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EDITORIAL BOARD MEMBERS

TABLE OF CONTENTS

BRAND-NEW CAR VS. SECONDHAND CAR: THE NEVER-ENDING DILEMMA

Pajaree Ackaradejruangsri, Asian Institute of Management

CASE DESCRIPTION

The primary subject matter of this case concerns some of the important issues that consumers might face when making buying decisions. The case is designed to suit the class discussion well, being very short and precise, but giving enough room for the students to engage in critical thinking (rational decision-making process versus bounded rationality decision-making process). The students must analyze the case from various perspectives (taking into consideration the cultural factor, social factor, personal factor, psychological factor, etc.), and make a decision based on the information provided, and assuming the roles of Tip and Pon (cognitive versus emotional decision making, optimizing versus satisfying decision making, compensatory versus non-compensatory decision making, etc.). The case also provides an opportunity for the student to exercise some basic calculations. The case has a difficulty level of appropriate for sophomore level of marketing management course. The case is designed to be taught in one and a half class hours and is expected to require one to two hours of outside preparation by students.

CASE SYNOPSIS

Tip had just come back to work after a few months of maternity leave. Things seemed to go well until the day that her husband Pon received a call, with news of his promotion to be a new sales manager. It was very good news indeed, but other alternatives would need to be given for Tip and her baby to commute around by themselves since, as a sales manager, Pon would have to visit his clients in the other cities. As of that time, they had only one car. Taking a taxi was ruled out as a good alternative for Tip; she had grown very tired of being refused and waiting for an hour at a time. Perhaps buying another car would prove to be a better alternative. Despite the subject complexity and the saving plan that they had for their baby boy, they agreed to buy a Honda Jazz, an eco-car. But which one should they go for? Should it be the latest model, with the warranty performance of 2014, in attractive yellow pearl? They would have to queue for this for two more months. Or, should they go for the more economical 2010 model, in reasonable condition, and colored crystal black pearl—ready for a hop inside? Tip and Pon are caught in a big dilemma!

CASE BODY

“Honey, I think we need to talk. I just can’t stand this anymore; it’s too tiring,” Tip exhorted, looking miserable while having dinner with her husband, Pon. “Today it took me almost an hour to catch a taxi. All the taxis that I hailed pulled over, but nine out of ten will come up with excuses not to go to our place. ‘Sorry Ma’am! I have to return the car before 6:00 PM,’ ‘the car is running out of gas Ma’am,’ or, ‘I am a new driver Ma’am, I am not so sure about the direction.’ Gosh! This is nerve-wracking. If they had to return the car or if the car was running out of gas, why did they turn on the 'Available' sign or even pull over, then? I don't know what's going on now and it has been like this for so long. May be it's the time for me to have my own car!" a stressed Tip complained to her husband.

Tippawan, or Tip, is a 29-year-old project assistant at one of the FMCG firms in Bangkok and a mother of a seven-month-old baby. After her maternity leave ended four months ago, she decided to go back to her work.

During the first month of her return to work, everything went fine, as both of them had planned. They would get up at 5:00 AM, drive to the house of Tip's parents about half an hour away for their baby's day care, take almost an hour's time to drive to Tip's office, and finally, take another thirty minutes to Pon's office, following the reverse route going back home. This was their everyday routine until one Saturday about two months ago, when Pon received a phone call from his boss and was informed of his promotion to new sales manager. This was great news for a growing family, but it also implied that Pon had to visit clients in other cities at least twice a week and that he would not be able to return in time to pick Tip and the baby up. Pon started to worry about his family, but Tip reassured him, "things will be alright, I just need to take a taxi on those days. Don't worry, I can do this."

Yes, there are thousands of taxis in Bangkok, but not many of them are good taxis. A number of passengers have complained about their high refusal rate, other unprofessional manners or unfair charge notwithstanding. Without a doubt, Tip was one of them.

The Road to Buying a New Car

After several serious talks, Tip and Pon agreed to buy a car. But what type of car? From what company? A brand-new car or a secondhand car? More issues were raised.

"Honey, don't look at me. I don't know anything about cars, except how to drive, but if you ask me, I would rather go for a small car like an eco-car—more fuel-efficient, simple but functional, easy for me to park at my office, but still enough space for my groceries when I shop," said Tip.

"Okay, that sounds alright, I think we could afford that. By having an eco-car, we can still make some savings for our boy as well. Oh! I remember now, there is a secondhand car dealer on the way back home. The other days I think I saw that some of them were eco-cars. How about we go there over the weekend? You wouldn't mind a secondhand one, right?" Pon asked.

"Well I don't mind having to drive a used car," said Tip. "Indeed it is cheaper, but in the case that there is an engine problem on the way back home, what should I do? I don't want to see myself with one hand holding our boy and another hand opening up the hood, trying to figure out what went wrong."

"And you remember my friend Pin, right? She bought a car a year ago, and it has broken down several times already. She said the garage that she went to for repairs told her that her car was submerged. I just hope that if we opt for a secondhand car, it will be a good one. No submerging, no odometer trouble, and no major accidents. I hope our investment is the right one, not with ongoing costs like Pin's. I really feel so sorry for her."

Pon seemed to be convinced by his wife's reasoning. "Okay," he said. "For now, let's leave this to me. I will try to ask my father and my friends if they know any good secondhand car dealers that we can rely on, or if he knows someone who has experience in this. At the same time, let's check out both the secondhand car dealers and the authorized showrooms. Then we will discuss and decide later."

Tip looked at her husband with a thankful smile in her eyes, but could still relive some moments from her long evening.

One month later and after sleepless nights of online searching and reviewing, discussing with friends, and visiting countless showrooms and dealerships, Pon and Tip finally sat down with excitement for a final discussion.

"So we agree on Honda Jazz, right? Not too small, not too big, and very stylish—just what you like. We can even drive the car to the beach for a weekend trip, or send our boy to school when he is ready for kindergarten later on. Now, my question is, should we go for a brand-new car or a secondhand car?"

As Pon pitched his final question and before Tip could respond, one point drew him back. "Oh, don't forget that if we want the brand-new Jazz in attractive yellow pearl—your favorite color—we have to queue for almost 2 months. But if we are good with the 2010 model in crystal black pearl, we can have it right away, probably by the end of next week."

Tip paused for a moment, looked at all the numbers that lay in front of her, and tried to recall what she felt like during the test drives, and many noises filled her mind. Then she replied, "Well, honey… what do you think?"

Table 1
Facts about Brand-New Honda Jazz vs. Secondhand Honda Jazz

Brand-New Honda Jazz 1.5S MT 2014, Attractive Yellow Pearl		Secondhand Honda Jazz 1.5S MT 2010, Crystal Black Pearl	
Offer Price	555,000 baht	Offer Price	395,000 baht
Down Payment	25%	Down Payment	25%
Interest Rate/Year	2.09%	Interest Rate/Year	5%
Term (Months)	60	Term (Months)	60
VAT	7%	VAT	7%
Promotion Campaign	- Cash back 5,000 baht - Patrol voucher value 10,000 baht - Free 1st class insurance value 13,000 baht for first year	Ownership Transfer Fees	3,000 baht
		Engine Checking & Tires Changing Fees	15,000 baht

Note: As of October 2014, 1 USD is equivalent to 32 Baht.

Table 2 **Tip and Pon's Monthly Income and Expenses**	
Lists of average monthly income and expenses	Amount (baht)
Pon's salary	50,000
Tip's salary	32,000
Pon's gasoline allowance	10,000
Tip's transportation allowance	3,000
Health insurance	998 x 2
Home loan	20,000
Trash collection	400
Home cable and internet	998
Baby day care and baby expenses	6,000
Saving	20,000
Electricity utility	1,500
Water utility	450
Tip and Pon's cell phones	998 x 2
Food	18,000
Pon's personal expenses	3,000
Tip's personal expenses	5,000
Entertainment and recreation expenses	3,500
Parents' allowance	5,000
Home telephone	150
Miscellaneous	7,510

Note: Tip and Pon currently have 285,000 baht in their saving account, and when they actually buy another car, it adds an additional cost of 5,000 baht for Tip's gasoline expenses.

ACADEMIC DISHONESTY IN AN ACCOUNTING ETHICS CLASS: A CASE STUDY IN PLAGIARISM

Donald L. Ariail, Kennesaw State University
Frank J. Cavico, Nova Southeastern University
Sandra Vasa-Sideris, Kennesaw State University

CASE DESCRIPTION

The primary subject matter of this case concerns the issue of cheating in the form of plagiarism, and plagiarism in the broader context of professional ethics. It is appropriate for any upper level accounting course (junior, senior, or graduate level students).While the case incident involves plagiarism in an accounting ethics class, it can easily be used in any course that addresses ethics including professional ethics. The case questions provide students "food for thought" and the basis for written assignments as well as in-class discussion of both the actual and potential consequences of plagiarism. While the incident described involves plagiarism in an accounting ethics class, the case can easily be used in any course that addresses ethics, including professional ethics.

CASE SYNOPSIS

This case is based on a real event in which a student, in an accounting ethics course taught by one of the authors, plagiarized two of his end-of-term papers. The names of the participants and the location have been changed. Given the ease with which students can copy and paste from electronic resources, plagiarism has become a major problem in higher education. Suggested questions are included which provide the instructor with a tool for educating students regarding what constitutes plagiarism, including the school's and instructor's policy regarding plagiarism; the CPA exam and professional requirements regarding ethical behavior; and the applicability of ethical theories to plagiarism.

CASE BODY

The following exchange took place during a phone call between Professor Blanchard and John Edwards, a student in his accounting ethics class:

John: "I did not cheat on those papers. The sources were included as references."
Professor Blanchard: "But John, on the ethics paper you copied word-for-word each of the four codes of ethics. Instead of comparing and contrasting them as required, you copied and pasted them one after the other without using quotation marks or citing the sources in the text. And, on the scandal paper you googled the scandal and then copied and pasted from four sources without any attribution. None of the words in the paper

were your own. What you did is the very definition of plagiarism, which is cheating by using the words or thoughts of others without proper attribution."
John: "I did not cheat."
Professor Blanchard: "I disagree. You have plagiarized both of these papers. Please meet with me tomorrow at 2:00 pm. At that time I will go over the papers with you, explain what constitutes plagiarism, and give you my decision regarding the grade on the papers including any additional consequences."

Background Information

After completing his doctorate, Professor Martin Blanchard received his first appointment as an assistant professor of accounting. Since his dissertation was related to accounting ethics the accounting department chair assigned Martin to teach the undergraduate accounting ethics course. In this Southwestern state, accounting students applying to take the CPA exam must have earned 150 semester hours of college credits and must have passed an ethics course approved by the state's board of accountancy. Professor Blanchard had gone through a rigorous process to get his course accepted by the board and had become the only professor at the University approved to teach accounting ethics.

The Professor's ethics course required students to apply Utilitarian, Kantian, and virtue ethics and the values of the accounting profession covered in two textbooks and in various accounting case studies. In addition, the students were assigned two term papers that were due several weeks before the end of the semester. The first paper required the student to compare and contrast the ethical principles of four different professional codes of ethics: the American Institute of Certified Public Accountants (AICPA), the Institute of Management Accountants (IMA), the state's code of ethics, and one additional code to be chosen by the student. The second paper required the student to explain the facts surrounding one accounting scandal and to analyze the ethical principles violated pursuant to Codes of Ethics and ethical theories. The course syllabus indicated that these papers would count for 20% of the course grade (10% each).

With almost 50 students in the class, the grading of these lengthy papers was quite time consuming. About midway through the grading process, Professor Blanchard came to John Edward's two papers. As soon as he read the first paragraph of the ethics codes paper, he became concerned. It was obvious to anyone familiar with the AICPA Code of Professional Conduct that the first paragraph of the paper was the Code's Preamble. His additional scrutiny found that the entire paper was composed of text copied word-for-word from the four codes of ethics. Not one word of the paper was that of the student. Following this discovery, Professor Blanchard proceeded to read John's second paper. With his suspicion aroused, a Google search was made of the accounting scandal. Not surprisingly, the very first reference that popped up yielded several pages of text included in John's paper. Additional research by the professor found that most of John's paper had been lifted word-for-word from four Internet available works. Again, John did not give any attribution within the text or by footnote to the authors of these works. In addition, only two of the four sources were included in the list of references. Consequently, Professor Blanchard intends to institute sanctions against the student for plagiarism.

BUNDLING, CORD-CUTTING AND THE DEATH OF TV AS WE KNOW IT

Dmitriy Chulkov, Indiana University Kokomo
Dmitri Nizovtsev, Washburn University

CASE DESCRIPTION

This case describes the changing landscape in the paid-television industry and provides an opportunity to review the underlying principles of bundling, price discrimination, a-la-carte pricing, and other pricing strategies. The case is designed to cover a number of learning outcomes in a managerial economics course at the M.B.A. or upper undergraduate level and has been tested in M.B.A. economics courses at two business schools over several semesters. The content of this case may also be used in other business courses including marketing and strategic management.

CASE SYNOPSIS

Firms in the paid-television industry, in particular cable TV companies, have relied heavily on the practice of bundling, selling only packages of channels to consumers. This pricing strategy is challenged by recent developments including the shift to internet streaming of television programs as well as rising costs of television programming content. Consumers respond to increasing options for obtaining video content as many of them abandon the traditional cable TV companies and "cut the cord". Consequently, the pay-TV industry is considering whether the ability to offer TV channels individually in an "a la carte" format is viable.

This case provides an opportunity to review the conditions for successful implementation of bundling and a-la-carte pricing strategies. An examination of the current industry trends also leads to the discussion of cable companies' optimal responses to higher costs of programming content and increased number of substitutes for consumers.

CASE BODY

The pay-TV industry faces a revolution both in the US and world-wide. On the one hand, the popularity of pay-TV programming is at an all-time high as pay-TV networks such as HBO and Showtime invest in lavishly produced programming that is well-received by both viewers and critics. Traditional pay-TV providers, which include cable and satellite TV companies, reach over 130 million households in the US and an average household spends seven hours a day watching TV (FCC, 2013). On the other hand, consumers who have long been at the mercy of cable and satellite TV providers are now finding a variety of new ways to get their favorite TV content. New entrants in the pay-TV market including Netflix and Amazon provide alternatives to the traditional cable TV at a significantly lower cost. More consumers choose to "cut the cord" and receive their video programming on demand from a free or a paid subscription service. Some industry observers have even proclaimed "the death of TV as we know it" (Yarow, 2015).

The rising price of traditional pay-TV offerings is noticed by consumers and regulators alike. According to the Federal Communications Commission (2014), the average cost of a monthly expanded basic cable subscription rose from \$27.88 in 1998 to \$64.41 in 2013. A separate research report from NPD Group states that the average cable TV monthly bill in the U.S. rose from \$40 in 2001 to \$86 in 2011, and is projected to rise to \$123 per month in 2015 (Kritsonis, 2013). Figure 1 compares the growth in the price of cable TV and the inflation rate measured by the Consumer Price Index. Over this period, cable TV prices have been rising at four times the rate of general inflation.

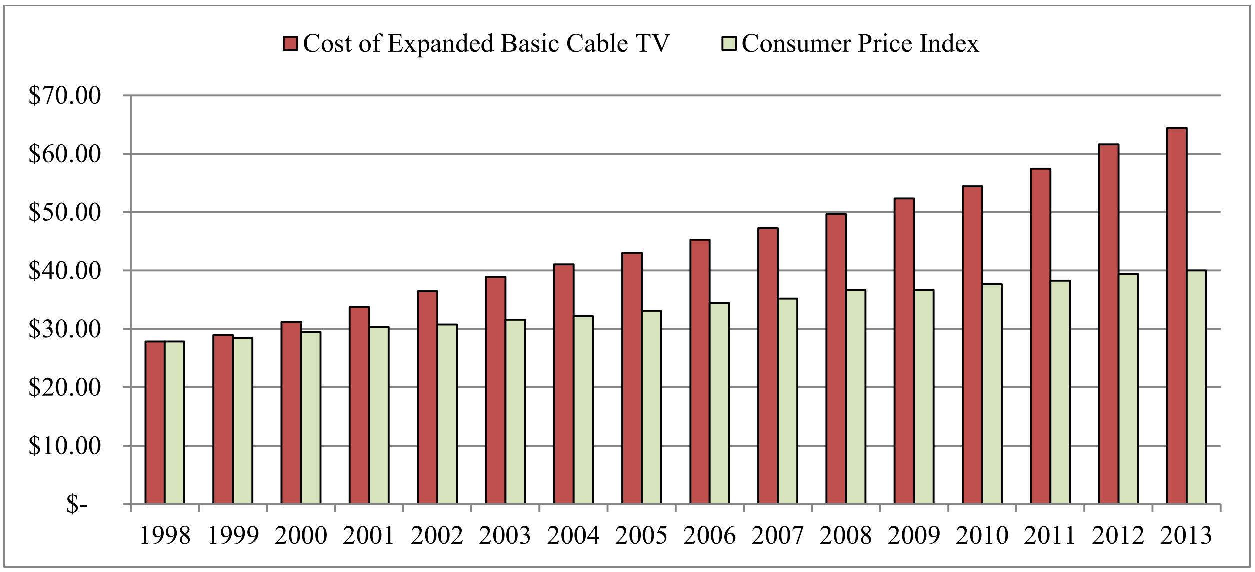

Figure 1. Cost of Expanded Basic Cable TV Bundle

Source: FCC (2014)

As prices of traditional pay-TV access continue to increase, there is an emerging narrative suggesting that the best way to cut those bills down and encourage more competition from providers is to offer consumers the opportunity to select individual channels they purchase. This model is known as “a-la-carte” pricing. Recently, Republican Senator John McCain and Democratic Senator Richard Blumenthal sponsored a bill that would require pay-TV operators to offer a-la-carte pricing. McCain asserts that special interest groups have “stacked the regulatory deck in favor of preserving an outdated business model” and advocates the benefits of a-la-carte selection of channels (Kritsonis, 2013). In Canada, broadcasters are now required to offer a low cost base package of local and educational channels to consumers. Beyond the base service, Canadians are now able to subscribe to individual channels or small bundles of channels that, by law, must be "reasonably priced." The Canadian system came to be known as "pick and pay." (Lazarus, 2015)

This push to a-la-carte pricing represents a major departure from the traditional pricing model in pay-TV. For many years, the pay-TV market in the US has been dominated by providers bundling the individual channels they offer into packages. Despite increases in the number of channels offered to consumers in these bundles, a typical consumer only chooses to watch a few channels on a regular basis. Figure 2 shows the number of channels received and watched in an average TV household. In 2013, a typical consumer watched only 17 channels out of 189 available in the programming bundle.

While bundling is common in many product markets – with McDonald’s Happy Meals and the Microsoft Office software suite providing two of the better-known examples – it has become pervasive in the pay-TV industry. Most consumers see no other option but to purchase their TV channels in a bundle. Bundling may help the firm realize economies of scale and economies of scope in product delivery. Proponents of bundling suggest that it is essential for the survival of niche channels that cater to specific interests or minorities and will not have sufficient support to be offered in the a-la-carte environment.

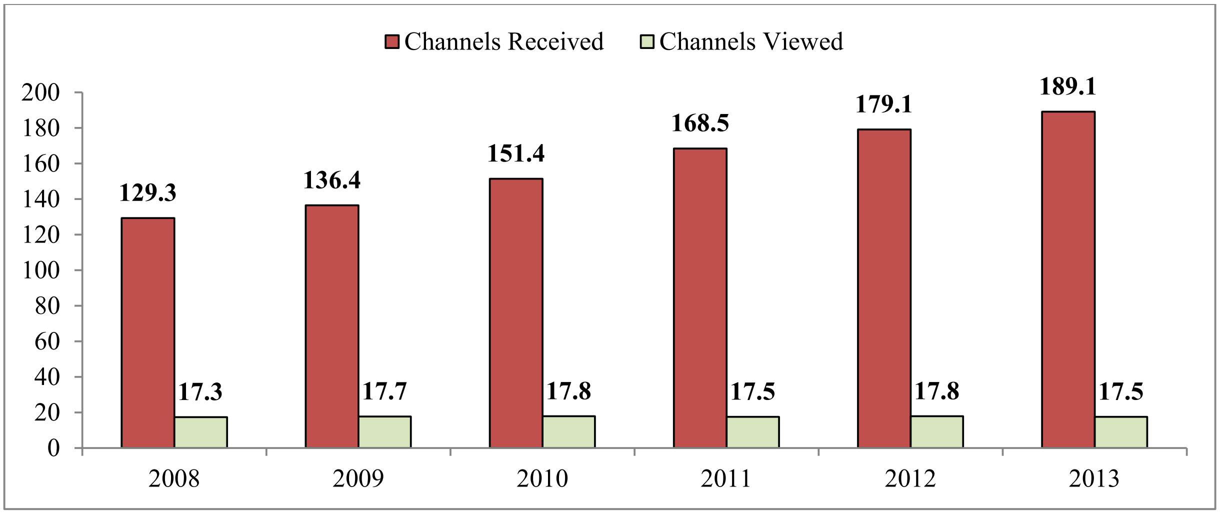

Figure 2. Channels Received and Watched per TV Household

Source: Nielsen (2014)

Critics of bundling claim that it forces consumers to buy channels that they never watch. Academic studies that compare bundling and a-la-carte pricing of TV channels (Crawford and Cullen, 2007; Crawford and Yurukoglu, 2012) suggest that consumers will be better off with a-la-carte pricing. Even with a higher price per channel, a consumer may choose to purchase a smaller number of channels and focus only on the channels they are interested in.

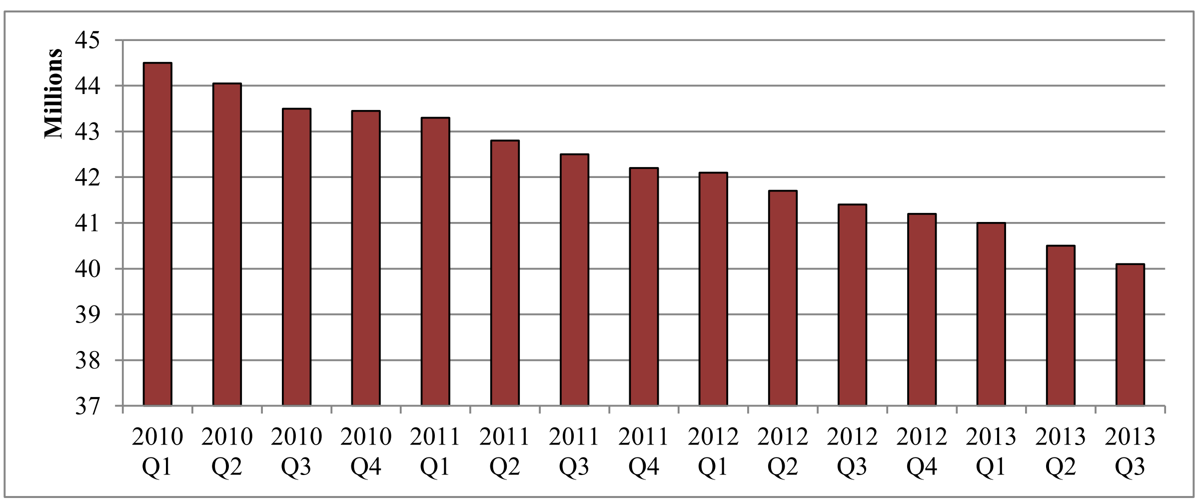

Figure 3. Cable TV Subscribers

Source: ISI Group, Edwards (2013)

The environment in which pay-TV companies make their pricing decisions is changing quickly. Cable TV companies face a declining customer base. Figure 3 reports the number of cable TV subscribers that shows a consistent decline since 2010.

Consumers have a greater number of options in accessing video content than ever before. As of 2015, Netflix and Hulu Plus offer on-demand monthly subscription plans that allow access to many of the popular TV shows and movies for under $8 per month ($96 per year). Amazon Prime offers access to hundreds of thousands of movies and TV shows for one annual fee of $99. All of these services are now available on Smart-TV and Blu-ray devices, as well as on tablets and mobile phones.

The increased choices for consumers fuel a generational divide. Millennials – the generation of 18- to 34-year-olds – access video content in a different way than their predecessors. Figure 4 reports survey data on video viewing behavior and demonstrates that the over-35 generation is still more likely to watch TV either live or recorded on a DVR, while millennials are more likely to utilize a streaming service. There is a greater share of "cord-cutters" among millennials, and many of them have never had a cable or satellite TV subscription. Furthermore, many cord-cutters do not even have a high-speed internet subscription that has been a requirement for using online streaming services until recently. In some of the larger cities, there is sufficient penetration of free Wi-Fi internet that allows a consumer to access the network and stream video content without any subscription fees (Edwards, 2013).

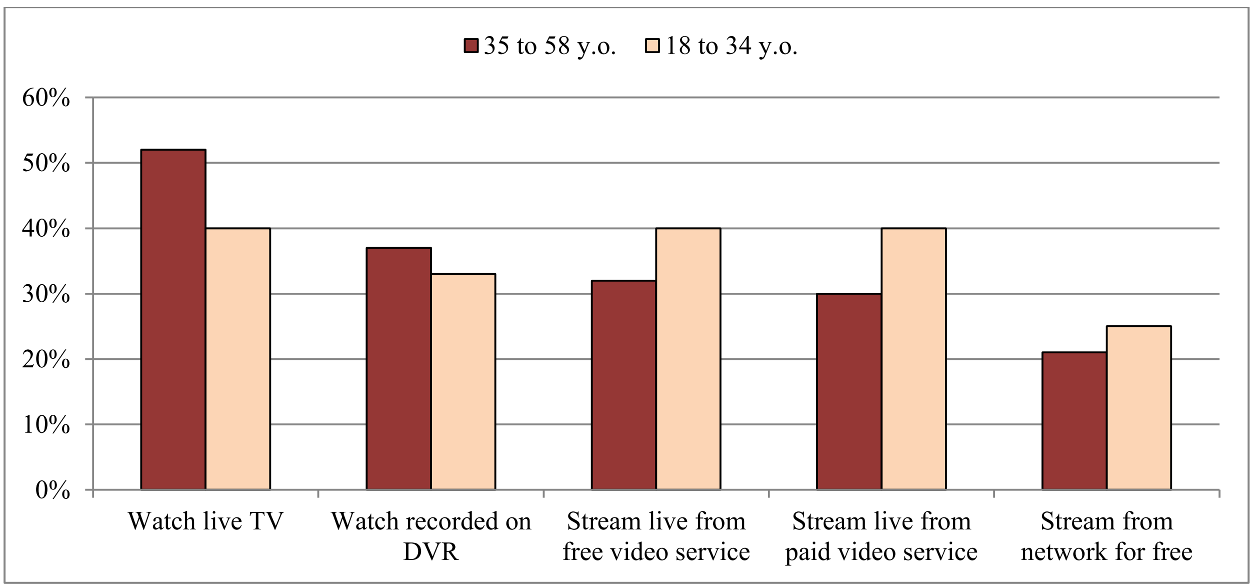

Figure 4. Ways Consumers Access TV Programming

Source: Forrester Research, Edwards (2013)

In addition to declining demand as consumers face a greater array of substitutes for live TV, the TV providers must also come to grips with the rising costs of their programming content. Improved production values led to the creation of many award-winning TV shows by pay-TV networks, as well as by recent entrants to the pay-TV industry such as Netflix and Amazon. However, the actors in these TV series now command salaries in the millions of dollars, and the rising quality of production also contributed to rising costs.

The financial performance of cable and satellite TV companies, however, has been exceptionally strong over the recent years. AT&T announced the acquisition of DirecTV satellite

TV company at a significant stock price premium in 2014. As seen in Figure 5, over the period from January 2012 to July 2015, the stock price of Time Warner Cable rose over 198%, Comcast went up 171%, Charter Communications stock price increased by 227%, and Dish network showed 134% growth. In comparison, the Dow Jones index rose only 46% over this period.

Figure 5. Cable and Satellite TV Company Stock Price Performance

Source: Google Finance

Investors seem to believe that the revenue streams of traditional cable and satellite companies still provide value to shareholders. Even as the number of households that subscribe to cable TV declines, the increased prices they pay for their TV packages contribute to stronger revenues (Edwards, 2013). Many advertisers still focus on the large, mass audiences that are difficult to access with any other kind of media, mobile or otherwise. The Super Bowl match watched live on TV is still the only media property than can reach over 100 million people in the US for a three-hour time period. The scarcity of such large audiences outside of live TV events makes even declining audiences of the cable and satellite TV providers valuable to advertisers.

Traditional pay-TV providers are not oblivious to change. The satellite TV company Dish network announced in 2015 its plans to offer a package of channels that are streamed over the internet for only $20 a month. The new service from Dish does not require any kind of cable or satellite TV subscription, and may even be used with free Wi-Fi internet. At the time of its launch, it has 10 channels, including TNT, TBS, CNN, Food Network, HGTV, Cartoon Network, Adult Swim, the Disney Channel, ESPN, and ESPN2.

In 2015, Verizon announced the creation of "custom TV" plans for its broadband customers. These plans will provide a low cost base package and will allow the customers to pick and choose among smaller themed bundles for genres such as sports, kids, and lifestyle. This decision from Verizon has been challenged in court by Disney, owner of ESPN sports channels. Disney and ESPN claim that removing their channels from the base package and putting them into a separate bundle for customers to choose is a violation of their contract with Verizon (Flint, 2015). Other cable companies such as Comcast and Time Warner Cable now offer TV packages based on internet streaming to accompany their high-speed internet services.

None of these providers seem willing to abandon the bundling strategy that has worked so well for them over the years.

Managers of pay-TV companies must develop action plans to respond to the changing business environment, characterized by the increasing number of substitutes for pay-TV services on the one hand and the increasing cost of programming on the other. They must determine the best way to compete with the emerging new content providers and explore whether to engage in price competition, or focus on product differentiation instead. The managers must also decide whether the reliance on bundling continues to be viable in this new environment.

CASE QUESTIONS

1. Explain the essence of the bundling and a-la-carte pricing models. What conditions are necessary for the implementation of these two pricing strategies? Which of the two models is closer to the traditional monopoly pricing?
2. Identify and summarize the constraints under which pay-TV firms are operating and the opportunities available to them.
3. Is the pricing power of pay-TV companies greater or smaller today compared with fifteen years ago? What implications does this have for their ability to experiment with bundling and other non-trivial pricing strategies?
4. Does bundling always produce higher profits than traditional monopoly pricing?
5. Does the a-la-carte pricing model always lead to higher price per TV channel?
6. Based on the facts described in the case, are you confident that demand in the pay-TV market is decreasing (shifting to the left)?
7. You are a consultant hired by one of the pay-TV companies. How should the company deal with the increasing number of substitutes for pay-TV services and the increasing cost of programming? Possible new legislation aside, would you recommend that the company offer its channels in bundles, or voluntarily experiment with a-la-carte pricing?
8. As the aforementioned consultant, can you suggest an alternative pricing strategy for maximizing profit (other than bundling or a-la-carte pricing)? In your answer, discuss the conditions for implementing your alternative strategy and the mechanism for implementation.

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BODY OF THE CASE
A LOONIE TOO MUCH: HOW TARGET FAILED TO BRING HOME THE CANADIAN BACON[1]

Ed Chung, Elizabethtown College
Carolan McLarney, Dalhousie University
Cristina Ciocirlan, Elizabethtown College

CASE DESCRIPTION

The primary subject matter of this case concerns MANAGEMENT. Secondary issues examined include CORPORATE STRATEGY, DECISION-MAKING, RETAIL AND SALES, INTERNATIONAL BUSINESS AND MARKETING. The case has a difficulty level of FOUR. The case is designed to be taught in ONE class hour and is expected to require TWO hours of outside preparation by students.

CASE SYNOPSIS

The case describes the 2011 entry of Target into Canada by leasing and renovating over 200 Zellers stores across the country. The corporation set an ambitious goal of $6 billion by 2017 and saw Canada as a tremendous growth opportunity. However, by 2013 the company did not realize its anticipated sales targets and gross margin tumbled. Some problems that the company faced included large stock-outs, underestimating the Canadian competitors, logistics issues, high price disparities between Canada and the US, data breach, and increased pressure from labour unions. The case is suitable in Marketing, Management, Retail and Sales, Corporate Strategy or International Business classes especially those at the undergraduate level. It may also be suitable for students in an introductory course at the MBA level. The case could be covered in a typical 45-50 minute class period. The case will provide a rich amount of learning, as several themes would emerge from the class discussion. Students could perform an industry analysis, evaluate several methods of foreign entry, identify heuristics in the decision-making process, appreciate the benefits of Evidence-Based Management (EBM) and understand the need to conduct deeper research into the cultural nuances between Canada and the US.

[1]This case is sourced from information available in the public domain up to the end of July 2014. The case is written to facilitate class discussion and is not intended to portray any of the mentioned parties in any evaluative light. No assessment of the actions of any parties involved is intended or displayed

PROLOGUE

In May 2011, amid much fanfare, Target Corporation officially announced its $4.4 billion push into Canada. It would be the company's first venture outside the US. It acquired the leases on 220 Zellers (a Canadian mass merchandiser) stores across all ten provinces of Canada. The leasehold acquisitions alone cost some C$1.86 billion.[2] In addition, the company planned a massive renovation of these acquired locations, investing upwards of $10 million at each location. Between 150 and 200 people would be employed at each store as they open. Target Canada anticipated opening its first stores in early 2013, with more than 100 stores slated for that year.[3] At the time, the company expected the Canadian venture to turn a profit by the fourth quarter of 2013.

By October 2013, it became apparent that Target Canada would not meet its ambitious sales and profit targets.[4] However, the company maintained that Canada remained key to Target's growth over the next five years. Target Canada's CEO, Tony Fisher, projected Canadian sales to reach $6 billion a year by 2017, despite its initial stumble. The company continued to open new stores in Canada.[5]

Full year 2013 results were disappointing, however. With 124 stores by the end of the year, the Canadian unit produced a paltry $93 revenue per square foot (vs. $300 in the US), and gross margins stood at a dismal 15%. For all of 2013, Target Canada generated sales of $1.3 billion, and a net loss of $941 million. In Q4 of 2013, Target Canada's gross margin tumbled to a miserable 4.4%.[6]

THE CANADIAN MARKET

Perhaps because of a common language (except in francophone jurisdictions such as Quebec), relatively similar consuming habits, and a long history of alliances, Canada is often one of the first markets that American businesses venture into in their overseas expansions. NAFTA reinforces this linkage, and a casual observer might not discern much to differentiate the Canadian market from the American one.

Statistics Canada reported that the country's population stood at 35 million at the end of 2013. With a GDP of about $1.9 trillion, Canada is one of the most developed economies in the world and is a member of the G7 group of industrialized nations. Median family income stood at about $75,000 in 2013. With annual inflation ranging around 2%, Canadians enjoyed a steady, if not high growth, economy. In 2012, Canada ranked sixth in the World Happiness Index, according to a study sponsored by the UN.[7] The country's unemployment rate stood at 7.4% at the end of 2011, showing a steady reduction from the 8.6% recorded in June 2009. According to *Statistics Canada*, unemployment rate further dropped to 7.1% by June 2014.

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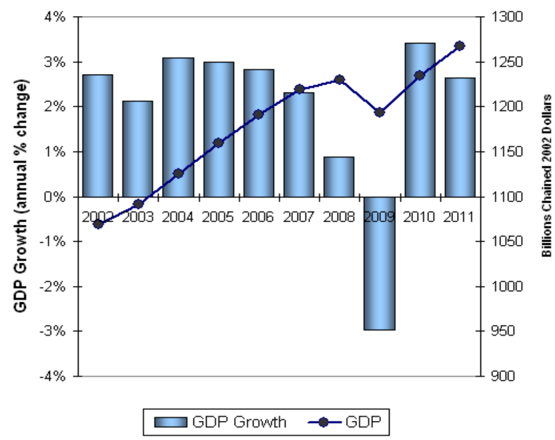
[2] CBC News (2011, January 13).
3 Laird (2013, March 19).
4 Shaw (2013, April 16).
5 Ho (2013, October 30).
[6] Trefis Team (2014, April 30).
[7] "UN First World Happiness" (2012, April 2)

Except for a drop in 2008, representing a milder yet still tangible effect of the Great Recession south of the border, Canada's GDP has been on the upswing in the decade leading up to 2011. The following chart, sourced from *Industry Canada*, shows the country's GDP and growth rates from 2002 to 2011.

Exhibit 1. GDP growth in Canada, 2002-2011.



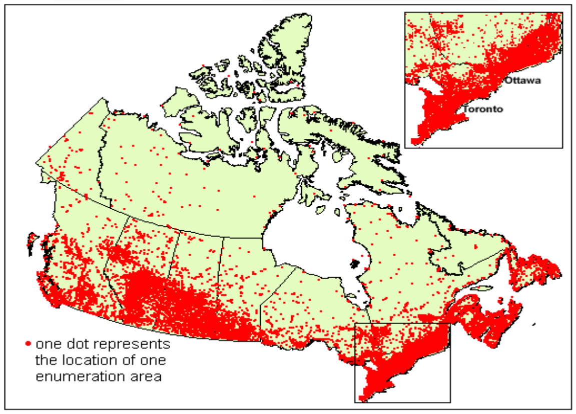
Source: "GDP and Growth in the Canadian Economy," (2011, Nov 22).

Having escaped (relatively speaking) the tremors of the Great Recession of 2008 which so devastated the US, Canada appeared to provide a robust market for expansion. Canadian retail sales are similar to that of the US on a per capita basis, but due to lesser available floor space, sales per square foot are higher in Canada than in the US. For examples, at shopping malls, Canadian sales per square foot are reportedly almost 50% higher than that in the US.[8]

Geographically, Canada is slightly larger (in land area) than the US. Its population of 35 million is spread throughout its 10 provinces and three territories, though between the provinces of Ontario (13.5 million), Quebec (8.2 million), and British Columbia (4.6 million), over two-thirds of the country's population are accounted for. The majority (around 75%) of Canada's population live within 100 miles of the US border (World Population Review, 2014). See map below.

[8] Hanuka (2014, March 5).

Exhibit 2. Land area, Canada.



Source: World Population Review, 2014.

Retail sales totalled $485.8 billion in 2012, showing a steady increase from the $436.6 billion recorded in 2009. Comparable US retail trade figures are shown in *italics* in the last column.

Year	**Retail Trade ($billion)**	***US Retail***
2012	485.8	*4,869*
2011	472.3	*4,628*
2010	453.1	*4,308*
2009	436.6	*4,082*
2008	454.9	*4,403*

Sources: Statistics Canada, Annual Retail Store Survey, March 26, 2014
US Census Bureau, 2012 Annual Retail Trade Report, March 31, 2014

As a result of the uneven population distribution across the provinces, Canada's retail trade varies significantly depends on geographic location, as can be seen below (2012 data).

Region	**$ billion Retail Trade**
Ontario	171.4
Quebec	108.7
Alberta	71.4
British Columbia	62.2
Saskatchewan	18.1
Manitoba	17.4
Nova Scotia	13.1
New Brunswick	10.9
All others	14.4

Source: Statistics Canada, Annual Retail Trade 2012, Summary Statistics.

Excluding automobiles and parts, 2012 total retail was $376.7 billion.

Many US companies have achieved dominating positions in the Canadian retail scene. In the non-food retailing sector, *The Globe and Mail* reported that of the top 10 retailers in 2012, half had American-based parents. The following summarizes the estimated sales of the top 10 non-food retailers.

	Company	*Sales (in $ billions)*
1	Walmart*	22.3
2	Costco*	13.2
3	Shoppers Drug	10.5
4	Canadian Tire	10.1
5	Home Depot*	6.8
6	Best Buy*	5.6
7	Home Hardware	5.0
8	RONA	4.8
9	Sears*	4.6
10	Parkland Fuel	4

* American parent
Source: The Globe and Mail, 2012

The phenomenon of Canadian shoppers crossing into the US just to shop began in the late 1980s, and reached its zenith in 1991 when 60 million same-day car trips were made by Canadians into the US (to shop). As the Canadian dollar declined versus the US dollar by the mid 1990s, the numbers diminished significantly. This was further dampened by security procedures instituted after the 9-11 attacks. But more recently, cross-border shopping has once again been on the rise (helped not least by a rising Canadian dollar which is close to par with the US counterpart). CBC News (Canada's national news network) reported that cross border shopping rose 18% to 28 million same-day car trips.[9] While not quite the numbers seen in its heydays, such large exodus of Canadians shopping in the US held much allure for US retailers contemplating a move north.

Attracted by a perceived lack of competition, a weaker Canadian dollar, and suggestively massive pent-up demand (to wit, for example, the exodus of Canadian shoppers to US border towns every weekend just to shop, discussed above), many US retailers have ventured north. The following table shows a selection of American retailers that have recently entered the Canadian market.

Company	Year Entered
Big Lots	2011
Brooks Brothers	2009
Crate & Barrel	2008
Dollar Tree	2010
J Crew	2011
Marshall's	2011
Victoria's Secret	2010

Source: "Updated List," (2012, August 17).

In addition, Walmart had entered Canada in 1994, while Costco had established a Canadian presence since 1986. Sears, on the other hand, had been in Canada since 1953. With their long track record, it is no surprise that these three are among the most successful US entries so far. (Sears is contemplating selling its 51% stake in Sears Canada at time of writing).[10]

BEST LAID PLANS

Walmart entered Canada in 1994 with the purchase of 122 Woolco (owned by Woolworth Canada) stores. Consistent with Walmart's anti-union stance, of course, only non-unionized Woolco stores were kept running. Twenty years on, Walmart Canada runs about 370 stores across Canada, employs more than 90,000 people, and is a major force in Canadian retailing.[11]

In the early and mid 1990s, cross-border shopping gained much notoriety as millions of Canadians poured over the US border to shop at American retailers. With lower prices, less taxes, and greater selection, US retailers, especially those near the US-Canadian border, benefited greatly from this southbound shopping traffic.

By that time, NAFTA (North American Free Trade Act) was in full swing, and the idea of a free and open North American market provided quite the draw.

Walmart saw the weak Canadian dollar (at about 75 cents US, hitting a low of 63 cents by 1998) offering a bargain opportunity for a low cost investment in Canadian retailing. And with cross-border shopping at its peak, brand recognition was a non-issue for Walmart.

As noted earlier, while Walmart did not, as some commentators had warned at the time, destroy Canadian retailers *en masse*, their entry certainly ignited new rigour in the country's retail scene. Some retailers did fail, and some merged with others, but Walmart Canada ushered in a new era of a more competitive retail industry in Canada.

[10] Marotte and Strauss (2014, May 14).
[11] "Walmart marks 20 years" (2014, March 17).

Certainly Walmart's success in Canada has not escaped the attention of its fellow American retailers. Target in particular, as a fervent competitor of Walmart's, must wonder how they could go north and replicate their success in Canada, much as they have enjoyed south of the border.

Nor is Target alone. Since Walmart's massive entrance, many US retailers have entered or announced their intention to enter Canada. Companies like Home Depot, Best Buy, Kmart, Costco, and so on also operate in the country. More recently, Nordstrom's and Saks Fifth Avenue made known their intention to enter the fray.[12]

For Target, though, the parallels must have been obvious. Their fellow discounter, Walmart, entered Canada at the height of cross-border shopping. They had done so by purchasing the stores of a failing Canadian discounter with locations across the country. And they had done very well, allowing their sophisticated retail management know-how to help them subdue local competitors.

When Zellers, a troubled Canadian discounter chain, was up for grabs, Target snatched it up. Zellers had been operating in Canada since 1931, and was known for its low price tags. If Target could freshen up the stores, put in their trademark "cheap chic" image and merchandise, they could surely give Walmart a run for their money. Besides, Target was every bit as well known in Canada as it was in the US. Gobbling up the Zellers stores seemed like a golden opportunity.

So the plan went.

INITIAL MISSTEPS

Target planned to spend upwards of $10 million renovating and converting each old (and rundown) Zellers location.[13] Indeed, many Zellers stores were located in plazas and malls that were difficult to access. And the stores themselves were more decrepit than Target had allowed for, resulting in more time and money spent to bring the stores up to standard.[14] Former Zellers employees were not automatically offered jobs as Target associates, ostensibly to ensure good customer service by Target workers.[15] Target Canada was to be a fresh new player in the industry, and the company aimed to achieve sales of $6 billion by 2017.

Prior to opening, Target sent its new Canadian employees to the US for extensive training that lasted months in some cases. However, upon return to Canada, employees discovered that the technology and system at the Canadian stores were different from what they had learned in the US.

Prior to Target Canada's unveiling, shoppers were eager for the chance to do some cheap chic shopping, Canadian style. Many shoppers even camped outside the stores in anticipation of the grand opening. For example, when the Target store in Guelph, Ontario did its "soft launch" in March 2013, more than fifty shoppers had lined up outside in -9 degree temperature in order to get a first glimpse of a Canadian Target store.[16] Initially sales results were robust, and the company achieved sales of $86 million at the end of its first quarter of operations in Canada, with higher than expected revenues in home and apparel categories. Indeed, Target Canada executives were "blown away" that there was such "quite remarkable the response" during the initial launch period.[17]

As early excitement faded, however, it became apparent that all was not well. A survey by a major newspaper found that shoppers rated their experience at Target as somewhat ho-hum. Indeed, many shoppers expressed disappointment that the new Target stores were no different than the old Zellers outlets they replaced. "One trip was enough," said one shopper. "It is like a renovated Zellers." A retail analyst noted that Canadian shoppers were expecting a shopping experience similar to that in US Target stores, but instead what they got was a "Zellers with lipstick."[18]

While Target offered interviews to existing Zellers employees, only about 1% of them were rehired by Target Canada. This resulted in some negative publicity for the company. *Huffington Post Canada* also reported in June 2013 that the firm had hired a lobby firm with ties to the Conservatives (the governing party in the federal government) to urge the Canadian government

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13 "Target selects initial Zellers leases" (2011, May 26).
14 Shaw (2013, March 18)
15 "Target Canada refused" (2013, June 12).
16 "Shoppers arrive early" (2013, March 5).
17 Shaw (2013, March 18).
18 Taylor, Ho and Hopkins (2014, May 8).

not to introduce mandatory country-of-origin label requirements, and also to not require compulsory health and safety inspections of source factories. [19,20]

According to a statement from the United Food and Commercial Workers union issued in June 2013, Target Canada's "lobbying firm states that Target is lobbying against federal regulations requiring voluntary compliance with rules regarding ethical sourcing of foreign goods. In contrast, Target's competitors such as Loblaw and H&M recently signed a binding international accord requiring mandatory health and safety inspections of source factories. Why is Target paying a professional lobbyist to make sure it doesn't have any commitments to global health and safety standards, international workers and their families?"[21]

Target Canada's first year was off to a sputtering start.

STOCK-OUTS GALORE

Any retailer would lament the impact of stock outs, and one would expect that a seasoned retailer such as Target would have the issue well in hand. Yet if the Canadian launch was any indicator, it appears that Target has a lot of work to do in this area.

Shoppers reported that often items that were advertised in flyers were unavailable when they visited the stores. This left a lot of disenfranchised shoppers who decided to go back to competitors like Walmart and Canadian Tire.

But Target Canada's problems did not end with unavailable flyer items. Shoppers also complained about the lack of variety of merchandise offered, and that shelves were often simply empty.[22] Empty shelves and stock outs poignantly indicated tremendous logistics problems at Target Canada that were not adequately addressed prior to launch. Such experiences are illustrated by what one shopper stated on Target Canada's Facebook page – "Was not impressed - visited the Milton store yesterday, 80% of the racks were empty and hooks in the change rooms were already ripped out of the wall." [23] (See pictures of empty shelves at the end of the case).

According to a report by *The Globe and Mail,* merchandise was coming into the warehouses faster than they were being shipped out. One of the many reasons for this was that the barcodes on many items did not match what was in the computer system. Other discrepancies included packages that didn't match descriptions, or the number of items in a package did not agree with what was in the system. Such inconsistencies led to a chain reaction of delays. Problem shipments needed to be unpacked and catalogued, a time-consuming process. And delays begot delays. And empty shelves and stock-outs. Furthermore, while Target did much of its own

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[19] "Target Canada refused" (2013, June 12).
[20] Major accidents at Third World (particularly Bangladesh) garment factories which supplied many western retailers have prompted action by many retailers (including Walmart and Gap) to push for better safety and health conditions at these factories ("US retailers in Bangladesh," 2013, July 10).
[21] "Target bracing itself" (2013, June 10).
[22] Taylor, Ho and Hopkins (2014, May 8).
[23] Shaw (2013, March 18).

distribution in the US, it decided to hire a third party company to do its distribution in Canada. Different computer systems, different companies involved, and a possible lack of consistency between the third party distributor and Target's own systems would have contributed to the problems.[24]

Reports also suggested that many of the items coming into the warehouses were selected by buyers in the US.[25] And they did not sell as well as expected in Canada. Perhaps not so surprising from a Canadian perspective. But it was detrimental from Target's point of view, since the unsold merchandise added to the congestion and delays in the supply chain.

The result was poor customer experience and disgruntled customers. A recent poll indicated only 18% of shoppers were "very satisfied" with the Target stores that were opened a year ago.[26] This was a drop from 27% back in August 2013, and a major tumble for the 32% "very satisfied" rating Target received when it first began its Canadian launch.[27] It was obvious that the brand had over-promised and under-delivered.

PRICES TOO HIGH

Customers who were used to Target's merchandise and prices in the US found neither in Target's Canadian stores. Canadian shoppers, fairly or not, were also expecting Target Canada's prices to be more consistent with those South of the border. And to be more competitive with other retailers. In this regard, they were once again let down. Certainly part of the problem lie with the logistic difficulties alluded to earlier. The company's slogan to "Expect More. Pay Less" may have contributed to a greater sense of disillusionment when actual prices did not reflect the brand's marketing wit.

It is common practice for US retailers to charge a premium in Canada to help recover their large initial investments. In addition, operating costs tend to be higher in Canada as well. For example, while US federal minimum wage is $7.25 an hour, in Ontario it is $10.25, and in Quebec it is $10.15. Unions are also stronger in Canada, as Walmart's experience in Quebec and Saskatchewan attested.[28]

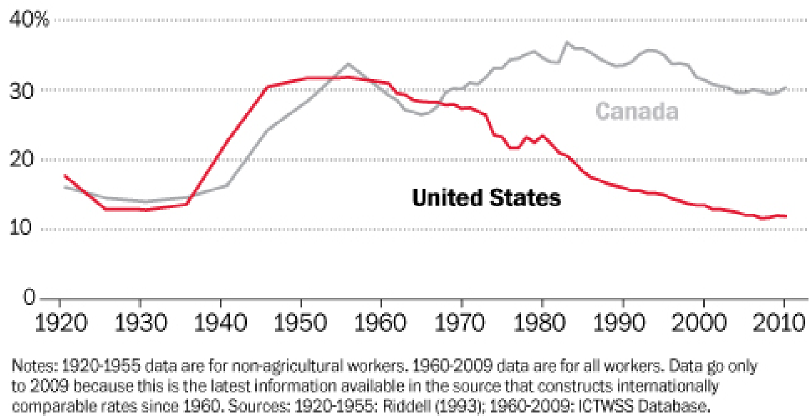
While in the US only about 10% of workers are represented by unions, that figure is around 30% in Canada (and increasing in numbers).[29]

And because of the lower population density, there is much less economies of scale than available in the US for retail operators. Higher levels of government rules and regulations north of the border also compounded the problems described above.

[24] Martell, Ho & Taylor (2014, May 21).
[25] Martell, Ho & Taylor (2014, May 21).
[26] Forum research (2014, May 16).
[27] Dummett (2013, August 19).
[28] "Wal-Mart runs afoul" (2012, Oct 23); Vieira (2014, June 27).
[29] "Union membership" (2012, September 6).

The following diagram shows the level of labour union participation in Canada vs the US.

Exhibit 3. Labour union participation in Canada vs the US.



Source: "Union membership," (2012, September 6)

But for the average shopper, especially one knowledgeable about price levels in Target's US stores, the price difference in Canada was a sore point. Nor is this unique to Target. In 2011, J Crew had to publicly apologize to Canadian shoppers for the higher prices they charged at their Canadian stores. [30] The sentiment is also fuelled by news reports that, despite a stronger Canadian dollar, Canadians are paying on average a 20% premium while two years ago the spread was only around 7% (and the Canadian dollar was lower then). [31] One might argue that perhaps Target should have taken to heart and learn from the J Crew experience.

Commenting on the price differences between US and Canadian Target stores in October 2013, then CEO of Target Corporation, Steinhafel was quoted by Financial Post (a major Canadian business newspaper) to have said, "We are right on where we need to be here in Canada." He added that comparing prices at Target Canada with that of certain Target stores in the U.S. "would be like comparing prices in Boston to prices in rural Iowa." [32] Perhaps so, though one wonders if the average Canadian shopper cared too much to have their country compared to rural Iowa.

DATA BREACH

Target's massive data breach, which took place during the holiday shopping season in 2013, added more uncertainty and lack of confidence in the retailer. CBC News reported in early 2014 that the number of Canadians affected was likely fewer than 700,000. But the number was less

[30] Austen & Clifford (2012, September 14); Strauss (2011, August 24).
[31] Industry Canada (2013).
[32] Shaw (2013, Oct 30).

important than the event itself. [33] Especially when Target Canada was already under pressure from so many fronts, the lack of confidence that the data breach engendered did much to further dampen trust in the retailer.

Target explained that the data in Canada was not hacked, because Canada uses the more secured chip-based card system (than the old magnetic strip system still prevalent in the US). [34] However, Canadians who had gone south to shop at US Target stores could have had their credit and personal information compromised. While as noted earlier that the number of Canadians affected was relatively small (under 700,000), the fact remains that close to three-quarters of a million Canadians were shopping in US Target stores when more than 100 Target stores were open at home. It begs the question why, as *Business Week* asked in January 2014. [35] It was obvious that even prior to the data breach, a chasm had already developed between Target Canada and its customers. The data breach simply added yet another straw on the poor camel's back.

THE COMPETITION

Target Canada's problems would have been substantial had their competitors simply sat on the sidelines. However, competition did not remain static. Other retailers, domestic and foreign, have all initiated strategies to protect and improve their performances.

Holt Renfrew, a high-end department store, has been renovating and enlarging its stores. The Bay, a mainstream department store chain, has also embarked on a major renovation effort. Even Sears Canada announced plans to refurbish their stores and to renew their merchandise selection. Canadian Tire is expanding its offerings to include more home improvement, sporting goods, and household products. And Walmart is adding to its $1 to $3 selection to reinforce its low price image. [36] It appears that no one is sitting still in the Canadian retail scene.

The industry has also seen a reverse takeover of sorts, when Hudson's Bay Company (owner of The Bay department stores) announced its buyout of US retail icons Saks Fifth Avenue and Lord and Taylor in July 2013. [37] In this light, one can see the entrance of Saks Fifth Avenue into Canada less as an invasion by a US retailer, but as a multibrand strategy by a Canadian one.

Meanwhile, US discounters (like Walmart) have found the Canadian grocery market more difficult to break into, and domestic competitors like Loblaws (a large supermarket chain) has held its own against Walmart's incursion (despite Walmart being the largest grocer in the US).

Some US retailers have decided that the Canadian market was too difficult to crack and have announced retrenchment or withdrawal plans. Big Lots announced in December 2013 that it was

[33] "Target data breach" (2014, January 20).
[34] Berfield (2014, January 22).
[35] Berfield, (2014, January 22).
[36] Austen & Clifford (2012, September 14).
[37] "Hudson's Bay Company to Acquire Saks" (2013 July 29).

pulling out of Canada, two years after its initial entry. The company lost between $52- $57 million in 2013.[38]

Despite initially trying to refresh its image, Sears announced in May 2014 that it is planning a withdrawal from the Canadian market. Meanwhile, the company continues to close down its stores.[39]

Best Buy Canada announced in 2013 that it was closing 15 of its 260 stores, and laying off 15% of its workers. Nordstrom recently postponed the launch of its Nordstrom Rack stores by two years, to 2017.[40]

But competitive pressure comes not only in terms of how competitors are changing their marketing or their store layouts. Especially in the case of large competitors, such as The Bay (Hudson's Bay Company) and Walmart Canada, they have established secured relationships (due to their large volume and their long history of dealing with them) with vendors and have used such relationships to lock up suppliers. While it would be impossible to "lock up" vendors like P&G or Kraft, due to their ongoing relationships with Target Corporation in the US, smaller, domestic Canadian suppliers do not have such relationships with Target, and are thus more compelled to prefer the more established retailers than Target Canada. Furthermore, some analysts questioned the way Target communicated with prospective vendors when it first set up shop in Canada. The company told prospective vendors to send emails to an anonymous mail box and then to just wait for a reply. [41] Not exactly the stuff of relationship building. It would be hard for a retailer to fill its shelves if suppliers do not whole-heartedly cooperate.

CANADA IS NOT THE US

While there are many similarities between the US and Canada, the two markets have fundamental differences that the casual observer might overlook.

Perhaps the most obvious difference is the issue of languages. Canada has two official languages: French and English, and depending on the jurisdiction, one might need to be more prominent than the other. Canada also practises multiculturalism, and is home to a multitude of ethnicities each demanding its day in the sun. Cultural nuances need to be catered to in a market as diverse as Canada.

And while Canadian consumers are very much affected by US media, significant differences are still present in consumption habits. The global consulting firm A.T. Kearney reported that Canadian shoppers demand more freshness in the groceries they purchase, for instance.[42]

The large geographic expanse that is Canada is also a source of difficulty for retailers. With only

[38] Feran (2013, December 6).
[39] Sturgeon (2014, May 22).
[40] D'Innocenzio & Noronha (2014, April 16).
[41] Brown (2013, April 18).
[42] Gustafson (2014, May 14).

about 10% of the US population, but spread out over an area larger than the US, Canada has far fewer major urban centres, and they are often separated by distances measured in the thousands of kilometres.[43] Canada's economy is very much based on regional commercial centres that are great distances apart, and in many ways independent of each other. Toronto, the financial and commercial hub of the country and its largest city, is more than 3,000 km (2,000 miles) from Calgary, where oil and gas looms large. This poses all sorts of logistical problems not often faced by retailers in the US.

The costs of doing business, especially labour costs, are higher as well. Minimum wages are higher in Canada in general than in the US, and unions have a much stronger presence. In addition, retail real estate is in much shorter supply compared to the US, resulting in higher rent costs. Add to those (and other) obstacles the cost of moving goods across the border which, despite NAFTA, increases the costs further.

A detailed discussion of the differences between the two countries is way beyond the scope here. Suffice it to say for our purposes that it is a common mistake to consider the Canadian market just a smaller version of the US.[44] And ironically this appeared to be precisely what Target Canada is guilty of.

Ironical, because Target had made a deliberate effort to recognize and embrace the differences that the Canadian market means. In an interview with his alma mater, University of St. Thomas, back in November 2012, before the first Canadian stores opened, then Canadian CEO Tony Fisher stated,

> "We were very clear from the beginning that it would have been a mistake for us to treat Canada as the 51st state, or Target's fifth region. We started our plans with what we called 'Listening and Learning' tours across the country." [45]

Furthermore, 99% of the company's workers are Canadians, and the company had organized visits around the country to gain input about what consumers want. [46] It would seem ironic, then, that these efforts appear to come to naught.

GOING FORWARD

In June 2013, when the full extent of the launch's failure was not yet evident, then-CEO of Target Canada, Tony Fisher, stated that the company was setting its sights online. Target Canada was to build a uniquely Canadian web presence, the company announced.[47] As of July 2014, its online store was not yet available.

By May 2014, the unit had suffered losses of some $1 billion since launch. On May 20, Target

[43] World Population Review (2014).
[44] Gustafson (2014, May 14).
[45] Guyott (2012, November 1).
[46] Nolan (2014, May 21).
[47] Johnson (2013, June 4).

fired Tony Fisher.[48] Questions rose as to whether Target should cut and run, or stay and fight the good fight.[49] In July 2014, Credit Suisse came out and suggested that the company should simply shutter its Canadian operation.[50] Tiburon Research, an independent equity research firm, estimated that Target Canada's loss could top $2 billion in 2014.[51] However, the company maintained that it would stay the course and move to aggressively improve the unit's performance. At time of writing, the jury is out as to whether Target Canada would survive and prosper in the medium to long haul.

A comparison between Target's Canadian and US operations is telling. The following diagram, sourced from a *National Post* report in February 2014, illustrates Target Canada's subpar performance.

Exhibit 4. Target Canada financial performance, 2014

TARGET CANADA'S SLOW START

	Number of stores				Average sales per store per day (US$)				Sales (US$ millions)			
	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2013	Q2 2013	Q3 2013	Q4 2013
Target Canada	24	65	88	121	$79,190	$62,642	$51,144	$59,777	$86	$275	$333	$623
Target U.S.	1,784	1,794	1,793	1,793	$106,044	$104,304	$102,603	$130,927	$16,620	$16,841	$16,925	$20,893

NOTE: The first Target Canada stores opened in March, 2013.

SOURCE: INTERSTATISTICS CONSULTANTS

JONATHON RIVAIT / NATIONAL POST

Source: Shaw (2014, February 26).

John Mulligan, the parent company's interim CEO, said in May 2014, "We recognize that we've disappointed Canadian guests....We think we're a great retailer. We have not lived up to our potential, nor our expectations." Mulligan went on to say that the company was heading back to the drawing board and to find better ways to appeal to Canadians.[52]

In June 2014, Target Canada took to YouTube with a video apology to its Canadian customers. The two and a half minute video pictured Target employees talking about the problems they had, and what they were doing to fix them. The video candidly discussed the problems that Target Canada faced during its first year of operation.[53] For example, Damien Liddle, the company's senior corporate counsel, was featured in the video and said, "Maybe we didn't put our best foot forward when we entered into Canada. We had some disappointments when we opened. Certainly we think we disappointed our guests." At time of writing, the impact of the video is

[48] "Tony Fisher fired" (2014, May 20).
[49] Anderson (2014, July 18).
[50] The Huffington Post Canada (2014, July 17).
[51] Banjo & Trichur (2014, May 7).
[52] "Target going back to the drawing board" (2014, May 21).
[53] Scott (2014, June 17).

unclear. In the month and a half since the video was first posted on YouTube, it has only garnered about 92,000 hits, and the number of “likes” and “dislikes” are split almost 50-50, as are the comments viewers made. The video can be found on YouTube at https://www.youtube.com/watch?v=vIBqv2BDU4E.[54]

On July 28, 2014, Target Canada announced it will match any grocery price in the country. A consumer can bring a flyer from any grocery store in Canada, and Target will match the price locally. The offer also extends to online purchases. A day later the policy was revised to match only grocery stores in local areas. The move pertained only to grocery items, which so far have not been a main part of Target Canada’s offering. Indeed, an analyst at Barclays suggested that Target would be better served to focus on household and other items rather than groceries.[55]

Target Canada has added more Canada-specific merchandise to its stores. It has also aggressively promoted its REDcard rewards program, and early data suggest a similar growth scenario compared to the US experience with the program. The company replaced its CEO for Canada with a seasoned veteran with vast experience in operations, apparently in an attempt to bolster its efforts in that area. The question remains: will that be enough? And what will Target have to do to achieve its goals in Canada?

On July 31, 2014, Brian Cornell became Target Corporation’s new CEO. Cornell is a Pepsi veteran who has spent close to ten years at PepsiCo, most recently running the company’s Americas Foods business. Before that he had tenures as CEO of Sam’s Club and CEO of Michaels Stores. It was the first time in Target’s history that an outsider was brought onboard as CEO, signalling perhaps the company was seeking a fresh perspective on things. [56] Surely on his agenda will include the question of what Target should do about its Canadian venture.

[54] TargetCa (2014).
[55] Tencer (2014, July 28).
[56] Ziobro & Lublin (2014, July 31).

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LUCY TAXPAYER: A CASE STUDY AND EXERCISE SET INVOLVING TAX RESEARCH, ANALYSIS AND RETURN PREPARATION

Tiffany Cossey, Drury University
Penny R. Clayton, Drury University

CASE DESCRIPTION

The primary subject matter of this case is personal federal taxation. Secondary issues examined include ethical decision making, research, and written communication. The case has a difficulty level appropriate for junior level courses. The case is designed to be taught in two class hours and is expected to require four hours of outside preparation by students.

CASE SYNOPSIS

This case introduces students to challenges they may face as first-year tax associates in a public accounting firm. It involves research of a tax issue, encountering an ethical dilemma, delivery of findings to a superior, and delivery of an unpopular result to a client. Students must also prepare and analyze a tax return and compare the results against a prior-year return.

These exercises are designed to make the subject of tax interesting and fun by presenting an unusual but not obscure problem and giving students the opportunity to use their skill sets to solve problems. After completing this case, students will have a sense of accomplishment, a greater feeling of confidence in their abilities, and a greater ability to solve real-world problems for clients. The case is modeled on a situation encountered several times at a free tax preparation clinic staffed by student volunteers.

The problem poses a tax anomaly which produces a counterintuitive result and requires closer examination to determine the reason for the effect. Students will approach the problem by analyzing the impact of a small change on a client's tax return to determine the source of a difference and will then be required to perform a small amount of research on the item causing the change. They will then communicate their findings in writing. When given to test groups, after completion of the assignment, students reported that that they became more familiar with the Form 1040 and its functionality and gained confidence in identifying and resolving issues.

CASE BODY

Last tax season Carson, an accounting student, decided to prepare tax returns at his community's volunteer income tax preparation clinic. One of his clients was Lucy Taxpayer, a good-hearted and hard-working woman who took over the care of her two grandchildren after they were abandoned by their mother. She worked as a custodian for an elementary school 32 hours per week. To make extra money, she cleaned other businesses and homes on the side. She also received federal and state benefits for her grandchildren in addition to free school lunches and Medicaid. Even with government assistance Lucy earned just enough to live above the poverty level.

Using the documentation (Table 1) that Lucy provided to Carson, he completed her tax return and explained to her that she was entitled to a tax refund of approximately $5,100. She was terribly disappointed. Based on her returns from prior years, Lucy stated that she was expecting a larger refund and she asked him to check his numbers one more time. Lucy said she was depending on the refund money to help pay past-due bills. As far as she was aware, nothing with her tax situation had changed. Neither her job as a custodian, nor her status as a part-time employee, changed. She was still claiming her grandchildren as dependents as she had done for the last several years. Her income from additional cleaning jobs was approximately the same. Federal tax was not withheld by her employer or her clients this year nor in prior years.

Carson agreed to review his work once more to ensure everything was input correctly. As he was going over the expenses associated with Lucy's business, Carson accidentally brushed against the "delete" key, wiping out her "advertising" deduction. Before he could make the correction Carson noticed that the large green number on the screen which showed the refund jumped up by approximately $30. He tested the system by reentering the deduction and noticed that the refund went back down. He thought this was strange because adding deductions usually makes a refund increase, not decrease. Curious, he deleted both the advertising and supplies expense and the refund climbed by hundreds of dollars. Finally he experimented by deleting Lucy's mileage deduction but leaving her self-employment income intact and he found that her final refund climbed to approximately $5,800, a $700 increase from the original number. Lucy liked the larger refund number much better and asked if she could opt to not report the expenses since business expenses usually reduce taxable income and therefore reporting them should be optional. See Table 1 for details pertaining to the preparation of this year's tax return.

Table 1
Lucy Taxpayer Tax Return Details

Taxpayer Notes:

1. Lucy's birthdate is April 15, 1961. Her social security number is 333-33-3331. She is unmarried.
2. Lucy's address is 17 Snuffoluffogus Lane, Anytown, MO 69231
3. Lucy has a grandson named Rodney Still, born on January 3, 1997. His social security number is 444-44-4441.
4. Lucy has a granddaughter named Kelley Oglesby, born on September 5, 2001. Her social security number is 555-55-5551.
5. Lucy is covered by medical insurance all year through the public school system and both grandchildren are covered all year by Medicaid.
6. Both grandchildren are full-time students, unmarried, and have lived with Lucy for the last five years. Lucy provides more than half of the support for both children.
7. Lucy receives no support for the children from either parent.
8. Lucy receives nontaxable state benefits for caring for the children. This does not amount to more than half of the cost to support the children.
9. Kelley receives social security payments of $500 per month. Lucy uses these for the care of the children.
10. In addition to being a part-time employee of the school district, Lucy also cleans small office buildings to earn extra money. She brings receipts to show the following expenses:
    a. Advertising $200
    b. Cleaning Supplies $1,300
11. Lucy brings mileage logs, and you calculate her mileage deduction associated with her cleaning jobs to be $1,582.

22222 | Void ☐ | a Employee's social security number 333-33-3331 | For Official Use Only ► OMB No. 1545-0008

b Employer identification number (EIN) 997777777	1 Wages, tips, other compensation 9,600	2 Federal income tax withheld 0
c Employer's name, address, and ZIP code R-182 School District 200 Main Street Anytown, MO 69231	3 Social security wages 9,600	4 Social security tax withheld 595
	5 Medicare wages and tips 9,600	6 Medicare tax withheld 139
	7 Social security tips	8 Allocated tips
d Control number	9 Advance EIC payment	10 Dependent care benefits
e Employee's first name and initial Lucy A. / Last name Taxpayer / Suff.	11 Nonqualified plans	12a See instructions for box 12
17 Snuffoluffogus Lane Anytown, MO 69231	13 Statutory employee ☐ Retirement plan ☐ Third-party sick pay ☐	12b
	14 Other	12c
f Employee's address and ZIP code		12d

15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name
MO	99-4444444	9,600	0			

Form **W-2** **Wage and Tax Statement** **20XX**

Department of the Treasury—Internal Revenue Service

For Privacy Act and Paperwork Reduction Act Notice, see back of Copy D.

Copy A For Social Security Administration — Send this entire page with Form W-3 to the Social Security Administration; photocopies are **not** acceptable.

Cat. No. 10134D

☐ VOID ☐ CORRECTED

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no. Small Offices 2005 Bentley Drive Any town, MO 69231	1 Rents $ 2 Royalties $	OMB No. 1545-0115 **20XX** Form **1099-MISC**	**Miscellaneous Income**
	3 Other income $	4 Federal income tax withheld $	**Copy 1 For State Tax Department**
PAYER'S federal identification number 99-5555555 / RECIPIENT'S identification number 333-33-3331	5 Fishing boat proceeds $	6 Medical and health care payments $	
RECIPIENT'S name Lucy Taxpayer Street address (including apt. no.) 17 Snuffoluffogus Lane City or town, state or province, country, and ZIP or foreign postal code Anytown, MO 69231	7 Nonemployee compensation $ 4,160	8 Substitute payments in lieu of dividends or interest $	
	9 Payer made direct sales of $5,000 or more of consumer products to a buyer (recipient) for resale ► ☐	10 Crop insurance proceeds $	
	11	12	
Account number (see instructions)	13 Excess golden parachute payments $	14 Gross proceeds paid to an attorney $	
15a Section 409A deferrals $ / 15b Section 409A income $	16 State tax withheld $ $	17 State/Payer's state no.	18 State income $ $

Form **1099-MISC** www.irs.gov/form1099misc Department of the Treasury - Internal Revenue Service

FORM SSA-1099 SOCIAL SECURITY BENEFIT STATEMENT

20XX	• PART OF YOUR SOCIAL SECURITY BENEFITS SHOWN IN BOX 5 MAY BE TAXABLE INCOME. • SEE THE REVERSE FOR MORE INFORMATION.

Box 1. Name Kelley Oglesby		Box 2. Beneficiary's Social Security Number 555-55-5551
Box 3. Benefits Paid in 20XX $6,000.00	Box 4. Benefits Repaid to SSA in 20XX	Box 5. Net Benefits for 20XX *(Box 3 minus Box 4)* $6,000.00

DESCRIPTION OF AMOUNT IN BOX 3	DESCRIPTION OF AMOUNT IN BOX 4
Paid by check or direct deposit: $6,000.00	
	Box 6. Voluntary Federal Income Tax Withholding
Kelley Oglesby c/o Lucy Taxpayer 17 Snuffoluffogus Lane Anytown, MO 69231	Box 7. Address
Total Additions: $6,000.00 Benefits for 20XX: $6,000.00	Box 8. Claim Number *(Use this number if you need to contact SSA.)*

Form SSA-1099-SM (1-2002) **DO NOT RETURN THIS FORM TO SSA OR IRS**

MANAGEMENT CHALLENGE: OBAMACARE

Robert M. Crocker, Stephen F. Austin State University
Marlene C. Kahla, Stephen F. Austin State University

CASE DESCRIPTION

The Patient Protection and Affordable Care Act (ObamaCare) became law in 2010 and the changes forced on the medical community are creating managerial headaches that are not easily resolved. While the general population focuses on health insurance, in the medical community anxiety and trepidation persist over increasing capitation and loss of revenues. Many medical practitioners are abandoning the profession. Those that remain are tightening their belts and preparing for lean times. Wage freezes and reductions in forces are two common strategies for reducing expenses. These strategies harshly impact the lowest paid members of the medical community which includes the receptionists, schedulers, file clerks, insurance clerks, medical assistants, and some nurses. Medical managers are being challenged to attract, motivate, and retain employees that can provide superior patient service under these conditions.

CASE SYNOPSIS

Rachel, the office manager for a multi-million dollar pediatric practice in Longview, Texas, is facing escalating employee problems as the doctors withhold raises and promotions from their staff. The doctors contend that revenue losses are an imminent result of the Affordable Health Care Act and have staunchly resisted most pleas for pay increases for deserving employees. Rachel has implemented a number of creative managerial initiatives in hopes of motivating and retaining valuable human assets. Despite her efforts, annual employee turnover in the clinic has jumped from 10 percent historically to more than to 60 percent in each of the last three years.

INTRODUCTION

On Friday afternoon in the Longview Pediatric Clinic, Angie and Rachel hugged for a long time and both were teary-eyed as they said good-bye. Angie's last day of work at the clinic, where she had spent the past fifteen years, ended with cake and a small gathering of the few remaining long-time employees, two of the doctors, and Rachel.

Rachel had been an insurance clerk when Angie was hired and had been responsible for showing her the ropes. Soon after Rachel completed her degree in Management, she was promoted to Assistant Office Manager and eventually to Office Manager. Meanwhile, Angie had been an exemplary employee and managed the insurance department. Angie had been one of the few employees that Rachel could depend on to do the right thing, the right way, every time.

Now Angie was gone and the young and inexperienced workforce that remained would be even more difficult to manage. Rachel grabbed her purse and headed to her car thinking that this weekend wouldn't be long enough to prepare for the weeks ahead.

OBAMACARE

The Patient Protection and Affordable Care Act was signed into law by President Obama in March 2010. Its major provisions went into effect in January 1, 2014, although significant changes went into effect before that date and will continue for several years (Affordable Care, n.d.). While the uninsured public celebrated in the hope of affordable healthcare, the medical community had grave concerns for the future. A sweeping survey of 13,575 doctors released in September 2013 by the Physicians Foundation found that 77 percent were pessimistic about the future of medicine. The main reason: malpractice lawsuits, which the president's law did little to address. After that, the top factors cited were "Medicare/Medicaid/government regulations," "reimbursement issues" and "uncertainty/changes of health reform" (Richardson, 2013). Physicians are fearing the onset of ObamaCare, with many of them believing they won't be able to make enough money to remain in practice (Moran, 2013). In California, where 70% of the 104,000 physicians are refusing to participate in ObamaCare, practices stand to lose millions of dollars under the state's bargain basement insurance rates.

Other facilities are opting out for the same reasons doctors are -- lower reimbursement rates (Perkins, 2013). Capitation payments, which are used by managed care organizations to control health care costs, limit the amount a physician is reimbursed for patient services (Alguire, n.d.). In addition, an unusual 90-day grace period for services provided to patients leaves doctors waiting on reimbursement and many worry that some patients will not pay at all.

"This puts the physician and their patients in a very difficult situation," said Dr. Ardis Dee Hoven, president of the American Medical Association. "If a patient is being treated for a serious illness that requires ongoing care, the physician is having to assume the financial risk for this," she said. "That's the bottom line." (Rabin, 2014).

LONGVIEW PEDIATRICS

Dr. Bernhard Smoot had no plans to visit Texas, let alone open a practice there, when he began his residency at Johns Hopkins Children's Hospital. In fact, Dr. Bernie planned on staying in the northeast and joining a lucrative practice on Long Island. But he hadn't counted on meeting Lynda Mae Pearson, another pediatric resident, who three years later became his wife. Together they opened the Longview Pediatric Clinic in her hometown of Longview, Texas in October of 1982.

Longview is the county seat of Gregg County and is located 125 miles east of Dallas and 60 miles west of Shreveport, Louisiana. The population of Longview is a little over 80,000 and more than 120,000 live in Gregg County. Since Gregg County is very small by Texas standards, the clinic draws patients from more than 400,000 people living in the surrounding counties of Harrison, Panola, Rusk, Smith, and Upshur. Annual wages per employee reported in 2012 for Gregg county area was about $45,000 (Quarterly Census of Employment and Wages, 2012). While the region's median household incomes are lower than the statewide average, such measures do not take the cost of living into account. A person earning an annual salary of $45,000 in Longview has the equivalent purchasing power as a person living in Dallas earning $56,343, or 25 percent more (Cost of Living Comparison, 2015).

Over time, Drs. Bernie and Lynda Smoot earned the reputation as the best pediatric doctors in the area and their practice flourished. Dr. Bernie was also an astute business man, and by 2010 the practice saw patients in 5 locations and employed 55 full-time and 12 part-time staff.

Two more doctors held junior partnership with the Smoots and two more provided contract services. Six nurse practitioners were the primary providers in the satellite clinics.

Most of the staff are in positions such as receptionists, file clerks, schedulers, and insurance clerks with hourly wage rates ranging from $8.50 to $12.50. A dozen medical assistants earn around $16 per hour, and the eight registered nurses earn around $30 per hour. The employer offers an insurance plan and pays 70 percent of the employees' premiums. After one year, employees are eligible to participate in a 401 retirement plan with an employer match of 3%. Employees have six paid holidays plus their birthday and they earn paid time off at the rate of 2 hours per 40 hours worked. Children of employees have insurance co-pays waived and are seen for free if the employee is uninsured.

TROUBLES BREWING

In a September of 2009 monthly business meeting, the doctors lamented the threat to revenues should pending legislation pass through the US Congress. Once The Affordable Health Care for America Act (or HR 3962) bill was crafted by the United States House of Representatives in November 2009 the doctors informed Rachel that wage and hiring freezes would be in effect until further notice. Rachel had a meeting afterwards with all staff and informed them of the decision.

The first few months after the wage freeze decision were uneventful, but when annual performance review periods for employees came and went without any raises, slowly but surely the reality of no raises began to sink in, and Rachel could see morale crumbling. She heard rumors that some employees were looking for work elsewhere. To make matters worse, one of the doctors parked his brand new $180,000 sports car outside the clinic while another doctor took off for a month to vacation in Europe.

As employee attitudes slowly gave way to misery, the number of patient complaints began to rise. After six months, the increase in tardiness and absenteeism put a strain on those employees who dutifully showed up to work. After nine months, several experienced personnel had given their notice and left for other jobs. As experience walked out the door, training new employees became a huge burden for Rachel and the remaining experienced staff, further increasing the burden on providing patient services. On top of all of these things, the worse flu season in years hit the area and the all the clinics were flooded with sick children.

SWIMMING UPSTREAM

Rachel had anticipated the deterioration in attitude and workmanship. Almost immediately she began to lobby the doctors to institute a longevity bonus. She created spreadsheet models to provide the doctors with several what-if analysis options. Her efforts paid off and the employees received a bonus just in time for Christmas. The next year she encouraged the doctors to give the bonus in November so that employees could have that money to buy gifts for Christmas. The next year she was able to have the cap on the bonus lifted which gave a few long-time employees a few dollars more.

Although raises were off the table, Rachel was able to purchase a variety of gift cards with values from $5 to $50. She used these to reward employees who performed a commendable act such as coming up with a good idea or going the extra mile to make a patient comfortable.

On days that seemed unusually busy, Rachel would try to do something to lift everyone's spirits. Often she would order milk shakes for everyone that wanted one. Sometime she would order pizza for lunch, or surprise everyone with breakfast treats. Rachel did something for each holiday including hiding prize filled eggs throughout the clinics for Easter.

Her efforts helped maintain morale and excellent customer service but couldn't hold people in their jobs. One by one she watched employees leave. After eighteen months the front office staff was brand new and every other area had many new faces. Employee training was an everyday event. Interviewing new applicants two or three times per week was commonplace. Now Angie, her best employee and good friend of fifteen years, was calling it quits.

Rachel is dreading Monday and the prospect of replacing another employee.

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THE UNIVERSITY GETS ITS ACT TOGETHER: CUTTING THE COSTS OF DISPUTES IN ORGANIZATIONS

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ABSTRACT

The primary subject matter of this case is a university grievance process that is no longer capable of resolving disputes before they escalate into costly conflicts. The case has a difficulty level of three and is therefore appropriate for seniors or graduate students. The case was crafted with courses in organizational development, human resource management, and leadership in mind, but given the pervasive need to manage conflicts this case is appropriate for a broad range of courses. The case is designed to be taught during one 75 minute class and we expect students will need at least three hours of preparation time outside of the classroom. An optional one 75 minute class time extension of the case introduces the student to why at times seemingly ethical people do unethical things drawing from the Stanford Prison and the Milligan Experiments. An optional alternative involves conflict resolution games designed to help students fully embrace the art and science of negotiations and mediation.

This case is framed around the personal experience of a faculty member whose dispute with supervisors lead to the resignation of a chair, the eventual firing of a dean, and the loss of good will with key community stakeholders. It focuses on the analysis of an internal grievance process that brings the student to two decision points, namely, 1) what shortcomings exist in the current internal grievance process and 2) what changes should be made to make them more fair and effective? The case briefly addresses and illustrates the foundational skills of dispute resolution and mediation designed to resolve conflicts efficiently and fairly at the lowest cost.

INTRODUCTION

Even in the best of organizations, it is reasonable to expect that from time to time conflicts will arise between employees. The two parties can deal with disputes that arise between them in a number of ways. They can attempt to resolve the conflict informally between themselves, try to overpower each other into submission, separate, or litigate. In addition, organizations can provide tools or processes to resolve such disputes before they escalate into costly conflicts for both parties as well as the organization itself. These processes or tools are mediation and arbitration.

Mediation is a process in which a third party neutral facilitates communication and negotiations between parties to assist them in reaching a voluntary agreement regarding their dispute. Mediators can range from a colleague respected by the disputing parties to certified mediation specialists in private practice. Most would argue that the skill of the mediation is critical but there is no agreement as to the entry-level qualifications to serve as mediators.

Arbitration, on the other hand, is a process by which a third party neutral listens to both side's arguments and issues a binding determination on the matter in dispute. It is an adjudicative process which means the arbitrator like a judge issues a decision based on the merits of the case. The parties do not create their own settlement as in mediation. Instead the arbitrator imposes a resolution on the parties, bounded by the limitations articulated in the organization's formal arbitration policies.

To frame the need and importance of such formal processes, consider for a moment a small university in a right-to-work state who at the time had a poorly developed process for mediating disputes between supervisors and their employees. Similar to all universities, their faculty administration manual outlined a process where a faculty member (regardless of tenure) could be terminated for cause. However the process where a faculty member could allege arbitrary or capricious action(s) of an administrative officer whose actions that resulted in harm of a subordinate was far less developed.

The alleged case occurred when a department chair (e.g., Bill) found himself in an untenable situation where he disagreed with having to implement his dean's directives. Rather than disobey or be insubordinate, the Bill chose to resign from the administrative post and return to the faculty. In resigning, Bill had the audacity to email his colleagues stating the reasons for his resignation and to suggest that, since faculty are evaluated, so should deans be evaluated by their faculty. Unknown to the faculty member, he subsequently became the target of a six month investigation by the dean (e.g., Robert) and the newly appointed chair (e.g., Steven). Knowledge of the investigation was leaked to the local media. As a further complication, the Steven and Bill were at the time friends where Steven and his wife often socialized at Bill and his wife's home. The investigation yielded four complaints which all were later determined unfounded. Bill was accused of misappropriating university funds (determined by the university's auditor to be unfounded), and accused of misusing the university's intellectual property (likewise determined unfounded). In short, after addressing the faculty, the Bill was subjected to a systematic attempt to at best brand him as a voluble faculty member and at worst drum him out of the university.

When informed of the formal charges, the Bill was advised to hire an attorney which subsequently led to him filing formal grievance citing efforts of the Robert and Steven to ruin his reputation and to deny him due process in defending himself. By university policy, such a formal grievance filing had to occur within 10 business days once the grievant became aware of the alleged actions. After reviewing the grievance, th Faculty Hearing Committee rendered a ruling that the faculty grievance had standing recommending that the provost office take the appropriate action in furthering the investigation and if warranted censuring the parties who had been biased in making the complaints.

Given that workplace harassment and personal slander charges did not fall under the purview of the faculty hearing committee, there was nothing more the committee could do on the faculty member's behalf. In a subsequent meeting with the Bill, the president of the university concluded that if the allegations described in the grievances were true, the Robert and Steven should be fired. Evidence supporting Bill's allegations was produced under the Freedom of Information Act, but repeated attempts to provide this evidence would not be accepted by either the provost or president. As legal costs mounted, the Bill chose not to litigate.

In the following weeks the newly appointed chair resigned, followed in a year the forced resignation of the dean by the president on multiple reasons. Deans are responsible for development (fundraising), and the word within the business community was that the business school was not well managed.

It took a new president and provost before the university realized the need for and potential value in a more developed dispute resolution process. During that time, as examples, a top grant writer in the sciences who was reprimanded by her supervisor for raising concerns of student safety in labs stopped all grant activity while looking for a new job; and a non-tenured faculty member who alleged a dean threatened to not support his tenure if he did not change student failing grades elevated his complaint to litigation. In fact, the outgoing president was forced to expand the Office of Legal Affairs to address the ever escalating number of legal issues facing the university including lawsuits being filed by employees against the university.

Literature describing the design of dispute resolution processes span the past 30 years. Such processes have been described by Ury, Brett and Goldberg (1988) in their examination of disputes between coal mine owners and labor unions offering broad design concepts that could guide designs in other settings such as universities (p.108-112).

Costantino and Merchant (1996) describe conflict management systems within government agencies and other organizations, providing practical ways to work collaboratively to create and implement new dispute resolution systems (p. 386-389). Rogers, Bordone, Sander and McEwen (2013) looked at the knowledge, skills and training of those who have proven effective in such design work. All three provides tools designed to resolve small disputes before they escalate into costly conflicts.

In organizations where conflicts are inevitable and frequently occurring, many create dispute resolution processes to resolve them at the lowest possible cost and effort for all parties. Research suggests that individuals care a great deal about the process and not just the results reached from the process. Procedural justice involves the perception of fairness in a dispute resolution process must meet the following expectations.

1. "People want the opportunity to state their cases to the authorities.
2. People expect neutrality of the authority's decision-making process.
3. People value the quality of their interpersonal treatment by the authorities, that is, whether they feel they are being treated with dignity and respect by legal authorities.
4. People focus on cues that communicate information about the intensions and character of legal authorities with whom they are dealing – trustworthiness" (Tyler, 2009; 187-188).

To illustrate, eBay realized it needed a dispute resolution process soon after it opened its doors in 1995. eBay's rationale was that people would use eBay more often if they had confidence that inevitable disputes between buyers and sellers would be well handled. Within a few years, eBay had contracted with a number of online mediators to help resolve disputes at a great cost to eBay as well as PayPal – a principle stakeholder in eBay's business model at that time. Eventually eBay realized that the parties in the dispute preferred a quick decision instead of an exhaustive process aimed a delivering a perfect decision in every case. To speed up the process, software was developed to manage the initial phase of the dispute. The software was designed to fit ranges of the various kinds of disputes with self-help tools to aid direct negotiations between the parties. eBay also employed a preventative technique detailing the number of times a customer returned merchandize for a refund (as well as buyers' rating of the seller) and prominently displacing that information at the point of sale. In addition, eBay reframed the language of mediation in an attempt to lessen the likelihood of escalation. For example, "fraud alert' was replaced by 'item not received'; 'non-paying bidder' became 'unpaid items.' The volume of disputes significantly decreased as well as user retention and loyalty measures increased (Rule 2008).

eBay also discovered that one system did not work well across all the cultures in which it operated. Many customers in Asia did not trust a system that charged their credit cards and paid a seller before the merchandize was received. eBay then began a policy of escrowing the funds until the merchandize was received and user retention increased. However, the same approach was provided as an option in North America but was later abandoned because of a lack of use (Rule 2008). Mediation processes must occasionally conform to cultural norms to be used and considered relevant.

DISCUSSION QUESTIONS:

1. What are the costs of unresolved internal disputes within an organization? How can they be measured?
2. What is the intent of a voluntary dispute resolution system? What role does procedural justice play in the design of such a system?
3. What shortcomings exist in the internal grievance process described above?
4. What changes should be made to make the grievance process more fair and effective?

An extensive amount of information can be found on the internet drawing from university and private enterprise's grievance and dispute resolution policies. Do not get caught up in the legalese in responding to questions 3 &4.

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MICHELLE JONES:
FINANCIAL CHALLEGES AND OPPORTUNITIES

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CASE DESCRIPTION

The purpose of this case is to explore the financial challenges faced by college students and to underscore the need for students to make sound financial decisions while in school and after graduation. This case is best suited for discussion in a Personal Finance class. However, there are components that lend themselves to the Introductory Finance class as well. The case can be discussed in 2 class periods and will require 3-4 hours of outside preparation by students. Upon completion of the case, students will be able to prepare and analyze Personal Financial Statements and assess one's net worth. They will be able to explain the importance of establishing credit, using it wisely and propose strategies for improving one's credit score. Students will also be able to apply time value of money concepts to calculate loan payments and make retirement projections. Students will explore key personal financial planning concepts through the eyes of Michelle Jones, a recent graduate of Johnson C. Smith University. They will also be afforded the opportunity to assess their own personal finances through a series of hands-on exercises.

CASE SYNOPSIS

Michelle Jones is a recent graduate of Johnson C. Smith University (JCSU). She received a BS in Business Administration with a concentration in Finance. She successfully completed an internship with Branch Banking and Trust (BB&T) while at JCSU and joined the bank full-time after graduation as a Credit Analyst. Michelle was supported financially by her parents while in college. She lived with her parents after graduation. This afforded her the opportunity to save money. She didn't pay any rent nor did she pay for utilities or food. More importantly, she enjoyed her father's cooking. One year after graduation, Michelle's mom said, "It is time for you to move out of my house." Michelle turned to her dad. Surely, he would let her continue to live in the family home. Michelle was crushed when her dad concurred that it was time for her to go. Now she is planning to strike out on her own and face the challenges of being financially independent. Michelle felt naïve about managing her finances so she reached out to one of her finance professors at JCSU for advice. This is where the "fun" begins.

