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LETTER FROM THE EDITOR

Welcome to the *Journal of the International Academy for Case Studies, Special Instructors' Edition.* The International Academy for Case Studies is an affiliate of the Allied Academies, Inc., a non profit association of scholars whose purpose is to encourage and support the advancement and exchange of knowledge, understanding and teaching throughout the world. The purpose of the IACS is to encourage the development and use of cases and the case method of teaching throughout higher education. The *JIACS* is a principal vehicle for achieving the objectives of both organizations. The editorial mission of this journal is to publish cases in a wide variety of disciplines which are of educational, pedagogic, and practical value to educators.

The Instructors' Notes contained in this volume have been double blind refereed with their corresponding cases. Each case for which there is an Instructors' Note contained herein has been previously published in an issue of the *Journal of the International Academy for Case Studies*. Each case was required to have a complete teaching note before consideration. The acceptance rate for manuscripts in this issue, 25%, conforms to our editorial policies. This publication also conforms to the AACSB requirements to publish case notes which are considered by that body to be of more academic value than the case itself.

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

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

JoAnn Carland
Western Carolina University

PHYSICIAN'S DILEMMA: BALANCING SERVICE AND PROFIT

C. Angela Letourneau, Winthrop University
Scott R. Lyman, Winthrop University

CASE DESCRIPTION

The primary subject matter of this case is the application of multiple-product breakeven analysis to a physician's office practice. It allows for the discussion of the different types of medical reimbursements, such as Medicare, Blue Cross/Blue Shield, and Private Insurance. The decision faced by the physician is which patient mix should be seen in order for the practice to be both profitable and still allow him to serve his constituents. The case has a difficulty of level of three (appropriate for junior/senior level courses). The case can be taught in one or two class periods depending on the number of issues considered, and is expected to require two hours of outside preparation by students.

CASE SYNOPSIS

Health care is currently operating in a very turbulent regulatory environment. Changes in physician reimbursement require the physician to pay more attention to the financial side of the practice. Government's nearly continuous change in compensation to physicians produces a varying set of profitable and unprofitable services. This case uses a multiple-product breakeven analysis to examine the difficult situation that a physician finds himself in as he works harder, gets paid less, and faces bankruptcy. He turns to his office manager, our student, seeking help. The case puts students in a position to analyze the financial data, using various accounting techniques including multiple-breakeven analyses to help our physician, Dr. Good Hearted, reach some conclusions about what he should do. By examining the fixed and variable costs of service in a physician's office, students can make different assumptions about the revenues to determine how they influence the physician's revenue and client mix. Developing a solution requires the student to calculate multiple breakeven analyses from various reimbursement sources. The students are then required to recommend to Dr. Good Hearted what course of action he should follow. This case represents a very realistic picture of what physicians are now encountering in delivering health care in a new environment.

INSTRUCTORS' NOTES

Discussion Questions and Answers

1. How do physicians get paid?

Multiple sources - Physicians get reimbursed as a fee for services rendered to patients. Three providers are: 1) Medicare - Government assisted program for individual over 65; 2) BlueCross/BlueShield - indemnity insurance program purchased by companies for their employees; and 3) Private Insurance - private insurance program purchased by companies and/or employees.

Most physicians' offices have contracts with many insurance providers. It is not unusual for a practice to have 50 separate accounts with different insurance carriers. Each of these contracts is negotiated separately, must be maintained and billed according to the contract. This represents a real burden to a physician in terms of staff and costs.

2. Calculate Net Income (ignore taxes) for the year under the following circumstances:

a. Assume only Medicare patients are seen
b. Assume only BCBS patients are seen
c. Assume only private pay patients are seen.

a. Medicare Contribution Margin (CM) per hour = $148.64-$8 = $140.64
($86,720) = TCM $ 281,280 (2,000 hours X $140.64 CM per hour)
TC (368,000) *
($ 86,720)

b. BCBS Contribution Margin (CM) per hour = $191.68-$8 = $183.68
($640) = TCM $367,360 (2,000 hours X $183.68 CM per hour)
TC (368,000)
($ 640)

c. Private Pay Contribution Margin (CM) per hour = $206.40-$8 = $198.40
$28,800 = TCM $ 396,800 (2,000 hours X $198.40 CM per hour)
TC (368,000)
$ 28,800
* TC = Total Variable Costs + Total Fixed Costs
$368,000 = (2000 hours X $8) + $352,000

As can be seen by servicing Medicare patients only, the practice would be in severe financial difficulties. On the opposite end, servicing Private Pay patients would put the practice in a profitable situation. However, this poses a certain ethical dilemma as will be seen in later questions. It is worth noting that even seeing only BCBS patients would still result in a loss to the practice; it is, of course, a much smaller loss than caused by servicing Medicare patients only, but a loss never the less.

3. Total profit maximization would occur with no Medicare patients and only private insurance. Two problems present themselves in this situation: 1) Doctor's ethical responsibility is to provide care to those in need--can he in good conscience exclude Medicare patients? 2) What happens if the physician has unused capacity i.e. more time to see more patients?

Physicians have certain defined ethical responsibilities. Their training and oath of service requires them to help those in need. This does not mean that they can only treat those in need or those who can pay. Physicians do not want to be in a position to deny care to patients who cannot pay. Therefore, most physician practices do not want to be in a position to exclude patients because they have a certain form of reimbursement. Excluding certain reimbursements looks bad for the physician in the community and may not enhance their prestige in other patient groups. Physicians, after all, must maintain creditability with patients in order to assure a steady clientele seeking services.

The situation of unused capacity raises an interesting question for the physician practice. In the situation where the physician could see more patients what should he do? Obviously, advertising and marketing strategies would be in order. However, if the physician's costs are truly fixed then taking any reimbursement would be better than no reimbursement. Thus, a physician, especially one just starting into practice, might actively recruit Medicare patients. The problem is that even if the physician fills up all his unused capacity with Medicare patients, he will still not be in a break-even position. Thus, to successfully employ a strategy for unused capacity the physician must increase Medicare patients but also attract BCBS patients and private insurance patients, at the same time. The key to success for a physician's practice is to balance different reimbursement to achieve an overall break-even point in the practice.

4. What are the consequences when you have multiple sources of revenue at different rates?

Different patient mixes provide different levels of revenue. Contribution margin ratio is critical; therefore, patient mix is critical. Understanding what and how contribution margin operates become critical when you have multiple sources of revenue at different rates. Being able to see how different revenue sources affect the practice helps the physician understand better his financial situation.

5. Determine the Net Income (ignore income taxes) if Dr. Good Hearted's patient mix is as follows: Medicare 50%; BCBS 35%; and Private Pay 15%.

Revenue:			
*	Medicare Patients	$148,640	
**	BCBS Patients	134,176	
***	Private Pay Patients	61,920	
Total Revenue			$344,736
Less:			
	Variable Costs	16,000	
	Fixed Costs	352,000	
Total Costs			368,000
Net Loss			($ 23,264)

*	Medicare Patients	(1,000 hours X $148.64)	=	$148,640
**	BCBS Patients	(700 hours X 191.68)	=	134,176
***	Private Pay Patients	(300) hours X 206.40)	=	61,920

6. Determine the number of hours Dr. Good Hearted must work to break-even if the patient mix is as follows: Medicare 50%; BCBS 35%; and Private Pay 15%.

$$\text{Break Even Hours} = \frac{\text{Total Fixed Cost}}{\text{Weighted Average Contribution Margin}}$$

$$\text{Break Even Hours} = \frac{\$352{,}000}{\$164.37} = 2{,}141.51 \text{ hours}$$

Weighted Average Contribution Margin:

Medicare patients	(.50 X 140.64) =	$70.32
BCBA patients	(.35 X 183.68) =	64.29
Private Pay patients	(.15 X 198.40) =	29.76
Total		$164.37

7. Recommend a product mix that maximizes profits while allowing Dr. Good Hearted to serve a balance patient mix.

Medicare 30%; BCBS 35%; and Private Pay 35%.

Revenue:		
Medicare Patients	$ 89,184	
BCBS Patients	134,176	
Private Pay Patients	144,480	
Total Revenue		$367,840
Less:		
Variable Costs	16,000	
Fixed Costs	352,000	
Total Costs		368,000
Net Loss		($ 160)

Medicare Patients	(600 hours X 148.64)	=	89,184
BCBS Patients	(700 hours X 191.68)	=	134,176
Private Pay Patients	(700 hours X 206.40)	=	144,480

As can be seen from the answer to question 2, the highest level of profit would be for the physician to see only patients with private insurance. The physician would receive the greatest reimbursement in that situation. However, for most physicians this creates ethical dilemmas for them. Physicians take an oath that asks they serve those in need and does not mention only those with private insurance. Many physicians do not want to be in a position to deny service to somebody based only on their ability to pay. With the case of Medicare the physician is not allowed to ask the patient for additional money once the physician has accepted assignment from Medicare. Thus, physicians want a mix of patients so they are serving all those people in the community.

Most physicians do not want to be in a position of accepting only one source of reimbursement. However, it is also clear from this case that only Medicare reimbursement would result in the practice not breaking even. If the practice does not break-even then it would eventually go out of business and then it would not provide service for any patients. The optimal product mix in this case would be 30% Medicare, 35% BCBS, and 35% private insurance. This would give the physician and the practice a break-even point and yet would serve all sectors of the community. In order to maintain this break even point the practice would have to pay close attention to the mix and would have to try and maintain that mix in order to break even. This might result in the physician stopping taking new Medicare patients if the shift of patients is too great towards Medicare. Again this would happen in order to maintain the practices break-even point. In order for physicians' practices to survive they must walk the delicate balance between breaking even and going under. This is the fine line that physicians struggle with in health care today in the United States.

8. What else can the physician do other than change product mix?

In reality there are only two options open to the physician. The physician can see more patients or cut costs. Since the variable cost per patient is already low, he should look at all of his fixed costs to see where they can be reduced. As mentioned in the case, Dr. Good Hearted has already taken less salary from his practice, in order to help it survive.

CUSTOM MADE SADDLE COMPANY

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CASE DESCRIPTION

The primary subject matter of this case concerns the marketing mix of a business. Secondary issues include small business management and budgeting. The case has a difficulty appropriate for junior or senior level. The case is designed to be taught in one or two class hours and is expected to require two to three hours of student preparation time.

CASE SYNOPSIS

Ben and Linda Black started Custom Made Saddle Company after a 3,000-mile trip on horseback in 1982 during which their horses began showing saddle sores. As he rode, Ben Black started thinking of ways to improve the saddle to prevent injury to the horse. When he returned home, he patented a design that allowed the horse to move freely in their natural motion. This eliminated bruises and sores on the horse and increased the ability of the horse to perform. Further, it was more comfortable for horse riders.

The couple started a business based on the new saddle design and soon sold saddles to many types of riders. Custom Made Saddles had an excellent reputation, and the company soon itself as the preferred maker of saddles for endurance racing. Ben and Linda made the strategic decision to apply for patents and trademarks and to use sales revenues to advertise, to create new products, and to develop new processes. For the Blacks, creating the best saddle in the world was an obsession.

INSTRUCTORS' NOTES

OBJECTIVES

There are multiple objectives for this case including:

1.	To expose students to real marketing issues in small manufacturing firms.
2.	To give the student experience in defining and refining the marketing mix.
3.	To provide an opportunity for the students to perform SWOT analysis leading to recommendations.

GENERAL TEACHING APPROACHES

There are two suggested ways to teach the Custom Made Saddle case. First, the instructor may use the case to teach the development of a marketing plan through targeting and positioning exercises. It provides a real world example of the tradeoffs or synergies between direct selling and the use of intermediaries, and gives students the opportunity to explore what part channels of distribution may play in Custom Made Saddle's marketing mix. In promotions-mix decisions, students should consider where, what, when, how often, and how much promotion is appropriate for a given product-market. Students should place their analysis and recommendations in the context of potentially entering global markets and the situation entrepreneurs often find themselves (i.e., constantly cash limited and unable to implement an optimum marketing plan).

Second, the instructor may use the case as an omnibus case to teach marketing strategy. In this approach, students would start with the segmentation and targeting of prospects/customers. Then they would craft a marketing mix for the chosen segment, considering the goals of the company, the competitive advantages of the company, and the current and future competition. Students should investigate and analyze: the best product configuration for the chosen segment, price tradeoffs, the appropriate promotional mixes, and channel configurations. In this approach the instructor may assign the case to students individually or as a team. Student teams may present their analysis and conclusions to the class as a way to stimulate class discussion while practicing business communication skills. Also, the case can be an end of semester project or a final exam case.

CASE DISCUSSION APPROACHES

One way to start class discussion is to do a "postmortem" analysis by asking how Custom Made Saddle got into its present position. The instructor can treat the case as a sort of detective story. When using this approach, the students should be able to see how the history of the firm influences decisions. Customers and intermediaries have memories and perceptions of the firm with which might be difficult to manage in the future.

Another way to begin the case discussion would be to ask the students to list the advantages that Custom Made Saddle offers or has the potential to offer and should develop. The teacher may use a series of open-ended questions to begin case review such as: What is this case about? What has been happening? What kinds of problems has the company been facing? One might start by addressing the idea that the company focused on "marketing" with the $50,000 in brochures. Often a knee-jerk reaction to lack of sales is to print brochures without thinking through the reasons why. Students should be able to understand and discuss the idea that a marketer should look at a complete marketing mix, and not just one isolated facet.

QUESTIONS

1. How would you characterize the distribution channel configuration and channel issues for Custom Made Saddle? What would be the optimum channel configuration?

The method of distribution was extremely important to the company. Direct selling was unique within the industry and allowed the company to build a personal relationship with its customers. This was part of the mystique of the firm. Customers felt a connection with the owners and felt like they were part of an exclusive group of riders, the "Custom Made Saddle Owners." All the other high volume saddle companies used dealers and all the other custom saddle makers had single retail shops. Buying a Custom Made Saddle meant a person could buy a high quality, custom saddle without traveling thousands of miles to get it.

Students should consider what value intermediaries add to the firm and to the customer. Also they should think about the fact that there may be markets that an intermediary has access to but Custom Made Saddle may not. In addressing the optimum channel configuration, students should include whether or not good intermediaries are available and whether or not the company needs retail outlets or showrooms for the targeted customers to visit. It must be remembered that Ben decided to use dealers after the money for brochures ran out. That is not necessarily an indication of a sound business decision.

2. From the company's perspective, what are the pros and cons of using dealers for distribution?

Pros

* Dealers are windows to prospects and customers to which the manufacturer may not have access.
* Dealers may advertise at the local level, attend local events, and possibly even stage local events. These are all valuable activities that Custom Made Saddle would have difficulty conducting.
* Dealers can buy and stock any non-custom tack and supplies that Custom Made Saddle sells, reducing the inventory costs that the company would otherwise incur.
* Dealers are set up to handle a wide variety of financial transactions (checks, credit card, cash, etc.).

Cons

* Dealers build personal relationships with their customers. However, when individuals buy from dealers, the relationship is with the dealer and not the manufacturer. This may affect customer loyalty to Custom Saddle. Customers buying through dealers will not feel as connected to the manufacturer.
* Dealers may add cost. Custom Made Saddle had to discount saddles and train dealers in product features and benefits, and in the company's capabilities. Product features changed often in the firm. In addition, dealers also require demonstration saddles. Most people buying saddles from dealers expected to see a floor sample, and because the company sold Western saddles and English saddles, at least two models were needed for each dealer. With

120 tack dealers in the network by 1998, this meant about 240 saddles. When the saddle design changed, the demo models had to change as well.

3. How would you characterize the products currently offered by Custom Made Saddle? What other opportunities are available and which would you recommend?

The company offered three major categories of products: 1. Custom Western saddles, 2. Custom English saddles, and 3. "Conversion" saddles. The complete saddles were one of a kind, with each personalized to the rider. This made the product exclusive; riding a Custom Made Saddle was a statement about the owner, a personal identity. The fact that the saddle was more humane to the horse showed everyone that the owner was more enlightened and caring than the average equestrian.

Until 1998, the company had prided itself in being the largest custom saddle maker in the world. However, management found that making custom saddles in high volumes caused some problems. The first problem was in the production of the saddles. Mass production methods were typically applied to large volumes but not to custom saddles. Because each saddle was different, production systems were not efficient, and the resultant production costs were high.

The second problem with making custom saddles in relatively high volumes was working with dealers. Dealers knew that custom saddle makers would produce to the customers' specifications, so when the dealers took an order, they often requested features the company was ill-prepared to offer. Custom Made Saddle was forced either to change production processes to satisfy the customer, or to tell the dealer that they could not fill the order. If the company changed the process, it could increase costs; if it declined to make the product, it could lose a customer and possibly a dealer.

The solution, according to Ben Black, was to create a standardized product line. This seemed reasonable from a cost perspective, but customers had a different expectation. The company had promoted itself as a custom saddle maker. Its advertising suggested Custom Made Saddle made unique saddles for each rider/horse combination. Now, the company was saying that a few standard models would fit any horse. This could be sending a mixed message to the customer.

4. How would you characterize pricing of Custom Made Saddle products? What is the optimum pricing configuration?

Custom Made saddles commanded a premium price and customers did not object. In fact, the price added to the prestige of the product. The firm was selling the saddles to dealers at a price discounted from the $2,000. Ben could lower the price. This would increase sales in the short term, because a significant group of people would likely be willing to buy the "Cadillac of saddles" for less money. Also, a lower price would be consistent with a standardized product. But why would a person pay $2,000 for a standardized product when the standardized saddle sitting beside it in the dealer's showroom looked the same and cost considerably less? The problem was that customers had a certain expectation of quality, exclusivity, and prestige. A lower price would put more pressure on profits, which had been elusive in recent years. Considering the totality of price, students should consider pricing factors such as terms (e.g. FOB, 30-day payment, credit card acceptance), trade-in value, value-in-use, and the cost of "wear-and-tear" on both horse and rider (from competitors' saddles).

5. How would you characterize the promotional activities of Custom Made Saddle? What promotional plan would you recommend?

Custom Made Saddle had targeted a specific type of buyer, who responded well to catalogs. Sending eye-popping catalogs to individuals made the product stand out. People could tell at a glance that the product was different. Just the fact that Custom Made Saddle was contacting them personally was a differentiation factor. While the catalogues seemed to work, they were discontinued when the money ran out. Students may have questions such as: How does the company communicate with this targeted customer? Does the firm know where to "find" them? Can the firm find their actual mailing address, telephone number, and e-mail address? Which TV programs do they watch, magazines do they read, trade shows do they attend? What message does the company need to convey? Does static pictures or video work best with the message/market? Do these people read?

From a sales perspective, this is a product/market that might benefit from the personal touch of a salesperson, or the product might effectively be sold in the required numbers over the phone/internet/through the mail. The firm intermittently offered sales promotions such as the Preferred Buyers Club discount, and expensive ads were placed in high profile magazines such as Western Horseman, and Horse Illustrated. The ads were not successful in bringing in the new business that was needed.

Other high volume manufacturers had a different promotional strategy. They placed ads in magazines to reach the mass market. The ads directed individuals to purchase their products from the customers' local dealers. Magazine ads were effective for the competition because these high volume companies were selling common saddles at popular prices. Name recognition was an important factor. An endorsement by Dee Pickett, 8-time world champion roper seemed to be effective in attracting the "roper" niche.

6. What does your SWOT analysis on Custom Made Saddle show?

Students are likely to discuss strengths at length, including the custom design, benefits to rider and horse, customer base, high profile users, and brand equity. Weaknesses will be less forthcoming, but students may include the lack of profitability, the lack of a management team, the constant change and lack of focus, and the high costs of custom manufacturing. Opportunities listed may include international markets, other products to manufacture, other products to sell (accessories and supplies purchased and resold), businesses, and the retrofitting market that seems to be going well. Threats listed may vary widely. New, high-tech designs with "space-age" materials may surface, horse ownership may diminish in popularity, and finally, increased costs may increase the "burn-rate" and force the firm to go back for money before they can implement a plan to increase profitability.

7. What is the central problem at Custom Made Saddle?

Students will tend to see symptoms and ascribe problem status to them. The primary focus of this question is to get students to look for root causes. Students should identify problems such as limited management resources, limited capital, and the decreased probability of raising more capital before the firm becomes profitable. As the class discussion of the facts develop, students should see the lack of a coherent marketing plan as a major issue for the company. If the students assume that there is a plan in place, they should be able to see the implementation of the plan as the central issue.

8. Was the original targeted segment a logical choice? Given the firm's present circumstances, which segment(s) would you recommend pursuing?

Students may disagree on this issue. Some might feel that there are too few prospects with the money to buy $2,000 saddles, that this niche is too small. Others may feel that "owning" a niche is better than having a small share of a large market. It would appear that this niche was a good place to start: upscale, high profile, accessible, and one that finds value in the product and the relationship with the firm.

9. What competitive advantage(s) does Custom Made Saddle presently offer, does Custom Made Saddle have the potential to offer, and should they develop?

Presently offer

Comments concerning present advantages should include the innovative saddle design, the satisfied customer base and the high profile nature of that customer base, control over the entire process including saddle tree manufacture, and a network of more than 100 dealers that seems to be working.

Potential to offer, should they offer

Students will vary on these issues. Some will point to designs and custom features as primary advantages. Others may suggest that the company should go with completely standard products, and sell them at lower prices. They may point to Custom Made Saddle's customer base, pointing out that "Pleasure Riders," at 71% of their total business offer the biggest prospect base. Some students may see a market in the new and innovative saddle trees, recognizing that a direct selling approach could work in a business-to-business context.

