

Volume 11, Number 6

ISSN 1078-4950

# JOURNAL OF THE INTERNATIONAL ACADEMY FOR CASE STUDIES

An official Journal of the

International Academy for Case Studies, Inc. and the Allied Academies, Inc.

Editors

Inge Nickerson, Barry University

Charles Rarick, Barry University

Editorial and Academy Information  
are published on the Allied Academies' web page  
[www.alliedacademies.org](http://www.alliedacademies.org)

The International Academy for Case Studies is an affiliate of the Allied Academies, Inc., a non-profit association of scholars, whose purpose is to support and encourage research and the sharing and exchange of ideas and insights throughout the world. The purpose of the IACS is to encourage the development and use of cases and the case method of teaching throughout higher education.

*Whitney Press, Inc.*

*Printed by Whitney Press, Inc.  
PO Box 1064, Cullowhee, NC 28723  
[www.whitneypress.com](http://www.whitneypress.com)*

Authors provide the Academy with a publication permission agreement. Allied Academies is not responsible for the content of the individual manuscripts. Any omissions or errors are the sole responsibility of the individual authors. The Editorial Board is responsible for the selection of manuscripts for publication from among those submitted for consideration. The Publishers accept final manuscripts in digital form and make adjustments solely for the purposes of pagination and organization.

The *Journal of the International Academy for Case Studies* is published by the Allied Academies, PO Box 2689, 145 Travis Road, Cullowhee, NC 28723, (828) 293-9151, FAX (828) 293-9407. Those interested in subscribing to the *Journal*, advertising in the *Journal*, submitting manuscripts to the *Journal*, or otherwise communicating with the *Journal*, should contact the Executive Director at [info@alliedacademies.org](mailto:info@alliedacademies.org).

---

**EDITORIAL BOARD MEMBERS**

Charlotte Allen  
Stephen F. Austin State University  
Nacogdoches, Texas

Thomas T. Amlie  
SUNY Institute of Technology  
Utica, New York

Kavous Ardalan  
Marist College  
Poughkeepsie, New York

Barry Armandi  
SUNY-Old Westbury  
Old Westbury, New York

Joe Ballenger  
Stephen F. Austin State University  
Nacogdoches, Texas

Lisa Berardino  
SUNY Institute of Technology  
Utica, New York

Thomas Bertsch  
James Madison University  
Harrisonburg, Virginia

Steve Betts  
William Paterson University  
Wayne, New Jersey

Narendra Bhandari  
Pace University  
North Brunswick, New Jersey

Barbara Bieber-Hamby  
Stephen F. Austin State University  
Nacogdoches, Texas

W. Blaker Bolling  
Marshall University  
Huntington, West Virginia

Lisa N. Bostick  
The University of Tampa  
Tampa, Florida

Michael W. Boyd  
University of Tennessee at Martin  
Martin, Tennessee

Marla Kraut  
University of Idaho  
Moscow, Idaho

S. Krishnamoorthy  
Amrita Institute of Management  
Tamil Nadu, India

Dave Kunz  
Southeast Missouri State University  
Cape Girardeau, Missouri

John Lawrence  
University of Idaho  
Moscow, Idaho

Jonathan Lee  
University of Windsor  
Windsor, Ontario, Canada

John Lewis  
Stephen F. Austin State University  
Nacogdoches, Texas

Rod Lievano  
University of Minnesota Duluth  
Duluth, Minnesota

Steve Loy  
Eastern Kentucky University  
Richmond, Kentucky

Anne Macy  
West Texas A&M University  
Canyon, Texas

Edwin Lee Makamson  
Hampton University  
Hampton, Virginia

Paul Marshall  
Widener University  
Chester, Pennsylvania

James R. Maxwell  
State University of New York College at Buffalo  
Buffalo, New York

Steve McGuire  
California State University, Los Angeles  
Los Angeles, California

## EDITORIAL BOARD MEMBERS

Thomas M. Box  
Pittsburg State University  
Pittsburg, Kansas

William Brent  
Howard University  
Washington, DC

Michael Broihahn  
Barry University  
Miami, Florida

Gary Brunswick  
Northern Michigan University  
Marquette, Michigan

Carol Bruton  
California State University San Marcos  
Poway, California

Chauncey Burke  
Seattle University  
Seattle, Washington

Gene Calvasina  
Southern University  
Baton Rouge, Louisiana

Yung Yen Chen  
Nova Southeastern University  
Davie, Florida

Wil Clouse  
Vanderbilt University  
Nashville, Tennessee

Clarence Coleman  
Winthrop University  
Rock Hill, South Carolina

Michael H. Deis  
Clayton College & State University  
Morrow, Georgia

Carol Docan  
CSU, Northridge  
Northridge, California

Scott Droege  
Mississippi State University-Meridian Campus  
Meridian, Mississippi

Michael McLain  
Hampton University  
Elizabeth City, North Carolina

Todd Mick  
Longwood University  
Allentown, Pennsylvania

Kenneth K. Mitchell  
Shaw University  
Raleigh, North Carolina

William B. Morgan  
Felician College  
Jackson, New Jersey

Inder Nijhawan  
Fayetteville State University  
Fayetteville, North Carolina

Adebisi Olumide  
Lagos State University  
Lagos, Nigeria

Joseph Ormsby  
Stephen F. Austin State University  
Nacogdoches, Texas

Karen Paul  
Florida International University  
Miami, Florida

Steven K. Paulson  
University of North Florida  
Jacksonville, Florida

D. J. Parker  
Tacoma, Washington

Terry Pearson  
West Texas A&M University  
Canyon, Texas

Edith Piaf  
LI schools  
France

Rashmi Prasad  
University of Alaska Anchorage  
Anchorage, Alaska

---

## EDITORIAL BOARD MEMBERS

Martine Duchatelet  
Barry University  
Miami, Florida

Steve Edison  
University of Arkansas at Little Rock  
Little Rock, Arkansas

Andrew A. Ehlert  
Mississippi University for Women  
Columbus, Mississippi

Henry Elrod  
University of the Incarnate Word  
San Antonio, Texas

Mike Evans  
Winthrop University  
Rock Hill, South Carolina

Werner Fees  
Georg-Simon-Ohm-Fachhochschule Nuernberg  
Nuernberg, Germany

Troy Festervand  
Middle Tennessee State University  
Murfreesboro, Tennessee

Art Fischer  
Pittsburg State University  
Pittsburg, Kansas

Barbara Fuller  
Winthrop University  
Rock Hill, South Carolina

Ramaswamy Ganesan  
BITS-Pilani Goa Campus  
Goa, India

Joseph J. Geiger  
University of Idaho  
Moscow, Idaho

Michael Grayson  
Jackson State University  
Jackson, Mississippi

Richard Gregory  
University of South Carolina Spartanburg  
Spartanburg, South Carolina

Sanjay Rajagopal  
Montreat College  
Montreat, North Carolina

Glenn Rhyne  
Mississippi University for Women  
Columbus, Mississippi

Ida Robinson-Backmon  
University of Baltimore  
Baltimore, Maryland

Sherry Robinson  
Penn State University  
New Albany, Pennsylvania

Joesph C. Santora  
Essex County College  
Newark, New Jersey

Sujata Satapathy  
Indian Institute of Technology  
New Delhi, India

Elton Scifres  
Stephen F. Austin State University  
Nacogdoches, Texas

Herbert Sherman  
Southampton College  
Southampton, New York

Linda Shonesy  
Athens State University  
Athens, Alabama

Mike Spencer  
University of Northern Iowa  
Cedar Falls, Iowa

Harriet Stephenson  
Seattle University  
Seattle, Washington

Philip Stetz  
Stephen F. Austin State University  
Nacogdoches, Texas

Jim Stotler  
North Carolina Central University  
Chapel Hill, North Carolina

## EDITORIAL BOARD MEMBERS

Robert D. Gulbro  
Athens State University  
Athens, Alabama

Allan Hall  
SUNY Institute of Technology  
Utica, New York

Karen Hamilton  
Appalachian State University  
Boone, North Carolina

Heikki Heino  
Governors State University  
University Park, Illinois

Terrance Jalbert  
University of Hawaii at Hilo  
Hilo, Hawaii

Marianne L. James  
California State University, Los Angeles  
Los Angeles, California