INTRODUCTION

Michelle Jones screamed with excitement when she opened the letter informing her that she had been accepted at Johnson C. Smith University (JCSU). Her parents were graduates of JCSU and Michelle always felt that she wanted to continue the tradition. Michelle is the youngest of three. Michelle's sister, Renee, attended UNC-Chapel Hill after graduating from the International Baccalaureate (IB) program at Myers Park High School in Charlotte, NC. Her brother attended NC State University after graduating from South Mecklenburg High School. Michelle decided to attend Harding University High School. Even though it was across town, Michelle was attracted by their IB program and their renowned marching band. Clearly, the Jones' children had a mind of their own. They attended three different high schools even though their parents lived in the same house for all of their high school years.

Michelle was an outstanding student in high school. IB Spanish presented a challenge, however, and Michelle thought about abandoning the IB program at one point. Her Principal would not allow her to take the easy way out. He challenged her to stick with IB. He was convinced that obtaining an IB diploma would pay dividends. He was right.

Renee previously completed the IB program at Myers Park High. The Program at Myers Park has the reputation of being the most rigorous IB program in Charlotte. Renee was one of only three minority students to receive the IB diploma her senior year. She received a number of scholarship offers including a full ride to Florida A&M University. Instead, Renee chose to attend UNC-Chapel Hill on a partial scholarship. UNC-Chapel Hill was far enough away that she would be on her own. Nonetheless, she could readily come home whenever she felt the need.

Michelle and Renee maintained an ongoing friendly competition. It was Michelle's goal to outperform her sister when it came to academics. Michelle consistently maintained a higher GPA and class rank. She also had a higher SAT score. This gave her bragging rights. Michelle was determined to receive her IB diploma since her sister had achieved this honor. Once again, she was successful.

Michelle also received numerous scholarship offers, but she had her mind set on attending JCSU. JCSU offered less scholarship money than some of the other schools, but that didn't factor into Michelle's decision. She was fortunate that her parents were willing and able to provide the financial support for her to attend the school of her dreams.

JCSU is a historically black college/university (HBCU) located in Charlotte, NC. Founded in 1867, JCSU has produced countless numbers of educators, corporate executives and small business owners. More recently, it has gained national exposure for its STEM program and its commitment to educate students who are motivated but lack the grade point average and/or SAT score that other institutions require.

Michelle decided to major in Business Administration. When asked to select a concentration, Michelle didn't have a clue. The Chair of the Department of Business Administration explained that she could choose a concentration from the following:

Accounting
Finance
Marketing
Management
Management Information Systems
International Business
Retail Management

Michelle's initial thought was to choose Management as her concentration. She felt this made the most sense given her goal of working her way up the corporate ladder after graduation. She was not knowledgeable about the different concentrations and asked the Chair to provide her with a description of each. What skills would she learn? Which is the most marketable? After considering the information received, Michelle decided that Finance was the "best fit" for her.

Michelle was an outstanding student at JCSU. She was inducted into Delta Mu Delta Honorary Fraternity during her junior year. She was also named a BB&T Global Scholar. As such, she participated in a week-long Financial Markets Seminar in New York. Michelle visited the New York Stock Exchange, the Federal Reserve, NASDAQ and a host of other financial institutions. She also participated in seminars led by representatives of Charles Schwab and several other mutual fund families and hedge fund managers. Michelle couldn't wait to get back to campus to share her experiences with her classmates.

Michelle participated in the PhD Opportunity Project during the summer of her junior year. This program, sponsored by Duke University, is designed to encourage minority students to consider pursuing a PhD. The selection process is highly competitive. Michelle was excited to participate. Upon her return from Durham, NC Michelle started her internship at BB&T. The internship provided her with practical experience and afforded her the opportunity to marry the classroom and the world of business. She was hooked! There was no doubt in her mind that one day she would be a senior executive at a large financial institution.

THE EARLY YEARS

Michelle's parents were college sweethearts. However, they took different paths after graduating from JCSU. Her mother went to law school at North Carolina Central University. Her father pursued an MBA at Howard University. They lost contact after graduation. However, they rekindled their relationship several years later. Both returned to Charlotte to begin their career. Michelle's mother joined a prestigious law firm. Michelle's father accepted a position with a Charlotte-based financial institution as Director of Productivity Improvement. He completed additional accounting classes at night and was successful in passing the CPA exam. They decided to marry after they determined that each had a promising career and had established a sound financial foundation.

Shortly after they were married, Michelle's father wrote a plan for the couple. The plan included the following. They would:

Have two children. The children would be born two years apart.
Purchase a larger home.
Have no debt other than their mortgage.
Save monies for their children's education.
Be active in the community.
Have investment assets of $1 million by age 50.

Renee was born after two years of marriage. The Joneses were ecstatic! Trevor arrived two years later – right on schedule. An investment account was established for Renee and Trevor under the Uniform Gift to Minors Act (UGMA) with Mr. Jones as the custodian. Mr. Jones controlled the account and was entitled to make all investment and distribution decisions. The monies in the account become the property of the minor child upon reaching the age of 18. Later, the Uniform Transfer to Minors Act was adopted in North Carolina. This allows the custodian to control the assets until the minor reaches the age of 21. Setting up this type of account also provided the opportunity to shift income from the parents to the minor child. This tax savings feature has been moderated, however. Each account was funded with annual gifts made by Mr. and Mrs. Jones. At that time, any individual could give up to $12,000 per year to another individual without incurring a gift tax. This amount could be doubled to a maximum of

$24,000 if the giver's spouse consented to make a joint gift. Currently, the annual gift exclusion is $14,000 which can be doubled to $28,000 for a joint gift.

Additional strategies are now available to accumulate monies for one's children's education. These include:

1. Coverdell Education Savings Account. $2,000 per year can be contributed to this account which provides for tax-deferred growth. Withdrawals can be made for education expenses.
2. 529 Plan created in 1996. This plan provides for greater maximum contributions (over $200,000 per beneficiary) and provides for tax-deferred compounding. Monies withdrawn for qualified education expenses are not taxed. This plan has a great deal of flexibility and allows the custodian to change the beneficiary to another family member if the original beneficiary does not go to college. There are two versions of 529 plans – a pre-paid tuition plan and a savings plan.

Mr. and Mrs. Jones bought a four bedroom home in the SouthPark area of Charlotte shortly after Trevor was born. The purchase price was $195,000. It seemed like a lot of money at the time. They made a down payment of 20% and financed the balance at 5.75% for 30 years. It was important to put 20% or more down for the home purchase. The Joneses were able to avoid an escrow account as a result. That is, the Joneses would be responsible for paying their homeowner's insurance and property taxes directly rather than pay one twelfth of the estimated amount of insurance and taxes each month to their lender along with loan principal and interest (i.e., PITI). Mr. Jones did not like the idea of having an escrow account because he could not control the timing of the property tax payment and lenders do not pay interest on the balance in escrow accounts. It is important to note that property taxes are a tax deductible expense. The tax deduction must be taken in the year property taxes are paid. It is not uncommon for lenders to pay the current year's property tax in January of the following year. Accordingly, the property owner must wait a year to claim the deduction.

A mortgage is an example of an amortized loan. That is, the amount of each required payment remains the same over the life of the loan. Each payment consists of interest and principal. The interest portion represents the lender's compensation. The principal portion is the repayment of the amount borrowed. The interest component in each payment declines and the principal portion increases over the life of the loan. The loan balance is zero when the last payment is made.

The Joneses were not required to pay for private mortgage insurance (PMI) given that their down payment was 20% of the purchase price. PMI protects the lender against default by the buyer and results in a higher monthly payment for the buyer.

Mortgage rates declined significantly after the Joneses bought their home. They decided to refinance after owning their home for 4 years. They learned that they could obtain a new mortgage at 4% for 25 years. They would have to pay closing costs of $1,200.

The Joneses settled into their home. Family life was great. They became active in their church and in the community. Each served on the Board of Directors of a number of non-profit organizations. Imagine their surprise when they learned that they were once again expecting. They planned to have two children. Michelle had different plans!

MICHELLE'S FINANCES

Michelle was fortunate to have parents who could pay her college expenses and provide her with periodic spending money. The spending money was never enough, however. There was always that one new outfit that she just had to have. She had a meal plan, but the food in the cafeteria was not satisfactory. She frequently joined her friends for meals off campus. No problem. She had a credit card.

Mr. Jones often talked to Michelle about managing her money. Sometimes she listened and sometimes she just didn't want to hear it. There were two things that her father said that made a lasting impression. "All college students should establish and maintain a cash emergency fund and they should establish credit." Michelle took this advice to heart. She opened up a savings account at BB&T for her emergency fund. She was not concerned about the rate of interest earned. It was most important that she have ready access to the money if the need arose. Michelle routinely maintained a balance of $300 in her savings account.

In order to establish her credit history, Michelle applied for and received a MasterCard. In selecting her credit card, Michelle evaluated the following:

1. Interest rate (fixed, variable or tiered) and method of computing the finance charge (i.e., adjusted balance method, average daily balance method or minimum finance charge)
2. Annual fee, if any
3. Grace period
4. Charges for late payment, cash advance, over-limit, etc.
5. Rewards (i.e., cash, airline miles, points)

She planned to pay her balance in full each month. Accordingly, she was not overly concerned with the finance charge and method of calculation. Her primary concern was the avoidance of an annual fee. Further, she preferred a card that offered a long grace period. The grace period is the number of days from the statement date that the card holder has to pay the balance in full and avoid a finance charge. Paying off the balance prior to the end of the grace period allows the card holder to utilize the float (i.e. earn interest on monies until payment is made).

Michelle also opened accounts at Belk, a regional department store, and her favorite retailer, Victoria's Secret. Michelle heard that it was advisable to open different types of credit in order to improve one's credit score. She routinely checked her credit file using annualcreditreport.com. First, she checked her credit report from TransUnion. TransUnion is one of three credit bureaus to which lenders report credit transactions and balances from financial institutions, retailers and other creditors. Equifax and Experian are the other two credit bureaus. Michelle obtained her credit report from Equifax four months later. She got her credit report from Experian eight months after receiving the report from TransUnion. Accordingly, she checked her credit history at one of the three credit bureaus every four months. She has maintained this practice over the last three years. Michelle has not incurred any charges for obtaining her credit reports because she is entitled to one free report per year from each credit bureau by going through annualcreditreport.com. There are other websites out there that promote free credit reports (e.g., freecreditreport.com). However, annualcreditreport.com is the only site that allows one to access all three credit reports one time per year at no cost or further obligation.

Checking one's bank and charge card statements regularly is a primary safeguard against identity theft. One should also check one's credit file at each of the three credit bureaus periodically to ensure that there are no errors or unauthorized transactions. Errors should be reported to the credit bureau in writing immediately.

Each credit bureau generates its own credit score. More recently, the credit bureaus jointly created the VantageScore. VantageScore 3.0 ranges from 300 to 850. Most lenders, however, rely on one's FICO score when making a credit decision and/or determining the interest rate to be charged. One's FICO score cannot be determined from the credit bureau reports. It can be obtained at www.myfico.com. There is a charge. Some banks and credit card companies provide the FICO score at no cost to select customers.

FICO scores range from 300 to 850. A FICO score of 800 or above is considered excellent. A good score ranges from 700 – 799. A fair score is 650 – 699. A score below 650 is considered poor. One of Michelle's goals is to improve her credit score. She did some research to identify the determinants of one's FICO score. Michelle learned that a FICO score is computed based on the following components and weights (Weston, 2012):

1. Types of credit maintained – 10%
2. History of timely payments – 35%
3. Amount owed relative to credit limits – 30%
4. Length of credit history – 15%
5. New credit – 10%

The most weight is given to one's history of making timely payments. Accordingly, the earlier a student establishes credit and makes payments on a timely basis, the higher his/her FICO score will be. Michelle also learned that it is best to maintain a balance of less than 30% of one's credit limit. This computation is made for each credit and in total. Note that one's income or net worth are not factored into one's credit score. Also, note that applying to open several different accounts in a relatively short period of time will adversely affect one's credit score. This will not occur if the applicant is merely shopping for the same type of credit (i.e., a mortgage) at different lenders.

TIME TO BE AN ADULT

Michelle remained in Charlotte after graduation. She currently works as a Credit Analyst at BB&T. She decided to live with her parents after graduation in order to save money. Further, she enjoyed her parents' company. She could retreat to her room whenever she felt the need to be alone. Most importantly, she enjoyed her father's cooking. What could be better? Michelle does not pay rent or buy food. Her auto coverage is included in her parents' policy and her cell phone is billed to her parents. Michelle loves her current status and has no reason to make changes.

Approximately one year after graduation, Michelle's mom told her, "It is time for you to move out of my house." This statement didn't particularly concern Michelle. After all, she was "daddy's girl". Surely, her father wouldn't force her to move and take on financial responsibilities now. "Everything is going so well." After all, "I need another year or two before I will be ready to be an adult." Much to her surprise, Mr. Jones told Michelle that he too thought it was time for her to strike out on her own. Michelle was devastated. The Joneses stated that they would transfer title to the Honda to Michelle. She would be responsible for obtaining and paying for her own auto coverage. They also suggested that she get her own cell phone plan. The Joneses maintained a family plan for them and their children. Renee and

Trevor got their own plans after graduation. Michelle remains on the family plan and consistently uses up most of the monthly data allowance. It is time for a change!

Michelle continued to drive the Honda Accord after graduation. Her parents purchased the car used while she was in College. The car has a current value of $9,992 per Kelly Blue Book. Hondas are noted for great gas mileage, reliability and relatively low repair costs. Michelle enjoyed driving the Honda while a student. Now, she believes it is time for a new car. "My Honda does not convey the image that I would like to project!"

Michelle has accumulated $5,000 in personal savings. Her checking account balance is currently $1,500. Additional assets consist of her car, value of clothing ($2,000), jewelry ($2,500), electronics ($2,200), furniture ($1,200) and the balance in her 401(k) which is $3,128. She has utilized her credit cards to make purchases of clothing, jewelry and household possessions. It is her intent to pay her credit card balance in full each month. Unfortunately, she has not done so. Currently, she has credit card debt of $2,687. The monthly minimum payment is $35. The annual finance charge is 18%.

TAKING CONTROL?

Michelle agreed to obtain her own auto coverage and cell phone plan since she now has "a real job." The days of "living off her parents" are over! She really does want to become more self-sufficient. However, there is one more major expenditure Michelle desires to make. She ventured into a BMW dealership one rainy Saturday afternoon. She had no intention of buying a car that day. However, she was immediately drawn to a red 3 series. It had the premium package and moon roof. This was her dream car. It had the options she desired. The BMW 3 series would provide Michelle the professional image she desired. She had to have it.

The salesperson informed Michelle that she had two choices to acquire the car. She could either lease the car or purchase it outright. In either scenario, she could trade her Honda and avoid having to make a down payment. Michelle had never negotiated a car purchase before. Further, she didn't want to call her parents because she knew they would disapprove of the purchase. She called her brother for advice.

Trevor highlighted the major differences in leasing a car versus buying. He explained that leasing typically requires little, if any, upfront money. Further, monthly payments tend to be lower. The downside is the lease term is fairly short (e.g., 3 years). At the end of the lease term, the lessee must either purchase the car or secure another vehicle. No equity is built up. He also suggested that a lessee should negotiate the terms of the lease as if he or she is buying the car. The key components of the monthly lease payment include.

1. Capitalized cost – the cost of the car plus associated fees
2. Money factor – akin to the interest rate
3. Residual value – the estimated value of the car at the end of the lease term
4. Annual mileage allowance – maximum number of miles the car can be driven each year without the payment of an additional fee

Trevor suggested that Michelle consider buying the car because she would likely keep it for many years. Leasing a car generally makes more sense for those who trade their cars frequently (e.g., every 2-3 years). She could trade her Honda. A cash down payment would not be required. He suggested that she visit www.truecar.com to determine the average price paid for the car in their area. This site also indicates a range that constitutes a good or poor deal. Michelle learned the following pricing information:

MSRP	$44,000
Factory Invoice	$41,095
Good Price	$40,770 or less
Average Price Paid	$39,821

Michelle was confused by the differing amounts. Trevor explained that she should not negotiate from the MSRP down. Instead, her offer price should be based on the dealer's cost. Clearly, the dealer must earn a profit on each car sold. Michelle asked, "How can the dealer sell a car below factory invoice?" Trevor explained that dealers often receive discounts, dealer incentives or receive a cash payment once the car is sold. This payment is referred to as the holdback. Thus, the dealer can make a profit even when a car is sold below factory invoice. More recently dealers have added a document prep fee which is preprinted on the Sales Contract. This fee, usually several hundred dollars, is not subject to negotiation. It is pure profit for the dealership.

Trevor suggested that Michelle negotiate the price of the BMW first. Once accomplished, she should then negotiate the trade-in allowance. It is a common practice of the dealership to negotiate the trade-in value and price of the car in one negotiation. Accordingly, it is more difficult to assess whether or not you are getting an attractive deal. Trevor also told Michelle that she needed to be patient and she should be prepared to walk away. Michelle followed Trevor's advice. A few hours later, she drove to Trevor's apartment to show off her new possession.

Michelle was very proud of her new car and her newfound negotiation skills. After several "back and forth offers" and threats to leave, Michelle negotiated a purchase price of $39, 100 with a trade-in allowance of $8,300. She was then escorted to the F&I Manager's office. He suggested that Michelle buy a paint protection package, extended warranty and credit life insurance. Credit life insurance, he explained, would pay off the loan balance in the event of Michelle's disability or death. Michelle passed on each of these.

Fortunately, BMW was offering incentive financing on the car she purchased. Michelle elected to finance her purchase at 0.9% for 60 months.

I NEED INSURANCE

Michelle obtained a quote from three auto insurers. Insurance is sold by both company agents (e.g., State Farm, Allstate) and independent agents who represent more than one company. It is also possible to shop for coverage on the internet. Auto rates are quoted based on a number of factors which include:

1. Driving record
2. Make and model of car
3. Home location
4. Safety equipment in the vehicle
5. How much the car will be driven (i.e., commuting to work, pleasure driving only, etc.)
6. Driver's credit history
7. Age and sex of driver

Discounts may be available for insuring one's auto and home/apartment with the same company, completing a driver's education program or having good grades.

Michelle learned that she must maintain liability coverage. This protects others in the event that there is an accident and Michelle is deemed to be at fault. Each state establishes the minimum amount of liability that a driver must carry. Liability coverage provides protection in the event of:

1. Bodily injury for one person injured in an accident
2. Bodily injury for two or more persons injured in the same accident
3. Damage to personal property

Liability protection written as 25/50/15 means that there is $25,000 of coverage for one person injured in an accident. There is $50,000 of protection for all persons injured in that same accident and property damage is covered up to $15,000. Since Michelle does not have significant assets, she feels that she can maintain relatively low limits of liability and thereby minimize her premium.

Michelle desires to maintain full coverage. Accordingly, she will obtain collision and comprehensive coverage in addition to liability protection. Collision coverage provides for reimbursement in the event her car is damaged in an accident and she is at fault. Comprehensive provides coverage against theft, fire, hail, etc. Michelle must decide on an appropriate deductible. The deductible is the out-of-pocket expense that Michelle will incur if there is an accident and there are damages to her car and she is at fault. She will also incur this expense if her car is damaged via hail, vandalism, etc., or stolen. A low deductible (e.g., $100) results in a higher premium. A higher deductible of $250, $500, $1,000 or more results in a lower premium, but increases the amount of financial risk assumed by the insured.

PLANNING FOR RETIREMENT

Michelle's father told her that it is important to start saving for retirement as soon as possible after graduation. Accordingly, she vowed to participate immediately in any company-sponsored retirement plans that she became eligible for.

BB&T offers a 401(k) retirement plan and matches the first 6 % of employee contributions. Michelle has been diligent about contributing 3% of her salary since she joined the Bank. The current balance in her 401(k) is $3,128. Monies contributed to her 401(k) grow tax-deferred. That is, she does not have to pay taxes on earnings until monies are withdrawn from her account. Further, monies contributed reduce her taxable income dollar for dollar.

Michelle's current asset allocation is 80% stable value fund and 20% money market fund. She has not researched the investment options available in her 401(k), but says, "I can't afford to lose my money." Michelle has the ability to allocate her money among one or more of the following investment alternatives.

Money market fund
Stable value fund
Short-term bond fund
Long-term bond fund
S&P 500 index fund
Large cap growth fund
Mid cap growth fund
Small cap growth fund
Real estate investment trust (REIT)
International growth fund

Clearly, Michelle does not understand the direct relationship between risk and return. Michelle has significantly limited her opportunity for attractive investment returns by choosing to allocate her retirement monies to the most conservative investment options. Further, Michelle does not understand that now is the time to take on investment risk. She should seek opportunities to earn a market rate of return. Time is on her side in the event that she makes an investment that doesn't perform as anticipated in the short-term.

Michelle's goal is to become financially independent at age 60. Accordingly, she plans to work for 37 more years. Her goal is to be able to generate $75,000 per year in today's dollars during her retirement years. She plans to "retire" at age 60 and have a life expectancy of 28 years.

TAXES

Michelle expects to receive a tax refund of approximately $600. She has been using a tax preparation service to prepare her Federal and state tax returns. Of course, she has to pay a fee for this service. One of her friends suggested that she prepare her own tax return. "That's too complicated and time consuming," Michelle thought. Her friend pointed out that Michelle's return is fairly straightforward since she doesn't itemize deductions. She should be able to complete her own tax return using one of the online software packages that does not charge for the Federal return. There is a nominal charge for the state return. Michelle's friend also suggested that she increase the number of her withholding allowances in order to reduce the amount of taxes withheld each paycheck. This would reduce her refund check, but it would increase her take-home pay throughout the year.

Michelle feels ill-prepared and overwhelmed to "take charge" of her finances. A personal finance class was not offered at JCSU when she attended. She believes that assistance from a professional financial planner is required. Michelle remembered that one of her professors had practiced for years as a Financial Planner. She emailed Dr. Thomas to request a meeting. Dr. Thomas informed her that he had retired as a financial planner. Further, it would be difficult to refer her to a professional planner because she really didn't have sufficient assets at this stage of her life to justify paying a fee. Dr. Thomas agreed to meet with Michelle. He stated that he would be willing to assess her current financial situation and provide recommendations. There would be no charge for this meeting.

During their meeting, Dr. Thomas asked Michelle, "What are your goals?" She offered the following:

1. To be wealthy
2. To own a home
3. To marry and have two children
4. To obtain an MBA
5. To move up the corporate ladder
6. To be financially independent at age 60

Dr. Thomas suggested that Michelle formulate short, intermediate and long-term goals. Short-term goals should include those things Michelle wants to accomplish within the next twelve months. Intermediate term goals are those to be accomplished between one and five years from now. Long-term goals are those with a target date for accomplishment more than five years away. Dr. Thomas also commented on the quality of Michelle's goal statements. They lack a timeframe and aren't measureable. Effective goal statements are:

S – specific
M- measureable
A- attainable
R – realistic
T – have a timeframe for accomplishment

Dr. Thomas was pleasantly surprised to learn that Michelle had prepared a monthly budget. She provided the following.

Table 1 Michelle's Monthly Budget	
Take Home Pay	**$3,418**
Expenses:	
Gas	120
Eating Out	125
Clothing	250
Travel	300
Personal Grooming	120
Gifts	60
Savings	500
Total Expenses	**1,475**
Monthly Surplus	**$ 1,943**

Dr. Thomas asked Michelle how she formulated her budget. She said, "I estimated the amounts based on what I thought I was spending". Dr. Thomas suggested that she maintain a record of her spending for the next six months. This can be accomplished by maintaining a manual spending log (Kapoor, Dlablay, Hughes & Hart, 2013) or by utilizing an online service such as www.mint.com. Mint pulls one's bank, credit card, loan and investment transactions and balances onto its site. This makes it extremely easy to track spending and generate Personal Financial Statements (i.e. Personal Balance Sheet, Budget) and retrieve items of income and deductions for tax purposes. This is a free service. Quicken is a rival service and perhaps more sophisticated. There is a fee for utilizing Quicken, however. He asked if she compared her actual expenses to her monthly budget. Michelle answered, "No".

"What should I do to take charge of my finances?" Michelle asked. Dr. Thomas responded, "There are no magic solutions. Assessing your current financial position and developing and implementing strategies to achieve your goals will take time and a great deal of discipline on your part. Let's get started!"

Dr. Thomas pointed out that Michelle's goals were not properly stated. You need to re-write your goal statements in the proper format. This will help us understand what it is you wish to accomplish and your desired timeframe for accomplishment.

Next, Dr. Thomas suggested that Michelle prepare a Personal Balance Sheet (Walker & Walker, 2013). This statement will show the value of the things she owns (assets) and the amount of debt that she currently has (liabilities). Assets are valued at fair market value (what one would receive for the items if they were sold in an arms-length transaction) as of the Balance Sheet date. They are listed in order of liquidity. The purchase price of the items is immaterial. Michelle can then compute her net worth by subtracting total liabilities from total assets. It is not uncommon for college students and recent graduates to have a negative net worth. This is largely driven by student loan balances. Clearly, Michelle was fortunate to have parents who paid her college expenses from their monthly cash flow.

Dr. Thomas implored Michelle to compare actual expenses to budgeted amounts on a monthly basis once her budget is revised. This will allow her to identify favorable and unfavorable variances. Spending less than budgeted or receiving more income than budgeted is a favorable variance. Conversely, spending more than budgeted or receiving less income than budgeted is an unfavorable variance.

Michelle's head was spinning. This sounded like a lot of work on her part. Nonetheless, she left Dr. Thomas' office determined to complete her "homework assignments" and to become much more astute at managing her finances.

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OCCUPATIONAL FRAUD: MISAPPROPRIATION OF ASSETS BY AN EMPLOYEE

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CASE DESCRIPTION

This case provides a practical example of occupational fraud. Losses suffered by small business due to fraud are disproportionate to larger companies due to lack of internal controls. Specifically, it examines the methods of how a human resources/accounting manager of a manufacturing company managed to embezzle more than $250,000. The unwitting victims of this scheme were the two principal owners who were engineers by trade and typical of most small business owners who focus their efforts on generating their product and maintaining customer relations. Essentially, the owners left the oversight of the day-to-day operations to their "trusted" employees.

The primary subject matter of this case is occupational fraud and lack of internal controls in small privately owned companies. Secondary issues include multiple components of asset misappropriation, employment screening, due diligence, and indicators or "red flags" to possible fraud. This case is targeted for students in a forensic accounting course to provide practical discussions on internal controls, accounting for the loss, and solutions to minimize occupational fraud.

CASE SYNOPSIS

This case provides a practical example of occupational fraud. Specifically, the examination of this case demonstrates the methods of how a human resources/accounting manager of a manufacturing company managed to misappropriate more than $250,000 from his employer using multiple schemes, including larceny (Cash), falsified wages & benefits (Payroll), and personal purchases (Billing). It also demonstrates that losses suffered by small business due to fraud are disproportionate to larger companies due to lack of internal controls.

The case got started when the author who is a consultant in forensic accounting and fraud examination received a call from the employment attorney for Satellite Manufacturing Company (It is important to note that the names of the business and the parties involved in this case have been changed to protect their identity). A meeting was set up between the author/consultant and the principals of Satellite Manufacturing Company (SMC) to discuss the principals understanding of what had transpired in this case. At the time of the original meeting, the principals indicated that they terminated the alleged perpetrator at the advice of their legal counsel. The principals, along with their Chief Financial Officer (CFO), believed that the perpetrator stole about $25,000.

The company generated gross revenues between 7 to 10 million dollars per year. Besides the two owners, the business had a part-time CFO, a three person accounting department which included both accounts receivable and accounts payable, and the human resources (HR) manager. These people were involved in the accounting function at the time of our engagement.

The company also maintained a combination of 20-35 part-time and full-time machine operators and plant workers. In addition, SMC had two administrative employees.

The unwitting victims of this scheme were the two principal owners who were engineers by trade and typical of most small privately-owned businesses who focus their efforts on generating their product and maintaining customer relations. Essentially, the owners left the oversight of the day-to-day operations to their "trusted" employees.

OCCUPATIONAL FRAUD

Occupational fraud is defined as "The use of one's occupation for the personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets" [Association of Certified Fraud Examiners (ACFE), 2014 *Report to the Nation on Occupational Fraud and Abuse (Report)*; Wells, 2004]. Occupational fraud is fraud against the employee's organization (Albrecht, Albrecht, Albrecht, & Zimbelman, Fraud Examination, 5th Ed., 2015). In such cases, the employee steals either directly or indirectly from the employer. Occupational fraud, fraud against organizations, includes asset misappropriation, corruption, and fraudulent financial statements. Asset misappropriation includes theft or misuse of an organizations assets; corruption is where a person uses their influence to obtain an unauthorized benefit contrary to the person's duty to their organization; and fraudulent financial statements is the fabrication of an organization's financial statements to make the company appear more or less profitable than actual (ACFE *Report*, 2014).

Of the three types of occupational fraud, asset misappropriation is the most common and occurred in approximately 85% of the cases of the study, but is the least costly of the three types of occupational fraud with a median loss of $130,000 (ACFE *Report*, 2014). The two main categories of asset misappropriation are: (1) cash and (2) inventory and all other assets. Cash misappropriation include: larceny, fraudulent disbursements, and skimming. Inventory and all other assets include the misuse of an organizations assets and larceny.

In the ACFE Report (2014), they identified and collected data on nine sub-categories of asset misappropriation. The following includes frequency and median loss of each scheme: 1. billing 22.3% ($100,000); 2. Non-cash 21.0% ($95,000); 3. Expense reimbursements 13.8% ($30,000); 4. cash on hand 11.9% ($18,000) 5. Skimming 11.8% ($40,000); 6. Check tampering 10.9% ($120,000); 7. Payroll 10.2% ($50,000); 8. cash larceny 8.9% ($50,000); and 9. register disbursements 2.8% ($20,000).

The median fraud losses that small businesses suffer are larger per case generally due to the lack of internal controls, predominantly with respect to the segregation of duties. The median loss suffered by organizations is $154,000 per scheme, which is 28% higher for organizations with less than 100 employees. Median losses due to fraud significantly increase when collusion is involved (ACFE *Report*, 2014).

FRAUDULENT ASPECTS OF THE CASE

In this case, the problem was discovered by the "part-time" Chief Financial Officer (CFO)/consultant with Satellite Manufacturing Company (SMC). The CFO served as an advisor to SMC for a number of years and was paid as an independent contractor. His functions were to review the accounts receivable, accounts payable, and internally generated financial statements and consult with the principals. Accordingly, he had familiarity and experience with the company and its operations. Though the CFO was confident that the company was profitable, he believed that the company's cash flow was insufficient given existing operating results. Since labor costs were one of the largest expenditures of the company, the CFO and one of the principals performed an initial review of the company's payroll register and related summaries.

Their suspicions grew deeper as they discovered that approximately $15,000 to $20,000 had been misappropriated by Jerry Smith, one of the company's trusted employees. They compared the payroll for Jerry Smith in the current year with the same period in the prior year and discovered that Jerry Smith had taken more than the requisite number of checks in the year. Upon learning of the additional checks to the perpetrator, one of the principal owners contacted his employment attorney who subsequently contacted the forensic accounting consulting firm to set up an initial meeting to be briefed on the facts of the case.

Jerry Smith was hired as the manager of human resources and was also entrusted with the responsibility for administering the payroll and benefits for approximately fifty employees. Ironically, the "Professional Profile" on Jerry Smith resume contained the following descriptive qualities:

- Highly motivated individual and loyal team player
- A problem-solver, dedicated to tackling all problems to a positive conclusion
- Willing to accept new challenges
- Self-starter, quick learner and flexible

Jerry Smith's resume showed that he had an Associate's Degree with a concentration in accounting from a local community college. Jerry Smith also indicated that he was a Program Manager for a security technology company for eleven years. His employment ended five years prior to the start with SMC. His resume contained no other work or professional experience after that time.

There were gaps in Jerry Smith's employment. What was he doing in the five years from his last job to the date of his hire? Moreover, his recent employment consisted of part-time maintenance and handyman work per his resume. Was Jerry Smith even qualified to perform any accounting functions? The principals questioned Jerry Smith regarding his employment with the security technology company and wanted to contact them for a reference. Jerry Smith indicated that his prior employer was out of business, but did provide a name of an individual who was with his previous company, but that person was out of the state. Unfortunately, no phone calls, other communication, or further background check was completed to obtain background information confirming Jerry Smith's employment for the prior five years since the principals felt "comfortable" with Jerry Smith. To compound this issue, no background check was performed to confirm Jerry Smith's academic credentials.

PAYROLL AND BENEFITS SCHEME

The misappropriation of assets started approximately one year after Jerry Smith was hired. One of Jerry Smith's responsibilities was to phone the weekly payroll information (hours worked, pay changes, etc.) into the outside payroll service. With oversight over both human resources and a piece of the accounting function, Jerry Smith identified an opportunity to take unauthorized vacation pay. He began by taking one additional week of unauthorized pay during his second year of employment. This was done by phoning into the payroll company one additional week of payroll for himself. The checks were sent to directly to Jerry Smith at the company. Jerry Smith was able to present the checks to the owners for signature. Any additional check written to Jerry Smith was buried among all the other employee's checks. Once Jerry Smith realized that neither of the owners reviewed the payroll checks or supporting payroll

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documentation, including the weekly payroll register or summaries, he saw an easy opportunity During the next seven years (until his termination), he took an additional two to twelve weeks of unauthorized vacation pay per year. The amount of this defalcation totaled $56,375.

Jerry Smith then identified other areas for enrichment. The company required its employees to contribute towards the cost of their medical and disability insurance through withholdings from their weekly paychecks. Initially, Jerry Smith deducted only a fraction of the full contribution for medical insurance coverage for his family. Similarly, Jerry Smith neglected to withhold his portion of short-term and long-term disability insurance from his weekly paychecks. This scheme continued for almost seven years. The loss to the company from this defalcation amounted to $16,700 for medical insurance and $9,190 in disability insurance.

The above referenced misappropriated assets were those that could be quantified. Other "gray areas" existed but could not be quantified during the forensic investigation. For instance, Jerry had the authority to approve his own overtime and his hourly wage increases. Unfortunately, no time cards were maintained to verify hours worked and performance reviews were not mandatory. Jerry's annual salary grew from approximately $30,000 to over $80,000, or a 167% increase in slightly over nine years.

CASH SCHEMES

If any internal controls were present at this company, they became inconsequential once Jerry Smith was given check-signing authority over both the regular checking and medical disbursement checking accounts. In addition, Jerry Smith was one individual in the accounting department who reconciled the bank accounts. Here was an opportunity for Jerry Smith to use his position to divert substantial dollars from his employer. With a few of years of experience and some confidence under his belt, Jerry started writing (and signing) checks payable to "cash" from the regular checking account. The checks were endorsed and cashed by either Jerry, his spouse or son-in-law. Checks written to cash totaled between $8,500 and $32,300 per year and were posted to the "Cleaning and Maintenance Expense" account in the company's general ledger. This defalcation totaled $90,825.

Aware that checks he wrote payable to cash from the regular checking account went undetected, Jerry then began to do the same with checks from the medical reimbursement checking account. Again, the perpetrator was both the signator and endorser on these checks. The total amount taken from the medical reimbursement checking account amounted to $62,845. At the end of each year, the owners paid a $100 to $150 bonus *in cash* to each employee who was on the payroll as of the second week in December. In order to obtain the currency to distribute to employees, Jerry wrote a check payable to cash and had a different accounting department employee cash it at the local bank. The other employee then returned the cash to Jerry who divided the money into a separate envelope for each employee. The only problem was that the check was written for *more than* the amount needed to cover the total bonuses. The excess amount taken was $3,700 over a three-year period prior to his termination.

ADDITIONAL LOSS TO SMC

This case also included an unusual twist. The forensic investigation revealed that the defalcator paid unauthorized vacation pay to another administrative employee and did so without deducting any related employee medical insurance contributions. These were not simply errors.

Medical insurance had been properly withheld from the "friend" on a weekly basis prior to the start of this misappropriation. Though no conclusion was reached as to the motive for this defalcation, a sexual relationship between Jerry Smith and the administrative employee was suspected. The loss amounted to $5,325 in additional vacation pay and $12,155 in lost medical insurance withholding. The company also had to pay additional Social Security taxes in the amount of $4,720 on the additional wages.

The table below is a summary by type of the assets misappropriated by Jerry Smith from SMC:

Table
Misappropriation of Assets

Assets Misappropriated Directly To Jerry Smith	**Amount of Loss**
Cash Larceny: Regular Checking	$ 90,823.18
Cash Larceny: Medical	62,843.76
Payroll: Excess Vacation Pay	56,374.80
Cash: Excess Bonus	3,700.00
Total to Jerry Smith	$213,741.74

Additional Loss To SMC	**Amount of Loss**
Payment of Social Security Taxes on Payroll to JS	$ 4,312.67
Payment of CAF Plan for JS	16,997.44
Payment of Disability Insurance for JS	9,186.12
Excess Vacation Pay for AE	5,324.63
Payment of Social Security on Payroll to AE	407.33
Payment of CAF Plan for AE	12,155.00
Total Other Loss	$ 48,383.19
Total Loss of Assets	$262,124.93

JS – Jerry Smith
AE – Administrative Employee

Epilogue

Jerry Smith was fired. Nothing happened to accounting/administrative employee since it could not be proven that she was directly involved in the additional benefits she received. Jerry Smith was later interviewed by the author in the presence of SMC's attorney. The interview took place under oath with use of a court reporter. Jerry Smith elected to be present without an attorney. After questioning, he admitted to all aspects of the misappropriation. When Jerry Smith was asked if he wanted to make a final statement, he said: (1) he would make restitution, (2) not to call the police or district attorney, and (3) do not tell his family.

POSSIBLE ASSIGNMENT QUESTIONS

1. What procedures should this company have instituted prior to hiring employees? When documentary evidence is lacking, what information is available to verify a prospective employee's background?
2. Many small businesses experience difficulty in adequately segregating critical accounting functions. In such instances, what can the principals do to mitigate the risks inherent in such a control environment?
3. What investigative techniques would be used to uncover the fraudulent activity in each of the areas described above?
4. If the principals of SMC called you in as a consultant, what advice would you give them to prevent such incidents from occurring in the future? What solutions should be recommended?
5. What specific internal control procedures could have prevented this fraud?
6. Does the cost of instituting internal control procedures outweigh the long-term benefits?

TOURISM IN ILHA GRANDE: THE PROMISES AND THE PROBLEMS OF PARADISE

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CASE DESCRIPTION

The primary subject matter of this case concerns sustainable tourism development (environmentally, socio-culturally and economically) on an exotic, natural island destination in the Brazilian Atlantic Rainforest. Secondary issues examined include stakeholder theory and life cycle stages in business development. The case has a difficulty level of three, appropriate for junior level courses and higher. The case is designed to be taught in two classes of 3 hours and is expected to require 2 hours of outside preparation by student.

CASE SYNOPSIS

Ilha Grande, a exotic, natural island located in the Brazilian Atlantic Rainforest off the coast of Brazil, has faced a series of challenges throughout history. However, the most serious threats to the sustainability of the island might be occurring now. From *environmenta*l threats such as increases in tourist visitation to invasive species and proximity to a nuclear plant to *socio-cultural issues* such as inequalities among residents and non residents with regard to education, loss of culture, land use and well being to *economic issues* such as lack of employment and income, Ilha Grande is at a crossroad in its opportunity towards sustainable development.

This island became a tourism destination only 20 years ago in 1994. As the 3rd most popular island destination in all of South America, Ilha Grande has the promise of a vibrant tourism industry because of its beautiful beaches, protected areas and biological reserves. This case study will outline the history of Ilha Grande and how tourism evolved despite the lack of infrastructure, overdevelopment, lack of qualified personnel, over abundance of tourists who arrive by boats and by cruise ships, the encroachment of oil drilling in the bay and the proximity of Brazil's two nuclear energy plants.

Students will read and view the positions of various stakeholders. This includes business owners, local residents, new residents (outsiders), tourists, oil exploration companies, government, cruise ships, and environmentalists. Using the perspectives of the various stakeholders, student will be asked to prepare a plan for sustainable tourism development.

BACKGROUND ON ILHA GRANDE

Location

Ilha Grande, which is Portuguese for “Big Island”, is an island that is part of the municipality of Angra dos Reis, located off the coast of the state of Rio de Janeiro. The primary public access to the island is a ferry boat ride of approximately an hour and a half from the port of Angra dos Reis, south of the city of Rio de Janeiro.

Ilha Grande has a lush, green, landscape that is a sanctuary of natural biodiversity with a wide range of diversified species. It is located inside an Area of Environmental Protection *(Area de Proteção Ambiental – APA*) that includes three natural parks, including tropical beaches, luxurious vegetation and mountainous landscapes. The island is the home of many of the largest endangered species, such as the brown howler monkey and the red-browed Amazon parrot.

The land is 74 square miles in surface area with a population of an estimated 7,000 to 8,000 that increases by another 10,000 to 13,000 during the peak tourism period (Exhibit 1 Population of Ilha Grande). Fifty percent (50%) of the island inhabitants (3,500-4,000) live in the village of Abraão. Proveta with 1,025 residents is the second largest village on the island. There are several more remote small villages with smaller populations that are only accessible by boat (Araçatiba, Praia Vermelha, and Matariz Longa).

Exhibit 2 Map of Ilha Grande, Brazil shows the scatter development of the island. Various tourism sites are indicated and trails are demonstrated in red. As can be noted on the map, there are protected areas of the island that are off limits to visitors.

History

Throughout history, the economic base of the island evolved from: early colonization period of exporting of coffee and sugar raised on plantations operated mainly by slaves; to serving as a quarantine site for immigrants arriving on over 4,000 boats from Europe; to housing and operating one prison for political prisoners and a second prison for hardcore felons. Once the prisons were no longer in operation, the fishing industry flourished. Eventually, tourism became the primary source of employment and revenue to the island. There were four (4) historic periods of Ilha Grande: 1) discovery, 2) colonization, 3) prison and fisheries, and 4) tourism. During each of these time periods in the history of the island presented challenges to the environmental, social-cultural and economic sustainability.

In 1502, the navigator, Andre Goncalves discovered Ilha Grande two (2) years after Brazil was discovered and after he had named the city of Rio de Janeiro. Between 1502 and 1750 there were only four (4) houses on the island. Colonization first took place in 1722 and continued with both sugarcane and coffee plantations during the 19th century where up to 20,000 slaves worked.

In 1884, the Brazilian Emperor financed a hospital, called Lazareto, which was needed to take care of European immigrants who were arriving on the boats with various diseases such as cholera and malaria. Lazareto was the critical quarantine stop for immigrants before they could arrive on the mainland of Brazil. After the proclamation of the Republic in 1889, the newfound government made one of its first orders to improve the Lazareto hospital by building an aqueduct to supply the hospital with a constant flow of fresh, clean water in 1893 which is still in use to this day. The Lazareto was in operation until 1913. Both the ruins of the Lazareto and the aqueduct are attractions located close to the Abraão Village where tourists can still visit today.

From the time of proclamation of the Republic of Brazil (1889) until 1954, there were two operating prisons on the island. The first prison, the converted Lazareto hospital, was taken out of service in 1954 and demolished in 1963. The second one, Cândido Mendes Penitentiary at Dois Rios, was a fully equipped maximum security prison that housed political prisoners from the military dictatorship, drug lords and criminal masterminds. Prior to 1994, the prison holding up to 1,000 major felons deterred many would-be tourists from coming to the island. Prison breaks were routine. Local residents delighted in telling stories of how fugitives occasionally terrorized islanders, running rampant and making a mockery of the prison guards. In 1994 after the end of the military rule and due to rising operating cost, local authorities dynamited the much-feared Cândido Mendes Penitentiary. Because the prison had provided employment for many people on the island, the local community opposed its destruction. Without it, their only livelihood would be the fisheries. However, after the prison was destroyed, the island began to slowly open to tourism.

From the last quarter of the 19th through the beginning of the 20th century, the island also developed a thriving fishing industry that gainfully employed the majority of the island's residents. In the 1930s, Japanese immigrants began a "dry fish" processing industry when they established 30 fish salting plants in the villages of: Proveta, Araçatiba, Praia Vermelha, Matariz, Longa and Aventureiro. They operated for 40 years until the 1970s when processing declined due to depletion of fish stocks in the Ilha Grande bay. These dry fish processing plants were eventually converted into hotels during the tourism era on the island.

In the 1970's, measures were implemented to help preserve the island's unique ecosystem and establish numerous laws, rules, and regulations to protect the island's wildlife and landscapes. Conservation Units were created in the 1970s by different legislative measures and managed by different government agencies**.** Similar to the U.S. system, Brazil has federal, state and municipal levels of government.

All of the protected areas on Ilha Grande occupying the majority of the island territory are managed by the environmental state agency called Instituto Estadual do Ambiente (INEA). This fact creates periodic friction with municipal government of Angra dos Reis to whom Ilha Grande belongs.

Three environmental protection developments are: 1) the State Park of Ilha Grande (1971) with 14,055 acres; 2) the Biological Reservation of Praia do Sul (South Beach) (1981) with 8,892 acres; and 3) the Marine State Park of Aventureiro with borders encompassing the entire coastline and the islands beaches (Exhibit 3 State Parks of Ilha Grande).

Specific acts such as pulling out/cutting down trees and flowers, feeding wildlife, lighting fires, hunting, and fishing activities – net fishing and submarine – were all prohibited unless people were three miles away from the coast and had proper licenses. No cars or trucks were allowed on Ilha Grande.

For example, Ilha Grande State Park provides a list of regulations for visitors that include the following points:

1. Walk within the designated paths only and follow the signs, use these for orientation and stay off restricted areas for your personal security
2. Do not throw your trash on the park. When you are on a trail, take your garbage with you
3. No dogs and cats, except dogs assisting disabled persons
4. Camping and barbeques are permitted only in designated areas. Fires are prohibited

5. Fishing is allowed only with line and hook on the sea
6. Hunting animals and collecting plants or minerals is not permitted
7. Do not feed or disturb wildlife, or damage its home or habitat
8. Do not film or take photos for commercial purposes without official authorization.

Tourism

With the prison gone, tourism began in 1994 with disorganized growth (Exhibit 4 "Deaths from Brazil Ilha Grande resort mudslide reach 26"). The locals who had no professional qualifications often converted homes into small hotels. There was a strong clash between the local native entrepreneurs and the outside entrepreneurs who came to the island to open small bed and breakfasts (B&B) also called pousadas and other businesses. In the 1970's the fishing industry structures at Proveta, Araçatiba, Praia Vermelha, Matariz, Longa and Aventureiro were converted into hotels to support the island's growing tourism industry.

Beginning in 1994, statistics showed a steady and sustained increase in the numbers of tourists visiting Ilha Grande (Exhibit 5 - Seasonal Visitation on Ilha Grande). The initial tourists were low maintenance back packers who required little infrastructure. Because there are no actual records of tourists' arrivals, it is not possible to accurately quantify. However, the report from Nelson Palma, editor of O Eco Journal states that the numbers of tourists on the island have tripled in the last 10 years.

Nelson reported that in 2013, there were 130 pousadas (100 in the village of Abraão and 30 on the rest of the island), 20 camping sites (10 in Abraão) and 60 restaurants (30 in Abraão and 30 on the rest of the island). Rapid uncontrolled growth on the island has exacerbated the challenges faced environmentally, socially, culturally, and economically (Exhibit 6 Average Visitation and Infrastructure).

In May 2000, Mr. Palma initiated O Eco Journal, a 32 page monthly journal, addressing the issues of ecology, history, culture and tourism on Ilha Grande. He funds this publication that has a circulation of 5,000 and 89% credibility among the readers of the journal (O Eco Journal, 2014).

Mass tourism (defined as tourism where large numbers of tourists appear at one time in large groups) is the most prevalent type of tourism on the island. The primary method of access is ferry boats that can bring up to 1000 visitors at a time. During holiday periods, more ferry boats are added to the schedule due to demand. A portion of the tourist arrivals are also day trippers who come for the day and spend less on food and nothing for lodging but use the other island resources.

Typically the tourists are environmental who are concerned with protecting the features of the island. Two examples are: 1) cultural heritage tourists who are concerned with the arts and crafts and 2) nature tourists who are interested in viewing the geographic formations, flora and fauna.

A second major category of tourist is interested in outdoor sports such as the physical challenges of hiking and surfing. The third type is the leisure tourist who is primarily interested in beaches and boat trips to the many lagoons and bays.

There are also event tourists who choose to come to the island for special celebrations such as "festas juninas" [June parties], the "Ilha Grande Music and Ecology Festival" or the "Forró Dance Festival". In recent years there has been a sharp increase in the numbers of cruise tourists who visit the island in large numbers, but only for a few hours.

Environmental Issues

Increased tourism to Ilha Grande has resulted in negative environmental impacts due to: 1) increased numbers of pousadas being built with little concern for location, trash removal and sewage; 2) increased waste production; 3) increased stress on the sewage system; 4) demand for water; and 5) increased boat tours to various tourist attractions. Some steps have been taken to reduce some, but not all, of these impacts.

In a recent (2014) documentary, (Exhibit 7 - "Green vs Gold" - Brazil's Race to Balance its Sports-Fueled Tourism Boom), Nelson Palma, reported "the sewage system on the Island is not functioning and the situation with sewage has gotten worse with the increase in tourists."

The Abraão Village sewage treatment system is the only one on the island. The system is not functioning properly due to the lack of maintenance and insufficient capacity. The largest part of the sewage has been dumped into the sea almost without treatment. There is a state government project, still in the planning phase, to build a new sewage system for the main villages of the islands. A garbage collection process is in place, but many locals do not respect the hours for placing their garbage on the streets.

With the growing number of cruise ships off the coast of Brazil, there is a constant demand for transfers on small boats from the cruise ship to the main village, Abraão which contribute to pollution of the water in the bay of Abraão. Often these cruise ships release raw sewage and dirty water from showers and dishwashers, oil, and other chemicals into the water surrounding the islands which puts organisms such as fishes and coral reefs at risk.

In the same recent documentary, (Exhibit 7 - "Green vs Gold" - Brazil's Race to Balance its Sports-Fueled Tourism Boom), Renee Jackson, owner of Aratinga Inn in Abraão said,

> *" Because Ilha Grande is the third most popular island in Brazil, the number of tourists including cruise tourists is increasing. What do you do when you have 8,000 people from a cruise ship come onto the island at one time? There are no public restrooms and facilities for the cruise visitors. The local, state and federal government have done nothing to help Ilha Grande. The cruise ships should be stopped until the problems with infrastructure have been addressed*."

The owner and operator of Phoenix Tour Company, however, said,

> *"The cruise boats are good for the island. When cruisers visit Ilha Grande, they decide that they want to return. It is good marketing that will help us all."*

Gigi Courau, the owner of a local ecotour company, remarked about the dramatic increase in numbers of tourists by saying:

> *"I try to differentiate my business from the others by taking smaller boats, going to less visited islands and going early. Otherwise, when you go to one of the lagoons, you will have 10 tour boats and hundreds of people in the water."*

Another environmental challenge is the fact that the Brazil's National Petroleum Agency recently discovered that large reserves of oil are located off the coast of Brazil. At this time, oilrigs have been installed in the bay between Ilha Grande and the coast. One example of the negative impact is that in 2011, the Japanese oil services company Modec was fined R$16.6 million for an oil spill in Ilha Grande Bay along the southern coast of the state of Rio de Janiero. (Exhibit 8 - Brazil Examines Nuclear Plan Safety).

To further complicate the situation, oil rigs constructed in China were transported to the waters off the coast of Brazil to meet the need for expanded oil exploration. These oil rigs became the vehicle by which foreign coral were introduced into the Ilha Grande bay and have been destroying the local indigenous coral reefs (Exhibit 9 - Countering Coral in Ilha Grande, Brazil.)

As long ago as 2001, a study by Schneider and Vasconcellos reported that fauna on the island were showing signs of degradation due to the introduced outside species and that mangroves and vegetation had been significantly altered and became vulnerable due to human activities.

And, finally, not the least of importance, the Angra I and II nuclear plants are located in the Ilha Grande Bay. Although measures are taken to assure safety at the nuclear plants site, a recent article in *Nuclear Power Today* indicated there have been environmental issues that could result in the need to close the plants (Exhibit 8 - "Brazil nuclear plants may close as floods kill 68").

Social–Cultural Issues

Many of the native descendants of the Tamoios and Tupinambás Indians who live on the island feel it has been invaded and, as a result, have left the island, while other residents have been marginalized, and a few have tried to stay and adapt. Adaptation is not easy because as the island continues to get more attention, visitors, more pousadas restaurants and shops are being built. A recent headline in the local publication O Eco Journal stated "Tourism in Ilha Grande at an all time high"(March 2014).

Tourism businesses including restaurants, pousadas and tour companies suffer from a shortage of qualified, trained service personnel to work in their establishments. Often, the more highly skilled service jobs are given to more experienced workers from the mainland who come only to the island to work and leave (Alves, Junior & Andrade, 2013).

Only 50% of the investment on the island is by local residents (Ferreira, 2013). Since the number of outsiders on the island has increased, the local residents have become concerned about safety and overdevelopment on the island. This fear has led to conflict between the local residents versus the outsiders. The outsiders come with a lack of knowledge or concern for Ilha Grande. Local residents believe that Ilha Grande is not what it used to be and was safer when the island economy was based on the prison employment.

An increase in the amount of protected areas on the island has resulted in a conflict between people interested in environmental tourism versus traditional tourism (Medeiros & Nascimento, 2010). In addition, there is conflict with large tourism investors who seek to further develop the island.

In 2000, a group of local Ilha Grande residents who had common values regarding the present and future of the island, joined together to form The Committee for Defense of Ilha Grande (CODIG). They are focused on: 1) preventing overdevelopment of the island, 2) promoting a local vibrant economy built on community-based tourism and fisheries, 3) supporting the protected areas, and 4) maintaining, preserving and promoting the Caiçara Culture.

As the state government has made certain areas of the island protected, there have been issues with the rights of the indigenous people who have lived historically in these areas. Consequently, the government regulations are allowing the indigenous people to defend their rights to remain on their lands and make "cultural use". However, their culture is based on such "traditional" practices as hunting, fishing, and farming which is not allowed in these areas.

Economic Issues

Ilha Grande, like many islands around the world, is heavily dependent on revenue from tourism. Some of the residents and business owners say, “Tourism is good because it creates jobs” or “We have greater opportunities for making money through tourism”.
Even though tourism brings higher income to the locals and adds a positive contribution to the economy, it also triggers greater economic turmoil such as:

- Rises in price of goods and services
- Seasonal employment due to fluctuations in tourists demand
- Significant amount of income coming to the island, but leaving it to be paid to business owners/cruise ship companies that are based off of the island.

Many of the cruise ships are all-inclusive vacation cruises that cater to the passengers while on board and discourage passengers to spend money at the various destinations. Most, if not all ferries and cruise ships to the island, are operated by mainland owned businesses or in other countries. Therefore, any revenue or profit generated does not remain in the island economy.

In a study on the economic impacts of cruise ships, Brida & Aguirre (2001) reported statistics on how much high end tourists spend at each port during their cruises. They also suggested that the rapid growth in the cruise industry has lowered the cost of cruises making it affordable for a less affluent tourist who may visit an island and spend very little money there. Brida & Aguirre (2001) also stated that very little research had been done to determine the cultural, political, economic and environmental impact of cruises at that time.

CONCLUSIONS

Exhibit 10 - Timeline of the History of Ilha Grande tells the story from discovery to colonization, to the expansion of coffee and sugar plantations, to building of quarantine hospitals, to the development of prisons, to legislation for protected areas and, now, to the expansion of tourism. The island residents have seen fluctuations in population, insufficient infrastructure for sanitation and waste removal; introduction of invasive foreign species in the waters; threats from a nuclear plant being located close by; as well as oil exploration and drilling in the bay. Considering the various threats and stakeholders, the future sustainability of Ilha Grande as a destination is in jeopardy.

J. C. PENNEY AND RON JOHNSON: A CASE OF FAILED LEADERSHIP: LESSONS TO BE LEARNED

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CASE DESCRIPTION

Leadership is the primary subject matter of the case. Secondary issues that may also be examined are corporate culture and the marketing mix of product, price, place and promotion. The difficulty level of this case is a three. It would be appropriate for junior, senior and graduate students. The case may be taught in as little as one hour or could easily be expanded into two hours. Students should be required to spend a minimum of at least 3 hours outside of class to prepare for the case.

CASE SYNOPSIS

The business story dominating the airways from late 2011 through 2013 revolved around the company J. C. Penney and the much anticipated arrival of their new CEO Ron Johnson, his new vision for the company, and then the subsequent failure of that vision. It is an amazing tale of how things can go from "boom" to "bust" in such a short period of time. It is destined to become a classic case of failed leadership that management students will study for years to come. Early on during Ron Johnson's reign, there was tremendous excitement among the financial community, the shareholders, and even the company itself. How all that turned so quickly sour and ended in his dismissal 18 short months later provides for multiple lessons in leadership.

A BRIEF BACKGROUND OF J. C. PENNEY'S HISTORY

J. C. Penney has a long history going back to its beginning in 1902 with a single store in a small Wyoming town. By the 21st Century, it had truly become an American icon and a dominant force in the retail business. By 2011 the company had over 1,100 stores, $17+ billion in sales, and 160,000 employees (JCPenney, 2011), (Steffy, 2013).

Mr. Penney's stores were founded on "The Golden Rule" and as such it was to a morally upright place to both work at and shop in (Reingold, 2012). A basic tenant of his philosophy was that great customer service made for a great brand. An often repeated and revered story was about the time Mr. J. C. Penney had brought in the manager of the most profitable store in his chain and chastened him for making too much profit. That manager obviously was not giving his customers a good deal.

But starting in the early in the 2000's, the company found itself struggling to find a niche in the retail apparel industry. Competition was heating up, from both brick and mortar retailers to the quickly expanding internet industry. Penney's sales were stagnating; company stock was going nowhere, leaving shareholders unhappy. Many retail analysts and even their own customers, particularly the younger ones, often described the company as having evolved into one with a dowdy, stodgy, boring image.

ENTER RON JOHNSON AND HIS VISION

The Board of Directors of J. C. Penney came under pressure to do something. There was a new, active, and very vocal member of the Board by the name of William Ackman. He had earned his seat on the Board as a result of acquiring an 18% of the company stock. Mr. Ackman had a long history of being a "hedge fund guy" - a wealthy individual who seeks to buy a large share in a company usually with the objective of using his influence on the Board for a turnaround, hopefully resulting in the appreciation of his stock investment in the company. Hedge fund guys are sometimes correct in their choices of where to bet their money and influence, and sometimes, not so much. Mr. Ackman had previously made a big bet with Border's in 2006 before it went belly up (Steffy, 2013).

Mr. Ackman's opinion was that J. C. Penney needed a turnaround and Ron Johnson was the guy to do it. Ron Johnson had a degree from Stanford and a MBA from Harvard. He also brought a proven track record of success at Apple as their Vice President of Retailing. He had worked directly under Steve Jobs. He had also recently served a short period of time as CEO of Target (Reingold, 2012).

Mr. Johnson was appointed CEO in late 2011, largely on the strength of Mr. Ackman's recommendation. Johnson's vision for J. C. Penney was to transform its current boring image to one of being a cool place to shop. His strategy, formulated within a matter of days, included changing each of the company's 1100 stores into a mini-mall concept. There were to be individual shops within each store. Each shop would be a lot more upscale as compared to what currently existed. These upscale shops would be designed to attract a higher-end customer. Some of the shops would even be leased; actually rented out to a high- profile designer company. J. C. Penney would be going after a different customer. Mr. Johnson was quoted as saying that J. C. Penney had the oldest customer base in retail (Reingold, 2012).

All those constant sales, discounts, and coupons that the company had come to depend on would be no more. The company had been conducting more than 700 different sales in a single year. It was Johnson's belief that customers would appreciate, and prefer, having an everyday fixed value pricing approach over an everyday low pricing strategy. Company employees were not even supposed to use the word "sale". That new strategy came while 75% of the company's present revenues were being generated by merchandise that had been discounted 50% or more. House brands (which were bringing in one-half of the company's revenues) were to be significantly scaled back under Johnson in favor of higher-priced name brands.

Typical of many turnaround specialists, Ron Johnson quickly surmised that the company had too many employees. Always a sure way of increasing stock price and igniting the financial community, pink slips were issued in mass. Almost 20,000 J. C. Penney employees were terminated in his first 12 months as Chief Executive Officer (Macke, 2014). This in a company where one of their values was loyalty, and even in the worst days of the 2009 recession, very few Penney employees were let go.

Ron Johnson brought in his own management team. Most of his new team was from outside the retail apparel industry. The new team also felt that the Plano headquarters had become "overstaffed and underproductive" (Bhasin, JCPenney COO, 2013). Johnson quickly move to clean out the entire existing corner suite - all the old senior team down through to the executive vice president and vice president levels were asked to leave. One-third of the 4,800 employees working at the company headquarters in Plano lost their jobs. One round of a 10% cut in personnel was referred to by the employees as "St. Valentine's Day Massacre" (Bhasin, Inside JCPenney, 2013). Many employees learned of their termination after being summoned to the Plano auditorium in groups of 100+ (Mattioli, 2013). The remaining long-term and previously loyal Penney executives were angered over rumors that the new team referred to the old team as "DOPE's - dumb old Penney employees" (Steffy, 2013) (Maheshwari, 2013).

The existing company logo was to be changed under Johnson. The Penney, from the existing J. C. Penney, was dropped in favor of the new "jcp" logo. Note the small case letters like the "i" in iPhone. Maybe they should have taken a lesson from the GAP logo change and the furor it raised. Traditional company-wide pep rallies flew by the wayside. Additionally, Johnson did away with commissions for floor salespeople; he felt commissions interfered with quality customer service.

THE CULTURAL CHANGE AT J. C. PENNEY UNDER JOHNSON

The new culture under Johnson became one of opacity - not transparency. There were few if any memos or written directives. Johnson kept many of his thoughts about Penney's new future close to the vest. Few details (if indeed there were any) were shared. Some likened it to the secretive environmental culture that existed at Apple. Few Penney employees knew what to expect next from Johnson and his team.

His personality was one that was hard to like. He has been described as egotistical, belligerent, insensitive, and one who would not accept excuses or no for an answer. Once he reached a decision, there was to be no wavering. Johnson once commented, several months into his strategy, "we have made the decision to change our pricing strategy and we're going to stick to it" (Talley, 2012). A childhood friend had commented that what people loved the most about Ron Johnson, other than his talent, was his persistence, he was just relentless.

For the entire time that Johnson was CEO of J. C. Penney, he maintained his home in California. He jetted from Palo Alto to the company's headquarters in Plano, Texas each week, where he stayed at the glitzy Ritz-Carlton hotel. Maybe not a big thing, but probably conveyed a small but significant signal to those who worked in Plano. Some ex-executives of Penney said he rarely worked a full week while he was in Plano. His new number two, the President of the company, refused to move to Plano also, keeping his office in Minneapolis where he had been living (Bhasin, Inside JCPenney, 2013).

One long-time Penney executive commented, after working a year under Johnson that the "corporate culture had become very different" (Bhasin, Inside JCPenney, 2013). Another long-term executive said "they (the new team) do not leave any opportunity for anyone to ask questions" (Bhasin, Inside JCPenney, 2013). One analyst was of the opinion that the company environment was becoming one of "Ron's way or the highway" (Bhasin, Deutsche Bank, 2012).

THE RESULTS OF RON JOHNSON'S VISION

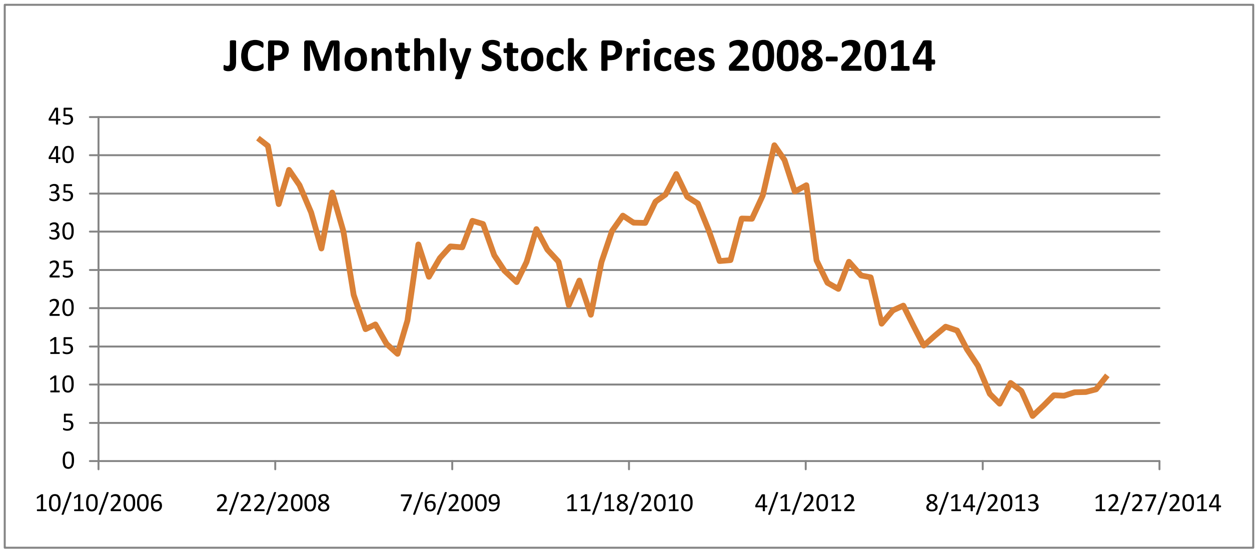
Ron Johnson's tenure at J. C. Penney lasted a brief 17 months (late 2011 until early 2013). The Board asked for his resignation in April of 2013. Net sales had fell over 24% from over $17 billion in 2011 to $12 billion in 2012. Along with lower sales, the company also posted a stunning loss of $1.38 billion (JCPenney, 2013). The company stock plummeted from over $40 a share when Johnson started to under $10 a share when he left (Table 2). The company's workforce had been cut by more than 40,000 during Johnson's tenure. Adding insult to injury, Ron Johnson was awarded the "Motley Fool's Worst CEO of the year" in late 2013 (Williams, 2012).

In the end, the company had paid out over $236 million in executive compensation to Johnson and his team. In return the company had nothing to show for it except billions in lost sales, thousands of once loyal customers were gone, a store remodeling program only just begun, a badly demoralized workforce, and worst of all, a mortally wounded American icon.

	Table 1. Four-Year Comparison of Operating Performance – in thousands				
	2013	2012	2011	2010	2009
Total Net Sales	11,859,000	12,985,000	17,260,000	17,759,000	17,556,000
Gross Profit	3,492,000	4,066,000	6,218,000	6,960,000	6,910,000
Income(loss)	(1,388,000)	(985,000)	(152,000)	378,000	249,000

*J. C. Penney, Inc. 2013 Annual Report

Table 2


JCP Monthly Stock Prices 2008-2014
45
40
35
30
25
20
15
10
5
0
10/10/2006
2/22/2008
7/6/2009
11/18/2010
4/1/2012
8/14/2013
12/27/2014

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ENCOMPASS SOFTWARE: GETTING STARTED, THE FIRST MONTHS AND FUELING GROWTH

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CASE DESCRIPTION

The primary subject matter of this case concerns ***Entrepreneurship, Entrepreneurial Marketing and aspects of Leadership in an entrepreneurial context.*** *Using an innovative chronological approach, this case addresses several key issues faced by entrepreneurs when launching and developing new ventures. Specifically, the case explores the key tasks that need to be undertaken in a startup business (a technology firm focused on the development and commercialization of software with utility in scheduling patients in a healthcare setting), and encourages students to consider the priorities that need to be established during the first six months of operations – the most critical time frame for an entrepreneur, where future success depends on the choices made in a time of considerable uncertainty. The case is divided into three parts (Part 1: Getting Started; Part 2: The First Months: Part 3: Fueling Growth) and has a difficulty level of three, appropriate for junior level courses in entrepreneurship. The case is designed to be taught in three 75 minute class periods and is expected to require up to 6 hours of outside preparation by students (approximately two hours for each part).*

CASE SYNOPSIS

This case is written from the perspective of the protagonist, the CEO of Encompass Software, a startup company dedicated to the development and commercialization of software with utility in scheduling patients in a healthcare setting. The CEO is faced with three unique sets of challenges, with the solving of each being critical to the company's future success.

In Part 1, the CEO has decided to "take the plunge" and has just resigned her corporate job to start Encompass Software. In Part 2, the CEO is two months into operations and is ready to launch the company's new software product. In Part 3, the CEO has just hired a team and must now consider ways to best generate revenue.

[NOTE: This case is a fictionalized account of a real-life situation. Names and other identifying information have been changed. However, the applicable facts and situations are true to the real case. Additionally, the actual dates and timeframes of the industry statistics presented have been adjusted for the purpose of this case.]

ENCOMPASS SOFTWARE: GETTING STARTED, THE FIRST MONTHS AND FUELING GROWTH

Part 1 – Getting Started

Jane Haywood leaves the meeting with her new business partners and smiles. After laboring long and hard on developing her business concept, Haywood has found a way to obtain the necessary funding to execute on her idea. She feels as if all her planning and efforts are coming together and that she is well on her way.

From her years of experience in the healthcare industry, Haywood has come to understand the inefficiencies and complexities of the healthcare market. Based on interactions with doctors in her current position as Executive Director, Outpatient Services at Rivers Community Hospital, she has devised what she believes to be a more efficient and convenient way to schedule patients into healthcare facilities, one that will save doctors, clinics, and hospitals time and money.

Haywood was able to convince the hospital to fund a "pilot program" and has successfully implemented and tested the system. Although her boss refused to sign a contract with the outside group of programmers she hired to code (develop) the software, he did agree to pay them and they moved forward, completing the software. After implementing and testing the system, doctors and patients seem to love the resulting product, as it is now much easier to schedule appointments at Rivers Community Hospital. Instead of spending an average of 15 minutes on the phone with the hospital, doctors' offices can now can schedule patient appointments themselves in less than one minute. Also, patients receive email or text reminders and are able to quickly book their own routine appointments. Thus, customer satisfaction is at an all-time high and Haywood has seen an increase of over 20% in outpatient revenue due to the benefits of the software.

Based on this early success, Haywood is passionate about the concept and spends much time working with the Rivers Community Hospital CEO in an attempt to convince him to commercialize the software. "We can establish ourselves as an innovative leader in the field" she urges, but these efforts fall on deaf ears. "We are not in the business of selling software", the CEO states to Haywood, putting an end to the conversations.

So, Haywood arrives at a decision point. Should she drop the idea of commercializing the software and be happy with her current position or should she "take the entrepreneurial plunge" and leave her corporate job? "Do I have what it takes to start and grow a high tech effort like this?" she wonders. "I really believe the software can improve services for patients and physicians and I am excited to see if I can turn the idea into a successful business. I think it's worth the risk". But questions remain and she asks herself, "Do I have the entrepreneurial mindset, skills, and knowledge for this type of an effort or if I decide to leave, should I instead consider starting something else, such as a lifestyle company or maybe something that will stay small?" After much deliberation, stress, and a number of sleepless nights, Haywood decides. She takes the plunge, quitting her job to start her own company, Encompass Software. It's now been two weeks since she's left Rivers Community and Haywood is excited at the prospect of running her own business and keen to get going.

This brings Haywood to where she is, having just left the meeting where she agreed to accept an investment of $350,000 from a group of four angel investors, comprised of three doctors and one food industry expert. Haywood previously had several productive meetings with the group. Each investor will put in an equal amount of money, $87,500, into Encompass Software. This $350,000 will be used to fully develop and commercialize the software system and to pay for company expenses for twelve months.

Haywood wonders, “What is the best way to ensure her expectations of the deal match those of the investors and how should she go about officially starting the company? What paperwork should I put together to make the terms of the investor transaction official? Also, what are my options for setting up the company so I can accept the investor funding? What are the advantages and disadvantages of those options and what is best for my company? Finally, what is the process for registering my company with the local and federal government? What kind of paperwork must be filed?” Haywood jots these thoughts down on her “to-do” list, as these are all questions that will need to be answered.

Based on Haywood’s business plan (she has worked diligently with financial experts to develop a fiscally sound plan), she expects to become profitable within twelve months and feels no further investment will be needed. In fact, she projects to internally fund growth and believes she can achieve over $2 million in revenues by the end of her second year in business.

In exchange for the investor funding, Haywood agrees the investors will receive a 50% equity share of the company and she will retain the other 50%. She feels this balance of a “50/50” split is fair and Haywood also agrees that any “big decisions” will be made jointly with the investors, such as taking on additional funding, selling the company or taking the company public. For these types of decisions, Haywood and at least two other investors will need to agree.

Haywood will serve as Encompass Software’s CEO and will report to a Board of Directors comprised of her investors. This seems like a good idea as she’s known the group (see Encompass Investor Background Information) for several years, she values their healthcare and business expertise, and looks forward to their contribution to the company’s growth. In particular, she feels Barry Motsovich, the food industry expert, can assist Encompass as he has experience running a large company. Yet, Haywood is unsure if it is a good idea to have investors serve on the board. “Is this in the best interest of the company or is there a potential conflict?” she wonders.

So, it’s finally happening. Haywood is starting Encompass Software. She gets into her car and drives off.

Encompass Investor Background Information

The investors are comprised of 3 doctors and 1 food industry expert.

Bob Black – Surgeon turned hospital and rehabilitation facilities owner. Black left his surgeon position at a hospital due to a disagreement with its CEO. In turn, he started a competing hospital that grew to be one of the largest in the area. He then established a successful chain of rehabilitation facilities. Black is widely viewed as a leading medical expert and healthcare visionary.

Aaron Hanks – Psychologist. Hanks runs a psychology practice and dabbles on the side in other business ventures. He had at one time invested in a copper mine in South America, only to see it “nationalized”, losing his investment. He had also purchased and installed a large number of mechanical cologne dispensers for public restrooms, again losing money because the machines were frequently out of order. Hanks views his Encompass Software investment as a way to make up for these past mistakes.

Scott Smart – Psychologist. Smart does contract psychology evaluations for the Veteran's Administration. He also owns rental properties and is an avid cyclist. Because of these endeavors, Smart considers himself to be an entrepreneur and is eager to lend his knowledge and expertise to Haywood.

Barry Motsovich – Motsovich is CEO of a large food distribution company that services restaurants. He considers himself to be a business expert but admittedly has never worked with a start up and has little technology experience.

Part 2 – The First Months

Things are going great. Haywood is just two months into starting Encompass Software and corporate life is quickly fading into a distant memory. She is in control of her own business and the future looks bright.

Haywood smiles and asks herself, "How did I get involved in starting a software company? Heck, I made a "D" in computer programming during college!" Yet, here Haywood is, having secured a $350,000 investment and having quit her job. There is no turning back and it's up to her.

It is more difficult than she thought though. Haywood is working 12-hour days, spending most of her time collaborating with her contract programmer on fine-tuning the software program. Haywood feels she is now ready to launch and there is much still to do.

So, Haywood has been thinking through what needs to be accomplished for Encompass Software to be successful. There are a number of things that come to mind. First, Haywood thinks of putting together an implementation plan. She'll need to be ready to install her system and train and support customers in using the software. As the company will connect doctors in a number of offices to clinics and hospitals, she realizes this effort isn't a simple process. Haywood will need WAN and LAN networking and hardware expertise in the company. Then there is the matter of training customers how to use the software. She'll also need a process to best service clients once they have purchased from Encompass.

Haywood also knows she'll need a way to sell to her clients. How is she going to do this? If that wasn't enough, she's got to implement marketing strategies and she also has to keep accounting and financial records as her investors want to know what is happening with the company. In short, Haywood has more work to do in a day than is possible for one person.

Long days make Haywood assess her strengths and weaknesses and she starts to figure out what she enjoys doing and what tasks have become burdens. On the positives, Haywood always likes interacting with clients and she has become good at matching their needs with technical solutions. Haywood also believes in her product and is able to see a clear direction for the company. On the negatives, she'll never be a technical expert and, frankly, programming bores her. She also doesn't like the daily grind of managing an office and accounting has never been her strong suit.

Haywood realizes it's time; she needs help. She has to put together a plan that will allow her to successfully launch while staying within her $350,000 initial investment. "Whom do I bring on board now and what skills are critical to the success of Encompass?" she contemplates. "Should I hire full-time employees, contract labor, or both, and what should the timing be of these hires?" To add to her thoughts, Haywood is nervous about taking on employees. “How can I be the most effective leader possible?” she asks herself. “How do I ensure my employees will be excited to come to work and be as motivated as I am? How will they know what we are trying to accomplish here?”

Part 3 – Fuelling Growth

Walking into the office, Haywood feels a sense of pride. In just under six months, she’s managed to get her product ready for the market and she’s hired a team she feels will make Encompass Software a leader in the field. The pieces are in place and Haywood is excited to take the next step.

So, she enters the conference room and greets her team. Haywood feels good but she also know there is much to do. Yes, the company’s product has tested well with healthcare professionals who have reviewed it, but Haywood knows Encompass now needs to generate sales. The company’s initial investment of $350,000 will carry Encompass through the end of the year, or for another 6 months based upon present monthly expenditures or “burn”. Haywood has become acutely aware that in an emerging business, “money is time”. Haywood’s mind is clouded with the possibilities. Foremost is, how does she identify and then reach potential clients, and how does she get them to buy her product?

Encompass Software is new in the marketplace (see Industry Overview), it is unknown, and Haywood understands it can be difficult to sell to hospitals. They are notoriously slow to make decisions and are committee-based (many persons are involved in the decision making process), especially when it concerns buying and installing new technology solutions such as hers. Haywood knows most hospitals currently schedule patient appointments manually, so marketing and selling an automated system to replace what they have been processing by hand for years may be a challenge.

Haywood thinks through why she started the company and developed the product. First, good customer service is important to Haywood and she knows it’s a competitive advantage. Second, Haywood understands doctors are frustrated with dealing with the manual process of hospital scheduling, where they spend on average 15 minutes per person booking needed appointments for their patients. The Encompass system solves this problem by completing the scheduling process in less than 60 seconds.

Encompass also offers the advantage of allowing doctor staffs and patients to undertake scheduling themselves via the Internet, so they can bypass calling the hospital if they desire. For hospitals, Encompass saves them time and money by automating the process, thus reducing the number of persons involved. And, because the system is completely automated, hospitals no longer need expensive medical experts to schedule appointments. Instead, by simply pressing a key, a patient’s appointment could be automatically completed.

Encompass is new to the healthcare IT market and the scheduling niche is one just evolving. This is a tough task as Haywood and her team have to figure out a way for potential customers to know about the company and its product and they have to convince clients to change the way they do things.

To further complicate her task, the hospital market is diverse, with differing needs depending on the size (number of beds) of the facilities or the markets served. Haywood reviews the following information put together by her team:

MARKET STATISTICS

1. There are 5,724 hospitals in the U.S., according to the American Hospital Association.[1]
2. Of these, 2,903 hospitals are nonprofit and 1,025 are for-profit. Additionally, 1,045 are owned by state or local (county, hospital district) government entities.[1]
3. Of all hospitals in the U.S., 1,984, or 35 percent, serve rural communities and are considered rural hospitals.[1]
4. Hospitals vary greatly is size, from small rural facilities with just a few key service lines to large, tertiary care facilities. Here is a break out of U.S. hospitals by bed count:[2]

0-99 beds	2,557
100-199 beds	1,063
200-299 beds	582
300-399 beds	348
400-499 beds	192
500 beds or more	266

Within these hospitals, doctors contract with insurance companies, and generally, they can do business with any facility in a given service area.

Haywood also knows hospital spending on IT solutions is growing. According to the leading healthcare software research group, Gartner, spending by global healthcare providers for IT services will grow by 4.33% to reach $31.96 billion within two years.[3]

Although the scheduling niche is a developing one, the company does also have competitors. Encompass' two primary ones are a very large company and a smaller one that has been in business for five years. The large competitor earns $2 billion per year in revenue and it sells complete hospital information systems.[4] As a part of its total package, it includes a scheduling module that can be as costly as a million dollars per hospital. The smaller competitor was the first to enter the market and it has sold a little over 20 systems, with most of its sales in the mid-west. It charges around $250,000 per hospital for the system. While the competitor products are computer-based, they are not completely automated (can't automatically process scheduling appointments by "pressing one key") like the Encompass Software solution.

Haywood is considering a low-cost entry strategy and wants to discuss it with her team. "It makes sense to me we can acquire more customers if we charge less, but is this best for the company?" she asks her team. "Also, what are the best ways to create awareness of the company and our product and do we want to market to all types of hospitals?" With these issues at hand, Haywood and her team get to work.

INDUSTRY OVERVIEW

Scheduling is one of the most basic, important functions a health care organization performs. Within most health care facilities, however, various departments, physician groups, outpatient facilities and other clinics all schedule appointments separately, resulting in conflicts and inefficiencies.

Other industries, such as manufacturing, have developed and used sophisticated enterprise-wide scheduling systems for decades. The first real scheduling systems began to appear in the health care field during the 1980s, when staff shortages required more effective nurse workload management. Many early users soon began to adapt these systems to help predict staffing needs and adjust work force resources for skill-level mix and associated costs as patient volume and workloads changed.

In today's complex health care environment, an enterprise-wide scheduling system allows a health care organization to better manage its business and financial needs by providing timely and accurate information capture of patient services.

What Should A Scheduling System Do?

Based on industry research and member feedback, the Voluntary Hospital Association, a volunteer member-based network, (https://www.vha.com) identified the following core features as critical to a successful enterprise-wide scheduling system. It should provide:

- The ability to schedule patients for multiple services across the health care organization from any location.
- Convenience in scheduling personnel, facilities and equipment – helping to efficiently use expensive resources.
- Access to current patient insurance and billing information.
- The ability to screen procedures for medical compliance prior to patient encounters, thereby reducing costly denials and claims resubmissions.
- Real-time capability to estimate the cost of scheduling and staffing decisions and forecast staffing needs and budgets.

What Are The Benefits?

The VHA concluded an enterprise-wide scheduling system provides a number of key benefits:

- Telephone time is reduced from 10 minutes to four minutes to schedule an appointment.
- Fifty percent increase in appointments starting on time.
- Rescheduling can be reduced by 85 percent, and patient delays cut by 60 percent.
- Phone time reduced from 20 minutes to five minutes through elimination of duplicative data collection.
- All resources required to deliver appropriate care are available at the right time and in the right place.

- Reduce clinicians' administrative workload and focus clinical resources on delivering patient care.
- Proper staffing improves the overall quality of care while greatly reducing costs.

Ultimately, an enterprise-wide scheduling system streamlines access to patient care and information capture, improves profitability by providing timely and accurate tracking of services and expected reimbursement, reduces waste and inefficiency, and ensures proper use of expensive resources.

The Current Scheduling Environment

Overall, health care organizations spend $250 billion annually on medical claims paperwork and $26 billion annually on hospital "revenue cycle operations". Research shows claim denial rates are up, gross inpatient charges are down and gross days in accounts receivable are increasing. As a result, many health care organizations are correcting wasteful steps in the revenue cycle caused by incomplete or erroneous data that slows the reimbursement process.

Revenue cycle operations involve many steps – including scheduling, registration, admissions, medical records, billing and collections. Scheduling or patient access specifically refers to all processes required to identify and register a patient for treatment and services. It is the patient's first point of contact with the hospital, and the entry point of information into the revenue cycle. A key objective of the patient access phase is comprehensive data compilation to ensure a "clean" claim.

Health Care Organization Needs

VHA identified a reasonably strong need for enterprise scheduling solution within its membership. VHA's Strategic Sourcing Study shows that 17 percent of VHA hospitals outsource scheduling, with 15 percent likely to outsource over the next two years. The study of 324 respondents from 254 member organizations represents 11.5 percent of VHA's total membership. Information technology functions – such as scheduling – make up the largest current segment of outsourced operations, with 13 percent of hospital technology budgets currently allocated to external vendor sourcing.

It is interesting to note that VHA's research found that few health care organizations have actually implemented scheduling enterprise-wide. Even in the most sophisticated facilities, implementation appears to be piecemeal. The results of a Gartner study validate these findings. According to the Gartner study, of the top applications that providers identified for acquisition or replacement in the next two years, enterprise-wide scheduling placed fourth among 35 percent of all providers surveyed.

The study also found that:

1. 21 percent of providers plan to add an enterprise-wide patient scheduling system.
2. 34 percent plan to purchase in the next 12 months, 37 percent in the next 12-24 months.
3. 61 percent of providers have an enterprise patient scheduling system. Of these only 38

4. 60 percent of respondents planned to implement a patient scheduling system throughout the enterprise. The remaining 40 percent planned to implement scheduling only in some function within the organization.
5. Nearly half (48 percent) of respondents indicated that a full implementation of the enterprise patient scheduling system is 12 to 24 months away, while 22 percent indicated that full implementation was more than 24 months away.
6. 63 percent of the providers that are looking to add or replace their enterprise scheduling systems have not selected a vendor. Gartner believes this may be due to the perception that many of the new scheduling products being developed by vendors fail to achieve the functionality of the systems they would replace.

Purchasing Barriers

Contrary to Gartner research, and based largely on anecdotal information from members, VHA has learned product maturity and functionality are not necessarily the top barriers to purchasing or implementing an enterprise-wide scheduling system. Significant barriers identified by VHA include:

1. Political issues. It is not uncommon for departments to view centralized scheduling as a loss of control due to political turf wars that make it difficult for organizations to eliminate redundant services.
2. Infrastructure barriers. Lack of automation is a significant barrier to enterprise-wide scheduling implementation. In fact, many hospitals have not been able to make the transition from paper-based processes to full automation.
3. Cost and capital funding challenges. Enterprise-wide implementation of a scheduling system can require a significant investment. Most providers are choosing to implement the application in a limited scope.

ENDNOTES

1. American Hospital Association. "AHA Hospital Statistics."
2. Centers for Disease Control and Prevention. "Table 116. Hospitals, beds, and occupancy rates, by type of ownership and size of hospital: United States." Available online at http://www.cdc.gov/nchs/data/hus/2011/116.pdf
3. Forecast: Enterprise it spending for the healthcare provider market, worldwide.
4. Complete hospital information systems include, in addition to scheduling, clinical functions, financial applications, and electronic medical records.

THE U.S. AIRLINE INDUSTRY IN 2015

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CASE DESCRIPTION

The U.S. airline industry is a highly competitive industry with high fixed costs and multiple competitors. The case is intended to be used in a strategic management course to study industry structure and competitive dynamics. Given the transparency in pricing and ease with which consumers can compare the alternative routes, prices, and amenities offered by multiple competitors, the tactics and strategic moves by any one competitor can impact the decisions of other competitors. This case is designed to help students understand how the external environment, industry structure, and competitive rivalry impact firms' financial performance. Typically these topics are covered and early in a strategic management course, and in this usage, the case can serve as a standalone analytical case on the drivers of firm and industry performance. It could also be used as a background note to accompany a case that focuses on the current situation facing a particular airline.

CASE SYNOPSIS

The U.S. airline industry has been plagued by financial losses, bankruptcies, union disputes, and expensive mergers over the past decade. The financial situation appears to be brightening, as the four largest U.S. based airlines each reported operating profits of over $2 billion in 2014. The history of the U.S. airline industry is described, including the impact of regulatory change and role of mergers and acquisitions in defining the industry structure. Changes in the general environment that impact all airlines are described, as are the key economic drivers within the U.S. airline industry. The key factors that inform a five forces analysis of the industry are explained, as is an understanding of buyer behavior. Profiles of each of the major competitors, and several smaller competitors, help describe how the actions of each firm potentially impact the actions and profitability of other firms in the industry.

INTRODUCTION

"[T]he airline business has been extraordinary. It has eaten up capital over the past century like almost no other business because people seem to keep coming back to it and putting fresh money in. You've got huge fixed costs, you've got strong labor unions and you've got commodity pricing. That is not a great recipe for success." (Warren Buffett, Berkshire Hathaway CEO, as quoted in Reed, 2013)

The U.S. airline industry has been plagued by financial losses, bankruptcies, union disputes, and expensive mergers over the past decade. Since 2009, profitability has returned for most airlines (MIT, 2015). The International Air Transport Association projected combined profits for North American airlines (predominantly U.S. airlines, but also including Canadian and Mexican airlines) of almost $12 billion in 2014 and over $13 billion in 2015 (IATA, 2014 a). Four large U.S.-based airlines (American, United, Southwest, and Delta) each reported 2104 operating profits of over $2 billion (MIT, 2015). A combination of an improving economy, lower oil prices, reduction in the number of competitors, increases in ancillary revenue, and cost cutting efforts all contributed to this improved profit picture. It was unclear, however, whether these changes were structural in nature and would lead to a period of higher profitability, or whether the airlines might again face financial losses and another round of bankruptcies. Regardless, the record profitability had attracted the attention of regulators and politicians. In July 2015, the U.S. Department of Justice announced it was initiating an investigation to determine whether airlines had colluded to keep airfares high (Harwell, Halsey, and Moore, 2015). New York's Senator Schumer issued a statement questioning why fares weren't falling in accordance with oil prices, while an industry group responded that competition remained intense, to the benefit of consumers (Naylor, 2015).

REGULATION OF THE U.S. AIRLINE INDUSTRY

The history of the U.S. airline industry has been influenced throughout the past 100 years by changing regulation. The Air Mail Act of 1925 authorized the postmaster general to enter into contracts for the transportation of mail by air. This was rewritten by the Air Mail Act of 1934, which required that aircraft manufacturers divest their ownership in airlines and required that rates be set by the Interstate Commerce Commission. Until 1936, airlines earned more revenue from carrying mail than they did from carrying passengers. The Civil Aeronautics Act of 1938 created a system whereby all passenger routes between city-pairs (e.g., Chicago-Philadelphia, Washington-Boston) were regulated by the federal government, which could decide which airlines would be allowed to fly which routes, and what fares could be charged. This regulatory environment remained in place until the Airline Deregulation Act of 1978. The 1978 legislation, which was phased in over 5 years, allowed airlines to determine their own routes and rates. It also allowed new airlines to enter the market, competing with existing airlines on some routes, and opening routes on previously unserved city-pairs. Existing airlines also took advantage of the new freedom to restructure their routes, open service on new routes, and discontinue service on undesirable routes. (Dana, 2004; Dempsey, 1984; Kou and McGahan, 1995; Millbrooke, 2006)

The impact of regulation, and changing regulation, has and continues to impact the airline industry. Up until the 1978 deregulation, airlines' routes and fares were strictly regulated, which minimized competition between airlines. In order to maintain air safety, significant regulation still remains, with unions, companies, and consumer groups all trying to influence regulations to their advantage.

