environment. They also come to know various sensitive issues while finalizing the deal between two unknown parties, further how deal got complicated consequently caused the deal failure in the two negotiations during two successive years.

- *Domain knowledge: Business Policy and Strategy*
- *Elective of the case: Inorganic Opportunities*
- *Focus part: Cross-border Mergers & Acquisitions*
- *For whom: BBA; MBA (Full-time and Executive); MDP's*
- *Estimated time for discussion: 120 minutes*
- *Method of lecture: Brainstorming; Group/Team participation*

CASE SYNOPSIS

To meet the international business commitments and prepare students to craft combat strategies for achieving translational entity's objectives, the present case aims to illustrate the effect of global business environmental factors while negotiating cross-country M&A deals. It has been assisted by India – South Africa, a cross-border telecom deal. Further, it discusses key issues which have led to delay' consequently broken the inorganic negotiations that lead to strategic competitive and geographical advantage. In particular, this case builds a platform for *management scholars to improve communication tactics whilst engaging in international business relationships. Conversely, it would be addressing sensitive issues in chronological order that how long-term negotiations would lead to collapse the cross-border relations. Exclusively, broken M&A deals help to find key failure negotiations which could be assist for choosing inorganic opportunities in future.*

We now know that the "World is flat" and "Knowledge is borderless". As such, economic changes are bound to be rapid. Complexity and disparity are possible major factors worrying world leaders and global institutions. Indian economy, today a competitive, deregulated and open economic system, is one of the major destinations for foreign investors in the world. India encourages foreign affiliates to establish operations in the country through direct investment, joint ventures, M&A and outsourcing contracts.

The objective of present case is to describe and track critical factors behind the failure of mega cross-border deal between Bharti Airtel (India) and MTN Group (South Africa) in the global telecom industry. The case covers failure of advisors role-play and how negotiations were extended and leads to calling-off deal in the second innings - 2009 after it was first attempt in 2008. It also covers the role of government and regulatory bodies of the respective countries. The alliance would have improved Bharti's competitive position as a leading telecom company in the emerging markets. Bharti and MTN needed an excessive inward focus for a feasible merger, when competitors were trying to snatch their business.

The history of mega mergers and acquisitions attest that most combinations end up by destroying shareholders value. Mergers fail largely because of expected synergies seize longer time to deliver, price is too high, or there is no complete in-charge. Bharti and MTN could have US$20 billion in revenues and over 200 million customers, making them the third biggest telecom company in the world after China Mobile and Vodafone. They would have spanned two continentals & able to cut costs by integrating technology and reducing overheads. After twofold negotiation talks in the two consecutive years, the deal has been broken and windup with some precautionary signals while choosing cross-border M&A by Indian entrepreneurs and other community world.

INSTRUCTORS' NOTES

CASE LEARNING OBJECTIVES

The case can be discussed in two courses, Strategic Management (SM) and International Business Environment (IBE). Therefore, learning objectives vary with selective courses, in addition to this integrative learning objectives also presented.

STRATEGIC MANAGEMENT

a. Mapping strategic growth opportunities, via organic and in-organic choices in the touched dry market.
b. To know cross-country mergers, acquisitions, takeovers, alliances and their critics in the corporate world.

c. Analyze broken stories to find erroneous steps and overcome those in future odds.
d. Describe the role of strategic leadership and action scheme behind failure to success.

INTERNATIONAL BUSINESS ENVIRONMENT

a. Impact of economic, geographic and political issues while entering international business transactions.
b. Analyze critical and sensitive issues in respect of financial market regulatory and legal provisions while finalizing M&A deals.
c. Examine the global environmental factors on cross-border deal negotiations.

INTEGRATIVE LEARNING OBJECTIVES

- Understand organizational restructuring like, board management, responsibility and corporate control.
- Identification of most critical success and failure factors (CSFFs) in achieving M&A.
- Role of business ethics, diplomacy and corporate governance issues in globalized business environment.
- Overview of telecom industry and M&A in domestic and global scenario.

TEACHING PEDAGOGY

This case shall be used for fulltime, part time and executive management programs in the post graduation. For fulltime MBA audiences, the emphasis should be on an integrative plan and providing simple numerical analysis, so that they can focus on analyzing critical factors that cause failure of the deal. Mainly this case fits for the students, who joined in application part rather than early stage, i.e. shall discuss among second year groups.

The faculty should explain theoretical concepts and varieties of focus areas in the respective section to meet the learning objectives of the case. Afterward, he/she can give case study as an assignment or discuss with in a minimum gap of 3-4 hours by preparing case analysis on Chart or PPT. The faculty shall insist them to handover the rough work, particularly sharing of work among the group, member responsibility and their contribution to the case analysis. The faculty does not need to teach case points, where he instruct student groups, further he may ask case analysis report in both print and soft copy. In the assessment process or marks valuation, student will get various grades that depend on the relevancy and logical explanation of case. Subsequently, he may mark the students who underperform and make them to write comments on each student group conclusions.

The simplest way of teaching management/business case is to avoid unwanted theory, notes and over discussions. So, it is suggested to accommodate the case while preparing teaching or session plan for the next semester. Figure TN-1 presents flowchart to guide some valuable points for case discussion and participation by the instructors, though these are not limited to anyone. For fresh/new faculty, we suggest them to kindly go through TN-1 for introductory and theoretical aspects in strategic management. However, it is essential to cover basic concepts in international business environment before handling case assignment and discussion. Instructors may cover topics like various environmental factors affecting business transactions in day to day life, environmental scanning, SWOT analysis and other theoretical aspects include corporate restructuring, mergers and acquisitions.

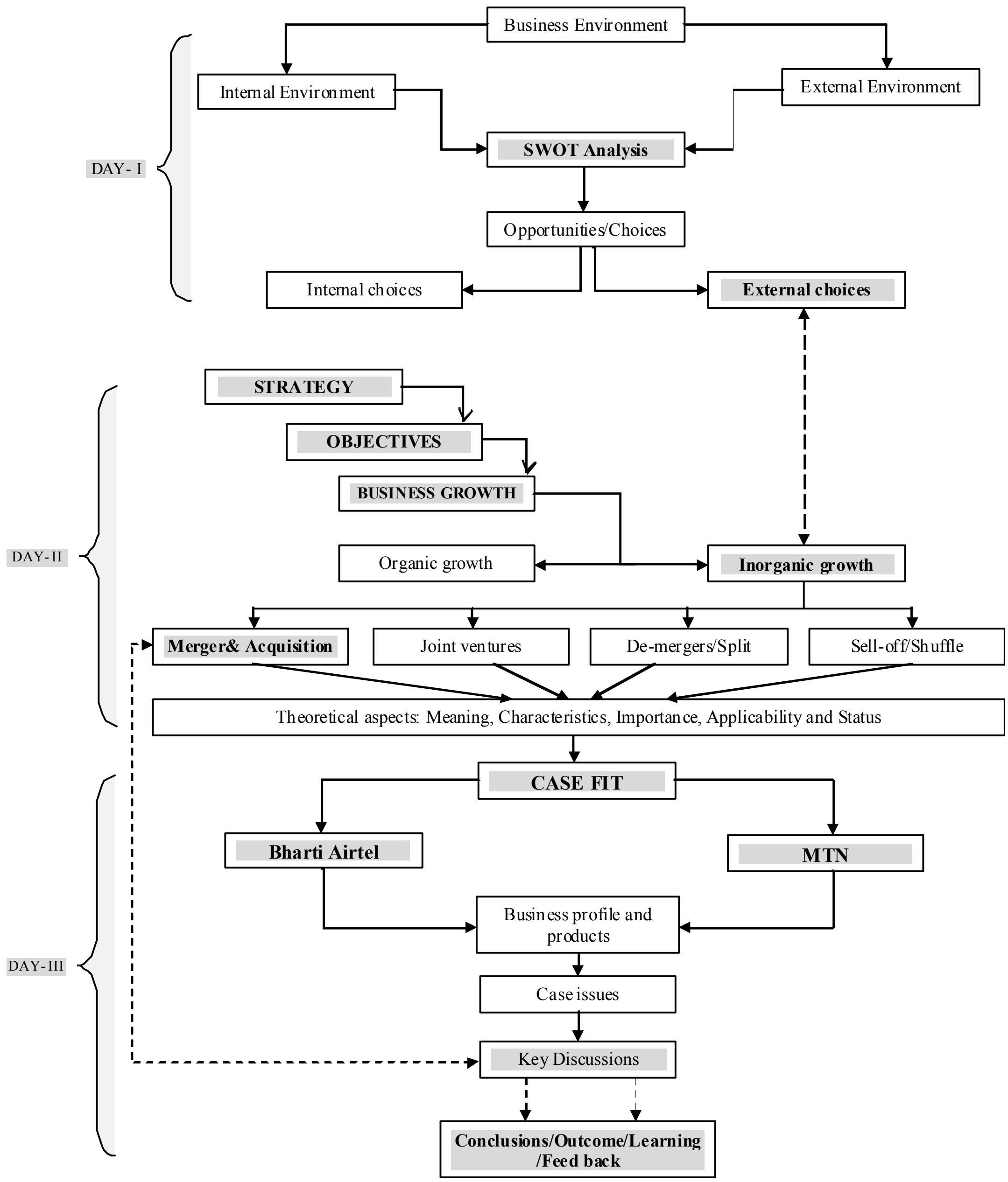

Figure TN-1: Teaching Plan

SUGGESTED PATTERN – SM & IBE

We can start the session by asking a narrow question from the heart of case, which must be focus on the central theme of existing study. For ex: Is it possible to achieve synergy "1+1=3" through merger or acquisition (or) Are failure business stories give any message to the next generation? The reason behind throwing an open question is to prepare students more attentive, interest and action. Before step into case discussion, faculty should pick one or two cornered students and ask them 'what is your personal comment on the given case'. Because the students shall think to find *What, Why, Where, When* and *How* from the exercise. If they could have found these questions, 50 percent of case analysis has done. The lecture hall and its ambience also impact on the student's participation. Finally, faculty shall make them to enter the pitch and throw the following questions.

1. Prepare PEST analysis/Environmental scanning from the given case and analyze the factors which were affected deal negotiations?

The question is designed in a broad perspective to understand, identify, analyze and their impact on M&A, exclusively cross-border deals. A student can understand, that how negotiations success and failure in the global business scenario. They will also know the variety of parties involved in making deals worth full. On the other hand, this question gives an opportunity and show narrow gaze for broad thinking in case analysis.

<u>For example</u>: Figure TN-2 presents environmental analysis to help new faculty while handling core part of this case. Prior to discuss about environmental analysis, faculty shall teach an introductory class on related aspects covering in the given case study.

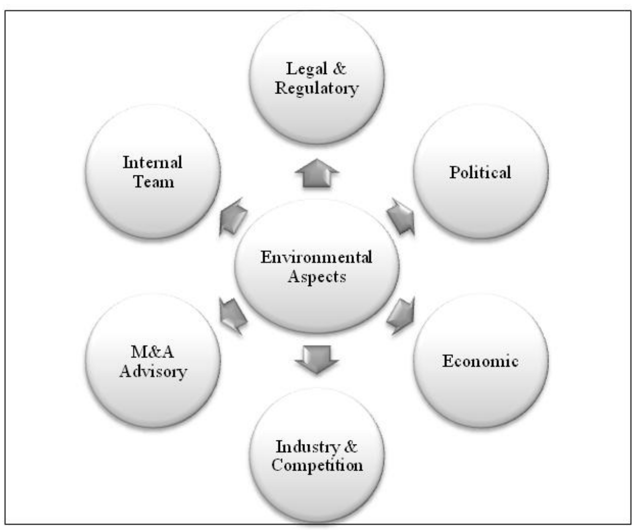

Figure TN-2: Environmental analysis

2. What Bharti-MTN could have done together to create world's third largest telecom service provider? Did Bharti acquire Zain Telecom as a reputation issue - Comment?

This creates a breaking point 'why' and 'what for' in the given case. The concerned lecturer must discuss growth opportunities of a firm in the multinational context. Because the answer for this query mainly depends on the theoretical map and it will assist to identify most attractive motive factors in Bharti - MTN deal. Accordingly, they would be coming to know the differences among merger, acquisition, takeover, diversification and cross-border deals, etc. The students shall list out various motive factors behind the two business houses and their impact on reputation. We suggest faculty go through case analysis and key discussion of case study that the reason behind going for cross-border horizontal merger is to absorb new opportunities in the emerging economies, African and Asian continentals.

3. Analyze the factors which have caused the mysterious failure of M&A story and identify the askew conversation in the given case – if, the deal structure could have complex, what M&A advisors would have done to boil the negotiation.

This is an integrated inquiry on the role play of M&A advisors between Bharti-MTN and to investigate the factors which were caused to break the deal. The students get inputs from this query that how negotiations failure, what factors to be considered in M&A deal structure and advisory role play while finishing the deal. This query can be discussed through group or team participation, moreover should be a live talk between two team members partaking.

ADDITIONAL QUESTIONS:

- *Do you think government intervention of two countries could be the root cause in the failure of Indo-South Africa cross-border deal?*
- *Undue delay in Negotiations leads to breakdown Corporate Marriages – comment*
- *Let's assume, both Bharti and MTN would have started Third Innings for possible cross-border merger between India and South Africa. If you are a partner in any advisory services, what is your strategy to achieve this synergetic deal?*

CASE ANALYSIS

Since 65 years of independence, Indian Govt. is maddening to accommodate the huge population & employment, on the other hand intriguing initiative to rewrite legal system for corporate business at domestic as well as international context. A new economic policy introduced in July, 1991 conversely globalization intends to unify the Indian economy with other economies. Further, M&A is a new chapter in Indian laws and there is no value added framework or guidelines to take any strategic decision on amalgamation, M&A or takeover. Though, there were two historic Indian cross-country M&A deals proved their success path, Corus Steels, UK acquired by Tata for US$12.9 billion and Vodafone, UK acquired Indian subsidiary Hutchison, China for US$11.1 billion in Jan and Feb, 2007 respectively.

In 2008, Bharti has shown keen interest on MTN to enter the African and Middle East markets. After few months, MTN could not make any successful negotiations or part contract with either Bharti or Reliance. In 2009, Bharti restarted merger talks with MTN for US$23 billion to create universal & integrated telecom company and to be placed at third largest telecom entity in the cosmos. The second time discussions with MTN, South African Govt. and Indian Govt. gave hope to Mittal to bring his dream true. But, mega deal called-off again, due to stumbling blocks and misunderstanding deal negotiations, like protective interest, dual listing, capital sharing and swap ratio, etc. Businesses like Bharti and MTN would have been depressed by the broken time being actions. Though, in March, 2010 Sunil Mittal entered African and Middle East markets by acquiring Kuwait based Zain telecom and trudged his company's position to fifth place in the world telecom market (subscriber base). This shows the spirit of leader and leadership strategy, which is a combination of burning desire, value added plan and right action.

Merger is like a marriage. Therefore, merger depends on mutual sharing among the parties involved in the deal, because businesses are born in the society, exploit for the society and initiate by the people. It means that how you act' business also act as concrete. Any social marriage or business deal or negotiation or communication can be pulled-off by petite slip-ups. Hence, M&A success is not only depends on interested parties, but it shall also correlate with the steps and actions suggest by legal and financial advisors, consequently their role is vital to make business deals triumph.

Chronological order of events occurred in the mysterious Bharti-MTN broken deal	
FIRST INNINGS	
May 6, 2008	First time deal proposal for a merger
May 25, 2008	Decided to call off talks
May 27, 2008	Negotiations with Reliance Communications
July 19, 2008	Reliance and MTN discussions have also broken
SECOND INNINGS	
May 26, 2009	MTN and Bharti Airtel were reengaged in merger talks
July 31, 2009	First deadline
July 6, 2009	SEBI informally advised Bharti that MTN would be required to make an open offer
July 30, 2009	Corporate Affairs Minister addressed the Loksabha that the deal has not yet been finalized
August 31, 2009	Extended the talks for a possible merger
Aug 28, 2009	Securities Appellate Tribunal (SAT) dismissed a Bharti Airtel shareholders appeal against the informal guidance of SEBI
Sept 30, 2009	Extended the talks for a possible merger
second week September, 2009	Govt. said that dual listing is not allowed in India
Sept 24, 2009	A special team came from South Africa and met Indian authorities to seek clarity on dual listing
Sept 29, 2009	Finance Secretary said that the government has so far not received any formal application regarding merger
Sept 30, 2009	Merger talks called off again
Oct 1, 2009	Bharti Airtel shares surged in reaction to the collapse of company's deal with MTN, thus share price rose by 11.5% Finance Minister commented that "Bharti-MTN Deal is a part of Game".

CASE KEY DISCUSSION

The broken cross-country Bharti-MTN deal shall become evidence for budding entrepreneurs and rising industries, who would be interested to partake in M&A, joint ventures, takeovers and strategic alliances. Moreover, the deal become complex due to non-availability of ready reckon of regulatory provisions on takeover code, open offer issues and dual listing. Since, India and South Africa are developing nations in the emerging markets, which were initiated after the globalization wave. If, Bharti and MTN could have report the Govt. of India with a detailed regulatory provisions and requirement of amendments in the existing security laws, which would have groomed the shape of Bharti and MTN in the world telecom market. If this matter could have suggested before reengagement, accordingly Indian government might have considered dual listing or would have done favor on the mega Indo-Africa deal.