Marlene Kahla  
Stephen F. Austin State University  
Nacogdoches, Texas

Joseph Kavanaugh  
Sam Houston State University  
Spring, Texas

William J. Kehoe  
University of Virginia  
Charlottesville, Virginia

Wasif M. Khan  
Lahore University of Management Sciences  
Lahore, PU, Pakistan

Joseph Sulock  
UNC-Asheville  
Asheville, North Carolina

Jennifer Ann Swanson  
Stonehill College  
N. Easton, Massachusetts

Prasanna J. Timothy  
Karunya Institute of Technology  
Tamil Nadu, India

Jeff W. Totten  
Southeastern Louisiana University  
Hammond, Louisiana

Jack E. Tucci  
Mississippi State University-Meridian Campus  
Meridian, Mississippi

George Vozikis  
University of Tulsa  
Tulsa, Oklahoma

Rae Weston  
Macquarie Graduate School of Management  
NSW Australia

Greg Winter  
Barry University  
Miami Shores, Florida

Chris Wright  
Central Missouri State University  
Warrensburg, Missouri

Thomas Wright  
University of Nevada - Reno  
Reno, Nevada

---

# JOURNAL OF THE INTERNATIONAL ACADEMY FOR CASE STUDIES

---

## CONTENTS

EDITORIAL BOARD MEMBERS .....	iii
LETTER FROM THE EDITOR .....	ix
USING APB OPINION 21 AND IRC SEC. 1274 TO EVALUATE ACCOUNTING AND TAX ISSUES FOR AN UNUSUAL LOAN .....	1
David Coffee, Western Carolina University	
Roger Lirely, Western Carolina University	
GREEN ENTERPRISES, INC. ....	9
Javad Kargar, North Carolina Central University	
Joi Ponder, North Carolina Central University	
Marcus Phillips, North Carolina Central University	
NUNIVAK ISLAND MEKORYUK ALASKA (NIMA) CORPORATION: AN EXAMINATION OF A NATIVE VILLAGE CORPORATION'S STRATEGY DEVELOPMENT .....	23
Wayne Don, NIMA Corporation	
Art Warbelow, Warbelow's Air Ventures, Inc.	
Steven P. Landry, University of Alaska Fairbanks	
LINES AT LOAF N' LATTE .....	29
William C. Brothers, Western Carolina University	
Stephen B. Jarrell, Western Carolina University	
THE GALACTICA SUV .....	33
Craig B. Barkacs, University of San Diego	
Linda L. Barkacs, University of San Diego	

MOUNTAIN SKIN CARE .....	45
Jillian Tueller, University of Idaho	
Philip D. Olson, University of Idaho	
MOTIVATIONAL ISSUES AND SAFETY	
REGULATIONS IN ARABIA: A CASE STUDY	
IN A MULTINATIONAL OIL COMPANY .....	51
Asya Al-Lamky, Sultan Qaboos University, Oman	
Unnikammu MoideenKutty, Sultan Qaboos University, Oman	
CHINA AUTOMOTIVE SYSTEMS, INC.:	
THE CASE FOR REVERSE MERGERS .....	57
Vaughn S. Armstrong, Utah Valley State College	
Norman D. Gardner, Utah Valley State College	
REIT VALUATION:	
THE CASE OF EQUITY OFFICE PROPERTIES .....	71
James Stotler, North Carolina Central University	
RFP, COLORFUL ORIGAMI TURTLES FOR	
DR. WRIGHT'S DECORATING DEBRIS, INC.:	
AN EXPERIENTIAL CASE STUDY .....	77
Christine M. Wright, Central Missouri State University	
Jo Lynne Koehn, Central Missouri State University	
STEPPING OUT OF THE BOX	
AT NORTHERN BOX COMPANY:	
PARTS A & B .....	91
Robert Golove, Long Island University	
Barry Armandi, SUNY-Old Westbury	
Herbert Sherman, LIU-Southampton College	
HOLE IN ONE BAGELS .....	107
Barbara K. Fuller, Winthrop University	
Michelle Burns, Winthrop University	



## 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 *JACS* 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.

If any reader is interested in obtaining a case, an instructor's note, permission to publish, or any other information about a case, the reader should correspond directly with the author(s) of the case.

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.

Inge Nickerson, Barry University  
Charles Rarick, Barry University

## **CASE NOTES**

---

# USING APB OPINION 21 AND IRC SEC. 1274 TO EVALUATE ACCOUNTING AND TAX ISSUES FOR AN UNUSUAL LOAN

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

## CASE DESCRIPTION

*This case considers the financial accounting and tax issues associated with a loan made by a manufacturing company to the Atlanta Braves baseball team. The case has a difficulty level of four/five and is appropriate for an upper level financial accounting class or tax class. It is designed to be taught in one hour and requires two hours outside preparation by students.*

## CASE SYNOPSIS

*A manufacturing company loans the Braves money at an interest rate below market. The Braves donate 20 season tickets to the company. Students are required to evaluate this transaction to determine: (1) how it should be treated for financial reporting purposes by the lender; and (2) the proper tax treatment of the transaction by the lender. The case demonstrates how financial accounting issues and tax issues can be similar as well as different in a business transaction.*

## INSTRUCTORS' NOTES

### Introduction

This is an illustrative case. The subject matter concerns the lender's financial accounting and tax treatment of a transaction, which includes a loan, made at an unrealistic market rate and the receipt of 20 Atlanta Braves season tickets. The case has a difficulty level of four/five, appropriate for senior level or graduate courses and is designed to be taught in one class hour and is expected to require two hours of outside preparation by students.

## Requirements

The case requires students to:

1. research authoritative accounting literature related to the proper accounting for notes receivable and make conclusions about the proper accounting treatment of the transaction.
2. research tax literature to identify tax issues and make conclusions about the proper tax treatment of the transaction.

### CASE OBJECTIVES:

The case presents an accounting transaction, which becomes the basis for conducting financial accounting and tax research to identify how to properly treat the transaction.

The first objective of the case is to require students to conduct financial accounting and tax research.

A second objective of the case is to provide a financial accounting issue, which requires students to think critically and apply accounting logic and reasoning using the financial accounting model.

A third objective of the case is to illustrate the similarity and differences between tax issues and financial accounting issues.

### APPLICABLE PROFESSIONAL PRONOUNCEMENTS AND TAX RESOURCES:

Financial Accounting:

"Interest on Receivables and Payables," *Opinions of the Accounting Principles Board No. 21* (New York: AICPA, 1971)

"Interest: Imputation of an Interest Cost (Section 169)," *Current Text, 1997/98 Edition, Volume 1, General Standards*, Financial Accounting Standards Board, (New York: Wiley, 1997)

Taxes:

Internal Revenue Code of 1986 and Treasury Regulations (2003)

West United States Tax Reporter

---

## RECOMMENDED TEACHING APPROACH:

We have tested this case in graduate accounting courses and found that it generates strong student interest and lively discussion. We have found a role playing scenario to be helpful in teaching the case. The case can be assigned to student groups of two, having one student in the group assume the role of Gary Gaines, the partner in charge of the independent audit, and the other assume the role of Phillip, the tax partner. This approach assigns one student responsibility for the financial accounting research and the other responsibility for the tax research. Each group can make a joint report to class.

## CASE OVERVIEW

The case describes a \$100,000 loan the Georgia Manufacturing Company has made to the Atlanta Braves Baseball team. The terms call for the return of the \$100,000 principal in three years along with interest payments of 2% due at the end of each year. The Atlanta Braves, who are paying 10% for borrowed funds at the time of the loan, give the Georgia Manufacturing Company 20 season tickets in exchange for the favorable interest rates.

The Georgia Manufacturing Company has accounted for the loan by recognizing a note receivable for \$100,000 on their books and crediting cash for \$100,000. They recognized interest revenue of \$2,000 for the interest payment received at the end of the first year, 12-31-03.

Gary Gaines, the partner in charge of the independent audit, must decide if the accounting treatment of the note is acceptable. He must also determine the proper treatment of the transaction for tax purposes.

## KEY ISSUES -- FINANCIAL ACCOUNTING

### 1. What is the proper valuation of the note on the books of Georgia Manufacturing?

APB 21, Par 11 states that "when a note is received or issued for cash and no other right or privilege is exchanged, it is presumed to have a present value at issuance measured by the cash proceeds exchanged."

Since \$100,000 was given to the Braves, a strict interpretation of this passage would assume that \$100,000 would be the value of the note if it is concluded "no other right or privilege has been exchanged."