BANKRUPTCIES, NEW ENTRANTS, AND CONSOLIDATIONS

As deregulation was phased in from 1978-1984, existing U.S. airlines included six major network firms - American, United, Delta, Eastern, Braniff, and Continental. Three other firms also operated domestic networks, while focusing more on international flights - TWA, Pan Am, Northwest Orient. There were also many firms that operated regionally, with typically a hub that served many regional airports (e.g., USAir, Republic, Eastern, Alaska, Frontier, Western, Ozark, Hawaiian, Piedmont). These regional airlines typically provided connections to large cities outside the regional market. (Dana, 2004; Dempsey, 1984; Kou and McGahan, 1995; Millbrooke, 2006)

Between 1978 and 1988, a number of new entrants tried to gain a foothold in the U.S. airline market. In 1979 alone, twenty-two new airlines were formed. Between 1980 and 1982, another forty-three entered the market (Dana 2004). Firms such as People Express, America West, New York Air, and Midway Airlines were more successful than most. By 1983, almost 200 firms were registered as airlines. A decade later, this number had dropped to 130, and by 1995 only six of the airlines started in 1979-1982 survived as independent firms (Dana 2014). Many others ended in bankruptcy, with some being acquired. In total, 150 airlines declared bankruptcy during this period, and price-based competition caused large losses at almost all airlines. By 1989 the three biggest airlines (American, United, and Delta) held a combined 50% of the market, and the next five (Northwest, Continental, TWA, USAir, and Pan Am) comprised another 40% of the market (Kou and McGahan 1995).

Delta started as a crop dusting service in Georgia, later adding passenger flights and moving its headquarters to Atlanta. It was encouraged by the federal government to offer services to smaller towns in the Southeast, and grew from there. Over the course of its growth it acquired a number of previously independent airlines either directly, or through the acquisition of an airline that had previously purchased the airline. Acquisitions included Northwest Orient, Republic, Southern, North Central, Hughes, Western, and Pan Am's east coast routes. (Davies, 1990; Delta, 2015)

United traces its roots to Varney,which started by carrying mail in 1926. Varney, along with several other airlines, were later purchased by Boeing, which built planes and manufactured engines.New regulations forced the breakup of Boeing into three separate companies, one of which became United. Through a series of transactions, United acquired some or all of the operations of the following airlines: Continental, Texas, Eastern, People Express, Capital, New York, Ozark, TWA, and Pan Am. (Garvey, Fisher, and Johnson, 2001)

American was formed in 1930 as the result of a combination of more than 50 smaller firms that provided air services for the post office. The company expanded its passenger services, and was a leader in developing computerized reservation systems. It was also the first to offer a frequent flyer program.Compared to Delta and United, American was less aggressive in making acquisitions and tended to grow more through internal expansion. Acquisitions included U.S., Piedmont, Allegheny, American West, Air Cal, and Reno. (Reed and Reed, 2014)

Southwest began in 1967 providing flights within Texas, in order to try and avoid federal regulation. A number of legal battles ensued in Texas and Federal courts, but with deregulation in 1978, Southwest was able to expand more easily. Southwest chose to operate as a low cost carrier, basing its business model on that of California-based PSA. Compared to Delta, United, and American that operated under hub-and-spoke systems, Southwest operated on a point-to-point basis, with the goal of maximizing the use of the crew and aircraft. The company chose to use just one model of aircraft, the Boeing 737, in order to simplify training and operations. Southwest did not provide customers with assigned seats, integration with other airlines for luggage, or booking via most computer reservation systems.Whereas a goal of most airlines was to get a passenger from any origin to any destination, with perhaps one or more plane changes, Southwest emphasized efficiently running operations. The company made a few acquisitions, including AirTran, Muse, and Morris. (Southwest,2015)

ECONOMIC DRIVERS OF THE AIRLINE INDUSTRY

Airlines operated with high fixed costs and limited ability to respond to irregular or changing travel patterns. Whether the aircraft were owned or leased, operating and maintaining aircraft was a significant expense for airlines, and thus a goal of most airlines was to have planes operating (and full of passengers) as many hours of the day as practical. The scheduling of flights, gates, landings, onboard pilots and crew, catering, and maintenance was incredibly detailed. The hub-and-spoke system also meant that simply adding (or dropping) one flight between two airports was not easy, as the plane and crew needed to get there in the first place, and then go somewhere else afterwards. Thus, any small change in flights or schedules could have significant impacts throughout an airline's overall system. The costs of operating any one flight was largely fixed, since the costs differed only slightly if the plane was 60% full or 90% full. (The difference in the amount of fuel, soft drinks, cleaning, etc. was small given the fixed staffing and aircraft operations costs.) Customer demand, however, varied by time of day, day of the week, and season. (Planes were often less full on late night flights; mid-week compared to Friday-Saturday-Sunday-Monday; or in October compared to December, for example.)

Given these high fixed costs, airlines' tried to fill the flights if possible. Whatever costs that were incurred for the last 20 passengers on a flight with a capacity of 120, for example, were trivial compared to the revenue generated from these customers' airfare. However, passengers travel plans would often change, so it was common for airlines to overbook flights knowing that some passengers simply would not show up for a flight. If more passengers showed up for a flight than there were seats available, airlines would either not allow passengers that arrived too close to take-off to board the plane, or offer incentives for passengers to switch to a different flight with more seats. Given the seasonality and variations in demand, it was not possible for airlines to operate at 100% capacity. Nevertheless, capacity utilization (how full planes were) was a key metric used to compare airlines.

Several other key statistics were passenger revenue per available seat mile (PRASM), costs per available seat mile (CASM), and total available seat miles per employee (ASM/E). Exhibit 2 shows each of these statistics for the largest airlines. Generally speaking, a higher PRASM, a lower CASM, and a higher ASM/E should all lead to higher profitability. But because of their route structure, equipment, and employment policies, different combinations were clearly observed across airlines.[Large data sets with airline statistics can be found on the U.S. Department of Transportation's Bureau of Transportation Statistics (USDOT, 2015). Some of this data is clearly targeted towards consumer information, such as fare data, on-time statistics, and baggage fees. Another source of data is MIT's airline data project at http://web.mit.edu/airlinedata/www/default.html.]

An important factor contributing to the financial performance of airlines was the overall state of the economy. When economic conditions were good, not only were leisure travelers more likely to take vacations, but businesses were more likely to spend on air travel. When the economic outlook turned bleak, however, capacity utilization often fell quickly, as airlines did not quickly cut back their schedules. Thus, revenue would not be sufficient to cover costs, and losses occurred.

MAJOR SUPPLIERS

Fuel, labor, and aircraft were the most significant costs facing airlines. Fuel costs made up a significant portion of operating costs, typically around 30 percent (IATA 2014a). Falling oil prices led to a drop in fuel costs of over 5 percent in 2014, even as consumption rose (IATA, 2014). Fluctuating oil prices caused different airlines to take different approaches to try and partially hedge their projected expenditures on fuel. When oil prices rose, airlines that effectively hedged their fuel costs would experience better financial performance than airlines that were more exposed to the rising costs. When prices fell, however, the airlines that locked in their fuel costs would not benefit as much from the falling prices. American chose to not hedge its fuel costs, and typically paid the market price. In contrast, Delta had tried to manage and stabilize its fuel costs (Nicas 2014b). In an unusual move for an airline, in 2012 Delta purchased a Pennsylvania refinery that supplied a portion of its jet fuel needs.

Labor costs accounted for around a quarter of most airlines' operating expenses. Many employees were members of unions that negotiated on behalf of certain groups of employees at each carrier (e.g., pilots, flight attendants, baggage handlers, maintenance workers). When airline routes and fares were regulated (pre-1978), unions had been effective in securing good wages and a large number of positions for union members. Deregulation had allowed new low cost airlines to enter the market with fewer employees due to a lack of union rules, and at starting wages lower than those paid to union employees at established airlines. Labor costs were 40% lower, on average, for new entrants compared to existing firms (Kou and McGahan 1995). As a result of cost pressures, most major airlines had been able to reduce labor costs through strikes, lockouts, bankruptcies, and negotiations. In 2013, however, low cost carriers produced about 20% more seat miles per employees than the large network carriers, and the number of passengers per employee was double that of the network carriers (see data in Exhibit 2).

Aircraft purchases were the single largest capital expense for most airlines. (Some airlines chose to lease aircraft rather than buy them, in which case lease costs were a significant expense.) Two companies, Boeing and Airbus, dominated the market for aircraft that carried more than 100 passengers and that flew long distances. Each of these companies competed aggressively for new aircraft orders, and sold aircraft in a variety of sizes and cabin configurations. For smaller aircraft that served more regional markets or as feeders for the network carriers, several other aircraft manufacturers competed for new aircraft orders (e.g, Bombardier from Canada, Embraer from Brazil). Other aircraft manufacturers in Russia and China also sold aircraft, but these had not gained any market share in the U.S.A.

Although not a large expense relative to those already described, airport gates and landing slots at major airports were critical "supplies" for airlines. At major airports, the number of landing slots at key travel times was limited by the number of runways and by air traffic control limitations. For network carriers operating with a hub and spoke system, the physical number of planes allowed to land and take-off during certain time periods was at its maximum at hub airports. With the hub and spoke system, an airline would try to maximize the number of flights that came and left a hub in a certain time period, allowing passengers to easily switch planes in order to get from their origin city to their destination. Delta's major hubs were in Atlanta, Detroit, Minneapolis, and Salt Lake City, with smaller hubs in New York, Seattle, and Los Angeles. Gates at airports were also being used to full capacity at some airports, and airport operators had limited ability to physically expand their terminals. The dominance of network carriers at some airport caused low cost carriers to seek out smaller nearby airports for their air service (e.g., the smaller Midway airport in Chicago rather than O'Hare, which served as a hub for both United and American). Less congested airports typically had lower costs (for gates and landing slots). In addition, the lack of congestion meant there were fewer flight delays. This allowed the low cost carriers to more quickly turn around their planes for the next flight, thus improving efficiency and maximizing aircraft and crew utilization.

PRICING AND CONSUMER BEHAVIOR

Most airlines had sophisticated models for setting prices that attempted to anticipate travel patterns and charge different customers accordingly. If a customer shopped around, had flexible travel dates, and was willing to fly at less desirable times, fares were much lower than at peak travel times. Flying to less used airports, but perhaps somewhat further from a city center, could also lead to lower fares (e.g., Newark, NJ rather than JFK in New York, or San Jose rather than San Francisco). As certain flights reached set capacity levels, the fares were raised for subsequent passengers. Likewise, if the number of passengers was falling below expectations, fares would be lowered to attract more customers.

Fares were posted on airlines websites, and could be accessed through a number of travel websites (e.g., Orbitz, Expedia). Leisure travelers shopped around for the best deal, and exhibited low brand loyalty. Business travelers tended to be less price sensitive, and were more likely to base their decision on flight times or preferred airlines. Airlines typically kept close track of the fares posted by competitors on routes, and adjusted their fares to remain competitive.

At times price competition led to significant losses at airlines. When a competitor offered service in a new city, or on a new route, it was common for the new competitor to try and draw customers via lower prices. The following example regarding Dallas – Fort Worth airport in the 1980s is illustrative:

> *Texas Air, which offered the least number of flights, began to introduce low fares in 1980, and Braniff responded by matching Texas. [American and Delta] were compelled to follow. According to one frustrated executive, "Texas is a pimple. They don't do as much business in a month as we do on a bad Monday. But Braniff just couldn't leave them alone. I guess that proves the old rule that the industry is led by the dumbest competitor". After two years of price cutting on flights out of Dallas – Fort Worth, American's CEO Robert Crandall made a now infamous call to Braniff's Howard Putnam in an attempt to restore price sanity. "Raise your goddamn fares by 20% and I'll raise mine the next morning," Crandall said.* (Kou and McGahan, 1995)

When a new competitor offered a lower price to attract customers, competitors typically responded, and overall fares on a route fell while traffic increased. Southwest used this approach when entering many cities and markets, and the impact became known as "The Southwest Effect" (Bennett and Craun 1993).

MAJOR U.S. AIRLINES: STRATEGIC GROUPS

U.S.-based airlines could be divided into three groups. Network airlines were large airlines that operated both domestic and international flights, and served airports nationwide. The network carriers all had been in operation since before deregulation, and most had gone through some mergers and acquisitions since deregulation. Low cost airlines generally emerged post-deregulation, and served specific routes. The third group comprised regional airlines (e.g., Alaskan, Hawaiian) and those that served a focused target market (e.g. Allegiant).

American, Delta, and United were the three remaining network airlines in 2015. They all operated nationwide, with several hub cities. All also offered international routes to Europe and Asia, with more limited service to Australia, South America, and Africa. They also had entered into alliances with carriers from other countries, and typically offered code-sharing flights with their international partners. Delta's SkyTeam partners included Air France, KLM, Aeroflot, Aeromexico, Alitalia, China Airlines, China Eastern, China Southern, Czech, Korean, Saudi, Middle East, as well as several other international airlines. United's Star Alliance partners included 27 airlines. The original members of Star Alliance were Scandinavian, Thai, Lufthansa, United, and Air Canada. These were later joined by Varig, Singapore, Air New Zealand, Air India, Air China. Swiss, and others. American was a member of the Oneworld Alliance, that included among other airlines, British, Finnair, Cathay Pacific, Japan, Malaysia, and Quantas. Thus, each firm not only operated its own network, but also worked with other airlines worldwide to offer travelers access to cities across the globe.

Among low cost airlines, many had entered and exited the U.S. airline industry since deregulation. Southwest was by far the largest and most successful, generating three times more revenue than the next largest – JetBlue. In 2013, the only other low cost airlines that generated more than a billion dollars in revenue were Virgin America, Spirit, and Frontier. Rather than operating with a hub and spoke system like the network airlines, low cost carriers tended to operate a series of point-to-point flights, and were focused on operating each of these routes as efficiently as possible.

Alaskan, despite its name, operated its largest hub in Seattle. It served most cities in Alaska, and then through the Seattle hub, connected passengers to major cities across the U.S. and Canada. Hawaiian served the Hawaiian Islands, and connected to major cities along the rim of the Pacific Ocean. These two were the largest of the regional airlines in the U.S. Another "regional" competitor was Allegiant, that primarily carried vacationers from smaller cities in the Northern U.S. to vacation destinations in the Southern U.S. and Mexico.

PROFILES OF THE LARGEST U.S. AIRLINES IN 2015

Following its merger with US, American became the largest airline in North America. (The data in Exhibits 1 and 2 still shows these as two separate airlines.) American filed for bankruptcy in 2011, and had been sorting through various options on its return to financial health. The merger with US was announced in 2013, and faced significant opposition on antitrust grounds. The final details of the merger, including what gates or landing slots needed be sold at certain airports, were being worked out. The integration of the labor unions for both companies also needed to be resolved, as did the overall scheduling of flights. The reservation systems of the two companies still operated separately, as did much of the internal operations software. Exhibit 1 shows that the combined company had losses most years, but it is a harder to combine the data (and adjust for size differences) in Exhibit 2. Questions were raised over whether it made sense to operate 8 different hubs and 28 different aircraft throughout the network. CEO Doug Parker commented, "As we looked under the hood, there was more opportunity than we thought there was going to be. That's all good. Those are all things we know how to fix." (Nicas, 2014a)

Both Delta and Northwest were in bankruptcy in 2008, when their merger was announced. The merger was completed in 2010, which allowed both airlines to come out of bankruptcy. Other than pilots, most employees at Delta were nonunion. CEO Richard Anderson stated that his goal is to pay employees better, and give them better benefits, than unionized employees received at other airlines (Anderson 2014, Tully 2014). Employees received profit-sharing checks each year on February 14th (Valentines Day). In 2013 Delta boasted a 15% return on invested capital, and profits of $2.7 billion – an industry record. Delta had taken equity positions in airlines in Brazil, Mexico, and Britain to strengthen its international network. Delta recently changed its frequent flyer program so that the "miles" earned on a flight were more tied to the fare paid than the miles flown. This change was designed to reward business travelers, and others who were paying for the more expensive tickets, hopefully building their loyalty to Delta. The average age of Delta's planes was 17 years, which was older than most competitors'. Rather than spend money, and take on debt, to purchase the newest and most fuel efficient planes, Delta tended to instead spend money on refurbishing older planes, and purchased used planes from other airlines. This contributed to somewhat higher operating costs as older planes were less fuel efficient, but also lower capital costs and depreciation.

United's merger with Continental, which was finalized in 2010, remained a work in progress. The flight attendants worked under two separate contr http://dl.fltmaps.com/enacts, which meant that cabin crews on flights could not be mixed. Likewise the information systems used by mechanics were different for planes from the two airlines (Carey, 2014). The company had purchased a number of new jets, but a large number of passengers system-wide traveled on regional jets with low capacity and high fuel utilization. Software problems also led the company to sell too many seats too cheaply in early 2014, contributing to a loss of over $600 million in the first quarter.

Southwest remained one of the most financially sound airlines, but as the large network airlines went through bankruptcy and mergers, their costs had come down and were now closer to Southwest's (Bachman 2014b). Southwest prided itself on the company's unique employee culture, which emphasized having fun and making travel enjoyable. It continued to offer point-to-point service across the U.S., and had announced it would start offering flights to vacation destinations in Central America and the Caribbean.

Hawaiian had survived a price war among airlines operating in Hawaii, and was the dominant airline providing service in the state (around 160 flights daily) and to destinations around the Pacific Ocean. It ordered new Airbus 330 planes in 2014, and had seen its stock price almost triple during 2014.

Alaska had added capacity during 2014, and reported an almost 10% rise in passengers. The stock price had almost doubled during 2014. Alaska was facing tougher competition at its Seattle hub as Delta increased the number of cross-Pacific flights it was basing in Seattle (Bachman 2014a). But this also had the possibility of increasing traffic on Alaska flights that would provide connections for customers traveling on Delta's international routes.

Allegiant had the worst on-time rating of any airline in 2012. The company didn't have partnerships with other airlines, and didn't offer to transfer baggage or help customers connect with other flights. It charged for just about everything, including carry-on luggage and water. Its non-fare revenue was over $40 per passenger in 2012 (Nicas 2013). But the company's operating margin remained around 15%, as was its return on capital. It flew primarily older planes, that burned more fuel, but were paid for. "Allegiant specializes in carrying leisure travelers from 75 small, underserved U.S. cities to 14 warm weather hot spots, including Orlando, Honolulu, and [Las Vegas]. Allegiant's network is so unusual that it faces competition on just 17 of its 203 routes." (Nicas 2013) Allegiant worked closely with hotels and other services to provide customers with a one-stop travel experience. (You could even book a Las Vegas wedding chapel with your plane reservation.) Some have argued that Allegiant is really in the vacation tour business, and just happens to use airplanes (Chandler 2010).

Virgin America was launched in 2007 by the U.K.'s Virgin Group and some U.S. investors. The company was 25% owned by Virgin, the maximum foreign ownership allowed for a U.S. chartered airline. Virgin America had a public stock offering in November 2014. Virgin's business model was to offer longer-distance point-to-point flights with high service and amenities from its hub in San Francisco. New Airbus planes with state-of-the-art entertainment systems and electronics were used on flights. Virgin America lost money for its first six years, but with slower growth, started to turn a profit in 2013.

JetBlue expanded its base at JFK in New York, and offered flights to over 20 U.S. destinations and another 20 in the Caribbean and South America. Most passengers traveling on JetBlue traveled either to, or from, New York. Hence, JetBlue did not need to be concerned much with connections. The goal was to offer somewhat upscale service and amenities at reasonable fares. The airline has been criticized in recent years for spending too much on customer service (free WiFi on planes, luxurious lounges), and not delivering returns to shareholders (Bachman 2014c).

Spirit operated as an ultra-low-cost airline, charging minimal fares but charging for just about anything, including the printing of a boarding pass, carry-on bags, checked bags, and assigned seats. Spirit operated routes between major cities in the U.S., and through its hub in Fort Lauderdale, to cities in the Caribbean, South America, and Mexico. Spirit was able to charge lower fares by operating its planes more hours per day, having more seats per plane, and having lower salaries than most competitors.

A CHANGED AIRLINE INDUSTRY?

The largest airlines were all working through major mergers and acquisitions, yet were beginning to show a profit. JetBlue and Virgin America had shown that there was a market for superior customer service and amenities, as long as fares remained reasonable. Meanwhile, several ulta-low cost (and low service, no-frills) airlines (e.g., Spirit, Allegiant) had demonstrated that there was a segment of the market that other airlines had failed in servicing. As 2015 looked like it was going to be a good year for U.S. airlines, opinions differed regarding whether this was just a short-term improvement in what had been a very turbulent industry, or if the airlines had finally figured out how to earn sustained profitability. Through a series of strategic moves, and acquisitions, had the airlines figured out how to compete with each while maintaining profitability? Or alternatively, was the structure of the industry such that intense competition would again drive some competitors out of the market while causing many other airlines to lose money?

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Continental	492$	5.49$	&.3&$	7.30 $	8.03 $	9.13 $	797$	7.35 $	7.33$	989 $	11.11$	13.01 $	14.11$	15.03$	113&$	14.01 $	16.17 $	• $	
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	891$	9.75 $	9.98 $	8.71$	9.87 $	10.96 $	959 $	9.15 $	9.18$	11.27$	1131$	12.55$	11.11$	14.10$	10.8& $	'$	• $	• $	
United	1489 $	1&.32 $	17.34 $	1752 $	1797$	19.33$	1&09 $	13.91$	13.40$	15.70$	17.30 $	19.33$	20.05$	2024 $	1&.3&$	19.68$	11.16$	37.1& $	38.29
us Airways	698 $	7.70 $	8.50$	85& $	8.46 $	9.18 $	8.15$	&91 $	&.76 $	7.07$	7.21$	11.85$	12.05$	12.4&$	10.78 $	12.20$	13.34 $	14.12$	14.94
Americ.aWest	15& $	1.75$	1.89 $	198$	1.16$	131$	2.04 $	2.01 $	2.22$	2.48 $	3.40 $	$	$	$	$	$	$	$	
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	1.16$	!.1! $	!.46 $	1.!>8 $	1.70 $	1.76 $	1.76 $	1.83$	2.03 $	2.14$	2.42$	'.''$	3.011$	W$	3.01 $	3.41 $	4.31 $	4.65 $	5.!5
Hawaiian	0.35 $	0.38 $	0.40 $	0.43$	0.49 $	0.61 $	0.61 $	0.63$	0.71 $	0.78 $	0.82 $	0.88 $	0.98 $	1.21$	1.18$	UI $	16S $	1.96 $	2.16
Allegiant	$	$	$	$	$	$	$	$	$	0.10 $	0.!1 $	0.23 $	0.34$	0.48 $	0.54 $	0.64 $	0.75 $	0.87 $	0.96
-sl.iiOitltr	1.51	1.69	1.86	2.01 I	218	2.37	37 I	46 I	L73 I	3.13 I	3.37 I	3.80	uo	492	473	5.37	6.71	7.48 I	8.U
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Data Sourct: US DOT Fonn41via BTS,Schedu1tP12.

Exhibit 1

Financial Petfonnance of Major U.S. Airlines

Source: MIT Airline Data Project, http://web.mit. edulairlinedata/www/default.html

TotalPassengers per Full·time Employee Equivalent

	IIII	1996	1997	1998	1999	2000	2001	2002	2003		IIIIII	2006	2007	2008	2009	2<110	2<11	1<111	2<113	2<114
		1,006	1,016				847		1,049	1,154	1,309	1,350	1,368	1,309	1,290	1,316	1,295	1,340	1,461	1,431
COntinental	1,167	1,186	1,175	1,118	1,078	1069	1,015	1,046	1,014	1,097	1,148	1,188	1,197	1,156	1,137	1,154	1,231			
IIWW																				
Nortltwest					1,080	1104	1,049	1,159	1,308	1,442	1,571	1,786	1,814	1,680						
United	1,312	1,653	1,596	1,491	1,457	1481	1,343	1,392	1,429	1,510	1,649	1,617	1,545	1,513	1,463	1,449	1,420	1,489	1,590	1,662
USAirways	1,133	1,152	1,156	1,025											1,378					
	1,041	1,035	1,011						1,061	1,165	1,179	1260	1,240	1,225	1,204	1,175	1,086	1,052	1,033	1,072
	1,392	1,424	1,473	1,514	1,401	1,403	1651	1,502	1,543	1,600	1,975	1,674	1,689	1,677	1,628	1,679	1,679	1,737	1,775	1,752
	1,665	1,700	1,600	1,431	1,341	1,637	1,634	1,582	1,547	1,582	1,823									
-SubNetwork	1,153	1,229	1,222	1,166	1,116	1,122	1,061	1,124	1,209	1,306	1.426	M41	1,434	1,390	1,334	1,350	1,334	1,336	1,393	1,424
SOl.llhwest	2649	2,490	2,136		2,392	2536	2,391	2,170	2,242	2,562	2,805	2,995	3,028	2,942	1,908	3,106	3065	3,058	3,102	3,076
jet81ue						1628	1,444	1,937	2061	2,005	1,967	1996	2,193	2,144	2,116	2,160	2,245	2,346	2,384	2,398
			1,907	1,543	1,663	1,870	1,961	2,044	2,179	2,267	2,573	2,704	2,861	2,981	2,919	▼IIIIII	3,187			
	1,876	2,205	1,716	1,493	1,327	1,658	1,398	1,556	1,705	1,772	1,939	2,215	1,993	2,154	1,9	2, 45	2,478	2420	3,154	3,095
Vlrgin America														26, 17	2,637	2,193	2,367	2,612	2,551	2,611
-subLCC	2,662	2,530	2,119	16,328	2,253	2,398	2,239	2,107	2,183	2,395	2,581	2,720	2,773	2,739	2,690	2,818	2,860	2,857	2,934	2,911
Alaska	1,447	1,544	1,491	1,499	1,463	1419	1,351	1,396	1,501	1,646	1,808	1844	1,814	1,746	1,746	1,909	1,997	2,019	2,080	2,003
	2,446	2,420	2,309	2,247	31	1911	2,026	2,037	1,975	1,794	2,045	1913	2,141		2,296	2,216	2,032	1,950	1,892	1,877
Allegiant									1,663	1,925	2,139	2,fp1	2,888	3,227	3,470	3,711	3,913	3871	3,661	4,225
-sub Other	1,670	1,740	1,667	1,658	2,041	1,555	1,506	1,552	1,608	1,689	1,876	1908	1917	2,60	2,076	2,196	2,211	2,209	2,208	2,207
iiTTIASB-Oi:!iv;;;;;;;131==1291]				1,334	1,220	1,233	1,178	1,239	1,340	1,457	1,604	1656	1,674	1,662	1,609	1,651	1,652	1,657	1,718	1,747

Data Source: US DOT F0ITI 41 Yia BTS. Schedule T1 & P10

TotalASMs Produced per Employee Equivalent

Millions

	1995	1996	1997	1998	1999	2000	2001	2002	2003		2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
AmeriCan	1.86	1.94	193	1.88	1.78	1.74	1.66	1.74	195	219	2.35	2.39	2.37	2.31	2.28	2.34	2.32	2.37	2.60	2.56
Continental	1.80	1.81	1.87	1.89	195	1.97	1.93	2.02	1.98	219	2.30	2.38	2.42	244	2.44	2.52	2.73			
Oela	1.96	227	2.15	204	2.00	2.06	2.02	2.02	2.04	2.26	2.56	2.75	2.70	2.72	264	2.62	2.64	2.56	2.69	2.72
Northwest	2.01	2.05	2.05	1.86	1.96	2.01	1.97	2.09	2.24	2.38	255	2.7'3	2.91	2.90	2.52					
United	209	2.06	2.03	1.98	1.91	1.84	1.76	1.97	2.19	2.39	2.48	2.60	257	2.64	2.63	2.65	2.56	2.46	2.44	2.53
USAirways	1A3	144	1.46	1.48	1.48	1.56	1.96	1.80	1.93	2.04	2.52	1.39	1.59	2.27	226	2.32	2.30	2.38	2.42	2.43
America West	1.92	2.02	2.06	1.96	1.86	2.n	2.21	219	2.15	2.26	2.51									
-Sub NeiWork	1.90	1.97	1.95	1.89	1.86	1.87	1.86	1.93	2.06	2.25	245	2.52	2.51	2.52	2.46	2.50	2.48	2.46	2.55	2.59
So.rth-	1.95	1.84	1.85		1.93	2.09	2.12	2.07	2.16	2.43	2.71	2.88	2.96	2.98	282	2.88	1.88	2.93	3.04	2.97
jetBiue						199	2.01	2.81	3.15	3.24	3.18	3.08	3.31	3.11	3.01	3.0	3.17	3.25	3.35	3.38
AirTran			248	1.55	1.50	1.47	1.56	1.78	1.89	2.06	2.38	2.56	2.73	1.88	2.84	2.92	3.19			
frontier	2.20	225	243	2.12	2.06	2.31	2.18	216	2.27	2.37	2.43	2.60	1A1	2A6	2.21	256	2.77	2.69	321	3.19
VirginAmerica														4 59	4.71	4.32	4.66	5.26	4.95	4.92
-SubICC	1.96	1.91	1.83	1360	1.89	2.03	2.06	2.09	2.2J	2.48	271	2.85	295	2.97	2.85	2.95	303	3.06	319	3.15
Alaska	1.98	1.95	1.87	1.93	1.86	1.82	1.77	1.91	2.08	225	2.41	2.50	2.50	2.52	2.60	2.83	297	3.07	3.21	3.10
Hawaiian	232	2.31	242	2.38	4160	2.27	2.75	2.27	2.51	2.31	272	2.48	2.78		2.67	2.67	2.82	3.02	321	3.18
Allegiant									2.06	2.69	283	3.28	329	3.22	3.44	3 81	3.92	4.06	4.04	4.64
-sub Other	2.06	2.03	1.99	2.02	250	1.84	1.99	2.00	2.11	2.28	249	2.55	2.63	3.47	271	2.89	303	3.11	331	3.28
Total All SectOfS	190	197	1.95	2.02	1.88	1.89	1.88	195	2.08	2.28	2.49	2.57	2.59	2.63	2.64	2.60	261	2.60	2.70	2.13

Data Source: US DOT Form 41 \'ia BTS, Schedule P10 & T2

System Passenger Revenue per Available Seat Mile (PRASM)

Cents per Available Seat Mile

	1995	1996	1997	1998	1999	2000	2001	2002	2003		2005		2007			2010	2<11	1<111	2<113
AmeriCan	as9	892	9.28	9.46	9m	10.17	9.1	8.37	862	8.61	941	10.25	10.65	11.14	9.90	1093	11.62	12.27	12.67
COntinental	&02	••••	9. 8	9.04	8.78	9.62	9	8.53	862	8.75	9.27	9.94	10.45	u.0.s	9.39	10.62	11.75		
Delta	&74	8%	9.20	9.27	9.12	9.60	8.81	8.15	8.53	8.33	848	9.30	9.99	10.67	9.14	10.57	11.50	12.16	12.63
Northwest	aas	9.15	8.98	8.22	862		8.40			9.21	9.62			11.11	9.09				
United	&11	8.75	8.91	8.74	8.74	9.46		7.74	7.78	8.22	8.88	9.71	10.46	10.84	9.18	11.03	11.90	11.95	12.14
USA,jrways	1068	11.86	1 2.	12.34	11.56	11.34	8. 1	926	9.55	9.35	9.44	16.37	14.57	10.75	9.27	10.44	11.52	11.91	1221
	7.43	752	6	7.62		8.02	7		7.56	7.27									
-4ub Network	8.67	912		9.21	9.05	9.73	▼▼▼								9.37	10.73	11.64	12.09	1Vt3
			9.30																
							••••	823	....	8.57	9.09	9.95	10-46	10.94					
SOuthwest												9.21	9.19			11.28	12.11		12.81
jetBlUI!							7.29			6A4	6.83	7.78	8.19		9.18		10.95		
Alman			7.18	7.48	8.37	10.22	9.83	849	8.78	8.35	904	9.52	9.66	1006	892	9.75	1054		
Fronner	7.48	804	7.21	838	8.66	10.72	9.16	8.58	827	7.82	8.77	907	8.84	991	875	9.86	12.32	981	1048
Virgin Amer ca														7.59	7.35	860	967	9.76	1049
-sub LCC	1.41	7.73	8.07	8.25	•••	911	824	7.71	7.83	1.13	8.16	8.97	9.00	9.81	937	10.58	11.56	1161	12.27
A"T b		742											10 24						
		6AO	6.11	6.35	6.33	639	6.16		869	9.69	9.67	9.90	964	1162		1138	12.31	12.03	
Allegiant										3.94	5.69	6.46	•••	7.73	7.10	759	864	8.65	8.85
-sub Other	6.77	716	7.61	7.71	7.--	8.25	793	831	8.43	8.83	935	9.83	976	1048	9.77	10.37	11.24	1134	11.13
Total All Sectors	,9•	•••	9.18	910	898	•••	!,!!	817	837	8.47	896	9.78	10.16	1070	939	1069	11.60	1194	1232

Data Source_ US DOT FOfm 41a BTS_Schedule T2 & P12

Exlubit 2 (page 1 of2)

Productivity Measures of Major U.S. Airlines
Source: MIT Airline Data Project, http://web.mit.edu/airlinedata/www/default.html

System Total Expense per Available Seat Mile (CASM ex-Transport Related)
Cents per Available Seat Mile

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
American	9.39	8.96	9.19	9.18	9.18	10.32	11.71	11.06	10.45	9.84	10.64	11.04	11.52	14.09	12.45	12.84	14.44	14.26	13.74	13.76
Continental	8.28	8.94	8.94	8.93	9.05	9.70	9.70	9.54	9.25	9.84	10.26	10.61	10.88	12.50	10.74	11.48	12.29	-	-	-
Delta	8.61	9.26	8.88	8.87	8.88	9.18	9.71	9.69	10.45	10.41	10.25	10.61	10.71	12.09	11.59	11.84	13.03	13.80	13.66	14.98
Northwest	9.01	9.09	8.93	9.59	9.06	9.83	10.39	10.44	10.41	11.22	12.31	11.84	11.67	14.49	11.86	-	-	-	-	-
United	8.59	9.00	9.20	8.97	9.06	10.00	11.27	10.58	9.78	9.70	10.10	10.76	11.17	13.60	10.55	12.03	13.53	14.19	13.87	13.65
US Airways	11.12	12.21	12.38	12.01	12.55	12.39	12.47	11.61	11.33	10.80	10.41	17.57	15.62	14.63	11.06	11.73	13.11	13.25	13.43	12.75
America West	7.19	7.73	7.27	7.29	7.52	8.50	9.21	8.06	7.86	7.72	9.16	-	-	-	-	-	-	-	-	-
--sub Network	8.99	9.28	9.27	9.26	9.27	10.01	10.81	10.38	10.13	10.08	10.55	10.92	11.20	13.49	11.44	12.05	13.35	13.98	13.72	13.99
Southwest	6.93	7.44	7.33	7.28	7.44	7.69	7.48	7.37	7.57	7.74	7.91	8.77	9.08	10.20	10.26	11.27	12.51	12.83	12.55	12.42
jetBlue	-	-	-	-	-	8.70	6.69	6.44	6.05	6.06	6.87	7.81	8.25	10.32	9.35	9.77	11.12	11.42	11.64	11.69
AirTran	-	-	8.28	8.28	7.70	9.18	9.25	8.34	8.23	8.40	9.34	9.74	9.57	11.02	9.29	10.35	11.96	-	-	-
Frontier	8.98	9.04	8.71	8.38	7.85	9.14	9.11	9.13	8.37	8.61	9.34	9.84	9.59	11.16	9.05	10.00	12.64	11.79	11.93	10.88
Virgin America	-	-	-	-	-	-	-	-	-	-	-	-	7.05	12.51	8.85	9.44	10.76	10.83	10.86	11.33
-- sub LCC	6.95	7.24	7.41	7.41	7.49	7.92	7.68	7.48	7.48	7.60	7.99	8.79	9.02	10.46	9.83	10.69	12.08	12.34	12.21	12.10
Alaska	7.71	8.16	8.52	8.16	8.67	10.17	10.13	9.84	9.69	10.12	10.78	11.92	12.08	12.38	10.86	10.93	11.79	11.90	11.60	11.07
Hawaiian	7.44	7.48	7.36	7.29	8.31	8.31	7.87	10.40	8.81	9.56	10.17	10.75	10.49	11.67	10.97	11.88	13.42	12.37	11.91	11.94
Allegiant	-	-	-	-	-	-	-	-	-	8.14	7.78	7.86	8.31	10.32	8.10	9.08	11.05	10.45	10.33	10.92
-- sub Other	7.64	7.99	8.21	7.94	8.57	9.57	9.42	9.92	9.27	9.91	10.48	11.31	11.31	11.97	10.51	10.90	12.13	11.83	11.51	11.30
Total All Sectors	8.85	9.12	9.13	9.09	9.12	9.82	10.46	10.05	9.76	9.73	10.16	10.57	10.80	12.84	11.07	11.72	13.02	13.50	13.26	13.41

Data Source: US DOT Form 41 via BTS, Schedule P6, P52 & T2.

Total ASMs Produced per Employee Equivalent
Millions

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
American	1.86	1.94	1.93	1.88	1.78	1.74	1.66	1.74	1.95	2.19	2.35	2.39	2.37	2.31	2.28	2.34	2.32	2.37	2.60	2.56
Continental	1.80	1.81	1.87	1.89	1.95	1.97	1.93	2.02	1.98	2.19	2.30	2.38	2.42	2.44	2.44	2.52	2.73	-	-	-
Delta	1.96	2.27	2.15	2.04	2.00	2.06	2.02	2.02	2.04	2.26	2.56	2.75	2.70	2.72	2.64	2.62	2.54	2.56	2.69	2.72
Northwest	2.01	2.05	2.05	1.86	1.96	2.01	1.97	2.09	2.24	2.38	2.55	2.79	2.91	2.90	2.52	-	-	-	-	-
United	2.09	2.06	2.03	1.98	1.91	1.84	1.76	1.97	2.19	2.39	2.48	2.60	2.57	2.64	2.63	2.65	2.56	2.46	2.44	2.53
US Airways	1.43	1.44	1.46	1.48	1.48	1.56	1.96	1.80	1.93	2.04	2.52	1.39	1.59	2.27	2.26	2.32	2.30	2.38	2.42	2.43
America West	1.92	2.02	2.06	1.96	1.86	2.22	2.21	2.19	2.15	2.26	2.51	-	-	-	-	-	-	-	-	-
--sub Network	1.90	1.97	1.95	1.89	1.86	1.87	1.86	1.93	2.06	2.25	2.45	2.52	2.51	2.52	2.46	2.50	2.48	2.46	2.55	2.59
Southwest	1.95	1.84	1.85	-	1.93	2.09	2.12	2.07	2.16	2.43	2.71	2.88	2.96	2.98	2.82	2.88	2.88	2.93	3.04	2.97
jetBlue	-	-	-	-	-	1.99	2.01	2.81	3.15	3.24	3.18	3.08	3.31	3.11	3.01	3.10	3.17	3.25	3.35	3.38
AirTran	-	-	2.48	1.55	1.50	1.47	1.56	1.78	1.89	2.06	2.38	2.56	2.73	2.88	2.84	2.92	3.19	-	-	-
Frontier	2.20	2.25	2.43	2.12	2.06	2.31	2.18	2.16	2.27	2.37	2.43	2.60	2.41	2.46	2.21	2.56	2.77	2.69	3.21	3.19
Virgin America	-	-	-	-	-	-	-	-	-	-	-	-	-	4.59	4.71	4.32	4.66	5.26	4.95	4.92
--sub LCC	1.96	1.91	1.88	13.60	1.89	2.03	2.06	2.09	2.23	2.48	2.71	2.85	2.95	2.97	2.85	2.95	3.03	3.06	3.19	3.15
Alaska	1.98	1.95	1.87	1.93	1.86	1.82	1.77	1.91	2.08	2.25	2.41	2.50	2.50	2.52	2.60	2.83	2.97	3.07	3.21	3.10
Hawaiian	2.32	2.31	2.42	2.38	41.60	2.27	2.75	2.27	2.51	2.31	2.72	2.48	2.78	-	2.67	2.67	2.82	3.02	3.21	3.18
Allegiant	-	-	-	-	-	-	-	-	2.06	2.69	2.83	3.28	3.29	3.22	3.44	3.81	3.92	4.06	4.04	4.54
-- sub Other	2.06	2.03	1.99	2.02	2.50	1.94	1.99	2.00	2.17	2.28	2.49	2.55	2.63	3.47	2.71	2.89	3.03	3.17	3.31	3.28
Total All Sectors	1.90	1.97	1.95	2.02	1.88	1.89	1.88	1.95	2.08	2.28	2.49	2.57	2.59	2.63	2.54	2.60	2.61	2.60	2.70	2.73

Data Source: US DOT Form 41 via BTS, Schedule P10 & T2.

Exhibit 2 (page 2 of 2)
Productivity Measures of Major U.S. Airlines
Source: MIT Airline Data Project, http://web.mit.edu/airlinedata/www/default.html

TAJ HOTELS TAKES AIM AT NORTH AMERICA

Robert Hogan, College of Charleston
John Crotts, College of Charleston

CASE DESCRIPTION

The primary subject matter of this case is ratio analysis on two potential acquisition targets being considered by Taj Hotels. The case has a difficulty level of three and is therefore appropriate for junior level students. The case was crafted with management or hospitality management courses in mind but given the pervasive use of ratio analysis throughout the business community this case is appropriate for a broad range of courses including finance and accounting. The case is designed to be taught during one, 75 minute class and we expect students will need at least two hours of preparation time outside of the classroom.

CASE SYNOPSIS

This case focuses on using ratio analysis to bring the student to a decision point, namely, which acquisition target is the best choice for Taj Hotels. The case includes background information on Taj and both acquisition targets, as well as financial data and a detailed description and calculation instructions for eighteen different ratios.

NOTE: This case is based on real-life facts, but all of the financials provided are completely fictionalized. As a result the case was developed as a class exercise and should not be used as a source of primary data or illustration of effective or ineffective management.

CASE BODY

Heather Talati stared contemplatively from her office at the corporate office of Taj Hotels, Resorts, and Palaces in Mumbai, India. It was October 6, 2014 and in three days she is scheduled to meet with Rakesh Sarna, Taj's Managing Director and CEO, to present her evaluation of two expansion opportunities in North America. Taj exited North America in the late 1990's but strategically re-entered the market seven years later focused on the luxury sector in the gateway cities of Boston, New York, and San Francisco. With complete backing from the Tata Group conglomerate, Taj Hotels, Resorts, and Palace is perfectly poised for expansion through the purchase of a privately owned hotel/resort group.

Heather knew that a careful analysis of Taj's options would be expected and hopefully rewarded. She and her husband Shyam desired to return to the US, and the expansion of Taj's US holdings could create opportunities for both of them. The company's operating income was $73 million on $310 million in sales making it one of the more profitable divisions of the Tata Group (http://www.tata.com/article/inside/Financials-of-Tata-companies).

Two expansion options seem promising. The first was Belmond Hotels (formerly Orient Express) whose North American properties included six (6) hotels and resorts it both owned and operated in South Carolina, Maryland, California, St. Martin, and Mexico. The second option is Salamander Hotels, Resorts, and Spas whose five (5) properties are located in Washington, DC, North Carolina, and Florida. Initial appraisals of the real estate of both companies indicated

Belmond and Salamander were similarly valued on a room key (e.g., guest room) basis. Belmond has a total of 715 guest rooms while Salamander is larger at 1,378. Heather was also informed that the strategic locations of both options were equally valued since Taj would continue to look for other companies to acquire to balance out its North American holdings. Heather retrieved from her bookshelf the textbook she used during her MBA coursework titled "Valuation for Hotel Investors".

HISTORY OF THE TAJ HOTEL GROUP

Established in 1904, Taj Hotels is one of Asia's largest and finest groups, comprised of 108 hotels in 63 locations across India with an additional 17 international hotels in the Maldives, Malaysia, Australia, UK, USA, Bhutan, Sri Lanka, Africa, and the Middle East. From world-renowned landmarks to modern business hotels, idyllic beach resorts to authentic Grand Palaces, each Taj hotel offers an unrivalled fusion of world-class service and modern luxury (www.tajhotels.com).

In 2013, four properties within Taj Hotels' luxury group were ranked by Condè Nast Traveler among the top 100 Hotels and Resorts in the World. They are Rambagh Palace in Jaipur, the Taj Mahal Palace in Mumbai, the Taj Lake Palace in Udaipur, and the Taj Exotica Resort & Spa in the Maldives.

TATA GROUP

Taj Hotels is a subsidiary of the Tata Group which was founded in 1868 by Jamsetji Tata as a trading company. Today it is made up of more than 100 companies with operations in more than 80 countries across six continents. The major Tata companies are Tata Steel, Tata Motors, Tata Consultancy Services (TCS), Tata Power, Tata Chemicals, Tata Global Beverages, Tata Teleservices, and Taj Hotels. The combined market capitalization of all the 32 listed Tata companies was $103.27 billion as of July 2014. While the Tata Group remains a family-owned business, Tata receives more than 58% of its revenue from outside India (www.tata.com/article/inside/Financials-of-Tata-companies).

The reason Jamsetji Tata entered the hotel business is the subject of wide speculation. The most often told story was that he was denied service in a British run hotel in Bombay and in protest built his own hotel. Another story suggested that he was offended when an international visitor to Bombay complained that there were no good hotels in India. Whatever the impetus, Jamsetji Tata took great pride in building his first hotel, which he called the Taj Mahal Bombay.

Taking three years to construct, the Taj Mahal Bombay achieved a standard unrivaled in 1904. The hotel had its own electrical power plant, an ice making plant, a soda water bottling plant, and interior furnishings handpicked by Jamsetji Tata on trips throughout Europe. Sadly Jamsetji Tata passed away days before the Taj Mahal Bombay's grand opening (Deshpande & Sinha 2011).

INDIAN HOTEL COMPANY

Indian Hotel Company (IHC), the holding company for Taj, acquired a number of new properties over the next century. In the late 2000's, IHC began organizing its hotels under different brands as a part of their market segmentation strategy (Deshpande & Sinha 2011). IHC brands include:

- **Taj/Taj Luxury** - The luxury brand composed of the Taj Hotels Resorts and Palaces.
- **Taj Exotica** - The resort and spa brand of Taj Hotels.
- **Taj Safaris** - The wildlife lodges amidst the Indian national parks come under this brand label. The brand is modelled on the concept of sustainable eco-tourism.
- **Vivanta by Taj** - The contemporary-luxury hotel brand which is positioned a step below the flagship Taj brand.
- **The Gateway Hotels and Resorts** - Gateway is a mid-market brand, positioned below the Vivanta. It contains properties in business and vacation destinations like Vivanta. The Gateway Hotel brand was created by Taj in its earlier market segmentation effort in the 1990s, and has been retained and expanded in the current wave of brand-segmentation.
- **Taj Luxury Residences -** Exquisitely designed and fully furnished townhomes located adjacent to key central business districts offering luxury amenities and services.
- **Ginger** – These properties are the economy hotels of the IHC group.

Most of the growth in IHC occurred under the lengthy tenure of Ajit Kerka who lead the firm from 1970-1997. Although IHC was a part of the Tata conglomerate, Kerkar was given autonomy to run IHC without interference from corporate. By the end of Kerkar's tenure, IHC was thriving financially but corporate became concerned with articles in the press that suggested Taj was not adhering to the ethical standards required of Tata companies. Krishna Kumar, currently the Managing Director of Tata Tea, was announced as the replacement of Kerkar. Keen to address the problems left by Kerkar, Kumar set out to put in place new human resource systems and policies. Many long term employees objected to these changes. Kumar put together a generous early retirement package offered throughout IHC. Some 265 executives and 1,697 staff members across Taj's hotels 15,000 employees accepted. Kumar next raised salaries across all Taj hotels to a level that was more in line with market rates (Delong & Vijayaraghavan 2002).

After years without a formal process for developing and evaluating its human resources, IHC adopted the "Taj people philosophy" that articulated the importance of people to the organization. The philosophy was the foundation of a new performance management process that utilized a balanced scorecard. This new performance management process linked the long term goals of the company to individual incentives that tied rewards to performance. The company also introduced an employee satisfaction system and Taj-focused training interventions driven through centers of excellence. The training interventions were critical in advancing the skills of the workforce to a level that could make full use of the IT investments that Taj made in each of its hotels. In addition, a fast track program was developed where individuals identified by their managers as high performers were selected to attend an intensive, externally run, mini MBA that cross trained them and prepared them for future general management positions. In this period of reorganization, the Taj group downsized its holding to 60 hotels primarily in India putting a hold on international growth (Sharma & Hyatt 2013).

The timing of this reorganization was important. With India's recent entry into the World Trade Organization, Taj's senior leadership knew that Ritz Carlton and Four Seasons would soon enter the market. According to K.R.S. Jamwal, executive director of Tata, "60-70% of the customer base of Taj luxury hotels is from outside India. Luxury hotels provide 50-55% of our revenue and 70-75% of our profits. With these top international chains coming here we need to offer not just equal service but better service because the global competitors have the benefit of global marketing and customer loyalty programs." Expanding their luxury brand internationally to the key source markets of North America, the United Kingdom, Australia, China, the Middle East, and South Africa would not only shore up their competitive position in India but expand the upscale brand internationally (Deshpande & Sinha 2011).

Heather's Dilemma

Thumbing through the index of the book "Valuation of Hotels for Investors" (Harper 2008), Heather ponders which ratios should Taj consider in making this acquisition decision. Heather is aware that ratios serve as a tool that can simplify numerous different factors into a single number. This "single number" aspect of ratios allows for ease of comparison and a quick reference as to the financial health or stability of a company. However, in her MBA program her professor's made it clear that a ratio by itself is of little use. Ratios are most useful when evaluated within a context, for example within an industry, between companies, or from one period to the next. Ratios are a very useful tool in the hands of an astute user, but care must be given when using any type of summary measure, as over reliance on a simplified comparison can blur details that are critical to a sound assessment. With these considerations in mind, Heather carefully selected ratios to include in her analysis of the two potential acquisition targets.

Solvency Ratios

Solvency ratios measure a firm's ability to meet its long-term obligations. These ratios are designed to help users evaluate a firm's ability to use the value of its operational assets and the firm's operational cash flows to generate enough funds to pay all future obligations. In general, relatively higher solvency ratios are preferred and these higher ratios suggest that the firm will be able to meet its long-term debt payment schedules.

Total Debt Ratio (Solvency)

$$\text{Total Debt Ratio} = \frac{\text{Total Assets}}{\text{Total Liabilities}}$$

The total debt ratio examines the amount of total assets as compared to the firm's total liabilities. A ratio of 1 indicated that for every dollar of firm assets the firm has a dollar of debt. Therefore a higher ratio is preferred. As the total debt ratio drops below 1 the firm will tend to have greater difficulty meeting its long-term debt payment schedules.

Debt-to-Equity Ratio

$$\text{Debt to Equity Ratio} = \frac{\text{Total Liabilities}}{\text{Total Stockholders' Equity}}$$

The debt-to-equity ratios is one of the most common ratios used to examine solvency and compares a firm's total debt to the amount of investment made into the firm by the owners. Again a higher ratio is preferred. Stockholders (or owners) do not want to see the firm overly burdened with debt payments and creditors want to ensure there is a high level of equity within the firm should the firm default on its loans.

Liquidity Ratios

Liquidity ratios measure a firm's ability to meet its current and short-term operational obligations. As compared to solvency measures, liquidity is narrower and more short-term in nature. A liquidity ratio of 1 suggests the firm has current assets, including cash or assets that will be converted to cash within 12 months, that equal the firm's obligations over those same 12 months. As liquidity ratios drop further and further below 1, firms tend to have greater difficulty maintaining adequate cash flow to supply the firm's on-going operational demands. Therefore, creditors typically prefer liquidity ratios that are greater than 1, as creditors are most interested in ensuring the firm is generating adequate assets to repay the firm's outstanding debts.

Current Ratio

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Generally, the higher the ratio the less likely the firm will face liquidity issues. The ratio describes the amount of current assets for every dollar of current liabilities. The nature of the firm's business can have a significant impact on this ratio. Variations in operations such as seasonal influences, or slow-to-pay customers can distort this ratios usefulness.

Quick Ratio (Acid Test)

$$\text{Quick Ratio} = \frac{\text{Current Assets} - (\text{Inventory} + \text{Prepaid Expenses})}{\text{Current Liabilities}}$$

Current assets minus inventories and prepaid assets are sometimes referred to as "Quick Assets". This term is in reference to the fact that the current assets excluding the firm's inventories and prepaid assets should be able to be converted to cash very quickly. As compared to the current ratio the quick ratio is even shorter-term in nature and demands assets are more readily available to satisfy operational obligations. However, the highly liquid requirement of quick assets does not consider the revolving nature of current assets and current liabilities.

Liquid Asset Ratio

$$\text{Liquid Asset Ratio} = \frac{\text{Cash} + \text{Marketable Securities}}{\text{Total Assets}}$$

This ratio is designed to expose the portion of the firm's assets that are either cash or can be very easily converted to cash. Different stakeholders will view this ratio differently. Owners will typically want this ratio to relatively low, but at a level adequate to sustain on-going operations. Creditors on the other hand will want this ratio relatively high as their interests are to ensure the firm has ample cash to meet the necessary debt obligations. Management is stuck in between these two competing positions and must find the appropriate balance. However, the general statement still holds, the higher the ratio the less likely the firm will face liquidity issues.

Asset Management Ratios

Successfully running a firm involves the day-to-day operational duties of sales, marketing, and staff management but accounts receivable and accounts payable must also be carefully managed. Without careful attention to these financial matters firms often run into problems related to cash management. Asset management ratios provide an assessment of management's ability to facilitate the revolving nature of current assets and liabilities as well as tools for assessment of the utilization of firm assets.

Accounts Receivable Turnover

$$\text{Accounts Receivable Turnover} = \frac{\text{Total Revenue}}{\text{Average Accounts Receivable}}$$

As accounts receivable represent credit extended to the firm's customers, therefore tracking customer payments is critical to firm success. Accounts receivable turnover provides a measure of how quickly a firm's receivable are converted to cash. In evaluation this ratio stakeholders prefer to see higher turnover rates and consistency in turnover from period to period. Average accounts receivable is calculated as accounts receivable at the beginning of the period plus accounts receivable at the end of the period divided by two.

Average Collection Period

$$\text{Average Collection Period} = \frac{\text{Days in the Year}}{\text{Accounts Receivable Turnover}}$$

This ratio captures the average number of days it takes a firm to collect payment from its customers on the credit the firm extended (accounts receivable). The fewer the number of days to collect, the better.

Fixed Asset Turnover Ratio

$$\text{Fixed Asset Turnover Ratio} = \frac{\text{Total Revenue}}{\text{Net Fixed Assets}}$$

The fixed asset turnover ratio is a measure of how well a firm manages its property, plant and equipment in its efforts to generate revenues. A higher ratio suggests that the company is managing it fixed assets efficiently.

Total Asset Turnover Ratio

$$\text{Total Asset Turnover Ratio} = \frac{\text{Total Revenue}}{\text{Total Assets}}$$

The total asset turnover ratio can be used to assess how effectively a firm manages its assets in its efforts to generate revenues. A higher ratio suggests that the company is managing it assets effectively, however a weakness to this ratio is that book values rarely mirror market values.

Profitability Ratios

Profitability ratios reflect management's ability to generate profits given a variety of different measures of investment. These ratios are designed to "allocate" each dollar of profit to one unit of the underlying metric, be that revenue generated in the form of sales, total assets, or an industry specific metric like the number of rooms available. In general higher profitability ratios are preferred.

Gross Operating Profit per Available Room (GOPAR)

$$\text{GOPAR} = \frac{\text{Gross Operating Profit}}{\text{Rooms Available}}$$

GOPAR considers the firm's ability to generate revenue through room sales while at the same time keeping operating costs relatively low, all scaled by the number of rooms available. A higher ratio is preferred. Gross operating profit is calculated by subtracting the cost of sales from total revenues.

Gross Operating Profit Margin Ratio

$$\text{Gross Operating Profit Margin Ratio} = \frac{\text{Gross Operating Profit}}{\text{Total Revenue}}$$

Gross operating profit margin ratio also examines the ability of management to generate revenue while keeping operating costs relatively low, but in this case the ratio is scaled by total revenue. Gross operating profit margin ratio expresses the firm's gross operating profit as a percentage of total revenue. While a higher ratio is preferred, care should be taken when evaluating this ratio between firms as differences in the mix of revenue sources can influence the ratio.

Net Operating Income per Available Room

$$\text{Net Operating Income per Available Room} = \frac{\text{Net Operating Income}}{\text{Rooms Available}}$$

As compared to gross operating profit, net operating income includes more costs and will therefore, by definition, be lower than gross operating profit. This ratio includes costs such as taxes and insurance, which are more difficult for management to directly control as compared to the costs captured by gross operating profit. However these costs are important to firm success and cannot be neglected. Again, a higher ratio is preferred.

Net Operating Income Margin Ratio

$$\text{Net Operating Income Margin Ratio} = \frac{\text{Net Operating Income}}{\text{Total Revenue}}$$

Net Operating Income Margin Ratio expresses operating income as a percent of total revenue. This ratio focuses on management's ability to generate profits from operations as a percentage of sales generated. When evaluating this ratio, typically, stakeholders preferred a higher ratio. Remember care should be taken when evaluating this ratio as differences in the mix of revenue sources between firms can influence the ratio.

Net Profit Margin Ratio

$$\text{Net Profit Margin Ratio} = \frac{\text{Net Income}}{\text{Total Reveune}}$$

Net profit margin ratio provides a measure of management's overall ability to manage operations, as net profit includes all of the costs of operations. This ratio expresses net income as a percentage of the firm's sales. When evaluating this ratio, typically, stakeholders preferred a higher ratio over a lower one.

Return on Assets

$$\text{Return on Assets} = \frac{\text{Net Income}}{\text{Total Assets}}$$

Return on assets is a measure of management's ability to utilize the firm's assets to generate profit. This ratio is an overall measure as it is based on net income which includes all firm expenses, and disregards how the assets were financed (debt or equity). For return on assets a higher ratio is preferred.

Return on Equity

$$\text{Return on Equity} = \frac{\text{Net Income}}{\text{Total Stockholders}'\text{Equity}}$$

Return on equity expresses net income as a percentage of total stockholder's (or owners') equity. When comparing this ratio between firms it is important to keep in mind the influence the financing choice of debt or equity will have on the ratio. This same distortion can also influence the ratio from period to period if the firm has made a dramatic change in financing, for example issuing a large amount of stock. The ratio can still be useful, but adjustments may need to be made to keep the ratio comparable. For return on equity a higher ratio is preferred.

Operational Ratios

Operational ratios are very useful in evaluating the operational performance of a firm, especially period over period. Management will often use these types of ratios to ensure day-to-day operations are being managed efficiently and effectively. Care should be taken when evaluating these ratios between firms as variations in the firm's operational model can dramatically impact these ratios

Total Revenue per Available Room Ratio (RevPAR)

$$\text{Total Revenue per Available Room Ratio} = \frac{\text{Total Revenue}}{\text{Rooms Available}}$$

This ratio measures the total revenue yield per room available. This ratio is scaled by the number of rooms available so it is useful in comparisons between properties, but users must be aware that total revenue can be strongly influenced by the mix of services offered on a property by property basis. In general, a higher ratio is preferred.

Financial Statements

Presented below are the financial statements of Belmond Hotels and Salamander Hotels, Resorts, and Spas. This financial information should be used to conduct a ratio analysis of these two acquisition targets. The ratio analysis can be summarized and compared on the student worksheet below. Belmond Hotels' balance sheet is presented in Exhibit 1 and Belmond Hotels' statement of consolidated operations is presented in Exhibit 2. Salamander Hotels, Resorts, and Spas' balance sheet is presented in Exhibit 3 and Salamander Hotels, Resorts, and Spas' statement of consolidated operations is presented in Exhibit 4. Exhibit 5 is the student worksheet for ratio comparison.

Exhibit 1
Belmond Hotels
Consolidated Balance Sheets

	2014 '000	2013 '000	Average* '000
Assets			
Cash and cash equivalents	$ 172,940	$ 163,159	$ 168,050
Restricted cash	1,914	6,003	3,959
Accounts receivable, net of allowances of $538 and $563	65,657	60,471	63,064
Due from unconsolidated companies	4,789	6,795	5,792
Prepaid expenses and Inventories	52,632	50,952	51,792
Assets of discontinued operations held for sale	720	34,416	17,568
Total current assets	$ 298,652	$ 321,796	$ 310,224
Property, plant and equipment, net of accumulated depreciation of $337,102 and $330,390	1,289,113	1,221,749	1,255,431
Investments in unconsolidated companies	258,676	251,255	254,966
Goodwill and other assets	226,696	293,216	259,956
Total assets	$2,073,137	$2,088,016	$2,080,577
Liabilities and Equity			
Working capital loans	$ -	$ 138	$ 69
Accounts payable	46,172	43,744	44,958
Accrued liabilities	36,585	34,187	35,386
Deferred revenue	43,388	36,983	40,186
Liabilities of discontinued operations held for sale	-	1,611	806
Current portion of long-term debt	7,286	72,816	40,051
Total current liabilities	$ 133,431	$ 189,479	$ 161,455
Long-term debt and other obligations	634,367	566,915	600,641
Liability for pension benefit	890	1,606	1,248
Other liabilities	23,919	18,851	21,385
Deferred income taxes	162,458	172,370	167,414
Total liabilities	$ 955,065	$ 949,221	$ 952,143
Shareholders' equity			
Class A common shares $0.01 par value (360,000,000 shares authorized): Issued — 121,943,345 (2013 — 121,704,245)	$ 1,219	$ 1,217	$ 1,218
Additional paid-in capital	1,235,947	1,201,010	1,218,479
Retained earnings/(deficit)	(7,213)	7,462	125
Accumulated other comprehensive loss	(113,482)	(73,317)	(93,400)
Total shareholders' equity	$1,116,471	$1,136,372	$1,126,422
Non-controlling interests	1,601	2,423	2,012
Total equity	$1,118,072	$1,138,795	$1,128,434
Total liabilities and equity	$2,073,137	$2,088,016	$2,080,577

* - Using averages in ratio analysis will help to remove year-over-year volitiality from the analysis.

Exhibit 2
Belmond Hotels
Statements of Consolidated Operations

	2014 '000	2013 '000	Average* '000
Revenue	$656,294	$646,614	$651,454
Expenses:			
Cost of services	257,082	249,514	253,298
Selling, general and administrative	217,992	222,474	220,233
Depreciation and amortization	49,780	47,434	48,607
Impairment of property, plant and equipment	-	71,360	35,680
Total operating costs and expenses	$524,854	$590,782	$557,818
Gain on disposal of property, plant and equipment	7,714	-	3,857
Earnings/(losses) from operations	$139,154	$ 55,832	$ 97,493
Loss on extinguishment of debt	(29,012)	-	(14,506)
Interest income	1,400	1,044	1,222
Interest expense	(36,112)	(31,194)	(33,653)
Foreign currency, net	(1,760)	5,998	2,119
Earnings/(losses) before income taxes and earnings from unconsolidated companies, net of tax	$ 73,670	$ 31,680	$ 52,675
(Provision for)/benefit from income taxes	(4,638)	(2,516)	(3,577)
Earnings/(losses) before earnings from unconsolidated companies, net of tax	$ 69,032	$ 29,164	$ 49,098
Earnings from unconsolidated companies, net of tax provision/(benefit) of $1,170 and $(2,048)	2,076	5,266	3,671
Earnings/(losses) from continuing operations	$ 71,108	$ 34,430	$ 52,769
Net (losses)/earnings from discontinued operations, net of tax provision/(benefit) of $0 and $(592)	(2,404)	(800)	(1,602)
Net losses/(earnings) attributable to non-controlling interests	54	166	110
Net earnings/(losses) attributable to Belmond Ltd.	$ 68,758	$ 33,796	$ 51,277

* - Using averages in ratio analysis will help to remove year-over-year volitiality from the analysis.

Exhibit 5

Salamander Hotels, Resorts, and Spas
Consolidated Balance Sheets

	2014 '000	2013 '000	Average* '000
Assets			
Cash and cash equivalents	$ 232,645	$ 219,223	$ 225,934
Restricted cash	13,350	10,685	12,017
Accounts receivable, net of allowances of $538 and $563	51,150	53,138	52,144
Due from unconsolidated companies	13,131	12,995	13,063
Prepaid expenses	49,270	46,095	47,682
Inventories	77,837	80,200	79,018
Assets of discontinued operations held for sale	-	11,260	5,630
Total current assets	$ 437,381	$ 433,597	$ 435,489
Property, plant and equipment, net of accumulated depreciation of $670,202 and $630,901	1,857,896	1,831,093	1,844,494
Investments in unconsolidated companies	113,442	112,854	113,148
Goodwill	261,802	279,310	270,556
Other intangible assets	24,563	25,191	24,877
Other assets	110,353	96,116	103,235
Total assets	$2,805,437	$2,778,161	$2,791,799
Liabilities and Equity			
Working capital loans	$ 262	$ 246	$ 254
Accounts payable	25,801	22,264	24,033
Accrued liabilities	84,024	82,053	83,038
Deferred revenue	75,929	67,830	71,879
Current portion of long-term debt	47,229	129,400	88,314
Total current liabilities	$ 233,244	$ 301,792	$ 267,518
Long-term debt and other obligations	653,558	605,522	629,540
Deferred income taxes	397,009	306,819	351,914
Total liabilities	$1,283,811	$1,214,133	$1,248,972
Shareholders' equity			
Class A common shares $0.01 par value (300,000,000 shares authorized): Issued — 213,283,450 (2013 — 216,565,895)	2,133	2,166	2,150
Additional paid-in capital	1,762,907	1,710,371	1,736,639
Retained earnings/(deficit)	(12,306)	13,605	649
Accumulated other comprehensive loss	(233,911)	(166,426)	(200,168)
Total shareholders' equity	$1,518,824	$1,559,716	$1,539,270
Non-controlling interests	2,802	4,313	3,557
Total equity	$1,521,626	$1,564,028	$1,542,827
Total liabilities and equity	$2,805,437	$2,778,161	$2,791,799

* - Using averages in ratio analysis will help to remove year-over-year volitiality from the analysis.

Exhibit 4
Salamander Hotels, Resorts, and Spas
Statements of Consolidated Operations

	2014 '000	2013 '000	Average* '000
Revenue	$ 1,034,441	$ 1,004,989	$ 1,019,715
Expenses:			
Cost of services	385,623	369,281	377,452
Selling, general and administrative	401,988	403,262	402,625
Depreciation and amortization	74,670	70,202	72,436
Impairment of property, plant and equipment	245	105,613	52,929
Total operating costs and expenses	$ 862,526	$ 948,357	$ 905,442
Gain on disposal of property, plant and equipment	11,571	450	6,011
Earnings/(losses) from operations	$ 183,486	$ 57,081	$ 120,284
Loss on extinguishment of debt	(43,518)	1,842	(20,838)
Interest income	2,100	1,545	1,823
Interest expense	(54,168)	(46,167)	(50,168)
Foreign currency, net	(2,640)	8,877	3,119
Earnings/(losses) before income taxes and earnings from unconsolidated companies, net of tax	$ 85,260	$ 23,178	$ 54,219
(Provision for)/benefit from income taxes	(6,957)	(3,724)	(5,340)
Earnings/(losses) before earnings from unconsolidated companies, net of tax	$ 78,303	$ 19,455	$ 48,879
Earnings from unconsolidated companies, net of tax provision/(benefit) of $1,890 and $(2,618)	3,114	7,794	5,454
Earnings/(losses) from continuing operations	$ 81,417	$ 27,248	$ 54,333
Net (losses)/earnings from discontinued operations, net of tax provision/(benefit) of $0 and $192	(3,606)	(1,184)	(2,395)
Net losses/(earnings) attributable to non-controlling interests	81	246	163
Net earnings/(losses)	$ 77,892	$ 26,310	$ 52,101

* - Using averages in ratio analysis will help to remove year-over-year volitiality from the analysis.

Exhibit 5
Student Worksheet - Ratio Comparison

	Belmond Hotels	Salamander Hotels, Resorts, and Spas
Solvency		
Solvency Ratio		
Debt-Equity Ratio		
Liquidity		
Current Ratio		
Quick Ratio (Acid Test)		
Liquid Asset Ratio		
Asset Management		
A/R Turnover		
Avg. Collection Period		
Fixed Asset Turnover		
Total Asset Turnover		
Profitability		
GOPAR		
Gross Operating Profit Margin Ratio		
Net Operating Income per Available Room		
Net Operating Income Margin Ratio		
Net Profit Margin		
Return on Assets		
Return on Equity		
Operational		
Total Revenue per Available Room (RevPAR)		

LANDSLIDE DEVELOPMENT CORPORATION: A CASE STUDY

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CASE DESCRIPTION

The primary subject matter of this case is a family owned media agency that has found itself in a business relationship that has soured. Secondary issues include ethical dilemmas with a family owned business. This case was designed for use in a Senior Level Leadership in Technical Settings course. The case is also appropriate for use in a undergraduate business ethics course or management course. The case is designed to be taught in one class hour and is expected to require approximately 2 hours of outside preparation by students.

CASE SYNOPSIS

This case has a myriad of issues involved. It focuses on the management of a real estate development company. The company is growing and is presented with an opportunity to move their operation to the next level. A media company that understands utilizing a specific data mining technique to provide can't miss contact information to the development company to rent out their properties. Marital infidelity causes one member of the development company to sabotage the whole operation. The media company has invested heavily in the project. They expect a large return on their investment and instead find themselves as an unwitting 3rd member of relationship triangle.

INTRODUCTION

Jim Benson sat staring at his telephone. He couldn't believe the call he had just received. He had just celebrated his 50th birthday and no one had ever spoken to him that way. The call was from Richard Williams. Williams and his wife Josephine ran Misty Glen Development. MGD as it has become known is in Big Bear Lake, California. It is a beautiful setting in the middle of the San Bernardino National Forest. The location seemed ideal, almost midway between Los Angeles and Las Vegas. Who would have known that it could have gone this poorly?

Jim had plans on this being the big one for his company. He was the CEO of the Champion Brothers Agency. The agency specialized in digital printing and web development services. Specifically, they specialized in the analytics of sorting through databases to find just the right people for a given activity. The technique was held in highest secrecy by the agency. They had subscriptions to numerous mailing lists. All of the lists had specific information about individuals. The analysts employed here, combed through multiple mailing lists to find the same people on multiple lists that had the correct interests. He had matched up numerous groups before. The last successful match was for a golf resort that wanted to increase their occupancy rates. Champion Brothers had promised the resort 30 guaranteed bookings per week. The resort had decided that was all of the new business they could handle. The resort didn't realize that Champion Brothers could have given them 500 per week if they could handle the traffic.

MGD had needed only 15 leads per week. Jim had been working with Williams and his wife Josephine for almost a year now. Even though the process of providing leads for cabins would seem similar to that of the golf resort, it actually required very different information. As it turned out, the "leads" that would almost always book rooms, were dominated by church and family groups on outings. The church group data sets were something Champion Brothers had never invested in. This would be a serious new cost for the agency. Benson looked at this investment as the foundation of a new market that Champion Brothers would soon dominate. There were markets across the country exactly the same as Big Bear. Soon Champion Brothers would duplicate the campaign with similar locations in Branson, Jackson Hole, Hot Springs and more places than he could count. This was the big one that he had been waiting for.

MISTY GLEN DEVELOPMENT

Misty Glen Development had two operations. Richard ran the construction group and Josephine managed the rentals. Business had been good but not great. The cabins ranged from 800 square foot 2 bedroom cabins to 10,000 square foot 7 bedroom behemoths. The finishes used in the different floor plans varied widely. This resulted in a huge range of prices for ownership in the cabins. The bare bones model could be purchased for less than $300,000. The most expensive model sold so far for just under 3 million. Richard knew that he needed to keep building units to keep the revenue stream strong. The biggest selling point was that the units would stay rented, thus providing the owners with a steady profit on their investment. Richard and Josephine worked closely on finding new renters to keep occupancy rates up.

Out of the blue, some guy called Josephine and introduced himself as the CEO of some agency that was making big promises about new clients. Richard was skeptical. Benson had showed up with a very polished presentation about some golf resort that was doing gangbuster business. The occupancy rates had gone from just under 50% to just over 90%. Williams was doing the math in his head about the money to be made if all of the cabins he was building were full all of the time.

Josephine wanted to know about the process and what her role would be in booking the cabins. Richard had questions of his own. Jim flew to Big Bear to make a formal presentation to all of the managers at Misty Glen. After everyone involved signed a non-disclosure agreement. He described his goals for their campaign and all of the details of the process for gathering the "hot leads" for the rental system. Normally, he would book the reservations in house at Champion Brothers. Since that would basically eliminate Josephine's role, Jim adjusted the system to provide Josephine's office with all of the contact information. The staff of the rental group would make cold calls or answer incoming calls from direct mail solicitations and book the rooms. Richard asked about the feasibility of generating actual customers. Jim pulled out a list that the staff had already generated and asked Richard to pick a name from the list. He looked amused but selected one half-way down the list. Jim pulled out his phone and dialed the number. A woman answered the phone. Jim worked through the prepared script like a pro. Richard could tell the prospect was excited about the offer. She said that her Woman's Club was looking for a location for an upcoming retreat and Misty Glen sounded perfect. She asked for a number to call him back after she talked to the officers of the club. Jim gave her the callback number and directed her to the website for more specific information. After they hung up, he looked at Richard and said there is your first client in our new program. Richard was still skeptical. He said that it couldn't be that easy. Jim explained that his system gathered information from many sources and only selected people that really wanted to hear about the offer. He explained that it was like reading peoples minds about their needs. Jim looked at Josephine and said imagine you were out of bananas. You were getting your coat on to go to the market and buy a fresh bunch. All of a sudden there is a knock on the door and there is a person on your porch selling bananas. How great would that be? Every name I give you is looking to rent a cabin in the vicinity of Big Bear California. All you need to do is get to them before your competition does. Jim answered a series of other questions about technical things and expectations. Richard said that he and Josephine needed to think for a couple of days and then make a decision.

THE WILLIAMS SITUATION

Josephine and Richard had been having some marital problems. She was loosing trust in him. There were all kinds of signs that didn't look good. He seemed to be coming home later and later. There were all of these trips to trade shows and vendor meetings. She finally got up the courage to confront him about it. He denied it and a huge argument ensued. After the name calling subsided, they went to separate bedrooms and called it a night. Josephine decided that she needed some proof before confronting him again. Josephine called a few of her friends to go out and talk about her suspicions over drinks. Her friends happily met her at the Brigantine, a local bar and grill. She told them the whole story. They talked for several hours about her suspicions. They decided to have some of their other friends to perform some detective work. Her friends were afraid of being spotted, so they talked to a private investigator. For a couple of hundred dollars he would do a quick analysis of the situation and if he thought something was actually going on, recommend the proper course of action.

Wes Chamberlin had been in the private investigation business for 15 years. He had seen a lot in his time, some very sneaky polished cheaters and some others that were oblivious to anyone seeing their transgressions. Richard Williams fell into the latter category. In the first hour, Wes observed Williams meeting a brunette at a local restaurant. He left the eatery and went to an apartment complex and disappeared inside.

An hour later he emerged and went back to work. Three other days that week, Wes observed similar conduct. That was all he needed to hand proof to Josephine of Richard's affair.

Josephine was stunned with the proof of her suspicions. Armed with a packet of photographs, times and locations, she decided to confront Richard with the facts. The argument was epic. Lots of loud voices, accusations, tears ensued, followed by admissions. Richard was hesitant to admit his wrongdoing. Faced with the facts, he told the whole truth. He told Josephine that he really didn't want to be married to her anymore and she could leave with the clothes on her back and nothing else. She protested and told him at he was in the wrong and she would get everything. Richard explained that all of the business components were in his name. As were the house, cars, beach house and motorcycles. He asked Josephine to think about the prenuptial agreement she signed. He reminded her that if they were to divorce, they would leave with their own individual assets. Since everything was in his name, there was nothing for her to take. As for the affair, he was happy with the arrangement and it would continue. If she wanted to leave then she should leave. If she wanted to stay that was fine too. He was very clear about his future actions.

REVENGE

Josephine read and reread the contract. How could she have signed such a thing? How could she have let Richard put everything in his name? She consulted a lawyer later in the day, who gave her a glimmer of hope, but only a slight one. She could fight it out in court and maybe win only to have him appeal the decision. He could win, which would lead to an appeal of her own. No matter which route she took, any closure would be, at best, years away. It was then that she decided what her plan would be. The great life with the big house and lots of money was getting ready to go away. Her husband would continue on without her. She was going to sabotage the business, hopefully to the point that it would go under and take Richard with it.

She immediately stopped renting cabins. She let the phones ring when she thought a potential customer was on the line. Voicemails were routinely disregarded and deleted. The only cabins that were rented were to walk up customers. Those customers got very low prices for their rentals. Richard came by frequently and asked why the cabins were empty. Her standard answer was always the same, "Jim hasn't sent us any contacts". As a few weeks passed, the cabins started to sit vacant, potential buyers started asking Richard why the existing cabins were empty. Sales ground to a halt almost immediately. Richard asked Josephine to call Benson about the lack of contacts. Josephine said she would and continued on with her day. Later when Richard checked in she told him that Jim was checking on it. The same discussion played out the same way for 3 more days. Josephine never called Benson. The next day Richard was as the end of his rope with Champion Brothers. He called Jim Benson himself to get to the bottom of things. He started the call with an accusation that Champion Brothers had ruined his business. The banks were threatening to foreclose on several of his properties, next week would be the last week they could meet payroll and without workers, MGD was in serious trouble. Benson replied that Champion Brothers had provided MGD with 150 contacts over the past 10 weeks, just as their contract had specified. Williams called him a liar, said his lawyer would be in contact and slammed down the phone.

Benson called his IT manager and asked about the contacts. Shelly, the IT Manager said everything was perfect on the data side of the house. The issue seems to be that no one at MGD was retrieving the names. Jim couldn't believe what he was hearing. They had trained Josephine on the system and she was consistently logging in. Why was she not using the contacts? Benson decided to go in person to MGD to get to the bottom of things.

SHOWDOWN AT MGD

When Benson arrived, the situation was nothing like he had seen earlier. The cabins were empty. There were probably 4 cabins under construction with no activity around them. The place was a ghost town. He started toward the rental office and stopped. Should he have brought some security with him? He pressed on. Richard and Josephine were the only ones in the office. Both had aged considerably since he had seen them last. Richard started toward Jim and asked why he was there? Jim said that he wanted to know why MGD wasn't using any of the contacts he had provided to them. Richard screamed that there were not any contacts. He said that Josephine hadn't had a contact in more than 2 months. Jim said that wasn't true and started walking toward Josephine's computer. Josephine didn't want to get out of her seat. She said the system didn't work and there were no names. Jim asked to see her screen. Reluctantly, she did give up her seat. Benson wiggled the mouse and the screen jumped to life. He clicked on the Champion Brothers icon and in a few seconds there were screen after screen of contact information. Benson said that his company has invested more than $200,000.00 in the system. It was his turn to be upset. What is going on here? It looks like you want the place to go under. You have all these names that want to come here and you never contact them? Do you want to go broke? It was at that moment, it hit Williams what had happened. He looked at Josephine and said you did this on purpose! She replied calmly but firmly, you were going to leave me with nothing. Now we are equal. She rose and walked out the door without speaking.

Benson was beside himself. Williams stood with his mouth open not knowing what to say. Benson walked out the door into the beautiful California Mountains to see Josephine's car disappearing in the distance. He got in his own car and drove in silence the 5 hours back to his office. What was he going to do? MGD was done. His company was down 200K. He called a meeting with his brother and the management at Champion Brothers. They had some serious decisions to make. Should they fold up the operation with MGD? The cabins were still there. Even though they were empty, they were in fact rentable. Champion Brothers knew the correct formula to put people in the cabins. Is there any hope of reconciliation with MGD? Knowing how much money was already invested, could they devise a plan to salvage the whole project?

FROM GP TO LLC: MAKING THE RIGHT CHOICE OF ENTITY DECISION

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CASE DESCRIPTION

This case requires students to explore the relative advantages and disadvantages of the various forms of business entities through the application of those options to a hypothetical case study. Secondary issues examined include contractual obligations of a business before it is legally formed and raising capital in a start-up business. The case is appropriate for undergraduate juniors (difficulty level: 3) in business law or entrepreneurship classes. It may also be used in a class on partnership and corporate taxation as it explores both federal taxation of business entities and the impact of a state limited liability entity tax. The case is designed to be taught in one to two class hours and is expected to require three to four hours of outside preparation by the average business student.

CASE SYNOPSIS

Peter and Ann Northcutt have an opportunity to open a bed and breakfast on Kentucky Lake, fulfilling Ann's life-long dream of owning such a business, provided that they are able to finance the purchase of the house and initial business expenses with a bank loan. In order to complete necessary renovations on the home, the couple enter into a contract with J.T. Allen, a general contractor. A close friend, Alex Lane, who owns and operates a waterpark in western Kentucky, has suggested that the couple could also convert an adjacent piece of property into a waterpark, increasing interest in the bed and breakfast. In order to open the waterpark, the couple will need additional funds, including investments from Lane and potentially others. However, the Northcutts want to maintain control over the business. The case is designed to explore the (1) advantages and disadvantages of the various forms of business entities given the original owners objectives, (2) contractual obligations entered into prior to entity formation, and (3) issues related to raising capital in a start-up entity.

A NEW OPPORTUNITY

Peter Northcutt opened his car door and looked fondly at the house on Kentucky Lake that his grandmother, Virginia, had left to him and his three cousins. The sprawling five bedroom home would work perfectly for the bed and breakfast that he and his wife, Ann, had been planning for years. The couple recently entered into a purchase agreement with Peter's cousins to buy out their interest in the home. Although the house needed some work, it would not take long to have it up and running for the summer lake season.

Peter met Ann in college where she first shared her dream of opening a bed and breakfast. Shortly after graduation, they married and moved to Louisville where Peter obtained a position in the marketing department of a publicly traded company. Ann used her bachelor's degree in hospitality management to land a job with an older, established hotel in the city. Although both enjoyed their jobs and had received several promotions, they eventually wanted to relocate to a smaller town to have a family; however, they knew that employment opportunities in their given fields would be limited in more rural areas.

When Virginia passed away leaving the house to Peter and his cousins, the couple decided it was time to leave their jobs in the city to pursue Ann's dream of owning a bed and breakfast. Although Ann had the experience and expertise to successfully run such a venture, and Peter planned to use his marketing skills to help build the new business, the couple understood that they would need to rely on the expertise of others to help get their business started.

HELP FROM A COLLEGE FRIEND

Peter decided to call his best friend from college, Alex Lane, for advice. Peter and Alex had become fast friends while playing on their collegiate tennis team together. In fact, Peter had introduced Alex to his wife, Julie, a friend of Ann's, their junior year. Alex and Julie lived in western Kentucky where Alex ran a waterpark that he had designed and developed with Julie's father. Alex had obtained the money needed to build the waterpark with the help of an investor that he had met in London, England, Robert Irvin, while he was playing for a summer tennis league there.

Alex agreed to meet Peter at the lake house to discuss the new business. Once Alex saw the house, he agreed that it would work well as a bed and breakfast. He talked to Peter generally about start-up costs. When Alex asked Peter how much money he thought he would need to get the business started, Peter replied that he would need $300,000 to buy out his cousins pursuant to the purchase agreement. He also believed that it would take around $40,000 to renovate the house and that he would need another $50,000 for equipment and other expenses. Peter told Alex that while he and Ann had some savings, they planned to apply for a loan to cover the initial costs. Alex gave Peter contact information for the general contractor, lawyer and banker used by his own business.

As Alex surveyed the land for sale adjoining the home, he saw another opportunity. He believed that Peter and Ann could build a small waterpark on the property with slides extending down into the lake. Alex told Peter that he would be willing to invest in the waterpark venture, that he thought Robert Irvin would be willing to invest as well, and that he could help the couple develop the waterpark should he and Ann decide to pursue it.

Later that evening, Peter relayed the meeting with Alex to Ann. Like Peter, she also was intrigued by the idea of the waterpark and the additional interest and business that it could draw to the bed and breakfast. She acknowledged, however, that neither she nor Peter had any experience with that type of business and that they did not have the capital, nor would they qualify for a loan in the amount needed, to buy the land and build the infrastructure necessary for a waterpark. If they were to pursue the waterpark aspect of the business, the couple would clearly need Alex's investment and involvement in the venture. It also seemed likely that they would need Robert to invest in the business.

This raised a lot of questions for Ann. She asked Peter how much Alex and Robert would be willing to invest and what they would expect to receive in exchange for their investment. Peter admitted that he and Alex had not discussed the waterpark in that level of detail. She was also concerned about how adding the waterpark would impact the management of the business; although she and Peter were good friends with Alex and Julie, she wanted Peter and herself to maintain control over future business decisions.

CONTRACTORS, LAWYERS AND BANKERS

Eager to get started, Peter and Ann contacted Alex's contractor, J.T. Allen, to get his thoughts regarding the renovations needed to operate the house as a bed and breakfast. The contractor generally agreed with their assessment regarding the renovations and made some additional suggestions. When they asked J.T. for an estimate for the cost of the work, he responded that he would send them a proposal in the next couple of days.

From there, the couple visited Kip Mathis, the attorney that Alex recommended for legal and regulatory issues. Peter and Ann conveyed their plans regarding the bed and breakfast to Kip, and Kip asked them if they had thought about forming a business entity to protect themselves against personal liability for business debts. Although both Peter and Ann had studied the basics of entity structures in their business law class in college, neither remembered much about the different options available.

Kip gave Peter and Ann a handout summarizing some of the different types of entity structures available: a sole proprietorship, general partnership, limited partnership, limited liability partnership, limited liability company, a C-corporation and an S-corporation:

Comparison of Entity Types

	Sole Proprietorship	**GP**	**LP**	**LLP**	**LLC**	**C-Corp**	**S-Corp**
Formation	No Formalities	No Formalities -- Can Be Formed by Oral or Written Agreement or Conduct of the Parties	File Certificate of Limited Partnership with Appropriate State Authority	File Statement of Qualification with Appropriate State Authority	File Articles of Organization with Appropriate State Authority	File Articles of Incorporation with Appropriate State Authority	File Articles of Incorporation with Appropriate State Authority File "S" Election
Owners	Owner	Partner	General Partners; Limited Partners	Partners	Members	Stockholders/ Shareholders	Stockholders/ Shareholders
Number	1	At Least 2	At Least 2	At Least 2	Open	Open	No More Than 100
Liability	Unlimited Personal Liability	Unlimited Personal Liability	General Partner: Unlimited Personal Liability Limited Partner: Only Investment is at Risk	Partners Generally Not Personally Liable Beyond Their Investment	Members Generally Not Personally Liable Beyond Their Investment	Shareholders Generally Not Personally Liable Beyond Their Investment	Shareholders Generally Not Personally Liable Beyond Their Investment

Ability to Transfer	Can Sell Business	Transfer of Ownership Interest Usually Requires Unanimous Consent, Unless Otherwise Agreed	Transfer of Ownership Interest Usually Requires Unanimous Consent, Unless Otherwise Agreed	Transfer of Ownership Interest Usually Requires Unanimous Consent, Unless Otherwise Agreed	Transfer of Ownership Interest Usually Requires Unanimous Consent, Unless Otherwise Agreed	Shareholders May Transfer Ownership Interest Unless Otherwise Agreed	Shareholders May Transfer Ownership Interest Unless Otherwise Agreed Restrictions on Transfer to Qualified Shareholders
Management	Self-Managed	Partners Manage or Appoint Managing Partner	Managed Exclusively by General Partner; Limited Partners Cannot Manage Without Losing Limited Liability	Partners Manage or Appoint Managing Partner	Members Manage or Can Agree to Appoint a Manager	Managed by Board of Directors, Who Appoint Officers to Manage Day-to-Day Activities	Managed by Board of Directors, Who Appoint Officers to Manage Day-to-Day Activities
Ability to Raise Capital	Loan	Sell Partnership Interest (Default: Share Equally in Profits and Losses, Unless Otherwise Agreed)	Sell Partnership Interest (Default: Profits and Losses Distributed According to Percentage Ownership, Unless Otherwise Agreed)	Sell Partnership Interest (Default: Profits and Losses Distributed According to Percentage Ownership, Unless Otherwise Agreed)	Sell Membership Interest (Default: Profits and Losses Distributed According to Percentage Ownership, Unless Otherwise Agreed)	Sell Shares (Preferences, etc. Can Be Specified By Articles or Shareholders Agreement)	Sell Shares (Limits on Classes of Stock; Voting Rights Can Vary As Long As Other Preferences Are the Same)
Life Span of Business	Can't Exist Beyond Life of Sole Proprietor	Not Perpetual Unless Otherwise Agreed	Not Perpetual Unless Otherwise Agreed	Not Perpetual Unless Otherwise Agreed	Not Perpetual Unless Otherwise Agreed	Perpetual	Perpetual
Taxation	Flow Through Taxation	Flow Through Taxation	Flow Through Taxation (Loss Restrictions for Limited Partners) Subject to KY State Limited Liability Entity Tax	Flow Through Taxation (Loss Restrictions for Non-Managing Partners) Subject to KY State Limited Liability Entity Tax	Flow Through Taxation (Loss Restrictions for Non-Managing Members) Subject to KY State Limited Liability Entity Tax	Double Taxation: Income Taxed at the Corporate Level and Again When Dividends Are Distributed to Shareholders	Flow Through Taxation (Loss Restrictions for Non-Managing Shareholders) Subject to KY State Limited Liability Entity Tax

He noted that the entity form most advantageous in a given set of circumstances depends on the objectives of the business being formed. He explained that while many factors can impact the choice of entity, two important factors are how the entity and its owners will be taxed under federal and state law and whether the owners of the entity will have liability for the entity's activities. He also noted that, unlike many states, Kentucky has a limited liability entity tax that could affect the couple's choice of entity decision. Other factors considered include the level of formalities required to form and maintain the entity, options for capital structure (i.e., the ability to raise capital through equity or loans), and the management structure of the entity.