10. How would you describe how Custom Made Saddle could affect growth through Market Penetration, Product Development, Market Development, and Diversification? What examples would you offer of what the company might do to grow in each of the four areas? What are examples of risk/reward tradeoffs for each?

Market Penetration growth involves selling more of the existing products to more of the existing target market. Comments from students may include "work harder," "sell smarter," and other generalizations. The problem with "penetration" is that if the firm has been doing its job, as market share increases, future sales in the same market may be more difficult to attain as well as more costly. Possibilities include: selling multiples to one customer at a discount, adding sales people to work with dealers, increasing dealer motivation through contests, competition, training, and increasing factory participation in events, especially the high profile, national-level ones. "Penetration" is the least risk in the short-term, but may not provide adequate returns.

Product Development growth is achieved by selling new products to the existing customer base. Students may suggest associated products that share either methods or materials (boots, belts, jackets, etc.), or other horse-related products such as trailers, blankets, or grooming gear. The key to this question is to elicit comments concerning products that offer value to the existing market. Answers should include less-visible options such as a warranty, after sales service, training, and seminars. While there is more risk (more investment, more unknowns), there is the possibility of more return with this growth option than with the "penetration" option. Students should demonstrate their understanding of this risk/reward relationship in their comments.

Growth through Market Development is accomplished by taking existing products to new market segments. This answer hinges on segmentation by use, value, and one more segmentation base such as geography. For example, there are a number of countries in which equestrian hobbies are significant and "high-dollar." Students may get confused at the blurred line between new products and the modifications necessary to complete a marketing mix for a market. It would be helpful at this time to introduce a simple framework for categorization. Reviewing material on products would aid in the students' recognition of the tradeoffs.

Diversification by entering a new market with a new product is also an option. It is likely that few students will offer substantial comments on this option. Far too little is known about Custom Made Saddle's strengths and weaknesses outside of those demonstrated in existing products and existing markets. We have little input to be able to generate a meaningful combination. It is possible that some students will offer creative alternatives that may or may not have promise. It will be difficult for them to support their choices. This is an opportunity to develop the characteristics of potential product-markets. The key to this option is the understanding that it is high risk, and it is probably not short-term.

11. Which growth strategy seems the most feasible or appropriate, and why?

The comments on this question depend on the previous answers. They need to be defended, and they must take risk/reward into account. It is important that the students articulate their measures of "feasibility," and "appropriateness."

Given the firm's present targeted market segment, and their present product, what promotional mix would you recommend? Students will have their own theories concerning the media and message appropriate to the present customer base. A review of the market segments will uncover a wide diversity of individuals. Age, sex, geography, and social economic status all may play a part in the firm's promotional program. Students should mention that the catalogue program was successful and possibly discuss the value catalogues offer. Some students will mention the internet and offer suggestions for using the Web as a promotional media (as well as one factor in the channel of distribution).

Discussion revolving around the differences among the three major markets should ensue. People who prefer the standard saddle are probably different in some meaningful way from those that prefer English saddles, and both probably differ from the person that gets an older, standard saddle retrofitted. High profile equestrian magazines were mentioned in the case, and should be offered in response to this question. The sales promotion (500 Preferred Buyers Club program) was withdrawn because "sales continued to be strong." Some students may cite the decreased sales in the year following its removal and contend that the reason for previous strong sales may have been this program.

To an extent, Custom Made had to decide what kind of company it was going to be. Was it going to have a niche market and differentiate the product or was it going to mass produce a standardized product? Because the company had a long history and an established reputation, the Blacks were most likely to succeed as a niche player. The company needed to stick to what it knew best—producing the highest quality saddles on the market. Then the company needed some stability. Every time the organization established a way of doing things, management changed methods again. The disruptions were expensive and caused confusion in the factory and in the marketplace.

BENCHMARKING THE ACCOUNTING AND FINANCE FUNCTIONS OF HONG KONG LISTED FIRMS: PERSONNEL AND COST OF OPERATION

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CASE DESCRIPTION

The primary subject matter of this case concerns benchmarking. Secondary issues examined include data summary and analysis. The case has a difficulty level appropriate for the undergraduate level. The case is designed to be taught in 1.5 class hours and is expected to require one hour of outside preparation by students.

CASE SYNOPSIS

In this case, students are provided raw data related to a survey of 633 listed Hong Kong firms. The survey was sponsored by the Hong Kong Society for Accountants, Financial Management Committee. The survey consisted of 32 questions that addressed seven areas of interest related to the accounting and finance functions within the firms. Sixty-seven firms responded to the survey crossing six different industries and a variety of capitalization levels. Using the data, students are required to develop benchmarks for other firms. The benchmarks can be used by firms to compare their operations to those of other similar firms. Students are also required to comment on the resulting benchmark figures.

INSTRUCTORS' NOTES

CASE QUESTIONS AND SOLUTIONS

Question A & B: Table Preparation And Interpretation.

Table 2: Ratio of Finance Staff to Total Staff					
Industry	Responses	Average	Median	Max	Min
CE Total	18	4.0%	10.0%	47.4%	1.7%
F Total	8	2.9%	3.3%	15.0%	2.3%
I Total	23	1.1%	4.4%	33.3%	0.2%
P Total	9	3.0%	6.0%	10.7%	0.3%
U Total	2	2.9%	2.6%	3.3%	1.9%
M Total	1	3.8%	3.8%	3.8%	3.8%
Overall	61	2.0%	6.0%	47.4%	0.2%

The overall average ratio of accounting/finance staff to total staff was 2% (1:50) while the overall median was 6% (1:16.6). Translated, this figure indicated that among the firms surveyed, there was one accounting/finance staff for each 50 total staff in the firm. The large difference between the median and the average indicates potential outlier data. Among the six industries, the median was the highest (10%) in the Consolidated Enterprises industry (1:10) while the median was the lowest (2.6%) in the Utility industry (1:38.4).

Table 3: Ratio of Qualified Finance Staff to Total Finance Staff					
Industry	Responses	Average	Median	Max	Min
CE Total	18	25%	31.0%	57%	0%
F Total	9	21%	22.3%	100%	10%
I Total	23	17%	17.5%	50%	3%
P Total	9	16%	23.1%	50%	7%
U Total	2	39%	36.4%	40%	33%
M Total	0	.	.	.	.
Overall	61	22%	23.1%	100%	0%

The overall average ratio was 22% and the overall median was 23.1% (1:4-5). The highest average of 39% (1:2.5) was for the utility industry while the lowest average was 16% (1:6.2) in the Property industry. The ratio varied widely among firms.

Table 4: Average Per Person per Year (Accounting & Finance Staff) Remuneration					
Industry	Responses	Average	Median	Max	Min
CE Total	19	315,234	281,746	857,143	22,222
F Total	8	309,854	350,120	500,000	166,667
I Total	21	230,601	250,000	500,000	100,000
P Total	9	265,517	341,667	569,231	45,455
U Total	2	748,603	731,295	762,590	700,000
M Total	1	16,667	16,667	16,667	16,667
Overall	60	333,876	281,746	857,143	16,667

The overall average remuneration was HK$333,876. The highest average remuneration was in the Utility industry at HK$748,603, more than double the average earned in any other industry. The lowest pay was in the miscellaneous industry at HK$16,667. The maximum remuneration in any firm was HK$857,143 and the lowest was HK$16,667.

Table 5: Ratio Finance Staff Remuneration to Total Staff Remuneration					
Industry	Responses	Average	Median	Max	Min
CE Total	19	5.2%	11.1%	63.6%	0.3%
F Total	8	3.4%	3.5%	8.7%	2.1%
I Total	21	3.6%	10.8%	37.0%	1.2%
P Total	9	7.8%	20.0%	36.7%	2.3%
U Total	2	4.7%	4.4%	5.2%	3.5%
M Total	1	8.3%	8.3%	8.3%	8.3%
Overall	60	4.2%	10.8%	63.6%	0.3%

Overall, total accounting and finance staff remuneration was 4.2% of total firm remuneration paid. The highest median was 8.3% in the miscellaneous industry and the lowest was 3.4% in the Finance industry.

Table 6: External Cost per Accounting & Finance Person					
Industry	Responses	Average	Median	Max	Min
CE Total	7	3,810	3,333	33,333	417
F Total	5	1,407	4,762	20,000	4
I Total	9	6,612	2,000	25,000	238
P Total	6	18,000	27,564	38,462	833
U Total	2	7,821	13,939	25,000	2,878
M Total	1	4,667	4,667	4,667	4,667
Overall	30	7,053	4,714	38,462	186

The overall average external training cost per accounting and finance employee was HK$7,053. The highest average external cost per accounting and finance employee was HK$18,000 in the Property industry while the lowest was HK$1,407 in the financial industry.

Question C: What benefits might one obtain from such benchmarking data as provided in this case?

The objective of the benchmarking case is to establish baselines for the finance and accounting functions of listed companies in Hong Kong. These baselines provide firms reference points for evaluating their operations when performing their own comparative studies. For example, you can compare your company's external cost per accounting & finance person with the benchmark figure you got in the same industry. If your figure is too low, it may indicate that you need to provide more training to your accounting team; if your number is too high, it may indicate that you need to examine whether your input is efficient enough. But when doing such comparison, you need to keep the limitations of the survey itself in mind. Is the survey biased? Do companies responding to the survey perform well? And so on.

Question D: For each indicator we calculate in Question A, we calculate both the median and the mean. Which one do you think best represent the reality and can be used as the benchmark figure?

From the perspective of statistics, the mean is the sample arithmetic average; the median is the arithmetic mean of the two middle values of the sample. The mean is more sensitive to the influence of the outliers. From the raw data, we find figures vary a lot within industry. So it may be better to use the median as the benchmarkin

MAXINE CLARK: FROM SHOES TO BEARS

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CASE DESCRIPTION

The primary subject matter of this case concerns marketing and strategic marketing or strategic management. Secondary issues examined include the social psychology of marketing. The case is appropriate for senior level strategy, marketing, or organizational theory courses, or MBA marketing, organizational theory or strategic management courses. The case is designed to be taught in a 50-75 minute class and is expected to require one-half hour of outside preparation by students.

CASE SYNOPSIS

This case pertains to the creative-marketing enterprise Build-a-Bear Workshops founded by Maxine Clark. This case chronicles the growth, profiles Ms. Clark, elaborates on the concept, and describes the store and the customer's experience in the store. Students analyzing this case will learn of the marketing and ongoing innovation strategies of this company and challenge themselves to think about the implications of what has transpired thus far and what the future might hold for Build-a-Bear Workshops.

Maxine Clark got the idea for the business when she went on a field trip to a toy factory with a friend and her children. She saw how excited they were in learning more about the toys and decided to open her own store where children could actually make their own toys-stuffed teddy bears. The first Build-A-Bear Workshop opened in October of 1997 in the St. Louis Galleria. The store was a huge success, and its sales by the end of 1997 had reached almost $400,000. It was obvious that Ms Clark had developed a winning formula, and she decided to open more stores.

Clark was President of Payless Shoes when the idea for Build-a-Bear Workshops came to her. During her three years as President, Payless Shoe source' market share grew from 16% to over 20% of all shoes sold in America, and she helped expand Payless Kids from 20 stores to over 750 stores and become the largest seller of children's shoes in the world.

The Build-a-Bear company was founded as an interactive entertainment retail experience based on the enduring love and friendship that connects us all to stuffed animals, especially teddy bears. The company reminds us that, "children use teddy bears to keep them warm at night and comfort them while protecting them from the monsters under the bed.

INSTRUCTORS' NOTES

OVERVIEW

Build-A-Bear Workshop is a fascinating new retailer who makes shopping with your children fun. The interaction between the customer and the store personnel make this shopping experience like no other. A new word retailtainment has been coined to describe this phenomenon of making the retail shopping experience a form of entertainment. Consequently, Build-A-Bear Workshop has grown from one store with $400,000 in sales in 1997 to 109 stores and $170 million dollars in sales in 2002, and they plan to open 44 new stores in 2003.

This case is very well suited to a Strategic Management (Policy) course because it illustrates how a unique strategy that would be difficult to replicate can give a business a tremendous competitive edge even in an industry that may not be growing. The case may also be used in a Marketing Management/Strategic Marketing class because the case shows how a retailer can distinguish itself from other retailers and use the shopping experience as a way to create value. The case may also be used in a Retailing class to show how a small specialty shop can effectively compete in the world of giant retailers and discounters.

DISCUSSION QUESTIONS

1. Why do you think Build-A-Bear Workshop has been so successful in the world of retailing?

There are several things that have contributed to Build-A-Bear Workshop's success. (1) The customer's interaction with the product as part of the buying experience is a great way to enhance customer service and to build brand loyalty. (2) Ms Clark is a very dynamic individual who definitely has a vision and the knowledge and expertise to carry out the vision. (3) The ability to keep the product fresh and to continually come up with new ideas is phenomenal. Their innovativeness is unparalleled. (4) The fact that they can keep their SKUs (Stock Keeping Units) so low while providing a customized product is a tremendous cost savings and does not hurt customer service. (5) Using the customer to evangelize about the store really reduces their advertising expenditures but is a very effective way to get their message to potential customers.

2. How has Ms Clark's experiences influenced this business?

(1) Her experiences of shopping with her mother as a child have had a big impact on how she feels a business should be run. (2) Her vast years of retailing experience and especially catering to children have helped prepare her for this role. While she does not personally have any children, her love for children influences everything she does.

3. What problems could Build-A-Bear Workshop encounter?

(1) Maxine Clark is such a big part of the company and its success, if something happened to her would they still be as successful? (2) Large retailers can sell the product (but maybe not the service) a lot cheaper. (3) Could the idea wane in time? (4) Most of the increase in sales is because of geographical expansion. What will happen to the business and sales when they get greater market penetration? (5) Can they continue to come up with new ideas and "fresh" products?

4. How has its unique strategy insulated Build-A-Bear Workshop from its competition?

Build-A-Bear Workshop's focus is not on the product but the experience. Larger retailers can and do offer more products and at a cheaper price, but they cannot duplicate Build-A-Bear Workshop's shopping experience. The interaction and entertainment value is what separates them from the competition. They not only sell the customer a product--they sell memories. This differentiation means that Build-A-Bear Workshop is not nearly as vulnerable to price competition as some of its competitors.

5. The case mentioned that Build-A-Bear Workshop pays a lot of attention to deals. How does this help them ward off the competition?

It is the attention to deals (clean bathrooms, well-trained staff, innovative ideas, etc.) that differentiates Build-A-Bear Workshop from the competition. In today's world of retailing we do not expect a retail clerk to be knowledgeable and courteous. We do not expect the bathroom to be spotless, with diaper changing stations in the men's bathroom. We do not expect the buying experience to be fun. It is the "unexpected" that keeps them in front of the competition.

6. What other types of retail businesses might benefit from using an interactive approach?

This could be done with other types of toys. It might be done with clothing stores where the customer could input a picture into a computer and try on clothes without actually trying them on until they had narrowed the options. This could be done with stores that cater to hobbyists--those making model air planes, making quilts, or involved in woodworking might use this strategy to generate repeat business and/or to get add-on sales.

7. How has Build-A-Bear Workshop's commitment to a variety of causes influenced its business?

This should lead to a very interesting discussion because most of the causes that Build-A-Bear Workshop sponsors involves the customer either coming into the store (creating traffic for the store) or visiting its website. Many of the projects relate directly to the sale of Build-A-Bear Workshop's products. They have done a wonderful job of tying their involvement in these causes to the sale of their products. In addition to being causes they support, these activities have become promotional tools for Build-A-Bear Workshop.

8. Is Build-A-Bear Workshop a fad or the beginning of a very successful business that will be around for a long time?

Some students will argue that Build-A-Bear Workshop is here to stay, and some students will argue that it is a passing fad.

Those arguing that it will be around for a long time will probably cite the ways it is different from other retailers-the shopping experience, innovative products, cost controls, astute management, and attention to detail. They will argue that as long as Build-A-Bear Workshop continues to differentiate itself from the competition that it will be successful. Those arguing that it is a passing fad will point out how difficult it is to constantly be innovative, that the competition will begin to offer similar shopping experiences, and that Ms Smith will not be around for ever to continually pump life into the company. They will point out that much of Build-A-Bear Workshop's growth has occurred through expansion and at some point they will saturate the market. Whichever side they take, they will be able to make strong arguments for their position, but in reality only time will tell.

THE TREACHERY OF RATIOS

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CASE DESCRIPTION

This case deals primarily with the subject of financial ratio analysis. Secondary issues include efficiency measurement in non-profit organizations and Du Pont analysis. The case has a difficulty level of three, and can be taught in one class hour. It will require approximately one hour of outside preparation by students.

CASE SYNOPSIS

Mr. Mueller represents a foundation that donates to international non-profit organizations. He is searching for a way to rank, by efficiency, potential recipients of his funds. His consultant advises him of the "program ratio" recommended by Philanthropic Research, Inc. (www.guidestar.org). This ratio is defined as the ratio of program services expense to total expense. Mr. Mueller likes the simplicity of this ratio, but the consultant adds that he has devised another, more comprehensive and accurate method of studying efficiency in international non-profit organizations. His approach involves the calculation of a "comprehensive efficiency ratio", which can, in a manner reminiscent of the Du Pont breakdown of the return on equity, be expressed as the product of two other ratios, each of which reflects the efficiency in a different area of management. The consultant insists that his ratio corrects all the "ills" of the "program ratio", and provides a richer framework within which to study efficiency of international non-profits. Mr. Mueller is uncomfortable with the consultant's approach, because he suspects it is flawed. However, he is unable to put his finger on the problem, and students are asked to detect the flaw in the model. The objective of the case is to alert students to the danger of employing ratios for financial analysis without carefully thinking through the meaning of each ratio used.

INSTRUCTORS' NOTES

SUGGESTED TEACHING APPROACHES

The idea for present case is derived from a journal article the author read in which this flawed model of ratio analysis was proposed. It seemed that it would be instructive to have a case built around an analytical error, and use it as a puzzle for students who are in the process of learning to employ financial ratios. Even though this case pertains to a simple efficiency analysis specifically of international non-profit organizations, it can be used to convince students of the virtue of expending some effort thinking through the information provided by any financial ratio. The central objective of the case, then, is to encourage students to think critically and approach ratio analysis with care. Each ratio should be examined closely to see what information it provides, and how it relates to other ratios. Such an understanding affords the student the luxury of not having to memorize formulae. Secondarily, the students are reminded that ratios pertaining to entities of significantly different size are typically not comparable; ratios veil differences in absolute size.

Prior to assigning this case, the instructor may wish to ensure that the students have a basic familiarity with income statements and balance sheets. In addition, it would very useful if students have already been introduced to the Du Pont analysis of the return on equity (ROE) for a corporation, since the consultant in the case clearly attempts a similar analysis, albeit with entirely different ratios. A common version of the Du Pont breakdown of ROE is provided below for the sake of review:

ROE = (Net Income/Sales)*(Sales/Total Assets)*(Total Assets/Equity)

Students tend to commit this equation to memory rather than try to understand the meaning of the three ratios in isolation and in combination. If they spent some time critically thinking through the message sought to be conveyed by each of those ratios, and about how the three relate to each other, they might very well be able to construct the Du Pont equation from scratch.

To facilitate the student's understanding of the case, the instructor is advised to explain the meaning of the following terms prior to assigning the case: "non-profit organization"; "program services"; and "administrative expense". The definitions of these terms are provided below (adapted from Martin and West, 2003):

Non-profit Organization: Such an organization resembles a governmental unit, and differs from business enterprise because, (a) its primary revenue sources are not the sale of goods or service; (b) its operating goals and intent are not driven by profit; and (c) there are no defined ownership interests in it. Examples of non-profit organizations include-churches, foundations, non-profit hospitals and schools, and human service organizations.

Program Services: "The activities that result in goods or services being distributed for beneficiaries, customers, or members that fulfill the purposes or mission for which the organization exists. Those services are the major purpose for and the major output of the organization and often relate to several major programs." (FASB Statement No. 117 Financial Statements for Not-for-Profit Organizations, paragraph 27.)

Administrative Expense: The consultant in the case uses this term to mean all management and administrative expenses-salaries for the CEO and support staff, expenses for accounting, budgeting, etc. In fact, as will be clear in the case, the consultant's model assumes that all expenses are comprised of program services expense and administrative expense.

If the instructor feels it will be helpful, he or she may provide the students with a copy of the first 3 or 4 pages of the IRS Form 990, or direct them to the website maintained by Philanthropic Research Inc. (www.guidestar.org), where they can find this form for numerous private non-profit organizations. Note that this form would be provided simply as an example of how a non-profit's reported financials can differ from a corporation's, and to familiarize students with the broad categories of expenses in such an organization. Clearly, not every non-profit organization in the world will use an identical form. Nor is the purpose of this case to introduce the student to a specific tax form. Also, note that the IRS Form 990 will not have a category of expense called "administrative expense"; instead, it will show a column each for "program services", "management and general", and "fundraising"; for the purposes of this case, the students can be asked to think of "administrative expense" as the sum of the last two categories.

It is recommended that students be asked to read the case before coming to class. In that case, a 50-minute class will allow for ample discussion. Two students could be asked to assume the roles of the manager of the philanthropic organization and the consultant, and act out the case. However, these two students should be very well prepared, else valuable class time will be lost. As such, they may have to be told in advance to prepare for their special part in the case discussion. If the instructor is pressed for time, a couple of students could be chosen at random to provide an overview of the case. After the case has been thus introduced, all students could be asked to explain why the consultant's services were sought. Next, they should explain how the "program ratio" (PR) is defined, and what information it seeks to convey. Finally, they should be asked to comment on the merits of the consultant's "comprehensive efficiency" CE model. The Discussion Questions section suggests one possible order of the questions the students might be assigned for in-class discussion.