Even assuming for the moment that nothing was exchanged but cash and a note, it seems questionable to value the note at the \$100,000 cash given the Braves because the interest rate

on the note (2%) is so far below the indicated market rate (10%). The true present value of the note would be the present value of the cash flows (\$2,000 + \$2,000 + \$102,000) discounted at the market rate of 10%. This would lead to a present value of:

Present value of \$100,000 discounted 3 periods @ 10%	\$75,132
Present value of the 3 interest payments of \$2,000 discounted @ 10%	\$4,973
	\$80,105

**2. Should the season tickets be recognized on the books of Georgia Products, and if so, at what value?**

Georgia has given the Braves \$100,000 cash for a note that has a value of \$80,105. Is some other right or privilege involved in the transaction? Yes, the season tickets. They have an implied value of \$100,000 - \$80,105 = \$19,850. This equates to \$992.50 (\$19,850/20) each. Is this reasonable? Checking the Braves website at [atlanta.braves.mlb.com](http://atlanta.braves.mlb.com) indicates 2003 season ticket prices ranging from \$850 - \$3,735 per seat. It appears that the season tickets should be recognized as some type of asset on Georgia Products books as of January 1, 2003.

APB 21 par 7 states: "If cash and some other rights or privileges are exchanged for a note, the value of the rights or privileges shall be given accounting recognition by establishing a note discount or premium account. In such instances the effective interest rate differs from the stated interest rate. In this transaction, from Georgia Products perspective, they have exchanged cash for a note and a right or privilege (the season tickets). They use the 10% rate as the effective rate, which differs from the stated rate of 2%. As noted in APB 21, the difference between the present value of the note received and the cash given is appropriately regarded as the value assigned the season tickets, which are an asset on January 1.

**3. How will interest revenue be recognized on the books of Georgia Products?**

An amortization table is constructed, recognizing interest at 10%

Period	Cash Interest Received	Interest Income	Discount Amortized	Carrying Amount
1-1-03				\$80,105
12-31-03	\$2,000	\$8,010	\$6,010	\$86,115
12-31-04	\$2,000	\$8,611	\$6,611	\$92,726
12-31-05	\$2,000	\$9,274	\$7,274	\$100,000

**4. What are the appropriate journal entries on the books of Georgia Products?**

1-1-03	Notes Receivable	100,000	
	Season Tickets (Asset)	19,895	
	Discount Notes Rec		19,895
	Cash		100,000
12-31-03	Cash	2,000	
	Discount on Notes Rec	6,010	
	Interest Income		8,010
12-31-03	Promotion Expense	19,895	
	Season Tickets		19,895
12-31-04	Cash	2,000	
	Discount on Notes Rec	6,611	
	Interest Income		8,611
12-31-04	Cash	102,000	
	Discount on Notes Rec	7,274	
	Interest Income		9,274
	Notes Receivable		100,000

**KEY ISSUES -- TAXES**

**1. Will Georgia Products recognize taxable income due to the below-market loan?**

With some exceptions for *de minimis* loans between natural persons, between employers and employees and between corporations and shareholders, Section 7872 of the Internal Revenue Code (I.R.C.) requires interest to be imputed on certain below-market loans. A below-market loan is a loan for which the amount loaned exceeds the present value of the amounts to be received [§7872(e)(1)(B)]. This excess is referred to as foregone interest [§7872(a)(1)].

Section 7872 mandates that the present value of loan receipts be computed using the applicable federal rate (AFR), compounded semi-annually [§7872(b)(1)]. The IRS computes and publishes AFRs monthly using the life of the loan and the market rate of interest on marketable government securities with similar lives as criteria [§1274(d)]. For this case, we assumed that the applicable AFR was 5.47%. Instructors may want to vary rates to give students an opportunity to see both discount and premium scenarios and to examine the effect of varying interest rates on the present value of the bond. Using this procedure, the

present value of the note for tax purposes is \$90,444.33. Since the present value of the loan receipts is less than the amount of the loan, the loan is a below-market loan.

The tax treatment of the foregone interest depends upon whether the loan is (a) a gift or a demand loan or (b) a term loan. Section 7872(f)(3) defines a gift loan as one in which the foregoing of interest is in the nature of a gift. Generally, one thinks of gift loans as a loan between members of the same family—i.e., parents loan a child the down payment for the purchase of a home. Despite the apparent donative intent expressed by Roger, the CEO, it is unlikely that a loan made in a business setting as part of a business transaction could be construed as a gift [CIR v. Duberstein, 363 U.S. 378 (1960)]. In addition, although Georgia Products may not have made the loan with the express expectation of receiving anything in return, the Braves will mention Georgia Products as a supporter of the program and gave season tickets to the company. Based on these facts, we concluded that the loan was not a gift loan. A demand loan is a loan payable on demand [§7872(f)(5)]. Since the dates for the payment of principal and interest are specified in the note, the loan is a term loan.

Section 7872 presumes that the foregone interest is first transferred by the lender to the borrower then re-transferred from the borrower to the lender as interest [§7872(a)(1)]. Both parties should treat the foregone interest as original issue discount, that is a loan in the amount of \$90,444.33 and original issue discount of \$9,555.67 [§7872(b)(2)]. Georgia Products should recognize taxable interest income under the effective interest method using a constant semi-annual yield to maturity equal to its AFR as follows:

Period	Cash Interest Received	Interest Income	Discount Amortized	Carrying Amount
2003				\$90,444.33
1st 6 months	\$ 0.00	\$2,473.65	\$2,473.65	\$92,917.98
2 <sup>nd</sup> 6 months	\$2,000.00	\$2,541.31	\$ 541.31	\$93,459.29
		\$5,014.96		
2004				
1st 6 months	\$ 0.00	\$2,556.11	\$2,556.11	\$96,015.40
2 <sup>nd</sup> 6 months	\$2,000.00	\$2,626.02	\$ 626.02	\$96,641.42
		\$5,182.13		
2005				
1st 6 months	\$ 0.00	\$2,643.14	\$2,643.14	\$99,284.56
2 <sup>nd</sup> 6 months	\$2,000.00	\$2,715.44	\$ 715.44	\$100,000.00
		\$5,358.58		



## 2. How does Georgia Products handle the receipt of the tickets?

Georgia Products “tax” journal entry would be as follows:

Prepaid Expenses	9,555.67	
Notes Receivable	100,000.00	
Discount Notes Rec.		9,555.67
Cash		100,000.00

The interpretation of this journal entry is that GP advanced \$90,444.33 to the Braves for a 2% note. The remaining \$9,555.67 is GP’s tax basis in the tickets, which are recorded as prepaid expenses.

## 3. What tax consequences are there when Georgia Products uses the tickets?

The tax consequences to GP differ depending upon how GP uses the tickets. We analyzed three possibilities: (1) GP gives the tickets to employees for their personal use; (2) GP offers the tickets to the general public as part of a promotional campaign; and (3) GP uses the tickets to entertain customers

- (1) The tickets are entertainment-related expenses. Unless entertainment expenses are either directly related to or associated with the active conduct of the taxpayer’s trade or business, section 274 disallows any deduction for entertainment expenses. However, if GP treats the tickets as employee compensation *and* as wages subject to withholding, they can deduct the cost of the tickets [§274(e)(2)]. Otherwise, GP’s deduction would be limited to 50% of its cost under the entertainment expense limitations of section 274(n).
- (2) Entertainment expenses are directly related to trade or business if during the entertainment, the taxpayer engaged in a bona fide business activity with a reasonable expectation of deriving income or some other specific business benefit [§1.274-2(c)(3)(i)-(iv)]. An entertainment expense is associated with a taxpayer’s trade or business if it immediately precedes or follows a bona fide business discussion and was incurred for a clear business purpose. Section 274(m) limits the amount of the deduction to 50% of its cost. Accordingly, GP could deduct \$4,777.84 if the customer entertainment was either directly related to or associated with their business.

- (3) GP would be allowed to deduct the entire \$9,555.67 as promotional expenses [§274(e)(7)].

### KEY ISSUES—RECONCILIATION OF ACCOUNTING AND TAX DIFFERENCES

#### 1. How should Georgia Products handle the differences between financial statement and tax return revenues and expenses?