After asking them some key questions, Kip learned that the couple planned to borrow money for initial start-up costs, that both Peter and Ann would manage the bed and breakfast, and that they were interested in the waterpark idea with Alex's and Robert's involvement and investment, provided that they could maintain overall control of the business. Given their objectives, Kip promised to send them a memorandum with his recommendations regarding entity formation within the next week.

The next day, Peter emailed Alex's banker, Debra Smith, regarding the possibility of a loan for the bed and breakfast. Peter explained that the house had appraised for $400,000 and that the couple would need to borrow approximately $300,000 to purchase the cousins' interest in the home and another $40,000 for renovations. He noted that the couple planned to use the home to collateralize the loan. He also indicated that they would need another $50,000 for initial business expenses.

NEXT STEPS

The Northcutts received a bid from J.T. Allen within a week of their initial meeting. Allen estimated that the renovations would cost approximately $38,500, slightly under Peter's original number. J.T. also noted that his crew could start work in about a week. Although Ann thought that she and Peter should check with other contractors, Peter was satisfied with J.T.'s proposal and would like for the couple to sign a contract with him in hopes that the work will be completed for the summer lake season.

While Peter and Ann were waiting to hear from Kip Mathis, Alex stopped by the lake home to see them. He had run some initial projections on the costs that it would take to develop a couple of water slides on the property adjoining the lake home. Given his calculations, he believed that they would need $150,000 to purchase the property and to buy, ship and install the two initial slides. That would also cover the costs of licenses, insurance and a lifeguard for the first summer.

Alex proposed that Peter and Ann could use the water slides as part of a bed and breakfast package to attract initial customers to both businesses. Once the bed and breakfast was successfully up and running, they could expand the slides into a small waterpark, open the facility to the general public and charge an admission fee for its use. At that point, patrons of the bed and breakfast would receive a discount for waterpark tickets.

He also noted that he and Robert were willing to put up an initial investment of $50,000 each, for a total of $100,000, if Peter and Ann were willing to invest the last $50,000. Accordingly, Alex proposed the following equity ownership in the waterpark:

Investor	Contribution	Percentage Equity Ownership
Robert Irvin	$50,000	33.33%
Alex and Julie Lane	$50,000	33.33%
Peter and Ann Northcutt	$50,000	33.33%
Total	**$150,000**	**100%**

Alex noted that while he could help Peter and Ann with the initial set-up of the slides, he would not be able to manage their oversight on a daily basis. Additionally, Robert would not be able to participate in the management of the business from England but wanted to invest given the success of Alex's waterpark and the return that he had received on that investment. The Northcutts promised Alex that they would give it some thought.

Later that night, while discussing the idea of the waterslides, Ann could tell that Peter was leaning toward moving forward with the project. Ann, on the other hand, had some reservations. While their personal savings could cover the initial investment, they would not have much left. Given that they could incur some unforeseen costs with the start of the bed and breakfast, she wondered whether it is the best time to invest in the slides.

The next day, the Northcutts received a memo from Kip Mathis outlining the various entity options. They realized that they needed to act quickly to properly protect themselves from personal liability with regards to the bed and breakfast. The same day, Debra Smith called regarding the couple's email inquiry for a business loan. She indicated that she would need more information from the couple before they would qualify for the amount requested. Between the choice of entity decision, the renovation contract, Alex's proposal regarding the waterpark and items needed for the loan application, Peter and Ann know that they have a lot of decisions to make and a lot to do.

DUMB STARBUCKS: PARODY OR CLEVER MARKETING PLOY? A TEACHING CASE

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Lynn M. Forsythe, California State University
Deborah J. Kemp, California State University

CASE DESCRIPTION

The primary subject matter of this case concerns the legal environment of business, intellectual property, and business ethics. Secondary issues examined include the law of trademark, trade dress, fair use, and parody. Another secondary issue is whether the opening of Dumb Starbucks was an effective marketing technique to gain publicity for Nathan Fielder and/or Comedy Central*. The case has a difficulty level of three: it is appropriate for junior level students or higher. It can be used successfully with more advanced students. Faculty should expect a more sophisticated level of analysis from more advanced students. The case is designed to be taught in one class hour. Most students can prepare in two hours outside of class.*

CASE SYNOPSIS

In 2014 Nathan Fielder, a comedian, opened an establishment in Los Angeles that he called Dumb Starbucks. He used Starbucks' famous trademark and inserted "Dumb" in front of it. He also used a number of terms associated with Starbucks coffee shops. News media reported on the opening of Dumb Starbucks and Dumb Starbucks became famous. Dumb Starbucks was giving its drinks away for no charge. Some individuals reportedly waited three hours for a free drink from Dumb Starbucks. Fielder claimed that he can legally use the Starbucks' name and logo because he is making a parody of Starbucks. The case asks students to analyze whether Starbucks' name and logo are generally entitled to trademark protection. If they are entitled to trademark protection, does Fielder have an effective legal defense under fair use and/or parody. The case is ideal for student analysis since the case was not litigated. Dumb Starbucks was only open for a few days before the Los Angeles County Department of Public Health closed it down for failing to obtain the necessary permits.

DUMB STARBUCKS: PARODY OR CLEVER MARKETING PLOY? A TEACHING CASE

On February 7, 2014, Nathan Fielder, a comedian promoting his *Comedy Central* show *Nathan for You*, opened a business that looked alarmingly like a Starbucks coffee shop but was named "Dumb Starbucks." He asserted that he was able to open the shop since Dumb Starbucks was a *legal* parody "because it fulfilled the minimum requirements under US law" (Dumb Starbucks, 2014; Krantz, 2014).Dumb Starbucks was located in a strip mall in Los Feliz, CA, near Los Angeles (Schaefer, 2014a). Its logo was identical to the Starbucks logo, except the logo was preceded by the word "Dumb." Fielder's Frequently Asked Questions said it was not really a coffee shop, but "for legal reasons, Dumb Starbucks needs to be categorized as a work of parody art" (Frequently Asked Questions).

When customers entered the store, they found a Dumb Starbucks barista wearing the familiar green apron and a Dumb Starbucks baseball cap. Dumb Starbucks used the name, logo, menu, and color scheme of Starbucks. In the coffee section, customers could choose from among Dumb Brewed Coffee items such as Dumb Blonde Roast, Dumb Vanilla Blonde Roast, and Dumb Coffee Traveler. Drink selections in the Dumb Tea group included Dumb Chai Tea Latte and Dumb Chocolate Chai Tea Latte. The drinks came in 3 sizes: Dumb Tall, Dumb Venti, and Dumb Grande ('Dumb Starbucks'). The drinks were free (People are Waiting for Hours). Dumb Starbucks displayed pastries and music CDs, including Dumb Jazz Standards, Dumb Taste of Cuba, and Dumb Nora Jones (sic). It's unknown whether the pastries and music CDs were for sale or were free.

Nathan Fielder is a comedian, director, and writer from Vancouver, B.C. Fielder earned a Bachelor of Commerce degree in 2005 from the University of Victoria, then pursued his career in comedy (Devlin, 2014; Moore, 2013). He has written for a number of Canadian TV series (Nathan Fielder – IMDb). He writes and performs in *Nathan for You*, a *Comedy Central* series. In it, he advises businesses on "how to do everything better" (Moore, 2013). In the comedic reality show Fielder gives strange advice to small business owners, such as adding poo flavored frozen yogurt to the menu to get attention (Devlin, 2014; Moore, 2013). Fielder's Dumb Starbucks prank made headlines and was discussed on news programs and in newspapers. Fielder discussed the prank on *Jimmy Kimmel Live!* (Devlin, 2014).

A news source said Starbucks issued a press release that said in part, "We are obviously aware of the Dumb Starbucks location in Los Feliz. It is not affiliated with Starbucks. We are evaluating our next step. While we appreciate the humor of the store, they cannot use our name. It is a protected trademark" (Kurzwell, 2014).

Interestingly Viacom is the parent company for *Comedy Central*. Viacom has diligently pursued YouTube and others for violating its copyrights and very recently settled its seven-year lawsuit against YouTube (Google, Viacom Settle Lawsuit, 2014). Viacom's spokesperson said, "The episode relating to 'Dumb Starbucks' constitutes protected free expression. Viacom takes intellectual property rights seriously, and also recognizes the important constitutional protection afforded to expressive works characterized by social commentary" (Gardner, 2014).

The Los Angeles County Department of Public Health closed Mr. Fielder's store three days after it opened since it lacked necessary health permits (Schaefer, 2014b). Fielder has indicated that he plans to open a Dumb Starbucks in Brooklyn, NY (Clymer, 2014).

APPENDIX A

FREOUENTLY ASKED QUESTIONS

Is this a Starbucks?

No. Dumb S&atbucks oS not altUied ;,. eny way WJ1h S Corpo<a--. Wa ate aomply usong 1heir name ancl 1090 lor matllet ngpu<pOSeS.

How is that legal?

Short answer - parody law.

can you--?

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Okay.l thlnk I u.nc:tereta.nd now.

GteaL Anything elsa?

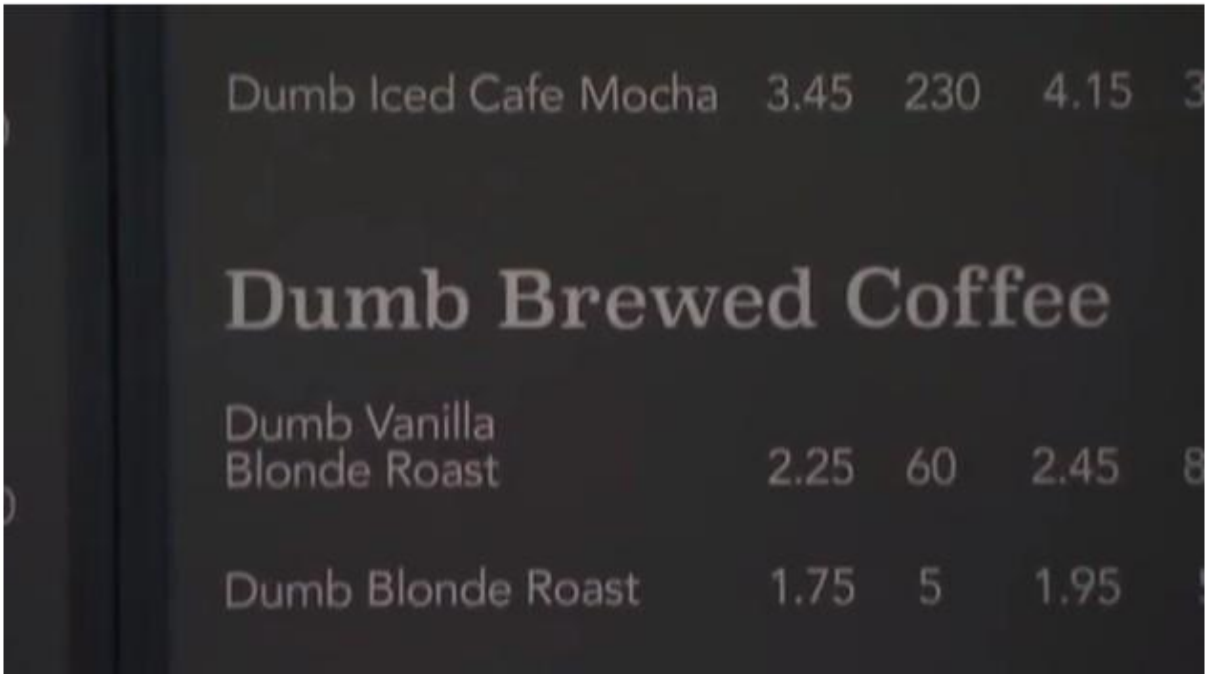
lgueaanoL

Okay thanks. See you laterl

For any other questions, please contact us at DumbStarbucks@gmail.com.

APPENDIX B

(Images fi·om Dumb Starbucks, Nathan Fielder explains the store's creation. Retrieved Febmary 28, 2014 fi·om http://www.youtube.com/watch?v=Bo deCOdlHU).


Dumb Iced Cafe Mocha 3.45 230 4.15
Dumb Brewed Coffee
Dumb Vanilla Blonde Roast 2.25 60 2.45
Dumb Blonde Roast 1.75 5 1.95


DUMB JAZZ STANDARDS
DUMB JAZZ STANDARDS
TASTE OF CUBA
DUMB NORA JONES "DUETS"

APPENDIX C

More About Starbucks

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EQUATORIAL GUINEA: THE KING'S CATTLE

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CASE DESCRIPTION

The project described in this case is the result of a political leader in a small, yet significantly petroleum rich African country, seeking to improve economic conditions and agricultural infrastructure for people in his country, Equatorial Guinea. The leader has hired a project director from Texas. As the project builds in momentum, an additional director steps in to assure that the cattle in the transaction meet required health standards and currency is exchanged based on appropriate United States currency value.

A small country and a large order of cattle create the setting that enables students to be able to apply knowledge of supply chain management on an international basis, develop an understanding of international trade and think beyond the immediate transaction and into customer relationship management (CRM).

CASE SYNOPSIS

A seasoned veteran of raising commercial cattle on the Texas Gulf Coast, Mavis Martin is somewhat of a fledgling to the world of registered Brahman cattle and their popularity throughout the world. She is the reporter in the case, learning as she goes with the help of a new friend, Harry Hudson. Through Harry, Mavis learns of the demand for Brahman cattle throughout the world, economic infrastructures that develop from agriculture, and how efficiently a large, international order for cattle can be filled.

The entire process of responding to the requests of a leader in a small, African nation may meet with failure unless creative thinking takes over and saves the transaction.

INTRODUCTION

What seems to be another, yet somewhat important, cattle show, presents a backdrop to a blend of international supply and demand of a breed of cattle that is perhaps the oldest breed known to civilization. The setting is in Dallas, Texas at the Pan American Brahman Cattle Show. Many ranches throughout the United States show Brahman cattle at this show.

Beef

As of January 1, 2015, there were 89.9 million cattle in the United States with Texas having the largest herds of cattle and calves with 11.8 million head. This number is up 1% from January 2014. The value of beef exports from the United States totaled $5.711 billion (2013), up from $3.839 billion in 2010. The top export markets are Japan, Canada, Mexico, and South Korea (Beef Industry Statistics, n.d.).

Over the last three years drought throughout parts of the United States, especially in Texas, urban expansion, and fewer young people returning to the ranch are driving forces in the downward trend in numbers of beef cattle. Research (David, n.d.) shows that many ranchers are using technologies such as embryo transport in order to address the challenges of exporting beef cattle during times when the number of cattle is declining (see Appendix A for additional information).

Equatorial Guinea

Slightly smaller than Maryland in the United States, Equatorial Guinea has been a constitutional democracy since 1991. Legislative elections in Equatorial Guinea have been constantly flawed and in question. The president of the country actually seized power in a coup, and exerts almost total political control over the country—much like that of a king. Equatorial Guinea has experienced rapid economic growth due to the discovery of large offshore oil reserves, and in the last decade has become Sub-Saharan Africa's third largest oil exporter. Despite the country's economic windfall from oil production, resulting in a massive increase in government revenue in recent years, improvements in the population's living standards have been slow to develop (The World Factbook, n.d.).

WHEN HARRY HELPS MAVIS

"Hey," Harry called out to Mavis, "I want you to meet someone who wants to buy cattle!"

Mavis Martin raised commercial cattle all her life, yet she was very new to the show circuit for American Brahman cattle. She was constantly surprised by how much she did not know about the very cattle that she grew up with on the salt grass pastures in Galveston County Texas. She and her father raised cattle on the range, then took them to the sale barn—that was the extent of their marketing activities.

So, when Harry Hudson called out to her about someone who is genuinely interested in buying show cattle, Mavis perked up.

"Harry, send them to our stalls, I want to talk with them. By the way, who are these people who want to buy Brahman cattle?" she queried.

"He says he's from Trophy Hunt, Texas. I think he's buying cattle for other people. Talk to him and find out. His name is Robert Rhine," and Harry trails off to his own cattle.

INTERNATIONAL VISITORS

A few minutes later several people come to Mavis' stalls, mentioned Harry as an introduction, and begin to talk about their mission.

"My name is Robert Rhine, and I am here with a few ambassadors for the country of Equatorial Guinea. We want to purchase American Brahman cattle to improve the local cattle in their country," Robert continues as he gestures toward the entourage of people accompanying him. "May I introduce Nancy Tames, her husband Jose and the consulate, Fernaso Vila, from Houston representing Equatorial Guinea," Robert concluded the introductions and continued, "The strategy of importing the American Brahman cattle is designed to make the best of genetic-environmental interaction. The Texas adapted genetic strategies would carry to Equatorial Guinea longitudinal improvement of their current beef cattle. The adapted cattle would be able to cope with the environment and improve both body type and milking levels."

Mavis was impressed by the introductions as she began to sort through the new names. She quickly determined that Robert Rhine was definitely the person from Trophy Hunt, Texas that Harry had mentioned earlier. She could only wonder why he was escorting these people from Africa around the National Show to buy cattle to ship to Africa. “Why didn’t he just go to some of the ranches?” she wonders.

Robert Rhine continues, “Harry mentioned that you have Brahman cattle for sale. Please tell us about them, how many do you have to sell, and if you do, then how much are they?”

Somewhat hesitant, Mavis replies, “I am just getting started in this registered Brahman business, I have a bull for sale, that one over there.”

She pointed in the general direction of the bull in the last stall, and said, “I will take $5,000 US for him today.”

Robert and the people with him looked puzzled, he replies, “Oh, he is not nearly enough, we are seeking to buy 3,000 head of Red Brahman, 2-year-old heifers.”

“Wow,” Mavis thought, “Why did Harry even send him to me. So much the kidder, Harry probably wanted to have a laugh at my expense,” Mavis digests the situation so that she could get back to Harry.

Finally, Mavis replies to Robert, “Well, the bull is the only animal I have to sell. I’m glad to meet you folks, but it appears that we have no further business to tend to today.”

Robert thanks her for her time, they part with, “Glad to meet you,” and continue strolling through the stalls of Brahman cattle.

SO MANY CATTLE SO FAR AWAY

Mavis remained curious about the whole situation, intrigued by the idea that somehow 3,000 head of two-year-old Brahman heifers would be traveling to West Africa within the year.

She knew that she had to use this opportunity to learn more about these exotic cattle and the world’s demand for them.

To settle the score with Harry, Mavis goes directly to his stalls. “What do you mean sending those people to talk to me about buying 3,000 head of heifers?! Harry, you were wasting our time. Really? Is this the way you break in the new comers like me to the show circuit?” Mavis questions.

Harry chuckles a bit, then replies, “Well, it’s gonna take a lot of us to fill that order. If this guy is serious, then we will all need to plan how to get that order filled and those cattle delivered. We’re talkin’ about a lot of money here. Think about it. He is talking about spending $5,000 per head for 3,000 head. Do the math. Everyone here will want a piece of the action.”

“Yeah, I wish I had at least one red heifer to sell, but I am totally raising greys. The size of the order and the amount of money and transportation challenges intrigue me. I want to stay in the loop just to learn more about these cattle and how they travel.”

“I’ll keep you posted,” Harry says as Mavis walks back to her stalls.

THE DEVIL’S IN THE DETAILS

As the Pan American Brahman Show concludes, several ranchers from Texas, Louisiana, Mississippi, and Alabama complete preliminary plans for the project, they now call “The Red Heifers to Africa Project” (RHAP) that Robert Rhine is directing for the African leader. Mavis learns that the project will be orchestrated by Lydia and Noel Vego, owners of a Red Brahman ranch with headquarters in Venezuela and a location in South Central Texas. When the cash transfer for the 3,000 Red Brahman heifers is complete in United States dollars, Lydia will notify each rancher to prepare health papers for all the cattle to be included in the project.

When a specific ship is about two days away from docking at the Port of Houston, Lydia will notify all the ranchers involved to transport their cattle to her ranch in Texas.

Throughout the southern United States, cattle would then be transported by truck and trailers to Lydia and Noel's ranch in Texas.

From their ranch, after all the health papers are checked, the cattle will be shipped via railcar to the Port of Houston. At the port, the cattle will be loaded on board the ship. They will travel through the Gulf of Mexico and across the Atlantic Ocean to the port at Malabo, Equatorial Guinea.

Only one person stood in the way of the transaction taking place as described, Johnny Hughes. Over the 40 plus years of raising and judging Brahman cattle, Johnny is very well-traveled and has spent time in Equatorial Guinea. He spoke to the ranchers, including Lydia, just before money and papers started being transferred. "Before we leave Dallas today, we all need to consider how to make the RHAP successful." Johnny continues, "Let us suppose that all the 3,000 Red Brahman heifers arrive at the Port of Malabo alive. Only about 60% of them will survive in that country—in about two months they will succumb to all the native cattle diseases there. That country is hot and humid all year long—nothing kills out any disease carrying insects there. Do we want to set ourselves and the king up for failure?"

One rancher voices, "Well, if we have their money, what will we care?"

Johnny replies, "This is bigger than just you selling some individual a cow. This sale is large enough to get attention from our buyers in Brazil and Australia. They need to be assured that we stand behind our transactions. We must think beyond just the sale. We want to continue doing business with these people."

Another rancher speaks up, "Well, how will we fill this order? This is just too much money to leave on the table. If we don't sell to them, then they may go to Brazil or Australia to fill the order."

Mavis listens intently as she tries to take in all the information that she needs to know as she contemplates her future in the international cattle business. Back when life was simpler, she and her dad never really thought about the cattle they sold after the sale other than the cattle were headed to feedlots in South Texas and that was that.

Thinking beyond the sale and always keeping an international presence seems to be a demanding dimension of the cattle business. Keeping a ready market for United States beef is something that every beef rancher thinks about now. The idea of staying on the good side of the customer is becoming first and foremost to many in the business.

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APPENDIX A.

An Excerpt from "Embryo Transfer in Beef Cattle" by Dr. Roger L. Davis DVM

Retrieved from http://www.davis-rairdan.com/embryo-transfer.htm on June 24, 2015

Embryo Export:

Embryos are an efficient, cost effective and safe way to move genetics throughout the world. Thanks to cutting edge research, embryos that are processed according to the International Embryo Transfer Society (IETS) standards by certified and accredited embryo transfer practitioners can be exported to most countries around the world. IETS washed embryos pose zero risk for the transmission of any known disease, including BSE and foot and mouth. The washing of the embryos with outer shells (zona pellucida) that are intact with an enzyme called trypsin, removes any potential viral and / or bacterial agents. Only embryos that are processed in approved laboratories (mobile or fixed) by ET practitioners that are CETA certified and approved by CFIA can be exported. I recommend that all embryos be washed by approved ET teams to ensure that they will qualify for future export in case markets become available in the future. To maintain export status, the embryos must be stored under the direct supervision of an approved ET practitioner. Embryos stored on farm with your semen will lose their qualification.

If embryos are produced for a specific market, you should have your ET practitioner check on specific requirements such as donor testing and special semen qualification. Although most countries accept washed embryos, some such as China, Russia, New Zealand, Australia and Japan have additional requirements.

Marketing features of exporting embryos to foreign countries compared to live cattle include:

- Economic means of transporting genetics versus live animals on planes
- Zero risk for disease transmission
- Rarely subject to health restrictions due to disease outbreaks (BSE)
- Offspring adapt better to new environments when born and raised there
- Offspring born with immunity to local disease (from recipient)
- Buyer can purchase genetics from elite cow that are not for sale
- Improved technology world-wide means good results

Marketing Tips:

- Get good quality photos of all potential donor cows on pasture when lactating (preferably not a dry fat cow)
- Write a short history and production record for each cow including EPD's
- Qualify embryos for export even if not exporting and keep them stored correctly to maintain status
- Keep a listing of embryo inventory and qualifications
- Post your donor(s) on your website if you have one.

PALACE FURNITURE

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CASE DESCRIPTION

"Palace Furniture" is a fictional teaching case based on one of the author's experience with furniture stores in the United Arab Emirates (UAE). The case has several unique characteristics that make it a valuable teaching tool for an introductory course in Management Information Systems (MIS): first, it exposes students to typical problems in an emerging economy; second, the case gives students a small introduction into the culture, economic environment, and business practices of the Persian Gulf states; third, the case highlights some of the most important concepts of an introductory course in MIS; fourth, the case is fairly short; finally, the case is written in simple English – this makes it appropriate for business schools outside of the United States (particularly, business schools in the Middle East), where a majority of students may have English as a second or even third language. While fictional case studies may lack realism, they can be tightly aligned with the teaching objectives of a course (Phillips, 1995). Thus, the case can be used both in class and as a part of a homework assignment to introduce students to core MIS concepts.

CASE SYNOPSIS

In 1962, Saeed Al Shamsi, a carpenter from Yemen, migrated with his family to Abu Dhabi. In Abu Dhabi, Saeed opened a small woodworking shop, where he produced and sold various wooden items, such as boxes for storing dates, chests, well covers, benches, etc. In the mid 1970s, Ahmed, Saeed's oldest son, assumed the responsibility of running his father's shop. By the mid-1990s, Ahmed transformed his father's company into a successful multi-million luxury furniture producer with more than 30 employees. While Palace Furniture had enjoyed a steady and impressive growth since its inception, the company's profitability began to decline in the late 1990s. Unable to find a solid plan for revitalizing the company, Ahmed decided to transfer the responsibility of running the company to his younger brother – Yousif.

Yousif Al Shamsi, a graduate of a prestigious MBA program in the UK, assumed the role of the CEO of Palace Furniture in 2002. In an attempt to minimize costs, gain access to expertise generally lacking in Abu Dhabi, and increase the client base, Yousif decided to spread out operations across several locations. The company's headquarters in Abu Dhabi hosted the business functions of Sales & Marketing, Human Resources, and Finance & Accounting. The company's Production & Operations function was spread across two offices: a design office in Dubai and a production facility in Al Ain. In addition to that, Yousif decided to open showrooms in neighboring Emirates: Dubai and Sharjah. Finally, furniture deliver was outsourced to a third party. These changes resulted in lack of coordination across the company. This undermined customer services –obviously unacceptable given the company's premium pricing and a target *market consisting of upscale clientele. Overall, with all these reorganizations, the company lost something very important to its identity and business.*

THE EARLY DAYS OF PALACE FURNITURE

The history Palace Furniture began in the early 1960s. In 1962, Saeed Al Shamsi, a carpenter from Yemen, migrated with his family to what was known at that time as Trucial States – a group of sheikhdoms on the coast of the Persian Gulf under the British protectorate. Saeed's family at that time consisted of his wife Fatima and his first-born son, Ahmed. Searching for work, Saeed eventually settled in Abu Dhabi – at the time, still a small town located on an island off the coast of the Persian Gulf. In 1950s, oil was discovered in the area and in 1962 the first crude oil export was shipped out of Abu Dhabi. By early 1960s Abu Dhabi emerged as a rapidly developing oil town, attracting migrant workers from the area as well as from Asia, Europe and North America. In Abu Dhabi, Saeed opened a small woodworking shop, where he produced and sold various wooden items, such as boxes for storing dates, chests, well covers, benches, etc. As the emirate of Abu Dhabi grew so too did Saeed's business. By late 1960s Saeed had three carpenters from India working for him. Saeed was very happy with his employees and treated them like family: they lived and dined in an extension attached to the main part of Saeed's own house. With his own hands now freed by his employees, Saeed concentrated on daily management of the shop and finding new clients. The business kept growing and Saeed took pride in being able to earn a comfortable living for his family which now comprised his wife Fatima, his oldest child and only son Ahmed, and three daughters: Hind, Mediayh, and Mariam.

AHMED ENTERS THE FURNITURE BUSINESS

Starting in the mid 1970s, Ahmed, Saeed's oldest son, began assisting his father in the shop. Over time, Ahmed took a more active role in his father's business, replacing him in the shop when Saeed had to attend for personal or business matters in town. Saeed took comfort in the thought that Ahmed would soon become a good replacement for him in the family business. Sometime in the late 1970s, Saeed decided to transfer the full responsibility of running the shop to Ahmed. Having spent most of his life in the harsh desert climate, Saeed began to develop health problems. Moreover, Saeed and his wife Fatima were recently blessed with their second son, Yousif. Yousif was born when Ahmed was already twenty-one years old. Because of these new developments in his life, Saeed soon decided to retire so as to have more time to spend with his family. Ahmed now assumed the full responsibility of running the shop and, thus, supporting his family. In the same year, Ahmed got married and had his first child.

Driven partially by ambition and partially by the need to support his growing family, Ahmed began to seek opportunities to grow his father's business. An opportunity emerged soon. With the growth of oil exports out of the United Arab Emirates, the standard of living of a formerly nomadic population had improved and became more settled. Beach huts woven from palm leaves and desert tents made from camel wool were being replaced with modern, spacious, air-conditioned houses that now required furniture. Ahmed quickly took advantage of this opportunity by hiring additional staff with knowledge in furniture design and production from nearby India. By the early 1980s, Ahmed's company was producing a variety of home furniture in accordance with the tastes of an increasingly well-off Emirati population.

Eventually, local traders began importing furniture from nearby India and Pakistan as well as some European countries. Absence of any significant tariffs, a cornerstone of economic development of the UAE at that time, made this business quickly pofitable. But the importers were of little threat to Ahmed's company. Very early in his career Ahmed realized that the key to business success was establishing and maintaining good personal relationships with clients. Ahmed, who inherited his father's friendly and outgoing personality, was very good at establishing personal relationships with clients, listening to their needs and making sure they got the exact furniture that they wanted. Ahmed was more than happy to modify a particular piece of furniture or even build a custom piece from scratch if his client so desired. Ahmed's furniture business quickly acquired a good reputation among his wealthy clientele for being able to produce quality and elegant furniture in accordance to customer specifications. A number of prominent families in Abu Dhabi became his loyal clients. To reflect this focus on producing custom luxury furniture for upscale clientele, Ahmed decided to name the company founded by his father "Palace Furniture".

By the mid-1990s, Palace Furniture was a multi-million enterprise with more than 30 employees, all still located in Abu Dhabi - now the booming capital of the oil-rich United Arab Emirates (UAE) and the second-largest emirate after Dubai. The company targeted wealthy UAE nationals whose needs and tastes with respect to home furnishing could not be satisfied by the UAE's emerging furniture industry. Exceptional quality, exclusive design, and personal attention that the clients found at Palace Furniture together with the UAE's rapid economic growth resulted in an ever increasing stream of upscale clients for the company. Unfortunately, Saeed Al Shamsi, the founder of the company and the patriarch of the family, did not live to witness Ahmed's success. He died shortly after retirement, in 1982.

DECLINING PROFITABILITY IN LATE 1990S

While Palace Furniture had enjoyed a steady and impressive growth since its inception, the company's profitability began to decline in the late 1990s (see Table 1). The 1997 Asian Crisis had a noticeable impact on UAE's oil revenues, creating a ripple effect across the economy. Moreover, numerous furniture stores opened throughout the UAE by that time. The growing competition made it hard for Palace Furniture to attract and retain clients. As opposed to placing an order for custom furniture and paying a premium, a client could find a suitable piece of furniture in one of the regular furniture stores in the UAE. Moreover, as the UAE has become more integrated into the global community, it became easier and cheaper for the UAE residents to order luxury furniture from Europe and Asia.

Table 1
PALACE FURNITURE
Income Statement: 1997-2004

(In millions of AED)	1997	1998	1999	2000	2001	2002	2003	2004
Revenue	45	39.21	37.78	36.94	35.01	33.09	32.64	31.32
Cost of Revenue	34.06	33.92	31.89	33.17	32.89	31.76	30.03	28.09
Gross Profit	10.94	5.29	5.89	3.77	2.12	1.33	2.61	3.23
SG&A Expenses	6.88	6.63	6.71	6.51	6.35	6.1	6.2	6.4
Other Operating Expenses	0	0	1.04	0.98	0	0.41	0.67	0.34
Total Operating Expense	6.88	6.63	7.75	7.49	6.35	6.51	6.87	6.74
Net Income (Loss)	4.06	(1.34)	(1.86)	(3.72)	(4.23)	(5.18)	(4.26)	(3.51)

YOUSIF BECOMES THE NEW CEO

Ahmed knew something had to be done to keep his business. Unable to find a solid plan for revitalizing the company, Ahmed decided that it was now time to transfer the responsibility of running the company to his younger brother – Yousif. In 2000 Yousif Al Shamsi graduated from a top MBA program in London and accepted a job offer from a leading European retailer. Ahmed himself, despite his late father's wishes, did not receive any formal education. He was only taught how to read and write in Arabic and from instructions in Quran from a local imam. Ahmed thought that his brother Yousif, being young, educated, and knowledgeable in the latest Western management practices, would be in a good position to revive the company and set it on a path of continuous growth. Yousif did not like the idea of leaving behind his lucrative career and comfortable lifestyle in London. But he felt obliged to honor his older brother's request, especially since the wellbeing of the entire Al Shamsi family depended on this. In 2002 Yousif returned to the UAE and assumed the role of CEO of Palace Furniture. Ahmed remained with the company in the role of a Chairman, playing a somewhat passive advisory role.

YOUSIF CHANGES THE BUSINESS MODEL OF PALACE FURNITURE

In an attempt to strengthen Palace Furniture's competitiveness and profitability, Yousif Al Shamsi, the new CEO of Palace Furniture, implemented a number of changes to the company's business model by 2004. These changes were fully backed by Ahmed. In an attempt to minimize costs, gain access to expertise generally lacking in Abu Dhabi, and increase the client base, Yousif decided to spread out operations across several locations.

The company's headquarters in Abu Dhabi would host the business functions of Sales & Marketing, Human Resources, and Finance & Accounting. The company's Production & Operations function was spread across two offices: a design office in Dubai and a production facility in Al Ain. Yousif believed that if Palace Furniture was to maintain its reputation for exclusive design and top quality, the design function had to be relocated to Dubai, where Palace Furniture would have better access to design and engineering talent. Yousif's youngest sister, Mariam, was put in charge of the Dubai office. Mariam, a graduate from an interior design program at a local university and the family's "fashion guru", was very keen to take on this new role.

Moreover, Yousif decided to move production facilities to Al Ain, the third most populous city in the UAE after Dubai and Abu Dhabi. The main factor behind this decision was cost. While Al Ain is close to Abu Dhabi and Dubai (only 150 km from both cities), land, labor and other factors of production were considerably cheaper in Al Ain. The recent construction boom in Dubai and Abu Dhabi had made land and labor considerably more expensive in the two cities. In addition to that, Yousif decided to outsource furniture delivery to a transportation company Mehmood's Trucks, LLC, believing that this will allow Palace Furniture to reduce costs and offer faster delivery.

Finally, Yousif decided to open showrooms in neighboring Emirates: Dubai and Sharjah. These showrooms were meant to advertise products of Palace Furniture and allow residents of these two emirates to place orders for custom luxury furniture at a location close to their homes. These showrooms were intended to help Palace Furniture to grow its customer base and, consequently, its branding and revenues.

THE NEW BUSINESS MODEL CREATES PROBLEMS

Relocation of company's offices and outsourcing of the delivery function helped Palace Furniture reduce operating costs and gain access to the necessary design talent, but Yousif quickly realized that the changes resulted in lack of coordination across the company. This undermined customer services –obviously unacceptable given the company's premium pricing and a target market consisting of upscale clientele expecting nothing short of royal treatment.

Lengthy Ordering Procedure

Under the new arrangement, the company's showrooms in Abu Dhabi, Dubai, and Sharjah accepted orders for custom furniture from clients. During the initial store visit, store sales associates helped clients specify the kind of furniture to order. Clients' answers to questions regarding the type of furniture, preferred design, dimensions, color, materials, etc an initial specification were then used to develop the initial specification. Store associates passed these on to the company's design office in Dubai. The customer was asked to pay a fee for the design work. The Dubai office employed professional furniture designers. Based on the initial specifications received from the store sales associates, designers would produce a detailed blueprint together with a 3D model for the furniture using a Computer Aided Design (CAD) application developed specifically for furniture design. The design would be e-mailed back to the store sales associates as well as the company's Accounting & Finance function in Abu Dhabi. The Accounting & Finance department would estimate the price for the order and email an invoice to the store associates who had accepted the order. Upon receiving the design from the Dubai office and invoice from the Accounting & Finance department, the store associates would contact the client and invite him or her to come to the showroom again. During this second visit, the client would be presented with a 3D model of the furniture piece he or she had initially specified as well as the final invoice. If the client liked the design and was happy with the price, he or she would be asked to complete the payment for the order. If the client wanted to change the specifications, he or she would be charged another design fee and the whole process would be repeated. On average, Palace Furniture clients had to visit a showroom three times before an order was finalized. After receiving the payment, the store associates e-mailed the agreed-upon design to the company's production facilities in Al Ain. It took approximately 2-3 weeks for Al Ain production facilities to produce the furniture. Then it took up to two weeks to deliver the furniture from Al Ain to the client's location. Many clients found the ordering procedure to be quite lengthy and inconvenient.

Problems in Customer Support

The company's upscale clients were particularly unhappy with after-sale service. When a client called the company's customer support located in Abu Dhabi, it could take a few days for customer support associates to get back to the client regarding his or her inquiry. Sometimes no one got back at all. The client had to call the customer support number again and again to get his or her question answered. Because of this, many clients would cancel orders and request refunds.

Several factors were behind the inefficient and often frustrating customer service. Responding to a customer order status inquiry required a customer support associate to use phone or email to communicate with several offices, such as the main office in Abu Dhabi, the design office in Dubai, the production facility in Al Ain, or the delivery company. Each of Palace Furniture's offices used a separate Microsoft Access database to store data. While the technology was adequate to store business data for each of the offices, several factors made cross-functional communication inefficient. In order to respond to a customer support representative question, an employee in one of the offices had to consult a database or open a design file and check information regarding a particular order. Since each of the offices used a separate database, problems with data consistency often arose. Every office used its own system for client IDs. Moreover, since the databases were maintained in English, sometimes client names were transliterated from Arabic in different ways in every database. Therefore, it often took a significant amount of time just to determine which record had to be retrieved from the database. To make things worse, some of the employees at Palace Furniture lacked IT literacy. Such tasks as updating a database, retrieving information from a database, or sending a file as an attachment were problematic for some employees. This was a result of the company's decision to minimize costs by staffing its customer support unit with recent graduates who lacked experience or whose qualifications did not match the job. High turnover in the company and, particularly in the customer support unit, made the problems in customer support even worse. The average employee at Palace Furniture had been with the company for about 2 years and, overall, the organization was somewhat understaffed. This was quite typical in the UAE at that time. In the UAE's rapidly growing economy new opportunities lured people into changing jobs quite often. Moreover, most of the labor force at Palace Furniture was brought from abroad. Thus, it took a long time for a new hire to become familiar with organizational processes at Palace Furniture and to get accustomed to the overall business culture in the UAE. All these issue often left clients wondering whether "anybody knew anything" at Palace Furniture.

Order Delivery

Once furniture had been produced at the company's Al Ain factory, it was delivered to a client location by the third-party logistics provider. Despite the fact that Palace Furniture had the client's "address" on file, a truck driver would typically call the client to ask for directions. Many of the drivers were brought from Pakistan and could not speak Arabic or English well. Many Emirati clients had problems expressing themselves in English, especially the older generation. Moreover, UAE, like many countries in the region, did not have a standard system for street addresses. This required the client to identify delivery locations by using building names and referring to landmarks. Thus, giving directions was often a very complicated and nerve-wrecking procedure full of misunderstandings and errors on both sides. When the furniture was delivered, the client would often discover that a wrong piece of furniture was delivered or something was missing. If this happened, the truck driver would usually tell the client to call Palace Furniture customer service, as he did not have any responsibility for the content of the delivery.

AHMED AND YOUSIF'S CONVERSATION AT THE WEDDING

In the summer of 2004 Ahmed Al Shamsi, the Chairman of Palace Furniture, organized a wedding reception for his oldest daughter. The reception was held at one of Abu Dhabi's "five-star" hotels on Abu Dhabi's sea-side Corniche Road. The reception was attended by hundreds of relatives, friends, co-workers, and business partners from across the Gulf Region and beyond. CEO Yousif went to the wedding reception from his office in Abu Dhabi. By that time, Yousif had been the CEO of Palace Furniture for almost two years. While the changes to the business model that he proposed and quickly implemented had proven to be quite effective in reducing costs and improving furniture design and quality, the company had started to lose some of its most loyal and valuable clients. One of those clients, an influential family from Abu Dhabi, just that week had cancelled a multi-million order for furnishing a newly built villa in Fujerah – one of the country's northern emirates known for its scenic mountain views and beaches. Yousif had spent the entire day trying to find out what happened with this order and what could be done to win the contract back from a client that had worked with his company since the time Ahmed became in charge of the company. Yousif did not even have time to go back home to shower and change clothing – he went to the wedding reception wearing the same kandura (a traditional male dress in the Persian Gulf region) he wore in the morning. While he was very happy for his niece and delighted to see numerous relatives and friends at the wedding, Yousif was still disturbed by the loss of this important client. .

Ahmed, standing at the entrance to the reception hall to greet guests and receive congratulation, immediately spotted that something was wrong with Yousif. Ahmed took Yousif aside, and hugged him with a warm smile. Yousif congratulated his brother on having his daughter married to such a fine young man from a family they both knew and respected. Suspecting that work was the reason behind Yousif's bad mood, Ahmed decided to cheer up Yousif a bit:

"My dear brother, the whole family is very proud of your accomplishments at Palace Furniture! Our father was right when he said that all of us would be proud of you one day. I wish he was here with us to see how big his family has become and to rejoice in your achievements".

Yousif replied, "Thank you dear brother for your guidance and constant support!"

Yousif looked at his brother for a second, as if he was contemplating whether it was the right time to say this or not. But Yousif could not hold this inside anymore,

"You know, Ahmed, Al Zaabi family cancelled that order I told you about; they didn't explain anything! I spent the whole day trying to find out what happened and what could be done to undo the damage, but to no avail."

Ahmed looked at his brother closely, realizing he was right about the state Yousif was in.

"Don't worry about this, my dear," said Ahmed, "it's all in the hands of Allah".

"I understand, Ahmed", Yousif replied. "But I still feel bad about this whole situation. I know you worked with them for many years. I don't know who talked to them and when, but I really need to find out what happened and why they cancelled their order," Yousif continued. "Somebody in the office told me they didn't like the way they were treated by one of our sales associates, but this is just a rumor".

Yousif looked at Ahmed. Ahmed's face, while still warm and smiling, had a slight shade of concern. Ahmed was thinking about the situation and was trying to find the right words for Yousif:

"You know, I think we disparately need a CRM," proposed Yousif.

"A CRM?", Ahmed asked.

Ahmed did not know what a CRM was. While he was not ashamed to admit his ignorance, he did not want to say anything that would discourage Yousif even further.

"Yousif, I would support you in everything that you do and you know that", Ahmed quickly added. "I will go and visit Al Zaabi's next week, Inshallah",

"To talk about this order?" A note of hope could be heard in Yousif's voice.

"Why talk about this order? I just want to see Mohammed Al Zaabi, an old friend of mine. I haven't talked to him in a long time!" said Ahmed with a cheerful voice, as if he was talking about something very pleasant.

"Well, let's talk about this some other time, let's celebrate now!" said Ahmed, ending the conversation.

Ahmed hugged and kissed his brother one more time and walked away towards the guests that were entering the reception hall. Ahmed had a mixed feeling after the conversation. He loved his brother very much and he had a lot of confidence in his abilities to lead the company. Yet he felt that with Yousif becoming the CEO and the company becoming so big and geographically dispersed something important was lost. He did not know what exactly was missing. But one thing was clear: it was not the same company he and his father created.

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THE CATAWBA NATION: GAMING AND ECONOMIC DEVELOPMENT

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CASE DESCRIPTION

The primary subject matter for this case is strategic management. Secondary issues examined include business and society, economic development, and public policy. The case has a difficulty level appropriate for senior level courses. The case is designed to be taught in one class session equivalent to one and a half hours (specifically if an assigned group of students does a 20-30 minute presentation of their analysis and recommendation and the rest of the period is spent for discussion (through question and answer)). It is expected to require between four and six hours of outside preparation by students.

CASE SYNOPSIS

Native American tribes have had to strategically seek out economic development opportunities in order to support their existence over time. Many of these groups have faced great adversity and have had success in developing profitable gaming and casino operations that benefit the tribe as a whole. In this case study, we examine the plight of the Catawba Indians and their interest in pursuing a gaming strategy within the states of North and South Carolina. However, the case also illustrates that the Catawbas faced several barriers to entry in pursuing this strategy that presented significant obstacles to be overcome.

INTRODUCTION

Despite the decimation of the Catawba tribe to small pox, the cessation of its homelands to the state of South Carolina, the lack of consistent recognition by the federal government, alleged corruption among its past leadership, and its ongoing economic struggles, the Catawba Indian Nation has managed to maintain its presence and even grow within the state of South Carolina. At one time, the tribe even had a successful gaming operation that generated significant revenues. However, in 2006, the bingo hall was closed.

The tribe was now studying new initiatives for economic development and a gaming strategy was back in the consideration set. Bill Harris, Chief of the Catawba Nation, was concerned. There were many barriers to entry in pursuing this strategy that the tribe would have to overcome before they would be able to create a casino business that had potential to generate substantial profits. He wondered if the tribe was ready for yet another battle for its survival.

GROWTH OF THE CATAWBA NATION

The first royal colony in the Carolinas was established in 1670. As the area began to see prosperity, more English settlers entered the region in the late 1600s. At the time, the Carolina region was already populated with several Native American tribes, one of which was the Catawba Indian Nation. The Catawba Indians were considered one of the most powerful tribes in the Southeast and it was estimated that in 1682, the population of the Catawba tribe was approximately 4,600 (Brown, 1966).

Although fierce warriors, the early Catawbas were sedentary agriculturalists. Their sustenance was derived from hunting, fishing and farming along the Catawba River in South Carolina. The tribe was in constant war with neighboring Native American groups, especially the Cherokee. However, the Catawba took a peaceful stance toward the English settlers that streamed into the region.

In 1712, the Carolina region was formally divided into two colonies, which was the beginning of North and South Carolina. In the 1700s, the Catawbas began to trade extensively with the growing number of settlers, exchanging animal skins for knives, guns, kettles, and cloth. These trade routes resulted in economic strength for the Catawbas, however, contact with European settlers also led to many tribal members contracting small pox. The sickness caused their numbers to slowly dwindle. By 1826, the Catawba tribe had a population of 110 people. And in 1840, the tribe ceded its homelands (approximately 144,000 acres or 15 square miles) to the state of South Carolina in a treaty, which was never ratified by the federal government (Christie, 2000).

In the early 1930s, the federal government began to concentrate on improving the living conditions of Native Americans throughout the United States. Congress passed the Indian Reorganization Act in 1934 that encouraged Native American groups to improve upon their government structures, but the Catawbas did not benefit from this legislation because they were not formally recognized as a tribe beyond the state level. The Chief of the Catawbas at the time, Samuel Taylor Blue, began the legal paperwork to gain federal recognition and the tribe gained formal recognition with the federal government in 1941. However, in the 1950s, the federal government identified a set of tribes that it deemed ready for assimilation into the larger culture. The Catawbas were one of the identified tribes and, thus, the relationship between the Catawbas and the federal government was "terminated" in 1959. This termination meant that the tribe no longer received any federal benefits, their collective assets were divided, and they were now subject to state law. However, the Catawba people maintained their tribal organization and in 1973 they re-applied to be formally recognized by the federal government.

Throughout the 1980s and early 1990s, the Catawbas filed several lawsuits against the federal government and state of South Carolina for the illegal loss of their homelands via the 1840 treaty that was never ratified by the federal government. In 1993, the federal government reversed its 1959 termination of its relationship with the Catawbas and granted the tribe federal recognition. The Catawba Indian Nation became one of 566 federally recognized American Indian and Alaska Native tribes and villages. Federally recognized tribes have a government-to-government relationship with the United States, possess certain inherent rights of self-government, and are eligible for funding, services, and protections provided by the Bureau of Indian Affairs (Bureau of Indian Affairs, 2013). Along with receiving federal recognition, the state of South Carolina settled the Catawba's land claim suits for $50 million. With this settlement from the state, a formal agreement was signed between the Catawbas and the state ofSouth Carolina limiting the sovereignty that the tribe as compared to other federally recognized tribes. The settlement agreement limits the tribe's ability to govern itself and limits economic growth. After paying attorney fees, the remaining settlement was to go towards economic development, social services, education, per capita for tribal members and land acquisition for the Catawba Nation (Elkins, 2012).

Despite the tribe's difficulties, the Catawba population began to slowly recover over time. By 2013, the number of Catawba Indians was 2,833 people, spread throughout South Carolina, Colorado, Oklahoma, and New Mexico. The largest collection of Catawbas, approximately 1,000 people, was on a 640-acre reservation in Rock Hill, South Carolina. Rock Hill was approximately 25 miles south of Charlotte, North Carolina.

THE TRIBE IN 2013

On the reservation in Rock Hill, the Catawbas had their own pre-kindergarten program, environmental department, social services, senior program and housing program. The tribe also offered other services to members on the reservation, such as dental and health care, job placement services, resume writing, and small business development. The members of the tribe wanted also to add their own police force, justice system, and a school in the future.

While some of the Catawba culture had been lost over time, the tribe had managed to maintain two important cultural traditions among its members. Early Catawba women were potters and more than 50 tribe members, both men and women, have maintained the tradition to the present day. Catawba pottery is thought to be the "oldest clay-based art form east of the Mississippi" (Blumer, 2003). Old time South Carolinians have claimed that certain foods, such as okra soup, cannot be adequately prepared without using a Catawba pot (Zug, 1986). The reservation also had a cultural preservation center that featured its pottery.

A second cultural tradition that has lasted among the Catawba Nation is its tribal governance structure, which was based on a General Council. The Catawba's General Council consisted of all adult men and women tribe members, who were given an equal voice in tribal affairs, similar to a Greek democracy. Any tribe member who was present at a General Council meeting was allowed to stand and address the council with any concerns or issues he/she wanted discussed (Blumer, 2003).

While the General Council has existed over time, it has not always been a utopic form of governance for the Catawbas. Gilbert Blue was elected in 1976 to serve as the Chief and the General Council voted to suspend the constitutional requirement for elections while the land settlement was being negotiated. After the land settlement was finalized and government operations commenced, the people felt that it was time to resume elections. When elections did not take place, members of the tribe alleged that his administration did not run the Catawba Nation according to its democratic, tribal traditions. Information and activities conducted by the administration of Chief Blue were not disclosed to the General Council. Grant monies and the 1993 settlement funds did little to benefit the daily lives of tribe members and funds were squandered or misappropriated. Some had even claimed that Chief Blue denied General Council members the right to gather for public assembly in buildings on tribal lands. Others have stated that Chief Blue and his administration discouraged tribal members from expressing dissent and voting against him by threatening them with the loss of their job or loss of housing on the reservation (Blumer, 2003).

Chief Blue resigned in 2007 and Donald Rodgers was elected to chief. Chief Rodgers' helped rebuild the tribal government and reestablish federal grants and contracts with the Bureau of Indian Affairs; however, his tenure was not without controversy. The General Council voted to suspend Rodgers after a petition was put forward which alleged that he received pay raises and used tribal funds to pay for health benefits for him and his family without the general council's approval (Self, 2010). And yet, the petition was later dropped when more information was presented to the General Council.

In 2011, Bill Harris was elected Chief along with four new Executive Committee members and they wanted to put the Catawba people first. Part of their mission was to pursue economic development in order to improve the quality of life for the Catawbas. When Chief Harris took over his leadership role, the per capita income of the Catawbas was estimated to be \$11,096 and the unemployment rate among tribal members was estimated to be approximately 45% (Collins, 2013; Bureau of Indian Affairs, 2005). Chief Harris believed the historical trend of these economic indicators held today. Harris and his administration started out by commissioning several studies in an effort to identify economic opportunities for the Catawba Nation. One of the studies pointed to casinos as a viable strategy that had been successful for other Native American tribes, such as the Seminole and Miccosukee nations in Florida. The Seminoles currently had three casinos and used the profits to diversify into the restaurant business (by buying the Hard Rock Café chain). The Miccosukees utilized profits from their slot machine and bingo operations to sponsor a NASCAR team and professional golf tournaments (Worthington, 2013).

ECONOMIC DEVELOPMENT

Several tribes, like the Seminoles and Miccosukees, had turned to gaming as a strategy to overcome taxation inequities and fund tribal services such as education, law enforcement, health care and social services. Individual tribal members paid federal income taxes, with the exception of income received directly from a tribal trust resource. Tribal members also paid state income taxes, with the exception of tribal citizens who lived on and derived their income from tribal lands; however, members living outside of tribal land paid state income, sales and other taxes.

Similar to state and local governments, federally recognized tribal governments do not pay federal income taxes and have the ability to raise revenues to provide services for their citizens. However, tribal governments, unlike state and local governments, are not generally able to levy property or income taxes, which leave tribal governments in search of other revenue sources to support their citizens. Further, states can collect sales tax from sales of imported products to non-members that occur on tribal lands effectively resulting in "dual taxation" where tribes are unable to collect their own sales taxes because of the potential dual tax burden.

As proven by other tribes, gaming could provide strong economic benefits and produce a revenue stream to support human and social services provided on tribal lands. Indian gaming revenues were approximately \$28.1 billion or about 43% of all U.S. casino revenue in 2012 (Meister, 2014). Indian gaming revenues are required by federal law to be used to provide essential services to tribal members. The function of tribal gaming is similar to that of the state lottery, where a government entity raises revenue to support government services. Gaming is regulated from the National Indian Gaming Commission and is conducted within the delegated rights provided by the passage of the Indian Gaming and Regulatory Act of 1988 (National Congress of American Indians, 2003). In addition to the financial impact for tribes, Indian gaming directly contributed to the state and local economies by creating approximately 291,000 jobs, $12.3 billion in wages and paid $1.6 billion to federal, state and local governments in 2012 (Meister, 2014). Despite the success of the Seminoles and the Miccosukees with their casinos, however the Catawbas were a different tribe and they faced unique barriers to entry related to political and social issues. So while they wanted to mirror the success of these other Native American Nations, the terms of the 1993 settlement between the federal government, state of South Carolina, and the Catawba Indian Nation somewhat restricted their ability to pursue this strategy (Elkins, 2012).

What the Catawba's gained from the 1993 settlement was formal recognition from the federal government, the right to stay on their current reservation, and funds to be devoted toward economic development of the tribe. However, the terms of the agreement also stated that the tribe was not to be included in the federal Indian Gaming and Regulatory Act that allowed tribes to engage in gaming, but instead, the Catawba Nation was allowed to establish two bingo halls in South Carolina, one on the tribe's original land and another anywhere in the state that gives local approval. The prize cap at the bingo halls was limited to $100,000 (Elkins, 2012).

Shortly after obtaining the 1993 settlement, the Catawbas opened an electronic bingo hall on Cherry Road, which is a main thoroughfare, in Rock Hill. The bingo hall was located in a former, somewhat aged shopping mall and contained 2,800 seats and 400 Bingo King handheld electronic bingo units. Initially, the bingo operation was quite successful. From 1997 until 2003, the bingo hall took in $87 million in revenues (Blumer, 2003). However, despite the large amount of revenue being brought in by the bingo parlor, members of the tribe saw very little benefit even though all the profits should have been going toward tribal welfare. Some individuals associated with the tribe alleged that the profits were embezzled or squandered by Chief Blue and his administration during that time (Blumer, 2003). In addition, in 2002, the state of South Carolina instituted its own lottery, which presented significant competition to the bingo parlor.

Interestingly, competition is viewed differently among Native Americans when compared to the larger culture. Native American culture traditionally favors values of cooperation over Western ideals of competition. Contrary to prevailing Western culture where resources are controlled and harnessed for human interests, Native American culture believes in the interconnectedness, sacred value and protection of all living things (Moore, Peters, Jojola, & Lacy, 2007). These beliefs have sustained Native American culture throughout the many changes and challenges faced throughout existence (Simpson, 2004). Further, Native American values of humility, honesty, and respect often run counter to Western business goals of maximizing self-interest and profit (Verbos & Humphries, 2013). Thus, between competition from the state lottery, gambling cruise ships and alleged corruption among its leadership, the profits of the bingo parlor began to diminish and the tribe's bingo operation was closed in 2006. The tribe sold the building and related land in 2007.

In 2013, after gaming was put back on the table as a viable strategy that would provide economic opportunities for the Catawbas, the tribe created plans to develop another bingo parlor on Cherry Road, a main thoroughfare, in Rock Hill. Recall that under the 1993 agreement, one bingo location was allowed on the tribe's original lands in either York, Chester, or Lancaster Counties. Rock Hill was located in York County. Thus, the Catawbas leased a 45,000-square foot space in the Northeast Plaza Shopping Center from Bi-Lo Corporation (O'Mara, 2013). Bi-Lo was a grocery store that had recently relocated to a newer shopping center on Cherry Road but had not leased out its former space.

The tribe was also approached by real estate developers in Myrtle Beach and Orangeburg, South Carolina about opening up a second bingo parlor. However, past inquiries made by the Catawbas in the late 1990s and early 2000s to operate gaming facilities in these jurisdictions were not approved by the local governments. Religious groups were strong throughout the state and often lobbied local governments against allowing gaming businesses to open up in their jurisdiction.

The Catawbas also wanted to open up a casino on their own reservation. However, such a casino was not possible without getting permission of the state, because the Catawbas were not part of the federal Indian Gaming and Regulatory Act per the 1993 settlement agreement. There was a clause in the 1993 settlement agreement, however, that stated the Catawbas did have the same right to gaming as is allowed elsewhere in the state (Collins, 2013). While the state of South Carolina had banned video poker in 2000, the state did allow gambling cruise ships to exist off the coast. The Catawbas believed that they should be allowed to open operations similar to the gambling cruise ships on their sovereign land and filed a lawsuit against the state of South Carolina. In January of 2013, the South Carolina 5th Circuit Court ruled against the Catawbas. The Tribe appealed the case, but it was never tried in an appellate court. Instead, the Supreme Court took the case and scheduled a hearing for January of 2014.

THE PERSPECTIVE OF THE STATE

The state of South Carolina appeared to be against the Catawba's request to build a casino. Chief Harris speculated that some of the opposition may have been due to the state's past experience with video poker. In the 1990s, the state allowed video poker and "garish, cheap-looking operations" popped up all over the state, especially on the border with North Carolina (Collins, 2013). Crime rose up around these businesses and the state banned these types of operations in 2000.

The Chief's speculation was confirmed by news stories that quoted Republican Senator, Wes Hayes, whose district shared a border with the reservation, as saying that, separate from the moral issues related to gaming, the state experienced many practical problems with these types of businesses in the past and thus he would do "anything in my power to stop the complex" (Worthington, 2013). Several other lawmakers in the state have also stated that they see a casino as too similar to video poker and thus have concerns about the Catawba's request (O'Mara, 2013).

In addition to the opposition of state senators, the Governor of South Carolina, Nikki Haley, also seemed to be against the idea of building a casino. Harris said that in his first 18 months of office, he and other tribal leaders tried to meet with Governor Haley to discuss these economic benefits of a casino within the state but she has not been able to fit them into her schedule. Moreover, the governor publicly stated to the press that she believes that there are better ways to raise state revenue than to allow the Catawba Nation to build a casino. One of the economic development studies, commissioned by the Catawbas, determined that the state of South Carolina would garner more than $100 million in shared revenue from the operation and the surrounding county would benefit from $150 million in tourism revenue (Elkins, 2012).

CROSSING THE BORDER

Just across the border, North Carolina permitted gaming. In fact, in 2012, North Carolina renewed its gaming agreement with the Eastern Band of Cherokee Indians. The new agreement was good for 30 years and it allowed the tribe to use live dealers on gaming tables in games, such as blackjack and roulette. The state was to receive a portion of the revenues, which it utilized to help fund education. In addition, the state also felt that the Cherokee casino, which was the only one in the state, provided economic benefits to the larger region, as it was the most visited tourist destination within the state.

Because of the close proximity of the Catawba reservation to North Carolina and the open stance that the state had taken toward gaming, the tribe approached the Office of North Carolina Governor, Pat McCrory, about potentially opening an Indian resort and casino in Cleveland County, just off of the interstate near Kings Mountain. This location was part of the Catawbas indigenous lands, prior to the English dividing North and South Carolina into two separate colonies. In addition, the Tribe's federally designated service area included six counties in North Carolina, Cleveland County being one of them. The Catawbas had planned to build two hotels and a 220,000-square-foot gaming center on the site. Their proposal would initially generate 5,000 construction jobs and later on create 4,000 permanent gaming and hotel jobs within the state of North Carolina, on top of sharing gaming revenues with the state and garnering additional tourism dollars within the region. While local government officials in Cleveland County supported the Catawba casino proposal, Governor McCrory and Attorney General Roy Cooper made their opposition to the proposal known citing concerns about out-of-state tribes petitioning for gaming rights in North Carolina. The Eastern Band of Cherokee Indians was also in opposition to the Catawbas opening a casino, which would compete with their profitable gaming operation in western North Carolina.

The Catawbas wanted the support of North Carolina state lawmakers but they did not need it to proceed. The tribe submitted an application to the Department of Interior's Bureau of Indian Affairs to take the land into trust as part of the tribe's right to a 3,600-acre reservation (Rothacker & Frank, 2013). If this application was approved the Catawbas could begin operating Class II gaming, including bingo and similar games of chance, without state approval. At the same time, the Catawbas sought to build a relationship with the State of North Carolina by offering revenue sharing in the hopes of signing a compact with Governor McCrory to approve Class III gaming, including casino-style games and slot machines. A similar compact had recently been granted to the Eastern Band of Cherokee Indians. In 2012, Class III gaming accounted for 98% of Indian gaming revenues while Class II gaming accounted for 2% of total revenues. While Class II gaming represented only a small portion of total revenue from gaming operations it was growing faster nationally than Class III gaming (Meister, 2014). However, if the North Carolina state legislature continued to oppose the Catawba casino, they had the ability to rescind the Governor's power to sign a compact with the tribe, which would then add another level of complexity to the situation for the Catawba Nation.

THE NEXT STEP?

Bill Harris, Chief of the Catawbas, vowed to keep fighting for the Catawba Nation. The tribe was at a point where they needed economic revival and the gaming business seemed to provide an answer. And yet, there were many barriers to entry in pursuing this strategy that the tribe would have to overcome before they would be able to create a bingo and casino business that had potential to generate substantial profits. Chief Harris knew the tribe faced competition from the state lottery and offshore gambling cruise ships, however, he did not believe these they presented an exact substitute for the experience of the proposed bingo hall or casino. Bill Harris knew his decision needed to be made from a strategic management perspective and believed gaming offered a viable economic growth opportunity for both the tribe and related government entities. However, state and local governments were not fully supportive of the tribe's plans and presented a barrier to entry with their sole power to grant gaming permits. The tribe was limited by the 1993 settlement with the state and federal government. Challenges also existed in the community where religious groups lobbied government leaders to block gaming industry growth. While the Catawbas had support from government leaders in Rock Hill, South Carolina to proceed with their new bingo operation, they were waiting for pending contracts and permits to complete the complex approval process. The tribe also needed support from other parts of the state in order to get the second bingo operation established. Furthermore, state leaders in North Carolina seemed to be against approving a casino to be built on the reservation but there were possibly legal ways around the state barriers. But solving the issue through the federal government could take years. On top of that, the Catawba people were suffering economically and they needed strong, ethical leaders to help them fight these battles. As Bill Harris thought about the situation, he was unsure about whether the Catawba's bingo and casino strategy would pay off, but the one thing he did know was that his people had survived for thousands of years on these lands and they would not give up.

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INTO THE BLACK WITH BLUEBERRIES: TO BUY OR NOT TO BUY—A BUSINESS CASE ANALYSIS STUDY

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CASE DESCRIPTION

This case study is designed for use in undergraduate business courses. The primary use of this case study is to help students determine whether the profitability of the business in question over the last twelve years justifies the purchase of additional contiguous property to expand and to support future growth. To conduct this evaluation and make a recommendation, students will need to utilize the principles learned in their economics and accounting courses and be familiar with spreadsheet software. The case has a difficulty level of two to three and is appropriate for junior or senior-level undergraduates taking an Entrepreneurship or Small Business Management course. The case should require approximately half an hour of class time to summarize and three to four hours of outside student preparation.

CASE SYNOPSIS

The purpose of this assignment is to determine whether Whippoorwill Blueberries Farm, a small Georgia-based agribusiness producing annual crops of blueberries since 2002, should expand in order to meet an increased demand for blueberries in the area. The owners are considering investing additional resources to purchase contiguous property so that they can plant more blueberry bushes to increase their crop production. This case involves the student in evaluating the efficacy of the farm's current operations and the strength of its financial position and in determining whether the suggested expansion plan is viable. The student will be required to prepare a SWOT (strengths, weaknesses, opportunities, and threats) analysis and to develop a supported recommendation based on qualitative and quantitative factors for the business regarding the proposed expansion.

INTRODUCTION

In 1994, Steve and Kay Smith, aged 39 and 37, respectively, purchased a 2.26-acre tract of property that would become Whippoorwill Blueberries Farm in 2002. Originally part of a larger, thirteen-acre mini-horse farm, the property had been subdivided by the previous owner into three smaller tracts, and the Smiths' tract included a house, two horse stables, and a corral. They bought the property thinking it would be a nice place for their six-year-old son to play outdoor sports with his friends. Their son, however, did not develop an interest in outdoor sports, and for many years the acreage around the house remained fallow, requiring labor to keep the grass mowed and actually costing money in terms of annual property taxes.

The Farm Idea

A short distance from the Smiths' property, Dr. John Miller (now deceased) owned Miller Blueberry Farm, a five-acre property operating with 1200 mature blueberry bushes. Dr. Miller, an expert on blueberries, worked for the Agriculture Department at the University of Georgia. In 1999, Kay began visiting Dr. Miller's farm to pick blueberries, and she spent some of her time there chatting with him about his business. Their conversations inspired her to propose the idea of starting up a blueberry farm to Steve.

Farm Evolution

The Smiths decided to become agribusiness entrepreneurs in 2002 for several reasons. Dr. Miller advised Kay that blueberries were an ideal crop for northeast Georgia's soil and climate, providing annual crops potentially for more than thirty years. Kay found that a growing number of studies were touting blueberries as an excellent antioxidant, combating free radicals and inflammation in brain tissue (Azar, 2001), preventing cancer, and improving cognition and motor skills (Underwood, 2002, Wedge et al., 2001). As a result, the public's awareness of the benefits of eating blueberries was increasing, creating a growing demand for the product in the health food market. An added benefit was their proximity to Dr. Miller, who volunteered to act as their mentor as they learned how to grow blueberries. He told them that blueberries were an "environmentally friendly" crop, which appealed to Kay's "nurture by nature" instincts, and Steve was enthusiastic about providing his own labor to generate an additional source of income. The Smiths would also be able to put their unused acreage (approximately two acres) into the county's Farm Conservation Use plan, decreasing their tax rate.

The Smiths made a list of startup costs, which included grading and clearing the two acres, purchasing blueberry sprigs (immature bushes planted over two years) and an irrigation system, renting an auger to dig the holes for the sprigs, and miscellaneous labor expenses (e.g., digging, raking). The well that came with their property was a 360-foot drilled well providing a more than adequate water supply to irrigate the blueberries. Table 1 shows a summary of the initial investment costs, which were very reasonable because the Smiths already owned the land.

Table 1
Whippoorwill Blueberries Farm
Initial Investment Costs

Grading and clearing 2 acres	$3,000
520 sprigs @$2.00/sprig	1,040
Irrigation system (4,000 line feet)	780
Gas powered auger (520 holes)	125
Miscellaneous Expenses ~	103
Total Initial Investment Cost	$5,248

Along with most consumers, the Smiths did not realize that there would be dozens of varieties of blueberries to choose from when purchasing the sprigs. Dr. Miller recommended that they plant only the early varieties, which would ripen at the beginning of the summer, during early June through early July, when the weather was more likely to be cooler and people would be enthusiastic about picking blueberries. For cross-pollination purposes, Dr. Miller further recommended that they plant four different varieties that would grow well in the soil in their area. He told them that insects, primarily bees, would cross-pollinate from one variety to the next

Austin blueberries tend to be tarter, grittier, and smaller. Brightwell and Climax blueberries offered tastes, textures, and sizes between the more extreme features of Premier and Austin.

In December 2002, the Smiths purchased 130 three-year-old sprigs per variety, totaling 520 sprigs (260 sprigs per acre) to plant on two of their 2.25 acres. They learned from research and from Dr. Miller that blueberries should be planted when they were dormant, just after the beginning of winter.

The Smiths rented an auger and planted each row of sprigs with a different variety, repeating every fourth row (Austin, Brightwell, Climax, and Premier). Most rows were planted parallel to the contour of the land to minimize rain runoff. As shown in Figure 1, the rows were ten feet apart, and the bushes in the rows were planted eight feet apart, forming a 10’ × 8’ grid, a pattern that would cut down on shading and allow as much sunlight as possible to reach the sprigs. Also, Dr. Miller advised them that if they planted the sprigs closer than eight feet apart, the mature bushes would bunch together and that the pickers would have problems trying to reach in to pick the blueberries. Kay built the farm’s irrigation system in 2003, positioning 4,000 line feet of plastic pipe to emit water for every bush.

Blueberry sprigs planted December 2002

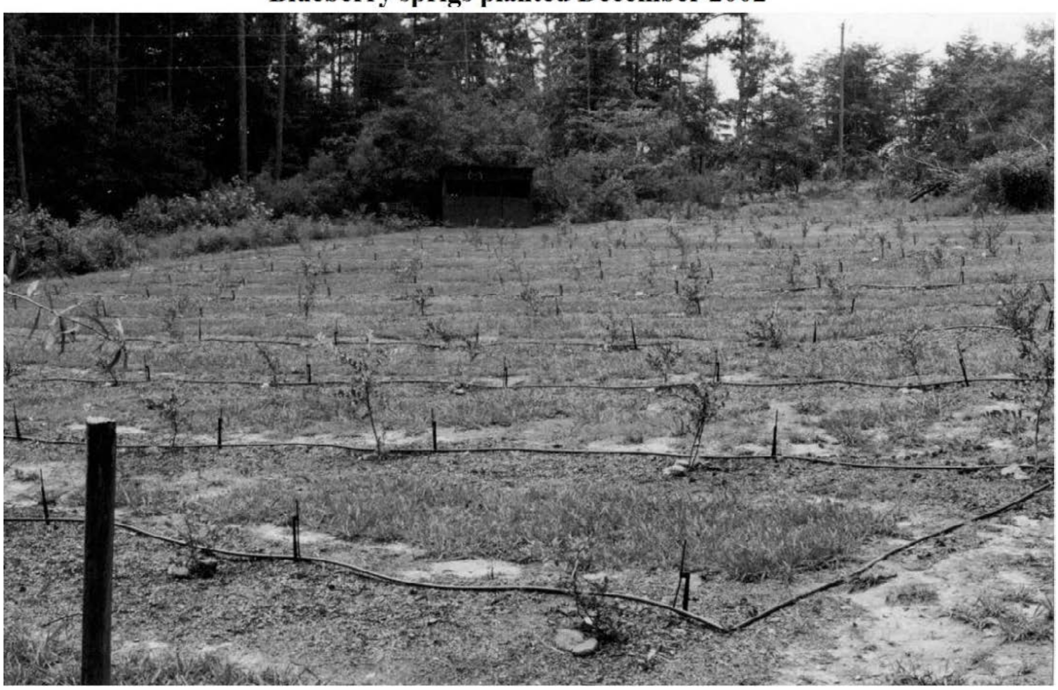


Figure 1

Farm Operations

The bushes did not bear any fruit until summer 2004, but the Smiths still had to maintain them with water from their irrigation system, fertilizer, pesticides, pH balancing double-mill pine bark, and general upkeep.

From 2002-2006, they fertilized three times a year by hand, once around the first of March during "bud break," again when the blueberries were finished for the summer, and a final time in late fall before the bushes became dormant. Each time they fertilized, they used three, 50-pound bags at approximately $20 per bag, for a total annual fertilizer cost of $180. Note, as the bushes reached maturity in 2006, the Smiths reduced the number of times they fertilized to twice a year, once during "bud break" in April and once in late July, for a total annual fertilizer cost of $120 after 2006.

In addition to fertilizer, the Smiths used different types of pesticides. One was a pesticide called NEEM made from an Indian citrus plant, harmless to humans but unpalatable to insects that might damage the blueberries. They also sprayed an Indar fungicide, another type of pesticide, directly on the bushes. Because they also used Andro to control fire ants and a small amount of Roundup to control weeds, their bushes would not be considered "organically grown," but they felt they were close to meeting the criteria. Altogether, the total annual cost of pesticides was approximately $130.

For a nominal fee at the local County Extension Office, Kay also had the soil pH tested in 2002, after which she used double-milled pine bark (~$290/year) to maintain the pH balance. During the first twelve years of operation, the Smiths did not use a ground cover for their bushes in the winter. In 2014, they converted to Dutch White clover as a ground cover for a one-time cost of $190. They anticipate that they will no longer need to purchase the pH-correcting double-milled pine bark.

Miscellaneous expenses (e.g., repairs, supplies, maintenance) averaged $250-$500 annually. A riding mower was purchased in 2004 and another, larger mower was purchased in 2011 to control the grass around the blueberry bushes throughout the year.

Members of the Tax Equalization Board inspected the Smiths' property and recommended that they be granted Farm Conservation Use status. This change in status reduced their property taxes to $150 per year initially for the two acres planted in blueberries. The property taxes gradually increased over the next twelve years, reaching $242 in 2014 ($121/acre).

From 2004-2008, the Smiths picked all of the blueberries they sold. From 2009-2014, they employed students from a nearby college to pick the blueberries that were not picked by customers. The students were paid $8 per gallon to pre-pick blueberries on Thursdays and Fridays for sale at the Farmer's Market on Saturdays or for customers who preferred to buy pre-picked berries at the farm.

Climate is an important factor in farming, but it has a particularly high impact on fruit-bearing crops. High heat, excessive rainfall, and late frost can seriously jeopardize crop yield. When the temperatures are high in early summer, the berries do not grow as fast, even with an irrigation system; if not killed outright, they tend to be smaller and tarter. In 2012, extreme heat reduced Whippoorwill Blueberries Farm's gross revenue by 50%, wiping out the last half of what would have been a bumper crop. Years with heavy rainfall can also impact yield, causing the berries to swell like water balloons and burst, leading to excess spoilage if extra care is not taken when they are picked. A late frost can seriously damage or kill that year's crop overnight. In 2006, a late frost over Easter weekend reduced the farm's gross revenue to $333, less than seventeen gallons for the entire year. Another late frost in 2007 reduced gross revenue to zero.

Blueberry bushes typically bear fruit for only six or seven weeks. Because the Smiths only planted early varieties, their season typically runs between early June and the middle of July, but depending on the weather, the bushes could start producing as early as late May. As mentioned previously, two years passed before the sprigs became fruit-bearing, revenue-producing bushes (2004), but even at that age the berries were still small, and there were not very many to pick.

The Smiths use the cash basis accounting to report their revenues and expenses. As shown in Figure 2, sales revenue from the tax returns was only $244 in 2004, but as the bushes matured, berry production increased, leading to increased sales revenue, except in years affected by extreme weather conditions. However, despite rising sales, Whippoorwill Blueberries Farm did not earn a profit until in 2008, six years after inception.

The Climax and Premier varieties reached maturity in 2011, nine years after being planted. The Austin and Brightwell varieties did not grow as fast and needed another two years to reach maturity. The mature bushes could potentially earn $12,000 in annual sales revenue if all conditions were "perfect," but the Smiths prefer to budget their annual sales revenue conservatively at $10,000.

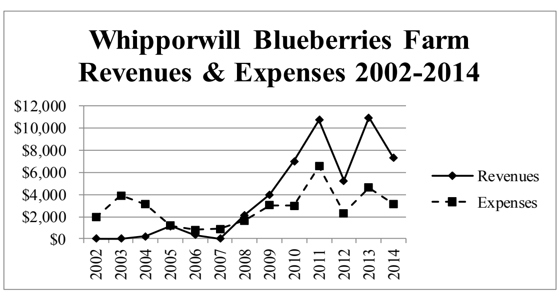
The farm's startup costs were expensed in 2002 and 2003 (see Figure 2). Because the startup began at the end of 2002, the expenses for that year contained startup costs related only to the bushes planted in December. Year 2003 included operating costs and some startup costs for the bushes planted that year.

Whippoorwill Blueberries Farm

Annual Income Statement Summaries From Tax Returns (including charts)

For Years 2002-2014

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Totals
Revenues	$0	$0	$244	$1,131	$333	$0	$2,130	$4,001	$7,004	$10,720	$5,257	$10,928	$7,318	$49,066
Expenses	1,927	3,921	3,090	1,175	817	912	1,630	3,027	2,990	6,515	2,311	4,629	3,155	36,099
Net Income	**($1,927)**	**($3,921)**	**($2,846)**	**($44)**	**($484)**	**($912)**	**$500**	**$974**	**$4,014**	**$4,205**	**$2,946**	**$6,299**	**$4,163**	**$12,967**
			lawn-mower		late frost	late frost				lawn-mower	extreme heat			



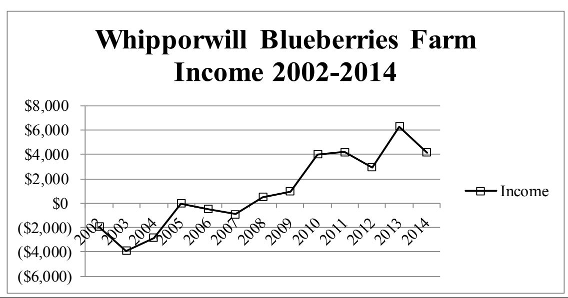


Figure 2

Blueberries are normally a classic, perfectly competitive, homogeneous agricultural product, so the Smiths needed to develop a plan that would differentiate their product, a way to make buying and eating their blueberries "chic." Their marketing strategy for promoting their product evolved as they gained experience in the industry and with their customers.

From 2004-2007, any blueberries they picked were sold at the Farmer's Market. Since 2008, they have essentially had two customer types: the pick-your-own customer and the customer who wants to buy pre-picked blueberries either at the farm or at the county Farmer's Market on Saturday mornings. The Smiths tell their pick-your-own customers to go into the rows on the farm and taste a handful of berries from each of any four consecutive rows. It doesn't matter where the customer starts. If they take a handful of berries from any four consecutive rows, they will get samples of Austin, Brightwell, Climax, and Premier, meaning they will get all four flavors and textures. Steve and Kay feel that if customers are picking their own blueberries, they should pick the varieties that taste best to them. One customer might prefer Austin, but the next customer might prefer Brightwell, or some customers might wander around and pick combinations of berries. Regardless, by picking the berries they like best, the customers should all be satisfied and, hopefully, deliver word-of-mouth advertising to their friends and family about how good the blueberries at Whippoorwill Blueberries Farm taste. Also, because blueberries freeze well (even through the winter), the Smiths encourage all of their customers to buy enough to last for a while.

The pick-your-own customers pay $10 per gallon ($2.50 per quart) for the blueberries they pick. These prices are significantly below what people would pay if they purchased blueberries from a grocery store. If customers come to the farm and want pre-picked blueberries, they receive bags containing all four varieties for $20 per gallon ($5 per quart). Notably, the bags are free because Kay stockpiles her grocery bags all year for use during the season. The berries that are not sold to farm customers during the week are taken by the Smiths on Saturdays to the county Farmer's Market where the blueberries are sold for $5 per quart.

In the last two years, farm sales have increased so much that on two or three Saturdays of each year, no berries were left to sell at the Farmer's Market. In part, the large farm sales might be attributed to the Smiths' desire to sell a blueberry "experience," not just blueberries. They want to make picking blueberries fun and interesting, especially for children. They provide picnic tables, benches, ice water, and over-sized hammocks in the shady areas. When customers visit the farm, they will see a large homemade wind chime and a bottle tree. The farm has fifteen bluebird birdhouses, a Martin pole, a butterfly house, pear trees, and a vegetable garden. Sometimes, deer will walk out of the woods while customers are picking their berries. The Smiths answer questions from the children and help them take group photos. They want the children to ask their parents (or their grandparents) to bring them back to the farm to pick more blueberries just because they enjoy the activity.

The Smiths try to capitalize on all the advantages of blueberries and deliver those advantages to their customers. Their marketing strategy has evolved to include providing multiple types of berries to satisfy a variety of tastes, arranging convenient alternatives for customers to acquire the berries, disseminating information about a healthy, nutritious product that can be frozen to be consumed year round, and offering the product in an environment that is "family-friendly." Although they do not include social media in their marketing strategy, their efforts have helped them develop loyal customers that return to the farm year after year, bringing friends who, in turn, spread the word about the excellence of Whippoorwill Farm's blueberries. Examples of the mature bushes and the finished product are shown in Figure 3.

Mature blueberry bushes 2014

The final product--luscious blueberries

Figure 3

Nationally, the demand for blueberries has increased every year since the Smiths started their farm. Georgia is now the top blueberry state in the nation, producing 96 million pounds of blueberries in 2014, exceeding the previous mark, Michigan's 91.5 million pounds (Melancon, 2014). The fruit is tasty, it freezes well, and advertising continues to emphasize the health benefits of eating blueberries.

The Expansion Challenge

As of 2014, only four other farmers in the county raise blueberries, so the threat of local competition is not currently a major concern. The threat level, however, could change as more producers in the county learn about the financial benefits of raising blueberries. Also, large national blueberry producers might be able to lower their wholesale prices if their costs decrease as a result of economies of scale. Grocers might then be able to offer blueberries to customers from national producers at prices that directly compete with Whippoorwill Farm blueberries. Currently, the farm's blueberries are priced significantly below grocery store prices, and the demand for the Smiths' blueberries is high, as evidenced by the weeks when there were not enough berries left to sell at the Farmer's Market on Saturday. The Smiths cannot increase their current production because their property has been planted to its maximum capacity on two acres.

Recently, Steve learned from his neighbor that two tracts of land abutting each side of the farm would be offered for sale for a combined cost of $16,125. The Smiths' property was not sectioned into a conventional geometric rectangle when it was subdivided in 1994. As shown on the aerial satellite map in Figure 4, the Smiths' tract has an irregular, oblong-shape; it looks vaguely like the tip of a thumb stopping at the first knuckle on Whippoorwill Road. To square the property off would require .497 acres on the nail side of the thumb shape and .846 acres on the pad side of the thumb shape, for a total of 1.343 additional acres.

Aerial satellite map of Whippoorwill Blueberries Farm (2.26 acres) and surrounding tracts (.497 and .846 acres)

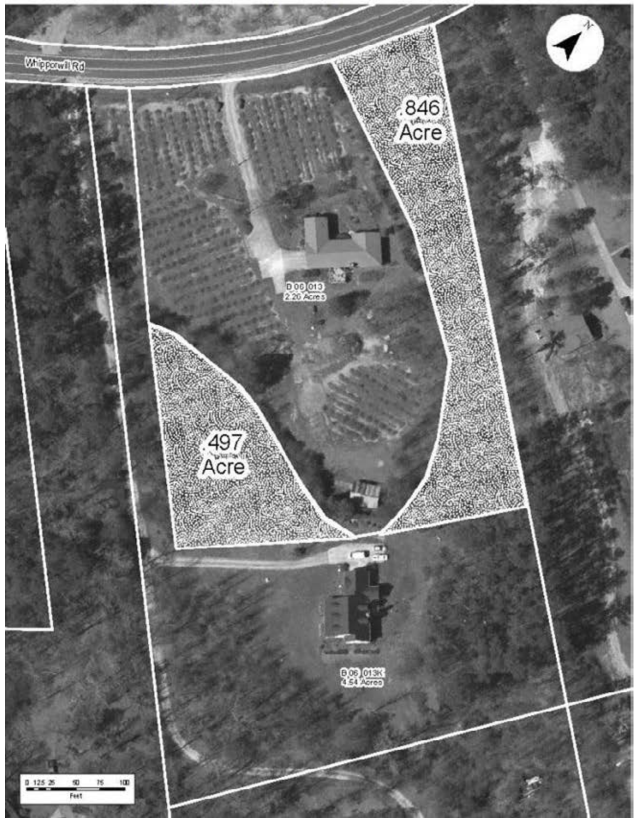


Figure 4

Investigating further, Steve checked at the local Tax Assessor's office and found that as of October 2014, the land abutting the farm was assessed for $12,007 per acre. Based on the purchase price, the value of the combined parcels (1.343 acres) on either side of the farm would be $16,125. Property values in the county have been sluggish in recovering from the national housing market crash that began in 2006. If the Smiths decided to purchase the two tracts to add to their farm, they would probably be able to bargain the price down close to the assessed value. This bargaining power could change, however, due to the county's proximity to an infrastructure 4-lane highway that leads directly to Atlanta. County land prices had begun climbing sharply prior to the housing market crash, and as the market recovers, land prices can be expected to increase again. Also, if the 4-lane highway becomes an expressway, land prices could increase even more dramatically in a short period of time.

Steve and Kay looked into the additional costs of putting the new land into production at the beginning of 2015. In addition to the cost of the land, they would need additional resources similar to their initial startup costs in 2002. As shown in Table 2, the total cost of the proposed expansion would be $19,784, including $16,125 for the land and $3,659 for other costs. If they decided to invest in the new startup, Steve and Kay would pay cash by liquidating some of their existing investments currently earning an average rate of return per year of 7%.

Table 2
Whippoorwill Blueberries Farm
Expansion Investment Cost (New Startup)

Purchase 2 tracts (1.343 acres)	$16,125
Grading and clearing 1.343 acres	1,933
350 sprigs @$2.67/sprig	935
Irrigation system (2,800 line feet)	342
Gas powered auger (350 holes)	148
Dutch White Clover (one-time ground cover)	127
Miscellaneous expenses	174
Total Expansion Investment Cost	$19,784

Based on their experiences with the original startup in 2002, the Smiths anticipate that there will be no additional revenue in the first two years of the new startup (2015-2016). They assume the weather will not impact production (best-case scenario) and that the new startup revenue in 2017 will be 67% (350 new bushes/520 original bushes) of the revenue earned in 2004. They expect the new startup revenue to increase approximately 86% each year for six years until the new bushes reach maturity in 2023, after which the revenue will stabilize ($6,700 annually).

The Smiths estimate that normal operating expenses for the new startup, not including labor, will be $900 (fixed) per year until 2023, at which time the total expenses should include labor and be an estimated 40% of total revenue. This percentage is less than the average percentage of expenses the Smiths incurred on the original startup (approximately 42-44% per year) from 2009-2014. However, they feel their expenses will be less because they are more experienced in keeping their operating costs low, especially because the acreage will no longer require the pine bark cover.

During this same time period, the Smiths anticipate that the mature bushes from the original startup will conservatively average $10,000 per year in total revenue and that operating expenses, including labor, will be approximately 40% of total revenue.

Should the Smiths buy the newly offered tracts of land in 2015 to expand their blueberry business?

1. Prepare a SWOT (Strengths, Weaknesses, Opportunities, and Threats) analysis for Whippoorwill Blueberries Farm.
2. A. Prepare a budgeted income statement similar to Figure 2 for the proposed expansion, beginning in 2015 and ending in 2027 (the same number of years that the Smiths have currently been in business). Land cannot be expensed, so do not include the cost of the land in the expenses for 2015; only include the other startup costs ($3,659) and the regular estimated fixed operating expenses ($900). Estimated expenses will be $900 from 2016-2022, after which total expenses will be 40% of total revenue. Assume a best-case scenario (i.e., no bad weather).
   B. Based on 2.A., prepare a budgeted income statement for the proposed expansion assuming weather damages equal to 70% of total revenue in 2018, 2022, and 2025 (sensitivity analysis). Assume expenses will not change until they become variable in 2023.
   C. Include a line for return on investment (ROI) for the land under each year's Net Income line for 2.A. and 2.B.

3. A. Prepare a budgeted income statement for the combined acreage (3.343 acres–original two acres plus the new 1.343 acres) beginning in 2015 and ending in 2027. Per 2.A. above, the expenses for 2015 should only include the other startup costs ($3,659) and the regular estimated operating expenses. Modify the statement to differentiate between original and new startup revenues and expenses, as shown in Figure 5 below. Assume a best-case scenario (i.e., no bad weather).

Modified Income Statement to Differentiate between Original and New Startup Revenues and Expenses

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	Totals
Revenues:														
New Startup														
Original														
Total Revenues														
Expenses:														
New Startup														
Original														
Total Expenses														
Net Income														

Figure 5

B. Based on 3.A., prepare a budgeted income statement for the combined acreage assuming weather damages equal to 70% of total revenue in 2018, 2022, and 2025 (sensitivity analysis). Assume expenses for the new startup will not change until they become variable in 2023.

C. Include a line for return on investment (ROI) for the land under each year's Net Income line for 3.A. and 3.B.

4. A1. From the income statement prepared in (2.A.) above, determine the cash payback period for the proposed startup based solely on the new acreage (1.343 acres), assuming a best case scenario with no bad weather.

A2. From the income statement prepared in (2.B.) above, determine the cash payback period for the proposed startup based solely on the new acreage (1.343 acres), assuming the scenario that includes bad weather.

B1. From the income statement prepared in (3.A.) above, determine the cash payback period if the original acreage (2 acres) is included in the calculations (3.343 acres), assuming the best case scenario with no bad weather.

B2. From the income statement prepared in (3.B.) above, determine the cash payback period if the original acreage (2 acres) is included in the calculations (3.343 acres), assuming the scenario that includes bad weather.

5. Based on the qualitative and quantitative information you collected in 1-4 above, prepare a recommendation for the Smiths, advising them to accept or reject the proposed expansion. The recommendation should be in Executive Summary format and be no longer than one single-spaced page. Your audience is Steve and Kay Smith, and they need to be able to understand easily the reasons for your recommendation.

Azar, B. (2001, December). Blueberries + exercise = healthy minds? *Monitor on Psychology, 32*(11), 26-28.
Melancon, J. M. (2014, October 15). Georgia leads the nation in blueberry production. *UGA Today*. Retrieved June 23, 2015, from http://news.uga.edu/releases/article/georgia-leads-the-nation-in-blueberry-production-1014/
Underwood, A. (2002, June). So berry good for you. *Newsweek*, 71 -72.
Wedge, D. E., Meepagala, K. M., Magee, J. B., Smith, H., Huang, G., & Larcom, L. L. (2001). Anticarcinogenic activity of strawberry, blueberry, and raspberry extracts to breast and cervical cancer cells. *Journal of Medicinal Food, 4*, 49-51.