CASE OVERVIEW

The manager of a philanthropic organization seeks the advice of a consultant on how to assess the efficiency of potential beneficiaries. The latter are international non-profit organizations. The consultant informs the client of a fairly well known efficiency measure, the "program ratio". This ratio simply divides the amount a non-profit spends on program services by its total expense. A higher ratio indicates a more "efficient" organization. The client likes the simplicity of the measure. However, the consultant, who is a recent hire in his firm, offers his own model, which he describes as being superior to the "program ratio" approach in a couple of ways. On the face of it, the model does seem attractive. It combines two seemingly independent efficiency measures, one for revenue generation and another for revenue allocation, to yield a "comprehensive" or "overall" measure of efficiency.

The client has misgivings about the consultant's approach, and at the end of the case, the reader leaves him in the conference room, still struggling to identify the problem with the model. One of the main problems with the model is that the two efficiency ratios mentioned earlier are not in fact independent. If one is maximized, then, by definition, so is the other. One method of demonstrating this is suggested in Discussion Question 7 below. The second problem with the consultant's approach is that it is vulnerable to the same criticism the consultant had of the PR measure of efficiency; it does not consider the absolute level of service provided to target groups. By definition, no ratio is designed to measure absolute magnitude; it is simply a measure of relative size. Thus, on both counts, the consultant cannot claim that his model provides more information about management efficiency than does the PR measure. These are the problems the students are expected to identify.

DISCUSSION QUESTIONS

1. Why did Mr. Mueller seek the help of the consultant?

Mr. Mueller's philanthropic organization, the Wilhelm Foundation, receives requests for funding from a very large number of non-profit organizations. Even after weeding out those who do not target the causes in which the Foundation is interested, Mr. Mueller and his staff are left with a significant number of applicants to choose from. Mr. Mueller hopes to find a quick way to rank the remaining applicants by their efficiency of operation, so that he and his staff can arrive at an allocation decision in a more timely, methodical, and objective manner. It is not his intent simply to grant funds starting with the entity at the top of the list; rather, he hopes to use such a list as an additional, objective, input into the decision-making process.

2. What information does the "program ratio" convey? Does it appear to be a reasonable way to measure the efficiency of a non-profit organization?

The program ratio, PR, is the ratio of program services expense (PSE) to total expense (TE). For every dollar expended by the organization, the PR shows the number of cents that went towards activities benefiting the cause for which the organization exists. Recall the quote from FASB in the Introduction section above; program services are "the major purpose for and the major output of the organization." Thus, it is reasonable that a non-profit organization would have a high ratio of PSE to TE. A higher ratio would indicate that the organization is directing a greater proportion of its revenue towards those activities that benefit the target group or cause.

3. What are the two simplifying assumptions made in the consultant's "comprehensive efficiency" (CE) model?

The new model assumes (1) that saving is zero, and (2) that total expense is comprised of program services expense (PSE) and administrative expense (ADEX). The first assumption implies that total expense (TE) is equal to total revenue (TR). This is a reasonable assumption, given the nature of an international non-profit organization. Even if there were any saving allowed in the model, the consultant is right in saying that the results of the analysis would not change; since saving occurs for the purpose of future benefit of the target groups, the PSE number could be adjusted upward by the amount of the saving. The second assumption is also a benign one; PSE and ADEX are by far the largest expense elements in a non-profit (see the definitions provided in the Introduction above).

4. **The consultant criticized the PR for ignoring the "revenue generating activity" of the organization. Explain his argument, using his example of a firm that has an efficiency ratio of 90% but revenues of only $5000. Does the consultant's model correct this "problem"?**

With his example, the consultant correctly demonstrates that the PR does not consider the absolute amount of revenue or expense, and so might classify a non-profit as "efficient" even if it has a very small magnitude of operations and hence a minimal total impact on target groups. No ratio could possibly capture the absolute level of operations, and the PR is no exception. It is not intended to measure the absolute impact the non-profit has on its targets. Obviously, since the consultant's model (the "comprehensive efficiency", or CE, model) also employs ratios, it does not correct this "problem" with the PR. The analyst should employ these ratios in conjunction with some absolute measure of activity, such as the PSE, to make a complete assessment of the efficiency and effectiveness of the organization.

The instructor could use a numerical example to make the point:

Consider two organizations, A and B, with the following revenue and expense data:

	A	B
Total Revenue (TR)	$50,000	$100,000
Total Expense (TE)*	$50,000	$100,000
Program services expense (PSE)	$40,000	$70,000
Administrative expense (ADEX)	$10,000	$30,000
1. The consultant's model makes the assumption that for an international non-profit, TR=TE, especially over the long run. Note that this assumption simplifies the analysis without changing the conclusions in any way; both the PR and the CE ratio are finally calculated using expense figures, not revenue figures, as can be seen below.		

Based on the data provided, we calculate both the PR (PSE/TE) and the CE ratio (PSE/ADEX) and get the following:

	A	B
Program Ratio (PR)	0.8	0.7
Comprehensive Efficiency (CE)	4	2.33

Now we see that the two models rank organizations A and B in an identical way, based on "efficiency"; B is ranked lower than A despite the fact that B has twice the level of operations, reflected in its total revenue and total expense. This result is unavoidable, given how the two ratios are calculated. Since PSE and ADEX are the two elements of TE, an organization with a higher PSE/TE ratio (i.e., PR) has a greater portion of every $1 of expense going program services; but that also means it is spending a lesser portion of that $1 on administration. As such, it must also have a higher PSE/ADEX ratio (i.e., CE ratio).

That the PR and CE approaches will yield the same efficiency ranking can also be proved mathematically as follows:

PR = PSE/TE = PSE/(PSE+ADEX)
Dividing both numerator and denominator by ADEX, we have:
PR = (PSE/ADEX)/{(PSE/ADEX)+(ADEX/ADEX)}
Recalling that CE = PSE/ADEX, we have
PR = CE/(1+CE)

For all positive values of CE, PR must increase as CE increases, since any increase in CE will constitute a greater percentage increase in the numerator of the PR equation than in the denominator. The restriction that CE is positive simply reflects the fact that the organization will not have a negative expense, whether it be PSE or ADEX.

Therefore, we conclude that the consultant's model does not supply for the defect that he claims the PR approach has. His model, too, can classify an organization as being more efficient than another even if the first has a far smaller total revenue or total expense figure. Besides, as stated above, ratios do not provide information about the absolute level of operations.

5. Discuss how the revenue generating efficiency (RGE) ratio is constructed, and what information it provides.

RGE = TR/ADEX. That is, RGE considers the amount of revenue the management of the non-profit generates per dollar of administrative expense. A higher value for this ratio indicates the organization has a tighter control over its administrative expenses.

6. Discuss how the revenue allocation efficiency (RAE) ratio is constructed, and what information it provides.

Note that RAE = PSE/TR. Thus, RAE indicates the amount of money directed towards program services out of each dollar of total revenue. A higher value for this ratio indicates that the organization has a tighter control over all other (i.e., non-program services) expenses.

7. Apart from the problem discussed in question 4 above, could there be some other "flaw" in the model proposed by the consultant?

We just noted in discussion question 6 above, that a higher value for the RAE ratio implies that a greater proportion of every dollar of revenue is directed to program services. This means that a smaller proportion of every dollar of revenue is spent is accounted for by all other expenses, which, in this model, is "administrative expense" (ADEX). So, when you increase RAE, you simultaneously decrease the proportion of every dollar of revenue that goes towards administrative expense; that is, you simultaneously increase RGE, which is TR/ADEX. Thus, the consultant's model does not have two independent measures of managerial efficiency, and does not decompose the "comprehensive efficiency" (CE) ratio into "two ratios", each measuring the efficiency of management in the areas of revenue generation and revenue allocation.

Observe that discarding the assumptions of the model discussed in question 3 will not fix the problem. The assumptions are, in fact, reasonable, and merely simplify the exposition of the model. Saving is exogenous to the model, and is therefore assumed constant. Whether that constant is $5000 or $0 makes no difference to the fact that maximizing PSE means minimizing ADEX, for a given level of saving and revenue. Discarding the assumption of "no other expenses" will mean that we write TE = PSE + ADEX + OE, where OE stands for "other expenses". The consultant's model will be written as:

$$CE = \{TR/(ADEX+OE)\}*(PSE/TR) = \{PSE/(ADEX+OE)\}$$

But obtaining a higher RAE ratio (defined as PSE/TR) still requires minimizing all expenses other than those related to program services, which immediately means maximizing RGE, the first ratio in the equation above.

8. What might be done to achieve the consultant's goal of measuring efficiency in the areas of revenue generation and revenue allocation?

More disaggregated cost data might be useful. For instance, if expenses were to be broken down by administrative expenses stemming from solely revenue generating activities, and administrative expenses associated with the process of allocating program services, one could certainly derive independent efficiency measures that focus on each functional area of the management of non-profit firms. However, combining ratios along the lines of the Du Pont equation will pose a greater challenge.

REFERENCES

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FARZAM V. GOURMET KITCHENS, INC.

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CASE DESCRIPTION

The primary subject matter of this case sequence is the integration of accounting and business law. Secondary issues examined include budgeting for various decision scenarios, the ethical responsibilities of decision makers, the legal responsibilities for product defects, and the enforceability of contracts restricting claims by injured parties. The case has a difficulty level of three, appropriate for junior level. The case is designed to be taught in three class hours per part (A and B.) That time estimate includes a formal class presentation by a team and a challenge by another student team. It is expected to require ten to fifteen hours of outside preparation by students for the two parts, Case A & Case B.

CASE SYNOPSIS

When design engineers at Gourmet Kitchens discover a way to produce their ovenware making it less expensive to produce (saving about 35 percent of variable production costs) but indistinguishable in looks and functionality from the original product, the product line manager, under pressure to produce a 25% return on sales (ROS), converts operations and books sales for the redesigned product. Unfortunately, during first quarter production, quality engineers discover a product defect that could lead to the product exploding and injury to persons in the immediate vicinity. A management team feels that they have two alternatives available to them: doctor the test results and continue to produce and sell while quietly working to correct the problem or scrap the production, delay shipment, and produce under the old production methods and cost structure while solving the problem. Management decides to take the first alternative, and ultimately several customers are seriously injured from the product.

The A case requires students to calculate a budgeted income statement and compute ROS under each of the available alternatives. Students also discuss the company's ethical responsibility and the stakeholders impacted by their decision. In Case B, students are provided legal opinions from the applicable jurisdiction and asked to evaluate whether a specific injured party is likely to recover compensatory damages for injury and a punitive award. In addition, students must evaluate Commercial Code to determine if a company disclaimer of responsibility for damages is likely to relieve Gourmet Kitchens of their legal liability.

This case requires students to apply materials learned in most Business School's lower division core (LDC). It is used in a course at the beginning of the junior year that has goals to integrate LDC material while developing teamwork and communication skills. Specifically, the case requires knowledge of financial and managerial accounting and a beginning business law course.

Student teams prepare the case with tutoring from faculty who provide "just-in-time" specific knowledge as requested by student teams. A team of students formally presents their case solution, another team acts as a "challenge team" and the whole class participates in an active question and answer session.

INSTRUCTORS' NOTES

Case A

Paragraph No. 1

Table 1: The Chef's Line Ovenware		
Budgeted Income Statement 2003, with Product Redesign		
	Perfect Product Redesign	Explanation
Sales	$ 81,000,000	(6,000,000)*(15*0.9)
Cost of Goods Sold		
Variable	21,645,000	6,000,000* 5.55 * .65
Fixed	24,033,769	2001 amount*1.035
Gross Profit	$ 35,321,231	
Attributable costs		
Marketing	5,670,000	Sales revenue *.07
Other (primarily fixed)	2,580,476	2002 amount *1.025
Product line profitbefore G&A allocation	$ 27,070,755	
Return on Sales	33.42%	

Students should understand that the product manager would be excited. His return on sales, as measured by product line profitability before any allocation for general and administrative costs, is above 33%. This is higher than his target and much higher than he has earned in the past.

The thing that students may have trouble with in this analysis is the idea of attributable cost. That term is discussed in the case. An attributable cost is a cost that the unit benefits from, and in a reasonable time frame (not in an extremely short run time frame), it is a cost that the organization would eliminate if the unit did not exist. That cost could include costs of services provided by corporate headquarters that they bill users for.

Paragraph No. 2

Table 2: The Chef's Line Ovenware Budgeted Income Statement 2003, with Product Recycled and Old Production Methods		
	6 months old; 6 months new product	Explanation
Sales	$ 54,000,000	(4,000,000)*15*0.9
Cost of Goods Sold		
Variable	18,315,000	2,000,000*5.55 + 2,000,000*.65*5.55
Fixed	26,533,769	2001 amount*1.035+500,000+2,000,000
Gross Profit	$ 9,151,231	
Attributable costs		
Marketing	5,670,000	Same as budgeted for 2003 above
Other (primarily fixed)	2,580,476	Same as budgeted for 2003 above
Line profit before G&A allocation	$ 900,755	
Return on Sales	1.67%	

Under this alternative, the ROS is only 1.67%, which is far below that required by the organization for the product line.

Paragraph No. 3

Table 3: The Chef's Line Ovenware Budgeted Income Statement 2003, with Defective Product Sold		
	6 months sale of defective products	Explanation
Sales	$ 81,000,000	6,000,000*(15*0.9)
Cost of Goods Sold		
Variable	21,645,000	6,000,000* 5.55 * .65
Fixed	26,033,769	2001 amount *1.035 +2,000,000
Gross Profit	$ 33,321,231	
Attributable costs		
Marketing	5,760,000	Sales *.07+ 0.0025*3,000,000*12
Other (primarily fixed)	2,580,476	Same as budgeted for 2003
Product line profit before G&A allocation	$ 24,980,755	
Return on Sales	30.84%	

This alternative provides almost 31% ROS. Students should understand how attractive this analysis looks to the managers. It does however ignore risk and ethical factors that should be considered in the decision.

Paragraph No. 4

The decision made by the three managers totally ignores their ethical responsibilities for defective products. Individual employees are responsible for their own behavior and should use their internal value and belief system to guide their decision making process. Perhaps pressure from top management on the product line manager to achieve a 25% return on sales has clouded his/her ability to act on principle. Perhaps the managers justified the decision by thinking it would save jobs within their unit.

In a situation such as this, ethical training guides decision makers to determine what stakeholders are impacted, and how they might be impacted. An ethical decision would provide the greatest good to the greatest number of stakeholders or would cause the least damage to stakeholders.

Many stakeholders are adversely impacted by this decision. These include customers (stores and consumers), upper management, other employees, shareholders, and creditors. Consumers can suffer severe and permanent injury that affects both them and their families. Stores that sell Gourmet's product have their reputation tarnished and suffer lost profits. They are not likely to buy from Gourmet again. The decision affects management, employees, shareholders, and creditors, because Gourmet's customer base is lost, its name is tarnished, and it suffers from potential lawsuits. This may greatly affect its ability to survive, and if it does, it may be a much smaller company with restructured debt, fewer employees, and less net worth.

The decision favorably affects short run profits so the product line manager would achieve his/her target. In the long run, it is likely that the entire product line will have to be dropped, and all these employees and managers will lose their jobs. They may also face lengthy litigation. This may be another situation where failing to take the correct ethical action causes enormous losses and perhaps bankruptcy of a company.

Case B

Paragraph No. 1

> Gourmet Kitchen, Inc. ("Gourmet") is likely to be held liable for damages Mrs. Farzam sustained under strict product liability. To prevail in an action for strict product liability, the consumer-plaintiff must establish that (a) the defendant was engaged in the business of selling the underlying product for use or consumption; (b) the product was defective; and (c) the product's defect must have been a substantial factor in causing the plaintiff's injury.

Here, there is no question that Gourmet was engaged in the business of selling ovenware for use by consumers. The plaintiff will then have to establish that the Chef's Line Ovenware was defective. Liability is imposed for products sold in a defective condition unreasonably dangerous to the user or consumer. Among other things, a product may be unreasonably dangerous because of a defect in marketing (such as failure to warn) or design. A defendant is liable if the lack of adequate warnings or instructions renders an otherwise adequate product unreasonable dangerous. However, there is no duty to warn of obvious risks. A product is defectively designed when it complies with design specifications, but the design itself causes the product to remain unreasonably dangerous. Determining whether a design is unreasonably dangerous requires balancing the utility of the product against the risks involved in its use. Under this risk-utility analysis, a jury must find the product defectively designed if the danger posed by the product outweighs the benefits of the way the product was designed and marketed. In applying the risk-utility analysis, evidence of the following factors are admissible: (a) the utility of the product to the user and to the public as a whole weighted against the gravity and likelihood of injury from its use; (b) the manufacturer's ability to eliminate the unsafe character of the product without seriously impairing its usefulness or significantly increasing its costs. Thus, the likely effects of the alternatives design on production costs, the effects of the alternative design on product longevity, maintenance, repair and esthetics are factors that may be taken into account; (c) the user's anticipated awareness of the dangers inherent in the product and their avoidability because of general public knowledge of the obvious condition of the product. See Robins et al. v. The Kroger Co, et al., 982 S.W.2nd 156 (1998).

In the case at bar, a court may find the ovenware product to have been defective because of a marketing defect and a design defect. The marketing defect arises out of Gourmet's failure to warn buyers of the ovenware product that it may explode and cause serious injuries under a small range of extremely high cooking temperatures if set on a cold trivet or placed in the refrigerator. Mrs. Farzam can also demonstrate a design defect in the product because the dangers posed by the modified ovenware outweighed the benefits the ovenware was designed to produce. First, while the likelihood of injuries taking place is indeed remote (.25%), the utility of the ovenware product to the user of conveniently cooking and serving food does not outweigh the gravity of injury arising out of its use: explosion causing serious cuts and substantial and permanent burns. Second, Gourmet had the ability to eliminate the unsafe character of the Chef's Ovenware product without seriously impairing its usefulness or significantly increasing its costs. While the alternative and older design of the ovenware product would have increased the variable production costs by about 35 percent and while it would have reduced its longevity by ten percent, that does not amount to "serious" impairment of the product's usefulness and costs. Further, the older-alternative design would have been indistinguishable in looks and functionality from the modified ovenware. Third, the risk-utility analysis suggests that the ovenware product suffered from a design defect because an average user of the ovenware would not have been aware of the dangers of explosion inherent in the product when using the item to cook between 450-500 degrees as such danger is not obvious to the general public.

Lastly, Mrs. Farzam would be able to demonstrate that the defect in the ovenware was a substantial cause of her injuries. Her injuries were sustained when she placed the ovenware product in the refrigerator after cooking a dish in at 475 degrees for two hours.

Therefore, since Mrs. Farzam is likely to establish all the required elements of the cause of action for strict product liability, she is likely to obtain a judgment against Gourmet for the damages she sustained.

Paragraph No. 2

Yes, Mrs. Farzam is likely to recover punitive damages against Gourmet. Punitive damages may be awarded in a product liability action based on strict liability. Punitive damages are allowable in exceptional and egregious instances for the purpose of punishing the tortfeasor and deterring both him and others from like conduct. The standard of egregiousness usually implies that there has been a deliberate act or omission with knowledge of a high degree of probability of harm and reckless indifference to consequences. In cases dealing with products, it has been uniformly concluded that punitive damages will lie when a manufacturer has knowledge that his product poses a grave risk to the health or safety of its users and fails to take any protective or remedial action. See Fischer et al., v. Johns-Manville Corporations et al., 472 A.2nd 577 (1984).

Here, Gourmet had actual knowledge during production that its modified ovenware poses a grave risk to the health and safety of its uses. That is, during routine quality testing in production, personnel of Gourmet discovered that under a small range of extremely high cooking temperatures, the ovenware would explode if set on a cold trivet or placed in the refrigerator. Gourmet further knew that such explosions could potentially cause the person holding the ovenware to suffer serious cuts and substantial and permanent burns. Having identified the problem during production and before delivery, Gourmet could have insisted on recycling the current production and producing the original and safer ovenware. Instead, Gourmet chose to proceed with the shipment of 1,500,000 units of defective ovenware knowing that there is a likelihood that .25% of purchases of such units would sustain grave injuries. Not only Gourmet shipped defective units with knowledge of their potential dangers, but it also failed to include any warning of such dangers. Further, Gourmet deliberately attempted to conceal the dangers associated with the product by toning down the unfavorable quality test reports.

Therefore, Gourmet's conduct meets the egregiousness standard for purposes of awarding punitive damages as it deliberately acted with knowledge of a high probability of harm and reckless indifference to the consequences of its actions.

Paragraph No. 3

No, the contractual disclaimer is not likely to relieve Gourmet Kitchen, Inc. of liability. Under section 2-719(c) of the Uniform Commercial Code, a party to a contractual agreement may not effectively disclaim liability for consequential damages (damages that indirectly arise from the breach of contract) for injuries to a person in the case of consumer goods. Since the ovenware sold by Gourmet Kitchen, Inc. is a consumer good, disclaimer of liability for consequential damages (i.e., the physical injuries she sustained as a result of using the ovenware) is not likely to be enforced by the courts. Such clauses are presumed to be unconscionable and hence unenforceable.

THE CASE OF BARTON MIRANDO OR CONSERVATION AND DARNITS!