The following table summarized these differences assuming GP deducted the entire cost of the tickets:

Expense fully tax deductible				
Pretax financial income	2003	2004	2004	2003-2005 Total
Interest revenue	\$ 8,010.00	\$8,611.00	\$9,274.00	\$25,895.00
Expense	(19,895.00)	\$0.00	\$0.00	(\$19895.00)
Income before taxes	(\$11,885.00)	\$8,611.00	\$9,274.00	\$6,000.00
Taxable revenue	\$5,014.96	\$5,182.13	\$5,358.58	\$15,555.67
Expense	(9,555.67)	\$0.00	\$0.00	(\$9,555.67)
Taxable income	(\$4,540.71)	\$5,182.13	\$5,358.58	\$6,000.00

Since taxable income temporarily exceeds financial statement income in 2003, Georgia Products has a deductible temporary amount that causes financial statement tax expense to exceed taxes payable in 2003. Georgia Products should create a deferred tax asset in 2003 and decrease financial statement tax expense in 2004 and 2005 as the temporary difference reverses.

---

## **GREEN ENTERPRISES, INC.**

**Javad Kargar, North Carolina Central University**  
**Joi Ponder, North Carolina Central University**  
**Marcus Phillips, North Carolina Central University**

### **CASE DESCRIPTION**

*The primary subject matter of this case concerns strategic planning. Secondary issues include financing, working capital analysis, cash flow estimation, and break-even analysis. In this field-researched case, Toppo Green, the CEO of Green Enterprises is faced with resolving some key questions about the direction of his company's strategy and turning around the company's operation. The company distributes good quality food products and makes profits, but is faced with negative working capital and cash flow difficulties. As the case closes, his advisors have asked him to address several key strategic questions. The case has a difficulty level appropriate for the first-year graduate level. The case is designed to be taught in 1.5 class hours and is expected to require 4 hours of outside preparation by students.*

### **CASE SYNOPSIS**

*The case centers on an entrepreneur by the name of Toppo Green, whose business has grown from a single truck food distribution operation into a \$6 million food distribution business in the State of North Carolina. After 23 years, the company faces significant growth hurdles in order to achieve nominal profitability with few cash flow difficulties. The company focused on distributing food products such as sandwiches to convenient stores mainly in North Carolina. Toppo's primary goals, in the context of this case, are to achieve better profitability, build a strong balance sheet, and to build the brand name on a limited budget. This case communicates the challenges experienced by an entrepreneur, and provides students with the opportunity to simulate the creation of strategy and implementation in the context of this case.*

### **INSTRUCTORS' NOTES**

#### **Recommendations for Teaching Approaches**

This case is designed for a variety of courses, including Strategic Management, Business Policy, Entrepreneurship, and Small Business Management. Instructors may assign the case as an

out-of-class assignment. They should encourage students to complete the financial performance assignment with the aid of a spreadsheet. The instructor can go over the solution in class after the students completed the assignment. Students need to have a familiarity with financial analysis. The instructor should be prepared to emphasize that the case is not hypothetical, but based on an actual company.

### **TEACHING OBJECTIVES**

There are a number of teaching objectives linked to this case, including the following:

1. Determine the validity of an organization in terms of its strategic position within an industry and potential long-term profitability.
2. Assess the managerial and financial resource requirements for expanding a small organization and developing a long-term strategy.
3. Provide students with the opportunity to do a SWOT analysis of a company.
4. Require students to actually make a strategic decision for the organization, coming to terms with the resources actually available.
5. Discuss the resource-based theory of the firm (Barney 1991) and the concept of key success factors as they apply to Green Enterprises.
5. Demonstrate to students what can happen to a firm when it fails to manage its cash flow.
6. Allow students to follow a turnaround effort and to understand how changes in strategy and structure were designed to allow the firm to regain control of its business strategy.

### **CASE TEACHING QUESTIONS / ANSWERS**

#### **1. What is Green Enterprises Company's Strategy?**

Strategy of Green Enterprises is built around the following elements:

- Use of drivers as savvy sales personnel
- Requiring salespeople to take extra time when storing the products
- Insisting that every aspect of the operation process follow specific procedures personally developed by Tippy Green
- A commitment to differentiating the company's products based on variety and service
- A broad product line of more than 90 varieties of sandwiches

- A focus on 3 customer groups—local convenience stores, local small grocery stores, and family owned grills and restaurants
- Premium pricing (usually a few cents above competitors)—the company seems to be a price follower, charging a few cents more than other high-end sandwich rivals.

It is clear that the company is a niche player in the specialty sandwich market—its strategy can be characterized as one of focused differentiation.

**2. What is your assessment of Green Enterprises financial condition and financial performance? Is the company in good financial shape? Why or why not? What are the principal causes of its financial difficulties?**

There is plenty of financial data in the case for students to grapple with. We suggest sending students a strong signal that you expect them to spend time assessing the financial condition of companies in assigned cases. This is something best done early in the course and this case is a good one for drilling students in evaluating a company's financial condition.

Analysis of the income statement and balance sheet data in case Exhibits 2 and 3 is presented in Tables 1, 2, 3, 4, and 5 and reveals the following:

- 2003 sales of \$6,247,303 represented a \$1,030,294 or 14.16% decrease over 2002 (Table 2). This is a relatively strong decrease and presents a strong and apparently convincing argument for lack of future growth prospects.
- Gross profit has decreased from \$1,980,341 in 2002 to \$1,552,456 in 2003. This represents 21.61% decrease over 2003 (Table 2).
- Gross profit in the first quarter of 2004 has increase 5.03% over the same quarter in 2003 (Table 1).
- Operating profit margin has declined from 0.38% in 2002 to 0.19% in 2003 (Table 2).
- Net income has declined from a profit of \$24,737 in 2002 to a profit of \$9,515 in 2003. This change is particularly a result of a 14.16% decrease in sales volume and a 2.79% increase in cost of goods sold.
- The break-even point for Green Enterprises is approximately \$6,187,279 using 2003 information at current prices (Table 5). In 2003, the company was slightly above the break-even point. You may ask students to calculate break-even point using the first quarter of 2004. The company's cost of goods sold in the first quarter of 2004 has improved by about 5% compare to the first quarter of 2003 and the overall year

2003. Future strategies should be based on the need to reach and exceed the break-even point on a consistent basis.

- Analysis of the balance sheet data reveals that both accounts receivable and inventory are decreasing at faster rates than sales. This indicates that the company has improved its accounts receivable management. Another indication of improved accounts receivable management is the average collection period which has decreased from 6 days in 2002 to 5 days in 2003 (Table 4). Even 6 days collection does not seem to be a problem.
- Its cash balance of \$3,500 at the end of March, 2004, is likely all gone, and its accounts payable (late supplier payments) are already badly stretched (34 days). As can be seen, the company collects from its customers within 5 to 6 days, but pays its suppliers within 34 days. While the company is making profit, it still has cash flow problem. In addition, the company has used over \$50,000 line of credit. It seems that the principal cause of financial problems is capitalization. The company is undercapitalized for the volume of business it does.
- Although the company's working capital has improved since 2002, still it has a negative working capital of over 250,000.
- In its current state, there is little likelihood that additional debt can be obtained, as most of the company's assets are already securing the debt already on the books.
- The sources and uses statement (Table 6) shows that the CEO was able to raise some funds (Just over \$10,000), but there's slim chance anyone would invest now, given the fragile state of the balance sheet and the flattening of growth in his market area.

Some students will argue that poor expense control is causing profit and cash flow problems. Astute students, however, will point out that fixed costs such as rent, management salaries, and utilities are not easily reduced. The real problem, they will argue, is sales, probably in part a function of poor routes. Still some students would argue that low gross profit margin is the real issue in this case.

Motivated and well-prepared students will have conducted some or all of the above analyses.

At this point in the discussion, it is a good time to ask how the company can improve its position. This question leads to a discussion of the firm's resources and how they link to sustainable competitive advantage, which is addressed by the next question.