BIG DREAMS AND LITTLE MONEY FOR SPEECH RECOGNITION: REVENUE GENERATION BY OUTSOURCING RESEARCH AND DEVELOPMENT

Rebecca Martin, McNeese State University
Christophe Van Linden, Belmont University & KU Leuven

CASE DESCRIPTION

This case concerns revenue recognition of software licenses. In particular, students play the role of a financial audit senior who must evaluate audit evidence concerning a licensing scheme of speech recognition technology. Based on the evidence in the audit file, students should draw a conclusion about whether revenue is materially misstated in the financial statements of the IT company according to International Financial Reporting Standards (IFRS). The case also illustrates the importance of independence during the audit. The case will expand students' understanding of risks related to revenue recognition and the implications and limitations of the concept of professional skepticism during a financial audit. The case also provides students with a perspective as to which challenges they will face once they are employed as an auditor. The case requires students to have an introductory knowledge of accounting and auditing and is appropriate for senior level students in accounting or auditing. The case is designed to be taught in 1-2 class hours and is expected to require 3 hours of outside preparation by students.

CASE SYNOPSIS

The case is based on actual facts and chronicles the transformation of an IT company from a small local private company to a global player publicly traded on NASDAQ. The company was founded by two businessmen who envisioned transforming the world with speech recognition technology. Due to its fast growth, investor interest, and the complexity of the business, the auditors considered the company a high risk client. The financial audit was conducted by a Big 4 audit firm with affiliates in several countries, and the company falls under IFRS for financial reporting purposes.

Since research and development costs are a financial burden for the IT company, management decided to start outsourcing developed speech recognition technology to interested parties overseas to further develop the technology into different language modules. The company record the license fees paid by overseas entities as revenue in the financial statements. Audit evidence related to this licensing scheme has been collected during the financial audit. The audit senior has to evaluate the audit evidence documented in the audit file and conclude whether the evidence provides sufficient assurance regarding the revenue recognition practices, whether additional evidence should be obtained and whether revenue is materially misstated or not.

Additionally, during the current year audit the lead engagement partner leaves the audit profession and starts to work for an entity related to the IT company. Consequently, the audit senior has to report possible independence threats into an independence reporting template and must decide whether it is suitable for the audit firm to continue performing the audit of the IT company.

BIG DREAMS AND LITTLE MONEY

Jo is a charismatic leader who envisioned a world where people would talk to their refrigerators and cars, as well as talk on the phone with an immediate translation into another language. Pol is an accountant who writes his own bookkeeping software. Together the two Belgian businessmen found ITCO. They dream the company will become the world leader in speech and language technology but they have little money. In order to fund the research and development needed to fulfill their dream, they vigorously seek money from private investors.

First, convertible bonds are issued in Belgium to finance the increasing R&D costs. Second, ITCO becomes the first Belgian company with an IPO on NASDAQ. Shortly after the IPO, share prices rise after a press release announcing that Microsoft has agreed to buy 8 percent of ITCO shares for $45 million. In the next years, total assets and revenue increase sharply due to numerous acquisitions in Europe and the United States. During this rapid expansion, ITCO takes over its US rivals Dictaphone and Dragon Systems, which had financial difficulties.

Since ITCO's IPO, Jo and Pol start to feel pressure to demonstrate growth figures every quarter. New acquisitions of entities with financial difficulties and the continual drain of R&D costs strain ITCO's financial resources. Therefore, Jo and Pol decide to sell licenses of their basic technology to foreign customers resulting in revenue for ITCO.

LICENSE AGREEMENTS

ITCO primarily develops fundamental speech recognition technology, which needs to be further developed into final applications for different languages. This development is outsourced to foreign language development companies (LDCs) via a licensing arrangement. These LDCs pay license fees for the fundamental ITCO technology and then develop the final applications themselves. ITCO intends to find initial investors into the LDCs for $200 million, which would be used for license fee revenue and further language development. The companies who buy the technology pay ITCO initial license fees and then additional royalties based on the sales generated by the products. The stipulations in the contract are outlined in Exhibit 1.

Exhibit 1 License contract between ITCO and the COMPANY

1. License Grant.
Subject to the terms and conditions of this Agreement, ITCO hereby grants to the COMPANY, during the term of this Agreement, an exclusive, worldwide, personal, non-transferable, royalty bearing right and license:
(a) to use and reproduce the Tools within the COMPANY for the sole purpose of creating Products in any or all of the Licensed Languages;
(b) to use, reproduce and bundle with or otherwise incorporate the Products, as created in any or all of the Licensed Languages, in object code form, into the COMPANY Products, and
(c) to sublicense and distribute the Products in any or all of the Licensed Languages, in object code form as bundled with or incorporated into COMPANY Product(s), to Distributors and End-Users on a worldwide basis.

2. Development by the COMPANY of the Products.
(a) The COMPANY shall develop the Products, in the manner as specified by ITCO. The COMPANY agrees and acknowledges that this work program constitutes valuable know how of ITCO, this work program is considered as Confidential Information and as such cannot be disclosed to other parties without the prior written consent of ITCO.
(b) To achieve the timely development of the PROJECTS the Parties agree to the following:
i) The COMPANY shall be responsible for the hiring of qualified personnel.
ii) The COMPANY shall at all times during the term of this Agreement dedicate on a full time basis sufficient individuals to the development, implementation and support of the Products. Rotation of individuals out of this group will be minimized to the greatest extent possible.

(iii) Within 3 months following the Notice, the COMPANY shall start the development of the Language Pair defined in the Notice and the COMPANY will do its utmost best to finalize the development of such Language Pair at latest 1 year following the starting date of the development of such Language Pair. Should the COMPANY not timely fulfill the foregoing for causes other than difficulties inherent to the structure of the languages, ITCO will have the unilateral decision power to cancel the license granted for such Language Pair.

3. Delivery of tools by ITCO to the COMPANY.
The COMPANY acknowledges and agrees that ITCO has, as of the effective date of this agreement, delivered a copy of the tools to the COMPANY, and that ITCO has no further obligation to deliver any additional information, tools or the alike under this agreement.

4. Transaction price
In partial consideration for the grant of license by ITCO of the tools to the COMPANY under this agreement, the COMPANY agrees to pay ITCO a one-time, upfront, non-refundable and non-cancelable license fee of US$4 million, of which US$ 3 million will be due upon the effective date and the balance will be due on or before December, 20, YEAR T. As further partial consideration, the COMPANY agrees to pay ITCO a fifty percent (50%) on all net revenues derived by the COMPANY from the use, sale, licensing and/or distribution of the COMPANY products incorporating all or part of the products in the licensed languages. ITCO agrees to pay the COMPANY a fifty percent (50%) on all net revenues derived by ITCO from the use, sale, licensing and/or distribution of the products in the licensed languages.

5. Purchase option
ITCO has the right to purchase 100% of the common stock of the COMPANY by issuing the COMPANY warrants for ITCO's common stock. ITCO can exercise this right during 60 days after the finalization of the development of the Language Pair which is expected to be at the latest 1 year following the starting date of the development of such Language Pair.

Investors in the LDCs are mainly located in Asia. For competitive reasons, ITCO often keeps clients' identities a secret to its shareholders and auditors. Identities of clients were thus confirmed via external confirmations of the LDC clients' accounting firms. An excerpt of such a confirmation is provided in Exhibit 2.

Exhibit 2 Excerpt from confirmation letter for German CLDC, French CLDC and Italian CLDC

…"*We confirm you that we are familiar with subject investors and therefor in a position to evaluate their representations. We confirm that we are acting under a non-disclosure agreement with these investors.*"...

Signed by Partner from NextBigAudit

In total 30 companies are taking part in the license arrangement during year 20X0 and year 20X1. The license contracts account for $21 million revenues in year 20X0 and $89.5 million in year 20X1 for ITCO. Exhibit 3 provides an overview of all signed license agreements in year 20X1.

Exhibit 3 Revenue from license fees in year 20X1 (in millions of dollars)

Contract date	Company name	Amount	Owners' identity confirmed
3-30-20X1	I-Merge	1.0	
3-30-20X1	I-news	3.0	
3-30-20X1	I-mail	3.0	
3-30-20X1	I-office	3.0	
3-31-20X1	Thai LDC	3.0	Audited, Letter from Mr. Snauwaert
3-31-20X1	Tamil LDC	3.0	Audited, Letter from Mr. Snauwaert
3-31-20X1	Hindi LDC	3.0	Audited, Letter from Mr. Snauwaert
3-31-20X1	Turkish LDC	3.0	Audited, Letter from Mr. Snauwaert
6-30-20X1	Urdu LDC	4.0	
6-30-20X1	Vietnamese LDC	4.0	
6-30-20X1	Taiwanese LDC	4.0	
6-30-20X1	Malay LDC	4.0	
6-30-20X1	I-Medical	3.0	
9-30-20X1	German CLDC	4.0	Audited, Letter from Deloitte
9-30-20X1	French CLDC	4.0	Audited, Letter from Deloitte
9-30-20X1	Italian CLDC	4.0	Audited, Letter from Deloitte
9-30-20X1	Mandarin CLDC	4.0	
9-30-20X1	Japanese CLDC	4.0	
9-30-20X1	Russian CLDC	4.0	
9-30-20X1	Spanish CLDC	4.0	
10-22-20X1	411.com	4.5	
11-19-20X1	I-travel	4.0	
12-29-20X1	Capital Union	8.0	Audited, Letter from Bahreinian Bank
12-30-20X1	Armenian LDC	4.0	
	Total year 20X1	89.5	

THE AUDITOR

Paul is signing partner with BigAudit Belgium for the ITCO audit for more than 6 years. BigAudit USA personnel provide assistance to BigAudit Belgium with the general audit, SEC filing, and US GAAP compliance. Robert M., a BigAudit USA partner, is consulted as a specialist in SEC regulations and US GAAP.

There is a close working relationship between BigAudit USA and BigAudit Belgium employees and between ITCO employees and BigAudit. ITCO relies heavily on the expertise of BigAudit to prepare the financial statements. ITCO staff have little knowledge of US GAAP and therefore BigAudit staff help perform the consolidation entries. The majority of the financial statement consolidation work is performed on Big Audit's premises. ITCO received a clean audit opinion from BigAudit Belgium for its consolidated financial accounts of year 20X0 during which the company demonstrated a net loss of $52 million.

In May of year 20X1, BigAudit Belgium was reappointed as the statutory auditor of ITCO. BigAudit Belgium received 8.5 million Belgian Francs from ITCO in year 20X1 for the statutory audit and US GAAP advisory. After the reappointment in May of year 20X1, Paul leaves BigAudit to become the CEO of the Speech Trust, an entity also founded by ITCO's founders. William becomes the new signing partner of BigAudit for the audit.

In pre-audited figures of year 20X1, ITCO demonstrated a net profit of $42 million. During the current audit of year 20X1 financial figures, Philippe, a BigAudit junior staff auditor, transfers from BigAudit to the finance department of ITCO. Before his transfer, Philippe performed substantive audit tests for the revenue that ITCO booked due to the licensing arrangement in year 20X1 and concluded that there was no material misstatement in the revenue recognition practices. The non-statistical sampling procedure performed by Philippe to support his conclusion is shown below. Determined sample size and projected misstatement are automatically computed by the template based on the values which Philippe provides in the template. The licenses which Philippe selected for testwork are noted in Exhibit 2.

Non-statistical sampling		**Prepared by**: Philippe		**Reviewed by:**	
Client name:	ITCO	**Test description**: Substantive test revenue recognition software licensing			
Step 1: Account information tested		**Step 3: Define misstatement**		**Step 6: Testing (summarize results)**	
Account name:	#71 Licensing revenue	1) if contract with customer can not be identified		Sampled total ($m):	24
Testing as of date:	January 20, 20X2	2) if performance obligation (p.o.) is not being specified		Targeted testing total ($m)	8
Total population:	$89.5 million **(see Exhibit 3)**	3) if transaction price is not clearly specified		Net differences ($):	0
Number of items:	24	4) if no allocation of transaction price to p.o. is specified		Notes (optional):	**1) and **2)
Planning materiality:	$12 million	5) if performance obligation is not being satisfied			
Step 2: Define population and sampling unit		**Step 4: Determine sample size**		**Step 7: Project misstatement**	
Define the pupolation:	All revenue from licensing contracts	Max. Tolerable misstatement:	$1.2 million	Projection method:	Ratio
Sampling unit:	Per language (per contract)	Estimated misstatement:	$0	Projected misstatement ($):	0
Targeted testing:	1 item of $8 million selected	Required level of assurance:	High	**Step 8: evaluation of results**	
Immaterial items:	none	Determined sample size:	6	Total sample misstatement :	0
Targeted tested:	Capital Union (contract 12-29-YT)	**Step 5: Sample selection method**		Targeted testing differences:	0
Immaterial items:	none	Sample selection method:	Random	Conclusion: No material misstatement	
	1) Contractual stipulations are identical for all entities **(see Exhibit 1)	**2) Identity of investors in German CLDC, French CLDC and Italian CLDC confirmed via confirmation letter from Deloitte under non-disclosure agreement. **(see Exhibit 2)**			

W2 SYSTEMS: STRATEGICALLY MANAGING PUNCTUATED FAMILY BUSINESS SUCCESSION

Michael D. Meeks, Louisiana State University-Shreveport
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CASE DESCRIPTION

The W2 Systems case deals with key aspects of necessitated family business succession including family post-traumatic stress, surviving spouse power, family obligation, customer and employee loyalty conversion, reputation management, strategic redirection, corporate DNA altering or reaffirmation, and career redirection and adaptation. Other issues highlighted by this case include (1) strategic planning and vision development for the visionless company Kirk inherited in 2006, (2) the reallocation of power and ownership in the aftermath of family trauma, and (3) the individual career desires versus family obligation faced by surviving family members.

W2 Systems presents on opportunity to apply key "family" theories to a living case, such as Family Development Theory, Quotidian Family Life, Work-Life Balance, Family Stress Theory, Family Systems Theory of Roles and Adaptation, Social Exchange Theory, Family Systems Theory, and Biosocial Theory. In addition, the case can address key entrepreneurial concepts such as types of entrepreneurship including necessity, lifestyle, specialist, and transgenerational; types of entrepreneurs including technicians, managers, innovators, and salespersons; as well as topics such as legal business structure, venture finance, risk management, and venture lifecycle.

CASE SYNOPSIS

Succession remains atop the list of critical factors facing family businesses. A special case of succession occurs when the process is punctuated by a death or debilitating illness at the top of an organization, resulting in the need for an immediate succession decision. This case study is about just such a situation, an examination into the history and abrupt transition of W2 Water Systems.

W2, a California company, was founded in 1986 and remains a family owned and operated business which designs and sells custom water treatment systems for commercial applications. Kirk Howard, while working part time during his high school years in the family business, had no intention of joining his father's company, choosing instead to forge his own legacy. In December 2004, Kirk was notified that his father had just been diagnosed with a life-threatening illness.

While the case represents a relatively small SME, the company has potential for growth. Can and should Kirk pursue a growth strategy in face of market indicators and opportunities, or should he remain in survival mode and tend primarily to the financial needs and emotional healing required within the family? Kirk also attempts to determine his options and balance his obligations to his family and his ambitions to pursue a career outside the family business.

INTRODUCTION

Kirk Howard, CEO of W2 Systems (W2), exalts with a grunt as he pushes out one last repetition of his last of three sets of bench presses at his local gym near San Francisco. It is August 2008, and summer is coming to an end. Hunched over, Kirk sits at the end of the flat bench recovering and feeling overwhelmed with indecision about his family's business. Serving as CEO for two years, Kirk unexpectedly took over the reins of W2 systems when his father passed of a sudden illness. The past two years have been fraught with uncertainty, grief, turmoil, chaos, and often times, panic. In many ways, he is not sure how he survived these two years, but now a decision needs to be made. What should he do? What is best for the company, for his family, for his career? Walk away and pursue another career? Sell the company and take time off? Grow the company and make a career of it? Bring in top management and retain ownership control? The stress is intense. The decision involves his mother's welfare, his sister's interest, his own career, the livelihood of eight loyal employees, promises made to more than 200 customers for whom W2 now maintains water treatment systems, and maintenance for a small group of 16 loyal customers who rely on W2 for their water treatment needs.

W2 is a water treatment company that designs, manufactures, installs, and maintains commercial water treatment systems in Northern California. Kirk's father, Don, founded the company in 1986. Don was the typical dominant patriarch of this family business, sharing only information as needed. He worked independently, focusing on building a business that could provide for his family. While Kirk did work in the business from time to time, his efforts were more busy work than educational in nature. The true education has come in the past two years.

ENTREPRENEURSHIP AND DONALD HOWARD

For Don Howard, W2 Systems was not a first attempt at entrepreneurship. Two earlier companies had preceded W2 Systems. The first company failed, while the second one succeeded. It all started in the early 1980s in San Francisco. Don Howard was raising a young family and working for a water treatment company as a water treatment salesman. The company eventually became part of Siemens Water, one of the largest companies in the industry. Over time, Don became more involved in the engineering and designing of water treatment systems. "He really loved water treatment," Kirk says. "He loved engineering and the designing of systems. It was truly his passion in life – he loved working with people and solving their problems."

It was this passion, combined with his extensive sales network, which gave Don all the tools he needed to start his own company. Don found a partner and opened his first water treatment company in San Mateo, California. The union, however, did not last long. While his partner had the requisite business experience needed to make the business successful, Don struggled with following basic business protocol. Serving as engineer of the water treatment systems company, Don was usually the first person a customer would engage about the project. Without his partner's knowledge, Don would frequently take on projects before he had purchase orders and would often give discounts to customers or offer the work for free. Although the company was growing successfully, Don eventually realized that things were not working and bought his partner out. At this point, the company was pulling in approximately $4 million annually. One of the major reasons for the company's initial success was its prime location in the Silicon Valley. At the time, Silicon Valley was experiencing substantial growth. "Silicon Valley was booming," Kirk says. "It was all industrial process water, so mainly semiconductor firms and computer chips. This was the time when Silicon Valley was exploding."

Although the company was succeeding financially, an unanticipated obstacle would arise and Don's first company would not survive. Because the company was doing so well, Don hired an accountant to control the company's finances. In 1985, Don discovered that his accountant had embezzled a substantial sum from the sole proprietorship and failed to pay the company's employment taxes. When the federal government came after the company for the past due taxes, Don was forced into bankruptcy. Declining the services and recommendations of bankruptcy attorneys, Don was able to keep the company together enough to sell it off and avoided losing his home. At the time, the company had 20 employees.

Starting Over From Scratch

In 1986, with the disastrous end to his first company behind him, Don started over. He initially began work as a water treatment engineer consultant, where he focused solely on the engineering aspect of his customers' projects. For his customer base, he relied on old contracts from his first company. Don called this second company Howard Engineering, and he ran the business out of his home in San Mateo, a suburb approximately twenty miles south of San Francisco in the high-tech enclave of Silicon Valley. Running the business out of his house allowed Don to get back on his feet and build Howard Engineering from the ground up.

The consulting company was immediately successful, and soon customers wanted Don to also build the water treatment systems he designed. Realizing that he could finally take on both aspects — engineering and manufacturing — Don opened W2 Systems, and operated it out of a small San Jose office. Because the family was still living in San Mateo, Don was spending a large part of his day away from his family. "He would wake up at six o'clock in the morning and drive an hour south to work out of the San Jose office all day," Kirk says. "Essentially, he spent the majority of his time working with clients. So, he would go to different meetings with different clients, then he'd come back to the shop and design systems, and then work late building equipment." Kirk remembers his father working a lot during the years after Don started W2 Systems. "A lot of the time he would come home pretty late," Kirk says. "He was always working." Even on weekends, Kirk remembers his father working from home.

During Don's reign over W2 Systems, it realized revenue between $300,000 and $780,000. "It's best year [was] about $780,000," Kirk says. "It's smallest being about $350,000." Throughout that period, W2 Systems employed between five and nine employees. Although there was a core group of employees, the number of total employees fluctuated from year to year depending on how busy the company was.

Although the company was successful, Kirk always believed that the company could have been run more efficiently. "It was a very loosey-goosey company without a lot of standards or business components to it," Kirk recalls. "It wasn't very systemized. There wasn't a lot of contracts or purchasing agreements. There were never financial reports. It's fair to say that my dad ran it by the seat of his pants. When mom said we needed money to pay bills, dad would go find work."

December 2004 Brings Bad News

The company seemed to plod along nicely from the time Don started it in 1986, but bad news would disrupt much of W2's progress. Out of the blue, 67-year-old Don was diagnosed with stage four colon cancer. Although Don was going to undergo chemotherapy, the doctors anticipated that Don would most likely have only three to five years to live. Because the chemotherapy would make Don extremely weak, Don told Kirk that he would have to step up and take over.

At first, it was dreadfully difficult. Kirk was really not in the position to take over the business at that time, but there was no time to delay. Initially, the transition worked. Kirk would talk with clients and gather all of the necessary information for the project. Don would design the equipment from home and then send the design to Kirk, who would write up the proposal. One of W2's employees, Curtis, would do the drawings. As a result, although Don was no longer interacting with clients, he was still involved in the production aspect of the company. Don was able to answer all of Kirk's questions, and Kirk was able to get a decent understanding of the business and how it worked.

As time went on and Don became weaker, his involvement in the company waned. By September 2005, Don was very sick and was frequently in and out of the hospital. Kirk recalls asking his father some questions about the business in November. "He was so out of it," Kirk says. "At that point, it was apparent to me that I'm now doing this without him."

To make matters worse, the family concealed Don's increasing sickness from W2's customers. Kirk and Don feared that if customers discovered just how sick Don was, they would leave. As Kirk remembers, "We were afraid that everyone was going to leave and not come back to us for more work because of his illness."

In addition to the difficulty Kirk was experiencing, one of W2's frontline employees quit. "[He] got scared and quit because my dad was sick," Kirk explains. "He was afraid the company was going to go under, so he ended up leaving and getting a job somewhere else. And that was a huge blow because he was somebody I was really relying on and was really a great source of knowledge and really knew what he was doing." After one-year of debilitating chemotherapy, Don passed away in January 2006. The timeline below shows the entrepreneurial paths of Don and Kirk Howard.

Entrepreneurial Timeline

1981:	*Don starts first company with partner in San Mateo*
1985:	*Don files bankruptcy; sells first business due to employee embezzlement*
1986:	*Donald Howard starts new business (Howard Engineering) to provide water treatment consulting and expands it into W2 Systems located in San Jose*
2000:	*Kirk Howard starts working during summer at W2 while in high school*
2002:	*Kirk Howard starts college at San Diego State University*
2004:	*Kirk Howard decides to attend junior college at College of San Mateo and starts working part time for W2 developing system designs*
2004 (Dec):	*Don Howard learns of stage four colon cancer and tells family he has 3-5 years* *Kirk Howard forced to take over some responsibilities*
2004:	*W2 has its most profitable year*
2005 (Sep):	*Don Howard is extremely sick, in and out of hospital* *Kirk takes over running of business*

Kirk's association with W2 Systems first began during the summer between his junior and senior years of high school. Kirk began at W2 building equipment. Each summer for the next four years, Kirk worked for his father. After the first summer working for his father, Kirk took on increasing responsibility in the business portion of W2. For $10 an hour, Kirk would help create marketing materials and would attend sales calls with his father.

Upon graduation from high school in 2002, Kirk moved 500 miles south to attend San Diego State University. Two years after starting at San Diego State and just months before his father was diagnosed, Kirk decided to take a year off from San Diego State and attend the College of San Mateo (CSM), a local community college. Kirk attended CSM and worked part time for his father at W2 Systems. In addition to learning about the business, Kirk helped develop system designs for the company in order to make it more efficient. "Instead of having to design a piece of equipment every time we got a job, we'd have a standard design," Kirk says. With Kirk helping with these aspects of the business, Don was free to spend more time designing the equipment.

When Don was diagnosed with colon cancer, Kirk immediately took the reins. As his father struggled through chemotherapy, Kirk took on more and more responsibility at the company and eventually began running it on his own. One thing that struck Kirk when he took over W2 was how simple it seemed to be to run the company. "I was struck by the simplicity of it," he recalls. "It seemed so much more complicated when my dad was doing it. And it seemed much simpler than it had appeared in the past." This gave Kirk the confidence he needed to take over the company earlier than anyone in the family had anticipated.

Kirk was also struck by how cooperative people were, because he had always viewed the running of a business as a cutthroat profession. "It was more like buddy buddy," Kirk says. "It was good friends, and everybody was very nice. It was sort of a very relaxed environment in that way." That was not to say, however, that W2's customers were always nice. "They would be the nicest, greatest people, [but] if you were ever late with your equipment or something, they would turn and become angry," Kirk says. For Kirk, that was troublesome. "It was very hard for me to deal with people getting angry," he recalls. "I took it very personally." Although it has been a challenge, Kirk believes he has learned to effectively cope with customers who become angry.

In Retrospect

Before Don was diagnosed with colon cancer, there was no succession plan in place. In fact, Don had been contemplating selling the company. "I was working on doing the business plan and putting things together to get it ready to sell," Kirk remembers. "And then his being diagnosed with cancer kind of put a kink in our plans." Naturally, when Don was diagnosed, Kirk became extremely busy just trying to keep the company going, and all plans to sell the company slid to the back of his mind. Kirk remembers being incredibly overwhelmed for the first two years. As he recalls, "The first year he was sick, but still alive and contributing, and the year after he passed everything was so frantic. That whole time, I was very much in fight or flight mode. . . . All the business stuff I had been working on previously was pushed aside. But at the same time I was still improving the company's operations and processes, putting in place, control processes and trying to make W2 operate more like a traditional company. But as time went on, I was doing less and less of that and doing more and more firefighting and daily operations and really just making sure that it was surviving."

As Kirk thinks back to the time when his father told him to step up and take over the family business, he surprisingly does not remember any initial feelings of fear or intimidation. "I really was incredibly driven to make the company succeed with or without him," Kirk recalls. Once his father died, however, fear inevitably set in.

Three or four days after Don died, one of W2's clients called and asked Kirk if W2 could do a particular type of system cleaning. Kirk had no clue. "I just remember running around in the office for about 18 hours, reading books and going online to research," Kirk recalls. "I was so afraid because I didn't know how to do this thing and feared I wasn't going to be able to figure it out. And finally at the end, about 2:30 or 3:00 in the morning, I figured it out, and I understood it. Wow, what a relief." For the six to eight months after his father's death, Kirk would experience several days just like this one. On many of these days, Kirk contemplated selling the business. As Kirk remembers it, he kept thinking, "We've got to figure out how to get rid of this thing. It's going to kill us all. I'm going to end up screwing something up so badly that the whole thing's just going to fall apart right in front of us, and we're going to lose everything." Over time though, Kirk's day-to-day successes changed his mind. "It was figuring out one thing after another and that led to a belief structure that I could do it."

But despite the fact that he was gaining confidence in his ability to operate W2 Systems, Kirk still did not feel happy.

Transitioning While Maintaining

During the transition period while Don was still at the helm, money was extremely tight. "We were barely squeezing by," Kirk says. In 2004, the company experienced its most profitable year-to-date. This provided some cash reserves going into 2005. Unfortunately, 2005 was not as profitable as 2004. This was in part because of the loss of W2's frontline employee, but also in part because of divergent viewpoints between Don and Kirk about how the company should be run. Kirk favored a more traditional business model, while Don wanted to continue to run the business in the loose manner he had always run it. Kirk admits that this was confusing for W2's employees and customers.

Still struggling with the transition, 2006 was another bad year for W2 Systems. Even with approximately $400,000 in revenue, the business operated at a loss for the year. But as Kirk began to get a grasp on how to run the business, things began to get better. "2007 was the first breakeven year for the company since I took over. In that year our revenue was $600,000," Kirk says. That is not to say it was not a scary year for Kirk. "It was a rough year because we'd run out of cash reserves from 2004," he recalls. "It was a roller coaster ride. We were barely eking by." During that time, Kirk struggled to support himself and his mother, which included making the mortgage payment on his parents' home. Somehow, however, W2 Systems managed to survive.

It was a difficult transition, but he had a lot of support from his family, employees, and customers. But after his father died, Kirk struggled with transitioning the company into a more systematic and organized business. Kirk had always felt that his father's loose operation style had inhibited the company's growth, and he felt that making the company more organized and systematic would take W2 Systems to the next level. With this vision in mind, Kirk set out to change W2 into a more business-oriented organization. One of Kirk's challenges was keeping employee morale positive during this process. In doing so, Kirk faced opposition from employees who had grown accustomed to the status quo. Part of his challenge was the result of Kirk's status as a former employee. "I didn't want to be the W2 Systems tyrant," he says. "Instead I wanted to create a team dynamic where everyone works with each other, and everyone has input."

Kirk worked diligently to maintain a good relationship with his employees throughout this process. He talked to his employees and shared with them his vision. He made sure that they understood that the process is not about phasing them out, but more about making the company more profitable and taking some of the pressure off the employees. Rather than thinking about the changes in terms of replacing a bad system, Kirk framed the transition as more of an improvement on a good system. "It's a much more equal working environment, much more team-oriented now," Kirk reflects.

Two years after initially asserting control, Kirk has successfully grown the company, moving the operations into an office space in Brisbane, California, just 12 minutes north of his parent's home. For the first time in the company's history, 2008 would bring W2 $1 million in revenue.

A Helpful Hand and a Potential Hand-over

During the transition period, Kirk was virtually alone. His mother, who had previously had some involvement in the company, was all but absent. Her signature was still on the company checks, but other than that, she was not involved in the running of the company. Beginning in 2007, however, Mary took on a more active role in the company. She began generating financial reports for the company so Kirk would have a more realistic picture of W2's fiscal fitness.

Part of the drive behind Mary's renewed involvement was a potential sale of W2 Systems. Halfway into 2007, one of W2's Southern California competitors approached Kirk, expressing an interest in buying W2. This seemed like an ideal situation for Kirk, who still had not found happiness in his position as the head of W2 Systems. Essentially, they were going to come in and take over the company. For that, they would provide all the infrastructure of a larger company. Basically, W2 would continue to do all sales and service out of its Brisbane office. The competitor would do the design work and build the equipment. During this time, Mary would take salary as compensation for the company. She would no longer be required to work. Kirk would be given $36,000 a year plus commissions for running the Brisbane shop. He would also travel around the U.S. as a salesperson. Kirk estimates that as a result of the deal, he would have likely made $80,000 a year.

In the summer of 2007, however, the deal fell apart. "We came to the realization that they were not going to be able to give us the money that we needed, while maintaining a reasonable lifestyle, and allowing us to move forward," Kirk explains. At this point, Kirk was unsure how to proceed.

Costa Rica Provides Respite Clarity

Just before the deal with W2's competitor fell through, Kirk realized that he needed to do some soul-searching—to figure out whether this was what he really wanted. He was stretched to the max. At the time, Kirk was working 12-hour days and was having a tough time sleeping. "I couldn't remember what I did yesterday because I was so exhausted and so stressed out that my mind kind of shut down," he remembers. "I just got to the point where I was completely overwhelmed, and I was freaked out. I was losing control of myself and the business." In addition to the stress of the business, Kirk had withdrawn emotionally from life. "I felt almost like a robot. I'd completely taken my emotions out of my life. And a lot of that was because I hadn't dealt with my dad; I had pushed it aside."

For some time, Kirk's friends and sister had been encouraging Kirk to take some time off and get away. He asked his mom if she could handle things in his absence. She fully supported his taking the time off. Immediately, Kirk purchased a plane ticket and flew to Costa Rica. He spent two weeks on a Costa Rican beach thinking, writing, and reevaluating his position. For those who find themselves in a similar situation, Kirk cannot stress enough how crucial taking a break can be to the success of a business. "The biggest problem is that you're exhausted," he says. "You're under so much stress and you sleep so little, and there's so much going on and there are so many distractions. You're always bombarded. What really clarified it for me was when I went to Costa Rica. That was the point where I was able to understand where I wanted to be and what I wanted to do."

The trip to Costa Rica was exactly what Kirk needed. He came back to the Bay Area refreshed and ready to make an honest attempt to turn W2 Systems into a "very" profitable company. Kirk launched his first marketing campaign for a company determined to increase sales. He also started working with everyone, realizing that building a positive work culture was important to rebuilding the company. With the help of his mother and his renewed vision for the company, Kirk grew 2008 sales to $1 million.

Kirk believes Costa Rica was critical for him. Upon returning home, he made some big changes in his life. "I got a gym membership, and I started yoga; I started exercising a lot more," he says. "And I saw a therapist. I started taking better care of myself, so I started going to sleep earlier and reading more and writing in my journal more. I decided to really focus on my life, and really bring it back under control and totally spend my time focused on making things right."

The Grieving Process

It is important to remember that Kirk was not only undertaking the monumental task of taking over control of W2 Systems, he was also dealing with the personal crisis of losing his father. When Don was diagnosed with colon cancer, Don and Mary withheld the true picture from the kids. "We really didn't know anything about anything," Kirk recalls. "I mean, we didn't even really know how bad his cancer was. When they explained it to us, they had told us it was going to be three to five years, and he was going to have to go through chemo and so on. In reality, they knew that he was not going to make it, and that it was going to be really hard, and that it was very possible he was going to be dead in a year." Kirk didn't actually realize how bad his father was until September 2006, five months before his father passed away.

Even Kirk admits that the stress and pressure of taking over W2 took away any chance he had of personally coping with the death of his father. Several months after the death of his father, Kirk sought out the help of a therapist. "I started to deal with it," he says, "and I've been kind of working through that – it's been a journey."

Kirk realizes that his father's illness was unforeseen, but stresses that his parents should have planned better for such an unforeseen situation. "I think that you have an obligation to your family to understand that the possibility is always there, no matter how good life seems, no matter how [well] things are going," Kirk explains. According to Kirk, that is why it is necessary to have an exit plan in place. One way to do this is to make the company liquid, which would ensure that "the transfer goes smoothly or you could sell the company off or something can be done so that you don't end up in the situation where you kind of ditch the company off on your son and say, 'Hope you can do it.'"

The loss of his father also changed Kirk's family dynamic. Don was the head of the family, and when he died, his mother became introverted. Mary did not step in and become the leader of the family, and they all did not unite in the way many families do in the face of such a loss. Kirk and his sister found solace in each other, but Kirk's relationship with his mother fell apart. "My mom withdrew and became quiet," Kirk recalls. "And this going off on [her] own created an alienation because we were a family. I was basically taking care of my mom. I was running the company that was paying her so that she could pay her house and eat. And to have her walk away and not talk, that was a big alienation." It took a long time and a lot of conversations for Kirk and his mother to get back their relationship. Working together has also helped them forge a tighter relationship. Don's death changed the Howards' family dynamic. "I think now we're almost like three friends rather than a mom and her two kids," Kirk explains. "It became much more an equal dynamic versus where my dad was very much in charge."

Don't Be the Lone Ranger

For those who find themselves in a similar situation, Kirk advises them to seek out a support network as quickly as possible. Kirk regrets not taking advantage of the multitude of resources available to help him cope with the situation. "There's such a support network," he explains. "There's always somebody who's willing to help, whether it be going to programs at the university, going to a program at a Small Business Development Center, or reaching out to friends and family."

Kirk also recommends not getting "lost in the chaos." As Kirk explains, "I think that hurt me a lot. I think you have to understand that you have to work through it and take the time to talk to people and to talk to your friends and to really have people who support you both emotionally and business-wise. Don't be the lone ranger." As Kirk elaborates on this idea of being the lone ranger, he says, "You're never going to be strong 24/7 by yourself. You have to have other people; you have to have a support team."

THE HOWARD FAMILY

In 1963, 26-year-old Donald Howard, met 22-year-old Mary. They were married in 1972. Mary gave birth to Christine in 1978 and Kirk in 1983. Donald and Mary were considered outstanding parents by those who knew them, very supportive of their children, and always willing to sacrifice for the family. Christine and Kirk were raised in the average American middle-class San Francisco urban neighborhood, both attending public schools.

Mary Howard

Prior to her involvement with W2 Systems, Mary worked for AAA, the Automobile Association. In 1976, she became the first female manager in the history of the company. After giving birth to Christine in 1978, however, Mary devoted herself to being a stay-at-home mom. During the early years of Don's entrepreneurial ventures, she performed the accounting for the businesses, but she did not become proactively involved after Don's death in January of 2006. And even at that point, her help with the accounting was very limited, as she was only responsible for depositing checks and paying bills. It was not until 2007 that she took on a more active role in the business by managing the finances, creating monthly financial statements, and advising on strategic issues.

Christine Howard

Growing up, Christine's feelings toward W2 Systems were drastically different from Kirk's feelings. While Kirk showed an interest in W2 Systems during high school, working for the company off and on so he could learn about the business, Christine had no interest in the company whatsoever. "My sister never wanted anything to do with the company," Kirk recalls. "She was always very detached from it and saw it as something that had taken her father from her. She felt she didn't get time from him because of the company. So she had a negative feeling for the company." She is married and still has no direct involvement with the company. She has repeatedly argued that she wishes the company would go out of business." It seems all my sister is concerned with is having children and raising a family."

THE INDUSTRY

W2: The Company

Donald L. Howard started W2 Systems in 1986. After working in the water and wastewater treatment field for more than 20 years, he built up an expertise in the industry many say was second to none. After patenting several designs, growing multi-million dollar companies, and being part of some of the water treatment industry's largest mergers, Donald Howard decided it was time to start his own company. The company was based on the idea of cost-effective, simple systems that got the job done in an efficient and user-friendly way. To this day, W2 Systems has continued to build systems that break the mold, with a simplistic design that lasts longer, works more efficiently, and costs less. W2 Systems has continued to research, design, and manufacture turnkey treatment systems that are easy to operate and even easier to service. Today, W2 Systems is a growing company. As the company perfects its designs and processes, W2 Systems is working to not only take on a larger market share, but also to expand deeper into the waste treatment industry.

W2 Systems is now offering the best designed, highest efficiency, systems available in the marketplace. It is currently running full throttle on a campaign to specialize in its niche, transfer stations, waste neutralization systems, and metal treatment systems. Not only does W2 Systems design exceptional process waste treatment equipment, it also offers what few others can—expertise in design and service. The vision for W2 Systems is a company built on passion, with uncompromising ethics, attention to quality, and drive to succeed.

Electro Deionization (EDI) Water Systems

W2 Systems offers various options for the production of SEMI grade and USP Purified water, taking into consideration feed water analysis at the particular site, as well as factors related to cost, operation and maintenance.

EDI Water Systems ideally purify RO permeate water to a level of 3-10 micro-siemens, but depending on quality needed, up to 20 micro-siemens, without using hazardous chemicals for deionization media regeneration and without concentrate recirculation. The EDI modules are supplied by Electropure EDI, Inc, which has the original EDI patent (1984) and has supplied more than 1500 electro-deionization modules. W2 Systems, which has served high-technology industries with standard and custom water treatment systems over 20 years, integrates the EDI modules into a turnkey skid module. The EDI System is mounted on an epoxy-coated steel frame and fabricated to allow single-point connection, reducing field install labor cost.

Advantages over Conventional Deionization systems

EDI does not require chemicals (as does DI resin regeneration)
EDI does not require shutdowns
Electropure EDI modules are the most compact per unit flow
Provides water of consistent quality
Requires little energy
Economic use of capital—saves operating expense Process

KIRK'S VISION FOR W2 SYSTEMS

Financial Outlook & Restructuring

With its current vision, Kirk sees W2 Systems achieving sales of $1.5-million by 2011. Eventually, Kirk would like to incorporate W2 Systems. He is inhibited from immediately doing so because the company is still carrying the debt from past years on the books, which they will not be able to write off if they incorporate. "The plan is to incorporate," Kirk says. "We're trying to get rid of the debt before we do that."

Financial Outlook – Hiring Needs

Kirk is now able to hire some employees and anticipates hiring more people as things progress. "Things are looking really healthy at this point," he says. Initially, Kirk would like to bring in someone with extensive engineering experience. "Because of my lack of industry expertise (my strengths being in business, not engineering), I think the company would be best suited to bringing on an experienced engineer with good skills and experience in the industry. He would take over product design and development, engineering, product specifications, as well as writing for promotional and public relations materials, etc. I'm debating between whether to outsource until we grow larger and bring on a full-time employee when we can afford $100,000 salary, or to bring on a partner. It seems better to build and then hire; we don't want to get stuck with someone who doesn't fit or who misrepresents their capabilities or commitment. Everything this hire will do is to be double-checked to assure it is to standard and quality that we expect. He would have no business authority but would need to have industry expertise. Trustworthy would be ideal, but we have the checks and balances in place to not require someone totally trustworthy. The industry is fairly cut and paste, so intellectual property and system information isn't a huge issue, although he would need to sign a non-compete and non-disclosure before starting to work for us."

Financial Outlook – Business, Industry, and Product Growth

There are two industries W2 can currently service. It currently services one segment but not the other. The first segment is industrial, commercial, and municipal water treatment. These are high flow, large ticket systems. W2 only needs to sell a few per year and work hard on each project. These systems require greater knowledge, more design, and engineering work, but no aesthetics are needed. Post purchase consumer needs are rare unless the customer wants preventative maintenance or some small amount of help. Customers demand performance but typically nothing else.

The second industry is private or consumer water treatment. This industry is heavy in customer service. There is no engineering involved, but a lot of marketing is needed and much more system throughput is needed. Success here is based on volume, aesthetics, and customer service. This is a much more demanding industry in Kirk's opinion, so W2 has looked into mass production or large, commercial residential work, to tap the market without having to deal directly with single private consumers.

Growth in the industry has been on the incline. Critical mass hit in the mid-1990s and continued with explosive growth until the dot.com bust of the late 90s. It declined again after 9/11. The main industries serviced, in extremely high growth segments, were Silicon Valley technology companies and biotechnology companies throughout the San Francisco Bay Area and surrounding regions. Today, the industry is once again experiencing tremendous growth as biotechnology is exploding and semiconductor and tech companies are experiencing a resurgence. Because of the explosive growth throughout the 1990s, there is now a tremendous demand for service and upgrade work throughout this entire geographic area. This has become a focal point and large growth area for W2 Systems and its local competition. Large consumer systems, technology R&D, and manufacturing biotechnology are all doing well with explosive growth once again. Without specific percentages, Kirk believes that growth is generally around 25 percent per year for industrial water treatment. GE, Siemens, and ITT are all big players in the industry, and they have recently engaged in an acquisition frenzy, buying up lots of smaller companies at eight to ten times their individual EBITDA. The industry is currently in a huge consolidation phase. Green business is also growing as consumers demand more sustainable initiatives. This is adding to the buying of cost effective, sustainable treatment systems, which is leading to faster technological growth and price sensitization in the industry than ever before.

Generating New Sales

W2 Systems has subsisted on repeat customers, warm contacts, and referrals for years. There has never been a marketing or cold sales effort made. Kirk's first goal in his new plan is to reestablish connections, show that the business is thriving and growing and able to do the work as well if not better than W2 could before Kirk's father died. Getting in contact with old contacts and customers who had strong relationships with Don has been a main focus for Kirk the past two years. Kirk's goal now is to show them that the business is thriving, that he is improving the company, and actively trying to reestablish connections. As Kirk does this, he is also exploring and developing several new strategies to grow the company and increase awareness.

1. <u>The Internet</u>: W2 Systems is currently generating new leads through its website, but they are inconsistent and extremely competitive, which makes it hard to get a reasonable closing rate. Kirk is in the process of developing a new website to optimize search capabilities with the ultimate goal of getting it onto more listings, blogs, databases, and industry specific sites. Kirk is also adding diagnostic tools to help consumers choose systems. His team is putting together the only comprehensive, informational database that is available in the industry today in order to draw more traffic and increase name recognition. The site will eventually have an engineering tool for people to select the system they need. This is a long-term project that is in development, but is something the industry lacks in catering to contractors and other companies that want inexpensive systems that are quick and easy. The concept is to sell water treatment systems like cars. The customer purchases a base model and adds custom options to create a specific, pre-engineered system for the customer's specific needs.
2. <u>Service</u>: With the large amount of small companies and struggling and underfunded companies that are survivors or newcomers from old sites during the 1990s, there is a huge need to maintain older systems and upgrade without having to buy brand new equipment. W2 Systems currently does this with many of the systems that the company built. The company, however, rarely gets accounts for systems built by other companies. By increasing its service presence in the Bay Area and becoming the only full service company centralized in the Bay Area, W2 is gaining name recognition and can become the go-to company for water treatment goods in the Bay Area. W2 is actively marketing service through mailings and follow-up calls offering a free "system assessment report," where the company inspects systems and generates a report on the status of their systems. So far, W2 has generated these leads through the local municipal districts water discharge permit listings, warm leads, and old customers.
3. <u>Public Relations</u>: By writing articles for industry magazines and going to trade shows, W2 is defining itself as an industry specialist. Kirk is also considering authoring a quarterly newsletter, white papers, and maybe an e-newsletter. Public relations is not a focus right now because it is more time consuming and less immediate-result oriented. As sales increase, however, strengthening cash flow and making more resources available, this will become a stronger part of W2's efforts.
4. <u>Engineering Firms</u>: This effort requires providing materials and expertise as needed to reputable engineering firms to eventually become their go-to water treatment partner. The plan is for these engineering partners to seek advice from W2 regarding water treatment

specifications and technical information. An additional benefit is for W2 to be placed on preferred bidder lists, as often these engineering companies specify who is allowed to bid on a project.

5. Contractors: W2 is developing a pre-engineered, turnkey program that will have fully designed equipment that will require no engineering work. It will require simply adding components to base systems and sending off already completed design and paper work. Kirk wants to keep this in the office, so the engineers do not have to work on it. By creating these systems, W2 will achieve the quickest turnaround time and fastest design-to-build time in the industry. This program is catered to contractors who are looking for quick, simple systems at very competitive prices. W2 intends to establish relationships with large contractors so that they have an easy, go-to company when they need water treatment equipment. W2 is currently putting together the sales packets and contacting contractors. Kirk wants to build strong relationships so that instead of long competitive bidding processes and large design phases in projects, these contractors do not need to think. They just call W2 and purchase a system.

The costs to implement these projects include (1) the time to develop systems, (2) creating brochures, (3) hiring an industry specialist, and (4) advertising. The largest cost will be the $100,000 salary of a decent industry specialist. Kirk estimates that it would cost approximately $1,000 for the website and $5,000 for brochure design and printing (which can be cut down by designing and printing in-house, which would then make the cost closer to $1,000). As W2 continues to grow, advertising, which will include public relations, will cost $10,000 per year by 2010. A turn-key, pre-designed systems database will cost about $50,000 to fully implement, but this cost is primarily the cost of organizing and fine tuning by Kirk and his draftsmen. Most costs are not recurring and become maintenance and upkeep. Kirk estimates that W2 will spend $70,000 per year on marketing and sales related work by 2010.

Long-term Vision – Exit Strategy

If Kirk decides to grow the company and implement this plan, he foresees stepping down as general manager of the company in three years. Kirk wants to be involved in the company, perhaps as a director on the board of directors. He also thinks that would be an appropriate time to buy his mother out. In five years, Kirk knows that he will likely be interested in starting a new company. He is unsure whether he would like to maintain an ownership interest in W2 Systems at that point.

Long-term Vision – Staying Put

If Kirk decides to implement this new plan and to make it his career, he will remain as the general manager, and eventual CEO. In this scenario, he envisions W2 as a company built on passion, with uncompromising ethics, attention to quality, and drive to succeed. As the business world transitions into the new millennium, there is a growing water-related awareness, interest, and market need. Clean and green has become the mantra of the business world, and sustainability is the new corporate mindset. Global warming, energy, food, and water are clearly the key emerging issues, which positions W2 quite nicely in the near future. Water quality, testing, treatment, recycling, and environmental stewardship show tremendous market promise. W2 is uniquely positioned to take advantage of this emerging business environment.

WHAT TO DO?

This case allows us to examine a plethora of family business issues. From a business perspective, is W2 Systems a viable entity? Will the custom water systems industry remain munificent in the Silicon Valley area? Will and should Kirk continue to expand his understanding and knowledge in water treatment systems? Is the business stable? Are key employees satisfied and loyal? How expendable are certain individuals in the firm? Who actually owns W2 systems?

From a family perspective, we have multiple issues that impact the business. Has the family recovered from Don's unexpected passing? Is the family unit healthy? From a family and individual perspective, are family members developing personally, and is the family developing in their relationships and interactions? What should Kirk do? Is it his decision? If Kirk were to pass unexpectedly, or leave the company unexpectedly, who would take over?

SAGE HILL INN ABOVE ONION CREEK: FOCUSING ON SERVICE QUALITY

Michael W. Pass, Sam Houston State University

CASE DESCRIPTION

This case helps students improve their understanding of consumers' evaluations of service quality by having them describe consumer expectations and factors that influence them. It also helps them understand research methods used to measure and monitor consumer expectations and perceptions as well as identify potential service failure points. The case difficulty level is 3-4, so it is suitable for undergraduate junior or senior level students taking services marketing or services management courses. It is designed for use in conjunction with the introduction of these specific topics: Five Dimensions of Service Quality, SERVQUAL, Research Design, and Service Blueprinting. The case is based on information from discussions between the author and Amy Dolan, innkeeper of Sage Hill Inn Above Onion Creek. In addition to the case, the website (Sage Hill Inn-Boutique Hill Country Inn) should be accessed for information.

A field test was undertaken with two undergraduate student classes taking a services management and marketing course. Seventy-eight students completed the case by working in teams of three students. The research methods topic requires up to an hour to teach in class while the other three topics are covered in about 30 minutes. Discussion of case answers takes 15-30 minutes. The time outside of class is generally two hours to prepare an answer for each case question.

CASE SYNOPSIS

Sage Hill Inn Above Onion Creek is located 25 miles south of Austin, Texas and a few hours drive from San Antonio and Dallas. Formerly known as the Inn Above Onion Creek, the property was purchased in 2012 by Eric Goldreyer, founder of bedandbreakfast.com, and John Banczak, former president of the internet firm. Features and services have been enhanced in order to attract new guests while continuing to appeal to guests that stayed there when it was known as the Inn Above Onion Creek. A conversation between Amy Dolan, the innkeeper, and a consultant indicates three needs: (1) the need to understand guests' expectations, (2) the need to determine and monitor guests' perceptions, and (3) the need to identify potential service failure points.

Students take the consultant's role when completing the case. They first describe each dimension of the Five Dimensions of Service Quality including examples of guests' expectations for a hotel stay. Students are also asked to describe factors that may influence formation of the expectations. To improve their understanding of how to measure the dimensions, they also study the use of SERVQUAL within the hotel industry. Students then describe research methods that can be used to measure and monitor guests' expectations and perceptions. Finally, they learn how to analyze service blueprints to determine potential service failure points.

INTRODUCTION

Sage Hill Inn Above Onion Creek is a popular lodging destination for those visiting the Texas Hill Country to relax and experience nearby attractions and activities. Located in Kyle, Texas, the 88-acre property is 25 miles south of Austin, Texas and a few hours drive from San Antonio and Dallas. The property, formerly known as the Inn Above Onion Creek, was purchased in 2012 by Eric Goldreyer, founder of Bedandbreakfast.com, and John Banczak, former president of the internet firm. The new owners focused on enhancing the popular Inn Above Onion Creek by adding new services, updating the facilities and expanding the use of environmentally-conscious practices. John Banczak was quoted in The Houston Chronicle as saying, “When we purchased the inn, we loved the location and topography of the land and surrounding area, and the architecture and layout of the main inn and buildings”… “So we set out to redesign with a modern yet rustic aesthetic, while trying to stay true to the Hill Country area" (Elliott, 2014).

A business consultant staying at the inn wanted to know more about the changes so he asked to meet with Amy Dolan, the innkeeper. She said, “We do our best to maintain excellent service in order to build repeat business and obtain positive word of mouth. If guests’ expectations are not met, then they are likely to be dissatisfied and occupancy rates will decline. That means lower revenues.” To continue attracting previous guests of the Inn Above Onion Creek and build loyalty among ones staying at the inn for the first time, Amy Dolan said, “We must listen closely to understand what they expect when deciding to stay here and, afterward, how they feel about their experience. With this feedback, we can provide an experience that meets expectations and effectively resolve service problems that are creating guest dissatisfaction.” In addition to knowing more about guest expectations and perceptions, she said it would be good to identify potential service failure points. These could then be monitored more closely, thus ensuring guest satisfaction.

BACKGROUND

When operating as the Inn Above Onion Creek, the lodging was designed to resemble a Texas homestead of the 1800s with a main house of rustic redwood and a second building similar to one an owner would build when expanding the family’s living area. The twelve guests’ rooms, named after famous Texans, conveyed the homestead image with a mix of modern amenities and antique furnishings. A gourmet breakfast and dinner were included with each overnight stay. Among the design changes for Sage Hill Inn Above Onion Creek were updated guest rooms with new flat-screen TVs and more contemporary furnishings. There are three suites, eight guest rooms, three cottages, and a three-bedroom ranch house. The cottages and ranch house include amenities such as gourmet kitchens, oversized porches and a private hot tub. The grounds were improved with a larger pool deck, a 14-person spa, and a large outdoor fire ring. Many other changes and service additions were completed, such as opening the Garden Spa in a separate building with four massage rooms, a lounge and covered porch overlooking a flower garden. The website for the inn (Sage Hill Inn-Boutique Hill Country Inn) has numerous photographs of accommodations and descriptions of services and activities available to guests.

A gourmet prix fixe breakfast and three-course dinner are included with each overnight stay and lunch is available, by reservation, for an extra fee. Individuals not staying at the inn may also enjoy dining at the inn by making reservations in advance. Chef Ryan Castille creates the menus with fresh produce from the garden and draws on local suppliers for seasonal ingredients.

The dining room is always open with complimentary tea, coffee, soft drinks, and a selection of homemade cookies. Across from the dining area is a large library with enough seating and tables for meetings and a wide selection of books, games, and DVDs.

GUESTS' EXPECTATIONS AND PERCEPTIONS

Knowing what guests expect is important because their satisfaction with the quality of a service is formed by comparing perceptions of a stay to previously formed expectations. Amy Dolan talked with the consultant about how guests' expectations form as they find out about a hotel property from a variety of sources, including friends and family, guidebooks, websites and previous experiences at the inn, or similar properties. She stressed that, "the website plays a big part in shaping perceptions of what they may experience when staying at the inn." The consultant said that it would be good to examine the website (Sage Hill Inn-Boutique Hill Country Inn) for explicit promises (e.g., breakfast and dinner menus) and implicit promises (e.g., pictures of the inn) that influence the development of expectations. He suggested that the *Five Dimensions of Service Quality* could be used as a guiding framework to figure out expectations and that a SERVQUAL questionnaire could be used to measure the five dimensions (i.e. responsiveness, assurance, tangibles, empathy, and reliability). However, he indicated some concerned about all of the five SERVQUAL dimensions and survey questions being useful for the hotel industry.

After a guest checks out, an e-mail message is sent thanking them for choosing to stay at the inn and asking for feedback via Google Reviews, bedandbreakfast.com or tripadvisor.com. These websites are monitored by regularly reviewing comments and responding to guests when they express a concern about their stay. Amy Dolan said, "Customer comments are helpful but some guests do not post a message on one of the websites. We don't know how they felt about their stay with us." The consultant explained this as a reasonable concern because, on average, across all services, only 50% of consumers complain about a problem they have with a service (Goodman, 1999). Several comments from previous guests were examined to obtain an understanding of how they perceive their stay inn. For example, the excerpts below show guests' perceptions of the caring individualized attention experienced while at the inn.

> "The innkeeper welcomed us by name, gave us our key, and showed us around the dining room, kitchen, and library. She was so welcoming, we felt right at home from the beginning."

> "We arrived a bit late, as we were both coming from work on a Friday. The innkeeper actually went above and beyond to accommodate us by plating our dinner so we could eat in the calm of our cottage."

FAIL SAFE THE GUEST'S EXPERIENCE

Service encounters occurring during a stay result in guests' perceptions of property features and interactions with the staff that may lead to satisfaction or dissatisfaction. In addition to identifying guest expectations before a stay and perceptions afterward, Amy Dolan expressed that they "would want to identify any *potential* service quality problems so they can be handled effectively." The consultant agreed that determining potential failure points, in advance, would help to fail safe the guest's experience. He said that closely examining the inn, as if you are a guest visiting for the first time, helps to identify areas requiring more attention. To this end, a service blueprint (Figures 1 and 2) was developed that represents the service process experienced by a guest during the first and second day of a stay. An initial review identified one potential failure point; guests have to carry their own luggage to the rooms.

CONSULTANT'S CONTRIBUTIONS

The consultant confirmed with Amy Dolan that he would help her with the situation by recommending ways to learn more about guests' expectations and perceptions. She could then decide which ones would be implemented as a research program at the inn. Before developing recommendations, he wanted to look at the website (Sage Hill Inn-Boutique Hill Country Inn) to get an idea of guests' expectations. The consultant also needed to complete secondary research to find out if a research tool based on SERVQUAL exists for the hotel industry. Finally, he wanted to examine the service blueprint to identify where there is even a remote possibility that guests' perceptions may not meet their expectations. Identifying these potential failure points would help to fail-safe the guests' stay at the inn.

Figure 1
Guest's First Day

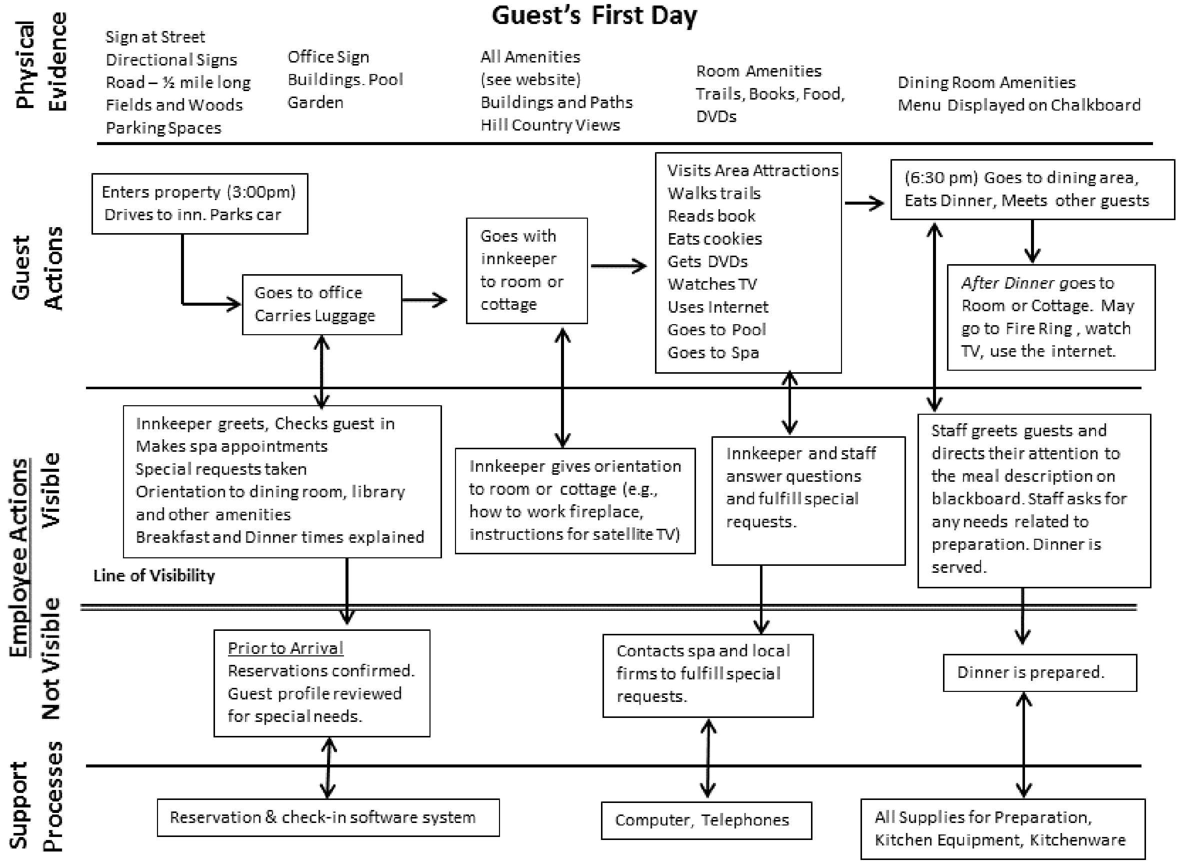
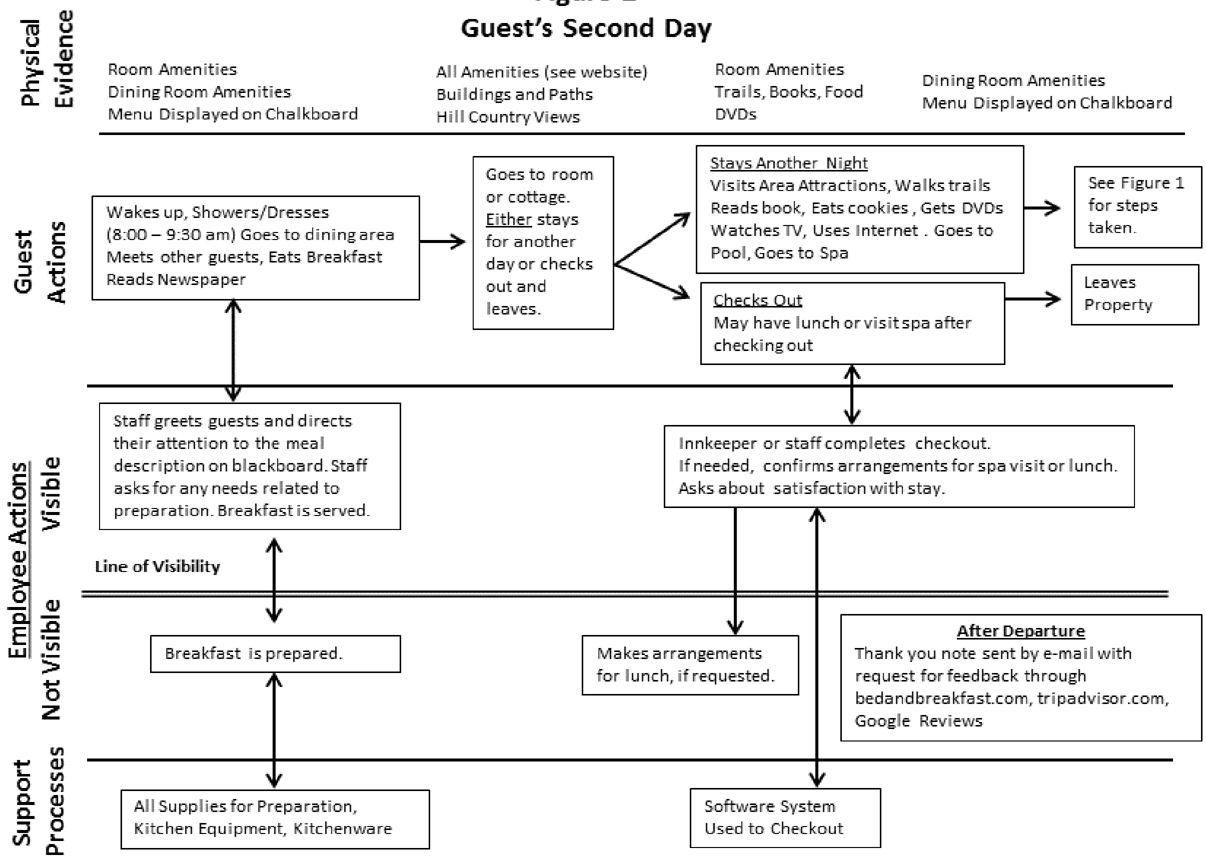


Figure 2
Guest's Second Day



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OLD WORLD BAKED GOODS: AN APPLIED EXERCISE TO DEMONSTRATE ATTRIBUTE SAMPLING

Stephen Perreault, Providence College

CASE DESCRIPTION

The primary learning objective of this case is to demonstrate to undergraduate business students how to use attribute sampling to test internal controls within an auditing context. Upon completion of the case, students should become familiar with 1) the definition and purpose of attribute sampling, 2) the factors which determine the necessary size of a sample, 3) the means of evaluating sample observations, and 4) how to draw inferences from the results of a sampling procedure.

The secondary learning objectives of the case include increasing students' understanding of factors which influence the assessment of audit risk as well as increasing students' understanding of how control testing fits into the overall audit plan. The case has a difficulty level of four and is appropriate for senior level courses, in particular courses which deal with auditing and attestation. The case typically takes approximately one hour of class time to complete and discuss.

CASE SYNOPSIS

Teaching attribute sampling can be difficult for auditing instructors, as students often struggle to comprehend how the technique can be applied within a real-world audit setting. This in-class exercise helps to alleviate this difficulty, by giving students the opportunity to demonstrate their understanding of attribute sampling concepts within a realistic auditing context.

Students are provided with a vignette describing the company being audited and also presented with selected financial statement information. The vignette also describes an internal control that, if operating effectively, may be relied upon to reduce the auditors' assessment of control risk. Using this information, students are required to develop an attribute sampling plan to test whether the control actually is operating effectively.

A unique feature of this exercise is that students are provided with outcome-feedback at its conclusion. That is, they are not only asked to design an attribute sampling plan, but asked to execute the plan in-class as well, requiring them to determine whether the results of their procedures suggest that the internal control can be relied upon. A series of de-briefing questions is also provided which allows for classroom discussion of the relevant issues examined in the case.

CASE BODY

Introduction

Old World Baked Goods specializes in the production, sale, and distribution of traditional European baked goods and pastries. The company maintains a 60,000 square foot baking and distribution facility located in Smithfield, Rhode Island. It primarily sells its products to supermarkets and specialty food stores located in the Northeast and Mid-Atlantic regions of the United States. Selected financial statements for the current year under audit as well as the prior year's audited financial statements are provided in Figure 1.

The industry the company operates in is highly competitive. Most major grocery chains, which have historically made up the majority of the company's customers, now have "in-house" bakery departments which produce baked goods on-site. These bakery departments are increasingly offering high-end pastry items, which not only compete directly with the products offered by the company, but also take up valuable shelf space which was previously available for items produced by Old World Baked Goods. In addition, the increasing popularity of "gluten free" living has led many consumers to reduce their consumption of wheat-based bakery items. As a result, many major grocery store chains are reducing their purchases from traditional bakeries, such as Old World, and increasing their purchases from alternative bakeries which produce "gluten free" and allergen-tolerant baked goods.

As a means of reducing the company's reliance on chain grocery store sales, Old World is increasingly targeting specialty independent grocers, as well as small restaurants and cafes, as a means of growing its sales. While these establishments are new customers for the company and are generally less reliable sources of revenue, Old World is hopeful that increased sales to these customer segments will allow the company to maintain its profitability, even as demand from chain grocery stores continues to decline. Figure 2 shows the percentage of sales derived from each major customer segment over the past two years.

While Old World Baked Goods is privately held, it has a five million dollar outstanding line of credit with a local bank that requires the company to maintain a debt-to-asset ratio of .35 or lower. As such, the lender requires that the company produce audited financial statements on an annual basis. Your audit firm has audited Old World Baked Goods for the past four years and has provided an unqualified audit opinion for each of these years.

The firm feels that management of Old World Baked Goods is generally competent and credible. Both the Chief Executive Officer and Chief Financial Officer are certified public accountants and have substantial experience in financial accounting as well as the design and implementation of effective internal control systems. The company's Board of Directors consists primarily of outside members and meets regularly to discuss accounting related matters, as well as to discuss operational and strategic issues. Your firm has found the Board to be respectful of its role as auditor, and feels that the Board understands the important need for accurate financial reporting.

Instructions

In this exercise, you will assume the role of a staff auditor assigned to the audit engagement of Old World Baked Goods. You will be required to execute an attribute sampling plan to test a control related to the valuation assertion of the company's allowance for doubtful accounts.

The control that you will be testing, #AR001, is relevant to the process of calculating and recording the allowance for doubtful accounts. As a result of performing a walkthrough and reviewing management documentation related to this control, you have determined that it appears to be designed effectively. Your manager would like you to design your attribute sampling plan to determine whether the assessed level of control risk for this control (MODERATE) is appropriate. It is estimated that the expected population deviation rate for the control may range anywhere from .25% to .75%. Management's process documentation for this control is presented in Figure 3.

As a means of testing the internal control, you will be required to determine the sample size you wish to test. The instructor will then provide you with a sample of the requested size generated using a random selection plan. You should review the credit approval forms provided in the sample to determine whether the internal control appears to be operating effectively.

Figure 1
Selected Company Financial Statements

Old World Baked Goods
Balance Sheet

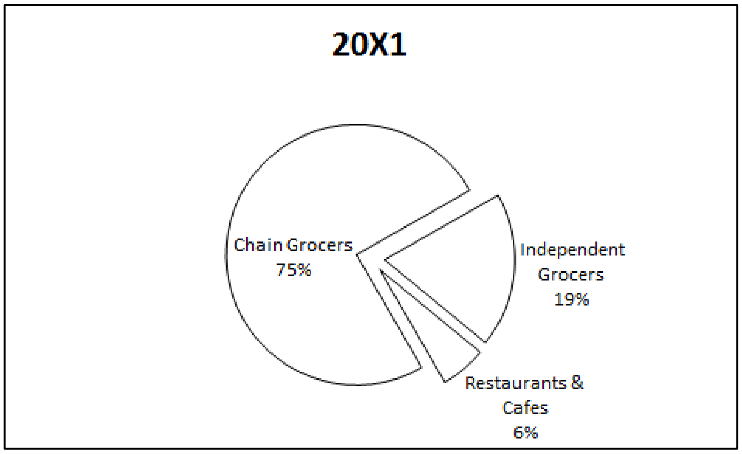
Assets	20X2 (unaudited)	20X1 (audited)
Cash and equivalents	43,000	44,500
Accouts receivable	687,000	624,000
Allowance for doubtful accounts	36,400	33,100
Net accounts receivable	650,600	590,900
Inventory	54,000	50,300
Total current assets	747,600	685,700
Plant and equipment	2,300,000	2,225,000
Accumulated depreciation	810,300	745,100
Net plant and equipment	1,489,700	1,479,900
Total assets	2,237,300	2,165,600
Liabilities and owner's equity		
Accounts payable	123,000	14,100
Short-term notes payable	210,000	145,000
Other current liabilities	14,000	200
Total current liabilities	347,000	159,300
Long-term debt	424,500	393,100
Total liabilities	771,500	552,400
Common stock	400,000	400,000
Retained earnings	1,065,800	1,213,200
Total owner's equity	1,465,800	1,613,200
Total liabilites and owner's equity	2,237,300	2,165,600

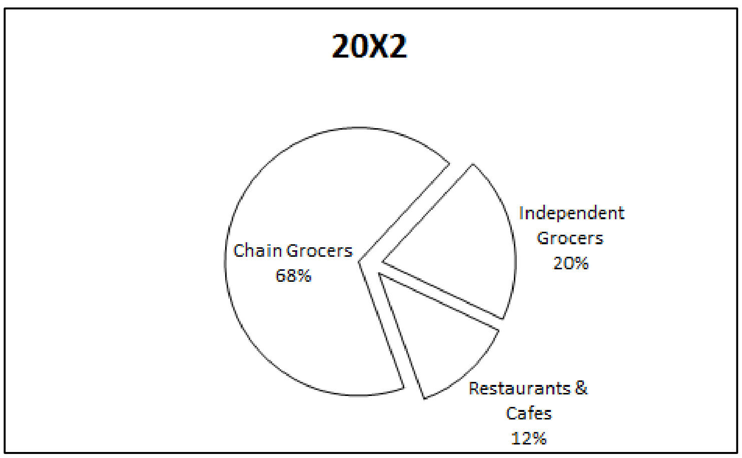
Old World Baked Goods
Income Statement

	20X2 (unaudited)	20X1 (audited)
Revenues	3,123,000	2,953,000
Cost of goods sold	1,564,935	1,476,205
Gross margin	1,558,065	1,476,795
Selling, general, and admin expenses	1,100,300	1,009,100
Depreciation	65,200	60,100
Interest expense	84,000	80,300
Other expenses	121,000	118,000
Total costs and expenses	1,370,500	1,267,500
Provision for income taxes	34,381	38,615
Extraordinary items	3,500	14,100
Net Income	149,684	156,580

This figure presents comparative financial statements for Old World Baked Goods.

Figure 2
Customer Segment Revenue Comparison





This figure represents the percentage of revenues generated by customer segment for both the 20X1 and 20X2 fiscal years.

Figure 3
Management's Internal Control Documentation

(Control #AR001): Before any order issued on credit is fully processed, the credit rating assigned by the order processing personnel must be reviewed and approved by a member of the Department of Credit and Collections. The following levels of approval are required:

Invoice Amount	Approval Needed		
< $500	Collections Supervisor		
$500 - $2,500	Collections Supervisor	Director of Collections	
> $2,500	Collections Supervisor	Director of Collections	VP of Collections

The company maintains evidence of these approvals by completing a "Credit Approval Report" which is placed in the customer's file maintained by the administrative assistant for the Department of Credit and Collections.

The credit rating assigned to the order is used to calculate the allowance for doubtful accounts using the following reserve percentages:

Rating	Reserve
High Quality	1%
Medium Quality	2.5%
Low Quality	4%

This figure presents management's internal control documentation related to control #AR001.

Appendix 1
Sample Worksheet - Clean

Invoice	Product	Amount	Signature 1	Signature 2	Signature 3
55673	Cake	$ 3,913.00	Collections Supervisor	Director of Collections	VP of Collections
54824	Cookies	$ 2,968.00	Collections Supervisor	Director of Collections	VP of Collections
52226	Muffins	$ 752.00	Collections Supervisor	Director of Collections	
53298	Muffins	$ 1,281.00	Collections Supervisor	Director of Collections	
54412	Breadsticks	$ 2,512.00	Collections Supervisor	Director of Collections	VP of Collections
54508	Eclairs	$ 2,620.00	Collections Supervisor	Director of Collections	VP of Collections
50874	Tarts	$ 147.00	Collections Supervisor		
53471	Donuts	$ 1,473.00	Collections Supervisor	Director of Collections	
53867	Cookies	$ 1,910.00	Collections Supervisor	Director of Collections	
50958	Puff pastry	$ 177.00	Collections Supervisor		
51608	Breadsticks	$ 417.00	Collections Supervisor		
52213	Cake	$ 747.00	Collections Supervisor	Director of Collections	
53439	Tarts	$ 1,437.00	Collections Supervisor	Director of Collections	
51965	Breadsticks	$ 611.00	Collections Supervisor	Director of Collections	
52078	Cookies	$ 680.00	Collections Supervisor	Director of Collections	
51988	Muffins	$ 624.00	Collections Supervisor	Director of Collections	
51048	Eclairs	$ 212.00	Collections Supervisor		
53707	Cake	$ 1,730.00	Collections Supervisor	Director of Collections	
54994	Pies	$ 3,160.00	Collections Supervisor	Director of Collections	VP of Collections
55808	Scones	$ 4,062.00	Collections Supervisor	Director of Collections	VP of Collections
55113	Pies	$ 3,294.00	Collections Supervisor	Director of Collections	VP of Collections
52249	Tarts	$ 763.00	Collections Supervisor	Director of Collections	
54289	Breadsticks	$ 2,378.00	Collections Supervisor	Director of Collections	
54016	Muffins	$ 2,073.00	Collections Supervisor	Director of Collections	
52023	Breadsticks	$ 647.00	Collections Supervisor	Director of Collections	
53780	Scones	$ 1,814.00	Collections Supervisor	Director of Collections	
52844	Tarts	$ 1,056.00	Collections Supervisor	Director of Collections	
53574	Breadsticks	$ 1,586.00	Collections Supervisor	Director of Collections	
54618	Scones	$ 2,740.00	Collections Supervisor	Director of Collections	VP of Collections
52371	Pies	$ 824.00	Collections Supervisor	Director of Collections	
52474	Cannoli	$ 875.00	Collections Supervisor	Director of Collections	
51460	Cannoli	$ 363.00	Collections Supervisor		
51045	Cannoli	$ 209.00	Collections Supervisor		
55222	Eclairs	$ 3,414.00	Collections Supervisor	Director of Collections	VP of Collections
50810	Eclairs	$ 123.00	Collections Supervisor		
54302	Cake	$ 2,390.00	Collections Supervisor	Director of Collections	
51308	Breadsticks	$ 308.00	Collections Supervisor		
52528	Scones	$ 901.00	Collections Supervisor	Director of Collections	
51109	Eclairs	$ 233.00	Collections Supervisor		
52783	Tarts	$ 1,027.00	Collections Supervisor	Director of Collections	
51759	Cannoli	$ 487.00	Collections Supervisor		
53076	Eclairs	$ 1,167.00	Collections Supervisor	Director of Collections	
53819	Puff pastry	$ 1,857.00	Collections Supervisor	Director of Collections	
53835	Muffins	$ 1,874.00	Collections Supervisor	Director of Collections	
54373	Muffins	$ 2,469.00	Collections Supervisor	Director of Collections	
53066	Scones	$ 1,163.00	Collections Supervisor	Director of Collections	
51029	Donuts	$ 203.00	Collections Supervisor		
55840	Breadsticks	$ 4,100.00	Collections Supervisor	Director of Collections	VP of Collections
53504	Pies	$ 1,509.00	Collections Supervisor	Director of Collections	
54675	Scones	$ 2,805.00	Collections Supervisor	Director of Collections	VP of Collections
55625	Muffins	$ 3,858.00	Collections Supervisor	Director of Collections	VP of Collections

54083	Cannoli	$ 2,150.00	Collections Supervisor	Director of Collections	
54019	Scones	$ 2,078.00	Collections Supervisor	Director of Collections	
53842	Scones	$ 1,881.00	Collections Supervisor	Director of Collections	
55548	Puff pastry	$ 3,774.00	Collections Supervisor	Director of Collections	VP of Collections
54032	Eclairs	$ 2,090.00	Collections Supervisor	Director of Collections	
54389	Eclairs	$ 2,488.00	Collections Supervisor	Director of Collections	
55229	Tarts	$ 3,419.00	Collections Supervisor	Director of Collections	VP of Collections
55509	Scones	$ 3,733.00	Collections Supervisor	Director of Collections	VP of Collections
50816	Tarts	$ 125.00	Collections Supervisor		
53362	Scones	$ 1,353.00	Collections Supervisor	Director of Collections	
55570	Scones	$ 3,798.00	Collections Supervisor	Director of Collections	VP of Collections
53259	Tarts	$ 1,238.00	Collections Supervisor	Director of Collections	
51585	Eclairs	$ 410.00	Collections Supervisor		
50990	Eclairs	$ 189.00	Collections Supervisor		
53050	Cake	$ 1,157.00	Collections Supervisor	Director of Collections	
51338	Scones	$ 317.00	Collections Supervisor		
53890	Donuts	$ 1,934.00	Collections Supervisor	Director of Collections	
53565	Pies	$ 1,574.00	Collections Supervisor	Director of Collections	
54295	Puff pastry	$ 2,385.00	Collections Supervisor	Director of Collections	
55213	Scones	$ 3,402.00	Collections Supervisor	Director of Collections	VP of Collections
50658	Puff pastry	$ 68.00	Collections Supervisor		
51125	Cookies	$ 239.00	Collections Supervisor		
52599	Eclairs	$ 936.00	Collections Supervisor	Director of Collections	
50649	Cookies	$ 63.00	Collections Supervisor		
52178	Cannoli	$ 728.00	Collections Supervisor	Director of Collections	
55554	Cake	$ 3,781.00	Collections Supervisor	Director of Collections	VP of Collections
53359	Muffins	$ 1,346.00	Collections Supervisor	Director of Collections	
53121	Muffins	$ 1,183.00	Collections Supervisor	Director of Collections	
50903	Cake	$ 158.00	Collections Supervisor		
52480	Eclairs	$ 877.00	Collections Supervisor	Director of Collections	
54025	Cannoli	$ 2,085.00	Collections Supervisor	Director of Collections	
51647	Eclairs	$ 431.00	Collections Supervisor		
54518	Pies	$ 2,632.00	Collections Supervisor	Director of Collections	VP of Collections
51457	Scones	$ 362.00	Collections Supervisor		
50636	Tarts	$ 59.00	Collections Supervisor		
53645	Cake	$ 1,665.00	Collections Supervisor	Director of Collections	
55870	Scones	$ 4,129.00	Collections Supervisor	Director of Collections	VP of Collections
54991	Tarts	$ 3,155.00	Collections Supervisor	Director of Collections	VP of Collections
53130	Cannoli	$ 1,187.00	Collections Supervisor	Director of Collections	
52441	Breadsticks	$ 859.00	Collections Supervisor	Director of Collections	
55538	Cookies	$ 3,762.00	Collections Supervisor	Director of Collections	VP of Collections
52837	Eclairs	$ 1,053.00	Collections Supervisor	Director of Collections	
53526	Cake	$ 1,533.00	Collections Supervisor	Director of Collections	
51157	Scones	$ 251.00	Collections Supervisor		
55087	Muffins	$ 3,263.00	Collections Supervisor	Director of Collections	VP of Collections
50690	Eclairs	$ 80.00	Collections Supervisor		
50681	Scones	$ 75.00	Collections Supervisor		
51466	Eclairs	$ 365.00	Collections Supervisor		
54073	Muffins	$ 2,138.00	Collections Supervisor	Director of Collections	
54453	Tarts	$ 2,560.00	Collections Supervisor	Director of Collections	VP of Collections
54144	Cannoli	$ 2,217.00	Collections Supervisor	Director of Collections	
52631	Cake	$ 952.00	Collections Supervisor	Director of Collections	
55854	Cake	$ 4,112.00	Collections Supervisor	Director of Collections	VP of Collections
52622	Breadsticks	$ 947.00	Collections Supervisor	Director of Collections	
54946	Breadsticks	$ 3,107.00	Collections Supervisor	Director of Collections	VP of Collections
50729	Donuts	$ 93.00	Collections Supervisor		
53671	Eclairs	$ 1,694.00	Collections Supervisor	Director of Collections	
51492	Puff pastry	$ 375.00	Collections Supervisor		
52004	Eclairs	$ 634.00	Collections Supervisor	Director of Collections	

54875	Pies	$ 3,028.00	Collections Supervisor	Director of Collections	VP of Collections
53980	Pies	$ 2,037.00	Collections Supervisor	Director of Collections	
54225	Cookies	$ 2,306.00	Collections Supervisor	Director of Collections	
51910	Puff pastry	$ 578.00	Collections Supervisor	Director of Collections	
54035	Tarts	$ 2,097.00	Collections Supervisor	Director of Collections	
53485	Scones	$ 1,485.00	Collections Supervisor	Director of Collections	
53162	Puff pastry	$ 1,199.00	Collections Supervisor	Director of Collections	
54904	Donuts	$ 3,059.00	Collections Supervisor	Director of Collections	VP of Collections
51267	Donuts	$ 291.00	Collections Supervisor		
52796	Cookies	$ 1,032.00	Collections Supervisor	Director of Collections	
51901	Cookies	$ 573.00	Collections Supervisor	Director of Collections	
53140	Tarts	$ 1,191.00	Collections Supervisor	Director of Collections	
51714	Pies	$ 459.00	Collections Supervisor		
55731	Cake	$ 3,978.00	Collections Supervisor	Director of Collections	VP of Collections
54524	Cookies	$ 2,637.00	Collections Supervisor	Director of Collections	VP of Collections
53465	Cake	$ 1,466.00	Collections Supervisor	Director of Collections	
50929	Eclairs	$ 167.00	Collections Supervisor		
55158	Cannoli	$ 3,342.00	Collections Supervisor	Director of Collections	VP of Collections
53652	Donuts	$ 1,670.00	Collections Supervisor	Director of Collections	
51840	Cookies	$ 535.00	Collections Supervisor	Director of Collections	
53591	Donuts	$ 1,605.00	Collections Supervisor	Director of Collections	
53279	Breadsticks	$ 1,257.00	Collections Supervisor	Director of Collections	
53211	Cookies	$ 1,217.00	Collections Supervisor	Director of Collections	
55239	Cookies	$ 3,431.00	Collections Supervisor	Director of Collections	VP of Collections
54428	Donuts	$ 2,529.00	Collections Supervisor	Director of Collections	VP of Collections
52181	Eclairs	$ 731.00	Collections Supervisor	Director of Collections	
53501	Tarts	$ 1,502.00	Collections Supervisor	Director of Collections	
54431	Muffins	$ 2,536.00	Collections Supervisor	Director of Collections	VP of Collections
52728	Pies	$ 1,000.00	Collections Supervisor	Director of Collections	
50951	Breadsticks	$ 176.00	Collections Supervisor		
55252	Puff pastry	$ 3,443.00	Collections Supervisor	Director of Collections	VP of Collections
55236	Pies	$ 3,426.00	Collections Supervisor	Director of Collections	VP of Collections
54154	Tarts	$ 2,229.00	Collections Supervisor	Director of Collections	
51302	Cookies	$ 305.00	Collections Supervisor		
54247	Donuts	$ 2,330.00	Collections Supervisor	Director of Collections	
54913	Scones	$ 3,071.00	Collections Supervisor	Director of Collections	VP of Collections
53462	Puff pastry	$ 1,461.00	Collections Supervisor	Director of Collections	
55319	Donuts	$ 3,522.00	Collections Supervisor	Director of Collections	VP of Collections
55680	Donuts	$ 3,918.00	Collections Supervisor	Director of Collections	VP of Collections
53098	Breadsticks	$ 1,175.00	Collections Supervisor	Director of Collections	
52409	Scones	$ 843.00	Collections Supervisor	Director of Collections	
51450	Muffins	$ 359.00	Collections Supervisor		
52059	Cannoli	$ 667.00	Collections Supervisor	Director of Collections	
54009	Donuts	$ 2,066.00	Collections Supervisor	Director of Collections	
50601	Puff pastry	$ 45.00	Collections Supervisor		
55628	Scones	$ 3,865.00	Collections Supervisor	Director of Collections	VP of Collections
54279	Pies	$ 2,366.00	Collections Supervisor	Director of Collections	
52297	Cannoli	$ 787.00	Collections Supervisor	Director of Collections	
52741	Breadsticks	$ 1,005.00	Collections Supervisor	Director of Collections	
55110	Tarts	$ 3,287.00	Collections Supervisor	Director of Collections	VP of Collections
51553	Puff pastry	$ 398.00	Collections Supervisor		
53851	Eclairs	$ 1,893.00	Collections Supervisor	Director of Collections	
52544	Tarts	$ 909.00	Collections Supervisor	Director of Collections	
54222	Pies	$ 2,301.00	Collections Supervisor	Director of Collections	
51199	Cake	$ 267.00	Collections Supervisor		
53295	Donuts	$ 1,274.00	Collections Supervisor	Director of Collections	
52767	Scones	$ 1,019.00	Collections Supervisor	Director of Collections	
53794	Eclairs	$ 1,826.00	Collections Supervisor	Director of Collections	
55152	Scones	$ 3,335.00	Collections Supervisor	Director of Collections	VP of Collections

51315	Puff pastry	$ 309.00	Collections Supervisor		
51425	Cookies	$ 350.00	Collections Supervisor		
54952	Puff pastry	$ 3,112.00	Collections Supervisor	Director of Collections	VP of Collections
51402	Cannoli	$ 341.00	Collections Supervisor		
53336	Breadsticks	$ 1,322.00	Collections Supervisor	Director of Collections	
52107	Muffins	$ 693.00	Collections Supervisor	Director of Collections	
54959	Cake	$ 3,119.00	Collections Supervisor	Director of Collections	VP of Collections
52931	Cake	$ 1,099.00	Collections Supervisor	Director of Collections	
53346	Cake	$ 1,334.00	Collections Supervisor	Director of Collections	
55339	Cannoli	$ 3,539.00	Collections Supervisor	Director of Collections	VP of Collections
54215	Tarts	$ 2,294.00	Collections Supervisor	Director of Collections	
51926	Muffins	$ 588.00	Collections Supervisor	Director of Collections	
51617	Cake	$ 422.00	Collections Supervisor		
52558	Cookies	$ 915.00	Collections Supervisor	Director of Collections	
53597	Muffins	$ 1,610.00	Collections Supervisor	Director of Collections	
54080	Scones	$ 2,145.00	Collections Supervisor	Director of Collections	
51640	Cannoli	$ 429.00	Collections Supervisor		
53352	Donuts	$ 1,341.00	Collections Supervisor	Director of Collections	
52831	Cannoli	$ 1,051.00	Collections Supervisor	Director of Collections	
52902	Tarts	$ 1,085.00	Collections Supervisor	Director of Collections	
55380	Donuts	$ 3,587.00	Collections Supervisor	Director of Collections	VP of Collections
54833	Puff pastry	$ 2,980.00	Collections Supervisor	Director of Collections	VP of Collections
51244	Cookies	$ 284.00	Collections Supervisor		
52313	Pies	$ 795.00	Collections Supervisor	Director of Collections	
54721	Cake	$ 2,853.00	Collections Supervisor	Director of Collections	VP of Collections
52036	Cake	$ 655.00	Collections Supervisor	Director of Collections	
51064	Cookies	$ 218.00	Collections Supervisor		
55531	Pies	$ 3,757.00	Collections Supervisor	Director of Collections	VP of Collections
54051	Breadsticks	$ 2,114.00	Collections Supervisor	Director of Collections	
53954	Muffins	$ 2,006.00	Collections Supervisor	Director of Collections	
51476	Pies	$ 369.00	Collections Supervisor		
50768	Cookies	$ 107.00	Collections Supervisor		
53993	Breadsticks	$ 2,049.00	Collections Supervisor	Director of Collections	
52883	Muffins	$ 1,075.00	Collections Supervisor	Director of Collections	
53961	Scones	$ 2,013.00	Collections Supervisor	Director of Collections	
52100	Donuts	$ 691.00	Collections Supervisor	Director of Collections	
54463	Cookies	$ 2,572.00	Collections Supervisor	Director of Collections	VP of Collections
51286	Eclairs	$ 299.00	Collections Supervisor		
55618	Donuts	$ 3,853.00	Collections Supervisor	Director of Collections	VP of Collections
51151	Muffins	$ 249.00	Collections Supervisor		
52567	Puff pastry	$ 920.00	Collections Supervisor	Director of Collections	
55499	Donuts	$ 3,721.00	Collections Supervisor	Director of Collections	VP of Collections
55602	Breadsticks	$ 3,834.00	Collections Supervisor	Director of Collections	VP of Collections
51054	Tarts	$ 213.00	Collections Supervisor		
55358	Cookies	$ 3,563.00	Collections Supervisor	Director of Collections	VP of Collections
52091	Puff pastry	$ 685.00	Collections Supervisor	Director of Collections	
51631	Muffins	$ 425.00	Collections Supervisor		
51711	Tarts	$ 456.00	Collections Supervisor		
54968	Muffins	$ 3,131.00	Collections Supervisor	Director of Collections	VP of Collections
53668	Cannoli	$ 1,689.00	Collections Supervisor	Director of Collections	
54566	Eclairs	$ 2,685.00	Collections Supervisor	Director of Collections	VP of Collections
53533	Donuts	$ 1,538.00	Collections Supervisor	Director of Collections	
51196	Puff pastry	$ 266.00	Collections Supervisor		
51212	Muffins	$ 272.00	Collections Supervisor		
52989	Cake	$ 1,128.00	Collections Supervisor	Director of Collections	
51070	Breadsticks	$ 219.00	Collections Supervisor		
53382	Tarts	$ 1,370.00	Collections Supervisor	Director of Collections	
55799	Donuts	$ 4,050.00	Collections Supervisor	Director of Collections	VP of Collections
52235	Cannoli	$ 757.00	Collections Supervisor	Director of Collections	

52709	Scones	$ 989.00	Collections Supervisor	Director of Collections	
55895	Cookies	$ 4,160.00	Collections Supervisor	Director of Collections	VP of Collections
54984	Eclairs	$ 3,148.00	Collections Supervisor	Director of Collections	VP of Collections
55126	Breadsticks	$ 3,306.00	Collections Supervisor	Director of Collections	VP of Collections
55467	Tarts	$ 3,685.00	Collections Supervisor	Director of Collections	VP of Collections
53233	Donuts	$ 1,225.00	Collections Supervisor	Director of Collections	
50967	Donuts	$ 182.00	Collections Supervisor		
55451	Scones	$ 3,666.00	Collections Supervisor	Director of Collections	VP of Collections
50546	Cake	$ 26.00	Collections Supervisor		
53938	Puff pastry	$ 1,989.00	Collections Supervisor	Director of Collections	
50977	Scones	$ 185.00	Collections Supervisor		
54444	Cannoli	$ 2,548.00	Collections Supervisor	Director of Collections	VP of Collections
50826	Cookies	$ 129.00	Collections Supervisor		
52693	Cake	$ 981.00	Collections Supervisor	Director of Collections	
51611	Puff pastry	$ 419.00	Collections Supervisor		
51370	Breadsticks	$ 329.00	Collections Supervisor		
51219	Scones	$ 273.00	Collections Supervisor		
50777	Puff pastry	$ 111.00	Collections Supervisor		
53755	Breadsticks	$ 1,785.00	Collections Supervisor	Director of Collections	
54344	Cookies	$ 2,438.00	Collections Supervisor	Director of Collections	
54843	Donuts	$ 2,992.00	Collections Supervisor	Director of Collections	VP of Collections
52455	Cake	$ 864.00	Collections Supervisor	Director of Collections	
50610	Donuts	$ 50.00	Collections Supervisor		
51991	Scones	$ 627.00	Collections Supervisor	Director of Collections	
51373	Puff pastry	$ 332.00	Collections Supervisor		
54151	Eclairs	$ 2,222.00	Collections Supervisor	Director of Collections	
54357	Puff pastry	$ 2,450.00	Collections Supervisor	Director of Collections	
51521	Cannoli	$ 386.00	Collections Supervisor		
50530	Cookies	$ 20.00	Collections Supervisor		
53217	Breadsticks	$ 1,219.00	Collections Supervisor	Director of Collections	
54547	Donuts	$ 2,661.00	Collections Supervisor	Director of Collections	VP of Collections
53661	Scones	$ 1,682.00	Collections Supervisor	Director of Collections	
50961	Cake	$ 179.00	Collections Supervisor		
52123	Eclairs	$ 701.00	Collections Supervisor	Director of Collections	
50523	Pies	$ 17.00	Collections Supervisor		
52574	Cake	$ 923.00	Collections Supervisor	Director of Collections	
54817	Pies	$ 2,963.00	Collections Supervisor	Director of Collections	VP of Collections
50935	Tarts	$ 170.00	Collections Supervisor		
52908	Pies	$ 1,088.00	Collections Supervisor	Director of Collections	
51682	Donuts	$ 445.00	Collections Supervisor		
54382	Cannoli	$ 2,481.00	Collections Supervisor	Director of Collections	
55664	Breadsticks	$ 3,901.00	Collections Supervisor	Director of Collections	VP of Collections
50617	Muffins	$ 51.00	Collections Supervisor		
53320	Tarts	$ 1,305.00	Collections Supervisor	Director of Collections	
55055	Pies	$ 3,227.00	Collections Supervisor	Director of Collections	VP of Collections
55016	Cake	$ 3,184.00	Collections Supervisor	Director of Collections	VP of Collections
53124	Scones	$ 1,185.00	Collections Supervisor	Director of Collections	
54563	Cannoli	$ 2,680.00	Collections Supervisor	Director of Collections	VP of Collections
50517	Tarts	$ 15.00	Collections Supervisor		
55287	Tarts	$ 3,486.00	Collections Supervisor	Director of Collections	VP of Collections
54540	Cake	$ 2,656.00	Collections Supervisor	Director of Collections	VP of Collections
51441	Cake	$ 356.00	Collections Supervisor		
55802	Muffins	$ 4,057.00	Collections Supervisor	Director of Collections	VP of Collections
52670	Pies	$ 971.00	Collections Supervisor	Director of Collections	
55609	Puff pastry	$ 3,841.00	Collections Supervisor	Director of Collections	VP of Collections
50993	Tarts	$ 191.00	Collections Supervisor		
52416	Cannoli	$ 845.00	Collections Supervisor	Director of Collections	
51086	Donuts	$ 225.00	Collections Supervisor		
53636	Breadsticks	$ 1,653.00	Collections Supervisor	Director of Collections	

51579	Cannoli	$ 407.00	Collections Supervisor		
54627	Eclairs	$ 2,752.00	Collections Supervisor	Director of Collections	VP of Collections
51096	Scones	$ 230.00	Collections Supervisor		
50890	Breadsticks	$ 153.00	Collections Supervisor		
52007	Tarts	$ 637.00	Collections Supervisor	Director of Collections	
54930	Tarts	$ 3,088.00	Collections Supervisor	Director of Collections	VP of Collections
51386	Donuts	$ 335.00	Collections Supervisor		
51428	Breadsticks	$ 351.00	Collections Supervisor		
52171	Scones	$ 725.00	Collections Supervisor	Director of Collections	
53787	Cannoli	$ 1,821.00	Collections Supervisor	Director of Collections	
54746	Eclairs	$ 2,884.00	Collections Supervisor	Director of Collections	VP of Collections
52316	Cookies	$ 797.00	Collections Supervisor	Director of Collections	
53906	Cannoli	$ 1,953.00	Collections Supervisor	Director of Collections	

This appendix presents the sampling worksheet without seeded errors.