Michael M. Grayson, Jackson State University

CASE DESCRIPTION

The case has a difficulty level such that it is appropriate for college students at any level. It is suitable for use as the first case in a course, particularly so because the case is structured so that students have to figure out an answer, rather than just regurgitate what they learned in the past week. The case is also fun to read, which makes it appealing for use as the first case.

The primary subject matter of this case concerns how value is determined in both closed markets and markets open to trading. While this is traditionally thought of as being either finance or economics, the case also incorporates ethical considerations, international business, and operations management. Secondary issues include international trade, the role information plays in setting value, the role of individual industry (i.e., willingness to work hard) in the well-being of a society, search costs, the roles of intermediaries, logistics, invasion of a society by outsiders, dietary changes, public health, and conservation.

CASE SYNOPSIS

This case tells the story of someone who is shipwrecked, taken in by the natives, and observes changes in the native society when outsiders come.

INSTRUCTORS' NOTES

Purpose

This case was developed for the purpose of instructing students in the material contained in the case. The case was originally written without questions pertaining to specific disciplines, but as more people asked me how to use it, the need for those questions to be set down was made more clear.

With some cases, the teacher might want to be assured that students have learned some specific technique, tool, or fact. This case is suitable for a more general application. From discussions with a small number of faculty, it appears that the best use of this case is as the first case in a course with multiple cases. Instead of giving students the answers and having the students trying to justify those answers, it makes more sense that the students should be challenged to do their own research, formulate their own answers, and justify their answers. This is a fun case to use for that purpose. Moreover, no matter what academic discipline the case is used in, by including other discussion questions, the teacher can have the students approach the case--and later cases in the course--with an interdisciplinary focus rather than a silo focus.

Overview

This is a very short case. The discussion questions themselves point out what the case contains.

DISCUSSION QUESTIONS

The discussion questions follow, arranged by academic discipline.

Finance

1. **What are the determinants of value?**

   Value can be thought of as a price in a complete market--one in which transactions are occurring frequently enough that the market is liquid. Thus, a pharmacy may have a pill which will completely cure an otherwise-fatal disease, so that pill has value, even if no customers come in to buy the pill for another year.

   Since value is essentially a price, value is determined by supply and demand, and can be influenced by the factors which influence supply and demand, including the demand for transactions.

2. **What role does information play in setting value?**

   As we see from the case of the darnits, the local people had no use for the darnits, so they discarded the darnits. The darnits had value to the men from the ships, so even though the local people still had no use of their own for the darnits, they could nevertheless use them in exchanges with the people from the ships. Thus, the information that the darnits had value to others also caused their value to rise to the local people.

   In general, information helps people ascertain whether something has value and, if so, what is that value. The information may be about supply and demand themselves, or about factors which influence supply and demand.

3. **What are some of the effects of information asymmetry on setting value?**

   There was an initial information asymmetry between the men from the ships and the local people. The men from the ships knew that the darnits had value to people elsewhere in the world, and could transport the darnits to sell to those people. The local people did not know that. Consequently, the men from the ships were initially in a position to take advantage of the information asymmetry to obtain darnits cheaply from the local people.

4. Is value something absolute, or is it relative?

Value may appear to be absolute, but it is really relative. Value is not determined in a vacuum, but rather by how much other value one is willing to give up to purchase something. Thus, a painting by a famous artist may sell for a very large sum of money, and we say that it is quite valuable. However, that value is determined by someone who was willing to give up a portion--and usually a small portion, at that--of what he owned in order to buy the painting.

5. What is the true, or intrinsic, value of a darnit? Does the color of the darnit matter?

The value of a darnit is dependent upon what a willing buyer, who is under no compunction to buy, will pay for it, and what a willing seller, who is under no compunction to sell, is willing to accept to give it up. The buyer wants to pay the value or less, while the seller wants to receive the value or more. The place where they meet is the value they determine, which may or may not be the value other people would have determined. Thus, the true value of anything, including a darnit, depends upon the transactions of a number of buyers and sellers to establish a clearing price in the market--in this case, in the market for darnits.

Because some colors of darnits may be more rare than others, and some colors of darnits may be more desired (i.e., in demand) than others, yes, the color of the darnit matters. Why? Because being more rare or more common, there is a different supply, and being more desired or less desired, there is a different demand.

6. How does logistics enter into the process of setting value?

The local people had no means of transporting the darnits to other places where people wanted the darnits. Consequently, to the local people, when they had not yet encountered the men from the ships, the darnits were simply objects to be discarded in piles. Once the men from the ships had the logistics available to transport the darnits to market, the value of the already-existing darnits rose.

Economics

1. What are the determinants of value?

Value can be thought of as a price in a complete market--one in which transactions are occurring frequently enough that the market is liquid. Thus, a pharmacy may have a pill which will completely cure an otherwise-fatal disease, so that pill has value, even if no customers come in to buy the pill for another year.

Since value is essentially a price, value is determined by supply and demand, and can be influenced by the factors which influence supply and demand, including the demand for transactions.

2. What role does information play in setting value?

As we see from the case of the darnits, the local people had no use for the darnits, so they discarded the darnits. The darnits had value to the men from the ships, so even though the local people still had no use of their own for the darnits, they could nevertheless use them in exchanges with the people from the ships. Thus, the information that the darnits had value to others also caused their value to rise to the local people.

In general, information helps people ascertain whether something has value and, if so, what is that value. The information may be about supply and demand themselves, or about factors which influence supply and demand.

3. What are some of the effects of information asymmetry on the price discovery process?

There was an initial information asymmetry between the men from the ships and the local people. The men from the ships knew that the darnits had value to people elsewhere in the world, and could transport the darnits to sell to those people. The local people did not know that. Consequently, the men from the ships were initially in a position to take advantage of the information asymmetry to obtain darnits cheaply from the local people.

Once the local people discovered that the darnits were objects of desire by the men from the ships, they lessened the information asymmetry without eliminating the asymmetry. It would only be through experimentation with varying price levels that the local people would be able to discover the clearing market price with the men from the ships. Thus, the fact that the men from the ships wanted the darnits conveyed information to the market, but this information alone did not complete the market.

4. Is value something absolute, or is it relative?

Value may appear to be absolute, but it is really relative. Value is not determined in a vacuum, but rather by how much other value one is willing to give up to purchase something. Thus, a painting by a famous artist may sell for a very large sum of money, and we say that it is quite valuable. However, that value is determined by someone who was willing to give up a portion--and usually a small portion, at that--of what he owned in order to buy the painting.

5. The islanders did not have to take very long each day to fulfill their needs. What role does individual industry (i.e., willingness to work) play in the material well-being of a society?

If everyone is willing to work hard, then under any given set of conditions, society is likely to be better off in a material sense than if not everyone is willing to work hard. Why is this so? Jealousy is one reason. When some people are well off but others are not, some of those who are not are jealous and, instead of working, would rather agitate and recruit others to take something away from those who are well off.

If those who are well off are well off simply because of inherited wealth, this may not be as deleterious as the case where those who are well off are well off because they work hard and are intelligent about what they do. The more wealth that is taken away from those who work hard, the less incentive they have to work hard and produce that wealth in the first place.

6. What is the true, or intrinsic, value of a darnit? Does the color of the darnit matter?

The value of a darnit is dependent upon what a willing buyer, who is under no compunction to buy, will pay for it, and what a willing seller, who is under no compunction to sell, is willing to accept to give it up. The buyer wants to pay the value or less, while the seller wants to receive the value or more. The place where they meet is the value they determine, which may or may not be the value other people would have determined. Thus, the true value of anything, including a darnit, depends upon the transactions of a number of buyers and sellers to establish a clearing price in the market--in this case, in the market for darnits.

Because some colors of darnits may be more rare than others, and some colors of darnits may be more desired (i.e., in demand) than others, yes, the color of the darnit matters. Why? Because being more rare or more common, there is a different supply, and being more desired or less desired, there is a different demand.

7. "A businessman on the ship had promised to buy all the coconut products which Barton Mirando could supply." Why wouldn't the businessman do business with the islanders themselves instead of Barton Mirando? What role does Barton Mirando play in facilitating transactions? What role does Barton Mirando play in reducing search costs?

People engage in pattern recognition, whether they realize it or not. Barton Mirando probably was closer to fitting the pattern of those people the businessman typically dealt with than did the islanders. Consequently, Barton Mirando, by doing nothing more than being there, helped the businessman get more of a feeling of comfort and therefore be willing to engage in transactions for which the islanders would supply coconut products.

Not everything goes perfectly all the time. The businessman wants some point of contact in case something does go wrong, or there is some question, so that he can get it taken care of. Barton Mirando is his point of contact. Therefore, he does not feel that he needs to search among the islanders for someone he can and will trust, even though those are the people who will ultimately be supplying him.

Production/operations management/logistics

1. **The islanders did not have to take very long each day to fulfill their needs. What role does individual industry (i.e., willingness to work) play in the material well-being of a society?**

   If everyone is willing to work hard, then under any given set of conditions, society is likely to be better off in a material sense than if not everyone is willing to work hard. Why is this so? Jealousy is one reason. When some people are well off but others are not, some of those who are not are jealous and, instead of working, would rather agitate and recruit others to take something away from those who are well off.

   If those who are well off are well off simply because of inherited wealth, this may not be as deleterious as the case where those who are well off are well off because they work hard and are intelligent about what they do. The more wealth that is taken away from those who work hard, the less incentive they have to work hard and produce that wealth in the first place.

2. **What are the benefits of not collecting the small valvos?**

   This allows the small valvos to mature, to grow to become large valvos, and to produce more small valvos. Without some means of producing more valvos, once all the existing valvos were collected, there would not be any more.

3. **What are the disadvantages of not collecting the small valvos?**

   This is a trick question. If you want to have a valvo industry or a valvo food source, you absolutely must leave the small valvos instead of collecting them.

4. **How does logistics enter into the process of setting value?**

   The local people had no means of transporting the darnits to other places where people wanted the darnits. Consequently, to the local people, when they had not yet encountered the men from the ships, the darnits were simply objects to be discarded in piles. Once the men from the ships had the logistics available to transport the darnits to market, the value of the already-existing darnits rose.

International business

1. **Some countries, particularly in Africa, claim that they were doing fine with subsistence farming until the colonial powers came in and forced their populations to change from farming food to farming cash crops. Once they did that, their populations become**

more vulnerable to famines, since they no longer grew enough food to feed themselves. Is their contention concerning vulnerability to famines correct?

Yes.

2. **When Barton Mirando landed on the island, there was very little heart disease, disease of the digestive tract, or tooth decay among the people on the island. Once the outsiders changed the dietary habits of the islanders, the health profile of the population also changed. Is it right to do this?**

This is a question which forces people to address values. Some people will claim that it is never right to do this, while other people will claim that it is right at least sometimes to do this. The question is not one with an absolute answer. Rather, it is intended to make people reason, present their ideas, present support for their ideas, and listen to other positions.

There will be some loudmouths who want to beat up on anybody who does not agree with them. There will be some people who are simply loud and overbearing, rather than providing any reasoned support for any position. There will be some people who think that just because it is their idea, it is right and everybody else is automatically wrong.

3. **The islanders had gone along fine without protecting the coconut trees. Why did they suddenly feel it necessary to limit the portion of coconuts to be processed?**

The islanders, coconuts, valvos, and fish were in a stable cycle whereby the islanders did not harvest more than could be sustainably drawn from the food production cycle. However, once the men from the ships found these food sources which were new to them, they had an incentive to grab up as much of it as they could. The problem was that this would leave too little behind to reproduce food in future seasons: not enough coconut trees growing up to replace those which sooner or later would stop producing, not enough valvos to grow from little valvos to big valvos, and not enough fish in the area.

This is really a variation of the commons problem. If sheep farmers live near a meadow which nobody owns, then every farmer has an incentive to graze as many sheep on the meadow as he can, since he owns his own sheep and will benefit from what they produce. However, as every farmer does this, the sheep overgraze the meadow, so the meadow will no longer support the sheep. If, on the other hand, you divide the meadow into individual ownership, then each sheep farmer has an incentive not to overgraze his own portion of the meadow. Moreover, if he does not wish to put his own sheep on the meadow, he can then charge a fee to others for them to graze their sheep on his ground. By changing the system of incentives, the sheep farmers go from all having incentives to overgraze the meadow to all having incentives not to overgraze the meadow, thereby allowing it to sustain sheep for years to come.

4. When the people from aboard the ships went to the feast and discovered the darnits, they seemed to lose interest in the food and started looking for more darnits. Would they be better off doing this themselves, or enlisting the help of the islanders? Why do you answer the way you do?

The islanders are experts at finding darnits. This can be good at helping the men from the ships at finding all the darnits available to be found. However, it can be bad if the islanders plunder all the oysters for the sake of finding darnits.

This is where a valid, indeed necessary, role for governments is found. Governments can be useful in setting rules for maximum harvests of valvos and darnits, in order to preserve the valvo population for future sustainable use. Even so, governments are composed of people. In such a small community, it might be possible for some one influential person from the ships to bribe the government to favor himself over all others, or to set the harvest limit too high for sustaining the valvo population.

5. "A businessman on the ship had promised to buy all the coconut products which Barton Mirando could supply." Why wouldn't the businessman do business with the islanders themselves instead of Barton Mirando? What role does Barton Mirando play in facilitating transactions? What role does Barton Mirando play in reducing search costs?

People engage in pattern recognition, whether they realize it or not. Barton Mirando probably was closer to fitting the pattern of those people the businessman typically dealt with than did the islanders. Consequently, Barton Mirando, by doing nothing more than being there, helped the businessman get more of a feeling of comfort and therefore be willing to engage in transactions for which the islanders would supply coconut products.

Not everything goes perfectly all the time. The businessman wants some point of contact in case something does go wrong, or there is some question, so that he can get it taken care of. Barton Mirando is his point of contact. Therefore, he does not feel that he needs to search among the islanders for someone he can and will trust, even though those are the people who will ultimately be supplying him.

6. The islanders "formed a Committee On Not Shelling Every Rare Valvo At The Instant Of Nativity to protest what was happening to the valvos. Some bureaucrat back in the home country where the ships had come from gave it an acronym, and started calling it the CONSERVATION movement." Why had the islanders not formed such a committee before the ships ever arrived? Why did they suddenly feel it necessary to form the committee after the ships arrived?

This is really a variation of the commons problem. If sheep farmers live near a meadow which nobody owns, then every farmer has an incentive to graze as many sheep on the meadow as he can, since he owns his own sheep and will benefit from what they produce. However, as every farmer does this, the sheep overgraze the meadow, so the meadow will no longer support the sheep. If, on the other hand, you divide the meadow into individual ownership, then each sheep farmer has an incentive not to overgraze his own portion of the meadow. Moreover, if he does not wish to put his own sheep on the meadow, he can then charge a fee to others for them to graze their sheep on his ground. By changing the system of incentives, the sheep farmers go from all having incentives to overgraze the meadow to all having incentives not to overgraze the meadow, thereby allowing it to sustain sheep for years to come.

When the islanders had been living by themselves before the ships came, they did not harvest more than was sustainable. Consequently, they had no need to conserve resources, because they always had enough resources. Once the ships came and put additional pressure on the resources, it became necessary to attempt to limit the harvest, or else the resources would be overharvested--overgrazed, in the example of the meadow.

Ethics

1. Some countries, particularly in Africa, claim that they were doing fine with subsistence farming until the colonial powers came in and forced their populations to change from farming food to farming cash crops. Once they did that, their populations become more vulnerable to famines, since they no longer grew enough food to feed themselves. Is their contention concerning vulnerability to famines correct? If it is correct, then what obligations (moral or otherwise) do the former colonial powers have--or ought to have--to prevent famines or to lessen the results of famines which occur? Is their contention concerning vulnerability to famines correct?

Yes.

If it is correct, then what obligations (moral or otherwise) do the former colonial powers have--or ought to have--to prevent famines or to lessen the results of famines which occur?

This discussion is ongoing. You might want to contact the United Nations to learn what they have said and are saying.

2. hen Barton Mirando landed on the island, there was very little heart disease, disease of the digestive tract, or tooth decay among the people on the island. Once the outsiders changed the dietary habits of the islanders, the health profile of the population also changed. Is it right to do this?

This is a question which forces people to address values. Some people will claim that it is never right to do this, while other people will claim that it is right at least sometimes to do this. The question is not one with an absolute answer. Rather, it is intended to make people reason, present their ideas, present support for their ideas, and listen to other positions.

There will be some loudmouths who want to beat up on anybody who does not agree with them. There will be some people who are simply loud and overbearing, rather than providing any reasoned support for any position. There will be some people who think that just because it is their idea, it is right and everybody else is automatically wrong.

3. The islanders "formed a Committee On Not Shelling Every Rare Valvo At The Instant Of Nativity to protest what was happening to the valvos. Some bureaucrat back in the home country where the ships had come from gave it an acronym, and started calling it the CONSERVATION movement." Why had the islanders not formed such a committee before the ships ever arrived? Why did they suddenly feel it necessary to form the committee after the ships arrived? Did the people from on board ship have any duty to regulate their valvo-hunting behavior? What were the effects of unchecked valvo hunting on the diet and food supply of the islanders?

This is really a variation of the commons problem. If sheep farmers live near a meadow which nobody owns, then every farmer has an incentive to graze as many sheep on the meadow as he can, since he owns his own sheep and will benefit from what they produce. However, as every farmer does this, the sheep overgraze the meadow, so the meadow will no longer support the sheep. If, on the other hand, you divide the meadow into individual ownership, then each sheep farmer has an incentive not to overgraze his own portion of the meadow. Moreover, if he does not wish to put his own sheep on the meadow, he can then charge a fee to others for them to graze their sheep on his ground. By changing the system of incentives, the sheep farmers go from all having incentives to overgraze the meadow to all having incentives not to overgraze the meadow, thereby allowing it to sustain sheep for years to come.

When the islanders had been living by themselves before the ships came, they did not harvest more than was sustainable. Consequently, they had no need to conserve resources, because they always had enough resources. Once the ships came and put additional pressure on the resources, it became necessary to attempt to limit the harvest, or else the resources would be overharvested--overgrazed, in the example of the meadow.

The people from the ships did not consider that the islanders would prevent them from harvesting any valvos nor finding every darnit they could. Furthermore, they were a long way from home, so whatever social strictures might exist at home were less of a constraint here on the island. Consequently, even though the men from the ships should not have been so greedy for the darnits, it would probably take either force or the availability of force to cause them to act in a more civilized manner. When the police are withdrawn from an area, that is when rioting and looting grow, even among people who otherwise would be mild-mannered.

TELECOMMUTING AT KENTUCKY AMERICAN WATER COMPANY

Stephen L. Loy, Eastern Kentucky University
Steven Brown, Eastern Kentucky University
E. Sonny Butler, Georgia Southern University

CASE DESCRIPTION

A public utilities company implements a telecommuting pilot project to improve the performance of its customer service department personnel. The case describes the effects telecommuting had on the attitudes and productivity of its customer service agents. This case is fairly simple, avoiding overly technical details, making it appropriate for juniors (level 4) and seniors (level 5). An instructor could make the case more challenging by having students develop a conceptual proposal for expanding the initial telecommuting program beyond the local telephone access area by using some sort of voice over Internet (VOI) and virtual private network (VPN) technology. This case is designed to be taught in a one hour class period and is expect to take three hours of preparation.

CASE SYNOPSIS

Kentucky American Water Company implemented a telecommuting system to improve the service performance of their agents in the customer service department. The case provides a background of the company, the reasons for initiating the pilot program, and the information technology architecture developed to support telecommuting. A brief description of the criteria used to select the agents for telecommuting as well as some of the problems and cost encountered in implementing the project. The statistics show that the productivity of the telecommuters more than doubled and service quality increased significantly. The cost-benefit analysis showed a 571% ROI the first year and a three-year NPV of $170,800 on a $25,000 investment. Comments made by the telecommuting employees and the project managers also indicate the project was successful. At the end of the case, the desire to add agents who live outside the local telephone area (LATA) to telecommuters is raised. The purpose of the extension would be to test the feasibility of using the Internet to avoid long distance phone charges. If this is feasible, it could impact the parent company's plan to develop a national customer service call center.

INSTRUCTORS' NOTES

Recommendations for Teaching Approaches

The teaching objectives for this case are:

1. Introduce the student to telecommuting and illustrate its effectiveness.
2. Illustrate some of the social and personnel issues involved in telecommuting.
3. Illustrate some of the technology involved in telecommuting.

Individual or small groups of students could be assigned to develop and present their answers to one or more of the discussion questions.

DISCUSSION QUESTIONS

1. Why was the telecommuting project successful for KAWC?

The Home Connection program was financially successful because the improvement in productivity and cost savings, primarily the elimination of five temporary positions. Every dollar spent on the Home Connection project returned ten dollars for KAWC. The project was also successful because of the reduction in CSA absenteeism and customer complaints. The sense of ownership, pride and independence that developed among the telecommuters resulted from their jobs being less routine, and they were trained to trouble shoot their computer problems rather than depend on someone else to do it for them. The project succeeded because management got the telecommuters meaningfully involved in planning and implementing the program, giving them control over their work schedules, and the increased attention and support they gave to the telecommuters.

2. What impact did telecommuting at KAWC have on the telecommuters' morale and job satisfaction? What do you think may be the cause of the decline in productivity for the non-telecommuting CSA?