CASE FEEDBACK

In addition to this, the faculty who teach this course at post graduation level, he/she thoroughly prepare and underline some key points. These points will be discussed in the case analysis as a concrete story. After case presentation, the students fill their feedback on case learning using five point Likert's scale. This helps the faculty member in selection of case studies and progress in teaching strategy that leads to career advancement.

Case Feedback Form

S. no	Factor	Likert's scale				
		Very poor	Poor	Average	Good	Excellent
1	Case title					
2	Relevancy of the subject					
3	Case learning					
4	Case inputs to students					
5	Strategic perspective					
6	Corporate finance					
7	Advanced marketing					
8	Overall opinion on the case					

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AFRO-CARIBBEAN CRAFT PRODUCTS: A CASE IN BUDGETING AND FINANCIAL ANALYSIS[1]

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CASE DESCRIPTION

The primary subject matter of this case concerns Managerial Accounting. Specific issues examined include classifying costs based on changes in the level of productive activity, estimating cost functions, preparing budgeted financial statements, and computing and interpreting selected financial ratios. The case has a difficulty level of three. The case is designed to be taught in two class hours and is expected to require about six hours of outside preparation by students.

CASE SYNOPSIS

Afro-Caribbean Craft Products, a sole proprietorship, which operated on an itinerant basis from the owner's home, was recently offered an attractive opportunity to lease space at an International Airport to establish a retail outlet. The proprietor (Ms. Earla John) estimated that she would need a $40,000[2] loan to finance the capital and operating costs associated with the proposed retail outlet. Ms. John approached your accounting firm for help with the preparation of a set of projected financial statements requested by a potential financier. She provided a set of historical financial statements for the two most recent years and information about her expectations for the business in the coming year. Students are required to estimate the behavior of all cost items in the income statement and prepare a set of projected financial statements. They are also required to prepare a financial analysis using key ratios and to make a recommendation to the potential financier. This case helps to fill a gap in the pedagogical literature by focusing on the application of basic budgeting principles in a small scale, sole proprietorship setting. The three colleagues that have evaluated the case material all indicated that the specified objectives were effectively targeted in the case material. This case has been used in three sections of the Managerial Accounting course offered in the B.Sc. Accounting program at a medium-sized university in the Midwestern USA. Students were generally able to properly classify most of the income statements items, compute the project income statement, and projected statement of cash flow amounts and to prepare the required financial statements. Most students provided a well-reasoned recommendation regarding whether the loan should be granted to Ms. John. Students generally indicated that the case material was clear and realistic.

INSTRUCTORS' NOTES

INTRODUCTION

This case was designed for use in the Managerial Accounting course of the Bachelor in Accounting program offered at a medium-sized university in the mid-west USA. To be admitted into the course, students must have completed the Financial Accounting course with a grade C (70 – 79 %) or better. The topics and the tools used by students to complete the case are very significant as they are used by organizations of all types and sizes to facilitate planning, control and performance evaluation.

EDUCATIONAL RATIONALE AND OBJECTIVES

The case had its genesis in the desire to diversify the range of instructional strategies used in the accounting program to better cater to the various learning styles of students and foster the development of their critical thinking skills. Currently, the primary instructional method used within the accounting program is the traditional lecture with highly structured problems and exercises. When attempts to locate suitable cases that integrated the desired aspects of the cost accounting syllabus proved futile, it was decided to develop an appropriate business case. This case helps to fill a gap in the pedagogical literature by focusing on the application of basic budgeting principles in a small scale, sole proprietorship setting. This setting was chosen because students are very likely to encounter such entities in their professional lives.

The objectives of the case are to provide students with the opportunity to enhance their ability to (1) classify costs based changes in the volume of productive activity, (2) estimate cost functions using the high – low method, (3) prepare projected income statements, balance sheets and statements of cash flows, and (4) compute and interpret selected financial ratios.

The case contains (1) historical financial statements – income statements, balance sheets, and statements of cash flows – for the two most recently completed years, (2) historical information about the structure of costs and revenues of the firm, and (3) a series of assumptions about business activities, costs and revenues for the planning period. Some of the more important data found within the body of the case are summarized below:

a. The average markup on all items sold is 200% of cost
b. Commissions of 30% is paid to sales representatives based on cash collections from completed sales
c. Wireless internet cost is a flat fee each period and the service is used in the ratio 3:1 for personal and business purposes, respectively
d. In both 2009 and 2010 the owner was responsible for 38% of sales

Also, students should pay some attention to the reasonableness of the assumptions provided by the proprietor in the light of the historical information. For example, it may be useful to examine the reasonableness of the projected level of withdrawals by the owner given that the planned reductions are based on transactions with closely related parties.

SUGGESTIONS FOR UTILIZATION BY OTHER EDUCATORS

This case may be used in an undergraduate Managerial or Cost Accounting course after students have completed work on the cost classification, cost behavior and budgeting (profit planning) aspects of the syllabus. It may also be used in the Managerial Accounting course in an MBA program. This case may be assigned as an individual or group assignment.

At least three different strategies can be employed in using the case, depending on the teaching objectives, the experience of the students and the time available. The first strategy is to provide students with the case material and only a general requirement, such as "assist Ms. John with the completion of the projected financial statements for her business plan." The major difficulty with this strategy is that it provides very little structure to guide students and may result in low quality solutions, especially by less experienced students, and lead to inappropriate assessment of the students' competency in the focal areas.

A second approach is to provide students with all the case information and ask them to complete the specific requirements one through eight. One difficulty with this strategy is the high probability that errors committed in the earlier requirements, especially in classifying the various cost items, will adversely impact responses to later requirements. This is not a major obstacle as consideration can be given to the logical consistency of the responses to subsequent requirements.

The third approach involves providing students with the case material and the first two requirements only as an in-class assignment. Once the students have completed these requirements, the professor can then review the solution with the class, providing appropriate explanations for the treatments implemented and queries raised by students. This process typically takes 20 – 30 minutes. Next, the professor could assign requirements 3 through 8 as homework to be turned in during the following class meeting. This strategy overcomes the challenges posed by the more unstructured and static approaches outlined in strategies one and two above, respectively. With all three approaches students may be provided with check figures for key items such as cash, operating income and net cash flows from operating activities.

Whichever approach is used, each student is required to prepare two copies of a written report, one of which is handed in prior to the in-class discussion of the assignment and the other is retained by the student for reference during the class discussion. The class discussion would involve the professor guiding students through the requirements and providing clarification as necessary. This process typically takes 50 – 75 minutes.

ADJUSTMENT OF CASE DIFFICULTY

The case can be simplified by providing students with the suggested solution to requirements one and two or by reducing the number of requirements to focus on a narrower set of objectives. For example, if one desires to focus on the critical assessment, decision-making and written communication components of the case, the students can be provided with the suggested solution to requirements 1 to 6 and asked to complete requirements 7 and 8. Conversely, the case may be made more challenging by removing the specific requirements and asking students to provide a comprehensive evaluation of the firm's loan application with appropriate workings, support documents, and indicating any financial or operating conditions that could be stipulated if the loan was approved.

SPECIFIC QUESTIONS

1. Classify each item of expense in ACCP's Income Statement as either fixed, variable, or mixed with respect to the volume of sales based on the descriptions provided in the case and your general understanding of how each item behaves in a merchandising firm. Provide a brief rationale to support each classification.
2. Using the high-low method, with annual sales revenues as the denominator, estimate a linear cost function for each variable and mixed expense item in ACCP's income statement.
3. Prepare a projected Income Statement for ACCP's for the year ending December 31, 2011 broken down by quarters, assuming that (a) the loan was received and the airport retail outlet was opened, and (b) the loan was **not** received and the airport retail outlet was **not** opened.
4. Prepare a projected Balance Sheet as at December 31, 2011, assuming that (a) the loan was received and the airport retail outlet was opened, and (b) the loan was **not** received and the airport retail outlet was **not** opened. (Hint: The current portion of the NEDCO loan has to be recognized as a current liability in 2011).
5. Prepare a projected Cash Flow Statement for the year ending December 31, 2011 assuming that (a) the loan was received and the airport retail outlet was opened, and (b) the loan was **not** received and the airport retail outlet was **not** opened.
6. Compute the following ratios for the 2009, 2010, and 2011 fiscal years. In computing the 2011 ratios, first assume that (a) the loan was received and the airport retail outlet was opened, and then (b) the loan was not received and the airport retail outlet was not opened:
    a) Quick ratio
    b) Current cash debt coverage ratio
    c) Times interest earned ratio
    d) Return on average total assets ratio
7. Assuming the role of the NEDCO Officer, and based on your responses to requirements 3 through 6 above, would you recommend the approval of the loan? Why?
8. How would the above analysis and or your recommendation change if Ms. John is unable to achieve the targeted level of drawings and reverts to the levels experienced in 2009 and 2010 (i.e., $48,000).

DETAILS OF ASSESSMENT

The case has been administered as an individual take-home assignment following the coverage of the relevant material in class. This assignment has accounted for 5 to 10% of the overall course grade. Grades are determined based on the (1) technical accuracy with which the requirements are completed, (2) reasonableness of the assumptions made, and (3) logical consistency of the explanations provided by students. See the Rubric in Appendix E.

SUGGESTED SOLUTIONS TO SPECIFIC QUESTIONS

Question 1 – Classify each item of expense in ACCP's Income Statement as either fixed, variable, or mixed with respect to the volume of sales, and provide a brief rationale to support each classification. The suggested solution is presented in Table 1.

Table 1
COST CLASSIFICATION AND RATIONALE

Expense Items	**Classification Fixed cost (FC) Variable cost (VC) or Mixed cost (MC) (with respect to sales)**	**Rationale**
Cost of goods sold	VC	Sales represent 300% of cost of goods sold (i.e., 200% markup).
Selling - Sales commissions	VC	Stated as 30% of sales by (independent) sales representatives.
General & Administrative Internet services	FC	This is a flat monthly fee allocated to the business based on the proportion of service used for business purpose. The proportion of internet services used is likely to vary with sales.
Electricity	FC	This is likely to vary with the usage of electricity in the home rather than sales by ACCP (which may only use it for lighting). Also, it is allocated to the business based on the proportion of total floor space in Ms. John's home that is used by ACCP.
Transportation (Ms. John)	VC / MC	This relates to travelling costs incurred by Ms. John to visit current and potential customers. It is likely to affect / be affected by sales.
Telephone (cellular)	VC / MC	This relates to prepaid cell phone usage costs incurred by Ms. John to communicate with current and potential customers, suppliers and business associates. It is likely to affect sales and is unlikely to be totally fixed.
Rent	FC	This is a flat monthly cost which is allocated to the business based on the proportion of total floor space in Ms. John's home that is used by ACCP. It is unlikely to change as sales changes.
Stationery & supplies	VC / MC	These miscellaneous selling and administrative costs are likely to vary with sales given their composition.
Bank charges	FC / MC	This is unlikely to vary directly with sales. It may change based on the type and volume of banking transactions conducted by ACCP. This assertion is supported by the fact that bank charges increased by 36% between 2009 and 2010 at the same time that sales increased by 52.5%. This suggests that the firm may be paying a per transaction fee that is related to the number of deposit or check written; neither of which are directly related to sales.
Depreciation **Expenses associated with proposed airport outlet**	FC	Declining balance depreciation is not related to sales. It is based on applying a constant depreciation rate to the net book value of depreciable assets.
Interest expense for 2011	FC	Varies with the loan balance at the start of each year not with sales / operating activity.
Wages	FC	Varies with time (hours worked, which is constant per year) not with sales.

Question 2 - Using the high-low method, with annual sales revenues as the denominator, estimate a linear cost function for each variable and mixed expense item in ACCP's income statement.

	2009	2010	Increase (Decrease)
Sales	82,172	125,284	43,112
Cost of goods sold (COGS)	(27,390)	(41,762)	14,372

Calculation of variable component of COGS
Unit COGS = Change in COGS / Change in Sales
$14,372 / $43,112 = .3333 of Sales
Calculation of total COGS for 2010
Total variable COGS in 2010 = 2010 sales X .3333
= $125,284 * .3333 = $41,762 which is the same as the total COGS. Therefore, there is no fixed element of COGS; it is a true variable cost and the cost function is:
Total COGS = .3333 X Sales

	2009	2010	Increase (Decrease)
Transportation (travelling)[1]	$3,568	$4,490	$922

Calculation of variable component of transportation cost
Unit transportation cost = Change in transportation cost / Change in Sales
$922 / $43,112 = .02139 of Sales
Calculation of total variable transportation cost for 2010
Total variable transportation cost in 2010 = 2010 sales ($125,284) X .02139 = $2,679.
Calculation of Fixed transportation cost
Fixed transportation cost = total transportation cost 2010 ($4,490) – total variable transportation cost 2010 ($2,679) = $1,811.
Therefore, the transportation cost function is:
Total transportation = $1,811 X .02139 X Sales

	2009	2010	Increase (Decrease)
Telephone[1]	$1,850	$2,690	$840

Calculation of variable component of telephone cost
Unit telephone cost = Change in telephone cost / Change in Sales
$840 / $43,112 = .01948 of Sales
Calculation of total variable telephone cost for 2010
Total variable telephone cost in 2010 = 2010 sales ($125,284) X .01948 = $2,441.
Calculation of Fixed telephone cost
Fixed telephone cost = total telephone cost 2010 ($2,690) – total variable telephone cost 2010 ($2,441) = $249.
Therefore, the telephone cost function is:
Total telephone cost = $249 X .01948 X Sales

	2009	2010	Increase (Decrease)
Stationery and supplies	$3,890	$4,192	$302

Calculation of variable component of stationery cost
Unit stationery cost = Change in stationery cost / Change in Sales
$302 / $43,112 = .00701 of Sales
Calculation of total variable stationery cost for 2010
Total variable stationery cost in 2010 = 2010 sales ($125,284) X .00701 = $878.
Calculation of Fixed stationery cost
Fixed stationery cost = total stationery cost 2010 ($4,192) – total variable stationery cost 2010 ($878) = $3,314.
Therefore, the stationery and supplies cost function is:
Total stationery cost = $3,314 X .00701 X Sales

	2009	2010	Increase (Decrease)
Bank charges	$1,286	$1,750	$464

Calculation of variable component of bank charges cost
Unit bank charges cost = Change in bank charges / Change in Sales
$464 / $43,112 = .01076 of Sales
Calculation of total variable bank charges cost for 2010
Total variable bank charges cost in 2010 = 2010 sales ($125,284) X .01076 = $1,348.

	Calculation of Fixed bank charges cost Fixed bank charges cost = total bank charges cost 2010 ($1,750) – total variable bank charges cost 2010 ($1,348) = $402. Therefore, the bank charges cost function is: **Total bank charges cost = $402 X .01076 X Sales**

Alternatively, the cost functions for transportation (travelling) cost and telephone cost may be estimated based on Ms. John's sales. This produces the following cost functions:

Transport expense = $1,811 + .0563 X Sales by Ms John
Telephone expense = $249 + .0513 X Sales by Ms John

Question 3 – Prepare a projected Income Statement for ACCP's third year of operation (2011) broken down by quarters, assuming that (a) Loan received and airport retail outlet opened, and (b) No loan and no airport outlet. The suggested solution is presented in Tables 2 and 3 below.