**Table 1: Percentage Composition of Green Enterprises' Income Statement,  
2002-2003 and Quarter 1 2003-Quarter 1 2004**

	2002	2003	Q1-2003	Q1-2004
Sales Revenues	100.00%	100.00%	100.00%	100.00%
Cost of Goods Sold	72.79%	75.15%	76.06%	71.02%
Gross Profit	27.21%	24.85%	23.94%	28.98%
Vehicle Lease and Expense	5.94%	6.17%	6.30%	5.88%
Sales	9.00%	9.00%	9.00%	9.00%
General & Administrative	11.59%	9.49%	7.44%	9.31%
Total Operating Expenses	26.84%	24.66%	22.74%	24.19%
Operating Income	0.38%	0.19%	1.20%	4.79%
Interest Income (Expenses)	-0.04%	-0.04%	0.00%	-0.04%
Net Income Before Taxes	0.34%	0.15%	1.20%	4.74%

**Table 2: Percentage Change in Income Statement Items, Green Enterprises,  
2002-2003 and Quarter 1 2003-Quarter 1 2004**

	2002-2003	Q1,03-Q1,04
Sales Revenues	-14.16%	-13.22%
Cost of Goods Sold	-11.37%	-18.97%
Gross Profit	-21.61%	5.03%
Vehicle Lease and Expense	-10.91%	-18.99%
Sales	-14.16%	-13.22%
General & Administrative	-29.68%	8.62%
Total Operating Expenses	-21.11%	-7.68%
Operating Income	-56.82%	245.20%
Interest Income (Expenses)	-12.09%	5870.00%
Net Income Before Taxes	-61.54%	242.14%

**Table 3: Percentage Change in Balance Sheet Items, Green Enterprises,  
2002-2003 and 2003-Quarter 1 2004**

	2002-2003	2003-Q1, 04
Cash	-35.93%	109.53%
Accounts Receivable	-28.77%	-11.71%
Inventory	-58.30%	74.59%
Autos & Trucks	0.00%	0.00%
Furniture & Fixtures	0.00%	0.00%
Building	0.00%	0.00%
Equipment	0.69%	-10.70%
Less Depreciation	0.00%	2.62%
Lease Deposit	0.00%	0.01%
Other Assets	393.64%	0.00%
Total Assets	-35.98%	40.29%
Accounts Payable	-28.98%	4.81%
Accrued Liabilities	877.23%	-59.29%
Accounts Payable to Affiliates	-53.06%	-95.04%
N/P Equity Line	-5.76%	47.66%
N/P Stockholders	0.00%	13.85%
Common Stock	-2.72%	0.00%
Retained Earnings	-35.98%	13.55%
Total Liabilities & Equity		40.29%

**Table 4: Selected Financial Ratios, Green Enterprises, 2002-2003 and Quarter 1, 2003-Quarter 1 2004**

Ratio		2002	2003	Q1-2004
Gross Profit Margin %	(Sales-CGS)/Sales	27.21%	24.85%	28.8%
Operating Profit Margin %	Profit before Taxes and interest/Sales	0.38%	0.19%	4.79%
Current Ratio	Current Assets/Current Liabilities	0.39	0.25	0.43
Quick Ratio	(Current Assets-Inventory)/Current Liabilities	0.10	0.10	0.18
Debt to Assets Ratio	Total Debt/Total Assets	1.93	2.43	1.83
Average collection period (days)	(Accounts Receivable/Totals Sales)*365	6.14	5.09	19.96
Working Capital	Current Assets – Current Liabilities	-326,714	-322,400	-259,622



**Table 5: Break-Even Point, Green Enterprises Based on Year 2003**

	Fixed Costs	Variable Costs
Cost of Goods Sold		75.15%
Sales Expenses		9.00%
Vehicle lease and expenses	\$385,238	
General & Administrative	593,146	
Depreciation & Amortization	Non-Cash	
Interest expenses	2,290	
Total	\$980,684	84.2%
Contribution Margin		15.9%
Yearly Company Break-Even Point	\$6,187,279	
Monthly Average Company Break-Even Point	\$515,607	
Monthly Average Route Break-Even Point	\$42,967	

Cash Flow Break-Even point = Fixed cost/Contribution Margin

**Table 6: Sources and Uses, Green Enterprises, 2003-Q1, 2004**

	31-Mar-04	31-Dec-03	Sources	Uses
Cash	3,785	-46,207		49,992
Accounts receivable	76,979	87,190	10,211	
Inventories	113,714	65,131		48,583
Other current assets	1,103	1,145	42	
Total current assets	195,581	107,259		
Property & equipment, net	43,753	60,858	17,105	
Deferred charges and other assets	8,657	8,657		
Total assets	247,991	176,774		
Accounts payable and accrued liabilities	373,146	358,346	14,800	
Long-term debt due within one year	81,513	70,768	10,745	
Total current liabilities	454,659	429,114		
Long-term debt-Stockholders	47,698	41,897	5,801	
Common stock	100	100		
Accumulated deficit	-254,466	-294,337	39,871	
Total equity	-254,366	-294,237		
Total liabilities & equity	247,991	176,774		
Total sources and uses			98,575	98,575
Based on case				

**3. What do you see as Green Enterprises Company's competitive strengths and weaknesses?**

We see Green Enterprises as having the following competitive strengths:

- Green Enterprises' sandwiches are made with good quality ingredients.
- Topy seems committed and dedicated to the company and its products and he has been enterprising in getting the company going and offering new products.
- The company's products seem to justify a premium price based on product variety and service.
- 90 different sandwiches—a rather broad product line for a small company

The company's considerable weaknesses and competitive liabilities are:

- Lack of accurate cost accounting system for tracking the costs and profitability of particular products and routes.
- Company success seems entirely dependent on Topy's marketing skills, which are limited. New customer is introduced almost solely by Topy.
- Company has a cash flow problem, despite making a profit.
- Competition is strong.
- Retention of salespeople is an ongoing problem.
- The company has struggled to get its product into local universities.
- Some of the company's distribution routes are relatively weak due to poor location.

These weaknesses prevent Green Enterprises from reaching a large number of potential customers and getting good market exposure for its products. To gain a larger market share, more potential customers must be reached. The company lacks marketing resources and valuable marketing skills.

**4. What problems can you identify with this company? Should Topy be pleased with the progress the company is making? Why or why not?**

Several problems are readily apparent:

- Topy does not have a strong grip on unit costs for various products. Offering 90 varieties of sandwiches may be costly and inefficient, especially if the volumes of some varieties are quite low relative to the prices charged. A good cost accounting

system would provide answers to whether particular sandwich varieties are cost effective and appropriately priced.

- It is not apparent that Topy has a clear and definite strategy for growing the business. Although Topy seems to have the marketing skills, with all other tasks, it is not possible for him to build a strong and growing customer base. The company does not have any internal marketing resources.
- The company's market access to educational institutions and convenience stores is limited by its failure to maintain a strong account such as Duke University and UNC Chapel Hill. Topy needs additional marketing clout for his product line that does not seem to be forthcoming by himself.
- The company has a low gross profit margin.
- The company is undercapitalized.

**5. What must Green Enterprises do to be successful in the food distribution industry?**

You may want to introduce the concept of key success factors here if you have not covered it prior to assigning this case. You can ask the class what it will take for Green Enterprises to be successful. Students ought to be able to single out many of the following factors:

- Ample marketing skills and resources
  - Favorable image and a well-known brand name
  - Attractive packaging and labeling
  - A distinctive product
- Good distribution
  - Strong salespeople
  - Strong network of convenience stores
  - Good shelf space and location of the product in the stores
  - Strong network of distribution to institutional market
- Efficient operation
  - Low-cost products
  - Good quality control
- Competitive pricing

**6. What resources can Green Enterprises count on to survive and grow in its increasingly competitive industry? Are they sufficient to give it a sustainable competitive advantage?**

The resource-based theory of the firm (Barney 1991) describes six types of strategic resources:

Type 1	Physical resources are tangible resources, such as trucks
Type 2	Reputational resources are intangible resources, such as brand loyalty and image.
Type 3	Organizational resources include structure, systems and skills of employees
Type 4	Financial resources are money-assets
Type 5	Intellectual resources are creativity and vision
Type 6	Technological resources include processes and intellectual property, such as patents, trade secrets and other proprietary information.

According to Barney (1991), strategic resources will provide a firm with a sustainable competitive advantage if they have the following characteristics:

- Valuable- valuable resources are those that help a firm implement a value-creating strategy.
- Rare- rare resources are those that are not readily available to the firm's rivals.
- Hard to copy- hard to copy resources cannot be easily duplicated. They are unique, such as patents.
- Non-substitutable- Non-substitutable resources are those that cannot be replaced by other resources.

The resources must be strategic resources, as opposed to common resources (e.g., trucks). If the firm's strategic resources meet all four criteria, then a sustainable competitive advantage can result. If its strategic resources meet some but not all of the criteria, then a temporary competitive advantage can result, but it may not be sustainable over the long term.

The key question, from the resource-based view, is the extent to which the company's resources meet Barney's four criteria: valuable, rare, hard to copy, and non-substitutable.