Telecommuting led to a new management approach in KAWC. It was the change in management style more than the telecommuting technology that led to increased productivity or job satisfaction of the telecommuters. Telecommuters were managed differently than the office CSAs. As a result, the telecommuters developed strong sense of job satisfaction from the autonomy, flexibility and freedom that working at home gave them. Also, the attention and respect given to them by the management seemed to elevate their prestige in the company. Managers made the telecommuters to feel important, because now management was giving them significant information, and asking for their opinions. Certainly they were treated differently, and possibly better, than the office-based CSAs. A spirit of team work and team pride developed among the telecommuters once they were free of the office culture. The telecommuters began to develop the own culture as a result of facing common problems and experiences. A culture were knowledge is shared freely.

The decline may have resulted from feelings of jealousy and resentment toward the "special class" of CSA because of the attention and praise the telecommuters were getting. Productivity will likely remain off unless management takes action to improve morale and possibly working conditions for the office CSAs. Management should attempt to enrich the jobs of the office CSA and to develop a team spirit among them.

3. What are security risks does telecommuting pose for KAWC?

The security risks involve data and hardware/software security. Measures might be needed to be taken to prevent interception of the two-way radio communication between CSA and field personnel. Tapping the CSA phone lines to intercept confidential information is possible, although a small risk. More likely risks involve the downloading and storage of confidential information at the CSA's home. Burglaries and fires at the home of a CSA also pose threats to equipment and software.

CSA's should have home security systems and property insurance riders to cover the workstations and computer resources. Security and fire risk assessments should be conducted before setting up the telecommuting system in the home. CSA workstations should not have confidential information stored on them. Regular inspection of CSA workstations should be conducted. KAWC could install a virtual private network (VPN) router (e.g., Cisco 7750) to encrypt transmitted data.

Policies should be made concerning personal use of the equipment and software on the home stations. Illegal coping of company software (i.e., breaking the software licence agreement) is a potential problem. KAWC is required to maintain record of all legal software used in the company and how many authorized and unauthorized copies exist as part of the routine auditing process. KAWC would need to check the home workstations regularly for authorized and unauthorized software.

4. Do you think the increase in productivity and morale will hold up in the long run?

Probably. The dramatic increase of the pilot team's performance levels from June 1999 to May 2000 as shown in Tables 1 and 2. The initial gains in productivity have remained well above the previous performance levels of the telecommuters themselves as well as the office-based CSAs. The group atmosphere in which the employees shared pleasant social relationships with one another and desired to do a good job. This work atmosphere is dramatically different than the office atmosphere. The different management approach in which management shares significant information and asked for telecommuters opinions may keep telecommuters job satisfaction high and turnover rates low.

KAWC, as part of their relationship management, is very committed to providing their CSA with an ergonomically designed work environment, so they tried to install a home-office setting that would be flexible yet provide sufficient physical support and comfort.

Table 1: Customer Service Agent Productivity Averages

Description	Before	After	Change
Average Calls Received per Month	12,213	12,102	-0.9 %
Average Calls Answered per Month	10,707	11,666	9.0 %
Average Calls Abandoned per Month	1,506	436	-71.0 %
Average Walk in Customers per Month	937	740	-21.0 %
Average Hold in Seconds	100	27	-73.0 %
Average % Calls Answered	87.8 %	96.4 %	9.8 %
Average % Calls Abandoned	12.2 %	3.6 %	-70.5 %
Avg. Percent of Calls Handle by Home Agents	17.1 %	39.3 %	129.8 %
Avg. Percent of Calls Handled by Office Agents	82.9 %	60.7 %	-26.8 %
Avg. Monthly Calls Handled by Per Home Agents	617	1543	150.1 %
Avg. Monthly Calls Handled by Office Per Agent	984	865	-12.1 %
Average Calls per Payroll Hour for Home Agents	3.7	9.4	150.1 %
Average Calls per Payroll Hour for Office Agents	6.0	5.2	-12.1 %

Table 2: Average Monthly Calls Handled Per Month

Year	Month	Average Calls Per Home Agent	Average Calls Per Office Agent
1998	April	880	780
	May	625	1,146
	June	800	1,054
	July	864	984
	August	1,017	914
	Sept	952	998
	Oct	742	896
	Nov	580	858
	Dec	388	923
1999	Jan	264	1,122
	Feb	203	973

Table 2: Average Monthly Calls Handled Per Month			
Year	Month	Average Calls Per Home Agent	Average Calls Per Office Agent
	March	93	1,159
	April	336	967
	May	1,274	711
	June	1,839	914
	July	2,086	853
	August	2,007	1,048
	Sept	1,760	968
	Oct	1,569	940
	Nov	1,433	868
	Dec	1,507	814
2000	Jan	1,668	813
	Feb	1,463	735
	March	1,554	859
	April	1,440	683
	May	1,668	933

5. Discuss the selection and training process for the three members of the pilot team?

KAWC provided the CSA the opportunity to bid on the positions according to the union contract. The selection process contained job-fit elements, such as physical fitness, length of employment, and home location. The selection criteria did not expressly include self-motivation and control elements as suggested in the telecommuting literature. KAWC did not deemed necessary for the initial telecommuter selection because new hires were not yet being considered. Since current employees were being chosen, there were few training needs.

6. Assuming the costs and benefits shown in Table 3 hold up, would it be a good investment to add CSAs who live outside the local calling area to the Home Connection program despite the $1600 monthly long-distance phone charges?

Financially, it would still return more than it would cost, if it results in a reduction of one full-time CSA position (savings each month would be approximately $3319). The productivity gains of one additional CSAs could more than offset the make staff reduction possible while having no negative effect on the quality of customer service. The marginal ROI would exceed 200%.

Reduction in complaints/month ($5000/3/12)	$ 139
Salary savings/month ($36000/12)	3000
Recruiting & Training/month (7500/3/12)	69
Office & Parking savings/month (4000/3/12)	111
Total Monthly Benefit	$3319

Table 3: Cost-Benefit Analysis

COSTS	ONE-TIME COSTS	RECURRING COSTS COSTS/MONTH	3-YEAR NET PRESENT VALUES*
Total Development Costs	$20,132	$147	$25,424
BENEFITS	FIRST YEAR	ANNUAL RECURRING	3-YEAR TOTAL
Reduction in PSC Complaints	$ 5,000	$ 5,000	$ 11,416
Salary Savings	36,000	90,000	158,534
Recruiting & Training Savings	7,500	7,500	17,124
Office & Parking Space Savings	4,000	4,000	9,133
Total Benefits	$52,500	$106,500	$196,207
Length of Payback Period	5.4 months		
Net Present Value of the Investment*			$170,783
Rate of Return on Investment	571.7%		
* NPV discounted at 15%			

7. What benefits might a national telecommuting call center program provide for American Water Company?

Reduced recruitment and training cost for new CSA. Existing pool of CSA could be used without paying moving and relocation expenses. Customer service quality could be maintained and probably enhanced. If the benefits of the Home Connection project are realized when expanded to include more CSA in the national call center, then AWC should see overall productivity gains, reduced operating and training costs, reduced personnel absenteeism and turnover reductions, employee morale gains and service quality improvements. AWC would gain increased staffing flexibility to deal with peak workloads and crisis situations without hiring temporaries.

EPILOGUE

AWC is currently constructing a national call center in Alton, Illinois where all customer service calls from all AWC subsidiary companies around the country will be consolidated. Customers from thirty-nine states will call an 800-number that will connect them to the Alton call center. The national call center is expected to employ 200 CSAs. It will be ready in two years. At that time, CS s around the country will be given the opportunity to move to Illinois or take their chances on being assigned another position where they are. It is unlikely that many CSAs will choose move to Alton, most will be "pink slipped" due to the lack of job openings at their current location. AWC will lose its pool of experienced and highly skilled CSAs, while having to train new ones in Illinois.

According to Bush, some sort of nationwide telecommuting program should be considered for the new call center. It would allow us to keep our best CSAs without having to relocate them to Alton. However, a way would have to be found to avoid or drastically reduce the long distance phone call charges between the call center and the telecommuters. Otherwise, the costs would be astronomical. Maybe some sort of voice over Internet (VOI) technology could be used to avoid the long distance phone charges or 800/888 phone service.

The current technology might not support this type of national call center telecommuting program. KAWC has about a year and a half to get a pilot project going to see if it's feasible. However, since some CSAs outside the local access and transport area (LATA). The InterLATA charges to put these people on our current telecommuting program would run about $1600 per month for each CSA.

Students could be asked to do a project that involves analyzing whether KAWC should pilot test the technical and economic feasibility of adding CSAs who live outside the Lexington LATA as telecommuters. The project would require research into current service CSA technologies, telecommunication companies like WorldCom and their services. Also, the financial analysis should include estimates of costs, assumed savings and rates of return.

ADJUSTING TO RAPID GROWTH AND NEW TECHNOLOGY: THE EDUSAT PROJECT

Robert Stretcher, Sam Houston State University
Geraldine E. Hynes, Sam Houston State University

CASE DESCRIPTION

This case involves the process of adjustment in a firm experiencing rapid growth in both the market it serves and in the technological sophistication of its product. It is appropriate for use in a variety of business courses to enhance coverage of technology management, entrepreneurial ventures, organizational communication, customer relations management, and the matching of marketing plans with production expectations. It should prove most useful at the undergraduate level, and should require one to two hours of outside preparation by students.

CASE SYNOPSIS

EduSat is a provider of instruction via satellite for elementary, middle, and high school curricula as well as undergraduate and master's level coursework. The system was initiated in 1997 to serve the demand for home study. Typical customers are home schoolers and individuals wanting to pursue both college degrees and topical learning. Cokesbury University provides this service, which has experienced phenomenal growth since the project's inception in 1997. A recent software and hardware upgrade combined with a surge in new customers has overloaded the technical and support staff and resulted in customer complaints about poor service.

INSTRUCTORS' NOTES

Recommended Teaching Approaches

This case presents opportunities for analysis and discussion of a range of topics. We recommend assigning a reading of the case and having students develop answers to the following groups of questions, according to the professor's desired outcome. The case can be discussed in class, assigned as a student task for grading, or used purely as a discussion case. We find the latter especially useful in longer evening classes where students can, in class, read the case, discuss it in groups, and then have a general discussion led by the professor. The case should prompt diverse responses, depending on student backgrounds and experiences. We have identified the following areas and corresponding questions as possible avenues of exploration.

Problem Identification

1. **What does each Division manager think is DSL?s problem?**

Randy thinks the problem is that the tech support and customer service areas aren't getting the job done, especially after his (self-perceived) superb 'marketing' of the educational system.

Donna thinks that the problem is 1)the bad attitude of the technicians, and 2) the call volume. Her view is that fewer customers would solve this.

Michelle thinks the problem lies with 1) the defective receivers and the lack of Igalactic service, and 2) the large call volume. She thinks Randy did an overzealous selling job.

2. **What does the Division Director think is the problem?**

Robert thinks that call volume is the problem, in combination with phone system problems (over which he has no control). He seems rather clueless when expressing to the academic dean that new satellite students created the problems. Devinna rightly points out that students are the root of the survival of the institution, NOT the root of the problems.

3. **What are the real problems, as opposed to the symptoms of problems at the DSL Division?**

The problem is that the organization failed to provide an adequate support system for the large number and rapid growth of the customer base. That this has happened cannot be changed, but alternatives for its correction should be proposed. As Dean Devinna put it, the problem for a educational institution is NOT that students have enrolled!

Collateral problems include 1)the 'glitch' in the phone system (whatever is causing the 'unable...' message) and the intentionally programmed problem of automatic disconnection after a customer has been on hold for an hour... and 2) the defect in the receiver units, which is causing frustration with system setup.

Often, solving the underlying problem takes care of the presence of symptoms. In this case, acquiring an adequate support system would solve the problems of excessive wait time. This would relieve the acuteness of the phone system problem, but left unsolved, the glitch and autoprogrammed disconnection has the potential of causing unfavorable results again. Unfortunately, this appears to be outside the division's control.

Nothing would help the 'defective receivers' problem except their replacement. A system needs to be in place for the future, ready to efficiently handle equipment problems if they occur again. A system was not in place for this episode of defects.

Problem Solving Processes

1. What suggestions have the managers proposed for the DSL Division's problems? How did they arrive at those suggestions?

Randy suggests everyone but him should get their act together. He also seems disgruntled about having to do work unbecoming a marketing manager. He arrived at this conclusion after being criticized unjustly for having done too good a job. It is unclear whether or not he actually accomplished the rapid increase in customers, but he obviously takes credit for it.

Michelle suggests that there is nothing that can be done (since she identifies Igalactic as the problem), and that workload reductions for her staff is in order.

Donna suggests not having so many customers as a solution.

(Samantha wonders why we can't all just get along.)

2. Do the suggestions address the problem or its symptoms?

Randy's suggestion that the others become competent isn't productive nor realistic, and doesn't address symptoms nor problems.

Michelle's only positive suggestion will only exacerbate the lack of service by removing available help for customers. Her other suggestion of doing nothing will not address the equipment problem.

Donna's suggestion indicates that she really doesn't understand the reason for the existence of her job, and only addresses the symptom of large numbers of customers.

3. How viable is each proposed solution?

None of the proposals comes close to being a solution. Hence, the value of this case; it is the student's task to recognize that the problem(s) are not being addressed, and to come up with their own problem identification, alternative solutions, and evaluation and selection of the best alternative(s).

4. Do you see any organizational problems with the DSL Division?

First, there appears to be a direct line of communication from everyone in the division to Robert. It's hard to figure out whether he is micromanaging or just hanging around. There is certainly no effective formal line of managerial communication present. The informality of the communication (e.g: various people stopping Robert in the hallway to discuss 'nightmarish' aspects of the business) leads the reader to believe that Robert is not very much in control.

5. What problem-solving processes can you recommend to the Division Director?

This open-ended question can have a wide variety of 'corrct' answers. Any variety of processes could suffice, if only those processes were implemented. It is suggested that students debate about the processes in class discussions.

Customer Relations Management

6. Track the current system for CRM at EduSat?s DSL Division. How well is it working?

Currently customer relations management is nonexistent. The staff are reactive rather than proactive, simply responding to any customer complaint or request as it comes in. Even the telephone lines and email systems available to customers for their questions and complaints have broken down.

7. What should they do differently?

Clearly, the Division needs to establish a formal CRM system that would enable 1) determining customer needs, 2) finding ways to meet those needs, 3) broadcasting improvements in its products and services, and 4) monitoring the level of customer satisfaction with their efforts. A feedback loop should be put in place immediately.

8. Most automated response lines are designed to increase efficiency. To what extent does DSL?s system reach that goal? What do you recommend instead?

Little will cause customer anger and frustration as readily as an inefficient automated phone system. Research shows that a significant percentage of consumers refuse to use automated response systems at all. DSL's phone lines are inadequate and are poorly serviced. The concept of an automatic timeout is dangerous to a customer-oriented organization. Instead, DSL should establish a system that allows callers to speak with a representative at any juncture in the process, and that doesn't result in overly lengthy wait times. Unfortunately, these corrections cannot be implemented, since the control exists outside Robert's division. Students may suggest that Dean Devinna could help.

Organizational Communication

9. Describe Robert Viner's management style.

It is possible that Robert, like many entrepreneurs, is a micromanager. He values his organization's products and services so much that he has trouble delegating. Every decision must come through him. As a business becomes successful and experiences growth, managers need to establish a chain of command, assigning responsibilities and authority to subordinates so that decision making becomes decentralized and work flows smoothly. His subordinate managers may not be able to handle this, given their behavior as reflected in the case.

10. How does Robert get most of his information about the Division's problems (from formal or informal channels)?

Although Robert has convened a formal, quarterly meeting, he relies almost exclusively on informal channels. He probably prides himself on his 'open door' policy and approachability. While the result is a comfortable work atmosphere, too often Robert is blindsided by problems that have reached the crisis stage before he becomes aware of them. Further, he is at the mercy of everyone who approaches him with a request or problem. His reaction during the meeting of slumping in his chair is indicative of a docile personality, not very useful in critical situations.

11. How well-developed and functional are the formal communication channels at the DSL Division?

Formal communication channels appear to be neither developed nor functional. Robert's readiness to abandon the quarterly meeting's agenda is an indication of his poor use of formal communication channels. Further, his office staff do not hesitate to dump their responsibilities on him so they can 'take a break.' Formal lines of responsibility appear to be ignored.

12. To what extent do the managers rely on informal channels to communicate with their Director? With each other?

Robert's staff and managers appear to rely entirely on informal channels to share information. Notice, for example, how Robert is stopped six times by employees as he walks toward the front of the meeting room. During the meeting people feel free to interrupt each other and blurt out their thoughts, regardless of the impact on morale. When Robert attempts to take over again, he fails to move the discussion beyond griping and blaming. He gives up and adjourns the meeting.

13. What should be done to strengthen the formal communication network, especially meetings?

First, Robert should establish a regular reporting system. He should not have to request information such as found in Exhibits 1 and 2; it should flow to him regularly and often.

Second, his managers and staff should acknowledge and accept their spans of control. They should be held accountable for solutions to their department's problems rather than being allowed to pass them on to someone else. Further, they should be told to come to the director with solutions, not with problems. Asking the managers to do other departments' work (as when the marketing manager was asked to join the customer service department) should be stopped immediately.

Third, a schedule of frequent (perhaps weekly), formal staff meetings should be established for information sharing.

Fourth, Robert needs to clarify to his office staff (Mike, Shera, and Samantha) the importance of coordinating their tasks and breaktimes so that he is free to pursue his own tasks. Robert should not be expected to fill in for them.

Marketing

14. How do you account for the rapid growth in demand for this program? Is the growth a result of effective marketing or is it that the product, on its own, meets a valid need in the marketplace?

DSL's product is definitely selling itself. Witness the fact that the customer base has continued to grow despite Randy Hall's marketing efforts being put "on hold" for a month. Word of mouth is a powerful sales tool.

Additionally, it is very difficult to sell this system of education to someone who is not already seeking it. The pairing of the market need to the division's product creates the transaction (the adoption of the satellite learning process). The point of the marketing effort should be (as Randy asserts) to increase sales. That the division needs a marketing person (much less a marketing manager), however, is highly questionable.

COUNTING THE RETURNS: WHAT CONSTITUTES FAIR DISCLOSURE?

David Coffee, Western Carolina University
Roger Lirely,Western Carolina University

CASE DESCRIPTION

The primary subject matter of the case is accounting for returned merchandise. The student is confronted with ethical issues about the responsibility of independent auditors to insure full disclosure, when such disclosure might not be specifically required under generally accepted accounting principles (GAAP). The case has a difficulty level of four/five and is appropriate for intermediate or graduate level students. It is designed to be taught in one hour and requires two hours outside preparation by students.

CASE SYNOPSIS

Hair Force One is a closely held manufacturer of aftermarket motorcycle parts. The company has done well in recent years, and there is speculation that larger companies may be targeting the company for buyout at a handsome profit to the shareholders. Recent quality control problems have led to a significant increase in sales returns and allowances. Nancy Clark, the firms' independent auditor is concerned that following the industry practice of reporting net sales may not fully disclose relevant information about the company related to the large number of returns and the quality control problems. Yamato Zhu, the major stockholder of Hair Force One, opposes any disclosure about sales returns and allowance, arguing that such information is proprietary. Students are required to research GAAP pronouncements and accounting literature to determine the generally accepted accounting for sales returns and make a series of professional judgments about professional responsibilities of independent auditors. Students must address issues about what is and is not proprietary information and what constitutes full disclosure.

INSTRUCTORS' NOTES

This is an illustrative case intended to create an unstructured situation that will require students to conduct accounting research and apply professional judgment.

Objectives:

The case has the following objectives:

Objective 1: Require research of professional accounting literature for guidance on the proper reporting of sales returns.
Objective 2: Focus attention on the fundamental differences between financial accounting for external reporting purposes and managerial accounting for use in internal decision-making.
Objective 3: To make students aware of the type of pressures which independent auditors encounter.
Objective 4: To make students aware that professional judgment is often exercised in situations involving "gray" areas. A definitive right or wrong answer may not exist.

Recommended Teaching Approaches:

Assign the case as reading prior to class and require students to search authoritative literature, such as Wiley's Original Pronouncements or Current Text. A useful teaching approach is to assign one or a group of students to assume the role of Nancy (the independent auditor) and one or a group of students to represent the view of Yamoto (management). These students could then negotiate the issue of properly reporting the sales returns.

Another approach, suitable for a graduate financial accounting class, is to ask students to use the FASB's Concepts Statement 2, Qualitative Characteristics of Accounting Information, as a framework to evaluate the issue.

DISCUSSION QUESTIONS

1. Research the professional accounting pronouncements to determine if there are guidelines on reporting sales returns and report your findings.

Although not authoritative as a source of GAAP, the FASB's Conceptual Framework is a good place to start. Statement of Financial Accounting Concepts 2, Qualitative Characteristics of Accounting Information, provides helpful guidance. Does separate disclosure of gross sales and sales returns have decision usefulness? This question is answered by examining the relevance and reliability of the information. The relevance is assessed the predictive value and feedback value of the information. Reliability would be assessed by verifiability and representational faithfulness. The materiality threshold for recognition would have to be met. Students may differ on these assessments, but we suggest that this information has both relevance and reliability.

Moving from the non-authoritative to authoritative pronouncements provides little help. Statement of Financial Accounting Standards No. 48 Revenue Recognition When Right of Return Exists specifically states that it does not apply to "sales transactions in which a customer may return defective goods, such as warranty provisions." (paragraph 4) Even if it did include such transactions, Statement 48 does not address the net versus gross issue, but rather, the issue of whether sales should be recognized at all.