Table 2								
ACCP								
Projected Income Statement for 2011								
(Loan Received & Airport Outlet Opened)								
		Annually		**Quarterly**				
	Cost			**Q1**		**Q2**	**Q3**	**Q4**
				10%		**20%**	**35%**	**35%**
Sales	**Behavior**	TT $	TT $	TT $		TT $	TT $	TT $
Ms. John = ($125,284 * 38%) * 110%		52,369		13,092		13,092	13,092	13,092
Sales Representatives = ($125,284 * 62%) * 110%		85,444		21,361		21,361	21,361	21,361
Airport outlet		137,812		13,781		27,562	48,234	48,234
			275,625	48,234		62,016	82,687	82,687
Less: Cost of Goods Sold (33.33% of sales)	VC		(91,866)	(16,077)		(20,670)	(27,560)	(27,560)
Gross Profit			183,759	32,158		41,346	55,128	55,128
Operating Expenses								
Selling Expenses								
Sales commission (sales by representatives * 30%)	VC	25,633	(25,633)	(6,408)		(6,408)	(6,408)	(6,408)
General & Administrative Expenses								
Internet services (2010 expense * 1.05)	FC	1,386		(347)		(347)	(347)	(347)
Electricity (2010 expense * 1.05) + **$100 * 12 Months**	FC	1,870		(467)		(467)	(467)	(467)
Transportation (Travelling) = [($1,811 * 1.05) + .02139 * Sales]	Mixed	7,797		(1,507)	1	(1,802)	(2,244)	(2,244)
Telephone [($249 * 1.05) + .01948 * 2011 sales]	Mixed	5,631		(1,005)	2	(1,273)	(1,676)	(1,676)
Rent (2010 expense * 1.05) + **$900 * 12 Months**	FC	21,384		(5,346)		(5,346)	(5,346)	(5,346)

Stationery and supplies [($3,314 * 1.05) + .00701 * 2011 sales]	Mixed	5,412		(1,208)	3	(1,305)	(1,450)	(1,450)
Bank charges [($402 * 1.05) + .01076 * 2011 sales]	Mixed	3,388		(625)	4	(773)	(995)	(995)
Depreciation (Net Book Value * 34% Depreciation Rate (provided) **includes $31,000 assets acquired in 2011**	FC	12,791		(3,198)		(3,198)	(3,198)	(3,198)
Interest on loan ($40,000 * .06)	FC	2,400		(600)		(600)	(600)	(600)
Wages ($12 * 160 hrs * 12 months * 2 representatives)	FC	46,080		(11,520)		(11,520)	(11,520)	(11,520)
			(108,138)	(25,822)		(26,631)	(27,843)	(27,843)
Operating Income			49,987	(73)		8,307	20,877	20,877
Notes								
1. (($1,811 * 1.05) /4) + .02139 * Sales	3. (($3,314 * 1.05) /4) + .00701 * Sales							
2. (($249 * 1.05) /4) + .01948 * Sales	4. (($402 * 1.05) /4) + .01076 * Sales							

Table 3									
ACCP									
Projected Income Statement for 2011									
(Loan Not Received & No Airport Outlet Opened)									
		Annually							**Quarterly**
	Cost				**Q1**		**Q2**	**Q3**	**Q4**
					25%		**25%**	**25%**	**25%**
Sales	**Behavior**	TT $	TT $		TT $		TT $	TT $	TT $
Ms. John = ($125,284 * 38%) * 110%		52,369			13,092		13,092	13,092	13,092
Sales Representatives = ($125,284 * 62%) * 110%		85,444			21,361		21,361	21,361	21,361
			137,812		34,453		34,453	34,453	34,453
Less: Cost of Goods Sold (33.33% of sales)	VC		(45,933)		(11,483)		(11,483)	(11,483)	(11,483)
Gross profit			91,880		22,970		22,970	22,970	22,970
Operating Expenses									
Selling Expenses									
Sales commissions (sales by representatives * 30%)	VC	25,633	(25,633)		(6,408)		(6,408)	(6,408)	(6,408)
General & Administrative Expenses									
Internet services (2010 expense * 1.05)	FC	1,386			(347)		(347)	(347)	(347)
Electricity (2010 expense * 1.05)	FC	670			(167)		(167)	(167)	(167)
Transportation (Travelling) = [($1,811 * 1.05) + .02139 * Sales]	Mixed	4,849			(1,212)	1	(1,212)	(1,212)	(1,212)
Telephone [($249 * 1.05) + .01948 * 2011 sales]	Mixed	2,946			(737)	2	(737)	(737)	(737)

Rent (2010 expense * 1.05)	FC	10,584			(2,646)		(2,646)	(2,646)	(2,646)
Stationery and supplies [($3,314 * 1.05) + .00701 * 2011 sales]	Mixed	4,446			(1,111)	3	(1,111)	(1,111)	(1,111)
Bank charges [($402 * 1.05) + .01076 * 2011 sales]	Mixed	1,905			(476)	4	(476)	(476)	(476)
Depreciation (Net Book Value * 34% Depreciation Rate (provided)	FC	2,251			(563)		(563)	(563)	(563)
			(29,037)		(7,259)		(7,259)	(7,259)	(7,259)
Operating Income			37,209		9,302		9,302	9,302	9,302
Notes									
1. (($1,811 * 1.05) /4) + .02139 * Sales									
2. (($249 * 1.05) /4) + .01948 * Sales									
3. (($3,314 * 1.05) /4) + .00701 * Sales									
4. (($402 * 1.05) /4) + .01076 * Sales									

Question 4 – Prepare a projected Balance Sheet for the 2011 fiscal year assuming that (a) Loan received and retail outlet opened, (b) No loan and no retail outlet. The suggested solution is presented in Table 4 below.

Table 4							
ACCP							
Projected Balance Sheet							
As at May 31,							
	2011 – With Loan				**2011 – Without Loan**		
Assets	**TT $**	**TT $**	**TT $**		**TT $**	**TT $**	**TT $**
Current Assets							
Cash		55,660				42,342	
Inventory		15,400				6,400	
Office Supplies		640				640	
Total Current Assets			71,700				
Property, Plant and Equipment							49,382
Leasehold improvements	28,000				0		
Accumulated Depreciation Leasehold Improvements	(9,520)	18,480			0	0	
Office Equipment	15,000				12,000		
Accumulated Depreciation Office Equipment	(9,570)	5,430			(8,550)	3,450	
Office Furniture	3,200				3,200		
Accumulated Depreciation Office Furniture	(2,280)	920			(2,280)	920	
Total Property, Plant and Equipment (Net)			24,830				4,370
Total Assets			96,530				53,752
Liabilities & Owners' Equity							
Current Liabilities							
Electricity Payable		512				512	
Unearned Revenue		5,588				5,588	
Current portion of NEDCO Loan		10,000				0	
Total Current Liabilities			16,100				6,100
Long-term Liabilities							
NEDCO loan			20,000				0
Total Liabilities			36,100				6,100
Owners' Equity							
Opening balance		34,843				34,843	
Investment by Earla John		0				0	

Add: Operating Income		49,987				37,209	
Less: Drawings		(24,400)	60,430			(24,400)	47,652
Total Liabilities and Owners' Equity			96,530				53,752

Question 5 – Prepare a projected Statement of Cash Flows for ACCP's third year of operation (2011) assuming that (a) Loan received and retail outlet opened, and (b) No loan and no retail outlet. The suggested solution is presented in Table 5 below.

Table 5				
ACCP				
Projected Statement of Cash Flows				
Period Ending December 31, 2011				
		With Loan		**Without Loan**
Cash flows from operating activities	$	$	$	$
Operating income	49,987		37,209	
Add: Non-cash expenses - Depreciation	12,791		2,251	
Less: Increase in inventory	(9,000)		-	
Net cash flows provided by operating activities		53,778		39,460
Cash flows from investing activities				
Purchase of property, plant and equipment	(31,000)		-	
Net cash flows used by investing activities		(31,000)		-
Cash flows from financing activities				
NEDCO loan	40,000		-	
Withdrawals by Ms. John	(24,000)		(24,400)	
Principal repayment on NEDCO Loan	(10,000)		-	
Net cash flows provided (used) by financing activities		5,600		(24,400)
Net change in cash		28,378		15,060
Add: beginning cash balance		27,282		27,282
Ending cash balance		55,660		42,342

Question 6 – Calculate the selected ratios for 2009, 2010 and 2011. In computing the 2011 ratios, first assume that the loan was received and the retail outlet was opened, then assume that the loan was not received. The suggested solution is presented in Table 6 below.

Table 6							
ACCP							
Ratio Trend Analysis							
Ratio		**Formula**	**2008-9**	**2009-10**	**2010-11**		
					With Loan	**No Loan**	
Quick ratio	=	Current Assets – (Inventories + Prepayments) / Current Liabilities	2.12	4.47	3.46	6.94	Times
Current cash debt coverage	=	Cash Provided by Operating Activities / Average Current Liabilities[1]	2.60	4.91	4.84	6.47	Times
Times interest earned	=	Operating Income + Interest Expense / Interest Expense	NA	NA	21.83	NA	Times
Return on average total assets	=	Operating Income / Average Total Assets[1]	34%	91%	73%	79%	
[1] = [(beginning balance + ending balance) /2]. The ending balance was used as the average for 2008-9 as there was no opening balance.							

Question 7 – Assuming the role of the NEDCO Officer, and based on your responses to requirements 3 through 6 above, would you recommend approval of the loan? Why? The suggested solution follows.

Each student is free to recommend either the approval or rejection of the loan based on her/his personal risk profile and the weights (s)he attaches to the various aspects of the available information. Most students assess Ms. John's Credit History and Background (education, expertise) as being acceptable.

Many of the arguments that can be used to justify the recommendation made whether for approval or rejection of the loan application, hinge on the assessment of Ms. John's Financial Commitment to the business and her Ability to Service the Loan from operating cash flows and income and are summarized in Table 7 - Strengths and Weaknesses of ACCP as Candidate for Loan, below. Overall, the company's operating income and cash flows seem adequate to service the loan.

Ms. John's *financial commitment to the business* is an area of concern. The high level of drawings by the owner in 2009 ($48,020) and in 2010 ($48,350) seem unsustainable. Fortunately drawings were projected to be reduced to $24,400 in 2011. Ms. John has presented a well reasoned plan to reduce drawings and improve the capitalization of her business. However, students may have different assessments of the extent to which the planned reductions are achievable and its impact on the business.

Table 7
Strengths & Weaknesses of ACCP as Candidate for Loan
Ability to repay loan from operating income / cash flows:

	WITH LOAN & AIRPORT OUTLET		**NO LOAN & NO AIRPORT OUTLET**	
Criteria	**Status**	**Trend**	**Status**	**Trend**
Liquidity				
Quick ratio	Very favorable; above the generic benchmark of 1:1 times	Positive compared to 2009 but negative compared to 2010	Very favorable; above the generic benchmark of 1:1 times	Overall very positive
Current cash debt coverage	Favorable	Overall positive compared to both 2009 and 2010	Very favorable	Overall very positive
Solvency				
Times interest earned	Excellent	NA (Interest expense only incurred in 2011 if the loan is approved)	NA	NA
Profitability				
Return on average total assets*	Excellent at 73%	Positive compared to 2009 but negative compared to 2010	Excellent at 79%	Positive compared to 2009 but negative compared to 2010

Question 8 - How would the above analysis and recommendation change if Ms. John is unable to achieve the targeted level of drawings and reverts to the levels experienced in 2009 and 2010 (i.e., $48,000). The suggested solution follows.

If drawings were maintained at $48,000 in 2011, the assessment of Ms. John's Credit History and Background (education, expertise) would be unchanged. However, ACCP's cash, quick assets, total assets and owner's equity account balances would each decline by $23,600. Also, the key ratios would be as shown in Table 8 below.

Table 8

ACCP Ratio Trend Analysis (assuming withdrawals of $48,000 in 2011)

Ratio		Formula	2008-9	2009-10	2010-11 With Loan	No Loan	
Quick ratio	=	Current Assets – (Inventories + Prepayments) / Current Liabilities	2.12	4.47	1.99	3.07	Times
Current cash debt coverage	=	Cash Provided by Operating Activities / Average Current Liabilities[1]	2.60	4.91	4.84	6.47	Times
Times interest earned	=	Operating Income + Interest Expense / Interest Expense	NA	NA	21.83	NA	Times
Return on average total assets	=	Operating Income / Average Total Assets[1]	34%	91%	88%	105%	

[1] = [(beginning balance + ending balance) /2]. The ending balance was used as the average for 2008-9 as there was no opening balance.

Although the ratios are still very good and suggest that the business may still be able to service the loan, the asset base of the company would be significantly reduced and the business would likely be under-capitalized and its status as a going concern would be in jeopardy. Again, Ms. John's financial commitment to the business may be called into question and could adversely affect the loan decision.

EPILOGUE

Ms. John submitted the loan request before the deadline indicated by the NEDCO officer. However, ***the loan was not approved***. The NEDCO officer indicated that Ms. John had not demonstrated the capacity to manage her finances in a manner that would ensure that she could effectively service a loan. The officer questioned whether the sharp reduction projected in drawings for 2011 was achievable given that the additional sources of household income was expected to come from Ms. John's close relatives. Ms. John was not able to secure the funds from other sources and declined the offer to lease space at the Piarco International Airport, Trinidad & Tobago.

The officer suggested the following actions that could be implemented by Ms. John to improve the finances of her firm:

1. Consider strategies to expand sales from traditional business which has a more attractive financial model (few fixed costs and little debt) than the "brick and mortar" outlet. For example, adding commission-based sales representative in other major local, regional and international cities.

2. Seeking equity financing from family, friends or business angels
3. Maintaining up-to-date financial records
4. Preparing periodic financial reports for management purposes
5. Restricting the amount of resources withdrawn from the firm for personal use by possibly implementing lifestyle changes.

At the time of writing this case Ms. John had not implemented any of the recommendations and ACCP continued to experience financial difficulties.

APPENDIX E
ACCP GRADING RUBRIC

ASSESSMENT CRITERIA	PERFORMANCE LEVEL			
	Needs Improvement			
	Significantly Below Expectations (D / F)	**Below Expectations (C)**	**Meets Expectations (B)**	**Exceeds Expectations (A)**
Appropriately classified costs in income statement as fixed, mixed or variable AND provides well-reasoned rationale	Most costs inappropriately classified and or classification unjustified or not attempted	Several costs inappropriately classified and or only partially justified	Most costs appropriately classified and reasonably justified	All costs appropriately classified and completely and reasonably justified
Appropriately estimated cost functions for all cost items classified as mixed or variable costs	Most cost functions inappropriately estimated	Several cost functions inappropriately estimated	Most cost functions appropriately estimated	All cost functions appropriately estimated
Completely and accurately prepared financial statements based on cost classification/ functions and proper interpretation of assumptions provided	Most elements of the financial statements inaccurately / improperly prepared or not attempted	Several elements of financial statements inaccurately / improperly prepared	Most elements of financial statements accurately / properly prepared	All elements of financial statements completely and accurately prepared
Completely and accurately calculated required ratios	Most ratios incompletely and or inaccurately calculated or not attempted	Several ratios incompletely and or inaccurately calculated	Most ratios completely and accurately calculated	All ratios completely and accurately calculated
Appropriately interpreted all ratios in a manner consistent with decision focus and or its usual meaning	Most ratios inappropriately interpreted or not attempted	Several ratios inappropriately interpreted	Most ratios appropriately interpreted	All ratios appropriately interpreted
Supported recommendation with appropriate specific information, arguments and examples AND Appropriate weight given to drawing trend, questionable assumptions	Recommendation not attempted or unsupported (used inappropriate information or examples and inappropriately weighted drawing trend, questionable assumptions)	Recommendation partially supported (used appropriate specific information OR examples BUT inappropriately weighted drawing trend, questionable assumptions)	Recommendation generally supported (used appropriate specific information OR examples AND appropriately weighted drawing trend, questionable assumptions)	Recommendation completely supported (used appropriate specific information, AND examples AND appropriately weighted drawing trend, questionable assumptions)

SUGGESTED READINGS

The following resources may provide useful background material.

Garrison, R. H., E. W. Noreen & P. C. Brewer (2010). *Managerial Accounting* 13th Ed. McGraw-Hill Irwin. Chapters 2, 5, 9, and 16.

Hempel, G. H. & D.G. Simonson (1999). *Bank Management: Text and cases*. 5th Ed. John Wiley and Sons. (Chapter 11 including Appendix 11A).

Horngren, C. T., S. M. Datar, G. Foster, M. V. Rajan, & C. Ittner (2008). *Cost Accounting: a managerial emphasis* 13th Ed. Pearson Prentice Hall. Chapters 2, 6 and 10.

Koch, T. W. & S.S. MacDonald (2009). *Bank Management.* 7th Ed. South-Western Cengage Learning. (Chapter 13).

CHANGES TO ACCOUNTING FOR INVESTMENTS AND THE EMERGENCE OF PRIVATE COMPANY FINANCIAL REPORTING STANDARDS – ISSUES, CHALLENGES, AND OPPORTUNITIES

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CASE DESCRIPTION

The primary subject matter of this case concerns proposed financial accounting and reporting changes that will affect virtually all U.S. public and private companies. The case addresses proposed significant changes to the measurement and recognition of investments and the emergence of private company financial reporting standards. Secondary, required financial reporting changes that must be implemented starting with the 2012 reporting periods are also briefly addressed. The main focus of this case is on the technical accounting changes and their likely financial statement effect, as well as short-term and long-term strategic decisions that may substantially be influenced by these significant changes.

This case has a difficulty level of three to four and can be taught in about 40 minutes. Approximately four hours of outside preparation is necessary for students to fully address the issues, concepts and suggested assignments. The assignments include both case-specific questions and questions requiring research. This case can be utilized in an intermediate accounting course, but also can be utilized in a graduate level course focusing primarily on the strategic issues. The case may enhance students' technical knowledge and their critical thinking, analytical, research and communication skills.

CASE SYNOPSIS

Significant changes to financial accounting and reporting during the next five years will affect nearly all private and public entities. One of the proposed changes that likely will affect most entities involves accounting for investments. As part of their convergence project, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) are revising the accounting rules governing the recognition and measurement of investments, while attempting to develop global consistency. In addition, the Blue Ribbon Panel on Standard Setting for Private Companies (BRP) recommended to the Financial Accounting Foundation (FAF) that accounting standards for non-public entities should be developed. While this may enhance the usefulness of financial reporting by private companies, it likely will cause comparability issues between private and public companies, particularly in light of the likely implementation of IFRS by public companies during the next five to seven years. In addition, since many private companies eventually become public and public companies frequently invest in or acquire private entities, it can also affect investment and acquisition strategies, as well as *financing decisions. Thus, the two issues – accounting for investments and private company financial reporting – are interrelated.*

This case addresses technical accounting issues as well as the strategic issues that may affect companies' investment and acquisition strategies. The introduction to the case provides brief background on the topics. The case was developed for an intermediate accounting course, but can also be used in a more advanced course focusing primarily on the strategic issue. The suggested assignments include case-specific as well as research questions. All questions are independent to allow for maximum flexibility; the case can be assigned as a group or as an individual project. Assigning this case may enhance students' critical thinking, research, and communication skills; as well as their technical accounting knowledge.

INSTRUCTORS' NOTES

TEACHING STRATEGIES

Accounting professionals must be knowledgeable not only about current accounting rules, but also must be aware of changes on the horizon that will affect their profession and the organizations or clients who engage them. Accountants who are knowledgeable and proactive play an important role in the ultimate success of an organization.