Appendix 2
Sample Worksheet – Seeded Errors

Invoice	Product	Amount	Signature 1	Signature 2	Signature 3	
55673	Cake	$ 3,913.00	Collections Supervisor	Director of Collections	VP of Collections	
54824	Cookies	$ 2,968.00	Collections Supervisor	Director of Collections	VP of Collections	
52226	Muffins	$ 752.00	Collections Supervisor	Director of Collections		
53298	Muffins	$ 1,281.00	Collections Supervisor	Director of Collections		
54412	Breadsticks	$ 2,512.00	Collections Supervisor	Director of Collections	VP of Collections	
54508	Eclairs	$ 2,620.00	Collections Supervisor	Director of Collections	VP of Collections	
50874	Tarts	$ 147.00	Collections Supervisor			
53471	Donuts	$ 1,473.00	Collections Supervisor	Director of Collections		
53867	Cookies	$ 1,910.00	Collections Supervisor			X
50958	Puff pastry	$ 177.00	Collections Supervisor			
51608	Breadsticks	$ 417.00	Collections Supervisor			
52213	Cake	$ 747.00	Collections Supervisor	Director of Collections		
53439	Tarts	$ 1,437.00	Collections Supervisor	Director of Collections		
51965	Breadsticks	$ 611.00	Collections Supervisor	Director of Collections		
52078	Cookies	$ 680.00	Collections Supervisor			X
51988	Muffins	$ 624.00	Collections Supervisor	Director of Collections		
51048	Eclairs	$ 212.00	Collections Supervisor			
53707	Cake	$ 1,730.00	Collections Supervisor	Director of Collections		
54994	Pies	$ 3,160.00	Collections Supervisor	Director of Collections	VP of Collections	
55808	Scones	$ 4,062.00	Collections Supervisor	Director of Collections	VP of Collections	
55113	Pies	$ 3,294.00	Collections Supervisor	Director of Collections	VP of Collections	
52249	Tarts	$ 763.00	Collections Supervisor	Director of Collections		
54289	Breadsticks	$ 2,378.00	Collections Supervisor	Director of Collections		
54016	Muffins	$ 2,073.00	Collections Supervisor	Director of Collections		
52023	Breadsticks	$ 647.00	Collections Supervisor	Director of Collections		
53780	Scones	$ 1,814.00	Collections Supervisor	Director of Collections		
52844	Tarts	$ 1,056.00	Collections Supervisor			X
53574	Breadsticks	$ 1,586.00	Collections Supervisor	Director of Collections		
54618	Scones	$ 2,740.00	Collections Supervisor	Director of Collections	VP of Collections	
52371	Pies	$ 824.00	Collections Supervisor	Director of Collections		
52474	Cannoli	$ 875.00	Collections Supervisor	Director of Collections		
51460	Cannoli	$ 363.00	Collections Supervisor			
51045	Cannoli	$ 209.00	Collections Supervisor			
55222	Eclairs	$ 3,414.00	Collections Supervisor	Director of Collections	VP of Collections	
50810	Eclairs	$ 123.00	Collections Supervisor			
54302	Cake	$ 2,390.00	Collections Supervisor	Director of Collections		
51308	Breadsticks	$ 308.00	Collections Supervisor			
52528	Scones	$ 901.00	Collections Supervisor	Director of Collections		
51109	Eclairs	$ 233.00	Collections Supervisor			
52783	Tarts	$ 1,027.00	Collections Supervisor	Director of Collections		
51759	Cannoli	$ 487.00	Collections Supervisor			
53076	Eclairs	$ 1,167.00	Collections Supervisor	Director of Collections		
53819	Puff pastry	$ 1,857.00	Collections Supervisor	Director of Collections		
53835	Muffins	$ 1,874.00	Collections Supervisor	Director of Collections		
54373	Muffins	$ 2,469.00	Collections Supervisor	Director of Collections		
53066	Scones	$ 1,163.00	Collections Supervisor	Director of Collections		
51029	Donuts	$ 203.00	Collections Supervisor			
55840	Breadsticks	$ 4,100.00	Collections Supervisor	Director of Collections	VP of Collections	
53504	Pies	$ 1,509.00	Collections Supervisor	Director of Collections		
54675	Scones	$ 2,805.00	Collections Supervisor	Director of Collections	VP of Collections	
55625	Muffins	$ 3,858.00	Collections Supervisor	Director of Collections	VP of Collections	
54083	Cannoli	$ 2,150.00	Collections Supervisor	Director of Collections		
54019	Scones	$ 2,078.00	Collections Supervisor	Director of Collections		

53842	Scones	$ 1,881.00	Collections Supervisor	Director of Collections		
55548	Puff pastry	$ 3,774.00	Collections Supervisor	Director of Collections	VP of Collections	
54032	Eclairs	$ 2,090.00	Collections Supervisor	Director of Collections		
54389	Eclairs	$ 2,488.00	Collections Supervisor	Director of Collections		
55229	Tarts	$ 3,419.00	Collections Supervisor	Director of Collections	VP of Collections	
55509	Scones	$ 3,733.00	Collections Supervisor	Director of Collections	VP of Collections	
50816	Tarts	$ 125.00	Collections Supervisor			
53362	Scones	$ 1,353.00	Collections Supervisor	Director of Collections		
55570	Scones	$ 3,798.00				**X**
53259	Tarts	$ 1,238.00	Collections Supervisor	Director of Collections		
51585	Eclairs	$ 410.00	Collections Supervisor			
50990	Eclairs	$ 189.00	Collections Supervisor			
53050	Cake	$ 1,157.00	Collections Supervisor	Director of Collections		
51338	Scones	$ 317.00				**X**
53890	Donuts	$ 1,934.00	Collections Supervisor	Director of Collections		
53565	Pies	$ 1,574.00	Collections Supervisor	Director of Collections		
54295	Puff pastry	$ 2,385.00	Collections Supervisor	Director of Collections		
55213	Scones	$ 3,402.00	Collections Supervisor	Director of Collections	VP of Collections	
50658	Puff pastry	$ 68.00	Collections Supervisor			
51125	Cookies	$ 239.00				**X**
52599	Eclairs	$ 936.00	Collections Supervisor			**X**
50649	Cookies	$ 63.00	Collections Supervisor			
52178	Cannoli	$ 728.00	Collections Supervisor	Director of Collections		
55554	Cake	$ 3,781.00	Collections Supervisor	Director of Collections	VP of Collections	
53359	Muffins	$ 1,346.00	Collections Supervisor	Director of Collections		
53121	Muffins	$ 1,183.00	Collections Supervisor	Director of Collections		
50903	Cake	$ 158.00	Collections Supervisor			
52480	Eclairs	$ 877.00	Collections Supervisor	Director of Collections		
54025	Cannoli	$ 2,085.00	Collections Supervisor	Director of Collections		
51647	Eclairs	$ 431.00	Collections Supervisor			
54518	Pies	$ 2,632.00	Collections Supervisor	Director of Collections	VP of Collections	
51457	Scones	$ 362.00	Collections Supervisor			
50636	Tarts	$ 59.00	Collections Supervisor			
53645	Cake	$ 1,665.00	Collections Supervisor	Director of Collections		
55870	Scones	$ 4,129.00	Collections Supervisor	Director of Collections	VP of Collections	
54991	Tarts	$ 3,155.00	Collections Supervisor	Director of Collections	VP of Collections	
53130	Cannoli	$ 1,187.00	Collections Supervisor	Director of Collections		
52441	Breadsticks	$ 859.00	Collections Supervisor	Director of Collections		
55538	Cookies	$ 3,762.00	Collections Supervisor	Director of Collections	VP of Collections	
52837	Eclairs	$ 1,053.00	Collections Supervisor	Director of Collections		
53526	Cake	$ 1,533.00		Director of Collections		**X**
51157	Scones	$ 251.00	Collections Supervisor			
55087	Muffins	$ 3,263.00	Collections Supervisor	Director of Collections		**X**
50690	Eclairs	$ 80.00	Collections Supervisor			
50681	Scones	$ 75.00	Collections Supervisor			
51466	Eclairs	$ 365.00	Collections Supervisor			
54073	Muffins	$ 2,138.00	Collections Supervisor	Director of Collections		
54453	Tarts	$ 2,560.00	Collections Supervisor	Director of Collections	VP of Collections	
54144	Cannoli	$ 2,217.00	Collections Supervisor	Director of Collections		
52631	Cake	$ 952.00	Collections Supervisor	Director of Collections		
55854	Cake	$ 4,112.00	Collections Supervisor	Director of Collections	VP of Collections	
52622	Breadsticks	$ 947.00	Collections Supervisor	Director of Collections		
54946	Breadsticks	$ 3,107.00	Collections Supervisor	Director of Collections	VP of Collections	
50729	Donuts	$ 93.00	Collections Supervisor			
53671	Eclairs	$ 1,694.00	Collections Supervisor	Director of Collections		
51492	Puff pastry	$ 375.00	Collections Supervisor			
52004	Eclairs	$ 634.00	Collections Supervisor	Director of Collections		
54875	Pies	$ 3,028.00	Collections Supervisor	Director of Collections	VP of Collections	
53980	Pies	$ 2,037.00	Collections Supervisor	Director of Collections		

51910	Puff pastry	$ 578.00	Collections Supervisor	Director of Collections		
54035	Tarts	$ 2,097.00	Collections Supervisor	Director of Collections		
53485	Scones	$ 1,485.00	Collections Supervisor	Director of Collections		
53162	Puff pastry	$ 1,199.00	Collections Supervisor	Director of Collections		
54904	Donuts	$ 3,059.00	Collections Supervisor	Director of Collections	VP of Collections	
51267	Donuts	$ 291.00	Collections Supervisor			
52796	Cookies	$ 1,032.00	Collections Supervisor	Director of Collections		
51901	Cookies	$ 573.00	Collections Supervisor	Director of Collections		
53140	Tarts	$ 1,191.00	Collections Supervisor	Director of Collections		
51714	Pies	$ 459.00	Collections Supervisor			
55731	Cake	$ 3,978.00	Collections Supervisor	Director of Collections	VP of Collections	
54524	Cookies	$ 2,637.00	Collections Supervisor	Director of Collections	VP of Collections	
53465	Cake	$ 1,466.00	Collections Supervisor	Director of Collections		
50929	Eclairs	$ 167.00	Collections Supervisor			
55158	Cannoli	$ 3,342.00	Collections Supervisor	Director of Collections	VP of Collections	
53652	Donuts	$ 1,670.00		Director of Collections		X
51840	Cookies	$ 535.00	Collections Supervisor	Director of Collections		
53591	Donuts	$ 1,605.00	Collections Supervisor	Director of Collections		
53279	Breadsticks	$ 1,257.00	Collections Supervisor	Director of Collections		
53211	Cookies	$ 1,217.00	Collections Supervisor	Director of Collections		
55239	Cookies	$ 3,431.00	Collections Supervisor	Director of Collections	VP of Collections	
54428	Donuts	$ 2,529.00	Collections Supervisor	Director of Collections	VP of Collections	
52181	Eclairs	$ 731.00	Collections Supervisor	Director of Collections		
53501	Tarts	$ 1,502.00	Collections Supervisor	Director of Collections		
54431	Muffins	$ 2,536.00	Collections Supervisor	Director of Collections	VP of Collections	
52728	Pies	$ 1,000.00	Collections Supervisor	Director of Collections		
50951	Breadsticks	$ 176.00	Collections Supervisor			
55252	Puff pastry	$ 3,443.00	Collections Supervisor	Director of Collections	VP of Collections	
55236	Pies	$ 3,426.00	Collections Supervisor	Director of Collections	VP of Collections	
54154	Tarts	$ 2,229.00	Collections Supervisor	Director of Collections		
51302	Cookies	$ 305.00	Collections Supervisor			
54247	Donuts	$ 2,330.00	Collections Supervisor	Director of Collections		
54913	Scones	$ 3,071.00	Collections Supervisor	Director of Collections	VP of Collections	
53462	Puff pastry	$ 1,461.00	Collections Supervisor	Director of Collections		
55319	Donuts	$ 3,522.00	Collections Supervisor	Director of Collections	VP of Collections	
55680	Donuts	$ 3,918.00	Collections Supervisor	Director of Collections	VP of Collections	
53098	Breadsticks	$ 1,175.00	Collections Supervisor	Director of Collections		
52409	Scones	$ 843.00	Collections Supervisor	Director of Collections		
51450	Muffins	$ 359.00	Collections Supervisor			
52059	Cannoli	$ 667.00	Collections Supervisor	Director of Collections		
54009	Donuts	$ 2,066.00	Collections Supervisor	Director of Collections		
50601	Puff pastry	$ 45.00	Collections Supervisor			
55628	Scones	$ 3,865.00	Collections Supervisor	Director of Collections	VP of Collections	
54279	Pies	$ 2,366.00	Collections Supervisor	Director of Collections		
52297	Cannoli	$ 787.00	Collections Supervisor	Director of Collections		
52741	Breadsticks	$ 1,005.00	Collections Supervisor	Director of Collections		
55110	Tarts	$ 3,287.00	Collections Supervisor	Director of Collections	VP of Collections	
51553	Puff pastry	$ 398.00	Collections Supervisor			
53851	Eclairs	$ 1,893.00	Collections Supervisor	Director of Collections		
52544	Tarts	$ 909.00	Collections Supervisor	Director of Collections		
54222	Pies	$ 2,301.00				X
51199	Cake	$ 267.00	Collections Supervisor			
53295	Donuts	$ 1,274.00	Collections Supervisor	Director of Collections		
52767	Scones	$ 1,019.00	Collections Supervisor	Director of Collections		
53794	Eclairs	$ 1,826.00	Collections Supervisor	Director of Collections		
55152	Scones	$ 3,335.00	Collections Supervisor	Director of Collections	VP of Collections	
51315	Puff pastry	$ 309.00	Collections Supervisor			
51425	Cookies	$ 350.00	Collections Supervisor			

54952	Puff pastry	$ 3,112.00	Collections Supervisor	Director of Collections	VP of Collections
51402	Cannoli	$ 341.00	Collections Supervisor		
53336	Breadsticks	$ 1,322.00	Collections Supervisor	Director of Collections	
52107	Muffins	$ 693.00	Collections Supervisor	Director of Collections	
54959	Cake	$ 3,119.00	Collections Supervisor	Director of Collections	VP of Collections
52931	Cake	$ 1,099.00	Collections Supervisor	Director of Collections	
53346	Cake	$ 1,334.00	Collections Supervisor	Director of Collections	
55339	Cannoli	$ 3,539.00	Collections Supervisor	Director of Collections	VP of Collections
54215	Tarts	$ 2,294.00	Collections Supervisor	Director of Collections	
51926	Muffins	$ 588.00	Collections Supervisor	Director of Collections	
51617	Cake	$ 422.00	Collections Supervisor		
52558	Cookies	$ 915.00	Collections Supervisor	Director of Collections	
53597	Muffins	$ 1,610.00	Collections Supervisor	Director of Collections	
54080	Scones	$ 2,145.00	Collections Supervisor	Director of Collections	
51640	Cannoli	$ 429.00	Collections Supervisor		
53352	Donuts	$ 1,341.00	Collections Supervisor	Director of Collections	
52831	Cannoli	$ 1,051.00	Collections Supervisor	Director of Collections	
52902	Tarts	$ 1,085.00	Collections Supervisor	Director of Collections	
55380	Donuts	$ 3,587.00	Collections Supervisor	Director of Collections	VP of Collections
54833	Puff pastry	$ 2,980.00	Collections Supervisor	Director of Collections	VP of Collections
51244	Cookies	$ 284.00	Collections Supervisor		
52313	Pies	$ 795.00	Collections Supervisor	Director of Collections	
54721	Cake	$ 2,853.00	Collections Supervisor	Director of Collections	VP of Collections
52036	Cake	$ 655.00	Collections Supervisor	Director of Collections	
51064	Cookies	$ 218.00	Collections Supervisor		
55531	Pies	$ 3,757.00	Collections Supervisor	Director of Collections	VP of Collections
54051	Breadsticks	$ 2,114.00	Collections Supervisor	Director of Collections	
53954	Muffins	$ 2,006.00	Collections Supervisor	Director of Collections	
51476	Pies	$ 369.00	Collections Supervisor		
50768	Cookies	$ 107.00	Collections Supervisor		
53993	Breadsticks	$ 2,049.00	Collections Supervisor	Director of Collections	
52883	Muffins	$ 1,075.00	Collections Supervisor	Director of Collections	
53961	Scones	$ 2,013.00	Collections Supervisor	Director of Collections	
52100	Donuts	$ 691.00	Collections Supervisor	Director of Collections	
54463	Cookies	$ 2,572.00	Collections Supervisor	Director of Collections	VP of Collections
51286	Eclairs	$ 299.00	Collections Supervisor		
55618	Donuts	$ 3,853.00	Collections Supervisor	Director of Collections	VP of Collections
51151	Muffins	$ 249.00	Collections Supervisor		
52567	Puff pastry	$ 920.00	Collections Supervisor	Director of Collections	
55499	Donuts	$ 3,721.00	Collections Supervisor	Director of Collections	VP of Collections
55602	Breadsticks	$ 3,834.00	Collections Supervisor	Director of Collections	VP of Collections
51054	Tarts	$ 213.00	Collections Supervisor		
55358	Cookies	$ 3,563.00	Collections Supervisor	Director of Collections	VP of Collections
52091	Puff pastry	$ 685.00	Collections Supervisor	Director of Collections	
51631	Muffins	$ 425.00	Collections Supervisor		
51711	Tarts	$ 456.00	Collections Supervisor		
54968	Muffins	$ 3,131.00	Collections Supervisor	Director of Collections	VP of Collections
53668	Cannoli	$ 1,689.00	Collections Supervisor	Director of Collections	
54566	Eclairs	$ 2,685.00	Collections Supervisor	Director of Collections	VP of Collections
53533	Donuts	$ 1,538.00	Collections Supervisor	Director of Collections	
51196	Puff pastry	$ 266.00	Collections Supervisor		
51212	Muffins	$ 272.00	Collections Supervisor		
52989	Cake	$ 1,128.00	Collections Supervisor	Director of Collections	
51070	Breadsticks	$ 219.00	Collections Supervisor		
53382	Tarts	$ 1,370.00	Collections Supervisor	Director of Collections	
55799	Donuts	$ 4,050.00	Collections Supervisor	Director of Collections	VP of Collections
52235	Cannoli	$ 757.00	Collections Supervisor	Director of Collections	
52709	Scones	$ 989.00	Collections Supervisor	Director of Collections	
55895	Cookies	$ 4,160.00	Collections Supervisor	Director of Collections	

X

55126	Breadsticks	$ 3,306.00	Collections Supervisor	Director of Collections	VP of Collections	
55467	Tarts	$ 3,685.00	Collections Supervisor	Director of Collections	VP of Collections	
53233	Donuts	$ 1,225.00	Collections Supervisor	Director of Collections		
50967	Donuts	$ 182.00	Collections Supervisor			
55451	Scones	$ 3,666.00	Collections Supervisor	Director of Collections	VP of Collections	
50546	Cake	$ 26.00	Collections Supervisor			
53938	Puff pastry	$ 1,989.00	Collections Supervisor	Director of Collections		
50977	Scones	$ 185.00	Collections Supervisor			
54444	Cannoli	$ 2,548.00	Collections Supervisor	Director of Collections	VP of Collections	
50826	Cookies	$ 129.00	Collections Supervisor			
52693	Cake	$ 981.00	Collections Supervisor	Director of Collections		
51611	Puff pastry	$ 419.00	Collections Supervisor			
51370	Breadsticks	$ 329.00	Collections Supervisor			
51219	Scones	$ 273.00	Collections Supervisor			
50777	Puff pastry	$ 111.00	Collections Supervisor			
53755	Breadsticks	$ 1,785.00	Collections Supervisor	Director of Collections		
54344	Cookies	$ 2,438.00	Collections Supervisor	Director of Collections		
54843	Donuts	$ 2,992.00	Collections Supervisor	Director of Collections	VP of Collections	
52455	Cake	$ 864.00	Collections Supervisor	Director of Collections		
50610	Donuts	$ 50.00				X
51991	Scones	$ 627.00	Collections Supervisor	Director of Collections		
51373	Puff pastry	$ 332.00	Collections Supervisor			
54151	Eclairs	$ 2,222.00	Collections Supervisor	Director of Collections		
54357	Puff pastry	$ 2,450.00	Collections Supervisor	Director of Collections		
51521	Cannoli	$ 386.00	Collections Supervisor			
50530	Cookies	$ 20.00	Collections Supervisor			
53217	Breadsticks	$ 1,219.00	Collections Supervisor	Director of Collections		
54547	Donuts	$ 2,661.00	Collections Supervisor	Director of Collections	VP of Collections	
53661	Scones	$ 1,682.00	Collections Supervisor	Director of Collections		
50961	Cake	$ 179.00	Collections Supervisor			
52123	Eclairs	$ 701.00	Collections Supervisor	Director of Collections		
50523	Pies	$ 17.00	Collections Supervisor			
52574	Cake	$ 923.00	Collections Supervisor	Director of Collections		
54817	Pies	$ 2,963.00	Collections Supervisor	Director of Collections	VP of Collections	
50935	Tarts	$ 170.00	Collections Supervisor			
52908	Pies	$ 1,088.00	Collections Supervisor	Director of Collections		
51682	Donuts	$ 445.00	Collections Supervisor			
54382	Cannoli	$ 2,481.00	Collections Supervisor	Director of Collections		
55664	Breadsticks	$ 3,901.00	Collections Supervisor	Director of Collections	VP of Collections	
50617	Muffins	$ 51.00	Collections Supervisor			
53320	Tarts	$ 1,305.00	Collections Supervisor	Director of Collections		
55055	Pies	$ 3,227.00	Collections Supervisor	Director of Collections	VP of Collections	
55016	Cake	$ 3,184.00	Collections Supervisor	Director of Collections	VP of Collections	
53124	Scones	$ 1,185.00	Collections Supervisor	Director of Collections		
54563	Cannoli	$ 2,680.00	Collections Supervisor	Director of Collections	VP of Collections	
50517	Tarts	$ 15.00	Collections Supervisor			
55287	Tarts	$ 3,486.00	Collections Supervisor	Director of Collections	VP of Collections	
54540	Cake	$ 2,656.00	Collections Supervisor	Director of Collections	VP of Collections	
51441	Cake	$ 356.00	Collections Supervisor			
55802	Muffins	$ 4,057.00	Collections Supervisor	Director of Collections	VP of Collections	
52670	Pies	$ 971.00	Collections Supervisor	Director of Collections		
55609	Puff pastry	$ 3,841.00	Collections Supervisor	Director of Collections	VP of Collections	
50993	Tarts	$ 191.00	Collections Supervisor			
52416	Cannoli	$ 845.00	Collections Supervisor	Director of Collections		
51086	Donuts	$ 225.00	Collections Supervisor			
53636	Breadsticks	$ 1,653.00	Collections Supervisor	Director of Collections		
51579	Cannoli	$ 407.00				X
54627	Eclairs	$ 2,752.00	Collections Supervisor	Director of Collections	VP of Collections	

51096	Scones	$ 230.00	Collections Supervisor		
50890	Breadsticks	$ 153.00	Collections Supervisor		
52007	Tarts	$ 637.00	Collections Supervisor	Director of Collections	
54930	Tarts	$ 3,088.00	Collections Supervisor	Director of Collections	VP of Collections
51386	Donuts	$ 335.00	Collections Supervisor		
51428	Breadsticks	$ 351.00	Collections Supervisor		
52171	Scones	$ 725.00	Collections Supervisor	Director of Collections	
53787	Cannoli	$ 1,821.00	Collections Supervisor	Director of Collections	
54746	Eclairs	$ 2,884.00	Collections Supervisor	Director of Collections	VP of Collections
52316	Cookies	$ 797.00	Collections Supervisor	Director of Collections	
53906	Cannoli	$ 1,953.00	Collections Supervisor	Director of Collections	

This appendix presents the sampling worksheet with seeded errors. Note that line items denoted with an "X" indicate seeded error observations. The "X" markings should be removed prior to distributing the worksheet to students.

THE HACK ATTACK AT WINTER'S TALE PUBLISHING

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CASE DESCRIPTION

The primary subject matter of this case concerns the vulnerabilities that poor management can expose an organization to as well as the widespread effects that a hacker attack can have on a business' operations. Secondary issues examined include, auditing frameworks to evaluate internal controls, designing a secure network for small start-up businesses, and addressing legal and marketing concerns of a hacked organization. The case has a difficulty level of three or higher and was designed to be taught in a 30 to 45 minute time period with approximately two hours of outside preparation by students. The case can be approached from five perspectives (business law, forensic accounting, information technology management, management, and marketing), thus the case can be used in multiple 30 to 45 minute classes. Instructor's notes from each of these perspectives have been written to allow for an integrated approach to learning across the curriculum.

CASE SYNOPSIS

The case describes Winter's Tale Publishing, an online startup publishing house started by John Winters after successfully publishing his own book. The organization grew quickly but cut corners in several areas which would later come to haunt them. Winter's Tale started a marketing campaign to build interest in a soon-to-be-published tell-all book. Controversy surrounded the publishing of the book and hackers attacked Winter's Tale's server. The hackers accessed personal client author information as well as employee emails and posted the information online for all to see. The case ends with John and his staff meeting to evaluate the circumstances, control the damage, implement a strategy going forward, and determine what led them into such a susceptible state.

BACKGROUND

Winter's Tale Publishing is a rapidly growing book publisher in Chicago, IL. John Winters started the organization out of his home in 2011 as a part-time venture to encourage his hobby, storytelling. John had always had a vivid imagination. As a child, John would regale his friends with elaborate stories based upon a shard of gossip. He had a knack for taking a small piece of hearsay and crafting it into an elaborate tall tale. John's audiences and requests for stories followed him from grade school to college, to work. His audiences, for the most part, could never hear enough of his stories. However, if you happened to be the subject of the gossip and the ensuing tall tale, the opinion often took a different tone. John had spent many late afternoons in high school detention from teachers he had angered with his half-truths, or from fights that erupted with the main character of one of his tales. He also almost lost his position in sales at his last job after painting an elaborate story depicting his boss as a philandering recreational drug user.

HISTORY

In 2008, John enrolled in a book writing class at the local community college. A semester long project required him to write a chapter a week for sixteen weeks. John's story seemed to flow through his hands and by the end of the semester, his project had turned into a full-fledged book. The class instructor was amazed with his talent and encouraged John to try to publish his work and to block off time every day to commit to writing his next big story.

John took his instructor's words to heart. He continued to write and started trying to find a publisher for his book. After multiple failed attempts to get his book published, John frustratingly decided to publish his book on his own using an online vanity press. For a small fee, the publishing site would feature their authors' books on their homepage and social media sites, as well as make sample chapters available for would-be readers.

John paid the fee and posted anonymous glowing reviews of his book to every online resource he could find. He staged a quirky interview on YouTube and made numerous Facebook posts encouraging viewers to like his video. His efforts paid off as his video went viral and he watched the number of downloads steadily rise and suddenly skyrocket. John's book became a best seller almost overnight. Riding on the wave of his sudden success, John published the sequel he had been writing. After a barrage of anonymous postings to social media outlets, it too shot to the top of the best-seller lists.

John's overnight success was not lost on the big publishing houses or would-be authors. He received several offers to contract with noted publishers, and an onslaught of emails seeking advice. John knew he had discovered the formula for publishing success. With both big name publishers and possible best-selling authors knocking at his door, he knew he had the makings for a future IPO and eventual buy out.

He quickly went to work setting up his own publishing group by incorporating a parent company named "Winter's Tale Publishing." John also planned on operating a subsidiary that focused on children's literature. He hired a lawyer to incorporate and organize his businesses, and to craft a contract to start sending to would-be authors under his labels. The contract contained standard legalese, a description of the services provided and the cost structure, a description of the royalty payment process and percentage fee that went to the house, and signature areas. The contract also required standard personal information from authors, including first and last name, address, tax ID number, driver's license number, a credit card number for monthly membership fees, and a preferred bank account number for future royalty deposits. The response rate of interested authors was practically 100 percent with 30 people signing on with the main publishing house or its subsidiary within one week.

Because he anticipated success for his publishing business equal to that he had encountered with his books and now, author signings, he decided to hire an Information Technology (IT) person to build a web server and web site for hosting his online publishing company web site. John also hired an administrative assistant.

EMPLOYEES HIRED

John posted an ad to an online employment site and received a number of emails from highly qualified applicants. One resume that stood out was that of Will Martin. Not only was Will purportedly a gifted techie, but he was also a skilled writer. His cover letter and resume read like an IT person's dream career followed by a Who's Who of experience and references. He was almost too good to be true, so John called him immediately to conduct an initial inquiry before Will could slip through his fingers.

WILL MARTIN, IT

What John had intended to be a short Skype chat turned into a full-blown job interview through Will's manipulation of their conversation. John's impression of Will continued to rise the longer he talked with him on the phone. (Will indicated that his internet connection was having difficulties that day, so he was unable to use video.) Although he tried to remain neutral, John was afraid his voice revealed his growing interest in hiring Will. As John prepared to end the interview, Will mentioned that he had a couple of tempting offers from some other companies and that if John did not act immediately, he wouldn't be available. Against John's better judgment, he immediately extended an offer to Will without interviewing other candidates or further evaluating Will's credentials. In less than 15 minutes, John had hired his first employee.

Will insisted that he start work immediately and showed up at John's home the following day. John was quite surprised by Will's youthful appearance. Based upon the accumulated years of experience indicated on his resume, he had assumed Will to be a much older man. Will assured John that youthful looks ran in his family and he should not let Will's outward appearance detract from his accumulated experience gained at work and in life. (Will failed to reveal to John that he had been convicted on a computer tampering misdemeanor less than a year earlier and had served 30 days in jail. Will had given an associate access to a folder on his previous employer's server. The associate stole employee personnel information from the system and sold it to a criminal identity theft ring.) John didn't ask Will to fill out a job application; and he never verified any of the information included on Will's resume.

SUSAN ADAMS, ADMINISTRATIVE ASSISTANT

John also hired Susan Adams to be his part-time administrative assistant. Susan had worked with John at his previous employer for five years before she left the company to take care of her new baby. The baby was now in pre-school and Susan wanted to find a part-time job to slowly start getting back into the workforce. John jumped at the chance to bring Susan on board. She had been the best administrative assistant at his previous company. She was a hard worker. They got along great and she had a sense of humor that rivaled his.

BUSINESS GETS UNDERWAY

John asked Will to compose a budget of all of the technology and resources they would need to begin operations. This list was to include back office resources as well as networking, network security, and Internet access. He was also asked to acquire resources to build and host a web site which could collect and store personal information, receive payments, manage company finances, as well as manage manuscripts.

Will presented John with what he thought was a reasonable technology budget for a business starting out. John's chin almost dropped to the floor as he said, "You do realize that we're just starting up and only have three employees. See what you can do to cut the budget in half." John put half of the requested funds in an account for Will to purchase the technology resources.

In addition, John gave Will full responsibility for setting everything up. Will knew he would have to cut some significant corners, but he thought he could find YouTube videos and online resources to piece together a secure network by himself. In fact, he had just found a nifty data security contract that he could borrow pieces from to incorporate into the security portion of the contract. That in itself should have saved them a couple of hours of lawyer's fees.

MANUSCRIPTS START ARRIVING

John had turned office operations, accounts receivable and accounts payable over to Susan. He also made Susan a signatory on all the company's bank accounts, and signed permission to have his signature made into a signature stamp. Susan suggested the signature stamp to save John time signing checks for routine bills and payments; and he thought this was a good idea. He didn't have time to oversee all that Will was doing, so John left that up to Susan to monitor as well. He assumed that Will must have been able to make his budget work as all of the operating pieces seemed to be in place. Everyone had a computer, Internet access, phones and a shared printer. Will had even shown John a copy of the contract that he, Susan, and—John assumed, Winter's Tale's lawyer—had crafted ensuring potential author clients of the security of their data. The wording was also included in the policy section of their web site. The system must have been pretty locked down when they could include a statement noting:

> ***Data Security.*** *Winter's Tale Publishing, Inc. uses encryption practices to help insure the integrity and privacy of personal information you provide to us. All personal information is kept physically behind firewalls that prevent intruders from gaining access. As an added security precaution, we deploy various methods of protection such as host intrusion prevention and detection systems to maintain the integrity and confidentiality of data. We make all reasonable efforts to protect your privacy, and you can count on our system to be secure against any potential known threat existing today.*

The company had a web site and more clients were signing on. John focused his time on talking to clients, and finding the next best seller from the deluge of manuscripts that started pouring in.

EIGHTEEN MONTHS LATER

During the first year in operation, Winter's Tale Publishing had been able to manufacture two new authors on the best sellers' lists. Accolades for his work and business were abundant. For a time, John seemed to be on track to be the next big name in the small book publishing industry. However, the past six months had been a drought. John was overwhelmed with mediocre manuscripts. None of the authors' works demonstrated sufficient promise to warrant further investing his time. His two success stories were busy writing their sequels, but were nowhere close to being ready for market.

Bills continued to pour in. John realized that he had invested considerable income into generating buzz for the business, as well as trying to create an image and name for himself in the publishing industry. Some of his clients started cancelling their contracts. A couple of them had threatened to pursue legal action as they felt like the services that they had received did not live up to what they felt they were promised on the company web site. John's voice mail and email were filling up with messages and complaints from dissatisfied clients.

One particularly stressful morning, John engaged in a series of email volleys to Susan belittling his bailing clients. John was relying more and more on Susan's help to make decisions about the direction of the business. Not only was she skilled and able to wear many hats, but Susan was always dependable, and never took a day off. John complained to Susan that although the clients might have felt that he had promised to make them all famous authors, they should have had the sense to know that the odds were not in their favor. He couldn't believe that so many naïve people would gravitate toward him. As their email exchange became increasingly derogatory toward the clients, Susan opened up yet another bill from an impatient bill collector. To soften the blow to an already bad day, Susan half-jokingly suggested that John turn the story he had concocted about their former boss into a best seller.

THE BOOK

John thought Susan's idea might be just the idea to get them out of the red and back to the top of their game. Their former boss had become a high profile captain of industry whose name was familiar to almost every household. He would be sure to mask some of the identifying information to market the book as pure fiction. However, he would have to include enough facts and details to take advantage of the interest generated from a scandal associated with such a high profile individual.

John feverishly started working on his boss' story. He relied heavily on Susan to be his sounding board, sending her emails with excerpts about their former boss that were outlandish in the extreme. To take advantage of the marketing hype that remained about Winter's Tale, he decided to start planting comments in social media outlets to begin generating interest for his next book. Some of John's former co-workers followed his career and the progress of Winter's Tale. As more details about the book were made public, they recognized the tall tale John had crafted about their boss several years ago.

News of the pending book made some of John's former coworkers--as well as his former boss--livid. Several co-workers contacted John and asked him to drop the book. Some even made threats and predicted that this book would be the undoing of John's career. John's former boss made personal appeals to him as well; yet John was determined to see the book through.

One month before the book was to go public, John started a countdown on Winter's Tale's web site as well as social media pages. At about the same time that the countdown started, Will noticed an increasing amount of unusual activity occurring from a particular series of IP addresses. He tried to meet with John to see about hiring an expert to go over the security of their system. However, John was too busy finishing the book and kept missing his meetings with Will.

THE HACK

About one week before the publication date, Winter's Tale's server was hacked. The server's contents were exposed to the public and a message from the hacker was left with a URL to a server in another country. Multiple messages containing the URL were posted to the same social media outlets that John used to drive his marketing campaign. Upon visiting the address, John found everything that had been stored on the server exposed for all to see including personal emails, such as those between himself and Susan, as well as a slew of personal information about his clients including their full names, social security numbers, bank accounts, and credit card numbers. The book had generated the notoriety that John had sought, and overnight, John and

Winter's Tale Publishing had gained national attention. His phone was ringing off the hook with news agencies seeking interviews, clients demanding their information be removed from public display, and lawyers threatening litigation.

To make matters worse, a policeman was standing in John's office with a warrant for Will's arrest. According to the policeman's affidavit, Will had violated his probation by working in a capacity allowing him unsupervised access to personal financial data. John started to wonder if his problems would ever end.

FIXING THE PROBLEM

John immediately called Susan, Will, his lawyer, and a marketing specialist for an emergency meeting. He also asked a close friend who was working as an auditor to join them. John knew he had to do something immediately, but he wasn't sure what needed to be done, or where to start. He had asked Susan to compile a list of those authors whose information had been breached, as well as a list of those who had contacted the office regarding the breach. John breathed a sigh of relief when he realized that authors affiliated with the children's book subsidiary had not realized its affiliation with Winter's Tale Publishing. He could see no reason at this time to alarm those clients who were unaware of the company's jeopardy. John asked each person to evaluate the situation from their perspective to help him figure out what the underlying problems were leading up to the current situation, and what needs to be done going forward from each perspective to rescue the publishing house and their customers from this devastating situation.

THE HACK ATTACK AT WINTER'S TALE PUBLISHING: THE FORENSIC ACCOUNTING/INTERNAL AUDITING PERSPECTIVE

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CASE DESCRIPTION

The primary subject matter of this case concerns the vulnerabilities that poor management can expose an organization to as well as the widespread effects that a hacker attack can have on a business' operations. Secondary issues examined include, auditing frameworks to evaluate internal controls, designing a secure network for small start-up businesses, and addressing legal and marketing concerns of a hacked organization. The case has a difficulty level of three or higher and was designed to be taught in a 30 to 45 minute time period with approximately two hours of outside preparation by students. The case can be approached from five perspectives (management, business law, information technology management, forensic accounting and marketing), thus the case can be used in multiple 30 to 45 minute classes. Instructor's notes from each of these perspectives have been written to allow for an integrated approach to learning across the curriculum. The following set of teaching notes evaluates the case from a forensic accounting/ internal auditing perspective.

Evaluation of the case from a forensic accounting/internal auditing perspective requires the application of AU §316, Consideration of Fraud in a Financial Statement Audit, the AICPA/Canada Trust Services and Principles, and COSOs Integrated Framework to the facts of the case. The case from a forensic accounting/internal auditing perspective is primarily designed for junior or senior-level undergraduate students majoring in accounting with a basic knowledge-base in internal controls.

CASE SYNOPSIS

The case describes Winter's Tale Publishing, an online startup publishing house started by John Winters after successfully publishing his own book. The organization grew quickly but cut corners in several areas which would later come to haunt them. Winter's Tale started a marketing campaign to build interest in a soon-to-be-published tell-all book. Controversy surrounded the publishing of the book and hackers attacked Winter's Tale's server. The hackers accessed personal client author information as well as employee emails and posted the information online for all to see. The case ends with John and his staff meeting to evaluate the circumstances, control the damage, implement a strategy going forward, and determine what led them into such a susceptible state.

STUDENT LEARNING OBECTIVES

The case can be examined across a business program in multiple courses to provide students with a holistic approach to evaluating the ramifications of business decisions to multiple dimensions of an organization. The case can also be addressed in an individual course. Upon reading, analyzing and discussing the case from the accounting/internal control perspective, students should be able to:

1. Demonstrate an understanding of internal control concepts related to fraud risk factors of AU §316 and objectives, components, and principles of the COSO's Internal Control-Integrated Framework (2013).
2. Apply analytical and critical thinking skills as they analyze the case to identify internal control deficiencies and recommend mitigating internal controls to address the deficiencies.
3. Evaluate the case from the perspective of the Integrated Framework's objectives, components and principles and from the perspective of the AICPA/CPA Canada Trust Services Principles and Criteria.

RECOMMENDATIONS FOR TEACHING APPROACHES

The case can be taught from multiple perspectives in several different courses such as upper level marketing, business strategy, business law, human resources, forensic accounting/auditing, and information technology management. The following case notes address the issues from the perspective of forensic accounting/ auditing. Case coverage should take approximately 30 to 45 minutes of course time. Senior level students may be asked to analyze and write up the case using a case analysis template such as:

Background
Main Problem
Minor Problems (stemming from main problem)
Possible Solutions
Recommended Solution and Implementation
Recommended Precautionary Measures and Implementation (What should have been done to prevent this situation?)

Possible forensic accounting/internal auditing questions that may be provided to students include the following:

Target courses: Forensic Accounting, Internal Auditing, Financial Auditing

1. *Define fraud. Describe the difference between fraud and errors as defined in AU §316,* ***Consideration of Fraud in a Financial Statement Audit.*** *What are the two types of misstatements relevant to the independent auditor's consideration of fraud? As the independent auditor of Winter's Tale Publishing, identify whether you believe the hacking was a fraudulent act, an error, or neither.*

In general, fraud is the intentional deception in which the perpetrator receives financial or personal gain. According to AU §316.05, the difference between fraud and an error depends on intent to materially misstate the financial statements. Fraud is an intentional act to materially misstate the financial statements.

The two types of misstatements relevant to the external auditor include (1) misstatements arising from fraudulent financial reporting and (2) misstatements arising from misappropriation of assets. Both types of misstatements cause the financial statements to be in nonconformance with generally accepted accounting principles (GAAP).

2. *Describe the fraud risk factors identified in AU §316 as the risk factors relate to John Winters and Will Martin.*

The three risk factors include incentive or pressure, opportunity, and rationalization or attitude. Pressures describe the reasons that fraud is committed. Opportunity is the existence of circumstances which allow fraud to be committed. Most often, these circumstances result from a lack of internal controls. Rationalization is the perpetrator's ability to justify and intentionally commit a dishonest act.

John's apparent successes had recently been met with a six-month drought of clients cancelling. In addition, John had invested most of his income in the business; he was attempting to make a name for himself, and had bills backing up with payroll to meet. The opportunity for John to commit this fraud existed only with the assistance of Will, the IT expert. Evidence of this opportunity does not exist.

Will's access to all of Winter's Tale's IT, provides Will the opportunity to create the current situation. John had conveyed all IT activity to Will, including all of the Internet access, networking, and website hosting. Given Will's prior conviction of computer tampering, Will may not have needed pressure or rationalization. He may have simply enjoyed the thrill of computer tampering. Will may also have been frustrated at John's inattentiveness to the unusual activity regarding the IP addresses. However, Will's multiple attempts to address the unusual activity with the particular series of IP addresses and Will's desire to hire a security expert to evaluate the IT system, might imply that he was attempting to divert the situation at hand.

3. *The AICPA/CPA Canada's Trust Services Principles and Criteria address security, availability, processing integrity, confidentiality, and privacy for assurance on information technology-enabled systems. Define the five criteria and identify which of the five listed criteria were violated?* http://www.aicpa.org/interestareas/frc/assuranceadvisoryservices/pages/trustdataintegritytaskforce.aspx

The principle of security refers to the protection against unauthorized access. The hacking that occurred clearly indicates that the system was not secure. The security criteria were violated. Availability refers to access to the system and processing integrity refers to the valid, complete, accurate, timely and authorized transactions. These two criteria do not appear to have been violated. Confidentiality refers to the company's information; whereas privacy refers to personal information. Both of these were certainly violated with the publishing of information to the social media URL.

4. *According to the Committee of Sponsoring Organizations Internal Control Integrated Framework (COSO-updated May 2013) three categories of objectives exist for an organization's internal control efforts. These objectives include (1) Operations, (2) Reporting, and (3) Compliance. Discuss these objectives from the perspective of Winter's Tale Publishing meeting these objectives. COSO's Framework* http://www.coso.org/documents/990025P_Executive_Summary_final_may20_e.pdf

The COSO *Integrated Framework* defines Operations Objectives as those that "pertain to effectiveness and efficiency of the entity's operations, including operational and financial performance goals, and safeguarding assets against loss." The hacking into the company's information system clearly indicates that assets were not properly safeguarded. Information specific to the company and the company's customers was the main "asset" that was not safeguarded. The lack of safeguarding their customers' information indicates Winter's Tale Publishing has not met their Operations Objectives.

The Reporting Objectives relate to both internal and external financial and non-financial reporting. Compliance Objectives refer to adhering to laws and regulations. Although a lack of apparent violation of the Reporting Objectives exists, the Compliance Objectives are likely to have been violated, as personal customer information (full names, social security number, and bank account numbers) was provided to the public on company's social media URL.

5. *The COSO's Integrated Framework suggests the need of five critical components and 17 principles to assess the effectiveness of internal controls. These controls include the control environment, risk assessment, control activities, information and communications, and monitoring. Which of these components, if any, appears to be lacking at Winter's Tale Publishing? Which COSO objective links to the hack of Winter's Tale Publishing's computer system?*

The risk assessment and control activities components appear to be lacking. Risk assessment requires the evaluation of potential threats that would adversely affect the company. The risk of hackers to the system and contingency plans should be in place. The hack created a direct threat and damages to the effective and efficient operations at Winter's Tale Publishing, providing a direct link to the lack of operations objectives.

6. *In an effort to evaluate the current situation with the hack, the auditor brought in by Winter's Tale Publishing decided to evaluate their internal control system based on the COSOs Integrated Framework. Assume as a first step in the process, Winter's Tale Publishing establishes the operations objective to "s**afeguard client information from unauthorized access, use, and dissemination**." As the auditor, continue the evaluation of the situation, using the Framework's components and principles, to identify internal control deficiencies and measures that should be taken to prevent and/or detect hacks in the future.*

The components are listed in question #5. Students should methodically identify the principles within each component that lead to the identification of internal control deficiencies. See Table 1 for a summary of internal control deficiencies and mitigating internal controls.

The **control environment** refers to the "tone at the top" and the "standards, processes, and structures that provide" the foundation for the internal control structure across the organization. Five principles are associated with the control environment with two principles that directly relate to the situation at Winter's Tale Publishing. Winter's Tale Publishing did not **provide for "appropriate authorities and responsibilities** in pursuit of the" objective to safeguard client information. The situation is such that John relegated complete authority of the information system to Will. Will was at liberty to develop a system, on the low-budget side, possibly forgoing critical applications and safeguards relevant to access to the system. The second principle that was not adhered to was **"a commitment to attract, develop, and retain competent individuals."** The lack of a background check on Will provides little evidence that John was objective in his decision to hire ill, instead relying on what he “felt” during the interview process. At a minimum, John should adopt better hiring practices by obtaining background checks, including criminal, on potential employees. Given the sensitive nature of client information and the need for a true information system’s expert, John also should have investigated Will’s credentials.

The **risk assessment** component requires the identification of risks that could prevent the achievement of the objectives. The four principles associated with the risk assessment component provide for the iterative process in the identification and assessment of threats to meeting the objective stated above. In general, the risk assessment principles include (1) the identification of the risks of the objectives not being met, (2) an analysis of the risks (and potential responses), (3) the consideration of fraud, and (4) assessing the impact of significant changes that would affect the internal control system.

The most relevant principle related to the risk assessment component includes an analysis of the risks (and related responses). An analysis of the potential vulnerabilities of the information system would have led to the identification that the system could be hacked and client information obtained. Assuming this risk was at a level high enough to warrant action, control activities would have been implemented to prevent the threat. In addition, an appropriate response to the occurrence of the hack, would have been documented in a disaster recovery plan. Given the small size of the company, three individuals, John should have decided that the risk of a hack was too large, and decided to outsource his information technology needs instead of keeping it in-house.

The **control activities** component refers to specific policies and procedures that serve to mitigate risks of the objective(s) not being met. Control activities apply to the organization as a whole, to business processes, and to the technology environment. The three principles include (1) the selection and development of control activities to mitigate risks of achieving objectives, (2) the selection and development of control activities over technology, and (3) the implementation of control activities.

The initial response by students to specific control activities to mitigate the risk at Winter’s Tale Publishing will probably be the implementation of segregation of duties. However, with only three people in the organization, each with an expertise in their respective areas but not in the other areas, segregation of duties is not feasible. However, at a minimum, John should obtain a minimum working-knowledge in all areas within his business. In addition, an evaluation of the system would have highlighted the need for alternative controls to achieve similar results as segregation of duties. The identification of the segregation of duties may have led to possibly outsourcing the IT function or hiring a CPA to evaluate the system based on the Trust Services Principles and Criteria ®.

The obvious principle that appears to have been overlooked is the implementation of control activities over technology. Several general controls exist that John should oversee. Specific general controls include authentication controls whereby only authorized users with unique user IDs and passwords have access to the system. Approved users should appear on a list, with each access compared to the computerized list prior to access being allowed. Unauthorized access should be flagged immediately, with a shut-down of the system to prevent further damage. Finally, a third-party verification, such as that provided by CPAs and based on the AICPA/Canada Trust Services Principles and Criteria, of the proper working of the controls within the system should be implemented.

The **information and communication** component refers to obtaining relevant information (both internal and external) to support the functioning of internal controls. Due to the lack of internal control, an internal control deficiency exists with this component. After establishing and implementing an internal control structure, John should ensure that relevant information is obtained and communicated both internally and externally. Regarding the breach of Winter's Tale Publisher's clients' personal information, the method of communicating with clients (external parties) should follow all legal requirements.

The **monitoring** component principles include (1) the "ongoing and/or separate evaluations" of the internal controls and whether they are properly functioning and (2) the timely communication of internal control deficiencies. Evidence of monitoring activities exists with Will's identification of "increasing amount of unusual activity occurring from a particular series of IP addresses." However, this basic monitoring activity went unnoticed by John, who was "too busy finishing the book and kept missing meetings with Will." John obviously should have met with Will to address the potential breach in the system.

Table 1
SUMMARY POINTS OF DEFICIENCIES AND MITIGATING MEASURES TO PREVENT AND/OR PROVIDE EARLIER DETECTION

INTERNAL CONTROL DEFICIENCY	MITIGATING MEASURE/INTERNAL CONTROLS
Control environment	
Poor hiring practices	Background checks to include criminal, work history, educational credentials
Improper assignment of authority and responsibilities	John should take responsibility with respect to the operations of the IT function within Winter's Tale Publishing. John might consider outsourcing the IT function.
Risk Assessment	
Lacks a risk assessment process	Implement a risk assessment process, taking into consideration the principles identified in the COSOs Integrated Framework
Control Activities	
Lacks segregation of duties	Outsource the IT function Hire an independent CPA to provide a Trust Services engagement, with a specific focus on evaluating the IT system's security and privacy Access controls
Possible unauthorized access	Access controls to include user IDs and passwords Access control log with unauthorized access attempts logged – follow-up on log reports
Lacks authorization controls	Create a computer-generated matching of approved users and availability of the systems data, files, etc.
Information and Communication	
Lacks a system for identifying relevant information to receive and disseminate information regarding the proper functioning of internal controls	Develop policies and procedures for obtaining and disseminating information
Monitoring	
Lack complete monitoring of internal controls	John should drop all activities and meet with the IT person immediately. The strange activity that occurred and was noted by Will, should have been investigated much earlier.

THE HACK ATTACK AT WINTER'S TALE PUBLISHING: THE BUSINESS LAW PERSPECTIVE

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CASE DESCRIPTION

The primary subject matter of this case concerns the vulnerabilities that poor management can expose an organization to as well as the widespread effects that a hacker attack can have on a business' operations. Secondary issues examined include, auditing frameworks to evaluate internal controls, designing a secure network for small start-up businesses, and addressing legal and marketing concerns of a hacked organization. The case has a difficulty level of three or higher and was designed to be taught in a 30 to 45 minute time period with approximately two hours of outside preparation by students. The case can be approached from five perspectives (management, business law, information technology management, forensic accounting and marketing), thus the case can be used in multiple 30 to 45 minute classes. Instructor's notes from each of these perspectives have been written to allow for an integrated approach to learning across the curriculum. The following set of teaching notes evaluates the case from a business law perspective.

Evaluation of the case from a business law perspective includes an examination of the issues of negligent hiring, civil tort liability in negligence and defamation, and potential violations of Federal Trade Commission regulations and the Illinois Personal Information Protection Act. The case requires students to have an introductory level understanding of business strategy, marketing, and general business issues. The case from the business law perspective is primarily designed for junior or senior-level undergraduate students in business law, accounting, or finance.

CASE SYNOPSIS

The case describes Winter's Tale Publishing, an online startup publishing house started by John Winters after successfully publishing his own book. The organization grew quickly but cut corners in several areas which would later come to haunt them. Winter's Tale started a marketing campaign to build interest in a soon-to-be-published tell-all book. Controversy surrounded the publishing of the book and hackers attacked Winter's Tale's server. The hackers accessed personal client author information as well as employee emails and posted the information online for all to see. The case ends with John and his staff meeting to evaluate the circumstances, control the damage, implement a strategy going forward, and determine what led them into such a susceptible state.

STUDENT LEARNING OBECTIVES

The case can be examined across a business program in multiple courses to provide students with a holistic approach to evaluating the ramifications of business decisions to multiple *dimensions of an organization. The case can also be addressed in an individual course. Upon reading, analyzing and discussing the case from the business law perspective, students should:*

1. Be able to recognize the importance of a well-designed and legally compliant company hiring policy, and how to conduct a proper background check on potential employees.
2. Learn the elements of tort liability in negligence and defamation actions, and how to avoid/minimize such liability.
3. Be able to identify requirements for a business under Section 5 of the Federal Trade Commission's Act (FTC Act: 15 USC 45) and how to protect against violations of the Act.
4. Become aware of how to properly protect client privacy information, and learn the nature of a company's liability under state consumer notification laws.

RECOMMENDATIONS FOR TEACHING APPROACHES

The case can be taught from multiple perspectives in several different courses such as upper level marketing, business strategy, business law, human resources, forensic accounting/auditing, and information technology management. The following case notes address the issues from the perspective of business law. Case coverage should take approximately 30 to 45 minutes of course time; expect an extended time allocation if including question/answer research and discussions. Senior level students may be asked to analyze and write up the case using a case analysis template such as:

Background
Identification of Legal Issues
Strengths and Weaknesses of Potential Causes of Action
Recommended Approaches to Identified Issues
Recommended Precautionary Measures and Implementation (what should have been done to prevent this situation.)

Possible business law questions that may be provided to students include the following:

1. After the data breach, several of Winter Tale's client authors discovered that the IT manager, Will Martin, was a convicted computer hacker. It appears that Will had provided a previous employer's computer data file access to an associate, who later stole personal information from the system and sold it to a criminal identity theft ring. It has filtered back to John that the authors are planning to file a "negligent hiring" suit against Winter's Tale Publishing. John has never heard of such an action, but is concerned that his failure to check Will's references may be a major factor in the case. *What are the general elements of a "negligent hiring" cause of action, and do the authors have a potential case against Winter's Tale? Assuming that a negligent hiring action does exist in this situation, what safeguards should the publishing house consider adding to their future hiring practices?*

A negligent hiring cause of action is made by an injured party against an employer, claiming that the employer knew or should have known that an employee's background posed a threat to the welfare of others. Nearly every state recognizes the negligent hiring tort, and the claim is based on the concept that it is the responsibility of an employer to take reasonable care in a hiring action. "To bring a prima facie case for negligent hiring, a plaintiff must demonstrate that: (1) employer was required to make an appropriate investigation of employee and failed to do so;

(2) an appropriate investigation would have revealed the unsuitability of the employee for the particular duty to be performed or for employment in general; and (3) it was unreasonable for the employer to hire the employee in light of the information he knew or should have known." (Reuters, 2015). Although negligent hiring cases most often involve employees with high intensity public contact, such as real estate agents, delivery personnel, and healthcare workers, such actions against companies who employ individuals with computer crime convictions is increasing. Ex-criminal hackers, despite their illegal actions, are usually highly skilled and may be sought after by companies—especially to help identify system vulnerabilities. Though with the concomitant rise in data breaches, employing an individual with a record of computer crime is certainly exposing the organization to potential liability (Skoudis, 2015).

In this case, it is likely that John was required to make an appropriate investigation of Will prior to his employment. Because Winter's Tale Publishing would be handling sensitive data, such as personal information of authors and unpublished literary materials, it was the hiring authority's (i.e. John's) duty to insure that the publishing house's IT personnel were fit for employment. John failed to check Will's references, failed to conduct a background investigation, failed to even Google Will or have him fill out a job application. After meeting Will, John did not investigate the obvious mismatch between Will's youth and extensive experience. It is clear that John failed to take reasonable care in his hiring of Will Martin. An appropriate investigation of Will's background would have, in the very least, brought to light the conviction for computer tampering. Based upon the nature of Will's crime—providing access to sensitive data—it could be argued that Will was unsuitable for his present position at Winter's Tale Publishing. Additionally, a proper reference check would have likely exposed Will's extensive computer experience as fraudulent, further establishing that Will was a negligent hire for the publishing house.

For future hiring actions, it is imperative that Winter's Tale Publishing establish proper procedures for employee background checks. References on a resume should be contacted. Although most human resources departments cannot disclose information about a candidate, other than whether or not they are eligible to be rehired, it is still a good idea to check with past companies and verify prior employment. Winter's Tale should draft a proper job application that complies with Illinois law—as of January 1, 2015 for example, the "Job Opportunities for Qualified Applicants Act" prohibits some employers from considering or inquiring into a job applicant's criminal record or history until the individual has been determined qualified for the position and notified of an impending interview. This Act means that employers cannot have questions about criminal background on their job applications, and cannot conduct background checks prior to scheduling an interview. Although currently only employers with 15 employees or greater are affected, this is the type of issue that Winter's Tale Publishing should be familiar with when establishing their hiring policies for the future.

** Winter's Tale Publishing was set in Chicago. Instructors may wish to change the location of the case to address laws associated with their own state.

2. During their meeting following the data breach, Winter's Tale's attorney told John she was concerned about the filing of a negligence suit by the corporation's client authors. *What are the general elements of a negligence cause of action, and do the authors have a potential case against the publishing house? Assuming that a negligence action does exist in this situation, what safeguards should Winter's Tale consider adding to their future operating practices?*

There is the potential in this case for a negligence action by the authors because their data was not secure. The tort of negligence consists of the following elements: (1) duty; (2) breach of duty; (3) actual and proximate causation; and (4) damages. The duty here by John's publishing company would be to avoid "preventable risk"--that is, potentially expected breaches that may be guarded against. Preventable risk does not include innovative breaches that are unexpected or novel. The key to fulfilling this duty would be to establish a properly designed and maintained data security system. It may be argued that John violated this duty by not having a proper system in place to guard the authors' data against a privacy breach. John also failed to hire qualified personnel to design, implement and maintain the computer system. The "hack" against Winter Tale's Publishing's system was entirely preventable; there was nothing new or unexpected in the method of the criminal data access. As far as causation is concerned, there may be a strong connection between John's negligence and the potential harm caused by the data breach. "But for" John's failure to properly set-up and operate readily available safeguards, the methods employed by the hackers would not have permitted access to Winter's Tale's data—therefore John's breach of duty is the cause-in-fact of his clients' harm. John's duty breach is also potentially the legal or proximate cause of the harm, in that his prevention failures are sufficiently related to the authors' injuries. However, despite this fairly clear correlation, courts have been finding problems with tracing causation solely to a single data breach, as this sort of incident is becoming, regrettably, commonplace. So the good news is that John may have some wiggle room on the causation issue. Also, fortunately for John, the greatest challenge in a negligence suit against Winter's Tale Publishing would actually belong to the plaintiff authors—and that is proving a cognizable injury or damages. Unless the authors have actual damages from the breach, then the tort may fail for the lack of this element. Increased risk of future harm is the most often plead injury in data breach cases; the belief is that such a data breach exposes the victims to greater risk of identity theft and fraud. Courts tend to reject this theory as insufficient to support a damage claim. The courts have also weighed in on other "injuries" posed by plaintiffs—including mitigation costs, emotional injury, and loss of privacy, among others—as unrecoverable damages. Unreimbursed monetary loss has really been the only damage claim in data breach actions that is typically recognized by the courts as validly satisfying the last element of a negligence action (Meal & Cohen, 2014).

To prevent future data breaches, the publishing house must conform to best practice guidelines for information technology operations. The key is to design and maintain a system that addresses "preventable risk" to safeguard against potential threats. Such a practice would establish recognition of the duty that Winter's Tale Publishing has to its clients, as well as serve as an affirmative defense in a potential negligence action.

3. At the meeting following the breach, IT manager Will Martin discloses that both the company's website and author contracts include the statement: "***Data Security.*** *Winter's Tale Publishing, Inc. uses encryption practices to help insure the integrity and privacy of personal information you provide to us. All personal information is kept physically behind firewalls that prevent intruders from gaining access. As an added security precaution, we deploy various methods of protection such as host intrusion prevention and detection systems to maintain the integrity and confidentiality of data. We make all reasonable efforts to protect your privacy, and you can count on our system to be secure against any potential known threat existing today."* Will shared that he had just copied this boilerplate statement from another source, and he wasn't sure any of those safeguards were in place, mostly because John didn't give him enough money

to “make it [the system] right.” *Based on this information, has Winter’s Tale Publishing violated any Federal Trade Commission regulations?*

If the publishing company posted written data security and privacy policies, then failed to follow these policies with regard to the authors' data, the company may have violated Section 5 of the FTC Act. Section 5 of the Federal Trade Commission Act (FTC Act) (15 USC §45) prohibits ‘‘unfair or deceptive acts or practices in or affecting commerce.’’ The FTC has brought privacy breach enforcement actions under the Act against well-known companies, such as Google, Facebook, Twitter, and Microsoft, as well as lesser-known companies. Snapchat was charged under the FTC Act in December 2014 because even though they told customers that the Snapchat photos and texts disappear forever after they fade, that actually is not true, and these images can still be accessed later. Snapchat was found liable under the Act and had to rewrite their privacy policy and submit to 20 years of privacy monitoring. The FTC also found that the company deceived consumers about the security measures taken to protect their personal data from misuse and unauthorized disclosure. Snapchat’s failure to secure its “Find Friends” feature resulted in a security breach that enabled hackers to steal 4.6 million Snapchat usernames and phone numbers.

Winter’s Tale Publishing’s privacy statement, as reported by Will, therefore could be a big problem for the company, as they are clearly not adhering to their stated policies. The first order of business is to remove the privacy policy from any source to which it is currently posted. Concurrently, an expert should audit Winter’s Tale Publishing’s computer system and data protection measures should be immediately established. Documentation of any safeguards present before the breach, as well as prompt remediation, should be filed internally and maintained in case of FTC inquiry. After ensuring the appropriate security measures have been implemented, a new privacy policy should be drafted, tailored specifically to Winter’s Tale Publishing’s privacy landscape and excluding promises that are unattainable.

4. During the meeting following the data breach, John’s attorney told him that all individuals subject to Winter’s Tale Publishing’s security breach must be notified as quickly as possible. John directed his assistant Susan to compile a list of those affected. The next day when John saw the list, he realized only a small group of the authors had contacted the company about their information being compromised; there were many on the list who were probably still unaware of the breach. Although the hack was widely publicized and associated with the Winter’s Tale Publishing’s name, the children’s books subsidiary operated under a different company label. These authors were still largely uninformed of the breach. In order to deal with all the problems and try to correct as many of the deficiencies as possible, John decided to wait to notify these authors. Despite the scope of the breach being fully known and understood about one week later, two months passed following the hack before everyone was formally notified. *Due to John’s notification delay, would Winter’s Tale Publishing be liable for a violation of the Illinois State Personal Information Protection Act?*

“The first state data security breach notification law was enacted in California in 2002. In response to state security breach notification laws enacted thereafter in numerous jurisdictions, over 4,488 data breaches and computer intrusions have been disclosed by the nation’s largest data brokers, businesses, retailers, educational institutions, government and military agencies, healthcare providers, financial institutions, nonprofit organizations, utility companies, and Internet businesses, as of the beginning of 2015” (FAS, 2015). Nearly every state in the U.S. now has a consumer notification policy with respect to data breaches. Illinois' statute (815 ILCS 530/1) is titled "Personal Information Protection Act" and requires that a breach of any personal information concerning an Illinois resident be reported to that individual "in the most expedient time possible and without unreasonable delay" (IGA, 2015). "Personal Information" is defined in Illinois as a first name or initial, last name, and one of the following: Social Security number, Driver's License number, or Credit Card/Debit Card/Other account number.

The personal information that was taken in Winter's Tale Publishing's hack qualifies as personal information as defined under the Illinois Act: "full names, social security numbers, bank accounts, and credit card numbers." The remaining question is, was John's notification of the affected authors "expedient" and "without reasonable delay"? Because John knew who was uninformed very close to the breach, and because the scope of the breach was known relatively quickly, there is a possibility that the notification delay of nearly two months would violate the Illinois statute. John may argue that the authors had constructive notice due to the widely disseminated public discussion of the breach, however this would not supplant his duty of notification, especially to the juvenile literature company authors. Additionally, Illinois also requires that certain information be included in the notification, such as contact data for consumer reporting agencies and the Federal Trade Commission. Complying with the notification law essentially requires a specific and direct contact with *any* affected parties. It is therefore likely that Winter's Tale Publishing may be liable under the notification law, a violation of which constitutes an unlawful practice under the Illinois Consumer Fraud and Deceptive Business Practices Act. Such a violation may result in significant fines and/or closure of the business.

5. Shortly following the hacker attack, Winter's Tale Publishing was served with a complaint from John's former boss, alleging defamation by libel. The pleading included statements that referenced the emails between John and Susan where included excerpts from the book were inadvertently published by the hackers. The section of one email described John's former employer in clearly identifiable terms, and stated that the character was an incompetent drug addict who cheats on his wife with prostitutes. There was absolutely no truth in any of these negative characterizations, and John knew it. It was one of those times when his vivid imagination and warped sense of humor got the better of him. *Based on the information released in the hacked emails, would John and Winter's Tale Publishing be liable to John's former boss for the tort of defamation?*

Defamation is the act of making an untrue statement about someone that damages their reputation. If the defamatory statement is published by a writing, it is known as *libel*; if spoken only, it is *slander*. In this case, John's former boss would be seeking an action for defamation based on libel, as evidenced by the written characterizations released in the hacked emails. In order to support a cause of action for defamation/libel, the following elements are required: (1) defendant made a false or defamatory statement about plaintiff; (2) defendant made an unprivileged publication to a third party; and (3) harm results. Some damages in a libel defamation action are generally presumed, and other damages may be pursued if supported by evidence. Because John's former boss is also a well-known public figure, he would also need to show what is known as "New York Times Malice" (based on the U.S. Supreme Court decision in *New York Times Co. v. Sullivan*) to prevail in his action. The requirement of malice means that the defaming party made their statements knowing that they were false, or with a reckless disregard for truth or falsity. In Winter's Tale Publishing's case, it is likely that the first element—a false or defamatory statement—was met by John in his descriptions about his former employer. Even though John was writing a book, and may have included a disclaimer about the characters in the final publication, he would still be liable for these defamatory statements. The requirement of malice is also likely met in this case as well. John knew that his former boss was neither incompetent, a drug user, nor a philanderer. Absolute truth is a counter to defamation, but unfortunately John can not avail himself of that defense in this case. Because John knew that these descriptions were false and damaging to his former boss, it is likely that actual malice may also be demonstrated in this case. Statements of opinion are also a defense to defamation; however John would not be able to simply make statements such as "So-n-So is, in my opinion, an incompetent drug addict." A court is likely to still find such a statement to be one of fact and not opinion. Opinions should be supported by relevant evidence, and not just added in an attempt to obscure defamatory facts. The second element here—that of unprivileged communication to a third party—certainly occurred when the emails were released to the public. Yet this element may have been met even earlier, when John shared the characterizations with Susan. The timing of this element would depend on how much Susan believed about their former boss to be truth, and how much she attributed to fiction and John's "tall-tale" imagination. The key to defamation is the defamed party is held out to ridicule and their reputation is damaged in the eyes of the third parties receiving the libelous communication. If Susan believed the negative comments made about her former boss, then the second element of defamation was likely met in the emails she exchanged with John.

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THE HACK ATTACK AT WINTER'S TALE PUBLISHING: THE MANAGEMENT PERSPECTIVE

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CASE DESCRIPTION

The primary subject matter of this case concerns the vulnerabilities that poor management can expose an organization to as well as the widespread effects that a hacker attack can have on a business' operations. Secondary issues examined include, auditing frameworks to evaluate internal controls, designing a secure network for small start-up businesses, and addressing legal and marketing concerns of a hacked organization. The case has a difficulty level of three or higher and was designed to be taught in a 30 to 45 minute time period with approximately two hours of outside preparation by students. The case can be approached from five perspectives (management, business law, information technology management, forensic accounting/auditing and marketing), thus the case can be used in multiple 30 to 45 minute classes. Instructor's notes from each of these perspectives have been written to allow for an integrated approach to learning across the curriculum. The following set of teaching notes evaluates the case from a management perspective.

Evaluation of the case from a management perspective brings several issues to the forefront such as hiring practices, managing employees, managing daily operations, and communication practices. The case requires students to have an introductory level understanding of business strategy, management, and general business issues. The case is primarily designed for junior or senior-level undergraduate students majoring in management.

CASE SYNOPSIS

The case describes Winter's Tale Publishing, an online startup publishing house started by John Winters after successfully publishing his own book. The organization grew quickly but cut corners in several areas which would later come to haunt them. Winter's Tale started a marketing campaign to build interest in a soon-to-be-published tell-all book. Controversy surrounded the publishing of the book and hackers attacked Winter's Tale's server. The hackers accessed personal client author information as well as employee emails and posted the information online for all to see. The case ends with John and his staff meeting to evaluate the circumstances, control the damage, implement a strategy going forward, and determine what led them into such a susceptible state.

STUDENT LEARNING OBECTIVES

The case can be examined across a business program in multiple courses to provide students with a holistic approach to evaluating the ramifications of business decisions to multiple dimensions of an organization. The case can also be addressed in an individual course. Upon reading, analyzing and discussing the case from the management perspective, students should be able to:

1. Discuss appropriate actions to take in starting a business.
2. Discuss appropriate actions to take in the hiring process.
3. Evaluate the owner's approach to managing the company and his employees.
4. Recognize the problems associated with having few employees and lacking separation of duties.

RECOMMENDATIONS FOR TEACHING APPROACHES

The case can be taught from multiple perspectives in several different courses such as upper level marketing, business strategy, business law, management, forensic accounting/auditing, and information technology management. The course can also be taught in a capstone course containing a classroom of diverse business majors. The following case notes address the issues from the perspective of management. Case coverage should take approximately 30 to 45 minutes of course time. Senior level students may be asked to analyze and write up the case using a case analysis template such as:

Background
Main Problem
Minor Problems (stemming from main problem)
Possible Solutions
Recommended Solution and Implementation
Recommended Precautionary Measures and Implementation (What should have been done to prevent this situation?)

A series of questions may be provided to junior level students such as the following.

1. What should John have done to get the company started?

Although John's personal experience in the publishing market led him to find a niche and marketing approach to personal publishing, a more thorough evaluation of the industry to examine the competition might have given him a better understanding of how small publishers were operating. John could have used Porter's Competitive Forces model to evaluate the publishing industry.

John should also have developed a vision and mission for Winter's Tale Publishing to drive their operations.

1. A vision for Winter's Tale Publishing might have been something like, "An organization to help future authors get noticed."
2. Winter's Tale Publishing mission might be something like, "A publishing house that will help authors develop and market their books online."
3. From the mission, Winter's Tale Publishing might craft business strategies and operational plans such as:
   - 3.1. "We will build a strong foundation of client authors."
     - 3.1.1. Ads will be placed on writing web sites and social media outlets to market to current writers.
     - 3.1.2. An ad for authors will be included in the rotating banner ad on the company's homepage and social media outlets.
   - 3.2. "We will use a thorough approach to advertising our published books."

3.2.1. Book excerpts will be rotated in a banner ad on the web site every 30 seconds.
3.2.2. Comments on client books and authors will be posted on company social media pages every month.
3.2.3. Reviews of client books will be posted to appropriate industry social media sites every day.

2. *What problems do you see with John Winter's approach to the hiring process?*

Although details are not provided, we do not know if John created a set of criteria and an evaluation instrument to use to compare all of the applicants. We also are not told whether or not he evaluated all of the applications that were received before contacting Will. John could have conducted an Internet search to see what was posted about Will, how Will represented himself in social media and if there was any information available about Will on his former employers' online presences.

John went into the phone conversation with Will ill prepared. He did not question Will's inability to get a Skype video call to work. John lost control of the conversation and allowed Will to manipulate its direction and hurry the process, leading to a premature job offer. We can assume that Will insisted on coming to work the next day to discourage further investigation into his background, and/or prevent John from having time to change his mind. John should have taken time to check Will's references, work history, and complete a background check.

John hired Susan because he had previously worked with her. The story does not tell how long he worked with her, and whether or not he knew her work history. He did not go through a formal hiring process, nor conduct a job search to fill the position. John did not take the opportunity to seek skilled applicants nor conduct a background check on Susan and her work history.

3. *What do you think of John Winter's approach to management and why? How has this approach led to their current situation?*

John seemed very unconcerned about the operations of the company and the performance of the employees. After John hired the employees, he did not provide much direction or oversight. Nor was John available to meet with them to discuss operations or their concerns when they arose. John essentially let the employees manage themselves.

Because John invested as little as he could into the company and did not take an interest in daily operations, their network was left vulnerable and hackers were given enough time to infiltrate the server. Had John taken an active role in managing daily operations and kept the lines of communication open, he would have understood the value of investing in a secure technology infrastructure. He would also have seen that action was taken, when initially suspected, to stop the hacker attempts before they penetrated the system.

4. *Winter's Tale Publishing, like many small start-up companies, operated with few employees and resources. What are some management problems caused by this scenario, and how could the company address these issues?*

A common problem for new companies is that they have too few employees to manage and conduct operations properly. Minimal resources compound the issue, potentially leading to mismanagement and—in the worst case scenario—fraud and abuse. Although John wisely started with the number of employees he could support financially in Winter's Tale Publishing, he did not concurrently provide adequate management infrastructure and oversight to meet the company's needs. One of John's poorest decisions, especially in light of weak hiring practices, was to give considerable authority and discretion to both Susan and Will. The story tells us that Susan had implicit control over the company's finances, and this is a function that should never be allocated to a single individual (unless it is the owner/sole proprietor).

The good news is that even small companies can take steps to segregate duties and monitor business operations. The best investment for Winter's Tale Publishing would be an online accounting system, such as QuickBooks. These programs are inexpensive (usually charging an annual fee of a few hundred dollars; some are even free) and provide multiple levels of access (Administrator, Accountant, View Only). Most also keep a log of all transactions—including time/date stamp and access identity—that occur within a company's accounts. Through such a program, John could monitor all the financial activity within Winter's Tale Publishing. There is also a "billpay" function available, which would eliminate the need for a signature stamp and allow John to see exactly where his outflows are going and to whom. John may also consider outsourcing some financial functions which are commonly the target of fraud/mismanagement, such as accounts receivable/payable, or payroll, to an accounting firm that provides bookkeeping/controllership support. Payroll services, such as ADP, are also available that will handle this complex function. As John mentioned that he hoped to take the company public one day, these types of internal controls will be crucial to the functioning of Winter's Tale Publishing before an IPO can be contemplated.

Another possibility for John is to consider hiring more employees to distribute the duties and responsibilities more securely and effectively. Full-time employees are expensive, however, so managers/owners should investigate more "creative" hiring options. One possibility is hiring stay-at-home moms and dads, many of whom have considerable skills and would like to continue working on a more flexible basis. Job sharing is another possibility, where multiple employees can serve the segregation of duties role at minimal cost. Interns and volunteers who are seeking valuable real-world experience, are also an option; often a win-win situation for both parties. Also, the U.S. government periodically offers tax credits for hiring certain groups of individuals, such as the "Work Opportunity Tax Credit" for veterans (2011-14)—this program provided over a billion dollars in support to employers who hired former military servicemen and servicewomen. The key then for John and Winter's Tale Publishing is to remain conservative, yet look for methods to move the company forward securely and productively.

5. How should John lead the company going forward?

John needs to take an active role in leading the company. He will need to control the damage and prepare for the future. He will need to hire and oversee security experts, technology consultants, lawyers, and marketers as they attempt to rescue the data, systems, people, and reputation of the company. He will also need to replace Will with someone with more experience who is better equipped to manage the information technology needs of Winter's Tale Publishing. He may, at first, wish to hire a technology consulting company to assist in returning to normal operations as well as the process of hiring a replacement for Will.

John will also want to reexamine the reporting structure of the organization as well as establish a schedule of regular meetings to keep him abreast of daily operations. As previously discussed in Question 4, Susan's job currently handles several aspects of back office operations with little oversight or separation of duties. Because the company is so small, John may consider using third party services or an alternate employee structure in order to provide better separation of duties.

As Winter's Publications recovers and rebounds. John will need to serve as a figurehead representing the company to the public. In this role, he can explain the measures that are being taken to rectify the situation, prevent further damage to client authors, and protect their systems in the future.

THE HACK ATTACK AT WINTER'S TALE PUBLISHING: THE MARKETING PERSPECTIVE

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CASE DESCRIPTION

The primary subject matter of this case concerns the vulnerabilities that poor management can expose an organization to as well as the widespread effects that a hacker attack can have on a business' operations. Secondary issues examined include, auditing frameworks to evaluate internal controls, designing a secure network for small start-up businesses, and addressing legal and marketing concerns of a hacked organization. The case has a difficulty level of three or higher and was designed to be taught in a 30 to 45 minute time period with approximately two hours of outside preparation by students. The case can be approached from five perspectives (management, business law, information technology management, forensic accounting/auditing and marketing), thus the case can be used in multiple 30 to 45 minute classes. Instructor's notes from each of these perspectives have been written to allow for an integrated approach to learning across the curriculum. The following set of teaching notes evaluates the case from a marketing perspective.

Evaluation of the case from a marketing perspective brings several issues to the forefront such as effective use of social media, strategic marketing for damage control, the value of public relation strategies in perception management, and marketing research. The case requires students to have an introductory level understanding of business strategy, marketing, and general business issues. The case is primarily designed for junior or senior-level undergraduate students majoring in marketing and has a difficulty level of three or higher.

CASE SYNOPSIS

The case describes Winter's Tale Publishing, an online startup publishing house started by John Winters after successfully publishing his own book. The organization grew quickly but cut corners in several areas which would later come to haunt them. Winter's Tale started a marketing campaign to build interest in a soon-to-be-published tell-all book. Controversy surrounded the publishing of the book and hackers attacked Winter's Tale's server. The hackers accessed personal client author information as well as employee emails and posted the information online for all to see. The case ends with John and his staff meeting to evaluate the circumstances, control the damage, implement a strategy going forward, and determine what led them into such a susceptible state.

STUDENT LEARNING OBECTIVES

The case can be examined across a business program in multiple courses to provide students with a holistic approach to evaluating the ramifications of business decisions to multiple *dimensions of an organization. The case can also be addressed in an individual course. Upon reading, analyzing and discussing the case from the marketing perspective, students should:*

1. Be able to understand the importance of Public Relations as a strategic tool and learn to design effective PR strategies.
2. Recognize the necessity of marketing research and its role in solving different business problems.
3. Have the opportunity to utilize their social media knowledge and skills and implement different social marketing strategies

RECOMMENDATIONS FOR TEACHING APPROACHES

The case can be taught from multiple perspectives in several different courses such as upper level marketing, business strategy, business law, management, forensic accounting/auditing, and information technology management. The course can also be taught in a capstone course containing a classroom of diverse business majors. The following case notes address the issues from the perspective of management. Case coverage should take approximately 30 to 45 minutes of course time. Senior level students may be asked to analyze and write up the case using a case analysis template such as:

Background
Main Problem
Minor Problems (stemming from main problem)
Possible Solutions
Recommended Solution and Implementation

A series of questions may be provided to junior level students such as the following.

1. *If you are the marketing consultant for the publishing company, what initial steps will you take to counter the negative press that the company is experiencing following the hack?*

The company may be able to distract the attention of the media by highlighting the incredible story of John Winters, a self-made publisher, and his contribution to realizing the dreams of other new authors who lack the resources to get their stories published. The meteoric rise of this independent publishing company made other big time publishing corporations envious, and they would not mind seeing John Winters close his doors forever. Thus, a marketing campaign oriented towards the world of readers, to convince them of the importance of supporting this small company in its troubled times, could be one starting point.

The other approach could be to play victim and show solidarity with other corporations that have been hacked in the past. John could present a more valiant self in the media by openly proclaiming that the hackers cannot stop the release of the new novel. Additionally he may encourage interest in the book by offering discounts for early orders of first editions personally signed by John. Obviously, John would have to revisit some of the chapters in the book and re-write the content so that the finished product or the story plot or even the characters do not seem to be from the released hacked version. The company can also release a statement that the hackers obtained a rejected draft and published it online before the formal unveiling of the new book.

2. *What strategies will you, as the marketing consultant, advise John take to handle the disgruntled former boss and colleagues?*

The hacked e-mails and the working draft of John's upcoming novel revealed that the protagonist of the novel is based on John's former boss. A lot of his former professional life is represented in the novel, and John did not make any effort to mask the similarity. This led to a lot of anger and threats of legal action from his former colleagues and boss. In a sticky situation like this, John can first work on changing some of the aspects of the plot of his novel so that the striking resemblance between the protagonist and his former boss is not so obvious. Excerpts from the book can be released in the media to validate the lack of similarity that has been claimed by the disgruntled boss. Finally, John can invite his former boss and co-workers to the official book release party and present them with autographed first editions. If confronted about the hacked emails, John would need to develop a statement indicating that e-mails were a jocular exchange between him and his administrative assistant, and at no point in time had he any intentions of releasing a novel disrespecting his former colleagues and boss.

3. *What strategies will you, as the marketing consultant, advise John take to handle the disgruntled authors whose data was stolen in the hack and may be reluctant to trust Winter's Tale Publishing again?*

   1. Winter's Tale Publishing has already lost a lot of equity due to the data hack which raises a big question about their information management practices. The founder John Winters will have to redesign the company's data security system with an industry expert, and then invite the contracted authors for an information dissemination session about the newly installed system to re-instill their confidence in the company.
   2. The company should also arrange free credit monitoring for the hacked authors to ward against possible future misuse of their stolen data.
   3. The company should also release digital copies of some of the books written by the disgruntled authors amidst fanfare and urge the readers to support the victimized authors by buying their books.

4. *Provide three social media strategies that you will implement in order to diffuse the PR nightmare Winter's Tale Publishing is having?*

   1. Post, using social media platforms such as Facebook and Twitter, pictures/evidence of past accomplishments of the company and John's overnight rise in the publishing world (which makes him a target for hackers who are destructive and vindictive). This strategy can distract the detractors and make the publishing company come off as a victim. Successful authors, contracted with the publishing house, should post video testimonials about John's brilliance and contribution to the independent publishing world.
   2. The social media channels should restart the countdown for the release of the book and also start taking pre-orders for autographed first editions. Excerpts from the upcoming novels and other works in progress should be released to generate excitement among readers and to create a perception that the hackers did not succeed in bringing an end to the company.
      can interact and answers questions through videos to wannabe writers/ fans.

5. *Think of some future strategies the company can follow in order to rebuild their brand once the current crisis ends.*

    1. Winter’s Tale Publishing should hire a marketing research firm to see current trends in publishing, readerships, and themes. Their finds would help John to venture into newer and profitable genres of publishing and, hopefully, discover a star writer who can cater to that genre.
    2. The company should also explore the possibility of converting some of their books into movies/plays to generate more revenues and exposure, and also venture into a new genre of television/ movie/drama scripts.
    3. The company will have to tighten its IT infrastructure to protect from future hacking attempts, and then explore offering digital versions of their published books through Amazon Prime, the iTunes store, or other digital book stores. They can also create audiobooks for people who are on the move and find it difficult to read from a traditional book or even a digital copy.