Students should be asked to assess Green's strategic resources against Barney's criteria, to help determine whether this business is most likely to be competitively viable, and for how long. Such an assessment might look something like Table 7. This is only representative of one possible answer to the question. Students will have their own lists of resources and their own interpretation of whether or not each resource fulfills each of the resource dimensions. Students should be prepared to offer a rationale behind each answer. For example, Toppo is an organizational resource. This resource is valuable because he can have

a direct impact on the survival of business. It may be rare because there is probably not a large supply of experience hard working general manager. It may not be hard to copy, because other firms can find capable general manager. It is substitutable, because another company can develop relationships with customers with different products. Thus, the organizational resource of a skilled general manager probably does not provide the firm with a sustainable competitive advantage. Astute students will conclude that, while Green Enterprises appears to sell good sandwich, others do, too, and good sandwich is not sufficient to keep the firm viable.

Overall, the most astute students may identify that the management team appears to be strong but undercapitalization is why the business is not performing well.

Type of Resource	Resource	Valuable?	Rare?	Hard to Copy?	Non-Substitutable?
PHYSICAL	Freezer & refrigerator	No	No	No	No
	Warehouse location	No	No	No	No
	Trucks	No	No	No	No
REPUTATIONAL	Product Brand	No	No	No	No
	Company Name	No	No	No	No
	Customer Service	Yes	No	No	No
ORGANIZATIONAL	Topy's background	Yes	Yes	Yes	Yes
	Skills of salespeople	Yes	No	No	No
	Structure, systems	No	No	No	No
	Marketing skills	No	No	No	No
	Distribution	No	No	No	No
	Management team	Yes	No	No	No
FINANCIAL	Money-assets	No	No	No	No
INTELLECTUAL	Product search skills	No	No	No	No
	Product development	No	No	No	No
TECHNOLOGICAL	Recipes	No	No	No	No
	Operational processes	No	No	No	No
	Inventory systems	No	No	No	No
	Ordering systems	No	No	No	No

**7. What recommendations would you make to Topy Green? If he follows your recommendations, what financial results can he expect over the next 3 years?**

Students ought to have no trouble coming up with an assortment of recommendations. Some possibilities include the following:

- Devise and implement a computerized financial management system such as Quick Books or Peachtree, to facilitate planning and control of the following operations: order processing/invoicing system, inventory control system, cost system, financial and accounting system, cash budget, and customer database.
- Evaluate opportunities for a private label product. Expanding volume through private label production could help achieve lower unit production costs.
- Keep inventory of the best selling products.
- The company must continue trying to recruit new customers in the local area, going after the institutional market, and convenience stores.
- Creating a Web site to promote the company's products may help reach new customer niches.
- Advertising its private label sandwiches with more meat may help overall sales by getting new customers to try the products.
- Improving gross profit margin by about 7 percent will produce positive cash flow. This can be done by better negotiation with the suppliers and raising prices.
- To sell the out of town routes and keep only in-town routes.
- To have occasional meetings with salespeople.
- Establishing incentive system for the salespeople. It is recommended to pay 9% commission to the salespeople up to break-even point for each route. Above the break-even point it is recommended to share the 16% contribution margin with the salespeople. This will help to retain them for a long time and increase the sales volume.
- Hire a controller to help him in strategic planning, cash flow budgeting and controlling, and market projections.
- Topy needs to take some classes in strategic planning and analyzing financial statements.
- It is more likely that the aged accounts payable have already been written off by the suppliers. Topy should start negotiating with those suppliers to reduce the aging accounts payable and have them to agree to be paid within 7 to 10 years without interest. This will remove his reduced aged accounts payable to the long-term debt and will improve his working capital.
- Put his building into the business. By doing this, his building can be used as a collateral to get more equity line from the bank.

Income statement projections are provided in Table 8. You may ask students to develop financial projections based on their recommendations.

	2003%	2003	2004	2004%	2005	2005%	2006	2007
Sales revenues	100.00%	6,247,303	6,497,195	100.00%	6,684,614	100.00%	7,018,845	7,369,787
Cost of Goods Sold	75.15%	4,694,847	4,672,983	71.92%	4,694,847	70.23%	4,929,589	5,176,069
Gross Profit	24.85%	1,552,456	1,824,212	28.08%	1,989,767	29.77%	2,089,256	2,193,718
Operating Expenses:								
Vehicle lease and expenses	6.17%	385,238	400,648	6.17%	412,205	6.17%	432,815	454,456
Sales	9.00%	562,257	584,748	9.00%	601,615	9.00%	631,696	663,281
G&A	9.49%	593,156	616,882	9.49%	634,677	9.49%	666,410	699,731
Depreciation	0.00%	0	0	0.00%	0	0.00%	0	0
Total Operating Expenses	24.66%	1,540,651	1,602,277	24.66%	1,648,497	24.66%	1,730,921	1,817,467
Profit (Loss) from Operations	0.19%	11,805	221,935	3.42%	341,271	5.11%	358,334	376,251
Interest Income (Expenses)	0.04%	2,290	2,000	0.03%	0	0.00%	0	0
Profit (Loss) Before Income Taxes	0.15%	9,515	219,935	3.39%	341,271	5.11%	358,334	376,251





---

# **NUNIVAK ISLAND MEKORYUK ALASKA (NIMA) CORPORATION: AN EXAMINATION OF A NATIVE VILLAGE CORPORATION'S STRATEGY DEVELOPMENT**

**Wayne Don, NIMA Corporation**  
**Art Warbelow, Warbelow's Air Ventures, Inc.**  
**Steven P. Landry, University of Alaska Fairbanks**

## **CASE DESCRIPTION**

*The primary subject matter of this case involves developing a strategy for NIMA to determine which ventures to accept with specific attention to developing a strategic framework to examine the viability of entering various markets based on incomplete information and the lack of full-time management as identified in the case. The case has a difficulty level of 4, appropriate for the undergraduate level. The case is designated to be taught in 1.5 class hours and is expected to require 2-3 hours of outside preparation by students.*

## **CASE SYNOPSIS**

*This case examines the evolution of native corporations under the Alaska Native Claims Settlement Act of 1971 and some of the challenges facing native corporations. The primary subject matter of this case concerns the development of strategy for a small native village corporation on Nunivak Island, with the added challenge of determining both strategic and operational issues falling solely within the purview of the corporation's board of directors. Specifically, the core issues surround the decision(s) whether to enter into some combination of three potential ventures where the board of directors acts as the principal operational manager. This uncharacteristic approach to management is a result of a tumultuous history and cultural issues. Embedded within the case lies an attempt by some to make the argument for hiring a full time general manager to the shareholders.*

## INSTRUCTORS' NOTES

### DISCUSSION QUESTIONS

1. **What do you see as the board's function? Consider the following:**
  - a. **What can individual board members do to best serve NIMA?**
  - b. **Should the board hire a CEO/GM from outside the village to run the corporation?**
    - (i). **If so, what qualification should they look for, and what authority/responsibility should be given?**
    - (ii) **How should (s)he be compensated?**
    - (iii) **If not, what alternative plan would you propose?**

This is a real case with the issues lined out in the case very much in an ongoing stage. Indeed, the case was designed to gather input from students to add to the "brain trust" of possible insights. While there might be several defensible responses to pursue arising from student discussions, the following notes are provided as a guide based on the history of the NIMA Corporation.

2. **Is it relevant that the board of directors are making operational decisions and piecing together joint ventures or creating business opportunities?**

Fundamentally this seems contrary to conventional wisdom; other options include hiring a general manager or abrogating all responsibility to other parties they are involved with. The issue of hiring a full time manager is discussed at length in the case, at this point is not an option for NIMA. The board could decide that they are policy makers and simply leave it up to their partners to develop their opportunities. Although this is a viable option NIMA has history with not being able to make informed decisions on the basis of fact and a position of knowledge. The failed opportunities of the past were attributed to abrogating responsibility and relying too heavily on their partners. In the end what the board has decided to do given the fast approaching timeline is take on the lion's share of responsibility to mitigate the likelihood that they are not aware of how their ventures are unfolding. The board sees this as a way to overcome their lack of full time management and bridge the gap in the short term with their eye on hiring a manager once their opportunities have materialized and they can make a case for it by demonstrating the need based on multiple businesses.