Accounting educators play a critical role in helping accounting students, the future accounting professionals, learn about proposed significant changes and emerging trends that will affect financial accounting and reporting. Accounting educators are in a unique position to help instill in accounting students the desire to seek knowledge about significant changes that will occur with respect to financial reporting.

Because of the prevalence of investments, proposed changes to the recognition and measurement of investments will likely affect many business entities. Accounting students must learn about these changes. Furthermore, many students will at some point during their future careers be involved in private entity financial reporting, which soon is expected to change. In addition, accounting professionals working for public companies that interact with private companies must also be knowledgeable about the proposed changes and how they may affect their company and potentially its strategic decisions.

This case accomplishes several goals. First, it can be used to help students become aware of the anticipated changes that affect accounting for investments, as well as the emergence of separate financial reporting standards for private entities. Second, the case also helps students learn the technical details of the expected changes. Third, the case can be used to discuss strategic issues related to financial accounting and reporting and explore the potential effect of accounting rules on a company's decision making process.

Two independent sets of suggested questions are provided and are shown below. The first set of questions can be answered based on the case and the students' current accounting knowledge; the second set requires students to research the issues. Each question is independent, providing instructors with the option to assign some or all of the questions. The case is designed as a group project, but can also be assigned as an individual student project. It is well-suited for an intermediate accounting course, but can also be used in a more advanced class focusing especially on the research aspects and the strategic issues.

IMPLEMENTATION STRATEGIES

This case is currently utilized in two sections of Intermediate Accounting II. Accounting for investments is covered in that class. Students receive a copy of the case one week prior to the discussion of accounting for investments. Students are instructed to read the case while preparing for the discussion of the topic during the following class meeting. After discussing the "investments" topic in class, the instructor discusses the case requirements and assigns the case; this requires about 25-30 minutes.

Since all the questions are assigned in the classes this case is currently utilized, students are allowed four weeks to complete the case. Each week, the instructor sets aside about 10 minutes at the beginning of class to resolve any questions student may have. After students submit their case reports, the case is discussed in class. This requires about 40-45 minutes. Since the suggested questions are independent, instructors have a high degree of flexibility in assigning specific questions. If sufficient class time is available, students can also be asked to present their case reports during in-class presentations.

SUGGESTED ASSIGNMENTS

CASE-SPECIFIC QUESTIONS

1. What would be the overall likely impact of the proposed accounting changes with respect to accounting for financial instruments on the company's statement of financial position (balance sheet)? What would be the impact on the company's income statement?
2. Review table 3 presented in the case, then recreate the table adding an additional column to the right and insert the heading "effect of market value changes on financial statements" in the new column. Complete the new column as follows: indicate the effect of (a) increases and (b) decreases in the fair value of investments on the company's financial statements. Indicate the specific financial statement that will be affected, major totals and subtotal that will change, and the direction of the change.
3. Review table 4 presented in the case, recreate the table adding an additional column to the right and insert the column heading "effect of market value changes on financial statements." Complete the new column as follows: indicate the effect of (a) fair value increases and (b) fair value decreases on the financial statements. Indicate the specific financial statement affected, major totals and subtotals that will change, and the direction of the change.
4. Why does Margot believe that the increasing importance of comprehensive income may mitigate the effect of the proposed changes with respect to investments currently classified as available for sale securities (AFS)? In answering this question, consider

the effect of changes in accounting for investments currently classified as AFS on net income and total comprehensive income.

5. What strategies might Fortschritt consider to mitigate the potential negative effect of the proposed accounting standard on its income and financial position?
6. Assume that public companies were required to prepare their financial statements in accordance with IFRS. What will be the potential advantages for private companies if private company financial reporting standards are developed? What will be the potential disadvantages?
7. Assume that Fortschritt, a public company, will be required to prepare its financial statements in accordance with IFRS, while private companies are utilizing a modified U.S. GAAP specifically tailored to private entities. Assume that Fortschritt pursues its expansion plans to acquire private entities.
    a. What would be the challenges for Fortschritt with respect to evaluating potential acquisition targets?
    b. What financial reporting issues would arise for Fortschritt's CFO and accounting staff?

RESEARCH QUESTIONS

1. Access the FASB.org website, choose the "projects" link, and locate the "Financial Instruments" project. What is the current status of the project (i.e., when does FASB expect to issue the new standard?) What major decisions have been reached since Fortschritt's CEO, CFO, and COO held their meeting. Summarize your findings. If no significant changes occurred, state so.

2. Choose a well-known multinational company and review its most recent financial statements. Determine whether the company uses a one or a two statement approach for presenting comprehensive income. Also review the notes to the financial statements and find out whether the company recently has changed or is planning to change its presentation format.

3. Retrieve and review the BRP's report. What was the reason for the BRP's appointment? (Hint: Find the "problem statement" in the report).

4. The BRP initially considered seven possible accounting standards models.

    a. What were the models they considered?
    b. What type of models did they eliminate from further consideration early on in their decision process? What was their reasoning?

5. What reasons did the BRP indicate to support their choice of the accounting model they recommended to the FAF?

6. What reasons did the BRP indicate for rejecting a standalone new U.S. GAAP for private companies?

7. Find the website for the Private Company Financial Reporting Committee (PCFRC). What is the composition of the committee?

8. According to the BRP's recommendation, what organization should be in charge of private company financial reporting standards?

9. According to the BRP report, how many private entities could be affected by a change in applicable GAAP?

10. The case indicates that Canada developed stand-alone accounting standards specifically for private companies. What type of standards do Canadian public companies utilize?

SUGGESTED SOLUTIONS TO QUESTIONS

CASE-SPECIFIC QUESTIONS

1. What would be the overall likely impact of the proposed accounting changes with respect to accounting for financial instruments on the company's statement of financial position (balance sheet)? What would be the impact on the company's income statement?

Fortschritt Company would have to reclassify most of its current and some of its non-current investments as "fair value through net income." The proposed accounting change would require that Fortschritt recognize and measure its investments that are currently classified as held to maturity at fair value instead of amortized cost. If the fair value of those debt securities changes, income, total assets, and total equity would increase (for gains) and decrease (for losses). If the fair value of investments currently classified as available for sale changes, income would increase (for gains) and decrease (for losses); however, the investment balance, total assets, and total equity would not change.

2. Review table 3 presented in the case, then recreate the table adding an additional column to the right and insert the heading "effect of market value changes on financial statements" in the new column. Complete the new column as follows: indicate the effect of (a) increases and (b) decreases in the fair value of investments on the company's financial statements. Indicate the specific financial statement that will be affected, major totals and subtotal that will change, and the direction of the change.

Table 3
CURRENT CLASSIFICATION AND MEASUREMENT OF MARKETABLE SECURITIES – INVESTMENTS LACKING SIGNIFICANT INFLUENCE

Initial Classification	Investment Objective	Subsequent Recognition and Measurement	Effect of Market value Changes on Financial Statements)
Debt Securities Held to Maturity	Investor entity intends to hold debt security until it matures	Amortized Cost	Fair value increases and decreases: Statement of financial position (SFP) and income statement (IS): changes in fair value will not affect either statement.
Available for Sale Securities (AFS)	Marketable debt or equity securities that are not classified as debt securities held to maturity or trading securities	Fair value, with (holding) unrealized gains and losses recognized as part of stockholders equity (accumulated comprehensive income)	Fair value increases: SFP: investment balance, total assets, accumulated other comprehensive income, and stockholders equity increase. Fair value decreases: SFP: investment balance, total assets, accumulated other comprehensive income, and stockholders equity decrease.
Trading Securities (Fortschritt currently does not have an investment strategy consistent with this classification)	Short-term investments that investor company holds primarily with a short-term gain objective	Fair value, with (holding) unrealized gains and losses recognized as part of income	Fair value increases: SFP: investment balance, total assets, total equity increase. IS: income increases. Fair value decreases: SFP: investment balance, total assets, total equity decrease. IS: income decreases.
Subsequent changes in categories	If investment objective changes	Changes in categories are permitted. May lead to recognition of gains and losses in income, depending on the change.	Depends on specific change.
Sale of investment	De-recognition of investment	All realized gains and losses are recognized in income	IS: Income will increase if sales prices exceeds original cost; decrease if sales price is lower than original cost

3. Review table 4 presented in the case, recreate the table, adding an additional column to the right and insert the column heading "effect of market value changes on financial statements." Complete the new column as follows: indicate the effect of (a) fair value increases and (b) fair value decreases on the financial statements. Indicate the specific financial statement affected, totals and subtotals that will change, and the direction of the change.

Table 4
PROPOSED CLASSIFICATION AND MEASUREMENT OF MARKETABLE SECURITIES

Initial Classification and Measurement of Marketable Securities (at time of purchase)	Requirements	Subsequent Measurement and Recognition	Effect of Market Value Changes on Financial Statements
Fair value through net income (FV-NI)	Default category unless specific criteria for other classification are a met. All equity securities are measured at FV-NI	Changes in fair value are recognized in income statement	Fair value increases: SFP: assets increase, retained earnings and equity increases IS: income increases Fair value decreases: SFP: assets decrease, retained earnings and equity decrease IS: income decreases
Fair value through other comprehensive income	Business strategy requirements: At acquisition, cash is invested in order to (1) maximize returns from collection of contractual cash flows or sale of the financial asset, or (2) manage risks associated with changes in liquidity or interest rates. Assets cannot be held for resale at time of investment.	Fair value; changes in fair value are adjusted through other comprehensive income and recognized in equity. (Initial recognition is at transaction price, rather than fair value)	Fair value increases: SFP: assets increase, accumulated other comprehensive income and equity increase; the IS will not be affected. Fair value decreases: SFP: assets decrease, accumulated other comprehensive income and equity decrease. The IS will not be affected.
Sale of investment	De-recognition of investment	All realized gains and losses are recognized in income	Gains increase income and losses decrease income.

4. Why does Margot believe that the increasing importance of comprehensive income may mitigate the effect of the proposed accounting changes with respect to investments currently classified as available for sale securities (AFS)? In answering this question, consider the effect of changes in accounting for investments currently classified as AFS on net income and total comprehensive income.

The proposed changes to the measurement of investments that are currently classified as AFS will not affect total comprehensive income. For example, if a loss in fair value occurs, under current accounting rules, income will not be affected, other comprehensive income will decrease, and total comprehensive income will also decrease. Under the proposed rule, the loss would have to be recognized in income, thereby decreasing income. However, total comprehensive income, which includes net income, would not be affected. To summarize, whether unrealized gains or losses are recognized in net income or in other comprehensive income, total comprehensive income will be the same. Thus, a trend towards focusing on total comprehensive income, rather than net income may mitigate the perceived negative effect of the proposed accounting change.

5. What strategies might Fortschritt consider to mitigate the potentially negative effect of the proposed accounting standard on its income and financial position?

Fortschritt could mitigate the negative effect of the proposed changes by acquiring less volatile and less risky financial instruments. However, predicting market changes is difficult. In addition, risk and rewards generally are complements and choosing potentially “safer” investments may lead to lower returns. In addition, presenting a combined income/comprehensive income statement may also mitigate a potentially negative impact. On the positive side, the proposed accounting change may cause Fortschritt to re-evaluate its investment strategies, which may be advantageous for the company.

6. Assume that public companies were required to prepare their financial statements in accordance with IFRS. What will be the potential advantages for private companies if private company financial reporting standards are developed? What will be the disadvantages?

Private companies may be able to lower their financial reporting costs, and prepare more relevant reports for financial statement users. However, comparability issues may arise between public and private companies that may have long-term implications with respect to their ability to raise capital. Furthermore, private companies that wish to become public would incur additional cost to comply with public company financial reporting requirements in preparation for an initial public offering (IPO).

7. Assume that Fortschritt, a public company, will be required to prepare its financial statements in accordance with IFRS, while private companies are utilizing a modified U.S. GAAP specifically tailored to private entities. Assume that Fortschritt pursues its expansion plans to acquire private entities.
    a. What would be the challenges for Fortschritt with respect to evaluating potential acquisition targets?

Fortschritt may have greater difficulties analyzing and selecting the “best” acquisition target.

    b. What financial reporting issues would arise for Fortschritt’s CFO and accounting staff?

The company’s financial statement consolidation process would become more complex and costly. The company’s staff and CFO would have to maintain competency with respect to both private company financial reporting standards as well as IFRS, which may involve additional staff development costs.

RESEARCH QUESTIONS

1. Access the FASB.org website, choose the "projects" link, and locate the "Financial Instruments" project. What is the current status of the project (i.e., when does FASB expect to issue the new standard?) What major decisions have been reached since Fortschritt's CEO, CFO, and COO held their meeting. Summarize your findings. If no significant changes occurred, state so.

The answer to this question will depend on the timing of assigning the case. The case presents updated information as of August 2011. The FASB expects to issue a final standard in 2012.

2. Choose a well-known multinational company and review its most recent financial statements. Determine whether the company uses a one or a two statement approach for presenting comprehensive income. Also review the notes to the financial statements and find out whether the company recently has changed or is planning to change its presentation format.

Students should be asked to provide a link to the financial statements they selected. Alternatively, students can be instructed to attach hard copies of relevant pages from the annual report they utilized.

3. Retrieve and review the BRP's report. What was the reason for the BRP's appointment? (Hint: Find the "problem statement" in the report).

According to the report, the current standard-setting process does not sufficiently consider (a) the needs of private company financial statements users and (b) the costs and benefits of applying current U.S. GAAP to private companies (BRP, 2011).

4. The BRP initially considered seven possible accounting standards models.
    a. What were the models they considered?

The seven models were: U.S. GAAP with exclusions and exceptions (current model), U.S. GAAP with exclusions and enhancements for private companies, U.S. GAAP – baseline GAAP with public company add-ons; separate stand-alone GAAP based on current GAAP, separate standalone GAAP from grounds up; Unmodified IFRS for SMEs, and customized IFRS for SMEs (BRP, 2011, H1-2).

    b. What type of models did they eliminate from further consideration early on in their decision process? What was their reasoning?

The BRP rejected the current "U.S. GAAP with exceptions" model because they felt that the status quo (current U.S. GAAP with exceptions for private companies) was unacceptable.

They also felt that the development of a new standalone private company GAAP would require too much time. In addition, the BRP rejected both IFRS models because it believed that private companies should not lead the way to IFRS (BRP, 2011).

5. What reasons did the BRP indicate to support their choice of the accounting model they recommended to the FAF?

The BRP (2011) recommended that immediate action be taken to modify current GAAP to better meet the needs of private company financial statement users.

6. What reasons did the BR P indicate for rejecting a standalone new U.S. GAAP for private companies?

Developing a new stand-alone GAAP would require too much time and would likely lead to too many difference between public and private entities (BRP, 2011).

7. Find the website for the Private Company Financial Reporting Committee (PCFRC). What is the composition of the committee?

The PCFRC consists of a chair who is a part-time employee of FASB, four private company financial reporting users, four private company financial reporting preparers, and four CPA practitioners working in small and midsize firms (http://www.pcfr.org/)

8. According to the BRP's recommendation, what organization should be in charge of private company financial reporting standards?

In their report (BRP, 2011), the BRP recommends that a separate board be responsible for Private Company Financial Reporting Standards, but that the new board should report to the Financial Accounting Foundation (FAF).

9. According to the BRP report, how many private entities could be affected by a change in applicable GAAP?

There are approximately 28 million private companies in the U.S. that could be affected by a change in GAAP for private entities (BRP, 2011).

10. The case indicates that Canada developed stand-alone accounting standards specifically for private companies. What type of standards do Canadian public companies utilize?

Starting in 2011, Canadian public companies must prepare financial reports consistent with IFRS (AcSB, 2011). Private companies utilize "made in Canada" standalone private company accounting standards.

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M&D INC. IN THE GOVERNMENTAL SECTOR: A MARKETING CASE

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CASE DESCRIPTION

The primary subject matter of this case involves the application of service quality models i.e. 'RATER' and 'Flower of Service' in the evaluation of strategic decision choices in service industries. M&D Inc. is a multifaceted business support services company considering expansion of its diversification efforts to enter a new market. The case has a difficulty level of three or four, appropriate for introducing junior and senior marketing or business administration students to both models. It is designed for a 50-minute class period and is expected to require two hours of pre-class student preparation.

CASE SYNOPSIS

M&D Inc. is a multifaceted business services support company focusing on the private sector. Its range of services includes mailroom management, e-commerce development, printing, and marketing. Until recently, Ron Lee was the CEO of the company, but he has had to give up the position as a result of ill-health. Prior to his resignation as CEO, Ron Lee was planning to sign a new service contract with another department of the U. S. federal government. M&D Inc. was successful in servicing its first federal government contract which was much smaller and less demanding. The new contract requires M&D Inc. to hire 250 additional employees who will be required to work extra hours every week with significant cost implications. The incoming CEO, Josh King is skeptical of M&D Inc's capability to service such a large contract, so he meets with Ron Lee to discuss the issue. At the meeting, Ron Lee suggests to Josh King to first fully familiarize himself with the operations of M&D Inc. before making a final decision.

NOTE: The case is a fictionalized version of a real-life organizational setting. Names and other identifying information were disguised to protect identities. The applicable fact situation is true to the real case.

INSTRUCTOR'S NOTES

LEARNING OBJECTIVES

Objective 1: To help students understand the Flower of Service model and the RATER model and identify their main elements.