Without a specific pronouncement addressing the issue, the student must then consider sources that might establish generally acceptability. Such sources would include surveys of annual reports to determine the actual reporting of sales returns. Such surveys will indicate that the generally accepted reporting of sales returns is to report them at net.

2. If you were Nancy, would you require Hair Force to report both gross sales and sales returns? Why or why not?

The research on the issue will allow, and in fact support reporting the sales at net. The problem will be the issue of "full disclosure" long followed by the accounting profession. This concept requires the disclosure of all financial information which is relevant to a knowledgeable decision maker in making investment and credit decision about a business entity. A strong case can be made that the separate disclosure of gross sales and sales returns provides relevant and reliable information to the decision maker. Students will have to reach their own conclusions as to what they would do. We hope that recent events in financial reporting like Enron and World Com might focus attention on the value of more transparent financial reporting and lead to students exercising professional judgment in favor of disclosure of both gross sales and sales returns.

3. Discuss Yamoto's assertion: "…you need to understand that some kinds of information are just plain proprietary and not the business of those outside the company…our responsibility to outside users…is to fairly measure and report net income and we are doing this by reporting net sales. Gross sales and sales returns are management information which we use to manage the company."

Yamoto's assertion is certainly true. This is an excellent way to get students thinking about the differences between management accounting and financial accounting and the idea of "proprietary" information and information which those outside the business have a right to know. Even the most militant advocates of full disclosure would acknowledge that some types of financial information are for management eyes only and would compromise the competitive position of the entity if disclosed. Such information might include highly disaggregated data such as individual salaries or certain detailed costs. Rates of product failure on individual products (perhaps the situation in this case) could be regarded by some as this kind of confidential proprietary information. Students can decide either way, but should be required to provide a basis of support for their conclusions.

4. Are there other areas of Hair Force's financial statements which might be subject to increased audit risk because of the sales returns?

Sales returns would require increased attention to inventory valuations, to insure that the returned inventory is properly valued and accounted for. Finished goods inventory, although not material in amount, has increased 400% and should receive increased audit attention. Accounts receivable has increased more than 100%, which is well above the 41% increase in net sales and require increased attention to ensure that adequate allowances have been established for the returns.

LABOR RELATIONS AT SMEAD MANUFACTURING COMPANY'S CEDAR CITY PLANT

Roy B. Johnson, Southern Utah University
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CASE DESCRIPTION

The primary subject matter of this case concerns labor/management relations. Secondary issues examined include company strategies in Labor Relations, Collective Bargaining, and Legal issues associated with Labor/Management Relations. The case has a difficulty level of four to five and should be appropriate in both undergraduate and graduate courses in labor/management relations, human resource management, or strategic management. The case is designed to be taught in either one or two class hours depending on instructor preference, with one to two hours of outside preparation by students depending on the use of the bargaining role-play exercise. Employee names have been disguised to protect their privacy.

CASE SYNOPSIS

This case examines the relationship between a company and labor union nearing the end of their first contract. The key issue to address is management's overall labor relations strategy to date and what is and is not working. This assessment will then become the basis for management preparation to begin bargaining of a new agreement. There are a number of secondary issues that can also be explored through the case including the company's decision to re-locate the plant from the Los Angeles, California area to a remote rural area in Southern Utah. An assessment of management's approach to bargaining over the first agreement and its outcome should also be explored. Depending on the amount of time the instructor chooses to devote to the topic, the case also presents a collective bargaining role-play opportunity.

INSTRUCTORS' NOTES

Recommendations for Teaching Approaches

The instructor can make assignments on a team or individual basis. All students should be required to develop responses to the assignment questions. Teams or small groups could then be utilized to reach a consensus as to conclusions. A collective bargaining role-play exercise could easily be utilized with teams assigned to represent labor and management. The teams could be assigned to utilize different bargaining strategies and develop contract proposals in their respective roles.

Specific Questions, Assignments, and Teaching Methodologies

1. How would you characterize Smead's overall labor relations strategy?

Smead's strategy could be characterized as a combination of union suppression and avoidance. The move from Pico Rivera, California to rural southern Utah under the guise of reducing cost. Firms looking to avoid unions typically locate plants in arrears where competitive wage rates and union membership are low.

Additional support for union avoidance strategy is seen in the letter to employees from the plant manager and the memo from Rose Winnere. Dragging out bargaining over the first contract is also typical of a union suppression strategy.

2. What is your overall assessment of Smead's labor relation's strategy to date? What is working, what is not working, and what should the organization be doing differently?

Since Smead lost the union representation election, their initial goal of union avoidance was not realized. With respect to union suppression, the dragging out of bargaining over the first contract, and some of the language in the letter home from the plant manager did seem to be effective. According to local union officials, the union has been unable to entice a majority of the employees to actually join the union. The union's financial position is also reportedly so week that the union could not afford to process a grievance to arbitration.

Some students might suggest more positive human resource management practices as a way to avoid unionization. Employee quotes like "We're treated like cattle. In some instances, I think cattle are treated better" could be sited as an example that the unionization effort at Smead was about more than just wages.

3. How would you characterize Smead's approach to collective bargaining? Assess Smead's approach to collective bargaining over the first contract. Was it effective? Assess the parties bargaining power in this relationship.

Smead's approach to collective bargaining is clearly what has been described as a distributive approach. This approach tends to view the two parties interest to be in conflict and the negotiation process as a win-loose (zero-sum) exercise. As far as bargaining power, there is clear evidence that Smead is the party with greater bargaining power in that the first contract clearly was on their terms and the lack of a union majority in the bargaining unit. With current economic conditions in the area, Smead is clearly still in control. (Suggested reading: Chamberlin and Kuhn, (1965) Collective Bargaining, McGraw-Hill. Given that Smead has the upper hand, staying the course is probably in order. The weak position of the union makes it unlikely that the union will be able to make strong demands. Decertification of the union is also a possibility given the union's inability to convince a majority of the bargaining unit to pay dues. (Utah is a right to work state and employees cannot be forced to join a union even though federal labor law places a duty on a union to represent all members of the bargaining unit covered by the contract).

4. **With the contract expiring in four months, what approach would you recommend? Why?**

5. **Role Play: have students assess relevant labor market, economic, political, and social conditions in preparation for bargaining. Give students time to prepare their bargaining strategies. Suggested background reading for the students would include Walton and McKersie (1965), *A Behavioral Theory of Labor Negotiations,* McGraw-Hill, and Chapters 4 and 6 of Holly, Jennings and Wolters, (2001), *The Labor Relations Process*, Southwestern.**

    Role for Union Members: You are a member of the Paper, Allied-Industrial, Chemical & Energy Workers International Union (PACE). Your major concerns continue to be wages and job security. You want to improve the contract in four major ways (1). A substantial wage increase and shift differential; (2) a cost-of- living adjustment clause; (3) more paid time off (holidays); and (4) more retirement options and increased employer contributions to those options.

    Role for Management: Your primary goal remains to keep labor costs down. Weak market demand has put your company in a difficult competitive position. Major objectives are to (1) keep wage increases cost effective; (2) to maintain flexibility in layoff procedures and (3) to increase employee contributions to the cost of benefits.

EPILOGUE

In June 2003, the employees voted to decertify the union. This election occurred with a minimum of publicity and no response from the community

REBOUND SPORTS TECHNOLOGY

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CASE DESCRIPTION

This case was developed for and used in an MBA marketing elective, Marketing for New Ventures. It has also been used in an undergraduate marketing management course. The focus of the case is on the entrepreneurial questions, Can the firm be profitable? and, What form should the firm have? The essential problem is that it is not clear that RST can be profitable given its current strategy; if not, students must determine a better strategic direction. Then, the question is how the best strategy can be executed. Specific challenges include sales management, channel relationships (getting distribution), product line management, and some advertising and segmentation issues, which may provide sufficient material for use in marketing courses. The case is moderately difficult, appropriate for juniors and seniors or graduate students. It is designed to be taught in one class session and typically requires three or four hours of student preparation work.

CASE SYNOPSIS

Rebound Sports Technology (RST) is an example a classic entrepreneur's challenge- building a sustainable business from a personal aspiration. This case is a chronological, first person account of a baseball enthusiast's passion and sacrifice to bring the joy of hitting a baseball to children. The entrepreneur, Larry Cripe, has developed a unique product to help new baseball players enjoy the experience of a well-hit baseball and also help established baseball players maintain their baseball hitting skills. The product has received strong endorsements from users and opinion leaders, but it simply hasn't made much money. Now, investors are out of patience; Cripe must design a business and marketing plan that will make RST profitable and meet his own personal objectives, if possible.

Students follow the venture to the point where Cripe must make critical decisions for long term success. The decisions require a clear understanding of the financial, marketing and managerial challenges facing RST. There is sufficient documentation in the case and exhibits to come to this understanding. The more difficult and exciting component of this case study is to derive an integrative market strategy that will achieve a sustainable competitive advantage for Rebound Sports Technology. To do so, students must think critically about the business opportunity, the basic objectives, and the competitive strengths and weaknesses of RST. Students should be able to apply whatever they have learned about business strategy.

It is useful to review RST's web site and competitor web sites to learn the benefits of the products and alternative technologies used in batting instruction. An internet search on such key words as "baseball equipment" or "batting equipment" will lead to many sources. The instructor may also suggest specific readings related to business strategy. Students will find sufficient data *in the case for most of their analyses; but, suggestions for new, creative strategies may require additional research.*

INSTRUCTORS' NOTES

Recommendations for Teaching Approaches

The essential objective of the case is that students should learn to evaluate entrepreneurial ventures, not in the narrow sense of the product, but in terms of strategic opportunity-sustainable competitive advantage, consistency with the entrepreneur's goals, and ability to execute as needed.

To achieve this overall objective, students must learn to

♦	define the proper market,
♦	understand and anticipate competitive strategy and response,
♦	evaluate consumer perception of the proposed product,
♦	conduct basic financial feasibility analyses,
♦	articulate personal goals and risk tolerances, and
♦	identify the organizational and marketing resources necessary to execute a business strategy.

Teaching Plan

The RST case is an good application of the concepts presented in Amar Bhide's, "The Questions Every Entrepreneur Must Answer," Harvard Business Review, November-December 1996 and "Note on Building the Self-Sustaining Firm," HBS case No. 9-395-200, 1996. These readings are assigned to students prior to the case study, as part the general readings relative to the environmental conditions that generate innovations and motivate entrepreneurs to pursue market opportunities. Instructors should consider assigning these or similar readings in conjunction with the case.

The teaching plan follows Bhide's questions for entrepreneurs (Are my goals well defined? Do I have the right strategy? Can I execute the Strategy). Correspondingly students are asked to identify Cripe's goals as an entrepreneur, assess RST in terms of sustainable competitive advantage, and analyze options for executing the necessary strategy.

If possible, instructors should obtain a SwingAway for the classroom, but a promotional video, which can be obtained from the company, works very well. The company website provides excellent illustration of the product. Begin with an evaluation of the product. Students typically give it very favorable reviews, supporting Cripe's contention that once people use it, they want to buy it. From this favorable evaluation, the discussion can move through the Guide Questions.

Once students have discussed the product a bit, the instructor can raise the central question-Does a good product make a good venture? From that, an application of Bhide's questions can be put on the board as an outline: 1. What are Cripe's motives for this venture? 2. Does the current strategy match those motives? 3. Is there a market for this product? 4. If so, what strategy will turn the firm around in the short run? 5. What strategy is appropriate in the long run? The Guide Questions for the case address these issues.

Guide Questions

1. What factors led to the development of the SwingAway prototype?

Passion for the sport of baseball (Cripe is a former player.)
Personal need to instruct son with hitting techniques.
Desire for an effective and convenient tool for hitting instructions.
Belief that improved hitting enhanced joy of baseball and led to increased general confidence and self esteem.

One point to make early on is the noticeable absence of financial motivation. Although a case can be made that Cripe is strongly committed to RST, it does not appear that his original motivation was to make money. Moreover, his commitments to baseball and improved instruction were evident from the start.

2. What motivated Cripe to pursue the commercialization of his prototype?

Previous experience and success as an entrepreneur.
Favorable reviews from associates who experienced the same "needs".
"Fortuitous" events:
Chance meeting with Seattle Mariners video coordinator.
Introduction to, Jay Buhner, who was favorable.
Baseball strike of 1995-presented opportunity of mariner's batting coach to assess the usefulness of SwingAway and subsequent purchase by players to use during strike.
Personal contacts, selling ability, and "passion" for providing both baseball instruction and value for children:
Ability to recruit a prestigious advisory board and board of directors who encouraged his pursuit.
Cripe was an effective salesman and performed well as original product designer and fabricator.
Strong personal commitment to "art of hitting" and potential value of enhanced self-esteem to children.

The objective of the first two questions is to guide discussion to the personal goals of the entrepreneur. The case does not offer a clear picture of Cripe's motivation and commitment.

Some students will argue that the RST venture is so closely aligned with Cripe's personal motives that it is a "lifestyle" venture. Perhaps a stronger argument can be made that Cripe's business experience, the involvement of professional business people as advisors and investors, and his choice of corporate structure imply a desire to build a "sustainable business," one that can thrive even without his continued personal involvement. Also, Cripe has made a substantial financial commitment to his investors and invested his own funds. Students who argue for a profit motive must account for Cripe's refusal to accept the offers from Precor or Huffy Sports.

The goal of this discussion is an understanding of Cripe's motives and risk tolerance. Students should assess the venture in terms of its consistency with those personal factors. After defining Cripe's personal goals students will be prepared to recommend strategic choices and resource commitments in the subsequent discussion questions.

3. Assess the "market opportunity" for the RST products.

A first question to ask is the feasibility of the SwingAway as a profitable venture. Students should attempt to measure the size of the market for SwingAway and related products and services. From the case, students will conclude that the potential market is significant. As many as 29 million annual baseball and softball participants, with additional institutional customers, such as schools, recreational facilities, and professional and amateur baseball/softball teams, represent a sizeable market opportunity, though geographically dispersed.

Students should also attempt to determine a "break-even" sales requirement and evaluate the market penetration required to meet this sales level. Students will need to make reasonable assumptions in estimating the fixed costs for break-even analysis. A minimum estimate would amortize the fixed assets and start-up costs over a relevant time frame (recommend 10 years for plant facilities and five years for start-up costs and furniture). Some students will develop a break-even with a targeted return on investment to determine the revenue necessary to meet an adequate return on its $3,188,000 investment (Contributed Capital from Exhibit 1, recommended discount rate of 20% with this level of financial risk.)

Exhibit A shows examples of calculations.

Students may present an "economic value assessment" of the SwingAway compared to competitive offerings to selected market segments. From the competitor analysis (Exhibit 3), students can develop indexes to compute the price point for SwingAway. Exhibit B shows an example.

After presenting break-even and DCF models students should conclude that the SwingAway has great market potential. This conclusion is enhanced by the opportunity to manufacture in Taiwan, which would reduce his fixed costs and allow flexible manufacturing capacity.

4. What strengths and weaknesses does Cripe have relative to reaching his goals?

Students may come up with a number of responses. The discussion should focus on givens and not jump ahead to aspects of strategy, which are at issue in subsequent questions. The structure of the discussion could be presented in the following format:

Capital Requirements: Like most entrepreneurial ventures RST faces critical financial hurdles. After 6 years of losses accumulating to $1 million (Exhibit 5), RST has achieved its first profit. However it had to cut expenses drastically, and its profit is the result of positive word of mouth from building a favorable (albeit small) customer base. Clearly it will need substantial funds in order to build a sustainable business. Its funding options are complicated by the fact its initial investors are becoming impatient as noted by their recommendation to take the deal with Huffy. In the subsequent discussion of students' strategic plans, the financing component should be a key consideration.

Management and employee capabilities: Cripe has demonstrated exceptional selling skills in convincing customers of the value of SwingAway and convincing investors of RST's profit potential. He has also developed an impressive network of contacts to support the enterprise and a management team with strong technical and customer knowledge (Exhibit 2). Students may state concerns about Cripe's willingness to recruit and delegate authority to a CEO since he has already dismissed two CEOs and has yet to hire a replacement after two years. However the management team is highly credentialed and should have the ability to pursue diverse growth opportunities and recruit and manage skilled personnel.

Marketing communication and distribution capabilities: RST's challenges in achieving product awareness and customer access are major barriers. Not many people know about SwingAway or have the opportunity to try it. A major advertising campaign could achieve the necessary brand identity, but it is unlikely that Cripe could justify a non-recoverable investment in mass media communications. Attaining widespread retail distribution appears equally unlikely. Given the limited money available, the venture capitalist's proposal of insuring the investment in an infomercial is intriguing. The returns would satisfy the speculative investor and establish brand recognition for SwingAway for a longer-term benefit. For most recommendations, students should be aware that they must wrestle with the strategic and tactical issues of communications and distribution programs.

5. What should Cripe do to build the RST business?

Like most new ventures based on a unique product concept, the breadth of options to achieve profitability are considerable. It is important to emphasize that Cripe must maintain and build RST's profits, ensure RST's solvency, and reassure current investors before longer-term strategic decisions (the next question) can be considered. After five years of losses, RST faces a critical cash flow challenge that prevents long term investments. It is important to insist that students offer specific strategies that are affordable and can be supported with clear tactics. The following four strategies are generally offered as potential directions RST could pursue:

1. Expanding and improving the current strategy:
   Some students will suggest that RST could be profitable if they simply did a better job executing the current direct marketing strategy. Several approaches, or some combination, can be proposed-creative new promotions, revised sales management, or a commitment to a "grass roots" effort. Whatever students suggest, they should be pushed for specifics, with cost estimates, sales forecasts, and break-even analyses, which will require reasonable assumptions or estimates. Exhibits C and D show calculations for two sample proposals.
2. Shift the distribution channel to retail outlets:
   To discuss retail distribution, students must consider the criteria retailers use to decide what products to stock. Among them, the discussion should identify the following:

   Profit per square foot.
   Consumer expectations-a sporting goods store must sell baseballs; a grocery store must sell milk.
   Demand drivers-a low profit item may compensate by bringing in additional customers or enhancing the satisfaction of the usual customers.

   How can RST respond to these retailer demands?

   SwingAway's space requirements probably make it undesirable. The SwingAway brand is unknown, so no consumers are going to expect any store to stock it. It may be argued that a SwingAway display would be an attractive demand driver, but it is unlikely that that benefit could off-set the space requirement.

   The usual incentives entrepreneurs make to retailers are higher profit margins, some type of guarantee (taking back unsold merchandise, for example), demonstrations of consumer interest (success in other areas or other channels), assurances of marketing support (advertising, promotion), and arguments that the product will sell itself, based on its merits. Students should be prepared to make a credible case for RST on these or other dimensions. (Not an easy task: In addition to being an unknown brand with excessive space requirement, a further concern for retailers would be the additional liability for injury-customers are bound to want to take a few swings with a bat.)

   The alternatives would be to introduce in non-typical retailers, where space is not so valuable-Costco, Sam's Club, and other warehouse stores (questionable if RST could generate sufficient volume); introduce during good weather months or in good weather climates, where outdoor space is available; or, get access to space on a temporary basis, with demonstrations designed to increase store traffic while spreading the SwingAway word. These may be used in combinations. Students should be encouraged to be creative with other approaches.

Students may identify a brand building strategy based on retail penetration with other RST products under the SwingAway brand name. The case identifies several products that could be packaged under the brand. These products could then promote the SwingAway Trainer both through package information and in-package printed or video brochures. However, there is little reason to expect that retailers would be eager to accept the other products, which are equally unknown and lack the intrinsic appeal of the SwingAway. RST does not have the money to support the promotion necessary to build a brand that would attract retailers.

3. Enhance direct to consumer sales with a direct response infomercial campaign: Students will be familiar with infomercials they have seen, and a lively discussion usually results. (I have had success in my marketing classes by assigning groups of students to "produce" the first 5 minutes of an infomercial on videotape.) The discussion should be directed toward characteristics that determine the success or failure of infomercials. A good source of information is the Script-to-Screen website, http://www.scripttoscreen.com.

Students should recognize the risk in this option. First, it is an all-or-none alternative, since it would require all the available marketing funds, at a minimum. Second, the success rate for infomercials is not high; industry estimates are that only one in five breaks even. And, a modest success will be no success for RST, given the payback required. Students should calculate the sales necessary to pay back a minimum $1 million (the maximum profits foregone to the VC). Assuming the Taiwan production with cgs at $72 ($65 plus $7 shipping), break even = $1,000,000/(400-72) = 3048. That figure is an increase of 30% over the last year; and, that payback level ignores any need for keeping revenue to fund operations during the payback period. Further, it is too low to justify the off-shore production (minimum of 4000/year). With a higher cost of goods sold, the break-even is higher (3226 with cgs=$90).

Students should also discuss the logic in the option. The high required level of success does not eliminate the option from consideration. If potential diffusion of the SwingAway follows a typical innovation adoption curve, success may merely be a function of achieving some threshold level of sales. Cripe's observations seem to support this idea-that people simply need to be exposed to the product to appreciate it. An infomercial would be both a way to promote it in detail, in motion, and in color, and a way to generate sales that would lead to other sales. The ultimate question is whether there may be less risky ways to achieve the necessary early sales.