The evolution of the Alaska Native Claims Settlement Act and creation of native corporations forced native leaders into the corporate arena regardless of preparation, education or training. In the beginning many of the corporations failed miserably because of fundamental lack of training, and education. Although many of the larger regional

---

corporations have grown and prospered, hundreds of the smaller village corporations have continued to struggle. One the many reasons include a shortage of human resources within the villages and an unwillingness to look outside the boundaries of the village for resources to run their corporations. Some village corporations have done this and hired managers who are not shareholders, while others have been fortunate enough to grow their leaders from within to run their corporations. In many cases the fundamental issue stems from a dismal success rate of native students graduating from post secondary school and the preponderance of societal issues such as alcoholism and drug abuse. Although there is a steady increase in the number of native students graduating from college their is also an ever increasing number of students who are moving out of villages because of lack of opportunities in the villages. Almost all of rural Alaska has been categorized as economically distressed with its people living below the poverty line. Couple this with a limited number of students graduating from college and moving away from the villages, and it is plainly obvious why a lot of small village corporations are struggling.

Another option is to relocate the village corporate headquarters to Anchorage and provide jobs and opportunities to accommodate shareholders and management unwilling to move to villages to take on the mantle of leadership. Some village corporations have done this and been successful at enticing qualified leaders to run their corporations, both native and non native. This is logical because the business hub of the state is in Anchorage and the human resources and opportunities are readily available.

Some villages are reluctant to relocate their corporations because of a lack of trust and an over reliance on a few select people to make decisions on their behalf, often times proving not to be prudent or business wise decisions. Many villages were victimized in the early 1900's with the introduction of missionaries, traders and alcohol into their communities. These experiences in many cases have been perpetuated from generation to generation which has created an extreme distrust of outsiders. Couple this distrust with the societal problems of rampant alcohol, drug and familial abuses, and this becomes such an enormous burden that in many cases qualified leaders may turn down opportunities to turn things around for their communities.

The issue of developing a core competency for NIMA has also been addressed. This is also a reason why the board is trying to develop business relationships and number of business with their eye on creating a viable competency for the corporation. The manner in which they are going about it seems to defy conventional wisdom, but in the end is more viable than waiting for some one else to do it for them.

- 3. What strategic framework would you suggest for the Board when it considers proposals put before it? In light of what you suggest, examine and discuss the three initiatives:**
- a. Housing Venture (Renovating Foreclosed Properties)**
  - b. Tourism Venture**
  - c. Partnership (Electric Company association with respect to 8A Program)**

The most appropriate framework is a SWOT analysis, and that is what we did in class. Michael Porter's value chain could possibly be used as well, but we think to less advantage. This is straight forward SWOT stuff, and probably more saleable as such. What we did in class was ask the students what would need to be done to implement each of the ideas. For example, on the housing:

1. Locate distressed property
2. Assess what needs to be done
2. Negotiate to buy
3. Close the deal
4. Finance
5. Acquire materials, labor
6. Manage and complete the work
7. Market the property

Then to the right of that we assessed NIMA's strengths and weaknesses to complete each of those steps, as compared to others currently in this market. Since there is nothing in the case about who is doing this now, you have to use your imagination a bit. But you have to believe it is entrepreneurial contractors in the deal stream with banks in Anchorage, who maybe do this as filler work. Or maybe realtors who become aware of these good deals, and have contractor friends who they arrange to do the work.

As one goes down this list, it should become painfully apparent that NIMA does not have a lot of competitive advantage in this arena. Maybe they have a few shareholders who have carpentry skills, but those people can probably get jobs easily with any contractor around the state. And since they are minority employees, contractors would be extremely happy to get them if the carpenters are good. And if they are not good, NIMA will have a hard time competing.

Maybe NIMA has the money to do some of the financing themselves, but is this not a high risk and undiversified way to invest money?

They could well get taken to the cleaners in the real estate and marketing end of this deal, as they have little experience there. In fact what is striking is that one of their more spectacular failures was in real estate in Anchorage - the condo debacle.

---

One thought for students is the concept of working with a Native owned bank - for example North Rim Bank has a lot of Native influence, and there may be a native owned mortgage company in Anchorage. When these financial institutions have distressed property, they may be more inclined to work with a native contractor, and NIMA may get an inside track. So look to your connections in the native community that may give you a leg up if you do down this path. But we would simply recommend against this proposal, NIMA has no competitive advantage here, and there are lots of risk.

A similar analysis with the tourism business shows a lot more potential. NIMA actually can implement things here in a way that no one else can. For example, virtually no one else has access to the land resources on Nunivak that will be a condition for any tourism operation. The bigger question is, is there an adequate market for this type of business? Can they effectively reach that market? My observation in the tourism business is that I can put together all kinds of neat trips, and operationally make them work, but getting an adequate flow of customers at a reasonable marketing cost is very difficult. Most of the large tour companies demand a 20% commission, and it is a good deal given in the alternative marketing options. And the season is short, three months or so. Capital investments must be paid for 12 months, but only have income for three. Not mentioned in the case is the possibilities for grants, which it turns out of course is where they really struck gold. Also, the business may not be down south tourists, but kids from school districts in western Alaska, etc. So this one seems to have possibilities.

The 8A proposal also seems to be a good fit. Many native corps in Alaska have hit pay dirt here. The only problem is probably that so many have, there is now some competition between the native corps for these projects, even though the white population may be cut out. Give that they have a potential partner already courting them, and there is virtually no downside to partnering with an established contractor on these deals, this is an obvious opportunity.

**4. What would you decide to pursue? Possibilities include any combination from zero to all three. Defend your decision.**

Based on the analysis noted above particularly in the narrative response to Q2, we would rank the proposals as follows: (1) 8A, (2) Tourism, (3) Renovation; with the first two a go and the last one a thumbs down.



---

## LINES AT LOAF N' LATTE

**William C. Brothers, Western Carolina University**  
**Stephen B. Jarrell, Western Carolina University**

### CASE DESCRIPTION

*This case applies queuing theory in a small business. Students gain an appreciation for the usefulness as well as the difficulties of producing appropriate data and analyses rather than working text problems that contain only summary measures. Specifically, students analyze interarrival and service times collected during a five day period. (Values are included and can be changed to renew and reuse the case.) The case has a difficulty level between three and four and can be completed by Junior and senior level undergraduate students in introductory quantitative analysis, operations research, or management science courses in 2 – 3 hours time. Analysis can include computation of the current situation at the business as well as explorations of alternative arrangements.*

### CASE SYNOPSIS

*Like many entrepreneurs, Anna Jamison believed she had an idea that would prove to be a viable and sustainable business. She created a coffee shop and vegetarian restaurant in a small college town. She succeeded. The business became a favorite among professors and college students. The alternative menu appealed to this demographic. It offered customers a variety of vegetarian items and baked goods that could not be found in other food establishments near the campus. Additionally, the relaxing atmosphere allowed customers to work and study, so students and professors spent hours in the restaurant drinking coffee and working on projects. Ms. Jamison appreciated these customers despite the limited space. In the past, long lines were never a problem, but recently several complaints surfaced, and some customers even walked out rather than wait in the long lines during lunch periods. Anna wishes to address this problem before Loaf n' Latte develops a reputation for slow service. She would like to evaluate options and remedy the situation.*

## INSTRUCTORS' NOTES

### Recommendation for Teaching Approaches

The project offers opportunities to appreciate difficulties as well as benefits of applying quantitative models in the real world. Specifically, the project investigates queuing models and cost effectiveness of different queuing systems for a small eating establishment.

There are actually three stages or levels of this project. We describe the first two as background for instructors who wish to pursue data collection and individual projects rather than employ the actual aggregate data available with this case.

During the first week of class, students initially encountered the business itself, its queuing system, and the participants (customers and servers). With minimal background information and instruction, they observed and recorded interarrival times and service times over a short time period. The students also noted aberrations that made it difficult to measure these times, such as servers who do something else in the middle of serving a customer, customers who balk or renege, or customers who arrive in groups. (We actually set up an extreme case with colleagues who arrived at different times and broke in line.) Class discussion based on their observations yielded a protocol and consensus on how to define and consistently measure arrival intervals and server times.

Student benefits from their experiences in the shop and with these technical aspects of the project include:

- ◆ Increased awareness of the messiness of real world data and, consequently, the need to define and consistently measure variables as well as treat resulting computed value more warily, and
- ◆ Impressions of queuing systems and increased attention to actual queues, both of which motivate further study of queuing models and recognition of technical terms.
- ◆ Even professors who do not proceed with the next stage may want to heighten student interest and understanding by requiring that they visit actual businesses to observe and collect data (however roughly).