Objective 2: To help students apply the RATER and the Flower of Service models to real-life organizational settings.

Objective 3: To improve students' decision making skills by allowing them to evaluate decision alternatives, choose the most appropriate alternative, and create an action plan and implement it to achieve the desired objectives.

TARGET AUDIENCE AND COURSE

The case is designed to expose junior and senior students seeking an undergraduate degree in marketing or business administration to the 'Flower of Service' and to the 'RATER' models used in service quality evaluation and to the essence of managerial decision making. Students taking services marketing general business course will benefit from this case study.

Normally, the 'Flower of Service' model is introduced towards the middle of the course and the 'RATER' model is introduced towards the end of the course. The 'Flower of Service' model illustrates the core service, the supplementary services and the delivery processes a business firm offers its clients. The supplementary services can be either facilitating or enhancing. The facilitating supplementary services include information, order taking, billing, and payment. The enhancing supplementary services include consultation, hospitality, caretaking, and exceptions (Rao, 2007). The 'RATER' model is used to identify and to improve the quality of service at a given firm by evaluating or assessing the implementation of core and supplementary services of the flower of service model. The model has five dimensions which can be used to measure the quality of service i.e. reliability, assurance, tangibles, empathy, and responsiveness (University of Wisconsin, 2011).

RECOMMENDED READING AND TEACHING APPROACH

It is recommended that the instructor utilizes this case only after having given a mini-lecture at the very least on 'Flower of Service' and 'RATER' models and services marketing in general. Depending on the level of instructor guidance desired, students may be directed to consider the discussion questions as they analyze the case. Students should be divided into groups of three or four individuals for prior analysis and subsequent in-class discussion purposes with the instructor serving as the facilitator. Students should be encouraged to participate in the discussion and respond to specific questions providing relevant reasoning. The instructor should also help students understand the main take away from the case, choose the most appropriate solution or decision alternative and implement it by creating an action plan.

Prior student reading can include relevant sections of chapters 4, 5, 6 and 14 of Services Marketing: People, Technology, Strategy by Lovelock and Writz (2007); Czaplewski, A. J., Olson, E. M., & Slater, S. F. (2002). Applying the RATER model for service success. Marketing Management, 11, 14-17 and Lovelock, C. H. (1992). Cultivating the Flower of Service: New ways of looking at core and supplementary services. In P. Eiglier, & E. Langeard (Eds.), Marketing, Operations, and Human Resources: Insights into Services, pp. 296–316, Aix-en-Provence, France.

DISCUSSION QUESTIONS AND SUGGESTED ANSWERS

Question 1: Characterize the components of the service provided by M&D Inc.?

The 'Flower of Service' model illustrates the main components of the service provided by M&D Inc. The model describes the nature of the service as comprising of a core, supplementary services and delivery processes. Supplementary services include both facilitating and enhancing elements.

The core service of M&D Inc. is business facilitation through support systems such as mailroom management. Its facilitating supplementary services are:

1) Information: M&D's clients need information on various aspects of the services and the products provided to them. M&D's employees are trained well, so they can provide clients with such information when they need it. M&D requires that all employees and managers receive continuous training. For example, the IT Department employees receive on site and off site software training on a regular basis. Moreover, M&D's employees know the type of service or products which best fit clients' needs, their cost, proper usage, and details.

2) Billing: M&D's clients expect to receive accurate bills and full disclosure of prices. M&D ensures that employees disclose prices to all clients prior to finalizing a sale to ensure accuracy and to avoid any billing errors (e.g., the price of the accounting books along with the shipping costs were clearly disclosed to Mr. Jones Solder before finalizing his purchase).

3) Payment: M&D gives its clients the freedom of choosing among different alternatives when making a payment. It accepts checks, debit cards, credit cards and PayPal payments.

4) Order Taking: M&D clients can place their orders over the phone, online or by mail. M&D makes sure that orders are processed promptly and accurately. Employees are always available to assist clients with their orders whenever needed.

The enhancing supplementary services are;

1) Consultation: M&D's employees are able to provide clients with advice regarding the service or product that best fits their needs and they also assist the clients with using the service or product if needed by providing usage instructions. M&D assigns permanent teams to clients to ensure that team members are familiar with the client services and products, the way they are used, their prices, and how they compare to each other. Such permanent assignments of employees to specific clients are implemented at M&D to increase the employees' expertise level in their client's offerings.

2) Hospitality: M&D encourages its employees to make clients feel welcomed at M&D. Employees call clients by their last name or by saying Sir or Ma'am to them. M&D drivers pick up visitors from the airport and they drop them back.

3) Safe Keeping: M&D ensures the safety of its clients' personal belongings when they are on premises for a site visit. Safe keeping includes providing clients with storage and safe deposit services.

4) Exceptions: M&D employees are required to treat clients special, particularly when they face unexpected problems. It also requires that clients problems be resolved as quickly as possible (e.g., Ms. Sally Smith's problem was resolved very quickly).

Service delivery option utilized by M&D Inc. represents remote electronic transactions with clients from a single location.

Question 2: Evaluate the quality of service provided by M&D Inc.?

The quality of service at M&D can be evaluated by using the RATER model which has five dimensions:

A) Reliability. At M&D, the percentage of returns is very low (almost 5%) which shows how accurate the company is in processing clients orders. M&D makes sure that all ordered products and services are delivered to clients in a timely fashion. For instance, the company guarantees delivering products to its clients within 2 to 3 business days (e.g., Mr. Jones Solder). Also, M&D is reliable because, as indicated by Mr. Lee, it keeps its promises with its clients.

B) Assurance. M&D ensures that its employees are knowledgeable and familiar with clients' offerings. Simultaneously, it ensures the courtesy of employees when dealing with clients and the ability of employees to gain the trust and confidence of clients. M&D considers all clients as part of its "big family". Employees' competence is emphasized at M&D, and therefore, the company makes sure to hire well qualified employees. This is evident in its job applicants' background and credit check and in requiring them to have past work experience along with job references before they can be hired. M&D also requires all employees to sign a confidentiality agreement to protect its clients' private or sensitive information and it also requires all employees to receive training to improve their skills.

C) Tangibles. M&D uses offices, a warehouse, equipment, technology, and communication materials to deliver its offerings to its clients. It also uses multiple computer software programs and hundreds of employees to deliver its service as promised.

D) Empathy. M&D requires its employees to pay close attention to clients' needs. The employees are always available to help clients and if a dire need arises, the employees are required to take extraordinary actions to satisfy such a need (e.g., Ms. Sally Smith was promised to receive the books in two hours without any extra charge and compensated with a 10% discount for the inconvenience).

E) Responsiveness. M&D responds to its clients' needs and inquiries as soon as they come in to ensure prompt and high quality service. This is evident in assigning a team to each project as soon as M&D takes it on, choosing the most appropriate computer software programs and training employees prior to launching projects. Also, the IT Department's employees keep the clients' websites up-to-date to satisfy clients' needs and requests.

Question 3: Based on the CFO's estimates, do you think the new governmental project is worth the risk associated with it? Why or why not?

Some students may think that the new project is worth the risk associated with it. They may use the estimates of the CFO which indicated that the project will generate a profit in the first year as a basis for their answer. They may also indicate that the profit margin will go up from 27.6 percent to 29.3 percent when overtime and extra revenues associated with it are taken into account. The employees will work from 7am to 6pm Monday thru Friday and from 12 pm to 5pm on Saturday twice a month. The following table illustrates the computation of net profit and profit margin expected to be generated by the project. It also shows how marginal costs (e.g., overtime) will impact overall profitability of the project. It is clear that after factoring in additional costs and revenues associated with them, the project will be more profitable. Instructors should make sure that students calculate marginal costs and revenues correctly as shown below:

Wages (M-F) = Hourly wage*1.5*15hr/wk*52wk/yr*248 employees (Page 2 of the case)
Wages (S) = Hourly wage*1.5*5hr/wk*26wk/yr*248 employees (Page 2 of the case)
Utilities = Monthly utilities*12mo/yr* 20% (Page 4 of the case)
Supplies= Monthly supplies*12mo/yr*35% (Page 4 of the case)
Revenue = Monthly revenue*12mo/yr*63% (Page 4 of the case)

New governmental project expenses and revenues calculation (Annual)				
Item	Formula used	$Amount before marginal costs	Marginal costs/revenue	$Amount after adding marginal costs
Revenue	Monthly revenue* 12	$13,458,828	$8,479,062	$21,937,890
Wages	Hourly wage*40hr/wk*52wk/yr*248 employees	6,963,840	4,570,020	11,533,860
Salary	Manager +Assistant Manager salary	150,000	0	150,000
Other expenses	12*(Rent+utilities+supplies+ insurance+fringe)	1,029,168	38,340	1,067,508
Total expenses	Wages+salaries+other expenses	8,143,008	4,608,360	12,751,368
Gross profit	Revenue-expenses	5,315,820	N/A	9,186,522
Tax	Gross profit*30%	1,594,746	N/A	2,755,957
Net profit	Gross profit-tax	3,721,074	N/A	6,430,565
Profit margin	Net profit/revenue	27.6%	N/A	29.3%

On the other hand, others may argue that these figures are only estimates and they cannot be used as a solid basis for making the decision to take on the project.

Question 4: What decision choices does Mr. King have? What are their probable outcomes? What do you recommend?

Mr. King has the following options:
A) Take on the new project.
Pros include:
1) An increase in M&D's market share.
2) An increase in M&D's profit because the project is expected to generate a profit in the first year of operation.
3) Providing M&D with more experience in handling large governmental projects.
Cons include:
1) Improper handling of the project can negatively impact the company's belief in its founder's attitude which emphasized M&D's ability to handle all types of clients and their needs.

2) Since the new CEO of M&D is personally interested in the project and is focused on its success, other projects may suffer if the CEO does not have sufficient time to attend to their needs or problems.

B) Abandon the project.

Pros include:

1) Enabling M&D to focus on its other projects to improve quality and profitability.

2) Allowing M&D to dedicate more resources (e.g., human resources, money) to marketing efforts to enhance its competitive position.

Cons include:

1) Losing the project to one of M&D's competitors which may lead to a competitive disadvantage.

2) M&D Inc. will forgo the expected profit.

3) Loss of an opportunity to gain more experience in governmental projects.

C) Do nothing for now.

Pros include:

1) Giving the new CEO more time to think about the project and perhaps to negotiate more favorable contract terms.

2) Giving M&D employees, particularly those who are handling the Department of Education project more time to learn and gain more experience in governmental projects. This way, if M&D decides to take on the project, it can use these employees to improve service quality and profitability.

Cons include:

1) Further possible deterioration of M&D's financial position as the company has been suffering from declining profits and market share in the private sector and an action needs to be taken to overcome this problem.

2) The employees may consider lack of action by the new CEO as lack of knowledge or leadership which could negatively affect their subordinate-supervisor relation.

It is recommended that M&D Inc. takes on the new project because its private sector market share and profits are declining. It has had some experience in handling a governmental project successfully. Also, based on the CFO's estimates, the project will generate profits in the first year of operation. The project will also help M&D Inc. increase its experience in the governmental sector. However, it should take steps to enhance likely success. For example, it might want to hire a project manager who has experience in handling large governmental projects and put in place a more stringent client service quality monitoring system for this particular project.

REFERENCES

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SUPPLIER COOPERATION VS. SUPPLIER COMPETITION: THE CASE OF SUPPLIERS IN XINTANG

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CASE DESCRIPTION

Operations Research, Management Science, and Decision Sciences courses help students understand quantitative approaches to decision making. However, it is more important for students to learn model-formulation and model-building skills; otherwise, students cannot apply their knowledge to real practices. Modified from a real consultant project, this tutorial case study emphasizes problem formulation under conditions. The case has a difficulty level of four. It is designed to be taught in two class hours and is expected to require two hours of outside preparation by students.

CASE SYNOPSIS

The background is Xintang International Jeans and Textile City, the largest manufacturing base of jeans in China. The specific focus is on Xintang's inferior labor conditions. This case analyzes the problems through a novel perspective: to some extent poor labor conditions are driven by suppliers' fierce competition and buyers' unfair procurement practices which trend to shorten lead times and squeeze prices. Since suppliers in the buyer-driven value chains are teetering on cannibalistic competition, it is exceedingly difficult for them to simultaneously achieve both the competitive cost advantage and the humane working conditions. This case explicates how competition and cooperation strategies impact on the behavior of rational and self-interested suppliers within Xintang. The game theory models and analyses of this case study indicate that the cooperation efforts here may point the way out for struggling suppliers to achieve the tricky balance between low prices, short lead times, and stringent working conditions.

INSTRUCTORS' NOTES

RECOMMENDATIONS FOR TEACHING APPROACHES

This case is a tutorial case, which can be used in graduate level Operations Research, Management Science, or Decision Sciences courses. Because this case requires comprehensive skills, it could be assigned to students at the late stage of the course, after they have learned all necessary topics, such as Linear Programming, Game Theory, Queuing Theory, Simulation, Sensitivity Analysis, etc. This case emphasizes the importance of proper assumptions. We wish to illustrate that any given real problem can be simplified as solvable mathematical models under certain reasonable assumptions.

Through reading, discussion, and deliberation of this case, students build skills of following business issues:

How to simplify the complicated reality to a solvable model;
How to study "what if" types of questions by simulation;
How to make decisions in cases where more decision makers have conflicting interests.

QUESTIONS FOR STUDENTS

Assumptions

Why the consultant team assumed $oi = o$, $\gamma i = \gamma$, $ai = a$, $bi = b$, $ci = c$, $dij = d$, and $eij = e$?

Why a factory's optional capacity is exogenous to the model?

Solutions

Solve Eq. 5 to get the optimal (p_i^*, g_i^*);

Solve Eq. 6 to get the optimal (p_i^*, g_i^*).

Simulation

The number of jeans factories is $n = 10$; the desired delivery reliability $\gamma = 0.9$; the unit operating cost $c = 3$; the investment coefficient $w = 0.6$; and the basic demand $a = 200$. Consider three different scenarios of clients' demand:

Scenario 1: the demand is more dependent on price than delivery time guarantee, i.e., $b > c$, $d > e$. In the numerical example, $b = 2.0$, $c = 0.4$, $d = 0.1$, and $e = 0.05$.

Scenario 2: the demand is dependent on price as well as on delivery time guarantee, i.e., $b = c$, $d = e$. In the numerical example, $b = 0.4$, $c = 0.4$, $d = 0.05$, and $e = 0.05$.

Scenario 3: the demand is more dependent on delivery time guarantee than price, i.e., $b < c$, $d < e$. In the numerical example, $b = 0.4$, $c = 2.0$, $d = 0.05$, and $e = 0.1$.

TEACHING PLAN

Discussion of this case can last 90 minutes. The facilitator should assign the case to students with the above questions before the class. During the discussion, the facilitator should cover the following areas:

Assumptions (20 minutes)

The reliability of those assumptions is based Xintang's background (factory town, easy entrance, labor intensive production, and price-war oriented competition).

Solutions (30 minutes)

The facilitator works with students to get the following solutions.

Solution of Equation (5)

$$\text{Max}\,\pi_i(p_i,g_i,P_{-i},G_{-i})=[a-bp_i-cg_i+\sum_{\substack{j=1\\j\neq i}}^{n}d(p_j-p_i)+\sum_{\substack{j=1\\j\neq i}}^{n}e(g_j-g_i)](p_i-o-w)+\frac{w\ln(1-\gamma)}{g_i}, \tag{5}$$

where $P_{-i}=(p_1,p_2,\ldots,p_{i-1},p_{i+1},\ldots,p_n)$, $G_{-i}=(g_1,g_2,\ldots,g_{i-1},g_{i+1},\ldots,g_n)$, *i = 1,2,…,n*. For factory *i*, given the other factories' prices and delivery time guarantee, we differentiate Equation (5) with respect to *pi* and *gi*:

$$\frac{\partial\pi_i(p_i,g_i,P_{-i},G_{-i})}{\partial p_i}=a-2[b+(n-1)d]p_i-cg_i+\sum_{\substack{j=1\\j\neq i}}^{n}dp_j+\sum_{\substack{j=1\\j\neq i}}^{n}e(g_j-g_i)+[b+(n-1)d](o+w), \tag{A1}$$

$$\frac{\partial\pi_i(p_i,g_i,P_{-i},G_{-i})}{\partial g_i}=-[c+(n-1)e](p_i-o-A)-\frac{w\ln(1-\gamma)}{g_i^2}. \tag{A2}$$

The Hessian matrix is

$$H=\begin{vmatrix}\frac{\partial^2\pi_i}{\partial p_i^2} & \frac{\partial^2\pi_i}{\partial p_i\partial g_i}\\ \frac{\partial^2\pi_i}{\partial p_i\partial g_i} & \frac{\partial^2\pi_i}{\partial g_i^2}\end{vmatrix}=\begin{vmatrix}-a[b+(n-1)d] & -[c+(n-1)e]\\ -[c+(n-1)e] & \frac{2w\ln(1-\gamma)}{g_i^3}\end{vmatrix}.$$

The second order conditions for profit maximization by each factory can be satisfied if

$$\frac{-4w[b+(n-1)d]\ln(1-\gamma)}{g_i^3}-[c+(n-1)e]^2\geq 0,\quad \text{i.e.,}\quad g_i\leq\left(\frac{-4w[b+(n-1)d]\ln(1-\gamma)}{[c+(n-1)e]^2}\right)^{\frac{1}{3}}.$$

To maximize $\pi_i(p_i,g_i,P_{-i},G_{-i})$, the first order conditions are given by equations (A1) and (A2), that is,

$$a-2[b+(n-1)d]p_i-cg_i+\sum_{\substack{j=1\\j\neq i}}^{n}dp_j+\sum_{\substack{j=1\\j\neq i}}^{n}e(g_j-g_i)+[b+(n-1)d](o+w)=0, \tag{A3}$$

$$-[c+(n-1)e](p-o-w)-\frac{w\ln(1-\gamma)}{g_i^2}=0. \tag{A4}$$

The optimal prices and delivery time guarantee can be found by solving equations (A3) and (A4) simultaneously. Since (A3) is a nonlinear equation, it is possible that there are multiple feasible solutions to above equations. If $g_i^* \in \left[0, \left(\frac{-4w[b+(n-1)d]\ln(1-\gamma)}{[c+(n-1)e]^2}\right)^{1/3}\right]$, then (p_i^*, g_i^*) is the optimal solution which maximizes $\pi_i(p_i, g_i, P_{-i}, G_{-i})$.