THE HACK ATTACK AT WINTER'S TALE PUBLISHING: THE IT MANAGEMENT PERSPECTIVE

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CASE DESCRIPTION

The primary subject matter of this case concerns the vulnerabilities that poor management can expose an organization to as well as the widespread effects that a hacker attack can have on a business' operations. Secondary issues examined include, auditing frameworks to evaluate internal controls, designing a secure network for small start-up businesses, and addressing legal and marketing concerns of a hacked organization. The case has a difficulty level of three or higher and was designed to be taught in a 30 to 45 minute time period with approximately two hours of outside preparation by students. The case can be approached from five perspectives (management, business law, information technology management, forensic accounting and marketing), thus the case can be used in multiple 30 to 45 minute classes. Instructor's notes from each of these perspectives have been written to allow for an integrated approach to learning across the curriculum. The following set of teaching notes evaluates the case from an information technology management perspective.

Evaluation of the case from an information technology management perspective brings several issues to the forefront such as the value of demilitarized zones, updates and patch management, information technology management, effective hiring practices, and data encryption. The case requires students to have an introductory level understanding of business strategy, management information systems, and general business issues.

CASE SYNOPSIS

The case describes Winter's Tale Publishing, an online startup publishing house started by John Winters after successfully publishing his own book. The organization grew quickly but cut corners in several areas which would later come to haunt them. Winter's Tale started a marketing campaign to build interest in a soon-to-be-published tell-all book. Controversy surrounded the publishing of the book and hackers attacked Winter's Tale's server. The hackers accessed personal client author information as well as employee emails and posted the information online for all to see. The case ends with John and his staff meeting to evaluate the circumstances, control the damage, implement a strategy going forward, and determine what led them into such a susceptible state.

STUDENT LEARNING OBECTIVES

The case can be examined across a business program in multiple courses to provide students with a holistic approach to evaluating the ramifications of business decisions to multiple dimensions of an organization. The case can also be addressed in an individual course. Upon *reading, analyzing and discussing the case from the IT management perspective, students should be able to:*

1. Recognize the importance of aligning business and IT strategies.
2. Understand the importance of investing in and managing IT assets, both technical and human.
3. Discuss in-house, contracted, and hybrid IT solutions.

RECOMMENDATIONS FOR TEACHING APPROACHES

The case can be taught from multiple perspectives in several different courses such as upper level marketing, business strategy, business law, management, forensic accounting/auditing, and information technology management. The course can also be taught in a capstone course containing a classroom of diverse business majors. The following case notes address the issues from the perspective of information technology management. Case coverage should take approximately 30 to 45 minutes of course time. Senior level students may be asked to analyze and write up the case using a case analysis template such as:

Background
Main Problem
Minor Problems (stemming from main problem)
Possible Solutions
Recommended Solution and Implementation
Recommended Precautionary Measures and Implementation (What should have been done to prevent this situation?)

A series of questions may be provided to junior level students such as the following.

1. *Describe the one main problem that has created the current situation? Explain why this problem occurred?*

John failed to realize the significant role that IT played in the successful operations of his online business venture. John had not developed an information technology (IT) strategy aligned to, and supporting, his business strategy. Had John developed such an IT strategy, he would have taken more time in researching and hiring an appropriately skilled technician to oversee and run the technical side of his operations.

A skilled IT manager would have designed a robust IT architecture that would adequately meet (and protect) the current IT needs of the organization while allowing for future growth in their operations. When asked to develop an IT infrastructure budget, the IT manager would have been able to itemize and support the current and future needs of their operations.

The IT manager would also have used a mix of local and cloud-based resources to reduce costs and take advantage of the established secure infrastructures developed by companies offering Software as a Services (SaaS) subscriptions.

In addition, had John realized IT's importance in the company, he would hopefully have taken a more active role in oversight and management of Will and the company's IT resources. He would have regularly met with Will to discuss IT operations and plans. When Will came to John with concerns about suspicious network activity, rather than failing to see the gravity of the situation, John would have immediately taken steps to protect their resources.

2. *Describe the technology infrastructure that Winter's Tale Publishing should have used to minimize their vulnerability? Research and create a budget that Will should have proposed to John.*

Examples of some of the technologies that could have been used include:

1. A Web hosting service with electronic commerce capabilities could have been used to host the web site, collect and protect author client data, process registration payments and catalog manuscript submissions. The site could also be used to sell their authors' completed work.
2. A secure cloud-based file storage system could be used to manage manuscripts through the editing and revision process.
3. A local area network for back office operations including.
   1. Laptops with docking stations can be purchased for John, Will and Susan.
   2. A local server with server software for sharing files and internal communication.
   3. A printer for the office to share.
   4. A hardware firewall to protect the local network.
   5. A backup storage device and encryption software for storing backup copies of operational data and manuscripts.
   6. A VPN could be used to access data on their cloud-based infrastructure.
   7. An office suite could be purchased for each machine, however they may choose to purchase licenses for a cloud-based option.
   8. Virus detection software should be installed on each machine as well as firewalls.
   9. Network monitoring and intrusion detection software.

3. *What is the difference between Software as a Service and Platform as a Service? Could Winter's Tale benefit by using one or both of these services?*

Software as a Service (SaaS) refers to software hosted and maintained on a third party provider's network. Access to the software is sold to customers on a subscription basis. The provider maintains the hardware, software and Internet connection to their subscribed services.

Platform as a Service (PaaS) refers to the hosting of a platform for housing user developed applications. The client develops and runs the application that is stored on the provider's server. The PaaS provider maintains the underlying infrastructure.

Because Winter's Tale Publishing has limited resources, their needs could most likely be met by a SaaS provider. They could purchase a Web site with e-commerce capabilities from a company that builds and hosts e-commerce sites and focuses upon keeping their services up-to-date and secure. Winter's Tale could also purchase cloud-based access to Microsoft Office as well as QuickBooks for performing their back office operations.

4. *Describe one management/IT security model that could be used to assess the situation or that should have been used to develop a secure system? Which model did you select and why? What benefits could this model contribute? Apply the model and explain your findings.*

Instructors could highlight a number of models for decision making, IT management or IT security such as the Value Chain model, Clark-Wilson Security Model or the OSI model.

4. *What do you think the solution to their current problem should be now?*

Winter's Tale Publishing needs to take their server offline to prevent further damage. They need to determine what data has been stolen, file a police report, and notify all clients, banks, credit card companies and parties. Winter's Tale Publishing needs to immediately hire a security firm to assist them in determining the source of the hacking attack and in getting the data removed from the Internet. They will need to work with their lawyer, the security company and the police to attempt to process charges against the attacker.

Winter's Tale Publishing may wish to create a temporary Web site on a third-party server to serve as an online presence for their company. They can also use this site to provide their version of the situation as well as keep the public updated on progress.

John should hire an IT consulting company, specializing in security and e-services, to assist him in going forward. John should also remove Will from immediate contact with the data. However, the third party consulting company will need to work with Will to more quickly understand Winter's Tale Publishing's systems and the extent of their vulnerabilities. John will need to work with the consultants to determine the best IT options for the publishing company and to assist him in their implementation. Because Winter's Tale Publishing is a relatively small operation, they should consider evaluating third party cloud-based solutions. If Winter's Tale Publishing goes with trusted third party providers, they may choose to develop a contract with the IT consulting company to provide advice and direction as needed. If an in-house IT person is deemed necessary, the consulting company should be retained to assist him in hiring someone with superior skills to fill this role. Once an IT manager has been selected, that person should work with John to develop an IT vision and strategy aligned with those of the business to provide guidance going forward.

SCIENTIFIC GASES UNIT, INDURA ARGENTINA

D.K. (Skip) Smith, Baze University
Carlos Aimar, University of San Isidro – P. Marin
Anibal Gervasoni, Buenos Aires, Argentina

CASE OVERVIEW

This case challenges students to develop a set of opportunities to dramatically increase (over the period 2014-2018) the revenues of the Scientific Gases unit of Indura Argentina. The case is based on data collected by one of the authors in Argentina. The case is appropriate for senior-level undergraduates as well as students in MBA and Executive Development programs. It is designed to be taught in a one hour and a half class session, and is likely to require at least a couple hours of preparation by students.

CASE SYNOPSIS

Mr. Anibal Gervasoni is the newly-appointed product manager of the Scientific Gases unit of Indura Argentina, the Argentine subsidiary of Indura S.A. Indura S.A. is a Chilean company; however, in 2012 Air Products, Inc. (a multinational company headquartered in Allentown, Pennsylvania, U.S.A) purchased a controlling interest in Indura S.A. At the time it was purchased (that is, in 2012) Indura S.A. was the largest independent industrial gases company in South America. While the Scientific Gases unit of Indura Argentina sells a variety of gases ***(acetylene, pure and liquid helium ,argon, hydrogen, nitrogen, specialty mixed gases, etc.)*** *throughout Argentina, over the last couple of years, the total revenues of the unit have grown very slowly. Based on the recent history of slow growth, the top management of Indura S.A. has taken the position that no additional capital should be invested in Indura Argentina's Scientific Gases unit. Gervasoni, however, suspects that there is enormous potential for the Scientific Gases unit of Indura Argentina; more precisely, he suspects that the Specialty Gases unit should be able (if additional efforts and investments are made) to dramatically increase its 2014 revenues by the year 2018. Last week Gervasoni received an invitation to come to Air Products, Inc. headquarters in Pennsylvania to present to Air Products senior management his analysis of the opportunities available to Indura Argentina's Scientific Gases unit. To assist him in identifying and describing specific opportunities available to the unit, Gervasoni has invited Prof. Carlos Aimar (a business school professor at the University of San Isidro, in Buenos Aires) to develop (within the next 30 days) a set of suggestions as to how the 2013 revenues of* ***$1,000,000*** *could be dramatically increased by the year 2018.*

Information provided in this case study includes:

1. *Regarding Argentina: Historical overview, a sample of recent demographic statistics from the World Bank, (and for benchmarking purposes, comparable statistics for the United States), plus information on the economy of Argentina.*
2. *Regarding the company: Business model, current marketing strategy, current performance, and numerous factors impacting that performance.*
3. *Additional information: Information on customers, information about the competition and competitors, and information about the scientific gas industry in Argentina.*

THE SITUATION

Sensing that his meeting with Mr. AnibalGervasoni, product manager of the Scientific Gases unit of Indura Argentina was ending, Professor Carlos Aimar gathered up his notes. Although he might, later on, need specific information from those notes, Aimar knew he would have no trouble remembering the challenge Mr. Gervasoni had given him, that is, to identify (within the next 30 days) a set of opportunities which could dramatically increase(over the period 2014-2018) the revenues of the Scientific Gases unit. Because his teaching schedule was already quite intense, Aimar knew that taking on this assignment meant that for the next 30 days, he would be very very busy.

THE COUNTRY

At 2.78 million square kilometers (larger than India, approximately 1/3 as large as Brazil), Argentina is South America's second largest (by land mass) country. The country is 3,500 kilometers long (2,170 miles), and 1,400 kilometers (868 miles) wide at its widest point. While the climate ranges from tropical in the north to sub-Antarctic in the far south, most of Argentina lies in the temperate zone. Similarly, while the landscapes range from jungles to glaciers, a significant portion of Argentina consists of fertile alluvial plains covered in grasses and known as "pampas." In the west (that is, in the rain-shadow created by the Andes mountains), these grasslands are quite dry. In eastern Argentina, however, the pampa receives adequate rainfall, is one of the best agricultural areas in the world, and is intensively farmed (soybeans, wheat, corn, sunflower and other grains) and ranched. Other parts of the country support a wide variety of additional agricultural activities, including the growing of fruits (including grapes for wine), tobacco, sugar cane, and vegetables. Patagonia (the southern quarter of the country) has a cool, wet climate, and supports some agriculture plus a large sheep-raising industry. Given all the above, it is no surprise that the production and processing of agricultural commodities accounts for a substantial portion of total economic activity in Argentina.

Institutionally, and as indicated in Appendix 1, Argentina is composed of 23 provinces and the Buenos Aires Federal District. Since 1995, the president and vice-president are elected for 4-year terms and can be re-elected once. The bicameral national congress has 72 senators (three from each of the above areas) serving 6 year terms. The lower house has 257 deputies, proportionately elected and serving 4 year terms. Because greater Buenos Aires makes up more than 40% of Argentina's total population, the city's influence on the lower house is very large. There is a federal judiciary system, and a nine-person supreme court.

In addition to the federal institutions, there are provincial institutions. In Argentina, each province has a governor, a legislature, and a judicial system. Across the country, the major political parties are the Justicialist Party (Peronists), the Radical Civic Union (UCR), the FAP (Frente Amplio Progresista); and the PRO (Propuesta Republicana).

THE PEOPLE

Prior to the arrival of the first Europeans, the area which has become Argentina was lightly populated. Starting in 1506 and continuing for the next 300 years, most of the immigrants coming to Argentina were Spanish. While African slaves were brought to Argentina in the 17th and 18th centuries, they were very susceptible to a variety of problems which disproportionately impacted the poor (wars, yellow fever and other epidemics, terrible living conditions for the poorest members of society, etc.), and relatively few of them survived. Beginning in the late 19th century and continuing on through the first third of the 20th, 3.5 million new immigrants arrived in Argentina, mostly from Spain and Italy. However, many other nationalities are represented in Argentina's population of approximately 41 million people, including the Welsh (primarily in Patagonia), the British, the French, the German, the Swiss, various Eastern Europeans, and Chileans. Indian peoples make up about 15% of the population. 93% of the population is Catholic (2% is Jewish, and 2% Protestant); yet, at 1%, Argentina has one of South America's lowest population growth rates. A few additional statistical characteristics of Argentine and its people, together with (for benchmarking purposes) comparable figures for the United States) can be mentioned:

	ARGENTINA	U.S.
Fertility rate (births per woman):	3.0	2.1
Illiteracy rates (adult males and females:	3%	--
Life expectancy at birth (years):	74	77
Infant mortality rate (per 000 live births):	**10**	7
Primary school enrollment:	100%+	--
Secondary School enrollment:	74%	--
% of population living in urban areas:	89%	77%
% of population who are internet users:	67%	78%
% of population, access to improved water	79%	100%
% of roads paved:	29%	59%
% of urban population, access to sanitation:	89%	100%
energy consumption per capita(kwh)	1938	11904

THE ECONOMY (OVERVIEW)

With a nominal Gross Domestic Product (GDP) of $448 billion (Purchase Power Parity-based GDP is $716 billion) and its current population of approximately 41 million people, Argentina has a nominal GDP per capita of approximately US$ 10,945. On a Purchasing Power Parity (PPP) basis, GDP per capita of approximately US$17,500 is the highest in Latin America. Historically, a very substantial portion of this economic activity has been based on agriculture and/or ranching plus related (for example, food and/or meat processing) activities. In 2011, however, and as indicated below, over 60% of Argentina's GNP is services-related:

SECTOR	PERCENTAGE OF GDP FOR THIS SECTOR
Education, health care, other	20.2%
Government	6.5%
Finance, real estate, and business services	14.3%
Transport, communications, and utilities	8.2%
Commerce and tourism	13.8%
Construction	5.3%
Manufacturing (a)	18.9%
Mining	3.1%
Agriculture, forestry, and fishing	9.7%
TOTAL	100.0%

(a) The major manufacturing industries in Argentina include: food processing and beverages; motor vehicles and auto parts; appliances and electronics; chemicals, petrochemicals, and biodiesel; pharmaceuticals; aluminum and steel; machinery; glass and cement; textiles; tobacco products; publishing; furniture; and leather.

With 2011 exports of $84.3 billion and 2011 imports of $73.9 billion, it is clear that Argentina is heavily involved in international trade. In 2010, Argentina's main export trade partners included: Brazil (21.2%), China (9.0%), Chile (6.6%), and the United States (5.2%). In 2011, major categories of exports from Argentina and the percentage of total exports accounted for by those categories include:

CATEGORY	THIS CATEGORY'S PERCENTAGE OF TOTAL EXPORTS
soy and soy products	23.8%
motor vehicles and parts	12.1%
cereals (mostly corn and wheat)	9.9%
chemicals	7.1%
fruit and vegetable products	4.2%
natural gas and petroleum	3.9%
aluminum and steel	3.7%
refined fuel	3.3%
electric machinery	2.9%
gold	2.9%
biodiesel	2.5%
other industrial products	5.9%
all other (mainly agro-industrial goods)	17.8%
TOTAL	100.0 %

Source: CIA World Fact Book

Regarding imports, in 2010 Argentina's major import trade partners included: Brazil (31.8%), China (13.6%), the United States (10.7%), and Germany (5.7%). In 2011, major categories of imports into Argentina and the percentage of imports accounted for by those categories include:

CATEGORY	THIS CATEGORIES PERCENTAGE OF TOTAL IMPORTS
Capital goods and parts	34.8%
Intermediate goods	29.5%
Refined fuel and lubricants	12.7%
Automobiles and parts	8.4%
Non-auto consumer durables	4.5%
Freight and farm vehicles	4.3%
All other (mostly consumer non-durables)	5.8%
TOTAL	100.0%

Source: CIA World Fact Book

One could easily believe that a country so richly endowed in natural and human resources should be extremely prosperous. At the beginning of the 20th century, this was true; at that time, Argentina's GDP per capita was the highest in the world. Due to a long history of inconsistent (and sometimes inappropriate) economic, political, and social policies, however, Argentina's economy first deteriorated and then (in the decade of the 1990s) started to crumble. In 2002, Argentina was unable to meet its debt obligations. The debt and debt service levels for Argentina in 2000 suggest the magnitude of the problem Argentina faced; those figures were as indicated below:

Total debt:	U.S. $154.9 billion
Short term debt:	U.S. $28.3 billion
Debt service as a % of exports:	142%

The declaration of bankruptcy in 2002 ushered in a very traumatic period for Argentina and its people. Unemployment rose to 25%, and the Argentine peso (that is, the local currency) lost 70% of its value. As early as 2003, however, based in large part on huge increases in the export of agricultural commodities, Argentina was on its way to economic recovery. Over the period 2003-2011, growth in GDP exceeded (except in 2008) 7% annually. During this period, over 5 million new jobs were created, and by the 4th quarter of 2011, the unemployment rate had fallen to less than 7%. In 2012, however, due in part to internal economic and political developments and in part to challenges associated with continuing global economic uncertainties, Argentina entered a period of fiscal and financial austerity.

Regarding characteristics of the economic situation in Argentina at the start of the new year (that is, 2014), observations which can be made include:

1) The forced devaluation of Argentina's official exchange rate, restrictions on the currency exchange market, inflation, and flaws in transport and infrastructure are the worst sides of an economic model that has prioritized consumption over sustainable growth. International indices reflect that since 2003, the Kirchners' economic policies have been based on high levels of public expenditure, subsidies and soaring levels of consumption, which have helped the country's gross domestic product (GDP) increase at a surprising rate.
2) Politicians and economists knew this model would not last forever. By maintaining a high growth rate and high levels of consumption, much needed changes that should have accompanied Argentina's progress were put off. Plans to upgrade the country's infrastructure, as well as adopting incentives on private investment and programs for a better exploitation of Argentina's natural resources were shelved. In 2006, Néstor Kirchner's former economic minister had warned: "There's a big risk [in decisions that the presidential office has to make], that is to accumulate mistakes that won't be noticed in the short-term … I don't know which is the course of politics, but I can notice a temptation to give easy subsidies or to assume from the public sector investments that could be done by the private sector."

3) From 2008, the ruling party has covered its deficiencies with a set of unorthodox measures that have aimed to keep economic variables balanced, but at the same time have undermined the government's credibility. The Argentine government has altered its official statistic indexes; forced price agreements with the private sector; created restrictions on imports and the currency exchange market; expropriated an oil company (Yacimientos Petrolíferos Fiscales); and implemented diverse measures in order to maintain good levels of consumption and growth.
4) A very high international soybean price and the discovery of new energy resources in the province of Neuquén (Vaca Muerta) encouraged the government to incorrectly assume that adjustments were not needed. Until 2013, rises in salaries exceeded inflation rates, even by the private sector's standards. The Kirchners' economic model remained successful, although it was increasingly convoluted and complex. However, none of these solutions resolved the real problem.
5) Following the re-election of President Fernandez in 2011, cracks began to surface: a widening deficit; the failure of local industries to meet demand; deficient and outdated infrastructure; and a lack of investment in the labor market. Over time, Argentina's growth was simply not enough to sustain the country's demands. In fact, since 2010, Argentina has spent millions of dollars from its central bank reserves on trying to import energy, as big cities and industries have suffered power outages.
6) Economists often agree that growth generates certain levels of inflation. This phenomenon is natural and controlled when growth is sustainable and part of a solid economic strategy. But when growth is based only on consumption, high inflation ends up being a very bad symptom for a country. According to calculations by Argentine opposition parties, inflation in 2013 stood at 28%, one of the highest in the world. For the current year, union representatives have already declared they will not accept less than a 30% increase in salaries.
7) During the first quarter of 2014, the government decided to devaluate its currency and remove some controls it had introduced to ban Argentines from exchanging pesos into dollars. Furthermore, efforts are being made to obtain international credit but first, Argentina must strike a deal with its existing creditors. Recently, an agreement was signed with the Paris Club in expectation that this will pave the way for new loans.
8) Very recently, Argentina edged closer to technical default after a U.S. judge decided on 27 June to block the country from paying regular creditors until the government settles with the holdouts. That said, it is possible that the country could still avoid the default by reaching an agreement with holdout investors. One expert has expressed the view that "Current legal issues are indicative of a lack of capacity or willingness to pay that normally drives sovereign defaults. Argentina's limited financial linkages and limited leverage, alongside investor positioning, downplay risk of financial or market contagion

to other economies or credits. […] The policy response will be biased to displaying a stable official peso—to support the government's narrative that debt problems are "technical" and not meaningful. We view Argentina's current payment problems as idiosyncratic. . . "

9) Hopes for the region and the country will be high, if Argentina manages to fix its economy with a solid plan. The current economic situation was self-generated by an irresponsible policy that needs to be corrected by the Fernandez government. A key task will be to regain credibility in the eyes of the international community, private investors and among its own population. In failing to do so, no economic plan will be able to save Argentina from a new economic crisis that could have a catastrophic impact on the nation. The most difficult thing for the government will be to retrace all of its bad decisions and rebuild confidence.

10) The outlook does not look good with a president that has decided to take a back seat. Argentines are beginning to think that Fernandez is out of touch and has no strategy in place whatsoever. National elections will be held next year and the president could very well suffer a loss at the polls. The result will be determined by the way Fernandez's administration handles the economic crisis.

THE INDUSTRIAL GASESINDUSTRY

There are a wide variety of industrial gases and mixtures of these gases. The most common industrial gases and their primary uses are as indicated below:

Acetylene: Used in oxy-acetylene flames for cutting mild steel and for welding.

Argon: Highly unreactive and so, like nitrogen, can be used as a protective blanket to prevent substances from oxidizing. Argon is mainly used to protect very hot metal, as this is highly reactive. Most of it is used in welding to protect the molten metal, and a small amount is used in light bulbs to prevent the white-hot tungsten filament from oxidizing.

Carbon dioxide: Used widely in the food industry for applications such as removing the caffeine from coffee beans to make decaffeinated coffee and for carbonating beer, soft drinks etc. It is also used for cooling in the food and manufacturing industries.

Helium: Helium is used in cryogenics (its largest single use, absorbing about a quarter of production), particularly in the cooling of superconducting magnets, with the main commercial application being in MRI scanners. Helium's other industrial uses—as a pressurizing and purge gas, as a protective atmosphere for arc welding and in processes such as growing crystals to make silicon wafers—account for half of the gas produced. A well-known but minor use is as a lifting gas in balloons and airships.

Hydrogen: Sometimes used to react with traces of oxygen in other gas streams. The two gases react forming water, which can be easily condensed out of a gas mixture. The majority of hydrogen sales are to the edible fats and oils industry where it is used to hydrogenate vegetable oils to make margarine.

Nitrogen: The two main uses are in cooling and as an inert atmosphere. As liquid nitrogen it is used for cooling in many industrial processes and in the food industry. As gaseous nitrogen it is used to form an inert blanket over substances that would otherwise be oxidized by the air. Nitrogen is used for cooling various mechanical equipment that needs to be kept extremely cold and for snap-freezing foods such as chicken, hamburger patties and fruit to be eaten out of season. Inert blankets of nitrogen are used over reactive liquids in tankers, in varnish manufacture and also inside potato chip packets.

Oxygen: Used by steel mills to oxidize unwanted impurities in the steel. Also used in the food industry, for medical oxygen for respiration and in oxy-acetylene torches.

Source: Wikipedia plus Smith, B. and H. Garrett (2013), "Industrial Gases"

THE SCIENTIFIC GASES INDUSTRY

According to Indura S.A., scientific gases are defined as "high purity gas for use in analytical instrumentation (laboratory) that requires a certification to be considered as such." In other words, scientific gases (whether pure or mixed) "comply with international standards (and are) used in industrial labs, research centers, universities, hospitals, etc."

THE SCIENTIFIC GASES INDUSTRY IN ARGENTINA

Several basic facts and figures describing the industrial gases industry in Argentina and the competition and competitors in that industry are as indicated below:

1) The total market for scientific gases in Argentina is currently approximately US$13 million per year. Industry sectors purchasing industrial gases and the amount of their purchases in 2013 are as indicated below.

INDURA Argentina

Specialty Gas Market

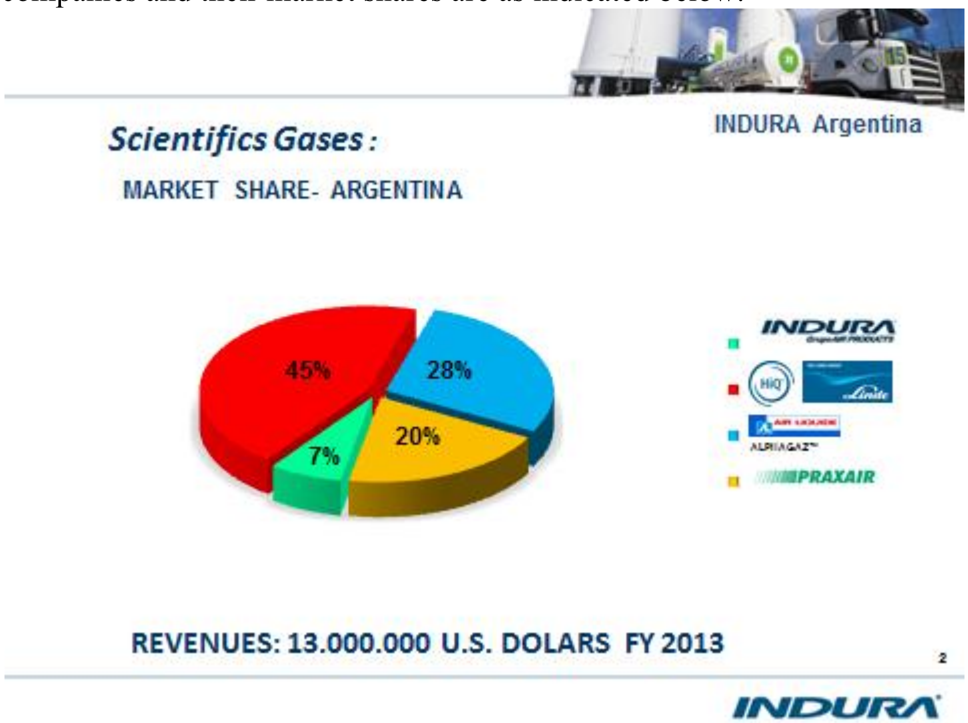
TOTAL ANNUAL ARGENTINE MARKET: US$ 13.000.000

Industry	Invoicing (US$)			%	
	Pure Gases	Gas Mixture	Total	Pure Gases	Gas Mixture
OIL	2.400.000	1.000.000	3.400.000	70	30
PETROCHEMISTRY	2.000.000	800.000	2.800.000	71	29
NATURAL GAS	1.400.000	600.000	2.000.000	70	30
AGRO-CHEMICAL	1.600.000	180.000	1.780.000	90	10
LABORATORIES	1.600.000	220.000	1.820.000	94	6
PHARMACEUTICAL	1.000.000	200.000	1.200.000	83	17
Total Market:	10.000.000	3.000.000	13.000.000		

INDURA
Grupo AIR PRODUCTS

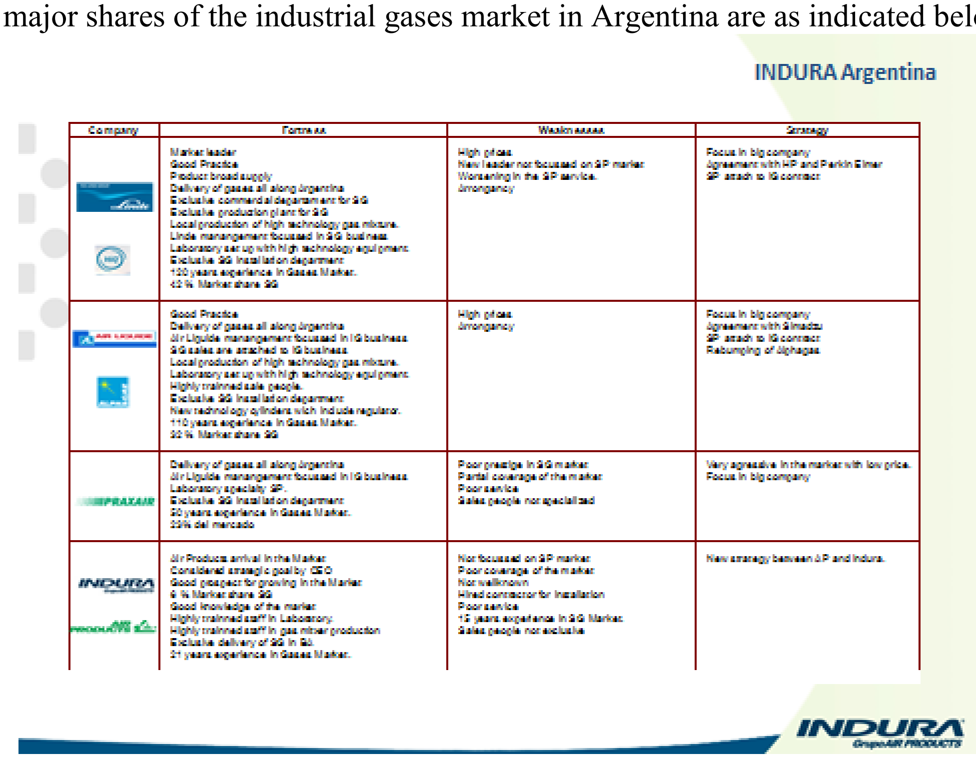
Source: Indura Argentina

2) The forecast for total purchases of industrial gases in Argentina in 2018 is: $17,561,000.
3) Four companies have major shares of the industrial gases market in Argentina. Those four companies and their market shares are as indicated below:



Source: Indura Argentina

4) Strengths and weaknesses of the four companies (including Indura Argentina) which have major shares of the industrial gases market in Argentina are as indicated below:

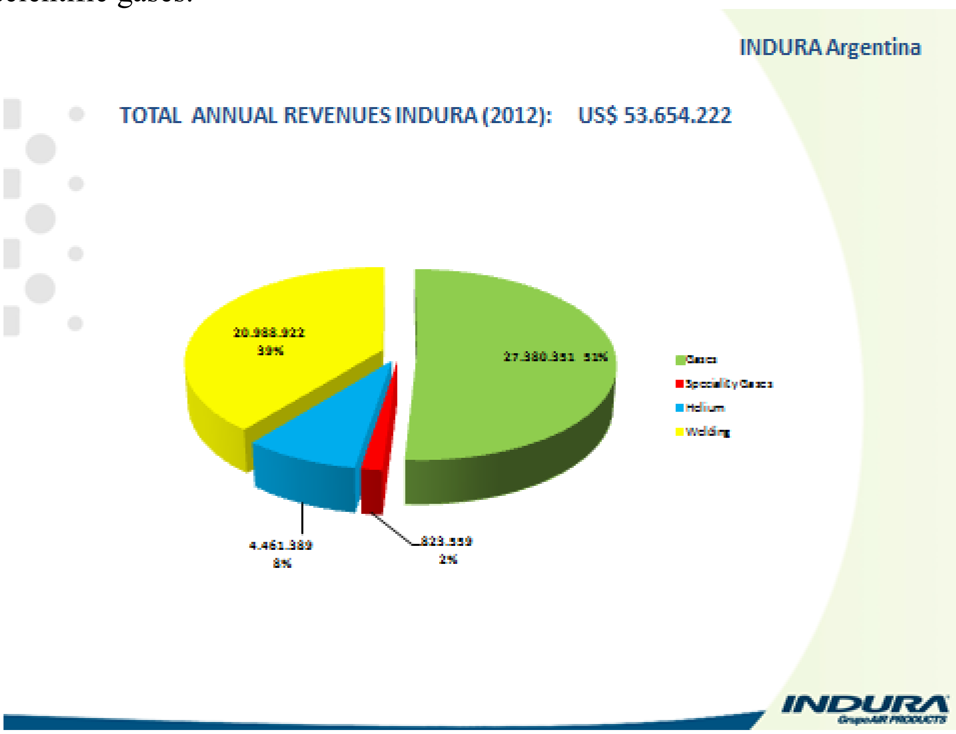


Company	Fortress	Weaknesses	Strategy
Linde	Market leader Good Practice Product broad supply Delivery of gases all along Argentina Exclusive commercial department for SG Exclusive production plant for SG Local production of high technology gas mixture. Linde manangement focussed in SG business. Laboratory set up with high technology equipment Exclusive SG Installation department 120 years experience in Gases Market. 42 % Market share SG	High prices New leader not focussed on SP market Worsening in the SP service. Arrogancy	Focus in big company Agreement with HP and Perkin Elmer SP attach to IG contract
AIR LIQUIDE	Good Practice Delivery of gases all along Argentina Air Liquide manangement focussed in IG business. SG sales are attached to IG business. Local production of high technology gas mixture. Laboratory set up with high technology equipment Highly trained sale people. Exclusive SG Installation department New technology cylinders wich include regulator. 110 years experience in Gases Market. 30 % Market share SG	High prices Arrogancy	Focus in big company Agreement with Shimadzu SP attach to IG contract Rebumping of Alphagas
PRAXAIR	Delivery of gases all along Argentina Air Liquide manangement focussed in IG business. Laboratory specialty SP. Exclusive SG Installation department 50 years experience in Gases Market. 23% del mercado	Poor prestige in SG market Partial coverage of the market Poor service Sales people not specialized	Very agresssive in the market with low price. Focus in big company
INDURA AIR PRODUCTS	Air Products arrival in the Market Considered strategic goal by CEO Good prospect for growing in the Market 6 % Market share SG Good knowledge of the market Highly trained staff in Laboratory. Highly trained staff in gas mixer production Exclusive delivery of SG in BA 21 years experience in Gases Market.	Not focussed on SP market Poor coverage of the market Not wellknown Hired contractor for installation Poor service 15 years experience in SG Market Sales people not exclusive	New strategy between AP and Indura.

Source: Indura Argentina

THE COMPANY

As indicated below, total annual revenues for Indura Argentina in 2012 were $53,654,222. Of that total, approximately $21 million was generated by welding; of the remainder, a bit more than $27 million was generated by sales of gases; a bit more than $4 million was generated by sales of helium; and a bit less than $1 million was generated by sales of scientific gases.



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Source: Indura Argentina

Regarding the current Marketing Strategy for the Scientific Gases unit:

Target market: Since Indura Argentina's inception in 1991, the Scientific Gases unit has targeted users of specialty gases in Argentina in various industry sectors including: Agrochemicals, laboratories, natural gas, oil, petrochemicals, and pharmaceuticals.

Product: The Scientific Gases unit of Indura Argentina manufactures (except for oxygen) and sells the following products in Argentina:

1) Acetylene
2) Argon
3) Carbon Dioxide
4) Helium (both liquid and gas)
5) Hydrogen
6) Mixed gases
7) Nitrogen

8) Oxygen (imported from outside of Argentina)

Price: The "strengths and weaknesses" exhibit shown earlier indicates that at least two of the major competitors (Linde and Air Liquide) have high prices compared to Indura. There is no table showing the exact prices charged by Indura Argentina's three competitors for the different gases they sell; average prices charged by Indura to customers in the various industrial sectors are as indicated below:

INDURA Argentina

Scientific Gases: AVS u$s

Average Prices (U$D)

Sector Industrial	Precio Medio(U$D)	
	Gases Puros	Mezclas
OIL	12,90	28,57
PETROCHEMISTRY	13,33	28,57
NATURAL GAS	14,29	28,57
AGRO-CHEMICAL	12,40	28,57
LABORATORIES	12,90	28,57
PHARMACEUTICAL	12,50	28,57

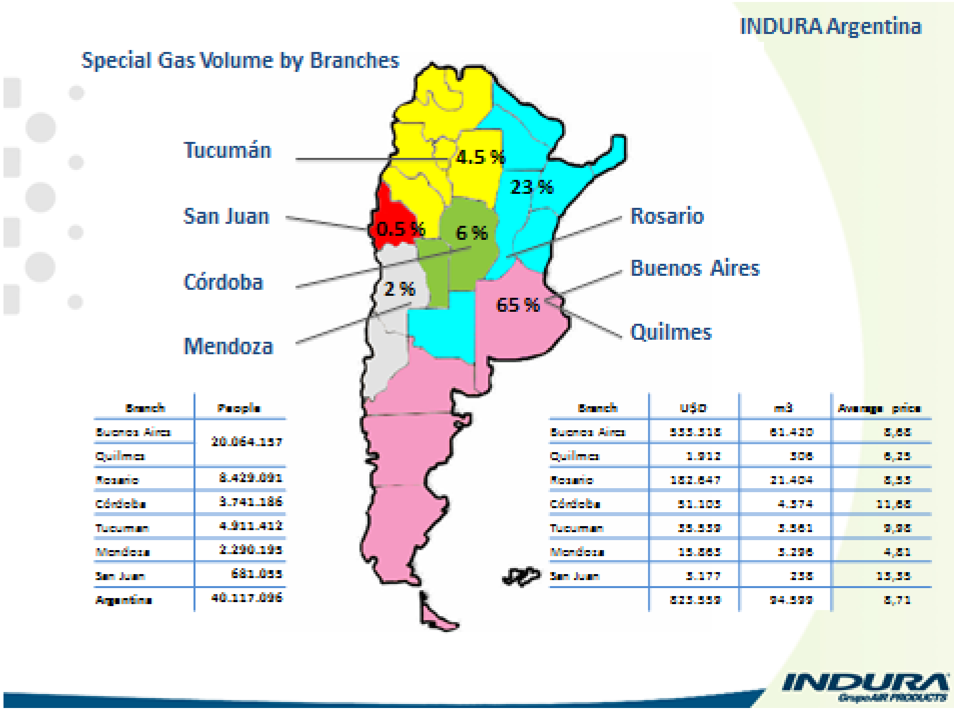
6

INDURA

Source: Indura Argentina

Promotion: The "strengths and weaknesses" exhibit shown earlier indicates that the Scientific Gases unit of Indura Argentina does not have its own salesforce; the implication is that these individuals are selling not just specialty gases but other products and/or services as well.

Distribution: The "strengths and weaknesses" exhibit show earlier indicates that Indura is characterized by "poor coverage of the market," while the three major competitors (Linde, Air Liquide,and Praxair) are characterized by "delivery of gases all around Argentina." Gas volumes sold by the Scientific Gases unit of Indura Argentina in different regions of the country are indicated below; as indicated, nearly 90% of all gas volumes sold are in Buenos Aires, Quilmes, and Rosario.

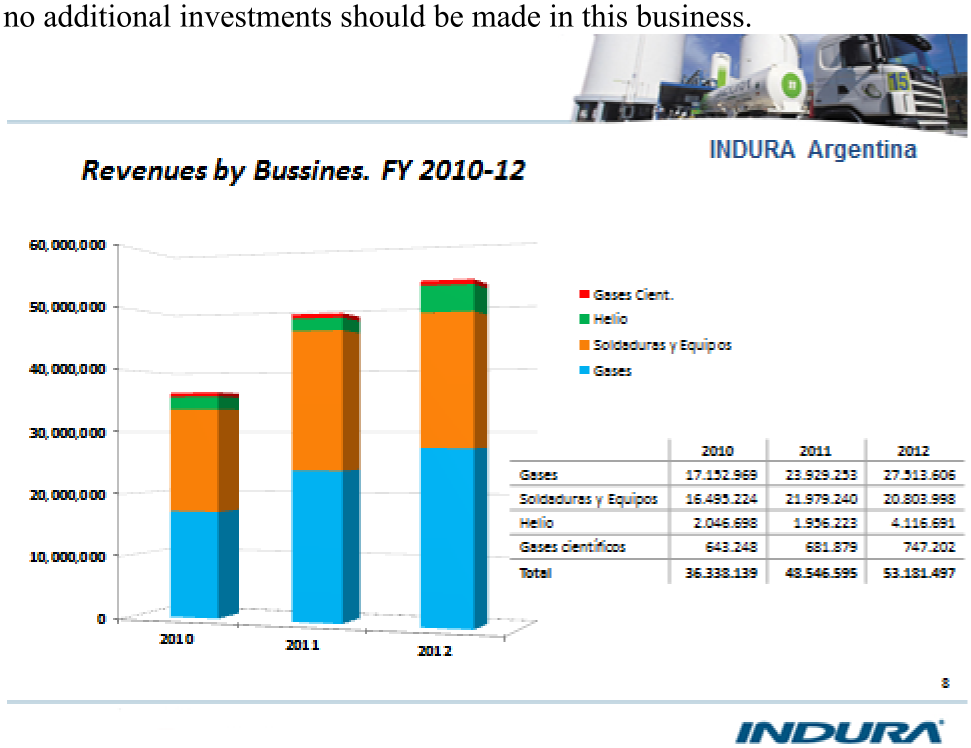


Branch	People
Buenos Aires	20.064.157
Quilmes	
Rosario	8.429.091
Córdoba	3.741.186
Tucuman	4.911.412
Mendoza	2.290.195
San Juan	681.055
Argentina	40.117.096

Branch	U$D	m3	Average price
Buenos Aires	535.518	61.420	8,68
Quilmes	1.912	306	6,25
Rosario	182.647	21.404	8,53
Córdoba	51.103	4.374	11,68
Tucuman	35.559	3.561	9,98
Mendoza	15.863	3.298	4,81
San Juan	3.177	238	13,35
	825.559	94.599	8,71

Source: Indura Argentina

Regard performance to date: The bar graph shown below indicates that the Scientific Gases unit of Indura Argentina has (over the last few years) grown very slowly; as indicated earlier, the slow-growth history of the unit has lead Indura S.A. to conclude that no additional investments should be made in this business.



	2010	2011	2012
Gases	17.152.969	23.929.253	27.513.606
Soldaduras y Equipos	16.495.224	21.979.240	20.803.998
Helio	2.046.698	1.956.223	4.116.691
Gases científicos	643.248	681.879	747.202
Total	36.338.139	48.546.595	53.181.497

Source: Indura Argentina

COMPETITION AND COMPETITORS

As indicated earlier, the four companies with major market share in industrial gases in Argentina are: The Linde Group, Air Liquide, Praxair, and Indura. As was also indicated earlier, in 2012 Indura S.A. (that is, the Chilean company of which Indura Argentina is a subsidiary) was purchased by an American multinational company named Air Products, Inc.

Globally, in the industrial gases market, the four companies with major share of the market are the same four companies identified above; their shares of the global industrial gases business are as indicated below:

The Linde Group	21%
Air Liquide	19%
Praxair	13%
Air Products	10%
TOTAL (4 companies):	63%

Source: The Linde Group

Additional information about each of the above 4 companies is as indicated below:

THE LINDE GROUP

In the 2013 financial year, The Linde Group generated revenue of EUR 16.655 billion, making it the largest gases and engineering company in the world with approximately 63,500 employees working in more than 100 countries worldwide.The strategy of The Linde Group is geared towards long-term, profitable growth and focuses on the expansion of its international business with forward-looking products and services.

Responsibility

Linde acts responsibly towards its shareholders, business partners,employees, society and the environment – in every one of its business areas, regions and locations across the globe. The company is committed to technologies and products that unite the goals of customer value and sustainable development.The Group comprises three Divisions: Industrial Gases & Healthcare, Engineering, and Gist.

Gases

The largest division, Gases, has three segments – EMEA (Europe, Middle East and Africa),Asia/Pacific and the Americas. These are divided into seven Regional Business Units(RBUs).The Gases Division also includes the two Global Business Units (GBUs) Healthcare (medical gases, medical devices, clinical care and related services) and Tonnage (onsite supply of gases to major customers), as well as the Business Area (BA) Electronics(electronic gases).

Engineering

The Engineering Division is a leading technology partner for plant engineering and construction worldwide. Our global success is built on our extensive process engineering expertise in the planning, project development and construction of turnkey industrial plants. We focus on promising marketing segments such as plants for the production of hydrogen and synthesis gas, oxygen and olefins as well as plants for natural gas treatment. Process plants are some of the largest and most sophisticated building structures ever built by mankind. Only a select few contractors are capable of designing and constructing them. With more than 1,000 process engineering patents and 4,000 completed plant projects, Linde ranks among the leading international plant contractors. Customers all around the globe trust Linde's unparalleled reliability, efficiency and competence in project scheduling.

Gist

The Gist Division provides end to end supply chain solutions for customers across the globe. Our business operates in a variety of markets and trades both locally and internationally through its comprehensive range of capabilities and services. Gist offers the complete range of supply chain solutions from end to end management to customer fulfillment. Our logistics experts identify and analyze your problems and provide a tailored solution for your business. The company employs about 5,000 people in 40 locations in Great Britain, Continental Europe, America and Asia/Pacific, serving customers including Marks & Spencer, British Airways, Carlsberg, Bakkavör, Uniq and Dairy Crest.

Source: The Linde Group website: www.linde.com

AIR LIQUIDE

Air Liquide is the world leader in gases, technologies and services for Industry and Health.
Our ambition is to be the leader in our industry, delivering long-term performance and acting responsibly. Our mission is that Air Liquide ideas create value over the long term. We anticipate the challenges of our markets, we trust our people, we invest locally and globally, and we deliver high-quality solutions. Our positioning is Air Liquide, world leader in gases, technologies and services for Industry and Health. Our strategyis to deliver profitable growth over the long term. To achieve this, we rely on competitiveness in our operations, targeted investments in growing markets, and innovation to create new markets and opportunities.
Our signature is Air Liquide – Creative Oxygen

In 80 countries**,** Air Liquide supplies its customers in extremely diverse industries such as steel industry, food and beverage, electronics or pharmaceuticals. In order to match the needs of all of these clients, the Group is organized in different World Business Lines :

The Healthcare Activity : Protecting vulnerable lives

The Healthcare Activity supplies medical gases, home healthcare services, hygiene products, medical equipment and specialty ingredients. In over 30 countries around the world, Air Liquide influences the lives of more than 1 million patients at home and serves over 7,500 hospitals and clinics.

Industrial Merchant Gases

Managing safety, optimizing production processes and enhancing the quality of products are just some major challenges faced by manufacturers all around the world. The Group's Industrial Merchant World Business Line (WBL) supports these businesses by providing them with the gases that are indispensable for their operations.

Large Industries

The Air Liquide's Large Industries World Business Line (WBL) provides gases to customers in the refining, chemicals, energy and metallurgical industries. These gases are vital to the production processes of customers in such industries. The Group's gas and energy solutions enable businesses to reconcile optimal productivity with respect for the environment.

Electronics

The Group's Electronics World Business Line (WBL) offers a large range of high added-value products and services used in the manufacture of the state-of-the-art technologies that we see all around us: flat screen displays, computers, mobile phones, digital cameras, mp3 players, etc. The Group also offers its electronics expertise to the booming photovoltaic industry.

Global E&C Solutions (Large scale projects)

The Engineering and Construction Division (Global E&C Solutions) constructs the Group's production units – mainly air separation units (ASUs) and hydrogen production units – and provides plants for third party clients.

Related Activities.

Other businesses include Technologies of the Future, Welding-Cutting (equipment, consumables and services for welding and metal cutting), Specialty Chemicals (compounds used in the pharmaceutical and cosmetic industries) and Diving.

Source : The Air Liquide website : www.airliquide.com

AIR PRODUCTS

Air Products: We make the world more productive, energy efficient and sustainable. Our strategy is: **winning** in energy, environmental and emerging markets; **executing** on innovation, integration and improvement; **delivering** on revenue, margin and return goals. We supply industrial gases, performance materials, equipment and technology. We are the world's largest supplier of hydrogen and helium and have built leading global supply positions in growth markets such as semiconductor materials, refinery hydrogen, coal gasification, natural gas liquefaction, and advanced coatings and adhesives. Our Chief Executive Officer is John McGlade.

Air Products by the numbers
21,600 employees
73 years in business, headquartered in Allentown, PA
50+ countries where we operate
750 production facilities

1,800 miles of industrial gas pipelines
16,400 MRI magnets cooled with our helium globally
160 hydrogen fueling stations in 20 countries
30+ industries served

Financial data
$10 billion revenue
$1.6 billion operating income
$2 billion capital expenditures with $2 billion estimated for 2014
33 percent total shareholder return
31 years of consecutive dividend increases

Source: The Air Products, Inc. website: www.airproducts.com

PRAXAIR

At Praxair, 27,000 employees in more than 50 countries are working together towards a common goal: making our planet more productive. For more than 100 years, Praxair has taken something as fundamental as air and turned it into ways to make plants operate cleaner and more productively, food taste better, breathing easier and manufacturing processes more efficient -- in short, to make all our lives better.Our Vision: To be the best performing industrial gases company in the world as determined by our customers, employees, shareholders, suppliers and the communities in which we operate. Our Mission: Making our planet more productive - We develop technology, products and services that help to sustain and protect our planet. We are committed to improving our customers' economic and environmental performance around the globe. Our core values:

Safety First - A passionate commitment to safety underpins all of our activities. The safety of our products and services, safety at work, safety on the road and safety at home are the highest priorities for our employees, contractors, families and customers.

High Integrity - We continually reinforce the high global standards upon which our reputation has been built, including honesty, ethical conduct and full compliance with the law.

Results Driven - With personal accountability, collaboration, and innovation, we focus on consistently delivering value to our shareholders and other stakeholders through flawless execution, operational discipline and continuous improvement.

Customer Satisfaction - We provide products, applications technologies and services that represent the highest standards of quality and reliability. We work closely with our customers to overcome their challenges and achieve their goals.

The Right People - We place a high value on attracting and developing talented people from diverse backgrounds who use their talent to make an impact in the world and make our company successful.

Environmental and Social Responsibility - We help customers worldwide improve their environmental performance and carbon footprint, while minimizing our own environmental resource intensity and maximizing our social and community contributions.

Source: The Praxair website: www.praxair.com

THE CHALLENGE

Assume you are Prof. Carlos Aimar. What alternatives will you suggest to Mr. Anibal Gervasoni, so as to achieve the objective of dramatically increasing (over the period 2014-2018) the revenues generated by the Scientific Gases unit of Indura Argentina.

APPENDIX 1
MAP SHOWING THE PROVINCES OF ARGENTINA

WARWICK MERCHANTS FLEET: AN INTEGRATIVE CASE

Susan L. Swanger, Western Carolina University
Roger Lirely, University of Texas at Tyler
N. Leroy Kauffman, Western Carolina University
Reed A. Roig, University of North Carolina at Asheville

CASE DESCRIPTION

The primary subject matter of the case is accounting for certain repetitive maintenance costs occurring at multi-year intervals. The case asks students to consider whether a more meaningful measure of periodic economic performance is obtained by allocating a part of these costs to each accounting year or by allocating all of the cost to the year in which the maintenance takes place. The students are confronted with key issues in accounting theory involving expense and liability recognition, industry practices, definitions of the elements of financial statements, the matching principle, objectives of financial reporting, and the issue of income smoothing. Secondary issues emerge when students are asked to also consider the tax, auditing, and ethical implications related to the various choices in accounting principles. Because this case integrates knowledge across the curriculum, it has a difficulty level of four to five, appropriate for either senior level or master's level courses. The case can be assigned with no advance instruction required and can be assigned to individuals or teams. Estimated time to complete the case is fifteen hours.

CASE SYNOPSIS

A decision must be made about how to account for materially significant maintenance costs that occur periodically every few years. In this particular case, management prefers allocating a part of the costs to each annual accounting period as opposed to charging all of the costs to the annual period in which they are incurred. Management believes this is the most accurate way to account for the costs because each accounting period benefits from the maintenance and therefore each accounting period should be charged with some of the costs. In addition, management prefers allocating the costs to each annual accounting period because this will have the effect of smoothing periodic income, and will avoid overstatement of income in annual accounting periods that had no maintenance and the related understatement of income in annual accounting periods in which maintenance was actually performed.

Students take on the role of CPA firm staff members in researching and evaluating the accounting, tax, auditing and ethical implications. Students must use appropriate research databases and methodologies, and consider information discretely embedded into the case materials. Findings and conclusions are then documented in the form of a written memorandum to the partners of the CPA firm.

WARWICK MERCHANTS FLEET 2013

Diane Crump, CPA and audit partner with Gayle & Fisher (a regional northeastern CPA firm) sits at a table in the Crow's Nest, a commercial fishing and merchant marine hang-out in the coastal town of Closter, Massachusetts. It is late November and there is a definite chill in the air. Across the table is Michael Still, Chief Financial Officer of WM Fleet division of World Ocean Logistics (WOL). Diane is continuing a discussion with Michael that began a few weeks ago as part of the initial planning for the audit of WOL for 2013. WOL owns and operates a fleet of seven large ocean-going freighters, which they refer to as the Warwick Merchants Fleet (WM). The seven freighters were purchased in early 2010 for $66 million each from HH Heavy Industries and represent the latest in freighter technology. The fleet has an expected useful life of thirty years, and each ship can be salvaged for an estimated $1.2 million. The WM fleet is a class of freighters called container ships which are designed in such a manner that no space is wasted. Their capacity is measured in TEUs (Twenty-foot equivalent units). This is the number of 20-foot containers that a vessel can carry. Informally known as "box boats," boats like the WM fleet carry the majority of the world's dry cargo, meaning manufactured goods. Each vessel in the WM fleet is propelled by a single MAN B&W K108ME-C diesel engine and has crews of 30 to 40 people. They have large accommodation blocks at their sterns, directly above the engine rooms. The WM ships carry up to 12,000 containers on a voyage. The total value of their cargo can reach $250 million. Each boat is nearly 430 yards long, 54 yards wide and has a top speed of 25 knots, driven by a 10-meter in diameter, 130-ton propeller.

Diane and Michael are involved in a discussion of the accounting treatment of the WM fleet's maintenance costs, a discussion which has become something of a disagreement. Diane senses Michael's growing frustration and is anxious to make peace.

"Look Michael, if WOL management is dead set on allocating a part of the painting costs to each and every accounting period, I'll do what I can. But I'm going to have to find some support. The senior partners are pretty serious about representational faithfulness, and, well, in my discussions, they just don't think, well, they just don't think allocating is a correct way to measure periodic performance. Besides, why has this all of a sudden become such an issue? You have always just expensed the maintenance costs as incurred."

Michael's blood pressure seemed to rise. The peace offering, if it was one, was not successful. Michael's voice seemed more agitated. "Diane, the matching principle is one of the most pervasive and respected postulates in accounting. We are only trying to match the costs of painting to the revenues earned each accounting period. Everyone agrees, you included, that each and every accounting period benefits from the painting. Why then, is it not proper to allocate these costs to each accounting period?"

The painting costs being discussed are a major operating expense of the WM fleet. With hulls constructed of a newly developed alloy that includes an increased mix of metals subject to oxidation, a special paint/sealer is required to be applied every four years. Painting each freighter requires approximately 180,000 gallons of the paint/sealer at a current cost of $18 per gallon, plus the labor costs of the sub-contracted painters, which is currently estimated to be $800,000 per freighter, bringing total painting costs to about $4 million per freighter. This means once every four years, currently scheduled for January 2014, WOL must spend $28 million to paint the fleet. These costs are considered material to the cost of the freighters and to the historical annual fleet gross revenues of approximately $600 million.

Diane responded to Michael's question. "Michael, maybe it is proper. I certainly agree that each annual accounting period benefits from the p

ainting. But it just seems to go against the normal accounting for maintenance costs. I've always felt that recurring maintenance that does not increase the original life or original productivity of an asset is expensed in the period it is incurred, which in this case, would be every four years. Just exactly how do you propose to allocate the painting cost to each annual accounting period?"

Michael's mood improved instantly, pleased that Diane had asked the question for which he was obviously prepared. "Diane, we think there are two approaches. In the first approach, we separate the painting costs from the original cost of the fleet, and depreciate these separated painting costs over four years, using straight-line depreciation. The remainder is straight-lined over 30 years, just like we do for the entire cost now. Subsequently, every four years we capitalize the cost of the painting and write it off over four years. In the second approach, we do not separate the painting costs from the initial cost of the freighters, nor do we capitalize the recurring costs. Instead we accrue the painting costs each annual accounting period by debiting painting expense for $7 million and crediting an accrued liability for $7 million. Then, in the fourth year, when the painting takes place, we debit the liability for $28 million and credit cash for $28 million."

Michael continued, "Diane, you're familiar, with the matching principle as articulated in the Financial Accounting Board's Concepts Statement Number 5. That principle dictates the efforts (expenses) be matched with accomplishments (revenues) whenever it is reasonable and practical to do so."

Michael studied Diane's face, looking for some kind of approval or at least an acknowledgement of some sort. Diane's response came after some moments. "Okay, Michael, this is what I see. We have three approaches: one, expense the painting in the year it occurs; two, capitalize the painting separately, and depreciate it over four years, and three accrue the painting expense each year. I need to think about each approach. Let me take this back to the office, do a little research, and talk this over with the rest of the audit team."

Wanting desperately to bring the discussion to a close, Diane asks, "Did you remember to bring the 9-month summary operating information for the fleet that we need for planning purposes?"

"Yeah, but it's not a pretty picture," Michael responds, sliding the summary across the table to her (see Exhibit B). Business has really slowed down in this sour economy. We saw it coming early in the year and dry-docked one of the vessels at the end of February so we could keep our active vessel utilization up at the 90% level, where it should be. That's why depreciation is down for the year. We only depreciated the dry-docked vessel for two months. Fuel costs have been just killing us. There has been a small drop and we hope that continues to get costs back in line. Good thing, too, because the home office has been all over me to keep the fleet afloat, if you know what I mean."

Diane looked at the numbers, noting a significant decrease in activity, not unlike many of her clients lately, all suffering from the recent global economic woes. Under normal circumstances the 9-month revenues should be in the $450 million range. “We’ll, take a look at these in the next few days. And, I’ll get back to you on the painting costs, after I have a chance to run it by the audit team.”

Diane returned to the office and immediately prepared a written summary of the discussion with Michael, including a spreadsheet presenting the three alternative methods of accounting for the painting costs (see Exhibit A). She also scanned the 9-month summary operating information provided by Michael and emailed all the documents to Fred Linder, the newly assigned Audit Manager. She knew Fred was working on another client out of town, but would return the next day. She suggests they meet the morning of the day after his return to discuss the audit. She also copied Marvin Gayle and Beth Fisher, the two founding partners of Gayle and Fisher, on the email because WOL is one of the firm’s oldest and largest clients, and she felt that they should be aware of these potential audit issues.

Two days later in the morning, Diane and Fred sit in the firm’s conference room nursing large cups of coffee. Diane takes another sip of coffee and opens up the conversation. ”Well Fred, I know that you have only had a little time to look at the information that I sent you on WM Fleet - but what do you think about it?” Fred responds, “The painting costs represent issues with GAAP that I have never encountered before. I can see Michael’s position, but it is not clear to me which method is the most consistent with the objectives of financial reporting or which provides the most useful information. More importantly, I don’t know if his proposals are considered generally accepted accounting principles. I am going to have to do some research on this. Once we resolve the accounting issue, we’ll still need to determine how it affects the audit process and taxes, too. I’m also concerned about their operating results and how that may be affecting their accounting choices.”

Diane begins to pack up her things and rises to leave, “Fred, I hate to throw you right into the fire on a new client assignment, but Marvin and Beth have scheduled a meeting for the day after tomorrow to discuss this. They are adamant that we approach these issues carefully and completely and that WOL management understands our firm’s position early in the audit process. Beth has become more concerned about clients that follow accounting practices that result in income smoothing or result in achieving some sort of targeted end result. You need to complete your research and be prepared to field questions by the day after tomorrow.” Fred also stands, “OK, Diane, let me get to work on this. I’ll have the answers we need for the meeting.”

Put yourself in the role of Fred Linder. What answers would you bring to the meeting?

EXHIBIT A Three Alternative Approaches To Account For Painting Costs (in 000'S)			
	1. Expense painting costs in year incurred		
2010-13	No entry		
2014	Maintenance Expense	28,000	
	Cash, Payables, Etc.		28,000
2015-39	Repeat cycle		
	2. Component depreciation: capitalize painting costs separately and depreciate over four years		
2010	WM Fleet	434,000	
	Capitalized Paint Costs	28,000	
	Cash, Payables, Etc.		462,000
2010-13	Depreciation Expense	7,000	
	Accumulated Depreciation		7,000
2014	Capitalized Painting Costs	28,000	
	Cash, Payables, Etc.		28,000
	Depreciation Expense	7,000	
	Accumulated Depreciation		7,000
	Accumulated Depreciation	28,000	
	Capitalized Painting Costs		28,000
2015-39	Repeat cycle		
	3. Accrue the painting expense each year		
2010-13	Maintenance Expense	7,000	
	Accrued Liability for Painting		7,000
2014	Accrued Liability for Painting	28,000	
	Cash, Payables, Etc.		28,000
	Maintenance Expense	7,000	
	Accrued Liability for Painting		7,000
2015-39	Repeat cycle		

EXHIBIT B Summary Operating Information World Ocean Logistics – WM Fleet ($ in 000'S)				
	2010	**2011**	**2012**	**2013 (9-months)**
Gross Shipping Revenues	**582,100**	**602,500**	**598,800**	**420,100**
Vessel Direct Operating Expenses:				
Fuel	396,100	427,500	420,700	370,200
Labor	15,900	16,300	16,425	12,300
Depreciation	15,120	15,120	15,120	10,080
Repairs & Maintenance	7,270	6,340	6,710	2,250
Other (insurance, etc.)	15,640	16,100	15,725	14,580
Total Direct Expenses	**450,030**	**481,360**	**474,680**	**409,410**
Net Contribution	**132,070**	**121,140**	**124,120**	**10,690**

CASE STUDY TITLE: BORDER ENFORCEMENT DEPARTMENT: A FACILITATOR OF COMMERCE OR CONSTRAINT ON ECONOMIC GROWTH

Annette Taijeron Santos, University of Guam
Philip S.N. Taijeron, Jr., University of Guam

CASE DESCRIPTION

The case study presents the primary subject matter of a Pacific island government border enforcement agency and its regulatory impact on economic growth from constraints at the island's commercial entry points. Other issues related to this case include national regulations, government organizational culture and management, political and personal agendas, leadership style and ethics, communications, and motivational theory. The case has a difficulty level of five, which is appropriate for first-year graduate students. This case is designed for discussion in four class hours in a management, leadership, government or business course. Students are expected to spend about four hours for outside preparation, consisting mainly of reading the case and of familiarizing themselves with the business environment in the Pacific region.

CASE SYNOPSIS

The case is about a small island nation Border Enforcement Department (BED) experiencing a change in Chief Executive Officer (CEO) leadership. The current CEO for the government department wishes to prepare her organization for an impending burst of economic growth on the island. The CEO desires her department's financial recovery systems to provide funding for the level of operations anticipated. However, the government's budget department imposes financial ceilings on her well- intentioned cost recovery proposal. External demands for economic growth increase the CEO's concern about the adequacy of inspection facilities at her seaport area of operations. The CEO's need to modernize outdated organizational strategies adds to the CEO's growing list of priorities. All these wishes for the future came to a halt when the CEO was notified she was being replaced: change happens. However challenging the change, the outgoing CEO and the BED hope to benefit from the appointment of an incoming CEO who recently completed an MBA at the local university and was awarded top academic performance. The BED should be in good hands. The intent of this case is to provide an opportunity for business students to become aware of the direct applications of business theories and concepts in public entities and the importance of corporate social responsibility through public-private partnerships in the interest of economic growth. The reader is invited to play the role of the managers, identify external and internal forces, determine the major factors that must be addressed to sustain the BED's core competencies, identify ways to reconcile the conflict between the cost recovery system and the department's underfunded budget, prioritize and allocate funding needed to achieve modernization, and establish plans for managing change and re-instilling positive organizational norms.

THE BORDER ENFORCEMENT DEPARTMENT (BED) CASE STUDY

Border Enforcement Department Authority

The general situation of the BED with regard to *security* continues to evolve and improve. The pace of improvement is dependent on the availability of funding, equipment, and collaboration with public and private organizations. The BED ensures an active link exists with the National Government's Department of Homeland Security (DHS). The national government exercises plenary authority over the island and empowers the Mayor of the island with the authority to execute border enforcement on the island.

BED Priorities

The BED is responsible for enforcing numerous local and national laws relating to passenger, cargo, and conveyance inspection and facilitation at the island's ports of entry. It is the mission of the department to protect the quality of life for the people of the island. This mission is performed by BED inspectors assigned to four major border enforcement sections. These sections are the Tactical Operations Section, Operations Support Section, Port of Entry Operations Section, and Administration Section (See **Figure 1**).

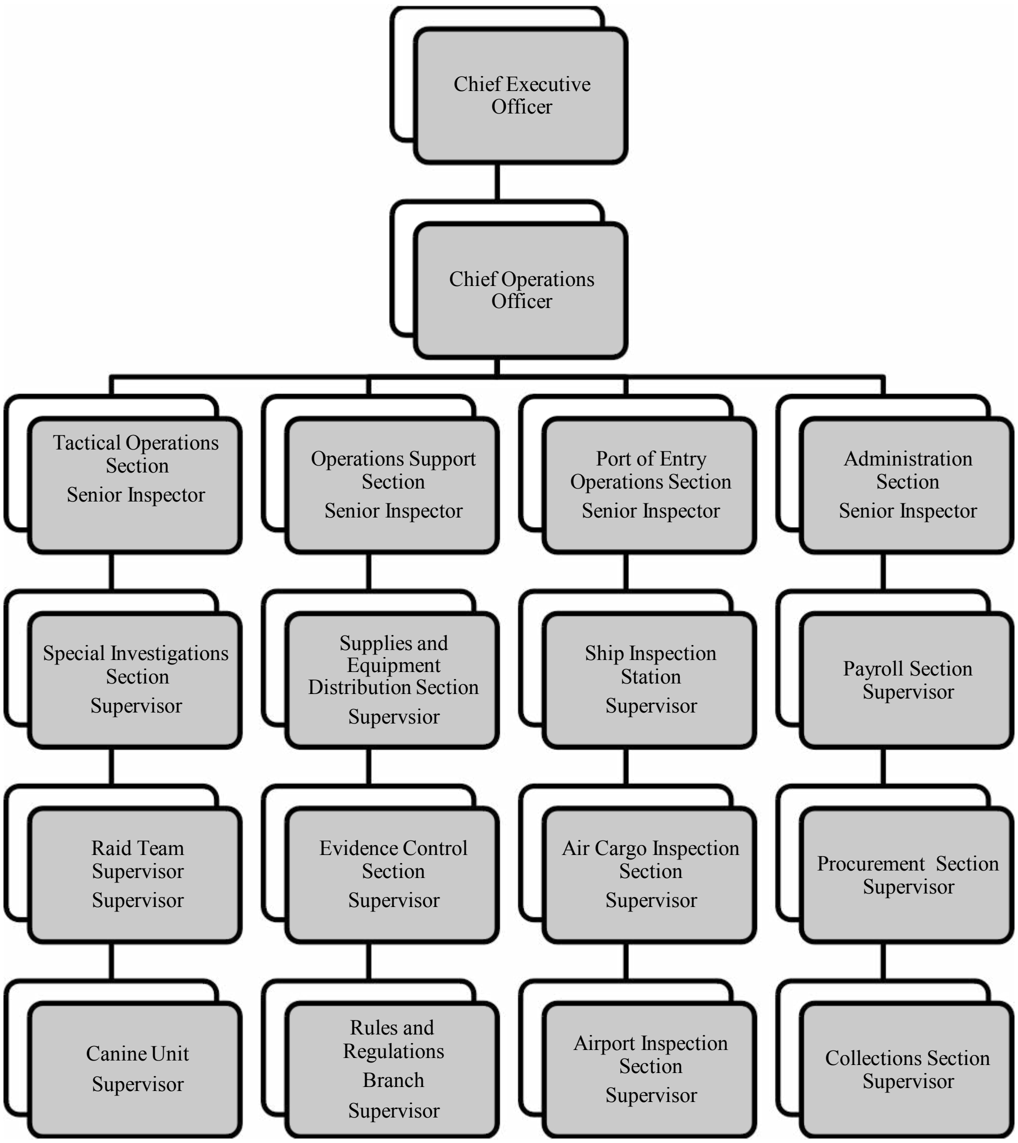
The work of the four sections contribute towards accomplishment of the BED mission, (See **Figure 2**) which consists of preventing the importation of illegal drugs, protecting the islands agriculture and wildlife, preventing the introduction and spread of diseases, regulating vehicle importations, enforcing environmental laws, preventing firearms from entry, collection of fees and taxes, preventing smuggling of counterfeit merchandise, safety inspection of consumable goods, provide assistance to other island governments at the island's ports of entry.

Personnel Description

The BED is comprised of approximately 142 trained and experienced border inspectors capable of conducting criminal investigations and initiating border enforcement operations to facilitate the detection, the deterrence, the disruption, and the eventual arrest of all persons and/or organizations involved in the smuggling of contraband into the island. Incorporated in this mission is the endeavor to provide highly probable information and intelligence allowing for the targeted inspections of persons, conveyances, and cargo. BED is responsible for the delicate balance of these border enforcement functions and the facilitation of commerce. Proper use of technology for selectivity of examination and reliable intelligence help to support BED's two-pronged mission.

BED personnel receive entry level training at the point of hire. This training lasts for approximately a year and encompasses border enforcement principles and law enforcement concepts during the first module of introductory training. The second module introduces port of entry regulatory training. The second module delivers national government regulatory requirement training coupled with the island's slew of regulatory and compliance training. The national government provides recurrent training for many of its regulations. The island's government does not provide additional training other than annual weapons proficiency testing. This situation holds true for any recurrent, developmental, or leadership type training.

Figure 1. Border Enforcement Department's Organizational Chart



Collaboration

The BED has benefited tremendously from collaborative efforts with the National Government. Productive outcomes have also been experienced from partnerships with other border enforcement counterparts such as the National Department of Agriculture, National Oceanic Observatory Agency, National Drug Combating Enforcement Agency, and the National Mail Carrier Inspection Service. Numerous operations conducted in conjunction with national law enforcement counterparts has contributed towards mitigating border threats while strengthening the security of the island's borders. Collaborative efforts have proven vital to accomplishing BED's desired layered coordinated approach to border enforcement at the island's borders.

Figure 2. Border Enforcement Department Mission Statement

The BED is responsible for enforcing numerous local and national laws relating to passenger, cargo, and conveyance inspection and facilitation at the island's ports of entry. It is the mission of the department to protect the quality of life for the people of the island by:

- Enforcing all local and national laws applicable to the island
- Preventing the importation of illegal drugs
- Protecting the islands agriculture and wildlife
- Preventing the introduction and spread of diseases
- Regulating vehicle importations
- Enforcing environmental laws
- Preventing firearms from entry
- Collection of fees and taxes
- Preventing smuggling of counterfeit merchandise
- Safety inspection of consumable goods
- Provide assistance to other island governments

The Border Enforcement Department is an island government department that traditionally received funding through general government revenues. However, BED instituted the Port of Entry Inspection Service Fee (PEIS Fee) designed to recover costs for BED enforcement service operations and inspection facility costs at the island's borders.

Currently, the PEIS fee involves charging airline carriers fees for passenger clearance at BED's Airport, inbound cargo document processing fees at the Air Cargo Inspection Station, and the clearance of maritime conveyances and cargo at the Ship Inspection Station. This program now serves as the sole funding source for BED services at the island's borders and is identified as PEIS Fees.

BED intends to open a new biosecurity facility. This facility will enhance the inspection process of arriving vessels and assist the consignees in the release of their inbound maritime cargo and containers. With the approaching economic growth, the increased commercial activities will require the establishment of this biosecurity facility to balance the protection of the island and ensure maximum and safe throughput of merchandise at the Ship Inspection Station Section. Increases will extend to all facets of operations such as personnel and logistics. The economic growth will cause tremendous strain and pressure on BED's limited resources of personnel and other logistics.

The Island's Distinctive Posture

The island is 100 miles in length, 70 miles at its widest point and is situated in the Western Pacific. Geographically located in the Pacific, the island is approximately five hours from Tokyo, Japan and Manila, Philippines. The island is less than 8 hours from Australia. According to a Census conducted in 2000, the island has a people population of 400,000. The island is also a vacation hotspot for national and foreign tourists. These tourists are vital to the island's livelihood and economic stability. Tourism is the island's main commercial source of revenue.

DECLINING CONTRABAND SEIZURES

BED's Contraband Control Mission

The mission of the BED with regard to contraband is to detect, seize and deter the importation of contraband into the island. This is accomplished through the effective use of department resources. Building labor capacity will contribute to the enhancement of BED leadership skills in the areas of foresight, drive, knowledge, ability, and ingenuity.

Historical Assessment

BED's highest number of contraband seizures was 322 cases during calendar year 1998. The number of BED inspectors during that period was well over 150 inspectors. Tactical Operations Section staffing consisted of 33 personnel assigned. Port of Entry Inspection Section consisted of approximately 18 inspectors per shift at the Airport Inspection Station, 12 assigned to Air Cargo Station, and 11 assigned to Ship Inspection Station. Operations Support Section, with staffing of 30 inspectors, provided BED operational support with evidence control, supplies and logistics, legal support, research and development and reporting of statistics as required. The remaining inventory of inspectors is assigned to the national government enforcement task forces. The Administrative Division that consisted mainly of civilian personnel provides support by way of tracking hours worked and ensured collections are accurate and occur on time. These activities ensure compensation of inspectors and department personnel.

Two years later, inspector and personnel staffing levels were cut in half because of the island experiencing an economic downturn because of Asian economic problems and natural disasters. National government conditions remained stable, so inspectors looking for a better life relocated to better their financial situations. Overall contraband seizures declined proportionately to the departure of trained and experienced inspectors. (See **Figure 3**)

Figure 3. BED's Historical Contraband Seizure Statistics and Inspector Staffing

Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Seizures	117	125	104	322	136	113	71	36	25	22
Inspectors	85	100	120	180	176	172	150	141	138	134
Year	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Seizures	52	43	35	19	12	14	17	30	26	24
Inspectors	128	127	125	122	119	126	126	125	124	137

BED has always boasted recruitment of the island's most qualified enforcement oriented candidates when the time comes to hire inspectors to man the border. When BED puts out a job announcement, at least 1,000 island residents apply for the job. Of the 1,000 applicants usually only 700 qualify. BED usually fills 30 vacancies at a time. One can easily see how quality recruits can be hired when your pool to select 30 inspectors is derived from 700 qualified candidates.

PORT OF ENTRY INSPECTION SERVICE FEE

The island serves as a major transportation and economic hub for the Pacific region. The island's government hired some of the island's best talents to protect the island from contraband, collect revenue from commerce, and protect business' private property rights. The department collects fees for services they perform at the border. This fee is called the Port of Entry Inspection Service Fee (PEIS Fee).

Historical Information on the PEIS Fee

In 1996, former CEO for BED successfully lobbied the island's Parliament to enact a law allowing the BED to impose a fee for individuals and companies who used BED's services. These fees would come to be known as the Port of Entry Inspection Service Fee (PEIS Fee). Initial charges implemented involved the charging of fees to airlines for their use of Port of Entry inspection Services or cargo document and vessel entry processing services.

The national government was initially opposed to Parliament's intent to pass this law because the law would violate the national government's prohibition of taxes on airlines and their operations. The only reason the national government ceded opposition was because BED performed sole enforcement of laws at the island's border. Because the BED enforced regulations on behalf of the national government, BED was allowed to implement their fee to recover costs for services performed on their behalf. This was only fair and logical considering BED's limited manpower and resources, and the National Government requiring BED to enforce national laws at BED's borders: a small victory for the BED.

A major stipulation to the national government's allowance for the PEIS Fee was the requirement for the airport to collect the fee on behalf of BED. This stipulation was set in place until BED promulgated procedural standards required by all Parliamentary Enactments involving the collection of fees. For 15 years, the island's Airport Bureau seized on this opportunity and arbitrarily deducted costs they identified were associated with facilitating collections of the PEIS Fee. Upon assignment to the BED, the CEO pursued remediation of this injustice to the BED by requesting an audit of historical charges and justification for all amounts charged against the PEIS Fee collections. This process is ongoing, and the Airport Bureau contends the Parliamentary Order allows them to do this. (See **Appendix 1**. Parliamentary Order 323, Port of Entry Inspection Service Fee. Sections 1967 through 1976)

For over 15 years, PEIS Fees remained unchanged. The PEIS fees were found to be inadequate to support BED's operational costs. For an example of the shortfalls experienced by BED that was calculated by the EAB see **Figure 4** for the Port of Entry Inspection Fee Financial History. This time the biggest opposition to the adjustment of fees was the all powerful Economic Association of Business (EAB). The EAB was opposed to the adjustment of rates because BED was incapable for many years of producing adequate justification for the fee adjustment, and their collections were lower than what BED was asking to be appropriated. The EAB had the BED in a lasting grip primarily because the BED did not have accountant positions authorized in their organizational chart. The EAB exploited this situation until the new CEO of

BED solicited the assistance of revenue generating local government agencies. With the assistance of the accounting teams from these agencies, BED was capable of producing an economic impact assessment and credible justification for rate adjustments.

Figure 4. Port of Entry Inspection Service Fee Historical

Port of Entry Inspection Service Fee					
	2009	**2010**	**2011**	**2012**	**2013**
Revenues	6,932,561	7,231,116	8,692,867	10,053,359	10,256,121
Total Revenue	6,932,561	7,231,116	8,692,867	10,053,359	10,256,121
Expenses					
Protection of life and property	9,189,703		11,568,536	11,315,442	
Accrued Payroll and other		7,650,190	388,627	351,366	8,723,510
Building Rent		1,776,374			3,228,504
Total Expenses	9,189,703	9,426,564	11,957,163	11,666,808	11,952,014
Other sources (uses)					
Net Change in Fund Balance	(2,257,142)	(2,195,448)	(3,264,296)	(1,613,449)	(1,695,893)
Transfer in from other funds	2,257,142	2,195,448	3,264,296	1,617,893	1,691,449
Transfer out to other funds					
Fund balance at beginning of year					

Pondering the Future

At the time of the latest PEIS Fee adjustment, the passenger service fee was too low to support BED's Airport Entry Section and Ship Entry Section operations. Simultaneously, the individual charges for cargo document processing were insufficient to cover the costs for the actual BED processes that accompanied cargo document processing and inspections. The CEO was extremely concerned the inaccurate cost recovery fees would create a chokepoint when the island's economic boom was anticipated to occur.

BED was paying over $100,000 a month for rent at one facility. The rental charges were based on volume rather than by area because the facility was a warehouse. The CEO considered the money spent on rent could be better spent on a facility the Border Enforcement Department could own after a mortgage period. The CEO also decided there was a better rate the department could obtain by building and financing BED's department-owned facility.

The CEO began pondering all the training and equipment enhancements the Department could use the money for down the road; perhaps when she would no longer be the CEO of the BED. Just then, the receptionists began knocking on the CEO's door advising the CEO of her 10:00am appointment.

EMERGING REQUIREMENTS

The BED was responsible for performing biosecurity enforcement at the island's borders. In anticipation of the economic growth, the national government conducted a regional biosecurity assessment in advance of the economic boom to determine the current biosecurity state of the surrounding Pacific region. The BED was one of the first members of a newly formed invasive species council. BED formed a task force and assigned personnel to perform biosecurity functions. The BED was praised for the level of enhancements made to the island's biosecurity posture. National government representatives publicly recognized the BED in their final regional biosecurity assessment report.

One of the primary recommendations made by the assessment was for the development of facilities large enough to handle the volume of cargo that would be generated by the economic growth anticipated.

Port Biosecurity Inspection Facility

The appointment announced by the receptionist was for the Biosecurity Task Force (BSTF) personnel. The BSTF set up the meeting to introduce to the CEO their rendition of a Biosecurity inspection facility that would address the regional biosecurity assessment's call for facility enhancements. The meeting provided the CEO with building cost estimates and preliminary concepts of the building's layout. What captured the CEO's attention most was the incorporation of the BED Headquarters (a facility that could house the entire agency).

The CEO quickly ran some numbers with her personnel and estimated the monthly financing for the facility to be almost half of what the BED was currently paying for the existing facility which they would never own and which they were paying for volume rather than square footage. Being familiar with the Vessel Operations Port original master plan, the CEO knew that there was a plot of land identified to accommodate the BED for this type of facility. The problem was this part of the plan was eliminated from the master plan. The CEO was thinking to herself, "who in their right mind would remove such a critical facility during a time when tremendous economic growth was within sight." The CEO thanked the BSTF for their excellent work and sent them on their way.

Meeting with the Vessel Operations Port CEO

The CEO called the receptionist and asked to set a meeting with the Vessel Operations Port (VOP) Chief Executive Officer. The CEO was hopeful a meeting with the VOP's CEO would produce beneficial results. Weeks later the meeting took place and the VOP's CEO was adamantly resistant to BED CEO's request for putting the BED facility back into the master plan.

Once back in her office, the CEO listed her options to secure the land and financing for the facility. Some of her major concerns consisted of (a) seeking assistance from Parliament to assign VOP land for the facility to BED; (b) approaching the economic development bureau for technical assistance on the financing; (c) tying up all loose ends and resistance by bringing on board the Vice Mayor of the island who was the next contender for the island's Mayor; (d) presenting the economic chokepoint BED could become if the facility and land were not acquired from the island's Professional Businessmen's Consortium: a major undertaking sighed the CEO. She considered this as she pondered discussions of modernization and organizational development she had with the Senior Inspectors of her department's major sections.

MODERNIZATION OF BED OPERATIONS

Several Senior Inspectors approached the CEO of BED to share some concerns with the manual processes being used to perform BED functions at the port of entry. The senior inspectors discussed how the national government uses technology to receive and process passenger and cargo manifests. They talk about how the national government is capable of handling immense volumes of cargo by their use of technology. The senior inspectors talked about the intelligence systems employed by the national government and how these systems direct them to pay closer attention to cargo or passengers at the border.

The BED's Chief Executive Officer frequently speaks with inspectors throughout the department about being aware of the changes required to make the department better. This after the CEO exhausted previously awarded national government asset forfeiture funding on pet projects like conferences, computers for administrative staff, and furniture. Aside from their pet projects, the top executives exhausted the funds on frequent off island trips. The national government designed the forfeiture program to reinvest in the special programs that enhance border protection. The BED appears to be on a downward performance spiral.

Senior Inspector's Observations

Several BED Senior Inspectors meet to discuss what can be done to influence and initiate improvements and eliminate the practices that continue to erode the effectiveness of the BED. Perhaps a viable plan, even a strategic plan that addresses proper financing, personnel development and training, and modernization strategies can be developed to provide treatment to this ailing department.

During their meeting, the senior inspectors discuss their different experiences during interactions with the two heads of the BED. One senior inspector remarked, "I can't understand why our CEO is always asking everyone around her for an opinion." It seems like she is afraid to make a decision on her own. This is starting to become so demeaning that after she asks me for my opinion, she quickly turns to my subordinates who do not have all the details or experience and asks what they think. She makes it a point to go to as many sections in a day and visit the people, but nothing is ever produced by these conversations. There are no directives or programs developed from all her discussions. She seems to be enjoying the attention and activity of conversations more than anything else.

Another Senior Inspector remarked, "our COO is not too far behind her." He is always looking for companionship with lower ranking inspectors and frequently spends time socializing with them after hours. He does this with a select team of inspectors. In fact, these are the same inspectors that appear to be catered to most. The senior inspector further remarks, "the other problem I see is he is always posturing himself for personal business gain during meetings about BED shortfalls." He continues, "our COO is not attuned to the legal and regulatory improvements and changes needed for BED to function effectively. This is his job, and he is not doing it." "He likes to meddle at our level of operations and frequently bypasses me and tells my subordinates to do something that is not a priority when I already have their tasks planned out." The senior inspector closes by stating, "I know a lot of managers who are overcome by the responsibility of their jobs and have not prepared or educated themselves, so they revert back to activities they are comfortable with."

As they depart from their little gripe session, Senior Inspector TOS thought to himself, what a funny situation that short meeting was because the COO has afforded special accommodations to the two inspectors who were making the complaints. Senior Inspector TOS was quite frustrated about how the COO allows double standards because these two Senior Inspectors perform flagrant violations of the uniform policy as well as manipulate overtime policies to their advantage. These two senior inspectors were the ones the COO confides in to obtain policy guidance on issues because the COO lacks competence in many areas. Senior inspector TOS recalls the conversation the COO had with him in which he tells him about his familial relationship with the current Mayor. Senior Inspector TOS frequently considers that relationship to be the key factor in his promotion rather than educational background or his competence in BED matters.

BED's current processes involve manual review of a binder that lists persons and organizations of interest. This process requires inspectors to open the binder and review the listing in comparison with the person or business agent requesting clearance. The same process occurs at the Ship Entry inspection Section and requires intense scrutiny by the inspector because of the voluminous documents encountered during routine document review and processing. Airline Companies and Cargo shippers have offered to supply BED with hardware and software programs to assist BED with their company's advanced screening. Advanced screening would help speed the processing of passengers and cargo, but the BED does not possess the technology to implement this capability. Fundamental to this operational improvement is the BED's access to intelligence.

The senior inspectors also shared some improvement templates produced during regional meetings with other Border Enforcement Departments in the Oceania Region, they all agree, "why can't we just use those ideas and move our department into the future." (See **Figure 5** Oceania Border Enforcement Consortium Best Practices). In her four years, the current CEO has yet to attend the Annual Oceania Border Enforcement Consortium Meeting. The CEO remains concerned her department requires modernization and will not be prepared for the economic growth. She contemplates this concern while businesses on the island continue to modernize and make use of technology to improve their efficiencies. Everyone else is applying modern concepts except her agency. The CEO's concern's of BED becoming an impediment to commerce is real.

Figure 5. Oceania Border Enforcement Consortium Best Practices

1. Solidify alliances with our business constituents
2. Implement the efficient, supportive, and facilitative ease of trade
3. Incorporate modern concepts
4. Application of new technology
5. Implementation of new philosophies on Border Enforcement Controls
6. Provide transparency and predictability
7. Develop and adopt the use of risk management techniques
8. Cooperate with other relevant authorities and our business clients
9. Use clearer, simplified and standardized procedures,
10. Continuous development and improvement of BED Control techniques
11. Maximum use of information technology
12. Develop a partnership approach between BED and Business Clients
13. The use of pre-arrival information to drive programs of selectivity
14. The use of electronic funds transfer
15. Coordinated interventions with other agencies
16. Making readily available, information on BED requirements, laws, and rules.
17. Providing a system of appeals in BED matters

BED OPERATIONAL PERFORMANCE AND ORGANIZATIONAL CLIMATE

BED employs tenured Senior Inspectors who have a responsibility to manage the major sections of the department. Recent troubles with scorpions found aboard airplanes by aircraft catering service workers instead of BED inspectors brings to light some performance troubles within the department. Senior Inspector for the Tactical Operations Section (TOS) is concerned about why the performance of the border inspectors is declining. This Senior Inspector is concerned that employees have not been rewarded for their efforts for quite some time. This lack of initiative and attention to detail does not align with the quality of employees hired by BED. The department hires the most intelligent people interested in this field of work. Something is amiss!

Senior Inspector TOS consults his long time friend Senior Inspector Port of Entry Operations Section (PEOS) who states, “I don’t know what’s wrong with these inspectors I told them, all I want for them to do is their job.” Senior Inspector TOS was wondering how inspectors would know what Senior Inspector PEOS’s expectations were. Senior Inspector TOS decided to look for anything that may clearly state the goals set by Senior Inspector PEOS. Senior Inspector TOS did not find anything tangible save for Senior Inspector PEOS’ memory and statement. This was troublesome because Senior Inspector PEOS was the lead inspector for BED’s largest section.

Senior Inspector TOS went back to his office only to find a stack of overtime pay requests submitted by hard working inspectors. Senior Inspector TOS found it difficult to explain to his hard working inspectors that they had to accept time off instead of compensation because the budget for overtime ran out. This was very distressing for Senior Inspector TOS because he put in a request for $200,000 of overtime based on the previous year’s accumulation of $195,000.00 in overtime costs. Senior Inspector TOS went searching for Senior Inspector AS, who told him there was no money because they were told to work with the budget provided by the Budget Management Center from the local government. Senior Inspector TOS remarked, "why didn't you tell me I would have been able to explain this to them and considered other operational approaches." Senior Inspector TOS asked the same question he had asked for many years since taking responsibility for his section, "How does a Department with a Cost Recovery System not have adequate funding to close out the year"?

Performance Evaluations

Three years ago Senior Inspector TOS performed an agency assessment of the department's Employee Evaluation System (EES). Utilizing a series of questions designed to gather key statistics on supervisory and employee involvement in the EES. The findings conclude interesting findings of the manner in which Supervisor Inspectors approach the EES.

Some barriers or perceived issues identified by supervisory inspectors that caused the erosion and lack of utilization of the EES is the lack of time, need for administrative assistance, frequent transfer of employees, frequent transfer of supervisors, operational requirements vs. administrative requirements, standardized personnel files and routing system, standardized processing for the Department, standardized documentation (exit & initial evaluation), and the lack of review by Assistant Chief's to ensure fairness and consistency in ratings. Supervisors indicated it would be too time consuming without the proper standardization of processes and administrative assistance to apply the EES. Inspectors indicated that they did not feel they were rated properly and did not fully understand nor agree with current EES processes.

Organizational Climate

Approximately ten years ago a former BED CEO established the BED's mission statement and statement of organizational values. He also conducted the first ever BED Leadership Development Symposium. During this time, inspectors could easily identify with the mission and values of the department because this information was conspicuously displayed throughout the organization.

Today none of these documents can be found displayed anywhere in the agency. Senior Inspector TOS considered bringing these issues up to the CEO for her awareness but remembered that the COO was present during that period so she should be the one responsible for advising the CEO of past practices that were beneficial to the organization's climate.