Students who argue for the infomercial option should discuss the following:

level of production and inventory ramp-up necessary

the need to lower cost of good sold

integrating the infomercial into the marketing mix-at the very least, the infomercial may be a valuable reference ("as seen on TV"); other expansion plans will have to be delayed; and, a tie-in with retail distribution may be feasible

specifics of the infomercial-spokesperson, information, demonstrations, cable channels and times

4. The SwingAway Academy:

The Academy idea may function either as a focus or a companion tactic. Students should do a breakeven analysis. The case estimates $25,000 to outfit a facility. If we assume a 5-year payback on that, it means a fixed cost of $5,000 per year. Add to that the salaries of $50,000 and $25,000 (which might also be paid on a commission basis) and the rent/utilities of $25,000 for a total fixed cost of $105,000 per year. The forecast of 600-700 students seems conservative-fewer than 25 students per week. On the low end, 600 would generate revenues of $165,000 (600 x $275). That's a $60,000 gross profit. In addition, if 30% of the students bought SwingAways, it would add another $49,500 (.30 x 600 x $275). *Note that the gross margin of $275 reflects the application of $75 from the fee--$400-$150 cgs-$75 fee.) Thus, each outlet is estimated to return almost $110,000 gross profit on an investment of $105,000. That return would be reduced by whatever promotion was necessary to support each academy.

RST could afford to set up three Academies easily and might launch all six that Cripe has in mind, given that most of the fixed costs will be paid out over the course of the year and could be funded from income.

The franchise idea may ultimately be workable, but it is clearly dependent upon some demonstration of success.

6. What "strategic" direction should Cripe pursue to make RST a sustainable enterprise?

After students have discussed ideas that provide a foreseeable financial self-sufficiency for RST, they are prepared to address the longer-term question of RST as a sustainable enterprise. At this stage students are asked to construct an enterprise that incorporates distinct capabilities that are defensible. The greater short term success RST is able to achieve, the keener competitive pressure it will face for the long term. RST's innovative product (SwingAway) has attracted investors and customers but the firm must face the phenomenon of the "next wave," when competitors imitate, and access to financial resources and talented employees diminishes. At this point students are asked to define a clear business position that will optimally leverage the unique capabilities and resources of RST. Its long term success depends on a durable business model that continuously upgrades skills and integrates complementary capabilities to build what Bhide terms "an innovative business system."

Before constructing a strategy for a more sustainable competitive advantage, it is useful to ask students to articulate the limitations RST faces. The constraints they must consider include:

No additional investment capital. It is clear from the case and RST's financial position that current investors are expecting immediate returns and that it is unlikely RST could attract much more from additional investors.

Economies of scale are unachievable. Larger sales volumes do not generate greater cost efficiencies. RST's production process requires high and constant variable costs as confirmed by the invariable cost of goods sold percentage as shown in Exhibit 3. Furthermore, if RST subcontracts its production to Taiwan its variable cost will be constant. If volume and geographic expansion are dramatically increased, distribution complexity and costs of coordination may even lead to diseconomies of scale. The suggested marketing options discussed in the previous section do not increase profitability disproportionately, and the financial resources for a rapid growth expansion are unavailable. It is unlikely that national or global manufacturing economies of scale, which might provide a competitive cost advantage, would result from expansion, even if expansion were feasible.

The SwingAway's product line does not insure customer loyalty (either end-users or trade). The SwingAway is not a repeat purchase product, so RST cannot hope to capitalize on satisfied customers beyond positive word of mouth. There are no switching costs to keep customers from buying one RST product and another from a competitor; nor does the product adapt to additional value added accessories or upgrades, other than replacement parts.

Product line innovations will be evolutionary. Changes and additions will be modifications to the initial break-through concept.

The product is not protectable. Although Cripe had applied for patent protection, he had not yet received it. Moreover, with nearly similar products already available (Solo Hitter), it is likely that a competitor could work around a patent to imitate the SwingAway.

If students do a careful analysis of RST's characteristics, they should conclude that the prospects for a sustainable competitive advantage are not good, with the firm's current strategy. It would be very expensive to establish a leadership position; such a position would not likely provide competitive cost advantages; and, already strong sports equipment manufacturers are in a position to challenge for leadership of any market that RST succeeds in creating.

Those students who have argued that Cripe's motivation and risk tolerance are not appropriate for a commitment to expansion and a market leadership position may propose that an appropriate long term strategy is some continuation of whatever they proposed in the previous question-so long as RST is reasonably profitable. Those students who argue for a more aggressive commitment, must propose a long term strategy with a greater chance of success. In that discussion, Cripe's role and the subsequent infrastructure of RST quickly become the focal point. If Cripe were to maintain control, the critical asset that RST could leverage is its knowledge in training "batting skills". RST will need to transform itself from a manufacturer to an educational service company, leveraging their accumulated teaching expertise, the suitability of the SwingAway for instructional purposes, and their emerging technology.

Many students will suggest that RST refine and expand its SwingAway Academy concept. With this focus RST could limit its manufacturing operations and focus its research on technologies to train batting skill. This technology could include state of the art electronics initiated through is technology grant and alliance with Video Motion. It could combine such electronic technology in its mechanical product to augment superior personal instruction from its skilled instructors. RST's human resource management efforts would emphasize the recruitment and training of talented hitting instructors. RST could capitalize on it contacts with professional players and coaches. Their marketing efforts would continue to leverage regional and community tactics with a goal of establishing academies as the destination site to improve "ball hitting skills" for baseball and softball participants of all ages. As was noted from it initial test, most of the participants purchased a SwingAway after their initial instruction. It is likely that students would return to the academy for "fine-tuning" and thus RST's customer relationship efforts will generate longer-term revenues through customer loyalty. Furthermore, financial constraints are mitigated by the ability to launch academies on a "pay-as-you-go" basis due to its relatively low fixed cost per academy and reasonably short pay back period (students should use the cost figures from the case to justify this premise.)

Some students will suggest franchising academies to accelerate growth. This idea has the added benefit of reducing the financial risk to existing investors, eliminates the need for RST to finance facility start-ups, and attracts new investors to RST in its new role as a franchiser.

In summary the academy concept leverages the unique talents and technology of RST while reducing its commitment to expensive and non-significant manufacturing assets. It would be a strategy ideally suited for Cripe's management competence and passion for skills-training.

A final strategic alternative that some students will propose is to sell RST to a national sports equipment manufacturer that could augment its existing product line with the SwingAway models. This would be an opportunity for a national firm to leverage its existing brand recognition and resources to acquire a new customer group with this innovative product. However, given the retailers' resistance to merchandise this product, the fragmented nature of the current direct competitors and the low purchase offer from Precor, the opportunity for Cripe and his investors to receive and adequate return on their investment seems remote. Students should also be challenged to relate this option to Cripe's goals of providing hitting instruction and confidence to "every kid in the country." Has his opinion changed since 1996?

EPILOGUE

In January 2002 RST issued the following press release:

"Hitting machine maker Rebound Sports aims to build a franchise in baseball instruction" This summer, the company hopes to open the second of what could be a series of baseball academies. SwingAway already operates one academy in its 12,000-square-foot manufacturing facility off 84th Avenue South in Kent.

Three months ago, Cripe turned his obsession over to Brian Cooper, who helped start Bogart Golf, a Bellevue-based company that uses similar technology to teach golf. So far, the company has existed on its revenues and $920,000 in angel investments. But Cooper, who is now chief executive officer, is hoping to land $1.5 million in new venture capital to help the company expand the baseball academy side of the business-"We hope to brand the idea of baseball instruction," Cooper said.

The academies are staffed by baseball and softball coaches who teach the mechanics of hitting and pitching using a combination of video and a high-tech wand that attaches to a bat. The wand records every movement of the batter's swing-everything from bat speed to how far in front of the plate the hitter's wrists are when they make contact. That information is then stored on a computer. Plans call for expanding the company's Web site to include a streaming media component that would allow players to view their lessons over the Internet.

Within the next year, SwingAway hopes to open four baseball academies in the Seattle area, and then expand into three more cities by 2003. Cooper also plans to add 10 new part-time sales positions in the next month and hopes to have the company's first infomercial in place by summer.

Exhibit A Estimated Breakeven Volumes		
BREAK EVEN ANALYSIS: B.E.=FIXED COST/CONTRIBUTION		
FIXED COST:		
Amortization Costs:		
Plant & equip	$275,000	
Furn./start up	60,400	
Administrative costs:		
	$400,000*	(* estimate of G&A expense from ex #3)
Total	$735,400	
Contribution margin = $399-$150=$249		
B.E. = $735,400/$259= 2953 SwingAways/year		
BREAK EVEN WITH TARGET RETURN		
A simplified version would determine the perpetual cash flow required to deliver a 20% return on the $3,188,000 capital investment.		
If the annual cash flow is $3,188,000, a 20% return = $637,600. This return requirement increases the break-even to $1,180,600/$249 = 4741 SwingAways/year.		

Exhibit B Competitor Ratings and "value" price*							
Products	Swing Guides	Rotators	Ball/Screen-Toss	Ball/Screen-Tether	Pitching Machines	Swing - Away	Total
Attribute Summary	18	21	22	26	27	28	142 23.6
Prices-aver.	$100	$250	$300	$130	$1500	$399	$546
"Value" Price	$409	$477	$500	$591	$614	$647	
* "Value" price indicates the perceived value of the "hitting machines" relative to their average attribute weightings.							

Obviously, this calculation is skewed by the expensive pitching machines that are likely purchased by an affluent segment of the hitting machine market. However, the SwingAway does seem to be competitively priced for its features.

Exhibit C Investing in Roving Vans for Demonstration and Trial
One option would be to invest in one or more vans, as Cripe originally thought. Each van would be run by two salespeople who would spend a few days, up to a week, at various locations-fairs, baseball camps and tournaments, schools, etc., during the six months of best weather. Students should provide estimates of the following:
Depreciation and expenses for a van, probably about $25,000. (Reasonable estimate that students could make.)
Expenses: If each employee is given $500/week (2 employees X 25 weeks X $500 = $25,000) and paid a base salary of $15,000 each ($30,000), the tactic would have a base fixed cost of $80,000. (Students should be expected to propose some similar estimates for expenses.)
Break-even: Given a gross margin per unit of about $190 (which assumes a per unit cost of about $150 and a sales commission of 15%), RST will need to sell only 422 units to break even-about 17 per week. At that level of sales, the commission would be $25,320 or $12,660 per salesperson. Thus, a total salary of $27,660 for 6 months' work. The potential income would likely attract salespeople, especially young baseball enthusiasts.
Target return: Students should do the spreadsheet work to find the sales levels that would produce various returns. (A 25% gross profit to the investment would be a reasonable goal. It would result from sale of 527 units-21 per week ($100,000 is 25% in excess of the $80,000 investment. $100,000/$190 = 526.3.)

Students should observe that this tactic is feasible in terms of costs, required production, and ability to attract salespeople. Students should also consider how the venture would be affected by promotional support. How much advertising would be needed in each location? Regardless of the short term financial return to investors the publicity and advertising would help establish brand awareness for SwingAway.

Exhibit D Revised Sales Management Program
Many students will observe that RST's sales force is poorly managed and ineffective. The case states that about 45 sales per month come from the web-540/year. Another 35 per month come from Baseball Weekly (15% of 300 inquiries)-420/year. It is reasonable to assume that at least another 200 per year come through the 1-800 number from other promotions. That leaves no more than 1140 sales from the last year from 120 sales reps-9.5 units per rep per year. Not even one per month. A good revision of the sales force should cover the following:
Selection: Both connection to the target market and selling ability and motivation should be considered. At present, virtually any one can be an RST representative.
Training: Currently the reps are given information only about the product. They should be given some selling and organizational training as well as information about other RST products and the SwingAway Academy (as applicable).
Organization: Reps should be organized geographically. Currently, RST could not even easily place its reps on a map; they made no effort to assure broad or specific overage. They should attempt to have reps in all major urban areas, to select reps within areas in such a way as to minimize conflict and overlap, and to coordinate rep efforts with other marketing efforts, especially expansion of the Academy effort.
Supervision/Monitoring: A management system could be developed that would be funded largely out of sales commissions. Several regional managers could stay in telephone/e-mail contact with as many as a hundred reps, making occasional personal visits (timed with regional baseball meetings, tournaments, etc.) for development and monitoring. A system of quotas could be established. With minimal analysis, the unproductive sellers could be culled and replaced with stronger candidates. Most sales reps will be working part-time. But, students should estimate a minimum pay for any serious part-time job, say $500/month. At a 15% commission, that is about 100 units per year ($500/month is $6000 per year. $6000/(15% x $400)=100 units). If RST had 100 effective sales reps, they should expect sales of 10,000 units per year (100 reps x 100 units/rep). Such a sales level would dramatically alter the scale of their business and would easily afford something on the order of 3% commission to a sales managers. (One sales managers would earn 3% x 10,000 units x $400/unit=$120,000.)

Students should observe that such a plan is reasonable in terms of attracting sales people and a sales manager. They should note, however, that the estimated sales level, 10,000, although well within capacity, is over nine times their 2001 sales. Students should be prepared to discuss whether such a sales level can be achieved without considerable investment in advertising and how sales should be expected to change over time. (SwingAways are essentially lifetime products.)

NEGOTIATING WITH THE CHINESE: CHINESE TIGER BARRELS IN THE CALIFORNIA WINE INDUSTRY

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CASE DESCRIPTION

The primary subject matter of this case concerns cultural differences in cross-cultural business negotiation between Chinese and American negotiators. Secondary issues examined include Chinese business practices and the importance of planning and preparation for the American businessperson doing business in an unfamiliar culture. The case has a difficulty level of three (appropriate for junior level) and four (appropriate for senior level). The case is designed to be taught in two-three class hours and is expected to require one-two hours of outside preparation by students.

CASE SYNOPSIS

This case study investigates the actions of a small California wine barrel company as it attempts to secures an agreement with a Chinese government forestry bureau to sell wine barrels into the California wine industry. The company operated a small but successful import distributorship selling French oak barrels and other wood products from around the world for winemaking. The marketing plan was to offer a product line covering all tiers of oak aging needs from the most expensive barrel to the least expensive oak chips. Lacking a middl- priced product, the owner sought to negotiate with the Chinese Forestry Bureau for the exclusive rights to sell "Chinese Tiger Barrels". Eventually the owner traveled to the manufacturing site in China to finalize the negotiation. He faced negotiating in a country and in a manner for which he was unprepared because of lack of prior relevant experience and planning. After a grueling five-day visit filled with elaborate formal luncheons and dinners, a five-year contract was signed by the two parties. As events unfolded the owner greatly regretted the terms of the contract and felt he had fallen victim to clever negotiating tactics that resulted in a contract that was not compatible with his best interests.

INSTRUCTORS' NOTES

Recommendations for Teaching Approaches

This case is designed to stimulate discussion about cross-cultural business negotiations between Chinese and American representatives. Although this case is specifically about the wine business and the unique characteristics of the stakeholders, it is general enough to fit most similar situations involving companies attempting to design and manufacture new product in China for export to America.

Students are encouraged to research factors of both the Chinese and the American cultures that influence negotiation before reading the case. The instructor may use the following questions, generate another list, or ask students to formulate questions about the case for whole class discussion.

QUESTIONS AND RESPONSES

1. Pursuing the Tiger Barrel was a risky endeavor for Lynn. Discuss the advantages and disadvantages of his motivation to market this barrel in California.

Advantages:

Lynn's marketing plan was to offer products to each segment of the market. He had the high end French barrel category. He covered the low end of the oak market with wood oak chips and planks. Now he was attempting to create and target a middle range of barrels between American Oak and Eastern European. The Chinese wood samples had shown unique French flavor attributes from the wood analyses performed. Therefore Lynn planned to have Chinese barrels that tasted French with a price structure very close to American barrels.

Lynn also hoped to gain recognition based on the uniqueness of the product. Due to his advertising, one of the largest wine companies in the world agreed to purchase the Tiger Barrel. The Chinese barrel was also a "door opener" for sales of his entire product line.

Disadvantages:

The Chinese supplier was new to the industry and was a government-owned company. Lynn had little hard information about Wang and Yu and the companies they represented.

Lynn had never worked with the Chinese before. He knew nothing about their culture, didn't speak their language, and was not familiar with their business negotiation style.

A poor quality product could jeopardize the reputation Lynn had taken 5 years to establish at American Consolidated Barrels.

Lynn budgeted only five days to visit the Chinese and negotiate a deal.

2. Why do you think Lynn went to China uninformed about Chinese business negotiation style?

Lynn was a successful businessman. He had negotiated with good results throughout his career with Americans, French, and Australians alike. If he could negotiate successfully with one culture, why not with another? Why would the Chinese be any different?

This is a fairly common belief held by businesspeople worldwide. It most likely stems from the notion of projected similarity: if my behavior enables me to get the results I want here in America, why wouldn't that same behavior get me results in China? I assume that because my negotiating style workers in Napa, California, it must work in Kweilin, China as well. With similar cultures, a businessperson is more likely to be successful at negotiation without modifying his style, but as the two negotiating cultures become more and more different, one should be aware that business negotiation style will begin to differ as well.

3. What should Lynn have known about Chinese culture and business negotiation style before travelling abroad?

Lynn knew little about the Chinese culture. He should have researched Chinese negotiating tactics and styles to negotiate more effectively with the Chinese, tough negotiators with motives often very difficult for foreigners to understand.

The Chinese place great emphasis on trust, friendship, and mutual connections which may later be used as pressure points in final negotiations. For example, they may point out that the spirit of friendship would be broken if things do not go as the Chinese plan, which puts their negotiating counterpart at a disadvantage. Negotiating counterparts should learn a bit about the Confucian beliefs of friendship reciprocity, social fairness and giving face to build each other up.

Location/Schedule: These are situational contingencies that the Chinese prefer to arrange. Negotiating in China gives them the upperhand, cuts down on their expenses, and gives them easy access to people and information. The Chinese can use the American's urgency to get home (Lynn scheduled 5 days in China) to their advantage by holding out with many of the specific details of the negotiation until the last few moments before the Americans are due to leave.

Time Orientation: Chinese negotiators strive for long-range benefits, not the typical shorter-term outcomes that Americans seek. They enter into a business deal with counterparts with the intention of long-term relations. If things aren't right in the beginning to one partner, there is time to work on a better solution. Wang was not anxious about immediate success in the first year. That would come eventually with further negotiation as needed. Lynn, on the other hand, was concerned about breaking even or suffering a small loss on his investment in the first year. After the faulty barrels arrive, he immediately begins to question his commitment to the business relationship instead of looking longer-term and exploring options for solving the problem.

Americans should try to arrange an open itinerary with lots of flexibility in it for departure dates. Negotiating will take longer in China than in San Francisco, California.

Size of Negotiating Team: Chinese negotiating teams tend to be far greater in size than those of their foreign counterparts. More people connotes greater power and importance, an essential nonverbal message. The higher the position of the team member, the more important the potential deal is to the Chinese and the more respect they will show their counterparts.

Lynn might have brought along a lawyer, a business associate, or even his wife to increase the size of his team and demonstrate more power.

Tactics: The Chinese may fake anger during negotiations causing the American to give into a demand to placate the "angry" Chinese.

Guanxi: Guanxi, or relationships, are very important to successful relations in China. Favors granted need to be reciprocated by recipients. The foreigner may be confused by the presence of many Chinese during the negotiating sessions. Some of these Chinese may simply be invited to the negotiation due to guanxi - their relationship to the negotiating team is being acknowledged. If a Chinese company is doing business with the government, these connections are essential. Massaging the relationship will help ensure that a contract is signed, a deal is made, etc.

In this case, Tiger Barrels belongs to the Kweilin Forestry Bureau which is controlled by the local government. Having guanxi with the government official and inviting him to the negotiation meetings will help ensure that the contract is approved by the government quickly.

Negotiation Rhythm: Americans believe that the Chinese consciously use slow-down techniques as bargaining ploys because they believe they can exploit a natural American tendency for impatience.

Sometimes Chinese make self-serving, unrealistic demands that may alert the experienced foreign counterpart some scheme is afoot.

Technical Demands: Frequently American companies are put into situations where very specific technical advice is requested by the Chinese. Non-technical negotiators should NOT cover this area; they should bring along technical experts to explain the detail the Chinese are asking for.

Hierarchy: Americans may bypass hierarchal lines of authority to accomplish a task, but the Chinese will not make any decisions independent of the top manager's approval.

Negotiators need to learn who the key players are in the foreign company and the governmental agency structure. They should attempt to find Chinese contacts beforehand who can help them communicate with the proper players.

Entertainment: Foreigners should be prepared for extravagant banquets with many toasts to friendship, trust and soon-to-follow prosperity. Large amounts of time are spent on relationship building. Informal meetings with a large number of people enable the Chinese to collect much information on their counterparts away from the formal negotiation table.

Face: The Chinese build a personal relationship with their counterpart to ensure that they are trustworthy before getting down to business. They "give face" to their counterparts by being gracious hosts, making the welcoming ritual long and extravagant. Close attention is paid to etiquette and formality. Frequent praise is given to the counterpart.

The contract: The Chinese see the contract as a starting point for a long-term relationship. It is a reference point from which the parties continue discussion. The contract is not seen as binding. Although they expect problems to arise later in the project, they feel that the mutual signatures declare a "friendship" or bond, giving both parties a responsibility to assist each other. The signed contract is simply the end of the initial stage of negotiation, and more negotiation will likely follow.

The contract may also be used as a memorandum of understanding, which is essential to avoid the need to renegotiate points already agreed upon. It is typical for the Chinese team to revisit topics already closed.

4. What economic factors contributed to a challenging business negotiation between Lynn and the Chinese?

At the time of the visit in September 2001 the Chinese had not yet been accepted into the World Trade Organization (WTO). It was very hard to move currency out of China. Only after joining the WTO would it be possible, in year 2004, to have foreign banks conduct local currency business with Chinese companies. Therefore, Wang's argument about reimbursement was not completely false.