Solution of Equation (6)

$$\text{Max } \prod = \sum_{i=1}^{n} \pi_i(p_i, g_i, P_{-i}, G_{-i}). \tag{6}$$

For factory *i*, given the other factories' prices and delivery time guarantee, we differentiate Equation (6) with respect to *pi*:

$$\frac{\partial \prod}{\partial p_i} = a - 2[b+(n-1)d]p_i - cg_i + \sum_{\substack{j=1 \\ j\neq i}}^{n} dp_j + \sum_{\substack{j=1 \\ j\neq i}}^{n} e(g_j - g_i) + [b+(n-1)d](o+A) + \sum_{\substack{j=1 \\ j\neq i}}^{n} (p_j - o - w)d.$$

Since $\frac{\partial^2 \sum_{i=1}^{n} \prod}{\partial p_i^2} = -2[b+(n-1)d] < 0,$ it can be obtained from the first order condition that

$$p_i^*(g_i, P_{-i}, G_{-i}) = \frac{w+o}{2} + \frac{a - cg_i + \sum_{\substack{j=1 \\ j\neq i}}^{n} dp_j + \sum_{\substack{j=1 \\ j\neq i}}^{n} e(g_j - g_i) + \sum_{\substack{j=1 \\ j\neq i}}^{n} (p_j - o - w)d}{2[b+(n-1)d]}. \tag{B1}$$

Substituting equation (B1) into equation (6), it can be obtained as:

$$\sum_{i=1}^{n} \pi_i(g_i, P_{-i}, G_{-i}) = \sum_{i=1}^{n} \frac{1}{2}\{a - [b+(n-1)d](o+w) - cg_i + \sum_{\substack{j=1 \\ j\neq i}}^{n} dp_j + \sum_{\substack{j=1 \\ j\neq i}}^{n} e(g_j - g_i) - \sum_{\substack{j=1 \\ j\neq i}}^{n} (p_j - o - w)d\} \times$$

$$\left(\frac{a - cg_i + \sum_{\substack{j=1 \\ j\neq i}}^{n} dp_j + \sum_{\substack{j=1 \\ j\neq i}}^{n} eg_j + \sum_{\substack{j=1 \\ j\neq i}}^{n} (p_j - o - w)d}{2[b+(n-1)d]} - \frac{o+w}{2} \right) + \frac{w\ln(1-\gamma)}{g_i}. \tag{B2}$$

Taking the derivative of (B2) with respect to *gi*, we can obtain that $\frac{\partial \sum_{i=1}^{n} \pi_i(g_i, P_{-i}, G_{-i})}{\partial g_i} =$

$$\frac{c(w+o)}{2} - \frac{ca}{a[b+(n-1)d]} + \frac{c^2 g_i}{2[b+(n-1)d]} - \frac{w\ln(1-\gamma)}{g_i^2} - \frac{c\left[\sum_{\substack{j=1\\j\neq i}}^{n} dp_j + \sum_{\substack{j=1\\j\neq i}}^{n} e(g_j - g_i)\right]}{2[b+(n-1)d]} +$$

$$\sum_{\substack{j=1\\j\neq i}}^{n}\left\{\left(\frac{w-o}{2} + \frac{a-cg_j}{2[b+(n-1)d]} + \frac{\sum_{\substack{j=1\\j\neq i}}^{n} dp_j + \sum_{\substack{j=1\\j\neq i}}^{n} e(g_j - g_i) + \sum_{\substack{j=1\\j\neq i}}^{n} (p_j - o - w)d}{2[b+(n-1)d]}\right)\frac{e}{2} - \frac{we}{2} +\right.$$

$$\left.\frac{1}{4}\left(a - [b+(n-1)d](w+o) - cg_j + \sum_{\substack{j=1\\j\neq i}}^{n} dp_j + \sum_{\substack{j=1\\j\neq i}}^{n} e(g_j - g_i) - \sum_{\substack{j=1\\j\neq i}}^{n} (p_j - o - wd\right)\left(\frac{e}{2[b+(n-1)d]} - \frac{dc}{[b+(n-1)d]^2}\right)\right\} \quad \text{(B3)}$$

In addition, by taking the second order derivative of (B3) with respect to *gi*, we obtain

$$\frac{\partial^2 \sum \pi_i(p_i^*, g_i, P_{-i}, G_{-i})}{\partial g_i^2} = \frac{c^2}{2[b+(n-1)d]} + \frac{2w\ln(1-\gamma)}{g_i^3} + \frac{1}{2[b+(n-1)d]}\sum_{\substack{j=1\\j\neq i}}^{n}\left[\left(e - \frac{dc}{2[b+(n-1)d]}\right)^2 - \left(\frac{dc}{2[b+(n-1)d]}\right)^2\right]$$

(B4)

It can be shown by (B4) that $\sum_{i=1}^{n} \pi_i(p_i^*, g_i, P_{-i}, G_{-i})$ is concave for

$$g_i \in \left[0, \left\{\frac{-4wb\ln(1-\gamma)}{c^2 + \sum_{\substack{j=1\\j\neq i}}^{n}\left[\left(e - \frac{dc}{2[b+(n-1)d]}\right)^2 - \left(\frac{dc}{2[b+(n-1)d]}\right)^2\right]}\right\}^{1/3}\right].$$

Therefore, we can obtain 2*n* equations with respect to $p_1, p_2, ..., p_n, g_1, g_2, ..., g_n$ by considering the first order conditions given in (B3) and (B1). Then we can find the profit-maximizing solution $p_1^*, p_2^*, ..., p_n^*, g_1^*, g_2^*, ..., g_n^*$ by solving these 2*n* equations.

Simulation (20 minutes)

Using Mathematica software to obtain the optimal prices, delivery time guarantees and each factory's profit as shown in Table 1

Table 1
Optimal Results under Competition and Cooperation Strategies

		Competition	Cooperation	Change
Scenario 1 Demand is more dependent on price than delivery time	Price	1.51	1.58	4.6%
	Demand	47.82	45.62	-4.6%
	Delivery Time	11.18	12.23	9.4%
	Profit	647.83	649.13	0.2%
Scenario 2 Demand is dependent on price as well as delivery time	Price	2.03	2.28	12.3%
	Demand	66.37	59.73	-10.0%
	Delivery Time	4.50	4.58	1.8%
	Profit	847.81	858.83	1.3%
Scenario 3 Demand is more dependent on delivery time than price	Price	2.33	2.61	12.3%
	Demand	53.52	48.16	-10.0%
	Delivery Time	2.43	2.43	0.0%
	Profit	825.17	835.90	1.3%

According to Table 1, the cooperation strategy leads to higher optimal price and profit than those under the competition strategy. For the delivery time guarantee, the cooperation strategy is in par with the competition strategy, i.e., when customers are not sensitive to delivery time (Scenario 1), it is not necessary to improve the delivery time guarantee (11.18 vs. 12.23); when customers are sensitive to price as well as delivery time or more sensitive to delivery time (Scenarios 2 and 3), the results under the cooperation strategy are comparable to those under the competition strategy (4.50 vs. 4.58 and 2.43 vs. 2.43).

Sensitivity Analysis (20minutes)

Using optimal prices and delivery time guarantees in Table 1 as base values, the facilitator can increase them by 10% and 20%, and computed individual factory's new demands and profits by utilizing equations (1) and (2) under the aforementioned three scenarios, and then obtained the elasticity of demand (= percentage change of demand/percentage change of price or delivery time guarantee) and the elasticity of profit (= percentage change of profit/percentage change of price or delivery time guarantee), respectively.

Table 2 Sensitivity Analysis under Competition and Cooperation Strategies						
			Elasticity			
			Demand		Profit	
			Competition	Cooperation	Competition	Cooperation
Scenario 1	Price	20%	-0.869	-0.211	-0.252	0.099
		10%	-0.517	-0.077	0.053	0.017
	Delivery Time	20%	-0.008	-0.006	0.000	0.000
		10%	-0.003	-0.001	0.000	0.000
Scenario 2	Price	20%	-0.921	-0.208	-0.276	-0.103
		10%	-0.557	-0.102	-0.015	0.006
	Delivery Time	20%	-0.631	-0.398	-0.425	-0.188
		10%	-0.406	-0.110	-0.376	-0.033
Scenario 3	Price	20%	-0.176	-0.118	-0.047	-0.025
		10%	-0.062	-0.021	0.084	0.061
	Delivery Time	20%	-0.832	-0.771	-0.203	-0.150
		10%	-0.322	-0.275	-0.044	-0.016

Table 2 shows that the elasticity under competition strategy is always more responsive than that under cooperation strategy. For example, in the first scenario, the elasticity of demand to price for the two strategies is -0.517 vs. -0.077 and -0.869 vs. -0.211 when the price increases 10% and 20%, respectively. This means that when price increases by 10% and 20%, under the competition strategy the demand will decrease 5.2% and 17.4%, but under the cooperation strategy the demand will only decrease by 0.7% and 4.2%, respectively. This implies that because all factories under the cooperation strategy can be treated as a signal negotiator in the market, they have the power of monopoly to take higher price and longer delivery time.

EPILOGUE

Based on the consultant team's analyses, the ABDX decided to establish unified standards for the lowest price and the shortest lead time in this factory town. In 2006, the cooperation agreement among Xintang jeans manufacturers was signed on February 1 and entered into force on March 15. The Anti-malicious Competition Committee, led by the Chairman of ABDX and made up by representatives from the top 30 factories in Xintang, provided for regular meetings to exchange information on this factory town's current enforcement activities and priorities, to solve unnecessary conflicts or inconsistencies between those enforcement activities and individual factories' policies, to discuss policy changes which they were considering, and to discuss other issues of mutual interest relating to the realization of cooperation in competition matters. The committee's mission was not to eliminate competition among factories, but to monitor factories to compete with each other on quality, design, and innovativeness rather than on price and delivery guarantee time.

On March 31, 2006, all jeans factories in Xintang began to carry out the unified standard of pricing and delivery. While different jeans products had different pricing ranges and cycle times, on average the new standard raised the lowest price by about 15% and extended the shortest delivery time guarantee by four more days. If a factory was found to have engaged in predatory pricing or violated the legal overtime, the ABDX would impose a heavy fine and in some extreme cases even shutdown operations.

In 2006 Xintang's total export was 212 million pieces, an increase of 10.23% from the previous production season. The average price per piece increased 15% from $4.27 to $4.93 and the workers' average monthly pay increased nearly 18%. This was the first occurrence of simultaneously increasing export and increasing price in this jeans town's history since 1992. In addition, workers' average overtime reduced from 26 hours per week to 16 hours per week; average turnover rate reduced from 140% to 35%. These achievements laid the foundation for the ABDX's next step of shedding the sweatshop image for this jeans town.

LARRY ELLISON AND ORACLE CORPORATION

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CASE DESCRIPTION

This case makes a contribution to the field of entrepreneurship by focusing on one of the most successful entrepreneurs and companies of our generation. The case can be used in undergraduate entrepreneurship, small business management, or strategic management courses.

Students will find the case study informative for several reasons. They will learn about the personality and background of Larry Ellison. What were his motivations and experience before he became an entrepreneur? Students will also learn about how Ellison founded and grew Oracle Corporation. Finally, students will examine the current problems and opportunities that confront Oracle in 2011 and they will be required to make recommendations to Ellison and Oracle.

CASE SYNOPSIS

The case examines the background, personality and rise of Larry Ellison, one of the most prolific entrepreneurs of our generation. Ellison, who co-founded Oracle Corporation, was the third wealthiest man in the United States in 2011 with an estimated net worth of $33 billion. The case further documents the startup, growth and current problems and opportunities confronting Oracle Corporation, the world's largest multi-faceted software company.

Ellison got his start by working on a database project for the Central Intelligence Agency (CIA). Codename: Oracle. In 1977, Ellison went into the database business for himself and founded Oracle with Robert Miner and Edward Oates. Over the last 33 years the mogul grew Oracle into a dominant player in the database, software, and server industries. The current market cap was $150 billion and Ellison owns more than 20% of the company.

INSTRUCTOR'S NOTES

DISCUSSION QUESTIONS

1) *Discuss the background and personality of Larry Ellison.*
2) *Perform Porter's Five Forces Model of Industry Analysis on Oracle. What distinctive competencies and resources does Oracle have?*
3) *Calculate the financial ratios (key profitability, liquidity, and asset management ratios) for Oracle using the financial statements in the case for Oracle over the past five year period. Based on the financial ratios, is Oracle financially healthy? Why or why not?*
4) *What were the major problems and/or opportunities facing Oracle Corporation in 2011?*

5) *What recommendations would you make to Larry Ellison and Oracle Corporation? Why?*

DISCUSSION QUESTIONS WITH SUGGESTED ANSWERS

1) Discuss the background and personality of Larry Ellison.

Lawrence Joseph Ellison was born in the Bronx, New York on August 17, 1944 to a 19 year old unwed Jewish mother, Florence Spellman. Ellison's childhood began with a bout of pneumonia, at nine months of age, which drove his mother to relinquish custody to her aunt and uncle hoping to provide him with a better upbringing. Ellison was adopted by his great aunt Lillian and her husband Louis Ellison, who lived on the South Side of Chicago. Ellison did not know until he was 12 years old that he was adopted, and would not meet or reunite with his birth mother until he was 48 (Encyclopedia of World Biography, 2004).

As a boy, Larry Ellison showed an independent, rebellious streak and often clashed with his adoptive father, Louis Ellison (Academy of Achievement, 2010). His father had very little faith in Larry and saw failure around every corner for him. According to Ellison, "My father would regularly tell me that I would never amount to anything. Oh, it was a powerful motivation. I think my dad had a wonderful effect on me. If fire does not destroy you, you are tempered by it. Thanks, Dad" (Wilson, 2002). In high school Ellison was quiet and withdrawn, an average student, but very intelligent.

After high school, Ellison enrolled at the University of Illinois in Champaign-Urbana with aspirations of becoming a medical doctor. However, he was uninterested in the subjects and found math and science stimulating. He dropped out of school his sophomore year when his adoptive mother died from kidney cancer. That fall, he enrolled at the University of Chicago. It was around this time that Ellison got into the computer business. Ellison learned how to program an IBM computer as part of a physics class assignment. He quickly realized that he had a natural talent for computer programming. He started working part-time programming for the university to earn extra spending cash. Ellison realized that he could make more money writing programs than a tenured professor made at the University of Chicago (Academy of Achievement, 1997). Ellison stated, "It was like a big game, it was like working on puzzles. So I enjoyed it. It paid extremely well, I could work at home, and I could work my own hours" (Academy of Achievement, 1997).

Unfortunately, Ellison dropped out of the University of Chicago after the first semester. His adoptive father was convinced that Ellison would not become successful. However, Ellison had learned the rudiments of computer programming in Chicago. He took this skill, headed out to California in1966, ending up in Berkeley. Ellison stated, "I thought I would just figure out what I would be when I got there" (Wilson, 2002). Over the next few years, Ellison hopped from job to job doing computer-related work at companies like Wells Fargo and Fireman's Fund. Ellison married, however, over time his wife had low expectations for Ellison's future. During their marriage of seven years, he switched jobs constantly. What compounded problems for Ellison were his lavish spending sprees. In 1974, his wife filed for divorce. According to Wilson (2002) it was at a session with a marriage counselor while Ellison and his wife were breaking up that he decided to become a millionaire. He had never talked about money or any concrete success before. His wife advised him to go make his million for his own sake; she was leaving anyway.

Ellison continued to work with computers. While working at a small company called Ampex, Ellison met Robert (Bob) Miner and Edward Oates, who along with himself eventually became the founding partners of Oracle. At Ampex the three worked on writing a database program for the Central Intelligence Agency (CIA). In that era, computers stored lots of information, but managing it and recalling it was difficult. Ampex was working on a way to maintain a database of information on videotape as opposed to traditional magnetic tape. The Ampex machine could search and rewind videotape at high speed. Miner, Oates, and Ellison wrote the program for the Ampex video database, which was called Oracle (Encyclopedia of World Biography, 2004).

Ellison left Ampex for a vice president position of a small firm called Precision Instruments Company. Precision Instruments was working on a project similar to that of Ampex, trying to find a way to store and retrieve masses of data, this time on microfilm. Precision Instruments needed to hire a contract company to program its software. Even though he did not have a business plan, Ellison decided to create his own company. He had a strong motivation and desire to be his own boss. According to Ellison, “I knew that I could never really survive in a conventional corporation” (Wilson, 2002).