The current organizational climate of the department consists of the lack of subordinate confidence in management's ability to improve the department, the lack of accountability for shortcomings and constant finger pointing to affix blame, disregard for procedural requirements, timelines not met, diminishing quality of work, and lack of confidence from the business sector. A semblance of agency pride flickers now and then, but no gust of wind comes along to nourish the flame.

Senior Inspector TOS went back to his Office and considered if perhaps applying for the CEO's or COO's job would be the solution to the department's performance, budgeting, and motivation problems. He also worried about the chokepoint BED would present when the period of economic growth occurred for the island. Senior Inspector TOS also worried about the balance of throughput and community safety. He knew that he would have to get inspectors to improve their proficiency in order for this balance to be achieved.

OPPORTUNITY KNOCKS: GET IT RIGHT THE FIRST TIME!

Recent elections conducted on the island produce greater uneasiness at the BED. Both the CEO and the COO have announced their plans for retirement and plan to leave the department at the same time the newly elected Mayor takes the helm after her inauguration. The inauguration is planned to occur in three months' time. The CEO is concerned for the BED but has her pick for who would be capable of running the BED. She requested Senior Inspector TOS report to her office, so she could tell him personally of her intent to retire and to recommend his appointment as the next BED CEO. This recommendation came easy for the CEO because Senior Inspector TOS and the CEO both recently completed an MBA program at the same time. The CEO graduated with honors and Senior Inspector TOS received top academic performance demonstrating the highest grade point average of the MBA cohort. The two knew and trusted each other well.

Senior Inspector TOS who is also known as Tumogue reported to the CEO's office as summoned. During their meeting, the CEO recounted Tumogue's extensive experience and list of accomplishments. Tumogue became a little curious about the reason the CEO was calling out his past performance (See **Appendix 2** for Tumogue's Curriculum Vitae). The CEO told Tumogue he received confirmation from the new Mayor that Tumogue was his selection as the new CEO for the BED. The CEO congratulated Tumogue and the two parted. Tumogue immediately went back to his office and began putting together his plan to bring the BED to a new level of government performance. The following segments provide the priority focus areas Tumogue targeted within the BED to prepare the department for economic growth. *You decide if Tumogue got it right the first time.*

The first task Tumogue accomplished was the establishment of key components or pillars of his strategy. Tumogue identified four pillars to base his initiatives; people, finance, security, and modernization. Based on these four pillars, Tumogue developed four operating principles influenced by one of his MBA course readings, *"What is Strategy?"* (Porter, 2000): (a) take care of people and people will take care of the rest; (b) plan to spend money and spend money based on your plan; (c) secure the border the smartest way possible; (d) seek or create opportunities to modernize.

LEADERSHIP AND STRATEGY

Tumogue considers the people he must lead and must determine an appropriate strategy to inspire and lead them. He considers the different leadership approaches he learned during his MBA experience. Tumogue selects the transformational leadership approach. Tumogue recalls this style of leadership requires the leader to identify the needed change, to create a vision as a guide for the change, facilitate change through inspiration, and execute the change through commitment of the members of the group.

Tumogue turns to the transformation leadership style that stresses followers must feel trust, admiration, loyalty, and respect toward the leader. They are also motivated to do more than they originally expected to do. Tumogue knows his influence must motivate followers by making them aware of the importance of the effects of completed tasks and convincing them to set aside their own self interest for the sake of the BED. Tumogue is convinced he has selected the appropriate style of leadership because leadership theorists insist seminal transformational theories have been modified to assimilate additional forms of effective leadership behavior. Tumogue understands numerous writers widely use the term transformational to describe any type of effective leadership. Tumogue knows the application of transformational leadership can be used for individuals as well as the entire organization.

Tumogue is reminded that he must remain open to other forms of leadership styles and theories and pull from applicable elements that will help him on his journey. Recognizing his inclination to be bold and forthright, he must seek ways to regulate his mental and emotional capacities and exercise self regulating awareness and actions, so he pulls from his studies of Emotional Intelligence. Leaders experience physical stresses and internalize their fatigue, so their followers remain inspired by their energy and resolve. Being attuned to his spirituality, Tumogue leans on spiritual leadership, which calls upon a higher calling to motivate the leader further. The diversity of people in organizations demands different approaches to motivate and inspire people of different cultures. Tumogue relies on his favorite leadership theory that incorporates global competencies. Through these competencies, Tumogue possesses a wealth of information that will assist him with the diversity within the BED. One of these competencies is acceptance of ambiguity, which aligns directly with tradeoffs and instances when he must choose no action for the moment or no action indefinitely.

Tumogue reviews his strategy and attempts to recall the lessons emphasized throughout his MBA studies. He is pleased to see his four pillars and operating principles aligned with Porter’s contemporary elements of strategy. Tumogue ponders the myriad of subtasks and activities that must be accomplished to achieve his goals and begins to dissect further the activities related to his strategy. It is not long before he realizes this is not a task for a single person. He recalls that transformational leadership requires that he must develop the vision and inspire others to action.

ENVIRONMENTAL ISSUES AND CHANGE MANAGEMENT

Recognizing he is not alone in this process, Tumogue begins to study the forces that may have a direct impact on successful execution of his strategy for improvement. He examines the anticipated internal and external forces and prioritizes the issues based on impact and urgency.

Tumogue identified four major external forces affecting the BED as (1) budget bureau imposing a collections ceiling on the BED’s cost recovery mechanism; (2) removal of the BED Seaport Inspection Facility Construction from the Seaport Master Plan; (3) improved sophistication of contraband smugglers; (4) lack of consultative relationships with the business industry.

Tumogue identified four major internal forces affecting the BED as (1) newly appointed CEO and COO; (2) lack of leader’s vision statement; (3) lack of communication providing guidance for goal attainment; (4) predominantly negative organizational climate (see **Figure 6**. Organizational Norms).

Figure 6. Organizational Norms Chart

Organizational Norms Chart

Norm	Positive	Effects on mission	Negative
ORGANIZATIONAL AND PERSONAL PRIDE	- People see themselves as an integral part of the unit - They display ownership	- High work standards - Unit Pride in mission accomplishment - Workers feel a stake in the outcome	- People quick to criticize unit - Show little concern for unit problems - Treat job as 8 to 5 - Little concern for off-duty activities
TEAMWORK/ COMMUNICATION	- People are open - Information freely shared - Rewards & recognition shared	- Shared information and expertise more effective - Cooperative atmosphere - Open communication maintained	- People hold vital information - People go out of their way to make themselves look good - People always looking out for themselves
LEADERSHIP/ SUPERVISION	- Open door policy active - People come to the boss for advice - Work gets done without the boss present	- Less psychological gaming - Supervision focused on leading, helping, and developing	- "When the cats away the mice will play" - Subordinates only communicate with supervisors when forced - Workers get quiet when boss enters room - Boss trying to catch workers doing wrong
CUSTOMER RELATIONS	- Attitude that everyone's time/mission is of value and treated with respect	- Satisfied customers - Customer feedback is seen as a motivator by workers and supervisors	- Complaints from customers - Lack of respect shown by workers - Rudeness, apathy, and anger highly visible - Intent to keep others waiting evident - Messages not passed on
PROFITABILITY/ COST EFFECTIVENESS	- Funds outlive budget - Not much waste - Workers question costs	- Fund available for priority items - Mission essential items last longer	- Unit is out of funds before end of FY - Blank checkbook mentality - Trash cans always full
INNOVATIVENESS/ CREATIVITY	- Workers experiment with new ways - Active suggestion program	- More effective methods surface - Creative people motivated to improve unit output	- People criticize new ideas - Nothing done differently in years - Listening is not a unit's acquired skill
TRAINING AND DEVELOPMENT	- Unit fully supports training (OJT), PME, off-duty education) - Training is vital part of job	- More qualified people do tasks - Experienced workers free to take on tough tasking - Unit available to adapt new technology	- OJT programs routinely miss target dates - High failure rate on CDCs, task certifications - Slow adapting to new systems

(College for Enlisted Military Education, 2011).

Tumogue selected the top seven priorities and developed the following plan in order of initiation:

1. Propose and implement new model for the BED that calls for a change to autonomous status, creation of a advisory board, and reorganizing the BED to include an Accounting Division, Information Technology Division and BioSecurity Division.
2. Schedule department-wide meetings with BED personnel to introduce the new CEO and open the lines of communication to initiate information exchange.
3. Publish CEO Tumogue's Vision including the four pillars dedicated to achieving BED's strategies.
4. Assemble a team of employees responsible for promoting BED's organizational values.
5. Develop training programs to enhance employee knowledge, skills, and proficiency.
6. Develop and institute performance measures and controls to gauge BED progress and support with meaningful awards and recognition programs.
7. Improve systems for selectivity for examination through improved consultative relationships with the trade.

Tumogue's financial plan resulted in a radical change of status for the BED. His strong belief is that the solution tothe BED's financial issues is to convert the status of the BED to an autonomous agency. Figure 7 presents Tumogue's analysis of the effects of the conversion. Through this conversion the BED can develop its own financing plan. Tumogue believes the presence of an advisory board would provide greater oversight over BED financial matters and align with similar big business corporations whose operations and finances are board driven. In line with this conversion, Tumogue is prepared to reorganize the agency by incorporating an Accounting Division, Information Management Division, and Biosecurity Division. Tumogue also plans to change the titles within BED to reflect business like nomenclature. As an example, Inspector position titles would change to Business Compliance Analysts. These decisions will help BED align itself with a more corporate and modern outlook.

Next, Tumogue must organize a team of employees to establish the department's values statement. Tumogue is confident that once established the organizational values would provide a department wide standard of acceptable behavior and practices. The values extend into other organizationally based documents such as the unit goals and strategic plans. Tumogue is certain that if a mix of employees from different levels of BED participated in the development of the department's values, then the organization will more readily accept the values as their own and incorporate them into their daily routines. He is confident the values would also prepare employees for the impending organizational change.

Tumogue recognizes that even with the most careful planning to involve employees from the organization in the crafting of the organizational values, there is still the possibility that he will still experience resistance because people are naturally resistant to change. To manage the implementation of change, Tumogue intends to address areas of anticipated concern such as (a) ensuring the need; (b) providing a plan; (c) building internal support for change; (d) ensuring top management support; (e) building external support; (f) providing resources; (g) standardize change; (h) pursue logical progression of change.

Figure 7: Tumogue's SWOT ANALYSIS of the New BED Model

STRENGTHS	WEAKNESSES
- Board members bring with them influence from their relationships - Board members bring experience and new perspectives - Managers must answer to the board - Board monitors and approves the budget - Accounting department ensures reconciliation of all revenue collections and expenses - Capital improvement and expansion projects can be planned and approved specific to BED needs	- Board conflicts might interfere with regulatory decisions - Increased conflicts may arise because of perceived diminished authority - Vision transfers from one individual to multiple individuals - Individual Board member motives - Increased politics - Increased time for decision making - Not all board member relationships and influences will be positive - Increased cost, paperwork, and added processes result from boards

OPPORTUNITIES	THREATS
New positions and responsibilities are created New business titles align with business clients Retraining or job redesign may take place Speed of modernization may increase Public support increases because of confidence in the board or perceived transparency	Decrease in revenues directly affects employment, operations, and salaries Increased costs to fund the board Increased bureaucracy from board processes Departure of skilled law enforcement officers due to new titles Strong resistance to change by BED employees Board may reduce security and compliance levels to foster trade

PROJECT AND OPERATIONS MANAGEMENT

Tumogue takes a step back and recognizes he will need to establish timelines and opportunities between projects that give him time to communicate with his staff. He is reminded of the GANTT charts, which provided key information on key tasks, critical paths and periods of slack where other important tasks can take place or even where rest and recuperation can occur. Tumogue looked at his seven priorities and rechecked his initial assumptions about priority. Confident that he had made the right decision, he begins assigning milestones and dates to the different projects and develops a full blown breakdown of how the projects should be accomplished - complete with goals, objectives, and activities. He is reminded of his project management concepts.

As he put his thoughts to paper, he relished the thought of having a capable and educated team of Senior Inspectors that he could rely on. Tumogue decided to call a meeting to present his priorities to his Senior Inspectors and delegate tasks based on their assignment, previous experience, and capabilities. He also assigned himself certain tasks of high priority that needed to be addressed specifically at his level. Tumogue clearly stated the timelines and milestones he expected into the Senior Inspectors' plans for task accomplishment. He clearly advised Senior Inspectors who were present that he expected all tasks completed within a one year period. He hoped he would not be regarded as too ambitious with his deadlines. Tumogue ended the meeting by setting the time and date for the next meeting at which time the Senior Inspectors of the BED would be responsible for presenting their complete plans on how they intended to accomplish the priority task assigned them. Tumogue was confident the BED was on their way. With a great plan and a great team, nothing should go wrong.

DECISION MAKING

Tumogue is aware of the distinction between problem-solving and decision-making. Confident that his four pillars and seven priorities can hold up to the scrutiny of the mayor and other stakeholders, he devises a plan of relationship building to address the issues of financing and the budget bureau. Tumogue is aware that his position power originates from the Mayor's delegation of authority to him. Surrounding that action is the political arena and all the players pulling and tugging to push their agendas forward. Tumogue decides that if the decisions he makes conflicts with the Mayor and others he must be prepared to deal with them.

Tumogue is aware that organizations are political and decision makers frequently establish differing objectives that frequently places them in conflict. He knows that those with greater influence must still succumb to those with greater position power. Such is politics, he thinks to himself. Tumogue decides to operate with integrity and always remain straight forward about his decisions to ensure he accomplishes his agenda. This may be in conflict with decision-making theories but it's his decision, and he is standing his ground because his commitment to securing the island justifies his need to remain rigid.

Tumogue thinks back and rehashes the actions he performed to reassure himself of his decisions. While analyzing performance, he used past benchmarks to determine declining trends. His analyses of performance standards indicate improper execution of the evaluation process, most especially the explanation of standards and expectations. This contributes directly to the decline in overall BED employee performance. Declining contraband seizures also support the need for the development of training programs to enhance employee knowledge, skills, and proficiency and the development and institution of performance measures and controls to gauge BED progress. These two initiatives are strengthened by his identification of the complement of a reputable awards and recognition program. Tumogue is assured he is on the right track.

Tumogue performs a similar check of his decision-making process by reviewing the notes he prepared when he got carried away assembling the master plan that corresponds to his seven priorities. He locates clear objectives and prioritization but notices that he is missing alternatives. He decides this condition can be rectified by guiding his Senior Inspectors to this conclusion rather than telling them right out. In this fashion, the interaction also becomes a teaching opportunity and helps to reassure his staff they are capable of accomplishing their assigned tasks.

APPENDIX 1: Parliamentary Order 323, Section 1967 – 1976

§ 1967. Promulgation of Procedural Standards.

The CEO of the Border Enforcement Department is responsible for the promulgation of procedural standards necessary to carry out the provisions of this Order. Such procedural standards shall be promulgated in accordance with the provisions of the Administrative Adjudication Law.

§ 1968. Border Enforcement Port of Entry Inspection Service Fee Established.

Each aircraft landing at the Emerald Airport shall be levied a Port of Entry Inspection Service
Fee reasonably related to the costs incurred by the Border Enforcement Department in providing, maintaining and operating the PEIS Fee facilities, and shall be allocated among air carriers in such a manner reasonably related to the relative demand for such services attributable to each carrier. Each consignment of air and sea cargo, and each passenger landing at a sea port shall also be levied a Port of Entry Inspection Service Fee, except for those passengers which may be exempted under the procedural standards promulgated pursuant to **§ 1974**.

The service fees shall be reasonably related to the costs incurred by the Border Enforcement Department in providing, maintaining and operating the inspection service fee facilities. Notwithstanding any other provision of law, the establishment, modification or adjustment of any service fee levied pursuant to this Section shall be subject to the provisions of the Administrative Adjudication Law.

§ 1969. Initial Service Fees.

Until the first Procedural Standards required by **§ 1974** have been promulgated, the Airport Bureau is authorized to collect on an interim basis service fees from air carriers reasonably calculated to recover the costs incurred by the Border Enforcement Department in providing, maintaining, and operating the service fee facilities. The Border Enforcement Department, or its agents, is also authorized to collect on an interim basis an initial port of Entry Inspection Services Fee to be levied as follows:

(a) Upon sea passengers landing at the Vessel Operations Port a Passenger Fee of $10.00 for each passenger, and a document processing fee of $6.00 upon each consignee or other applicable party for each consignment of cargo landing on island, and $26.00 fee upon each consignee or other applicable party for consolidated consignments of cargo landing on island.

§ 1970. Authorization for Border Enforcement Department and the Emerald Airport Bureau to collect Port of Entry Inspection Service Fees.

The Emerald Airport Bureau is authorized to assess and collect, from air carriers, the PEIS Fee for Border Enforcement Department inspection services rendered at Emerald Airport. The Border Enforcement Department is authorized to assess and collect the PEIS Fee, for Border Enforcement services rendered at the Vessel Operations Port of the island.

§ 1971. Emerald Airport Authority Reimbursement Agreement.

It is hereby established that the Emerald Airport Bureau agrees to reimburse the Border Enforcement Department, and/or their agents for the costs incurred in performing the various duties and obligations of the Border Enforcement Department at the Emerald Airport.

§ 1972. Deposit of Port of Entry Inspection Service Fees in Port of Entry Inspection Services Fund.

Notwithstanding any other provisions of law, all funds received in accordance with Parliamentary Order 323 shall be remitted, within five (5) days of receipt, to the Treasurer of the island for credit to the Port of Entry Inspection Services Fund as provided for in **§ 1972** of this Order; provided, however, that, upon authorization and certification by the Chief Executive Officer of the Border Enforcement, the Emerald Airport Bureau may deduct from the remittance any actual expenses or fees attributable to the Border Enforcement Department incurred in administering or carrying out the purposes of this Order, and any other fees incurred by the Border Enforcement Department at the Emerald Airport.

Expenses and encumbrances, except those outlined above, of the Border Enforcement Department, or their agents, incurred in performing their duties and obligations as prescribed in this Order shall be paid from the Port of Entry Inspection Services Fee Fund upon appropriation by the island's Parliament. Any funds appropriated to the Border Enforcement Department shall be administered by the Chief Executive Officer, who shall also be the ratifying officer for the Department.

§ 1973. Penalties for Non-payment or Late Payment of Port of Entry Inspection Service Fees.

If an air carrier, vessel operator, passenger, consignee or other applicable party is more than thirty (30) days delinquent in paying any PEIS Fee due under this Order, an interest fee of Twenty Percent (20%) per annum shall be added to the balance due.

§ 1974. Procedural Standards for Port of Entry Inspection Service Fee.

The Chief Executive Officer of the Border Enforcement Department subject to the Administrative Adjudication Act, shall promulgate and adopt Procedural Standards to implement the provisions of **Section 1967 through 1976** of this Order, including provisions establishing the procedure for collection of the service fee, and for periodic review of the costs of providing the services, the level of the fees levied, and the amount of reimbursement payable to the Emerald Airport and the Border Enforcement Department and/or their agents reflecting the administrative cost of collecting and remitting the fees.

The Procedural Standards shall also provide for such exemptions from the service fee as may be required by applicable law, other regulations, or as may be prescribed by the Chief Executive Officer of the Border Enforcement Department. In addition, to the extent the interim fee authorized by **§ 1969** is determined to have either over collected or under collected the revenue required during the interim period, the final procedural standards should adjust the service fees accordingly.

§ 1975. Border Enforcement Department and Agriculture Inspections Services Fund.

There is hereby created, separate and apart from other funds of the island's revenue, a fund to be known as the "Port of Entry Inspection Services Fund" (hereinafter referred to as the Fund"). The Fund shall not be commingled with the Common Fund and shall be kept in a separate bank account. All expenditures of the Fund shall be made exclusively by appropriation of the island's Parliament. The Fund shall not be used as a pledge of security or as collateral for government loans. The Chief Executive Officer of Administrative Matters shall make a quarterly report to the Mayor and the Parliament of the condition of, and activity within, the Fund. The CEO shall make a quarterly report to the Chairman of Parliament's committee which oversees the Port of Entry Inspection Services Fund (the Fund) of the condition of, and activity within, the Fund. The CEO of Administrative Matters shall further make an annual report which shall be made available to the general public.

§ 1976. Severability Clause.

If any provision of **Sections 1967 through 1976** of this order or the application thereof to any person or circumstance is held invalid, such invalidity shall not affect other provisions or applications of the Order which can be given effect without the invalid provision or application, and to this end the provisions of this Order are severable.

APPENDIX 2: Tumogue's Short Resume

SUMMARY OF QUALIFICATIONS

- Top-notch manager with over 20 years of experience administering customs trade facilitation and border security enforcement for the island of Agang and the region
- Over 18 years of extensive involvement in regional and international customs administration organizations
- Highly trained and proven as a manager in the administration of Agang's border security
- Extensive background in establishing and maintaining interagency relations between Agang's Border Enforcement Department (BED), other local government agencies, and national government agencies, high performance tiger teams, and various law enforcement task forces. This quality is complimented with a forte for resolving highly sensitive issues and tension between disagreeing entities.
- Two decades of experience in managing armed and specialized tactical units whose daily operations involve exposure to life threatening conditions
- Diverse border enforcement work experience as a certified contraband inspector, BED technical course instructor, border statutes reconstruction and review officer, special operations group commander, and program development coordinator for new projects such as the first ever Bio Security Task Force and the Mealy Bug Detector Dog Training Academy
- 10 years of combined military service formerly as a fulltime soldier in the national government's armed forces.
- Demonstrated ability to be innovative and resourceful most especially during conditions of adversity
- Plethora of border enforcement certificates of completion and achievement, and letters of commendation.

EDUCATION AND TRAINING

1980 Agang College Preparatory High School
2003 Associate of Arts in Business Degree, University of California
2005 Associate of Applied Science Degree, Human Resource Management, Community College of the National Armed Forces
2005 Bachelor of Science in Business Degree, Global Business Management, University of Phoenix, AZ., *Magna Cum Laude*
2010 Professional Master of Business Administration, University of Agang, Copra, Agang

MOST SIGNIFICANT ACCOMPLISHMENTS

- Development and establishment of BED's Intelligence Section
- Development and update of BED's governing statutes
- Inspector of the Year 1983, 1985, and 1990
- Manager of the Year 2000 and 2003
- Development and Establishment of the BED's Technical Training Academy
- Development of BED's Personnel Staffing System
- Development and continuing course instruction of BED's Leadership Development Training Program

GENDER DISCRIMINATION AT INDITEX KOREA

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ABSTRACT

This teaching case addresses a situation where a Korean subsidiary of the Inditex Group, a global clothing manufacturing and retailing firm, is confronted with a gender discrimination situation which violates both parent firm policies and local laws, but is consistent with the traditional Korean HR approach. A decision must be made as to how to address the situation. Despite the legal ramifications, there is relatively little business incentive to implement radical change. However, modifications to the status quo, if any need to be made, will have both strategic and tactical implications on their present operations.

Key Words: HR Teaching Case, Gender Discrimination, Korea HR Policy, Gender Equality

INTRODUCTION

One evening, long after the normal business day had concluded, one office was still lit up at Inditex Korea, a subsidiary of the international clothing manufacturing and retailing firm best known for its flagship brand, Zara. Sora Kim[1], a senior Human Resources manager, was still at her desk struggling with a problem that used to be such a simple and straightforward occurrence but now, to her, it had become potential evidence of a deeper organizational problem. This quandary kept her at her desk reading and re-reading the email she received from the subsidiary's Vice-President of HR.

The email that occupied the full attention of Ms. Kim contained the reasoning behind the decision of a 31 year old woman, the newest member of the HR department and still within her second month of her training program, to leave the firm. The letter detailed the uncomfortable pressure placed upon her by the manager of her training program. The former staffer described comments and suggestions, made by the manager, urging her to quit after discovering the fact that she was married and had a young child. Despite the fact that the family had not impacted the employee's attendance or performance up to that point, the training manager forthrightly stated her firm adherence to a belief, held by many Korean business professionals, that married women, especially those with children, were unreliable on the job due to conflicting loyalties and could not be counted on in a professional workplace. Although her family status had been provided to Inditex by the woman's recruiter and it had never come up during the interview process, she learned that she was the first and only female employee with a family to have been hired by the company in their five years of operation in Korea.

[1]The individual names found in this case have been slightly modified to protect identity of the former employee. All other facts have been represented as accurately as possible.

The European headquarters in general was very hands-off in terms of the operations of its subsidiaries, as long as they followed certain corporate guidelines in terms of strategies and objectives. Thus, the domestic subsidiary had maintained the long standing traditional corporate culture, which was heavily influenced by Confucian beliefs and values, commonly found in Korean companies. The pressure to leave work to raise a child and for married women to stay home to care for the family's wellbeing was essentially second nature in the Korean corporate world. Ms. Kim's struggles with this resignation, which usually would simply have been processed without a second thought and summarily dismissed, was due to the fact the staffer had also sent the email to the European HQ's HR department. The VP, who forwarded the issue to Ms. Kim, tasked her with the responsibility of ensuring that no negative fallout resulted from this email and that the subsidiary's HR practices were not called into question. Essentially, Ms. Kim had been asked to provide potential damage control and treat this as a simple resignation with no extraneous issues or problems arising and that business was proceeding as normal. Ms. Kim's experience abroad was also cited as a reason by the VP in tasking her with this responsibility as she would understand how to best communicate and respond to any concerns raised by HQ and essentially maintain the status quo at Inditex Korea.

What local management had not considered was a change in Ms. Kim's outlook pertaining to professional women in the workplace. Ms. Kim had always followed the traditional approach in the utilization (or underutilization as she had begun to think) of professional Korean women and had largely ignored the current inefficiency of their use. However, Ms. Kim's experience with HR policy and activities at Inditex's European headquarters had opened her eyes as to the potential conflicts between them and the Korean approach. Trying to balance the traditional status quo versus the "foreign" approach as well as considering the implications of a failure to adhere to both corporate and governmental policies has left Kim in her current quandary. Should Ms. Kim simply maintain the status quo, or rather should she breach the issue of gender equality and foment change at the subsidiary level?

INDITEX OVERVIEW AND HR APPROACH

Inditex is one of Spain's most famous companies. Founded in 1963 by Amancio Ortega Gaona, by 2012, Inditex has grown to be a major player in the fashion retail industry.

Inditex was originally established to manufacture clothing for retailers within the fashion industry. Twelve years after their founding, Inditex took a major step by launching their first Zara retail store. Over the following decade, they further expanded their business by building a network of stores across Spain. In 1988, the firm truly began to globalize by opening their first international store in a neighboring country. In addition to their primary store network, Inditex also launched additional retail brand stores in a number of complementary clothing niche markets. In the last several years, Inditex has quickened its expansionary efforts by signing exclusive franchise or joint venture agreements with local retailers in countries such as Korea and India. Overall, after fifty years of growth, Inditex now has over 6,000 stores in more than 400 cities on five continents with net sales of almost 16 billion Euros. See Tables 1 and 2 below for more detailed information regarding their historical expansion and company financials.

Table 1 SUMMARIZED EVENTS THAT MARK THE INDITEX HISTORY	
Year	**Event**
1963	-Inditex founded as a clothing manufacturer.
1964-1974	-Merchandise distribution began to several European countries. -Several factories established.
1975	-First Zara store opened in Spain.
1976-1984	-Network of stores is created across Spain.
1986-1987	-All firm manufacturing devoted solely to supplying company stores. -New distribution system implemented.
1988	-First store outside of Spain opened in Portugal.
1989-1990	-Additional stores opened in the US (1989) and France (1990)
1991-1992	-Retailer Pull & Bear founded. -Purchase of another retailing brand group, Massimo Dutti, began.
1992-1994	-International expansion continued in Europe and North America.
1995	-Purchase of Massimo Dutti is completed.
1998	-Retailer, Bershka, aimed at young women and teen girls, is launched.
1999	-Retailer, Stradivarius, Inditex's fifth, is acquired.
2001	-Lingerie retailer, Oysho, is launched. -Inditex's first shows in the Middle East are launched.
2003	-Inditex's seventh retailer is opened. -Distribution system is further expanded.
2004	-Additional stores are opened in Asia and Africa. -Inditex Group's total stores number 2,000 across 56 countries.
2007	-First on-line store is opened.
2008	-Accessory and fashion extra retailer opened. -Shops number more than 4,000 in 73 countries. -Korean subsidiary formed.
2011	-Shops pass 5,500 store mark on five continents.
2012	-Inditex revamps image. -World-wide stores reach 6,000.

Data from: Inditex

Table 2
INDITEX FINANCIAL STATEMENTS

Fiscal Year	2012	2011	Growth Rate
Net sales[(1)]	15,946	13,793	16%
Net profit[(1)]	2,361	1,932	22%
Nº of stores	6,009	5,527	482
Nº of markets	86	82	4
Employees	120,314	109,512	10,802

Note: The Inditex financial year is from 1st February to 31st January of the following year (1) in millions of Euros. Final column is the growth recorded from 2011 to 2012.
Source: Inditex

From an HR perspective, Inditex employs over 120,000 professionals with more than half working outside the home country. On average, employees are female and fairly young with a mean age of 26 years. Inditex prides itself on a corporate culture based on teamwork, open communication and professionalism. Although performance expectations are very high, the firm places a high value on job stability, training and internal promotion.

Their HR approach is further underpinned by their adherence to a certain code of conduct regarding their employees. Their policies state their beliefs as “individuals to be a key business factor, [so] it upholds and promotes observance of human and labor rights and undertakes to enforce the regulations and best practices in the field of employment conditions and health and safety at work (Inditex)”. They furthermore hold that “all employees shall be bound to interact with other employees, pursuant to the criteria of respect, dignity and justice…without allowing any manner of discrimination on account of race, religion, age nationality gender or any other personal or social condition beyond qualifications and capacity (Inditex)”. These policies though are sometimes overlooked or modified due to their agreements with foreign partners or observance of foreign cultural backgrounds. See Table 3 for an excerpt from the official Inditex Group's Code of Conduct statement. To date, Inditex has also not acknowledged initiating any major disciplinary action against their subsidiary firms for breaches of corporate HR policies that do not conform to local practices.

The size of their network, however, may make maintaining a clear, consistent approach across their entire footprint difficult. For example, in March, 2012, a Swedish investigative television program reported about severe abuse and terror against a number of Swedish and European employees. However, it has been reported that the "HR manager and the Scandinavian regional manager of the men’s department deny most of the things stated by the 25 employees in the documentary" (Ljungberg & Pena, 2012).

Despite infrequent issues such as the report from Scandinavia, Inditex's HR record, especially in regards to gender discrimination, remains clean and focused on providing a safe and productive work environment for all of their employees.

INDITEX’S KOREA OVERVIEW AND HR APRPOACH

The Inditex Korea subsidiary was formed in 2008 as a joint venture between Inditex and the Lotte Group. The Lotte Group is one of Korea's largest conglomerates with annual sales of more than $10 billion with various divisions that provide food products and services such as retailing, finance, construction, hotels, trade, oil and sports (Lotte International). The joint venture was designed to benefit both Inditex and Lotte. Inditex gained a large local ally possessing knowledge and local influence that was critical to the planned rapid expansion of their flagship brand Zara's stores in Korea. Lotte, in turn, received an international partner with a proven track record and quality goods currently in high demand. Although Lotte maintains a 20% ownership stake in Inditex Korea, its activities are currently minimal as their primary responsibility was in the initial setup of the venture and not related to on-going management. This hands-off approach to management has also impacted Lotte's contribution to HR policies. Despite Lotte's espoused equal opportunity policy, they do not appear to have had any input into the current Inditex Korea's HR regulations (see table 3 for Inditex’s group code of conduct and responsible practices).

Table 3 INDITEX GROUP CODE OF CONDUCT AND RESPONSIBLE PRACTICES
3. General principles The Code of Conduct is defined as an ethical commitment that includes basic principles and standards for the proper development of the relations between INDITEX and its principle stakeholders wherever it carries out its business activities. The Code is based upon the following principles: - All the operations of the Inditex Group shall be developed under an ethical and responsible perspective. - Compliance with laws and regulations of each country. - The conduct of Inditex' s employees shall follow in letter and spirit the provisions of this Code of Conduct and Responsible Practices. - All persons, whether natural or legal, who maintain, directly or indirectly, any kind of professional, economic, social or industrial relationships with Inditex shall be treated in a fair and honourable manner. - All the activities of Inditex shall be carried out in the manner that most respects the environment, promoting biodiversity preservation and sustainable management of natural resources. **Employees** The Inditex Group does not employ anyone who has not reached the age of 16. No one who is employed at Inditex shall be discriminated against because of their race, physical disability, illness, religion, sexual orientation, political views, age, nationality or gender. Inditex forbids any manner of physical, sexual, psychological or verbal harassment or abuse to its employees, as well as any other behavior which may create an intimidating, offensive or hostile environment

Source: Inditex Group Code of Conduct and Responsible Practices, p.5.

Inditex Korea currently operates over 200 local stores, many in the country's most trendy shopping locations. These stores are considered an integral part of Inditex's Asia-Pacific regional expansion. The stores maintain the international firm's retailing approach, in supplying high quality, reasonably priced trendy clothing, that has been touted for its "fast-fashion clothing system" in which the firm claims that it can take a design from sketch to store shelves in just two weeks. This system allows Inditex to introduce new selections every week, maintaining a competitive advantage over other competitors in its area of business.

Inditex employs more than 3,000 workers, working in the subsidiary management office and its stores, the majority of whom are female and in their 20s to 30s, maintaining the average line employee demographics found within most divisions of its global organization. However, unlike most of Inditex's other global subsidiaries and even many similar style Korean domestic firms, the Korean venture possesses a predominantly older, female Korean management team. Despite their gender, the managers have taken a very traditional Korean approach to their HR policies. Younger women are brought into the company to primarily serve the lower levels and often are forced to occupy part-time positions (Patterson & Walcutt, 2014; Patterson & Bae, 2012; Kim & Jun, 2011). This controversial practice is used by many Korean firms as an approach to minimize salary and benefit expenses paid to employees (Lee, 2008; Kim, 2007; Kugelmann, 2006).

In addition, as mentioned earlier in the case, women with families are discouraged from working at any level within the organization under the premise that they are unreliable for long-term employment. This premise is held due to what many Koreans managers believe to be conflicted loyalties between the workers' families and workplaces, and hence, women should not be considered for stable long-term employment. Only women, such as those on the management team, who are unmarried, are allowed to remain and rise within the organization long-term. The current HR approach has become ingrained within Inditex Korea's culture through both the influence of the Korean traditional gender approach and the lack of HR policy change since the firm's founding.

KOREAN GENDER DISCRIMINATION SITUATION

Gender discrimination in Korea has only relatively recently been considered a potential issue by some elements of the population and although many legal steps have been taken to address it, very little real progress has been achieved in eradicating more traditional HR customs (Patterson & Walcutt, 2014). This lack of progress can be demonstrated in Korea's rank of 107th out of 134 countries in the 2011 Global Gender Gap Report (Hausmann, Tyson, & Zahidi, 2012), despite the enactment of a comprehensive package of antidiscrimination policies and improved education for women (Patterson & Walcutt, 2014).

The typical perception of women has often been linked to Korea's patriarchal, Confucian past (Patterson & Walcutt, 2013; Patterson, Bae & Lim, 2012; Cha, 2013). Traditionally, although they have always been involved in the Korean workplace, women have primarily served in unskilled, temporary or support capacities (Ahn, 2006). Most of these working Korean women tend to be young, unmarried and childless. Part of their underutilization was often attributed to the perception that they provide less value as compared to comparable male workers (Cha, 2013). The perception also stemmed from the belief that once women married, they would either quit and stay home to look after their children or would simply put their family above their job and therefore compromise their proper devotion to their workplace (Patterson & Walcutt, 2014; Kim & Jun, 2011).

Over the past thirty years though, this attitude has shifted enough to encourage the South Korean legislature to enact several laws that made all forms of gender discrimination illegal. The Equal Employment Act was the first applicable law and was enacted in 1987. This act prohibited discrimination and provided the basic standards for judging equality (Patterson & Walcutt, 2014). After this initial action, several more laws were passed that further fleshed out gender discrimination protection and enforcement and began an affirmative action program that would span all public and large private firms. These laws are enforced by several governmental agencies which accept and investigate complaints and, to a lesser degree, seek out potential violations. If potential violations are identified, these agencies issue warnings, attempt to negotiate resolutions and can recommend cases for prosecution by the Korean Ministry of Justice. If individuals or firms are indicted and found guilty by the courts, penalties can include fines of up to 30 million won (roughly $29,000) or up to 5 years in prison (Republic of Korea, 1987).

Although a comprehensive body of laws was enacted, very little change has actually occurred regarding the treatment of women in Korean workplaces for a number of reasons. First, a recent study (Patterson and Walcutt, 2014) has identified that out of 30,000 complaints made over a five year period, only a handful were recommended for judicial sanctions and, of those cases, only 15 resulted in disciplinary actions. Total punishment for all court actions was roughly $24,000 and a one year prison sentence. These low enforcement levels are attributed to being at least a partial explanation factor for the low levels of legal adherence. Traditional culture and the fundamental disagreement of many business owners to the current policies was another potential factor. A third factor pertains to many Korean women simply seeing the current discriminatory situation as unavoidable, which leads to their passive acceptance of the status quo (Patterson & Walcutt, 2014).

Although not all businesses are affected, the discriminatory climate found in many South Korean firms is not expected to dramatically change in the future as long as governmental and societal influences remain fairly ambivalent to the issue.

CONCLUSION

The Inditex Korean subsidiary is faced with a gender discriminatory situation that must be intelligently and pragmatically addressed. The first option on the table revolves around either consciously ignoring the situation at the potential peril of a regulatory breach or issues with Inditex's HR policies. These perils, if they actually occur, are not believed to have much of a drastic effect on the firm or its management so may beg the question of justifying whether or not changes need to be made. The second option before the subsidiary is to make all necessary adjustments to the local HR approach and avoid external issues, but in doing so, the firm may face cultural issues, increased costs and resistance from within its own ranks. Other options may also exist, but are yet unidentified.

After reviewing the choices in front of her, Inditex Korea HR manager Sora Kim is still unsure as to which course of action would be the best choice for her and the firm.

FINAL QUESTIONS

1. Explore the merits/demerits to Inditex Korea's HR position in regards to both their external and internal environments.

2. Why hasn't Inditex Korea adhered to the policies and laws set forth by both the Korean government and the Inditex parent firm and should they continue this policy? Look at this situation from legal, ethical, economic and practical contexts.
   Dowling et al (2013) states that a multinational firm must have a strategic approach in its HR function where it must adopt a global corporate HR role, HR practices, and crisis management and coordination. As MNEs operate in the context of worldwide conditions, including the influences of industry (global or multi-domestic) and regional, national, and local markets this includes geopolitical, legal, socio-cultural, and economic characteristics. In strategic management practice, PEST (Political, Economic, Sociological, and Technological), describe the macro-environmental factors that can influence MNEs.

3. Discuss the implications the multinational control of Inditex versus the institutional pressures of Korean traditional business practices.

4. If Inditex Korea were to seek full adherence to appropriate internationally-standardized anti-discriminatory policies, outline a course of action the firm must take to fully implement the new HR approach?
   Dowling et al (2013) state that an international JV faces several challenges when two partners with different institutional, cultural and national backgrounds come together and must balance their interests. As Inditex HQ in Spain has different sets of rules than Lotte Group in Korea does this has lead to critical dualities within the HR function. The HR department did not develop appropriate HRM practices and strategies for the IJV entity itself as Zara Korea is following a domestic model, specifically, Lotte Group's rules.
   Mercer's report (2014) recommends, in order to build a diversity and inclusion strategy, multinational should do:

GLOCAL		ENGAGED		EMBED
Global best practices, Local relevance	→	Engaging senior leadership and middle managers	→	Holistic view of all HR processes

Dowling et al (2013) recommend for an international human resource management approach that a geocentric firm will have more influence on host-country industrial relations systems, due to their greater propensity to participate in local events. Connor and (2012) give an example of Samsumg Tesco using a glocal approach – global policies and processes but utilizing local Koreans. This combination has been successful for this IJV. In other Korean organizations, the corporate culture is centered around the CEO but they instead have their culture transcending to the individual, allowing openness and balance without compromising their social 'Korean' identity. Inditex Korea should follow their example.

5. What might be the primary stumbling blocks to a new HR policy implementation?

For most organizations in the Asia Pacific, in a report by Mercer (2014), it appears that they focus primarily on inclusion and on "harmony" in the workplace. Rather than highlighting the differences and honoring the individual – a common approach in the West – companies in the region place a higher value on the group and on achieving balance between the different elements in the group.

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A MATTER OF LIFE AND DEATH

Janis Warner, Sam Houston State University
Irfan Ahmed, Sam Houston State University

INTRODUCTION

The news was not good. It was June, 2012. In the roller-coaster ride that had been Tami's life the past few years, this was surely a large speed bump. Tami had just been told that as yet, no kidney donor had been found for her daughter Courtney. Tami knew she had to step up her efforts, and also get help and enlist others in her efforts. Between her work commitment and taking care of Courtney, there was little time left to pursue the search for a donor on her own.

TAMI'S STRUGGLES

At the age of eight, Tami Carroll's daughter Courtney Carroll had been diagnosed with IgA Nephropathy, a complex blood disease that affects the kidneys and can cause renal failure over time. At this time, there was no known cure for the disease. Soon after the diagnosis, Courtney's parents relocated to the Conroe, Texas area, about 40 miles north of Houston, so Courtney could receive treatment at the highly regarded Texas Children's Hospital in Houston. Even though Courtney was in and out of the hospital frequently, she graduated from Conroe High School in 2007. Courtney's precarious health did not keep her from shining in school -- she proved herself to be a gifted musician, playing the saxophone, beginning in intermediate school until she graduated. A talented visual artist, Courtney had won many art show awards all over the state for painting and illustrating. A recently started project – illustrations for a children's book – had been occupying a good amount of Courtney's time lately. Courtney believed in life and in doing things to give back to the community and society.

In 2008, in spite of the excellent ongoing care that she had been receiving, Courtney's kidneys failed. Courtney was fortunate to receive a kidney transplant from her father, without the long wait that is often the case with unrelated donors matched by donation registries. However, within a period of three years, the donated kidney had also been ravaged and rendered dysfunctional by IgA. The only solution for Courtney's survival and continued health was to receive a kidney from a living donor. Tami, though, was not a compatible donor, and that closed one possible avenue for Courtney. Tami Carroll knew she had to work proactively to find a living donor so that Courtney could have a chance to live.

LOOKING FOR A KIDNEY DONOR

The organ donation registries sought donors and matched them with needy patients systematically, and their system was good at matching donors with recipients, but it was also excruciatingly slow. According to statistics from the National Kidney Foundation that Tami had read, more than 594,000 people in the U.S. suffered from end-stage kidney disease; Tami had personally seen evidence of this close to home – in the form of new dialysis facilities opening up everywhere. According to the same statistics, in 2010, nearly a hundred thousand had died due to various causes arising out of kidney failure. In 2012, over 90,000 people were waiting for a kidney transplant, and the availability of donors was less than 5,000. This mismatch between need and availability of kidneys meant that a very small percentage of patients received a kidney, and the wait for a well-matched donor could take years. Tami also had another serious concern that made it necessary to expedite the search: Courtney would be covered under her father's health insurance until she was 26, and then she would be without the insurance necessary to pay for the transplant and post-transplant recovery and care, which could take up to a year. Since the slowness of the registry system was a problem and it could make the difference between life and death, it could not be relied on entirely.

However, if an individual were to attempt finding a donor on her own, how would she go about it? What would be the best approach for an ongoing search? It appeared to be a daunting task. Tami knew she needed help, and the more people she could enlist in her cause, the better her chances of finding a compatible living donor would be.

This was when Dr. J.W.'s offer to her came back to Tami's mind. A business professor at a nearby university and a client of Tami's massage therapy practice, Dr. J.W. had mentioned more than once about using social media to spread the word about Courtney and her need for a kidney donor. Dr. J.W. had told her about the huge numbers of people who were on Facebook, Twitter and some other social media that Tami hadn't even heard of and couldn't remember the names of. The possibility of Courtney's case being promoted by her friends and relatives and then spreading through the world of social media through their network contacts and in turn those people's contacts was fascinating. To Tami's mind, it appeared to offer the multiplication of her efforts, many times over. Why, just recently, Tami had heard on the evening news about how Facebook had nearly a billion registered users the world over. Now even if a small percentage of Facebook users in the U.S. could be exposed to Courtney's situation and need, someone might know someone who knew someone who could be a possible donor. In fact, Tami had also even come across a study done by Loyola Medical Center, which showed a small degree of success for efforts to seek kidney donors through Facebook. She had heard of a family in New York, dubbed "The Flood Sisters," who had successfully secured a kidney donor for their father using Craig's List.

Tami also thought of the publicity Courtney might get if she vigorously used social media in the quest of a donor. The local news sometimes carried stories about people who were using social media in unusual ways to promote themselves and their causes – sometimes in crazy ways and for what appeared to be frivolous causes. Tami had also heard of people using Craig's List and eBay for advertising their need and getting solicitations, but that became news only for the notoriety it gained, and Tami knew that was not what she wanted for Courtney. Yet, such free publicity in the normal media would be a nice additional benefit, and could only help.

The next morning, Tami met with Dr. J.W. at a local coffee shop. They had a detailed discussion about what Tami needed to accomplish through the use of social media. One thing was clear: Tami did not have the knowledge or skills to run a social media campaign. With all that she had on her plate, Tami felt she couldn't possibly invest the time to run a social media campaign, much less learn enough to plan and organize it. Dr. J.W. mentioned to her that most effective social media campaigns were run by specialists or social media agencies, but that was also not a feasible option because of the cost involved. Dr. J.W believed a cost-effective solution had to be found, and quickly, but there were only so many hours that she herself could spend helping Tami.

"I can do a class project next semester," said Dr. J.W. "I'll be teaching a class on social media and communications next semester, and the class can develop several campaigns for you."

"It'll take a few months, but we can get the perspective of young people and harness their day-to-day familiarity with social media. This will add a realistic dimension to any plans they come up with," said Dr. J.W.

"Thank you," said Tami, with her hopes raised a bit, and more confidence that she may soon be on the way to the beginning of a social media campaign on Courtney's behalf.

SEXUAL HARASSMENT ON CAMPUS: "HE'S JUST A PERVERT AND EVERYBODY KNOWS IT!"

Federickia Washington, Stephen F. Austin State University
Marlene C. Kahla, Stephen F. Austin State University
Robert M. Crocker, Stephen F. Austin State University

CASE DESCRIPTION

Sexual harassment has been and continues to be a real problem on college campuses across the United States. Most colleges require faculty and staff training to help identify, prevent, and report sexual harassment. Yet each week reports of sexual harassment flood the television news, draw heated debate on talk shows, elicit intense commentary on social media, are scrutinized and debated in academic media such as The Chronicle of Higher Education.

This case describes a very subtle example of sexual harassment in a collegiate setting. Situated at a small university somewhere in the United States, the principal characters are: Bob Mayberry, Ph.D., a tenured, male professor and director of graduate studies in the College of Liberal Arts; Mary Robin, a female graduate student in the College of Liberal Arts having completed her bachelor's degree in the College of Business at the same university; Caroline Wallace, Ph.D., a tenured, female faculty member in the College of Business; and Allen Goodnight, Ph.D., a tenured, male department chair in the College of Business.

This case recreates a student's experience and compresses a series of events into a shorter time frame in an attempt to capture the more indirect aspects of sexual harassment. The case demonstrates the vulnerability of a student whose collegiate success is wholly dependent on a senior tenured faculty member. This culture and political nature of the organization is explored from the vantage of why many people, for a variety of different reasons, choose to look the other way or to completely ignore the deviant behavior of a faculty member. Finally, the case challenges students to address appropriate workplace behaviors and to make discernments when the line between right and wrong has been crossed.

What better setting can be used in the classroom to encourage discussion of sexual harassment in higher education and elsewhere? Many juniors and seniors in college, both female and male, have probably had at least one encounter that they thought might have been sexual harassment. Since students are not required to take "training" in the subject to continue pursuing their degrees, discussions regarding sexual harassment should take place at least once in a semester to heighten their awareness of the topic and prepare them for life after college.

CASE SYNOPSIS

A small university with post graduate programs provides the setting for the scenario. The key player in the case is the female graduate student, Mary. Mary's undergraduate advisor, Dr. Wallace, is chosen as the confidant whom Mary shares her version of a series of awkward, uncomfortable encounters she has experienced with the director of the graduate program Dr. Mayberry. Mary also tells Dr. Wallace the other things she has heard about the director of her program, Dr. Mayberry.

Dr. Wallace and Mary meet with the Dr. Goodnight, the department chair, to seek guidance in determining what to do about the situation. The subtle nature of this sexual harassment allegation should be explored and possible courses of action should be vetted. It will be useful in Human Resource Management programs but can lend itself to a wide variety of discussions on workplace behavior.

INTRODUCTION

Mary entered Dr. Wallace's office as she had so often done over the past four years. Dr. Wallace had been Mary's adviser since her freshman year and even now that Mary has graduated, the two have remained close friends.

Mary was not her usual cheerful self and appeared withdrawn. She stared out the window and paused too long in responding to the "Good morning," offered by Dr. Wallace.

"Dr. Wallace," Mary started dryly, "Who do you know in the graduate office in Liberal Arts?"

"Let me think. I know several people in Liberal Arts, but whether they work in the graduate office, I don't know," replied Dr. Wallace. "Why do you ask? You know more people over there than I do."

Staring out the window Mary continued, "You have always encouraged me to get my Ph. D., and I plan to, I really do. But, right now, I may have to switch to another college."

"Why on earth would you do that now?" exclaimed Dr. Wallace, "You are doing so well in your courses and so close to finishing. Didn't you tell me last week that you only have nine more hours and your research project to complete the program?"

"I know, and yes, I did tell you that about being so close to completing my research and my course work," Mary hesitated, then continued, "But, I may need to either transfer to another department or change degree or something, I just don't know what to do."

"What's going on Mary?" Dr. Wallace asked.

CREEPY

"You know that I have been putting together my committee as part of the requirements for the degree. Dr. Mayberry is the program advisor and has been helping me select the people to be part of my committee. Last week he asked that I meet him in his office to discuss my progress." Mary took a deep breath, "When I arrived his door was open and he asked me to come into his office. Neither the administrative assistant nor the student worker were in,"

"He's my committee chair. I kept an appointment with him to discuss progress with my research study, too," she repeated the purpose of being there.

"You know, he has approached me at the rec center several times this semester. He always comes over and says hello, then he gets too close to me and asks me creepy things like do I want to work out with him or go one-on-one on the court. I've always been nice and politely declined his come-ons, but he just creeps me out!" Mary sighed. "I'm afraid to say much of anything, thinking that maybe he might hold up my graduation."

"Anyway, when I entered his office this morning, he seemed even sleazier than those rec center encounters," she trembled. "What I am going to do? I've just got to talk with somebody, and you are it."

"And now Dr. Wallace it seems my troubles have exploded. Get this! He has a string on the inside door knob to his office so that when he heard me arrive he did not get up to open the door, instead, he remained seated, pulled the string just enough to let me enter. He started talking about working out at the rec center right away. Going on and on about watching me work out earlier this week, and he asked me again to work out with him. Just talking about this makes me feel dirty. What has he actually said or done? Nothing. I just feel dirty after listening to him," Mary continued. "It's the way he says, 'work out together,' that really gets to me, the tone, the look he gave me when he said it, all of it makes my skin crawl," she stated.

"I left his office as quickly as I could once he started talking about 'working out.' He directs graduate studies for my program. He confirms the members of my committee. I need only one more committee member. I still have to talk to Dr. Mayberry," Mary thought aloud.

"I know that I can do this, just telling you about it makes me feel a little better, I only need to meet with this guy a few more times at the most," she reasoned.

LOOKING FOR HELP

Dr. Wallace looked compassionately at Mary. "Well, I'm glad that you feel comfortable talking with me about something that bothers you deeply. But, I think we should see if Dr. Goodnight is available to meet with us. You really need to tell him what has happened and how it makes you feel," encouraged Dr. Wallace. "There is a lot about what you have told me that just doesn't seem right, and as part of university protocol, we are required to take this to the next level. That level for us is Dr. Goodnight," stated Dr. Wallace.

As Dr. Wallace called to see if Dr. Goodnight was available, Mary continued to talk. "You know I've heard about Dr. Mayberry from the girls that work in his office. They joke about him. They even say he is a pervert out loud while he is in the office. How do they put up with the comments? I guess they want to keep their jobs, so they make it seem like a joke," concluded Mary.

"I also heard about him from another graduate student. This girl is in the same program as me, and she said that the same thing happened to her while working in the rec center. She said he came over to where she was working out, made some comments about working out with her, and asked her if she wanted to drink from his soda. Yuk. Why did I even repeat that? Yuk," Mary grimaced as she walked with Dr. Wallace to Dr. Goodnight's office.

"Knock, knock. Got a moment," Dr. Wallace announced as she and Mary entered his office. "Mary and I need to talk with you."

"Sure thing. What do y'all have for me this morning?" Dr. Goodnight asks.

After Dr. Wallace closed the door she sat down and introduced the situation to Dr. Goodnight. Mary picked up the story and filled in the details.

Dr. Goodnight listened as Mary told him of the encounter in Dr. Mayberry's office, the rec center encounters, and the other things she heard from the office employees and the other graduate student's encounter with Dr. Mayberry in the rec center.

APPENDIX A: WHAT IS SEXUAL HARASSMENT AND REPORTING IT

It is in accordance with federal and state law to prohibit unlawful discrimination as outlined in university policy (Discrimination Complaints/Sexual Harassment). Sexual harassment is a form of sex discrimination.

What is Sexual Harassment?

Sexual harassment is described as unwelcome sexual advances, requests for sexual favors and other verbal or physical conduct of a sexual nature even if carried out under the guise of humor. These actions constitute sexual harassment when:

Submission to or tolerance of such conduct is made either explicitly or implicitly a term or condition of an individual's employment or education;

Submission to or rejection of such conduct by an individual is used as the basis for academic or employment decisions (including admissions and hiring) affecting that individual; or

Such conduct has the purpose or effect of unreasonably interfering with an individual's academic or professional performance or creating an intimidating, hostile or offensive employment, education or living environment.

Physical conduct that, depending on the totality of circumstances present, may constitute sexual harassment includes but is not limited to:

- Unwelcome intentional touching;
- Deliberate physical interference with or restriction of movement; or
- Sexual violence.
- Verbal conduct, defined as oral, written or symbolic expressions (regardless of the method of communication) that, depending on the totality of circumstances present may constitute sexual harassment, includes but is not limited to:
    - Explicit or implicit propositions to engage in sexual activity;
    - Gratuitous comments, jokes, questions, anecdotes or remarks of a sexual nature about clothing or bodies;
    - Gratuitous remarks about sexual activities or speculation about sexual experiences;
    - Persistent, unwanted sexual or romantic attention;
    - Subtle or overt pressure for sexual favors;
    - Exposure to sexually suggestive visual displays such as photographs, graffiti, posters, calendars or other materials; or
    - Deliberate, repeated humiliation or intimidation based upon sex.

Reporting Sexual Harassment

A member of the university community who wishes to file a complaint regarding sexual harassment by an employee or student of the university should take the following action:

- If the alleged harasser is a faculty or staff member, the complaint should be made to the alleged harasser's supervisor and/or the director of human resources.

- If the alleged harasser is a student, the complaint should be made to the dean of student affairs.
- If the alleged harasser is a third party, neither an employee nor a student, the complaint should be made to the director of human resources.
- Any complaint also may be made to the university's Title IX coordinator

Since the University can only take corrective action when it becomes aware of problems, the university encourages individuals who believe that they have experienced sexual harassment to come forward with their complaint and seek assistance.

Reports of sexual assault and other crimes should be directed to the university police department, regardless of whether the matter also is being reported and investigated as sexual harassment. Those making a criminal complaint will be informed of their option to also make a sexual harassment complaint under the university's Discrimination Complaints/Sexual Harassment policy.

The university can most effectively investigate and respond to alleged sexual harassment if the complaint is made as promptly as possible after the alleged harassment occurs. Complaints must be made in writing and must be filed within 180 calendar days of the alleged violation.

DEUTSCHE AUTOPARTS, LLC – RECONCILING U.S. GAAP TO IFRS

James A. Weisel, Georgia Gwinnett College

CASE DESCRIPTION

This case focuses on comparing and contrasting U.S. GAAP and IFRS through a case analysis. Students must utilize basic accounting research skills and analytical methods to complete the case. While the case explores only five potential differences between U.S. GAAP and IFRS, they are representative of the current status of the U.S. GAAP - IFRS convergence effort.

Several issues highlight the more "principle-based" approach of IFRS compared to the so called "rule-based" approach of U.S. GAAP. The case also emphasizes the need for professional judgement in applying accounting standards. Moreover, the case focuses on the ***process*** *of examining the differences between the two sets of standards.*

The case has a difficulty level of three or four and is appropriate in an undergraduate International Accounting course or an upper-division undergraduate course in Financial Accounting and Reporting. At a minimum, students typically have completed an introductory financial accounting and reporting course. Completing the case as an in-class exercise will generally take approximately 2 hours. The case is also suitable as an outside of classroom experience with an expected 2-3 hours to complete.

CASE SYNOPSIS

A U.S. based manufacturer of after-market automobile components has prepared their financial statements in conformance with U.S. GAAP. The entity desires to attract new investors to fund an expansion of operations. Several of the targeted investors are based in Europe and have asked the company's CPA, the role of the student, to reconcile After-tax Operating Income and Shareholders' Equity "as if" the manufacturer were to apply IFRS. The investors also use Return on Shareholders' Equity as a significant measure of performance.

This case is designed to focus on three learning outcomes related to international financial reporting. After completing the case students will understand:

1. *why accounting standard harmonization, or convergence, is considered important,*
2. *the current status of the convergence effort of the FASB and IASB,*
3. *the strategy for reconciling a U.S. GAAP based income statement to IFRS standards.*

DEUTSCHE AUTOPARTS, LLC

In 2002 the FASB and the IASB agreed to work together to remove differences between U.S. GAAP and international accounting standards. The agreement is documented in the Memorandum of Understanding (MoU), also known as the Norwalk Agreement. Proponents for accounting standard harmonization, or convergence, put forth several arguments. There are two arguments that are paramount. First, harmonized accounting standards would significantly reduce the costs of reporting consolidated financial statements for multinational companies and those companies seeking foreign source investors. A worldwide set of standards would eliminate the need for companies to prepare their financial statements based on a variety of local standards. Second, they make the case that comparability of financial statements worldwide is necessary to reduce impediments to global market capitalization. A worldwide set of financial reporting standards would make it easier for investors to evaluate potential investments and reduce risk through international diversification.

Deutsche Autoparts, LLC is a U.S. based manufacturer of after-market automobile components targeting primarily the German automobile market. For Fiscal Year Ending 2014, its first year of operations, Deutsche Autoparts, LLC prepared their audited financial statements in conformance with U.S. GAAP. After-tax Operating Income amounted to $630,000 ($900,000 before-tax) and Shareholders' Equity was reported at $3,500,000. The company's tax rate is assumed to be 30%. Deutsche Autoparts uses straight-line depreciation for financial accounting purposes.

Deutsche Autoparts is interested in attracting additional external investors to help finance a major expansion of sales. Several of the targeted investors are based in Europe and are familiar with evaluation of financial statements prepared in accordance to IFRS but are concerned about evaluating U.S. GAAP based financial statements. These investors have asked the company's CPA (you) to reconcile U.S. GAAP After-tax Operating Income and Shareholders' Equity to IFRS. The investors have recommended that Deutsche Autoparts use fair market valuations where available under IFRS. The targeted investors have also indicated that they rely significantly on after-tax return on shareholders' equity as a decision criteria.

You have identified the following items as having ***potentially*** material impacts for the reconciliation process.

a. The 12/31/2014 U.S. GAAP balance sheet shows inventory with a balance of $302,500. Records indicate historical cost of $312,000 and replacement cost of $302,500. Through additional analysis you determined that the current estimated selling price is $310,000 with $3,000 cost to sell. The normal profit margin is 15% of selling price.

b. The balance sheet shows Property, Plant, & Equipment, all acquired in January 2014, with historical cost of $2,000,000 and accumulated depreciation of $200,000 as of 12/31/2014. Your analysis indicates the fair market value as of December 31 is $2,100,000.

c. In 2014 Deutsche Autoparts entered into a 3-year lease agreement for manufacturing equipment with 3 annual lease payments of $70,910 at the beginning of each year. The present value of the minimum lease payments at the time of executing the lease was $200,916. The equipment has a fair market value of $250,000 and a useful life of 5 years. After reading the lease agreement you determined that there is no transfer of title and no bargain purchase option. Deutsche Autoparts is responsible for all maintenance, insurance, and taxes during the lease term.

d. Deutsche Autoparts is the defendant in a product liability lawsuit. The damages being demanded amount to $150,000. Attorneys believe that it is more likely than not to be settled unfavorably with an estimated range between $100,000 and $150,000. The facts and circumstances of the lawsuit are disclosed in the footnotes of the FYE 2014 financial statements.

e. In 2014 Deutsche Autoparts incurred research and development costs totaling $50,000. Deutsche Autoparts is able to clearly distinguish the research phase from the development phase of the project. Research-phase costs amounted to $30,000 and development-phase costs are $20,000. An additional $15,000 of development costs are expected in 2015. The product is expected to be brought to market in 2015 and is expected to be marketable for five years.

Use the following templates to reconcile U.S. GAAP After-tax income and Shareholders' Equity to IFRS After-tax income and Shareholders' Equity. In the Item column, simply indicate which of the five items you are addressing (e.g. Inventory). In the Amount column indicate the dollar amount of the adjustment (if any) necessary to reconcile ***from*** U.S. GAAP ***to*** IFRS. These adjustments represent the difference in treatment between the two sets of standards. Don't forget to include the income tax effect of the adjustment. In the Explanation column briefly describe the relevant U.S. GAAP standard applied and the original treatment of the item. Also identify the relevant IFRS standard and treatment of the item.

Table 1
AFTER-TAX OPERATING INCOME RECONCILIATION

Item	**Amount**	**Explanation**
After-tax Operating Income (U.S. GAAP)	**$630,000**	
After-tax Operating Income (IFRS)		

Table 2 SHAREHOLDERS' EQUITY RECONCILIATION		
Item	**Amount**	**Explanation**
Shareholders' Equity (U.S. GAAP)	**$3,500,000**	
Shareholders' Equity (IFRS)		

NEGOTIATING THE LEVERAGED MANAGEMENT BUYOUT

Dennis Zocco, University of San Diego

CASE DESCRIPTION

The primary subject matter of this case concerns the cross-cultural negotiation of a management buyout (MBO) of a private American company, Energy Management Systems, that had previous financing from Danzig Ventures, a German venture capital firm. The MBO is being financed with equity funds from the management team and a Brazilian private equity firm and debt funds from a Japanese bank. Secondary issues are to understand 1) the elements of a multi-party, cross-cultural negotiation,2) the rationale and motivations of all parties in a management buyout, 3) the role of debt and equity in a management buyout, 4) the impact of debt and equity terms that affect the deal attractiveness, and 5) the complexities of constructing a multi-party agreement that has value for all parties. The case has a difficulty level of four, appropriate for senior level. The case is designed to be taught in three or four class hours, depending on the student proficiency in finance, and is expected to require three hours of outside preparation by students.

CASE SYNOPSIS

Energy Management Systems (EMS) is an enterprise software company in the U.S. that provides private and public organizations with a strategic and auditable approach to tracking, managing, and optimizing energy usage. Henry Larson, the company's founder and Chairman of the Board, owns 65% of the company. Danzig Ventures, a German venture capital firm, owns the remaining 35%. Danzig made their investment from their Danzig IV fund. Over the past few years, the strategic vision of Ann Blake, CEO of EMS, and her management team has diverged from that of Larson. As a result, Blake and her management team make a $200 million management buyout (MBO) offer to Larson. He rejects the offer, not wanting to sell his company. However, Danzig is in favor of the buyout, as it gives them the opportunity to sell their shares and realize a gain from their investment. Danzig had a "drag-along" provision included in their investment term sheet that allows them to force a buyout if an offer is made at $250 million or above. Blake and her management team increase their offer to $250 million. She begins the process of raising the required financing for the deal. Blake sets the stage for equity financing from Pilar Empreendimentos, a Brazilian private equity firm, and debt financing from Keosho Trust and Banking Co., a Japanese bank. In addition, the management team, led by Ann Blake, will provide some equity. Each of the four parties—the American CEO, the Brazilian private equity general partner, the Japanese banker, and the German venture capitalist—brings its own set of terms to the proposed transaction. After discussions with the equity providers, Blake believes she will fall short of the required $250 million needed to finance the transaction. Danzig Ventures agrees to participate with an investment from their Danzig Fund V in order to gain liquidity for their EMS shares from the Danzig Fund IV investment. Blake arranges a meeting to negotiate the leveraged MBO deal. The parties to the deal bring their set of objectives to the negotiation. Furthermore, the parties bring their own cultural style of negotiating. The four parties are about to begin discussions to craft the elements of a leveraged management buyout agreement that has value for both sides, with the added challenge of navigating the often tricky waters of a cross-cultural negotiation.

CASE DESCRIPTION

The primary subject matter of this case concerns the cross-cultural negotiation of a management buyout (MBO) of a private American company, Energy Management Systems, that had previous financing from Danzig Ventures, a German venture capital firm. The MBO is being financed with equity funds from the management team and a Brazilian private equity firm and debt funds from a Japanese bank. Secondary issues are to understand 1) the elements of a multi-party, cross-cultural negotiation,2) the rationale and motivations of all parties in a management buyout, 3) the role of debt and equity in a management buyout, 4) the impact of debt and equity terms that affect the deal attractiveness, and 5) the complexities of constructing a multi-party agreement that has value for all parties. The case has a difficulty level of four, appropriate for senior level. The case is designed to be taught in three or four class hours, depending on the student proficiency in finance, and is expected to require three hours of outside preparation by students.

CASE SYNOPSIS

Energy Management Systems (EMS) is an enterprise software company in the U.S. that provides private and public organizations with a strategic and auditable approach to tracking, managing, and optimizing energy usage. Henry Larson, the company's founder and Chairman of the Board, owns 65% of the company. Danzig Ventures, a German venture capital firm, owns the remaining 35%. Danzig made their investment from their Danzig IV fund. Over the past few years, the strategic vision of Ann Blake, CEO of EMS, and her management team has diverged from that of Larson. As a result, Blake and her management team make a $200 million management buyout (MBO) offer to Larson. He rejects the offer, not wanting to sell his company. However, Danzig is in favor of the buyout, as it gives them the opportunity to sell their shares and realize a gain from their investment. Danzig had a "drag-along" provision included in their investment term sheet that allows them to force a buyout if an offer is made at $250 million or above. Blake and her management team increase their offer to $250 million. She begins the process of raising the required financing for the deal. Blake sets the stage for equity financing from Pilar Empreendimentos, a Brazilian private equity firm, and debt financing from Keosho Trust and Banking Co., a Japanese bank. In addition, the management team, led by Ann Blake, will provide some equity. Each of the four parties—the American CEO, the Brazilian private equity general partner, the Japanese banker, and the German venture capitalist—brings its own set of terms to the proposed transaction. After discussions with the equity providers, Blake believes she will fall short of the required $250 million needed to finance the transaction. Danzig Ventures agrees to participate with an investment from their Danzig Fund V in order to gain liquidity for their EMS shares from the Danzig Fund IV investment. Blake arranges a meeting to negotiate the leveraged MBO deal. The parties to the deal bring their set of objectives to the negotiation. Furthermore, the parties bring their own cultural style of negotiating. The four parties are about to begin discussions to craft the elements of a leveraged management buyout agreement that has value for both sides, with the added challenge of navigating the often tricky waters of a cross-cultural negotiation.

INTRODUCTION

Energy Management Systems (EMS) is located in Boston and is the leading enterprise software company in the U.S. that provides private and public organizations with a strategic and auditable approach to tracking, managing, and optimizing energy usage. The company's software allows its clients to automate energy and sustainability data management and maximize clients' return on invested capital in energy and sustainability projects.

Henry Larson, a Boston native, founded EMS in 1998. Larson holds a B.S. and M.S. in electrical engineering from MIT and spent eight years in various positions with Duke Energy. He left Duke and founded EMS with the idea that the rising costs of energy would increase the demand from corporate and government organizations for a management system to control those expenses.

Larson spent the first year of EMS as its only employee. He began the programming of the company's first software product with some of the work subcontracted to MIT computer science graduate students. In the second year, he invested $500,000 of his savings in the company and hired five full-time programmers. He devoted himself to sales.

Six months into Larson's sales effort, he sold the first EMS energy management software system to a medium-sized city in western Massachusetts. That sale generated the first cash flow for the company. A second city bought the two months later. Then a chemical company in northern New York and a plastics company in Western Pennsylvania became EMS customers. After six months, all customers showed energy cost reductions from ten to twenty-five percent. The company was off and running.

Within two years, the company had grown to thirty employees, mostly in programming and sales, with a few managers. Larson needed a top-level management team in order to achieve his vision of a national company. He knew they would be expensive. He also realized that to achieve the growth he saw possible, he would need a cash infusion into the company.

In 2004, the growth of demand for the EMS energy management system increased dramatically due to an increase in energy costs. To meet that demand, Larson needed to increase both staff and production facilities. To do that, he needed $20 million, which meant that he needed financing from a venture capitalist. He contacted several firms on the West Coast who invested in the energy and software sectors and who might be willing to invest what EMS needed. He found no interest.

Larson was about to put his expansion plans on hold when he received a call from Rolf Loese, a General Partner of a German venture capital firm, Danzig Ventures. Danzig specialized in investing in clean technology companies. Loese had heard about EMS from a friend in one of the venture capital firms that Larson had contacted. He told Larson that, although his firm had not invested in software companies, he believed that a energy-related software company such as EMS might be a good diversification fit for their portfolio.

Due diligence meetings took place and resulted in an agreement for Danzig to invest $20 million at a pre-money valuation (the company valuation before the investment is made) of $37.14 million and a post-money valuation (the pre-money valuation plus the investment) of $57.14 million. Danzig would purchase Preferred A shares representing 35% ownership of EMS, while Larson would own 65% of the company in the form of his original common shares. The transaction took place in January, 2005.

Upon receiving the funding, Larson immediately hired a top-level management team—Chief Financial Officer, Chief Operating Officer, and Chief Technology Officer. Larson would continue as CEO and Chairman of the Board of the company and would also be the de facto head of the company's sales effort. Larson also increased his programming and sales staffs and embarked upon his planned expansion.

Within three years, EMS had doubled its revenues and earnings. Its client base included twelve major cities (including Boston, Hartford, Buffalo, Des Moines, New Orleans, Phoenix, and Sacramento) and fourteen Fortune 500 companies, all in the U.S. In 2006, health issues forced Larson to reduce his responsibilities with the company. He kept his position as Board Chairman and appointed his CFO, Ann Blake, as the CEO of the company. The Board of Directors consisted of Larson and Rolf Loese, with Larson having two votes as Chairman and Loese having one. The company continued to prosper until the recession began in 2007. That event, and its impact on the company, brought to the surface a divergence in the visions of Larson and his CEO.

Larson believed that the company should contract, operate conservatively for however long the recession was going to last. Blake, however, believed that the recession created an opportunity for EMS to leap ahead of its competitors. Hiring by software companies had declined dramatically and Blake felt the time was opportune to hire the top computer science graduates from such schools as MIT, Carnegie Mellon, and Cal Tech. Blake also wanted to expand internationally. With its track record of success in the U.S. in reducing clients' energy costs, she felt that the European and South American markets offered great potential.

Larson disagreed with both strategic initiatives. He put a freeze on hiring and restricted sales efforts to the U.S.

EMS grew over the next four years, but the U.S. recession persisted and dampened that growth. The management team became more frustrated each year as they believed there was significant value in EMS that remained untapped due to the conservative direction Larson imposed on the company.

THE MANAGEMENT BUYOUT INITIATIVE

As the end of 2011 approached, Blake called a meeting of her management team (MT) at her home. She presented an idea to them that she had been considering and wanted their opinion. She told them that she would like to initiate a management buyout (MBO) of the company at six times (6x) 2011 EBITDA of $33.333 million, or $200 million, The MBO would result in the purchase of EMS from Larson and Danzig Ventures using debt and new equity funding, as well as some funding from each member of the management team (Butler, 2001). The success of the MBO would depend on the willingness of Larson and Danzig to sell their share of the company and the ability of the management team to secure that financing (Billett, Jiang & Lie, 2010).

The management team was enthusiastically in favor of the MBO. Blake indicated that she would be willing to invest from $1 million to $2.5 million in the buyout, with preference for the smaller amount. The other three members of the management team said they would be willing to match her investment. Everyone agreed that each member would invest equally and that Blake, as CEO, would represent the management team in constructing the management buyout deal and negotiating the MBO terms with the key players. Whatever terms Blake negotiated, the other three members of the management team would accept.

Blake approached Larson with the buyout proposal. Larson was adamantly against selling his ownership in EMS. He had founded the company with a vision that he said was yet to be realized. He restated his plans to ride out the recession without expanding the company. He told Blake that he was considering contracting the company by reducing staff by ten to twenty percent and postponing key capital expenditures even though the company's cash balance was strong. Considering Larson's thinking, Blake believed even more that the company needed new ownership but felt she had no choice but to back away from the MBO since Larson owned 65% of the outstanding shares of the company and was not willing to sell.

Two weeks later, in a regularly scheduled end-of-quarter discussion with Rolf Loese, Blake brought up the unsuccessful proposal she had made to Larson. Loese indicated that he would support the MBO if the price was right. Danzig had been invested in EMS for seven years, had seen its investment increase at a very acceptable rate, and was looking for a way to liquidate its shares. The Danzig fund from which the investment had been made, Danzig IV, was maturing in less than a year and Danzig needs to realize the increased value of their ownership in order to pay their investors (limited partners). When Blake told Loese that Larson had vetoed the MBO, Loese said that there might be a way to override the veto. He showed Blake a paragraph that Loese had insisted be included in the term sheet and purchase document when he had invested in EMS. That paragraph described the drag-along rights of Danzig:

> *Drag-Along Rights: The holders of the Common Stock and Series A Preferred, being the only Preferred stock outstanding, shall enter into a drag-along agreement whereby if a majority of the holders of all Preferred agree to a sale or liquidation of the Company, the holders of the remaining Preferred and Common Stock shall consent to and raise no objections to such sale under the condition that (a) the cash proceeds from the sale or liquidation of the Company allocated to the holders of Preferred will be six times (6X) the total investment made by all holders of Preferred or (b) the total cash proceeds of the sale or liquidation of the company will be at least $250,000,000. If either condition (a) or (b) is not met in a proposed sale or liquidation of the Company, then the consent of the holders of at least two-thirds of all shareholders, with holders of Preferred voting on an as-converted basis, shall be required for approval of the sale or liquidation of the Company.*

Blake realized that if either of the two conditions of the Drag-Along provision were met, Danzig, as the sole holder of preferred stock, could override any veto by Larson, as majority stockholder, of a buyout offer (Hellman, 1998). Immediately, she saw that the team's buyout offer of $200 million did not meet condition (b). She did the calculations on condition (a).

The two paragraphs of the 2005 Danzig investment term sheet that determine the payout to Danzig on any acquisition, including a management buyout, are the Dividends and Liquidation Preference paragraphs.

Dividends: The holders of the Series A Preferred shall be entitled to receive cumulative dividends in preference to any dividend on the Common Stock at the rate of 10 percent of the Original Purchase Price annually with no compounding. The holders of Series A Preferred also shall be entitled to participate pro rata in any dividends paid on the Common Stock on an as-converted basis.

The Danzig investment had seven full years (2005-2011) of accumulated dividends. Each year the annual dividend has been ten percent of the $20 million investment, or $2.0 million. The accrued dividend total over the seven years is $14.0 million.

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

The Liquidation Preference paragraph provides Danzig with a double-tranche payout—preference and participating. The preference tranche ("…holders of the Series A Preferred shares will receive, in preference to holders of all Common shares, an amount equal to the original purchase price plus any accrued or declared but unpaid dividends) has Danzig receiving its initial investment ($20 million) plus accrued dividends of $14.0 million for a total of $34.0 million.

After the preference tranche payout is deducted from the acquisition amount of $200 million, leaving $166 million, Danzig is entitled to the participating tranche (…the remaining assets shall be distributed ratably to the holders of the Common Stock and the Series A Preferred on a common equivalent basis.) Since Danzig owns 35% of the company, they would receive a participating payout of $58.1 million (35% of $166 million).

The total payout to Danzig would be $92.1 million. Condition (a) of the Drag-Along Right provision sets the lower limit on the proceeds from the acquisition at six times Danzig's initial investment of $20 million, or $120 million. The Danzig proceeds from the proposed management buyout do not meet that condition.

Blake realized that the proposed buyout amount was not high enough to meet either Drag-Along condition and thus allow Danzig to override Larson's rejection of the buyout offer. The management team would have to raise its offer.

An offer of $250 million would meet Condition (b), but it would mean that they would have to raise an additional $50 million to fund the buyout. She performed the calculations to determine the purchase price that would yield Danzig $120 in proceeds. The result was $280 million. Based on her calculations, the lowest purchase price that would allow Danzig to force the deal would be $250 million. If Blake could successfully negotiate the terms of the financing of $250 million, the MBO would take place.

DEAL CREATION

Blake informed her management team that the MBO would require a $250 million purchase price, which represented a company valuation of 7.5 times 2011 EBITDA of $33.333 million, still reasonable considering the plans the team had for the future of the company. The team decided to give Blake the approval to structure the deal.

The management team already had decided that each would invest from $1.0 to $2.5 million, with each member investing an equal amount and each getting an equal ownership share of the new company in common stock. The minimum they would accept for the management team, in total, is an ownership stake of 10.0%, (2.5% for each member.)

That left between $240 million and $246 million in required funding. Ideally, the entire financing would be in the form of debt, allowing the management team to own all of the new company. But that was not feasible. The current financial condition of the company would not support a loan of that amount. Therefore, Blake would also have to raise private equity funds, in which case ownership would have to be given for the equity funding.

Blake first contacted the banks in the U.S. that she believed might be willing to lend from $150 to $200 million. But U.S. banks were still reeling from the financial crisis that started in 2007 and seemed to be lingering on even into 2011, when fears of a second recession surfaced. Blake was turned down by all the major U.S. banks. She knew that without the leverage of bank debt, the MBO was doomed (Korteweg, 2010). She called Loese in Germany and asked whether he knew of any non-U.S. banks that might be willing to lend from $150 to $200 million to finance the MBO. Loese told him that the European banks were preoccupied with the Greek bailout, but that a Japanese bank, Keosho Trust and Banking Co., might be worth contacting, as they had participated in a few European MBOs.

Keosho's headquarters are located in Tokyo, but the bank also has offices in New York and San Francisco. Blake contacted the office in San Francisco and began discussions with Hiroki Sawamura, the bank's Vice President of Corporate Lending. Sawamura was interested, but stated that the bank had specific lending conditions for loans of such a large amount. They would be willing to participate anywhere up to 40% of the transaction value. The loan amount could not be greater than three times EBITDA, and the minimum acceptable interest coverage, as measured by EBITDA/Annual Interest, must be at least four times. The maximum term of the loan is five years and must be amortized, with both interest and principal included in equal monthly payments. The lending rate would be the current Japanese prime lending rate (1.4%) plus a risk premium that would be determined after a closer look at the EMS's financial statements. Another condition was that the management team would have to invest an amount equal to at least 5% of the transaction value.

Blake did a quick calculation. With 2011 EBITDA of $33.333 million, the loan could go as high as $100 million. That met the bank condition of the loan not exceed 40% of the transaction amount. The interest coverage ratio would have to be calculated based on the annual interest on the loan, and that would depend on the loan amount, the lending rate, and the term of the loan. She would need an amortization schedule. Blake had used http://www.myamortizationchart.com/ before to create an amortization schedule for his home loan. She would use it again to determine the annual interest on the loan being negotiated.

The banks requirement of the management team's equity contribution being at least 5% of the transaction value would be a problem. On a $250 million buyout, that requirement put the management team's equity participation at $12.5 million, $2.5 million over the maximum the management team was willing to invest. She would probe during the negotiations to determine whether the bank would make any concessions on that requirement. Assuming the bank would allow the management team to invest $10 million in the transaction and the bank lending the maximum of $100 million, Blake would have to raise $140 million in additional equity funding to make the deal work.

Blake made the rounds of private equity firms who might be willing to invest $140 million in the MBO. She was offering them a super majority ownership in a growing company with bright prospects for a liquidity event in the near future. The company would have a significant amount of debt in its capital structure, but the debt would be manageable and paid off in five years.

Blake contacted the private equity firms on the West Coast, but none had interest at that time. Some were fully invested. Others were adopting a "wait-and-see" attitude on where the economy was headed. Others just didn't want to take such a big "gamble" on a software company, even if it was in the hot energy sector.

Blake headed to the East Coast and began making cold calls on private equity firms in Boston's Route 128 area. She had just made an unsuccessful pitch to a group of general partners of one of the more prestigious private equity firms in the Boston area when, on his way to the parking lot, she was stopped by a woman who identified himself as Adriana Tabor, a General Partner at one of the largest private equity firms in Brazil—Pilar Empreendimentos (PE).

Tabor had been a Harvard classmate of one of the general partners who had just listened to Blake's pitch. She had attended Blake's pitch at the invitation of her former classmate, liked what she heard, and wanted to know more about EMS and the potential MBO. She told Blake that if further due diligence was positive, she might be interested in being the investor that Blake was looking for to invest in the new company (Kaplan & Strömberg, 2009; Demiroglu & James, 2010).

Ann Blake couldn't believe her luck. She was about to give up her search, but might be saved by a serendipitous turn of events. Blake and Tabor had dinner together that night, and traveled together back to Palo Alto. Tabor spent three days with Blake learning more about EMS—its history, product line, financial performances, and strategic vision for its future. Tabor called in a team of accountants and attorneys from Brazil to spend another week with the company performing even more due diligence. The team returned to Brazil and a week later, Tabor informed Blake that PE was interested in participating in the financing of the MBO and negotiating an equity position in the new company with a maximum investment of $100 million (Ivashina & Kovner, 2011).

Blake was ecstatic. She had brought together sources of financing from around the world—a bank from Japan and a private equity firm from Brazil. She still had to negotiate the deal and, at this early stage, the numbers were not adding up. Complicating the negotiation was the fact that the providers of the funding were from different cultures—the banker from Japan and the private equity general partner from Brazil. That promised to add a level of complexity to the negotiation (Salacuse, 1998; Sebenius, 2002).

She decided to invite the principals to a three-day conference in Cabo San Lucas, Mexico, to negotiate the details of the financing. She believed that having everyone at the same table at the same time would lead to quicker and more value-based agreements than to have separate negotiations at various places around the globe. She realized that there likely would be private discussions/negotiations among the parties, but that would be normal for complex, cross-cultural negotiations of this type.

Out of courtesy, she also invited Rolf Loese of Danzig as he was responsible for introducing Blake to Hiroki Sawamura of Keosho. She also had an ulterior motive in inviting Loese. Blake was $40 million short on the financing needed to get to the $250 million purchase price. She might need to ask Loese to participate in the MBO with an investment necessary to get to the $250 million target. Loese would have an incentive to invest and make the deal happen. He had made the investment in EMS from the Danzig IV fund that was closing within the year. He needed to be able to sell his EMS shares to provide funds to pay his limited partners when Danzig IV closes. Blake knew that Danzig had started a new fund, Danzig V, from which they were making investments. Danzig might be willing to provide some financing from the Danzig V fund for the MBO in order to provide liquidity for his shares representing the Danzig IV investment.

Blake met with her management team to develop some preliminary structure for the MBO. They decided to set the share price for PE at $100 and use it as a reference point for the pricing of the shares bought by the equity providers.. Blake contacted each of the participants in the upcoming negotiation and asked them to provide the terms for their participation. She realized they would be optimistic, yet justifiable, and may allow some room, hopefully, for concessions to make the deal happen.

Within the week, Blake received the participants' terms and consolidated them into the following table (Table 1):

Table 1 **PARTICIPANT TERMS**	
Management Team (MT)	1) Maximum member investment: $2.5 million each, with all members investing equal amounts, giving team a $10 million investment
	2) Minimum team ownership: 10%, with each member having an equal share
	3) Price of management shares: minimum of 30% discount from PE purchase price
Pilar Empreendimentos (PE)	1) Minimum PE investment: $70 million; maximum PE investment: $80 million
	2) Minimum PE ownership: 75%
	3) Price of management shares: maximum of 20% discount from PE shares
	4) Management ownership range: 5.0% - 10.0%
	5) Secondary investor(s) buy in at higher price than PE with minimum premium of 25%
	6) PE having majority seats on Board of Directors; ideally, a three-seat Board with PE holding two seats and the EMS CEO holding the third.
Danzig Ventures	1) Maximum Danzig investment: $20 million
	2) Minimum Danzig ownership: 20%
	3) Price of management shares: maximum of 30% discount from Danzig shares
	4) Management ownership range: 8.0% - 10.0%
	5) Maximum Danzig price premium over lead investors shares: 20%
	6) Danzig has one minority seat on Board of Directors.
Keosho Bank and Trust	1) Loan is to be senior debt with assets of EMP as collateral; all subsequent debt from other lenders must be subordinate to Keosho debt.
	2) Term of debt: 5 years
	3) Loan must be amortized with monthly payments
	4) Loan can be no more than 40% of total transaction value
	5) Loan amount: 3.0 times EBITDA
	6) Loan interest coverage (EBIT/Interest Expense): 4.0x
	7) Lending rate is the Japanese prime lending rate (1.4%) plus risk premium

In response to the participants' requests, Blake sent them the financial statements (Exhibits A-C) that show the past performance of EMS and the management team's projections of the performance over the next four years (Fischer & Louis, 2008; Meuleman, Amess, Wright & Scholes, 2009).

Exhibit A
EMS INCOME STATEMENT AND PRO FORMA

	2008(a)	2009(a)	2010(a)	2011(a)	2012(p)	2013(p)	2014(p)	2015(p)	2016(p)
Net Sales	34,828	49,456	73,195	101,008	127,271	184,542	267,587	388,000	562,601
Cost of goods sales	1,741	2,473	3,660	5,050	6,364	9,227	13,379	19,400	28,130
Selling, general and administrative expenses	17,414	24,728	36,597	50,504	63,635	92,271	133,793	194,000	281,300
Research and development expenses	4,179	5,935	8,783	12,121	15,272	22,145	32,110	46,560	67,512
Depreciation	120	156	203	264	343	446	579	753	979
EBIT	11,373	16,164	23,951	33,069	41,657	60,453	87,724	127,287	184,679
Interest expense	0	0	0	0	0	0	0	0	0
EBITDA	11,493	16,320	24,154	33,333	41,999	60,899	88,304	128,040	185,658
Taxable income	11,373	16,164	23,951	33,069	41,657	60,453	87,724	127,287	184,679
Taxes	3,981	5,658	8,383	11,574	14,580	21,159	30,704	44,551	64,638
Net income	7,393	10,507	15,568	21,495	27,077	39,295	57,021	82,737	120,042

Exhibit B

EMS BALANCE SHEET AND PRO FORMA

	2008(a)	2009(a)	2010(a)	2011(a)	2012(p)	2013(p)	2014(p)	2015(p)	2016(p)
Assets									
Current assets									
Cash and marketable securities	23,910	32,054	44,078	61,271	83,744	114,741	160,116	226,467	323,401
Receivables	6,966	9,891	14,639	20,202	25,454	36,908	53,517	77,600	112,520
Inventories	0	0	0	0	0	0	0	0	0
Other current assets	0	0	0	0	0	0	0	0	0
Total current assets	30,875	41,945	58,717	81,473	109,198	151,650	213,633	304,067	435,922
Fixed assets									
Property, plant, and equipment	3,000	3,900	5,070	6,591	8,568	11,139	14,480	18,825	24,472
Total fixed assets	3,000	3,900	5,070	6,591	8,568	11,139	14,480	18,825	24,472
Total assets	33,875	45,845	63,787	88,064	117,767	162,789	228,114	322,892	460,393
Liabilities and shareholders' equity									
Current liabilities									
Accounts payable	3,483	4,946	7,319	10,101	12,727	18,454	26,759	38,800	56,260
Total current liabilities	3,483	4,946	7,319	10,101	12,727	18,454	26,759	38,800	56,260
Long-term debt	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Total liabilities	3,483	4,946	7,319	10,101	12,727	18,454	26,759	38,800	56,260
Other long-term liabilities	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Shareholders' equity									
Common stock and other paid-in capital	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000
Retained earnings	7,393	17,899	33,468	54,963	82,040	121,334	178,355	261,092	381,133
Total shareholders´equity	27,393	37,899	53,468	74,963	102,040	141,334	198,355	281,092	401,133
Total liabilities and shareholders' equity	30,875	42,845	60,787	85,064	114,767	159,789	225,114	319,892	457,393

Exhibit C
EMS STATEMENT OF CASH FLOWS AND PRO FORMA

	2008(a)	2009(a)	2010(a)	2011(a)	2012(p)	2013(p)	2014(p)	2015(p)	2016(p)
Cash provided by operations									
Net income	7,393	10,507	15,568	21,495	27,077	39,295	57,021	82,737	120,042
Adjustments to net income									
Depreciation	120	156	203	264	343	446	579	753	979
Changes in working capital									
Decrease (increase) in receivables	(6,966)	(2,926)	(4,748)	(5,563)	(5,252)	(11,454)	(16,609)	(24,083)	(34,920)
Increase (decrease) in accounts payable	3,483	1,463	2,374	2,781	2,626	5,727	8,304	12,041	17,460
Total adjustments	(3,363)	(1,307)	(2,171)	(2,518)	(2,283)	(5,282)	(7,725)	(11,288)	(16,481)
Cash provided by (used for) by operations	4,030	9,200	13,397	18,977	24,793	34,013	49,296	71,448	103,560
Cash flows from investments									
Gross investments in tangible fixed assets	(3,120)	(1,056)	(1,373)	(1,785)	(2,320)	(3,016)	(3,921)	(5,097)	(6,626)
Cash provided by (used for) investments	(3,120)	(1,056)	(1,373)	(1,785)	(2,320)	(3,016)	(3,921)	(5,097)	(6,626)
Net increase (decrease) in cash	910	8,144	12,025	17,193	22,473	30,997	45,375	66,351	96,934

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