Another major obstacle for foreigners is the control the Chinese government managers have on the outcome of any negotiation. The inability of foreigners to make deals is often due to the foreigner not offering enough incentive to the sole Chinese manager, whether through introduction letters, financial benefits, or status improvement. As some entrepreneurs have discovered, once friendships are cemented and favors exchanged, projects pass without impediments and often the future projects are implemented, unchallenged by the Chinese hierarchy to the chagrin of competitors.

5. What "dirty tricks" did the Chinese play?

The Chinese haggled long and hard over who should pay Lynn's way, possibly to stall the first meeting which would put Lynn at a disadvantage as his product would come too late for the barrel selling season.

The Chinese initially put Lynn up in a non-Western hotel far from Western conveniences. He then traveled by car for many hours with a non-English-speaking driver.

Wang feigns anger by ranting and waving his arms on the last day of negotiations. Lynn interprets this as real.

6. What mistakes did Lynn make negotiating with the Chinese?

He allowed the Chinese complete control of the situational variables. He met them in their country, he allowed them to schedule his travel, he let them book him in a non-Western hotel far from the conveniences of the city, he allowed them to hire a driver with whom he could not communicate for many hours in the car to Kweilin.

He only allocated one week for the visit. He allowed the Chinese to set all the time limits and schedule. Therefore, he was unable to plan some rest time to combat jet lag before the negotiations began.

He allowed the Chinese to schedule the negotiations as they wanted, leaving the most important part until the very end when he we very tired and willing to make concessions in order to go home.

He failed to understand the importance of all the activity the Chinese scheduled outside of the negotiating room. Being so very task-oriented, he saw no value to the sightseeing, the banquets, the introductions to many people, etc.

At the Napa restaurant, he focuses on the 40 faulty barrels instead of the relationship between the two parties. The Chinese, having signed the contract, are committed to the relationship. With time and discussion, the problems will be worked out. For Lynn, the faulty barrels are a major hurdle, possible a reason to end the contract. For the Chinese, they are simply a small bump in a long road to be smoothed out and worked through.

7. Why do you think Lynn signed the contract in spite of his misgivings?

Escalating commitment may have played a role. He had spent lots of time and money on the project; coming back from China with a signed deal was a justification for this effort and expenditure.

Getting the deal signed before the harvest season was over was important. Lynn wanted to sell his barrels in the fall harvest season. Allotting more time to negotiate further would have waylaid his selling season one year.

Lynn felt the uniqueness of the Chinese barrel would be intriguing to winemakers. It would be a nice complement to his existing product line.

Lynn trusted Yu, the woodbroker and translator, who convinced him that signing the deal would only signify a beginning to a business relationship with the Chinese. Finding the right consultant to help with negotiations is crucial. Perhaps Yu was not the best contact in China for Lynn.

Lynn was suffering from jet lag. The entertainment schedule exhausted him. He planned only five days for his visit to China - too short to negotiate with people for whom relationships are important.

Lynn may have felt pressured to show his thanks for the hospitality of the Chinese by accepting the deal offered.

8. What advice would you give an American businessperson going to negotiate a business deal in China?

- ♦ Do your homework before you go. Learn not only about Chinese culture and business negotiation style, but learn as much as you can about the organization you are going to be dealing with.
- ♦ Seek a consultant to help you with your business dealings. Get recommendations from other American or Western companies who have negotiated successfully in China. Ask your Embassy for advice, tips, recommendations for consultants.
- ♦ Schedule more time than usual for the trip. Build in time for sightseeing and entertainment.
- ♦ Leave your departure date open-ended. Let the Chinese think that you have ample time for negotiation.
- ♦ Be patient. Slow down. Take time to build relationships with the Chinese. Give them time to get to know you. Use the time the Chinese have budgeted for entertaining to gather information on your counterparts.
- ♦ Seek common ground in negotiation. Emphasize the friendship and trust you have developed.
- ♦ Think longer-term than you would at home. What are the long-term benefits that you can work towards in your negotiation?
- ♦ Don't give into to Chinese tactics that upset you. Take a break, focus, and continue as usual.
- ♦ Bring along a technical expert. The Chinese are known to ask for very specific technical detail. They will not respect the efforts of a non-technical representative attempting to satisfy their questions.
- ♦ Don't be pressured into signing a deal at your first meeting. Continue the negotiations later on, perhaps in your own country where you have more control over the situation.

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HELP ME! AN ETHICAL DILEMMA

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CASE DESCRIPTION

This case concerns an ethical decision that needs to be made by Scott Peterson. Scott takes a job at a company that he later discovers is, in all probability, fraudulently billing the federal government. Scott is financially strapped and desperately needs the pay from this job and must decide whether to quit the job, and if he is to quit the job, how to quit to the job. He also needs to decide whether to turn in his boss or not, and if so, who to contact. Scott has assisted with the fraudulent billing so he could go to jail. The case is appropriate for freshman through graduate students.

The case requires approximately 20 minutes for the students to read and analyze. Subsequent discussion may be as short as ten minutes, or 30 to 40 minutes, or longer. The instructor can require the students to read the case during the class period or outside of class. The students do not need to obtain additional materials outside of class to be able to analyze the case. The case can be taught in any discipline (marketing, management, finance, etc.), however, the case is particular suited to an accounting course because Scott is an accounting major performing billing responsibilities.

CASE SYNOPSIS

This case is based on an actual situation. The issue is an ethical decision that needs to be made by Scott Peterson. Scott takes a job at Bennett Contracting and he later discovers, in all probability, that Bennett Contracting is fraudulently billing the federal government. Scott is preparing the invoices and worries about his legal involvement. Can, and will he go to jail for this? Scott is financially strapped and must decide whether to quit the job, and if he is to quit the job, how to quit to the job, and whether to turn in his boss, knowing he could be prosecuted also. The case is an excellent ethical case because the situation evolves slowly and subtlely, similar to how an actual ethical situation usually occurs, and there is not a perfect solution.

INSTRUCTORS' NOTES

Case Details

Scott Peterson is an accounting major at a university. He is an older student that is married with two young children. He is the sole supporter of his family. It is necessary for him to continue to make a good income while obtaining his degree. His wife does not work because she would not make enough to cover the day care cost for the children.

Gloria Bennett owns Bennett Contracting, a federal contractor that purchases food for the navy from various suppliers. The suppliers ship the food directly to the bases, but invoice Bennett Contracting. Bennett contracting sends one monthly invoice to the navy. Such that the navy receives one invoice and deals with one supplier, simplifying the purchasing process for the navy. They do not have to deal directly with a multitude of suppliers, such as a meet supplier, diary supplier, etc. Bennett Contracting qualifies as a minority owned business for federal contacting.

Bennett Contracting is allowed mark ups on the various products they purchase to cover their costs, and have an allowable profit. The mark ups vary depending on the product and are listed in a manual provided by the federal government. The manual is periodically updated. On a monthly basis, Bennett Contracting applies the correct mark up to each product and then prepares a new invoice for the federal government that includes all groceries purchased for that month. The federal government does not see the original invoices from the suppliers, only the "marked up" invoice from Bennett Contracting.

Gloria appears to be using larger mark ups then allowed on most products and probably has been doing it for some time. When Scott first started working, he was simply told the numbers to put on the invoice and did not see the original invoices or the allowable mark up percentages. After Scott had worked for some time, Gloria had Scott apply the mark ups and prepare the invoice for the government. At one point, when Gloria was out of the office, Gloria left the federal government contracting manual on her desk, and Scott glanced through it noting that her mark ups were high compared to what was listed. Scott begins to worry that fraud is occurring and he could be implicated since he is applying the mark ups and preparing the invoices.

Scott believes he needs to leave the company, however, he is being paid a high wage that he needs to make the payments for the five months left on a one-year apartment lease and two car payments. He is making $18.00 per hour, and most likely a new job will pay around $11.00 per hour. He is afraid to look for a job while employed by Gloria. If she is committing a fraud as Scott suspects, she might find out that he is looking for a new job and black mail him. He cannot afford to quit because of his apartment lease and car payments. He can sell the cars, but that will take a few weeks, and there appears no way out of the lease. Scott is scared to talk with anyone about this because he at first unknowingly, and now knowingly, is part of the fraud. Will he go to jail?

Recommendations for Teaching Approaches

This case is a very good ethical case because there is no obvious answer. Scott is in a bad situation with no easy way out. He cannot just walk away from the job. He has to have an income. He is scared. Scott is too scared to implicate Gloria, because, after all, he did the fraudulent billing and he is afraid he will go to jail right along with her. And, Scott is not 100 percent positive that there is a fraud, the federal contracting manual is very thick and very complicated and in his brief readings he could have misinterpreted it or not read the appropriate sections. However, he is convinced enough that something is awry that he is too scared to ask Gloria about it.

Discuss with the students how Scott got into this situation slowly and subtly. All of the sudden it caught him off guard, just when his life was going great. This is very frequently the case with ethical situations. You do not expect them. It is the last thing on your mind.

Discuss how difficult it would be for Scott to quit immediately. Scott has bills to pay and has to adjust his financial life style before he can quit. He does not know how he can get out of the apartment lease and he needs time to sell his cars.

Discuss how Scott fears repercussions if Gloria finds out that he is looking for a new job. Scott will need to put on his resume "Bennett Contracting". What if they look up the phone number up for Bennett Contracting and call Gloria? Gloria will find out he is looking and might suspect that he discovered the fraud and will turn her in. Scott will be implicated along with her. Scott is leery about putting on his resume not to contact the present employer because that will draw red flags. What if they call anyway? Scott is difficult to get a hold of if you can't call him at work. What phone number does he list on his resume, work or home? He is rarely at home. He is either at school or at Bennett Contracting. How will he get the time off if he has an interview? Gloria knows his schedule well and will be suspicious if he makes changes. What will he say?

Discuss how much pressure Scott feels, trying to provide for his family, get an education, and deal with the situation at work. Discuss how Scott may not want to turn Gloria in, even if he is not implicated himself, because of the time commitment to the federal prosecutors as a witness to the case. It will cut into the time he can work and take classes and study. Is Scott being selfish? How will Gloria retaliate if he turns her in? Will she try to smear his name in the community? Will he be known as a "whistle blower" and not be hired?

Discuss how Scott may be less likely to be charged in the case if he tells authorities now, right after discovering the potential fraud. The longer he stays the more problems he will have.

Discuss how if Scott is charged in the case he might be able to plea-bargain for his willingness to cooperate and testify against Gloria. The federal prosecutors are most interested in going after Gloria, the person at the top, and most likely they will need Scott's cooperation to convict Gloria.

Discuss how Scott must feel. Just after getting back on track after losing the service station and now this. Will this make him feel like a "loser" the rest of his life? That everything turns out this way?

QUESTIONS

1. What are the clues that Gloria was possibly defrauding the government?

- ♦ Paying higher than market wages to Scott
- ♦ Giving Scott more than "normal" raises
- ♦ Promising Scott permanent employment upon graduation
- ♦ Promising Scott permanent employment with a higher rate, $45,000, than most similar positions
- ♦ Treating Scott like family and getting to know him and his family well to get his loyalty to make him less likely to talk

- Lifestyle - nice house, nice car, vacations
- Not showing him everything or having him do everything until he worked for awhile, after she obtained his trust

2. Should it have been obvious to Scott from the start that Gloria was defrauding the federal government?

No, the clues came slowly and subtly.

This is typically the way these situations happen. You get involved in the situation and the signs of fraud slowly unfold.

3. What choices does Scott have now?

- Quit with out a new job - but he cannot afford to be without a job - he has the apartment lease and the car payments - he needs to get out of his apartment lease and sell the cars
- Quit with a new job - he may get caught in the job hunt and she fires him, implicates him, or tries to smear his reputation
- Turn Gloria in - will he get in trouble also? What will be the time commitment dealing with authorities.
- Don't turn Gloria in - she will continue to defraud the federal government

4. What is the theoretical "perfect" choice for Scott if he did not have any budget or time constraints?

Contact an attorney and through the attorney quit the job and turn Gloria in as soon as possible.

5. Why might Scott not make the above theoretical perfect choice?

He can't afford to be without a paycheck.

He is scared.

It is simpler to quit without turning Gloria in.

He does not have the time to devote to the process of turning Gloria in.

6. What choice do you think Scott will make and why?

Remain at Bennett Contracting while he looks for a new job, hiding the job search from Gloria and selling his cars during this period buying one cheaper car and trying to get out of his apartment lease. This is financially the best decision.

Some students may suggest that Scott attempt to obtain a loan from a bank or relative so he can quit immediately.

7. What choice would you recommend and why?

Students will come up with their own choice as to whether to quit and how to quit and whether to turn Gloria in and why.

8. Why would Scott fear looking for a new job while employed by Gloria?

A potential employer may call Gloria for a recommendation and Gloria would discover Scott is looking.

If Scott requests potential employers not to call Gloria, that may be a red flag to potential employers and hinder Scott from obtaining a new position.

If Gloria found out that he was looking she may fire him, she may turn him in, she may black mail him to get him to stay and/or not talk, she may try to smear his reputation in the community, he may become known as a "whistle blower" and make it difficult to obtain future employment.

9. Is timeliness important with Scott's actions? Should he wait and observe Gloria and her operations longer?

The sooner Scott is able to quit and turn Gloria in, the less likely he will be charged in the case.

The longer he stays the more it looks like he was a willing accomplice.

10. Should Scott turn Gloria in? Give reasons why and reasons why not.

Scott will consider the time commitment it will take working with the federal prosecutors trying to convict Gloria. He needs to be studying to finish school and working.

Scott will consider that he was part of the fraud and could be convicted also. The last thing he wants is to leave his wife and children alone to provide for themselves.

11. If he is going to turn Gloria in, whom should he call?

This is a good thought provoking question for the students because most people have not thought of who to contact.

It would be best to call an attorney, but he has no money to pay the attorney.

He could check if there is an organization in the area that gives free legal advice.

12. If Scott is charged in the case what will be the likely outcome?

Typically, the authorities are most interested in the person or persons "at the top" that mastermind the fraud.

The government will most likely need Scott's testimony to prosecute Gloria. Scott will probably be able to plea-bargain for his willingness to cooperate and testify against Gloria.

13. How might this situation, coupled with the service station closing, affect Scott's outlook on life?

Just after Scott's life was getting back on track after the service station closing he gets another set back.

Scott will need to maintain a good attitude to keep this situation from giving him a poor outlook on the world and lower his own self-esteem.

A CASE STUDY OF FOREIGN EXCHANGE EXPOSURE MANAGEMENT: XMETAL LTD

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CASE DESCRIPTION

The primary subject matter of this case concerns the design and implementation of foreign exchange exposure management policies in a Singapore company. Secondary issues examined include the organizational context in which decision-making for foreign exchange exposure management is set, the identification of problems posed by the organizational context, an examination of actual and potential hedging tools, and the provision of adequate foreign exchange protection when there are capital controls .This case is used in international financial management courses in an MBA program taught in 3 countries.

CASE SYNOPSIS

Xmetal Ltd is a joint venture company with Singaporean and Japanese partners The company has been successful and has grown fast .This is now exposing problems for management with respect to its organisational structure and its foreign exchange exposure management policy .The company is exposed to risk in the US$, Japanese yen and Malaysian ringgit.

This case allows students to consider how foreign exchange exposure management ought to be established within a company and how its decision-making should be operationalized. The case content includes extracts from interviews with company management and staff .The company's existing organisation makes it a potential Baring's and comparisons may readily be drawn .In the first stage the organizational problems are identified and their impact on foreign exchange exposure management analysed. The second stage is an identification of the range of tasks that need to be undertaken to structure an efficient foreign exchange exposure management policy, including formulating the role and composition of a foreign exchange exposure management review committee.

A key element in the case is the range of currencies on which hedging may be required which includes a capital control currency. Natural hedging and the use of derivatives need to be discussed in order to suggest appropriate solutions

FOREIGN EXCHANGE EXPOSURE MANAGEMENT (FEEM) PRACTICES IN XMETAL LTD.

INSTRUCTORS' NOTES

Recommendations for teaching approaches

This case allows students to examine the design and implementation of foreign exchange exposure management in a company with an existing Barings'-like organizational context. It is suggested that this case may usefully be placed after a consideration of the foreign exchange disasters of the day and will incite student interest because of the obvious parallels.

It is easiest to take the case in three parts: first, an identification of the problems revealed in the organizational context and a consideration of possible solutions; second , an identification of the range of tasks to be done to structure an efficient foreign exchange exposure management policy, including the role and composition of the review committee; and third, detailed consideration of the hedging strategy and tools the company should adopt. A comparison with Barings at the end may add some further dimension to the case.

DISCUSSION QUESTIONS

1. What are the key problems identified from the case description with respect to the organizational context?

These are:

the instability of top management
lack of control and coordination between departments
unclear corporate culture
lack of formal job descriptions and staff responsibilities
inefficient organizational structure
inefficient human resource management selection
poor recognition of the importance of the foreign exchange exposure management function and,
a shorter payments cycle compared to the receivables cycle

2. What are the key tasks that you think should be identified as part of structuring an efficient foreign exchange exposure management policy for X Ltd.

The establishment of formal foreign exchange management policies

Application of systems
Centralisation of treasury duties
Setting up risk management and performance evaluation strategies

Segregation of duties
Introduction of well-defined accounting systems and procedures
The establishment of independent risk oversight
The training of treasury staff
The introduction of mark-to-market valuation requiring the daily valuation of foreign exchange positions
The establishment of clear reporting lines
The clear identification of economic, transaction and translation exposure; and
The setting up of a cash flow forecasting system to estimate foreign exchange cash flows for current and future periods.

3. Discuss the issues of conflict revealed in the case and explain how you would resolve them.

There are eight issues of conflict revealed

1. The conflict between Japanese rotation of management every five years and the need for stable management. This issue might be ameliorated if policies were more established, although a discussion with the Japanese partner may yield better results.
2. The conflict between the technical and sales departments. If the company's processes were mapped into an overall chart together with the necessary information flows, it would be possible for both groups to see the other's viewpoint
3. The conflict between the hierarchical and bureaucratic structure and the requirement for better information flows. Again a mapping of the structure of the organisation and the actual and required information flows might assist in recognition of current problems
4. The introduction of the computerised system has created conflict. The systems administrator needs to work carefully through all areas of the company to ascertain how computerisation could assist in each in order to elicit cooperation from all parts of the company
5. The availability of internal exposure management information. This issue would be resolved with the establishment of an FEEM committee at senior management level
6. The lack of a formal foreign exchange exposure management policy and conflict over what it should contain again will be solved by the establishment of the FEEM Committee.
7. The centralisation vs decentralisation conflict could only be resolved here by a centralisation policy able to provide economies of scale by centralising and advantaging the recognition of natural hedge positions.
8. The conflict about whether foreign exchange exposure management should be a staff or a management function needs to be resolved in favour of a management function because of the potential levels of risk.

4. How do the company's current hedging tools work?

Currently the company uses *forward market contracts*, the *money market*, and *matching receivables and payables*.

A *forward foreign exchange contract* is a contract to set the exchange rate for a future date at the present level

A *money market hedge* enables a company with a future receivable or a future payable to make the currency exchange at the current spot rate by borrowing the currency it is owed and paying the loan back when it receives the foreign currency funds from the business transaction.

Matching receivables and payables involves recognising the receivables and payables that involve the same currency from different parts of the company and matching these instead of hedging both transactions

5. What other hedging tools should be considered?

Exchange-traded derivatives may be available between the $S and the yen and either options or futures could be used depending on whether there is any volume of trade in these contracts. A currency option gives the holder the right to buy or sell a currency at a specific price on or before a specified date. The buyer pays a non-refundable premium for an option to the seller(writer).A currency option can be a call option which is the right to buy currency, or a put option which is the right to sell the currency

A swap is an agreement between two parties to exchange one form of financial obligation for another of differing characteristics over time. oA cross-currency swap agrees to exchange interest payments in different currencies over a period of time. These swaps may also involve an exchange of principal at the beginning and the end. They can be used instead of forward foreign exchange agreements where markets are very thin

6. Outline the tasks for the FEEM committee?

The Foreign Exchange Exposure Management Committee must comprise senior management representatives, possibly an external expert and the corporate treasurer.

Its tasks should be to decide on the foreign exchange exposure management policy

Define the strategies and establish which tools should be used.

More specifically the Committee should develop a three-phase exposure management framework comprising a policy phase in which the amount of currency exposure is determined and a policy setting is established to reduce exposures to acceptable limits. The policies should be agreed by the Board of the company.

The second phase is to determine in conjunction with management what strategy should be adopted taking into account the current economic environment. The third phase is the review phase in which exposures are monitored, existing cover is considered and management action is undertaken with respect to ongoing cover. Management are the key players in the second and third phases. A reporting system and performance benchmarks should also be established.

7. What hedging strategy should the company adopt?

Natural hedging should be investigated first. Xmetal could negotiate settlement terms with their suppliers in currencies such as the US$, the yen and $S. They could also request their customers to settle their payments in ringgit and US$ to match Xmetal's payables in those currencies.

To the extent that natural hedging fails to cover the risks, and this seems likely, the use of forwards, options and currency swaps should be discussed. In the light of the capital controls in place in Malaysia there is a good opportunity to discuss the structure of adequate foreign exchange protection in these circumstances.

EPILOGUE

This company with its existing foreign exchange exposure management policy could very easily be the victim of a serious fraud and it would take some time to realise that such an event has happened. It is very important even if the rest of the company is not well organised that the foreign exchange area in particular be as well organised as possible.