2) *Perform Porter’s Five Forces Model of Industry Analysis on Oracle. What distinctive competencies and resources does Oracle have?*

The software industry was a labor-intensive industry with relatively few capital requirements. Because the computer hardware industry was mature, and many of the supplying industries had strong competition with multiple competent suppliers, they did not have strong bargaining power. In addition to hardware requirements, Oracle required substantial input from labor. Software and computer engineers were not only employees, but also suppliers of the knowledge that Oracle required in order to compete. With so many potential employers, the bargaining power of suppliers of the labor and knowledge (employees or independent contractors) was medium in a strong economic environment, but currently lower considering the continued weak economy and strong demand for jobs.

Oracle stated that “substantially all of our customers, including customers from acquired companies, renew their support contracts when eligible for renewal” (Oracle Annual Report, 2010). Many of Oracle’s customers depended on its solutions for day to day operations in their businesses, and even if they wanted to switch, the barriers to replace Oracle’s products were very high because changing a information management system can be very time consuming and prohibitively expensive. In addition, Oracle was a leader in innovation, so new buyers would often look to them for potential solutions.

In today’s global economy, computers are necessary to compete. Although the software and applications may be delivered in a variety of ways, there was no real substitute for the solutions offered by Oracle and its competitors.

The threat of new entrants was medium. New companies faced a competitive environment where both branding and knowledge-base requirements posed significant barriers.

However, small companies did have the ability to provide customer service, which might pull some market share away from Oracle and other established companies.

Among companies that could enter the larger enterprise applications market in the future are Intuit, which currently offered small business solutions, and Google, which may expand its product offering in the future to become more of a competitor to Oracle. Both Intuit and Google have the history and resources to compete on a larger scale against Oracle in some segments. Many other companies in various segments of the technology industry may also provide increasing competition to Oracle. The risk of new entrants into the database market was low.

The high profit potential of technology firms attracts many new entrants, and many startups are acquired by industry leaders before they become serious competition. Oracle has acquired 71 companies since 2005. It has purchased companies that will expand its product and service offering, and allow the company to diversify (Oracle.com, 2011). Although the threat of new entrants does exist, Oracle's acquisition strategy provided the company with many opportunities to expand, rather than surrender market share. In this way, the threat of new entrants was partially controlled. So what might have been a high threat was reduced to medium.

Industry rivalry in the enterprise software industry was of medium strength. Microsoft and IBM were Oracle's two main competitors in business software solutions, with SAP AG (Germany) and CA Technologies also providing significant competition. Salesforce.com was an example of a newer company that provides a Customer Relationship Management (CRM) platform to companies ranging from a few employees to major banks and corporations. Oracle's industry leadership and customized solutions help the company maintain its leadership position in relational database management. Competition from smaller companies has created some pricing pressure and risk of market share loss for Oracle (Datamonitor, 2010). Many companies offer solutions that competed with Oracle, although few could offer the comprehensive variety that Oracle had.

Because switching costs were high for customers, competition was focused more on new customers that were entering the market for enterprise software solutions. Once a relationship had been established, companies generally stayed with their current provider. This reduced the strength of industry rivalry from strong to medium. Rivalry was higher in growing areas than in established markets, although there were some companies who did switch to new providers. Rivalry was intense in some areas of Oracle's operations, but because it was such a strong industry leader, rivalry was lessened for Oracle than it was for smaller competitors.

DISTINCTIVE COMPETENCIES

Oracle's distinctive competencies included its innovation and ability to acquire and assimilate other companies. In fiscal year 2010, Oracle spent approximately $4.5 billion on research and development to develop new technologies and enhance existing products. This investment continued a three year trend of approximately 12-13% of Oracle's annual revenue being invested in R&D. It was also a reason that Oracle was one of the top 50 ranking companies for patents in 2010.

Since 1994, Oracle also invested billions of dollars in recent years to acquire and assimilate companies, technologies, and products that support and expand its existing offerings.

This investment has supported the company's growth through knowledge, resource, and customer acquisition (Oracle.com, 2011).

The two main barriers to imitating Oracle's competencies was the ability to develop software on a major scale, and the financial strength that allowed Oracle to acquire new entrants into the market. With its vast array of enterprise solutions, the development necessary to compete broadly with Oracle would be very difficult due to the resources required to develop so many solutions. However, many companies have developed solutions that competed with Oracle in a narrower scope. Many of these competing products have ended up as Oracle acquisitions.

The other main barrier to Oracle's strategy was the ability to acquire and assimilate technologies and companies. Unless a company had significant financial strength, it would not be able to acquire as easily. Also, without sufficient research and development capability, it might not be able to assimilate new technology into its own product line.

RESOURCES

Between cash and marketable securities, Oracle had $28.8 billion in liquid assets that it could use for acquisitions and other strategic uses. That balance was greater than the total of Oracle's operating expenses in 2011 (Oracle Annual Report, 2011). In short, Oracle had the cash to weather almost any storm or make any strategic move that the company chose.

In addition to assets held by the company, Oracle had a portfolio of customers that included all 100 companies from the Fortune 100 list. That client list led to more than $13 billion in 2010 revenue from software license updates and other client support, nearly half Oracle's total revenue for 2010 (Oracle Annual Report, 2010). Because it was difficult for database clients to switch service providers, Oracle held a strong position that continued to generate revenue for the foreseeable future. This continuing revenue stream helped Oracle weather economic downturns and other misfortune that may face the company or the software industry.

3) *Calculate the financial ratios (key profitability, liquidity, and asset management ratios) for Oracle using the financial statements in the case for Oracle over the past three year period. Based on the financial ratios, is Oracle financially healthy? Why or why not?*

Despite the poor economic environment worldwide, Oracle's net income has held steady at 24%, 23%, and 24% in the 3 fiscal years from 2009 to 2011. However, operating expenses have increased slightly, from 64% to 66% during that time. Although not unhealthy, Oracle has faced some decline in profitability that must be addressed. The company has also become more balanced, with hardware-related revenue increasing from $0 to 7 billion, or 0% to 19% of total revenue, while software-related revenue increased from $19 billion to 24% during that time.

Oracle's cash position has improved significantly from 2009 to 2011. The company's cash and marketable securities increased from 27% of total assets to 39% of total assets in 2011. Its cash ratio (Cash and Marketable Securities/Current Assets) improved from 138% to 203% in 2011. The current ratio (Current Assets/Current Liabilities) improved from 203% to 276% during the same time period. The company has held a constant 9% of total assets in Accounts

Receivable for each of the preceding 3 years, while Cash and Cash Equivalents have more than doubled.

Debt to Equity (Liabilities/Equity) was 86%, 97%, and 83% in 2009, 2010, and 2011 respectively. This represents much higher leverage than many competitors, which shows a high level of risk. While the company does have adequate cash on hand for immediate needs, its debt is high.

Asset turnover (Sales/Total Assets) fell from 49% in 2009 to 44% in 2010, but increased to 48% in 2011. Profitability (Net Income/Equity) dropped from 22% in 2009 to 20% in 2010, and improved slightly to 21% in 2011. This may show an improvement in operations following a lower year in 2010, but it is still a small improvement.

Overall, the company is financially healthy, with the exception of its high debt. If the company were to pay $9 billion of its cash toward debts bringing it in line with its 2009 cash ratio, then debt to equity would drop to 60%, saving on interest and reducing risk, while still maintaining a healthy cash position.

4) *What were the major opportunities and challenges facing Oracle Corporation in 2011?*

OPPORTUNITIES

Some conditions in the current technology market provided opportunities for Oracle to expand its market share. Current opportunities for Oracle included internet technology, increasing IT spending, an expanding market for software-as-a-service (SaaS), and the recent acquisition of Sun Microsystems (Datamonitor, 2010). SaaS is a software delivery method that provide access to software and its functions remotely as a Web-based service, usually through cloud computing (Webopedia, 2011). When a person searches for a book on Amazon, posts an item for sale on Ebay, or makes any online purchase using a credit card, the technology used in the transaction was likely to be from Oracle. While the internet has made products, services, and information provided by companies available to consumers in their own living rooms, that data has to be stored somewhere, and Oracle's databases provided the perfect solution. Growing internet use increased companies' needs for Oracle's systems and provided a major opportunity for Oracle to expand its market share. Particularly with Oracle's processing and cost reducing potential as demonstrated by the Transaction Processing Performance Council (TPC), Oracle had the capability of providing both the highest quality and lowest-cost solution for companies doing business online (SearchSOA.com, 2011).

In 2010 it was estimated that 240 million people, or 77% of the US population, regularly used the internet. This represented 152% growth over the number of people using the internet in 2000, and still had room to expand. Among the top 20 countries ranked by the number of internet users, the US was in second place behind China, which had 420 million internet users, which was just 32% of its population. With Chinese internet users expanding by 1,767% from 2000 to 2010, it was estimated that the China market would experience significant growth for years to come. Ten of the top 20 internet-using countries experienced greater than 1,000% internet use growth over that decade. Also, among the top 20 countries, the total growth was 417%, but has still reached just one third of the combined population of those countries. Worldwide, internet use expanded by 448% and has only reached 29% of the total world population (InternetWorldStats.com, 2010).

If the growth of the internet were to increase 100% over the next 10 years, the total number of internet users would be approximately four billion people, just over 50% of the world population. As Oracle continues to improve its offerings, it will have a massive opportunity to provide the technology necessary to run those systems. The technology to be used includes Oracle products beyond databases, including server hardware and SaaS.

With the acquisition of Sun Microsystems, Oracle had hardware available to its customers. Along with meeting the needs of an expanding internet-using population, Oracle could also sell that technology to governments, universities, and other enterprises. Many large organizations had technology filing systems that utilized servers and large mainframe computers, and Oracle could meet that need on and off the internet.

Further capitalizing on expanding internet use, many software solutions were being developed to be used as a service through a monthly or annual licensing relationship. Oracle provided multiple on-demand software solutions as services, as do many other companies. SaaS therefore provided software revenue opportunities to Oracle, and hardware revenue opportunities by meeting the needs of many other SaaS providers.

Both an opportunity and potential threat to Oracle was the economic expansion in Asia. While markets and demand are growing, so was the number of software engineers that are capable of developing competing systems. India, for example, was quickly gaining a reputation for competent technological innovation at a lower price than US companies have been able to offer. As the industry becomes increasingly more global, competition will continue to increase, but may provide a way for Oracle to seek qualified talent at a lower cost.

CHALLENGES

In recent years, Microsoft and other competitors have worked to compete effectively with Oracle in the database market space. Although a late entrant into the database market, because of its strong position in PC software, Microsoft has both the resources and credibility to compete effectively in databases. It was estimated that Microsoft may have had as much as 22% of the worldwide database market (SeekingAlpha.com, 2010). This was particularly significant as the world becomes increasingly global, and technology levels the field of competition in favor of small businesses that are more likely to use Microsoft than Oracle. Microsoft was forecasted to increase its database market share at a faster rate than Oracle through 2017, although Oracle's market share was forecasted to increase to approximately 54%.

Although Oracle had a strong first-place position in RDBMS, competition from companies including Microsoft was growing and may eventually begin to take market share from Oracle. As of 2011, Oracle was still capturing market share, but it must continue to work to maintain its position.

As demonstrated by its recent lawsuit with Google, a major risk in the technology industry was that patents and technology can be infringed upon, eroding the value of a company's intellectual property. Recently, Oracle was in a lawsuit related to Java (Gralla, 2010), which was acquired along with Sun Microsystems and may have been one of the primary benefits of the acquisition. It was possible for further Oracle-owned patents to be infringed upon, or for Oracle to be accused by other companies of infringement. Either of these scenarios could lead to financial loss, productivity loss, and the erosion of competitive advantage.

Oracle was a leader in providing technology and software solutions, and relied on constant research and development to remain competitive. The industry was dominated by the most recent, most innovative solutions as well as providers with established systems already in place. As an early leader in the industry, Oracle became a leader in relational database solutions for both private industry and governmental customers, and had expanded its expertise in middleware and applications. Regardless of size, every company must constantly improve its product offerings and innovation to solve ever-evolving problems faced by customers. If Oracle failed to innovate, it would lose market share.

Although an internal consideration, another threat to Oracle may be the risk that something happens to remove Larry Ellison from his longtime leadership role at the company. At age 66, he may not have too many more years to remain at the helm of the company he built. When the day comes that he was no longer able to lead, it is unknown who will replace him, or the effect that it may have on the company whose culture so strongly reflects the personality of its primary founder.

5) *What recommendations would you make to Larry Ellison and Oracle Corporation? Why?*

RECOMMENDATIONS – SPECIFIC FUNCTIONAL ACTIONS

Reduce selling, general and administrative costs – Oracle has slightly reduced SG&A expenses relative to sales in the last two years and it should continue to do so. Research and development should not be affected by lowering costs, other than administratively, but consulting and education may be streamlined through a lean service process, reducing the number of workers necessary to complete each project and making use of online communication technology to reduce travel. Sales and marketing are another area where Oracle could lower costs. Online demonstrations of technology, using Oracle technology, can be performed without travel costs. Both sales and educational segments of Oracle could reduce costs by implementing greater use of technology.

Outsource non-core tasks – While maintaining the necessary quality, Oracle should outsource various customer service, accounting, and administrative tasks to countries with lower operating costs. Because of its Silicon Valley location, Oracle may recognize significant savings by moving those operations to less expensive areas.

Increase database marketing toward internet vendors – Oracle should capitalize on transaction processing market leadership of its database and servers at this critical time of rapid internet use expansion. Global vendors such as Wal-Mart and Tesco, along with transaction companies such as Visa and MasterCard, are key targets for Oracle to market to as they have significant growth potential as more people use the internet. With its cost-saving capability, Oracle should focus marketing on these and other internet vendors and service providers.

Continue acquisition strategy – Oracle should continue pursuing acquisition targets that provide technological benefits and diversification potential to the company. With its strong cash balance, Oracle can leverage its financial strength through cash purchases, stock offerings, and a combination of the two.

Reduce acquisition costs – Oracle's acquisition and restructuring costs increased from $165 million and $234 million in 2008 and 2009 to $776 million and $695 million in 2010 and 2011, largely as a result of the Sun Microsystems acquisition. Because acquisitions are such an integral part of the company's strategy, Oracle should focus on keeping those acquisition costs as low as possible without affecting innovation and customer service. Although many of those costs are unavoidable, this was one area that provides significant potential for cost savings.

Anticipated Implementation Issues - Continued acquisitions run the risk of corporate culture clash and low morale of acquired companies. This could reduce the effectiveness and benefit of acquisitions. Acquisitions may also result in unanticipated costs that could negatively affect the company's financial performance.

As a global company, acquisitions and expansion into other countries may also be affected by a changing global political climate. China was one of the fastest growing markets for technology, but it has a government that can dictate how companies do business. Both directly from governments and indirectly as customers are affected by different governments, Oracle may face unanticipated barriers due to changing laws in other countries. Outsourced operations may also be affected by a changing political climate.

Attempts at reducing costs may require a reduction in benefits offered to employees, which may lead to dissatisfaction among employees. Also, if Oracle moves some operations to lower-cost areas, the company may experience reduced morale among the employees that it retains.

Imitability/Sustainability - As long as Oracle continues to invest in research and development to maintain its position as the performance leader in database technology, no other company will be able to significantly imitate its performance. The only close competitor was IBM, but with its much lower market share, challenges from IMB can be deterred through continual improvement and marketing.

Companies such as Google and Microsoft also have significant cash resources and may therefore be able to imitate Oracle's acquisition strategy, but as long as Oracle continues to push for additional quality acquisitions and moves faster than other companies that may also become interested, it can continue to acquire companies and technologies that will be beneficial to its customers and shareholders. If selected and implemented correctly, each new acquisition can provide a sustainable competitive advantage for Oracle.

Debt and expense reduction may be imitated by competition, but that would not harm Oracle's ability to save money and thereby increase profits. These are only sustainable to the point that Oracle maintains discipline and continually seeks cost saving measures moving forward.

Time Frame - Reducing debt can happen within the next quarter or as fast as it wants to start saving on interest payments. However, Oracle should reduce its debt to an acceptable target over a period of 12-18 months.

Acquisitions are an on-going process at Oracle, and should be reviewed continually to act as targets become both attractive and available. Increased marketing to capitalize on internet and other worldwide technological expansion will be most critical over the next 5-10 years. After that, growth potential may be reduced as the current market level nears its potential market.

While a large part of Oracle's success comes from its aggressive acquisition strategy, Ellison and Oracle may be wise to slow down on purchasing any other companies next few years. The Sun Microsystems deal was monumental and appears to be successful thus far, but will require continual focus and attention to reach its maximum potential. Also, waiting until the economy stabilizes will reduce the chance of potential financial losses, should customers' expendable capital tighten, forcing them to maintain current operations without purchasing new relationship software products. Oracle would be wise to make integrating the Sun culture, and their products and services, into their own environment their number one priority before taking on any more large endeavors. How well Oracle, and its stock, perform in the future will depend on how well the company succeeds at bringing together its many different parts. Its healthy financial standing, aggressive business strategies, and intelligent organizational leaders form a successful foundation for the company to stand on. It was recommended that Oracle continue to acquire businesses and expand their products and services in every industry, but it should to so with conservatively in the current economic environment.

In order to increase its profitability and market share, Oracle must not only innovate from within but also look to acquiring strategic companies that fit with the overall direction of the company. Oracle has a sizable cash basis with which to take advantage of strategic opportunities. Therefore it was recommended that Ellison and Oracle formulate a venture capital team and look to invest and/or acquire companies.

EPILOGUE

As of December 2, 2011, Oracle's stock price was $31.20. The market capitalization of Oracle was $157 billion, and the stock price was up more than 35% over the previous 2 years. Oracle provides the world's most complete, open, and integrated business software and hardware systems, with more than 370,000 customers—including 100 of the Fortune 100—representing a variety of sizes and industries in more than 145 countries around the globe. Oracle's product strategy provides flexibility and choice to our customers across their IT infrastructure. Now, with Sun server, storage, operating-system, and virtualization technology, Oracle was the only vendor able to offer a complete technology stack in which every layer was integrated to work together as a single system. In addition, Oracle's open architecture and multiple operating-system options gives customers unmatched benefits from industry-leading products, including excellent system availability, scalability, energy efficiency, powerful performance, and low total cost of ownership (Oracle, 2010).

In July, 2010, Oracle began its Mexico Development Center also known as Mexican Silicon Valley in Guadalajara. Oracle was also indicted for fraud in the same month, which involved a contract with the US for $1 billion.

On September, 2010, Mark Hurd was named President. On November 23, 2010 Oracle won a $1.3 billion lawsuit against SAP, the largest software piracy judgment in history. In March, 2011, Oracle announced that total revenues were up 37% to 8.8 billion.

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DRINKING UP THE PROFITS: A FORENSIC ACCOUNTING CASE

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CASE DESCRIPTION

This case introduces students to several forensic and cost accounting techniques. Students will read along as Dr. Scott Graham performs a forensic investigation at Sullivan's Bar. Students will be exposed to determining expected sales based on inventory usage, invigilation, observation, and other general accounting techniques. The case is targeted for students in an undergraduate forensic accounting class or cost accounting class. The case may be used as an in class discussion mechanism or assigned as a take home project. The case can be discussed fully within a one hour class if students have pre-prepared for the case. Students should expect to spend about 3-6 hours of preparation time outside of class.

CASE SYNOPSIS

This case is based on happenings at Sullivan's Bar, a drinking establishment owned by Frank Sullivan. Over the past few years Frank has noticed a decline in profits from Sullivan's Operations, even though there seems to be more customers in the bar. Frank asks one of his regulars at the bar, Dr. Scott Graham for help. Dr. Graham is an accounting professor at the local university and teaches accounting information systems. Dr. Graham challenges a few of his graduate students to help determine what could be causing the decline in bar revenues.

The case features Dr. Graham and his students as they explore operations at Sullivan's Bar. To determine where the lost profits may be hiding, Dr. Graham and his students examine the financial records, document operations, brainstorm on ideas, and do an onsite investigation and invigilation at the bar.

INSTRUCTOR NOTES

CASE OBJECTIVES AND USE

This case illustrates several cost and forensic accounting methodologies that can be used to investigate employee theft and operational compliance. The case takes place in the setting of a local bar where the employees are stealing cash, giving away drinks, and not following company policies on pouring alcohol. The case can be used in cost accounting, fraud, auditing, or forensic accounting classes to demonstrate how failure to follow company policies may impact company profits. The case also demonstrates methodologies used to investigate the theft of assets.

CASE OVERVIEW

This case follows accounting professor Scott Graham and his graduate students as they offer assistance to bar owner Frank Sullivan. Mr. Sullivan fears that he is losing money in his business as profits just are not what they use to be. Scott Graham and his graduate students begin by performing a forensic cost analysis for Sullivan's as well as conducting covert surveillance and finally an invigilation to determine if Frank Sullivan's employees are stealing from him. Students are exposed to the thought processes of Scott Graham and his students as they work out how to obtain the information they need to conduct the analysis.

SUGGESTED CLASSROOM USE

This case has been specifically designed for use in an undergraduate fraud or forensic accounting class. Before being exposed to the case students should be familiar with the following accounting topics:

- Accounting for Sales and Inventory
- The Fraud Triangle
- Internal Controls
- Invigilation (although this concept is explained in the case)
- General bar terminology.

The case works equally well as a group or individual project. Students should expect to spend about 90 minutes outside of class reading the case. Based on past history student should expect to spend about 3-6 hours working on the case questions.

Learning Objectives

1. To understand how the cost of goods sold methodology can be used to predict sales.
2. To understand how invigilation may be used to determine the amount of theft a business may be experiencing.
3. To understand the trade-off between cost accounting policies and customer service.
4. To foster a discussion regarding the types of controls that should be in place within a bar setting to prevent and/or detect theft.

Student Questions and Answers

1. Revising the Estimate:

In their original analysis Dr. Graham and his team made a few errors in their assumptions. These assumptions were critical to the analysis. Using the following assumptions recalculate the expected sales for Sullivan's Bar.

Assumptions:
a. The estimated spillage for draft beer is about 10%.
b. The estimated spillage for bottled beer is about 5%.
c. Assume that bartenders have been pouring 1.5 ounce shot drinks.
d. The bartenders are pouring beers with no foam head at the top.

Based on the revised assumptions above, what were the expected sales for the year?

NOTE TO PROFESSOR:

Answers for question 1 may vary slightly. Students may calculate spillage for draft beer and liquor drinks before determining the total number of drinks sold or they may do so after determining the number of drinks sold. This may change their answer slightly. We did not see anything wrong with either method.

Revised Estimated Sales Based on Assumptions A-D			
	KEG OF BEER		
	ORIGINAL	REVISED	
	16 oz 1-Inch Head Beer	16oz No-Head Beer	(Assumption D)
Measure: 15.5 Gallon Keg			
Average Cost Per Keg	$ 75.00	$ 75.00	
Servings per Keg*	164	124	
Estimated Spillage	0	0.1	(Assumption A)
Spillage Servings Per Keg	0	12.4	
Servings After Spillage	164	111.6	
Sale Price	$ 2.50	$ 2.50	
Sales in Dollars Per Keg	$ 410.00	$ 279.00	
Number of Kegs Sold	929.02	929.02	
Estimated Sales	$ 380,898.20	$ 259,196.58	
	BOTTLED BEER		
	ORIGINAL	REVISED	
Measure: 24 Twelve Ounce Bottles			
Average Cost Per Case	$ 15.00	$ 15.00	
Servings Per Case	24	24	
Estimated Spillage	0	0.05	(Assumption B)
Revised Servings Per Case	24	22.8	
Sale Price	$ 3.50	$ 3.50	
Sales Per Case in Dollars	$ 84.00	$ 79.80	
Cases of Beer Sold During Year	$ 3,174.17	$ 3,174.17	
Total Sales	$ 266,630.28	$ 253,298.77	
* Students may opt for the easy calculation of taking the original sales of $266,630.28 and subtracting the spillage (266,630.28 * .05)			
	LIQUOR		
	ORIGINAL	REVISED	
Measure: 1.5 Liter Bottles	1 Ounce Shots Per Drink	1.5 Ounce Shots Per Drink	
Shot Size	1oz	1.5oz	(Assumption C)
Shots Per Bottle	50.72	33.82	
Sale Price	$ 5.00	$ 5.00	
Sales Dollars Per Bottle	$ 253.60	$ 169.10	
Number of Bottles Sold	1351.77444	1351.77444	
Total Sales	$ 342,810.00	$ 228,585.06	

2. Comparing Estimates:

Using the recalculated expected sales, compare your calculations from question 1 to the actual results Sullivan's Bar achieved for the year.

Make sure you detail the differences between the original estimate and the revised estimate for each category of product.

Original vs. Revised Sales Figures			
	Actual	Revised	Difference
Product Type			
Draft Beer	$228,214.84	$ 259,196.58	$ (30,981.74)
Bottled Drinks	$240,233.63	$ 253,298.77	$ (13,065.14)
Liquor Drinks	$164,589.35	$ 228,585.06	$ (63,995.71)
Total	$633,037.82	$ 741,080.40	**$ (108,042.58)**

3. Investigate the Invigilation:

Using the answer you calculated from question 2, answer the following question: Did the amount of theft estimated by the team using the invigilation process explain the difference between expected sales and actual sales?

Note to instructor: The purpose of this question is to have the students calculate the estimated theft percentage as determined by the invigilation. They can then apply this percentage to the actual sales to see if the estimated theft percentage would explain the $108,042.58.

The invigilation showed that on the 2nd Friday when the maximum controls were in place there was $1,493.96 more in sales than on the 1st Friday. This $1,493.96 is a 12.28% increase over the first Friday's sales. Thus in the case we are assuming 12.28% of sales are lost to theft.

Difference Between Actual Sales and Revised Estimate After Considering Theft as Estimated by Invigilation		
Revised Sales Estimate		$ 741,080.40
Actual Sales	$633,037.82	
Estimated Theft %	12.28%	
Estimated Theft	$ 77,737.04	
Explained Sales (Actual + Est. Theft)		$ 710,774.86
Unexplained Difference		$ 30,305.54

4. Differences?

Examine your answer to question three. Are there any differences? What could possibly cause these differences?

Note to Instructor: The student's answers for this question will vary. The purpose of the question is to make the students realize there could be problems with the methodology used to determine *several of the factors in the problem. Students should indicate several of the following issues that may have caused the difference.*

In question three, the students should have estimated a difference of $30,305.54 between actual sales (including the estimated theft) and estimated sales (using the revised numbers).

- Average pricing was used to determine estimated sales. Since there will be deviations from the average price of products the expected sales figures could be off and explain the difference.
- The amount of theft estimated using the invigilation was done on a Friday night. This amount could be higher or lower on other nights of the week.
- The invigilation was a not a random sample and may not be representative of the total sales for the year. The sample size of one just may not be enough to predict theft over the course of the year.
- Other types of theft may be occurring such as inventory being stolen or billing schemes etc.

5. Policies:

How should Frank address the issue of the employees not following the policies? Specifically address different steps Frank can take fix this issue.

Frank needs to make sure the policies are in writing (employee manual). He should also make sure his employees know the policies and understand how to carry them out. Frank should implement training and testing on the company policies. He can let employees know that they are going to be tested by “shoppers”- customers who report to Frank any issues they see.

Frank can also install security cameras around the bar and aimed at all of the registers. This will help remind the employees that they need to follow the policies, even when they do not see a supervisor around.

6. Controls:

List and describe some controls Frank can put in place to fix the issues at his bar?

Instructors Note: We believe the answers to this question will vary as well. Students’ answers can be graded on quality. Students should be able to come up with some controls on their own but they also may be given access to do research on the web to find controls. A typical “A” answer will break the controls down into Preventative, Detective, and Corrective categories.

Preventative Controls:

- Management on the floor. While this may be considered a detective control by some students, the managers should act as a preventative deterrent to some employees.
- Video monitoring. Once again this will be both a preventative and detective control.

- Mirrors around the bar also help with visibility and may make bartenders feel like they are never “invisible”.
- Lock extra inventory up in the storage room. Have a supervisor be responsible for getting needed inventory (or at least have them supervise the bartenders as they check bottles out).
- Require that all drinks poured are entered into the register. Even spilled drinks (or dropped bottles) and comp drinks should be entered. This way inventory can be accounted for accurately.
- Put the caps on the liquor bottles that automatically pour the correct shot measurement. The bartenders would have to “tip” the bottle twice to add more liquor.
- Require training of all new hires.
- Test the employees periodically on the bar policies.
- Create a policy that every customer gets a receipt for their drink. Tell customers that if they do not get a receipt and they report this to a manager, they will get a free drink!

Detective Controls:

- Cash counts at the end of the night.
- Random cash counts during operating hours. Bringing in a new “cash drawer” and having the bartenders start their sales over allows management to see if the draw is correct during a shift. Bartenders will often sell drinks without ringing them up and to avoid suspicion they will add the money to the cash draw and remove it later in the night.
- Measure the amount of inventory used nightly.
- Some bars measure the amount of spilled draft beer by having the drain in the draft pouring area funnel into a holding tank.

Corrective Controls:

- When employees break policies punish them or send them to retraining.
- Let employees know if there is a suspicion of money or product missing. Warn them of the consequences.

7. Freebies:

Discuss the impact of Frank giving some of his customers free drinks from the both the point of view of the bartenders and of the owner. Should Frank discuss his behavior with his employees?

Instructors Note: This question allows instructors to bring up the fraud triangle and discuss the rationalization employees may use after watching Frank giving freebies to customers.

Some points to consider:

- The freebies should be entered into the register as comps to account for the inventory.
- If Frank is giving complementary drinks the bartenders may feel like they are losing tips. Perhaps Frank should put an automatic gratuity on complementary drinks.
- Frank needs to let the employees know that it is his bar and when he gives away free drinks he is giving away his own money but when the bartenders give away free drinks, they are giving his money without his permission.

8. Sliding:

In the case sliding was considered fraud. However, some experts do not agree. Do you consider sliding fraud? Should Frank give him employees some latitude in giving out complimentary drinks?

Instructors Note: The student answers will once again vary based on their experience in bar settings and the local customs in their region.

In some areas it is customary for a bartender to give a complimentary drink for every 3 or 4 drinks purchased. In other areas, that may not be the norm.

If the students argue the bartenders should be able to give free drinks to customers, they should express some method of accounting for this behavior.

9. Bartender Fraud:

Why was it so easy for the bartender to get away with fraud in this particular case?

Obviously there was a complete lack of internal controls around the bar areas. There was no supervision, no preventative, detective, or corrective controls. The bartenders were not properly trained when hired and they were either not aware of company policies or just did not care about the policies.

10. Other types of fraud schemes I:

An additional type of fraud that has been discovered in the hospitality industry is bartenders selling drinks from their own bottles. What would be the effects of this type of fraud on the financial statements compared to skimming or sliding? Make sure you discuss the specific accounts that would be impacted and the ratios that would be affected.

In the types of frauds that were included in the case (skimming and sliding) we would see the impact of the frauds in reduced sales and increased cost of goods sold percentages. Since skimming and sliding sales are not entered into the books the sales will be understated.

If the bartenders bring their own bottles to work, our inventory records are not going to be off (unless the bartenders do not keep track of how many drinks they are pouring from their own bottles). This type of fraud will be hard to detect if the bartenders pour drinks from their own bottles and do not ring the sales into the register. We should notice that overall sales will appear to be lower than our crowd may indicate. We may also see a rise in the percentage cost of mixer drinks (OJ, Soda, etc.).

Careful supervision should be able to prevent a fraud such as this.

11. **Other types of fraud schemes II:**

What other types of fraud schemes could happen at a bar like this? List at least three schemes and the impact they would have on the various financial statements and managerial measurements. How would the fraud likely be committed and how would it be prevented and/or caught.

Instructors Note: Once again this is a very open ended question and student responses will vary.

- Stealing Inventory from stockroom- impact cost of goods sold
- Procurement Fraud- this could include buying goods from select vendors with kickback arrangements. This type of fraud increases our costs but within the company there may be no proof of the kickback. Frank needs to make sure he knows his vendors and Frank needs to watch his employees who are ordering the inventory.
- Stealing Cash from the register- small amounts of cash missing may be disregarded as poor cash handling when making change. This type of discrepancy in cash needs to be monitored. Employees who cannot handle cash need to be retrained or let go.
- Charging extra to serve under age customers- If the bartenders keep the extra money this will not show up on the books. One method to prevent this fraud is to separate checking the IDs of patrons with giving drinks. Hire a full time doorman to check IDs. The bartenders could then ID anyone they were suspicious of as a detective control over the bouncers work.

12. Frank's Perspective:

Assume that Frank is correct and that he will lose some business if he starts pouring beer with a 1 inch head and 1 ounce liquor drinks. Frank estimates he will lose 10% of his customers. From the financial perspective, if Frank makes this change, would Sullivan's Bar be more or less profitable?

Below is a comparison of following the original pouring formulas (draft beers with a 1 inch head and liquor drinks with a 1 once shot) vs. what actually been happening in the bar (beers filled to the rim and liquor drinks with 1.5 ounce shots). These figures include the new spillage assumptions under both columns. Frank estimates that by changing the way his bartenders pour drinks, the bar will lose 10% of sales to unhappy customers. As can be seen in the chart below, with the original pouring formulas, Frank's sales estimated to be $938,917.14. If Frank were to lose 10% of this amount to unhappy customers, his revised sales would be $845,025.43. Using the current pouring methods, Frank's sales are estimated to be $741,080.40. Thus by switching to the more stringent pouring policies Frank, even after losing 10% of his sales, Frank would still expect to make an estimated $103,945.03 more in sales and profit.

Comparison of Sales Based on Different Pouring Policies

	Estmated Sales		
	1 in head and 1 oz shots	**No head, 1.5 oz shots**	**Difference**
Draft Beer	$ 342,808.38	$ 259,196.58	$ 83,611.80
Bottle Sales	$ 253,298.77	$ 253,298.77	$ -
Liquor Sales	$ 342,810.00	$ 228,585.06	$ 114,224.94
Total Expected sales	$ 938,917.14	$ 741,080.40	$ 197,836.74
Estimated 10% loss of sales	$ (93,891.71)		$ (93,891.71)
	$ 845,025.43		
Increase in Sales/Profit			$ 103,945.03