Following their data collection, students did individual analyses of the queuing situation and its cost effectiveness based on their individual data sets and their personal observations. They determined:

- ◆ Usual queue statistics (system and queue times and lengths),
- ◆ Acceptability of these statistics from a customer standpoint (subjective),
- ◆ Reductions in queue and system statistics that benefits customers when a second server is added to the system,



- ◆ Cost effectiveness of adding a second server, and
- ◆ Non-quantitative suggestions for improving the shop's queuing system.

Individual data sets promote independent analysis so that students share unique aspects of their analysis rather than a unique answer from a single data set. For instance, an explosive situation could occur, especially if there are outliers. Note that we told them to recognize this situation, and then proceed with their analysis substituting the reciprocal of the utilization factor as their individual factor.

Finally, this case offers professors the opportunity to use the students' data and proceed directly to the analysis. We aggregated the students' data sets into one overall data set (included in the text of the case) and repeated the required analysis mentioned above. This is an excellent review problem, such as before a final exam. We cleaned the data in the following ways:

- ◆ included only lunch time data from 11-1 (also the busiest period),
- ◆ omitted redundant values (some students collected data simultaneously because of their limited schedules),
- ◆ ignored balks and included times for people who actually entered the system, even if they later reneged, and
- ◆ omitted outliers (though asked to make notes beside all observations to help them understand unusual values or unusual events, student efforts varied, so z-scores are the basis for eliminating observations).

Histograms of arrival and server times are skewed to the right as expected for observations from exponential distributions. At this point, we calculated the following averages for a single-server system:

- ◆ The interarrival time is 1.98 minutes between customers, while the service time is 1.14 minutes per customer. Conversely, the arrival rate is 0.51 customers per minute, while the service rate is 0.88 customers per minute.
- ◆ The average time in the system is 2.70 minutes, while the average time in the line is 1.57 minutes.
- ◆ There are 1.38 customers in the system and 0.80 customers in the line.
- ◆ The system is idle 42.05% of the time.
- ◆ The average cost per minute to operate this system is \$0.27 (using waiting time) and slightly less than \$0.39 (system time).

Based on the small time in the system and waiting line, customers have their order in less than three minutes and wait about half of that time in line, we conclude that Loaf n' Latte does not have a

waiting problem. However, we decided to extend the calculations and compare the single-server system to a team system and to a two-server system. Using the same customer arrival rate and server rate for the new second identical counter worker, the following statistics result:

- ◆ The average time in the system drops to 1.24 minutes, while queue time decreases to 0.10 minutes (not bad if they wanted to sell themselves as a place with “no waiting”).
- ◆ The average number of customers in the system drops to 0.63, and the average in the queue is 0.05 customers.
- ◆ The system is idle 71.02% of the time.
- ◆ The average cost per minute to operate this system is \$0.24 (using waiting time) and \$0.35 (system time).
- ◆ With two servers, the shop can offer “no waiting” and use a less costly system. The additional idle time of the servers could be used to increase the bakery’s output.

Alternatively, a two-person team that costs \$13.50 (both paid \$6.75/hour) and reduces average server time by 15 seconds will generate the following results:

- ◆ The average time in the system drops to 1.64 minutes, while queue time decreases to 0.75 minutes.
- ◆ The average number of customers in the system drops to 0.84, and the average in the queue is 0.38 customers.
- ◆ The system is idle 54.46% of the time.
- ◆ The average cost per minute to operate this system is \$0.30 (using waiting time) and slightly more than \$0.39 (system time).

Obviously, the team system is not as efficient and cost effective as the two-server system. It is more efficient than the single-server system, but not as cost effective because the second team member is paid at the same rate as the first. This information could be useful for training, if Ms. Jamison uses the team approach as an intermediate stage between the single-servers and the full-fledged two server system. Some additional capital costs (not reflected in the computations) may be incurred to fashion the counter to accommodate a second queue.

In addition to the quantitative alternatives presented above, Ms. Jamison could try an approach that allows customers with simple orders, such as regular coffee and ready-to-eat bakery items, to enter a separate queuing system. Similarly, coffee drinks (including specialty coffee drinks) could be ordered from a separate queue.

---

# THE GALACTICA SUV<sup>1</sup>

**Craig B. Barkacs, University of San Diego**  
**Linda L. Barkacs, University of San Diego**

## CASE DESCRIPTION

*The purpose of this case is to provide an intercultural/international negotiation exercise that tests the ability of students to overcome cultural obstacles and think outside the box in order to structure a creative deal. The case has a difficulty level of five to seven, depending upon the depth with which the instructor wishes to explore the case, as well as the comfort level of the instructor with respect to the various issues. The negotiation exercise is designed to take from one and a half to two class hours (including the debrief), although more time may be spent on it. The case also requires approximately thirty to forty-five minutes of in-class or outside preparation time by the students.*

## CASE SYNOPSIS

*What do you suppose would happen if a space alien from a distant and different culture arrived on the lot of a futuristic planet earth spacecraft dealership to negotiate the purchase of a space vehicle? In order to find out, climb into a Galactica SUV spacecraft, buckle up, and enjoy the ride!*

*This case is designed for use as a role playing opportunity in an international negotiation class. The subject matter of the negotiation derives from an activity many students have already engaged in – the purchase of a vehicle (in this case, however, that vehicle is a futuristic spacecraft, i.e., the Galactica SUV). Each student is assigned a role, either that of space alien CN-319 (the buyer) or that of earthling Spacey Starr (the seller), and then given time to prepare. The student is instructed to stay in role for the duration of the negotiation. Moreover, the student must make use of the cultural characteristics provided for each assigned role.*

*In order to avoid the cultural stereotyping that occurs in most intercultural or international negotiation exercises, this case deftly finesses the issue by creating two fictional cultures. CN-319, the prospective buyer, is a Banatarian from the planet Banatar, and each student playing this role is given a confidential role sheet describing certain cultural characteristics of Banatarians. Spacey Starr, the seller, is an earthling. Unfortunately for Spacey Starr, however, earthlings often confuse Banatarians with Vanatarians (from the planet Vanatar). While Banatarians and Vanatarians share some common cultural characteristics, they are diametrically opposed on others. Spacey Starr, who*

*mistakenly believes prospective buyer CN-319 is a Vanatarian, prepares for the negotiation by becoming acquainted with Vanatarian cultural characteristics, which are outlined in the confidential role sheet provided to those playing the role of Spacey Starr. Accordingly, the well-intentioned (but ill-informed) Spacey Starr character inadvertently tends to commit cultural faux pas after cultural faux pas.*

*In addition to substantive lessons on conducting an integrative negotiation, the case also introduces a variety of cultural issues that often can and do occur in a real world intercultural or international negotiation. By having to contend with cultural confusion, the case tests the ability of students to deal with cultural errors, learn from mistakes, and overcome them. After the negotiation exercise has been completed, the instructor thoroughly debriefs the case to explore both the negotiation and cultural issues. Detailed instructions on how to conduct a debrief are included. Moreover, there is also a list of negotiation terms and definitions to assist those who are new to teaching negotiation.*

## **INSTRUCTORS' NOTES**

### **Recommendations for Teaching Approaches**

The instructor should be familiar with the entire case before attempting the exercise in the classroom. At the beginning of the class, separate the students into individual groups of two. One student will play the role of CN-319, the potential buyer of a Galactica SUV. The other student will play the role of Spacey Starr, the seller of the Galactica SUV. Each student is given his or her confidential role information, which includes the factual background necessary for the negotiation, as well as the cultural characteristics they need to be familiar with. If possible, it is recommended that you copy the material (i.e. the role sheets) so that the factual information is on one side of the sheet of paper, and the cultural characteristics information is on the reverse side. It is also often helpful to copy the role sheets for each side of the negotiation on different colored paper so that you can quickly identify which student is the buyer and which is the seller.

Once all the pairings of students have reached a deal or an impasse (or time has been called), the students should be instructed to fill out the attached "deal sheet." (See end of this document for copy of the "deal sheet"). The deal sheets are then collected. The students are then instructed to write the outcome of their negotiation on the board for all to see. At this point, the debrief begins.

### **HOW TO DO THE DEBRIEF – PART ONE: THE DEAL**

The instructor should begin with a discussion of "BATNA"– the **B**est **A**lternative **T**o a **N**egotiated **A**greement. By definition, there is only one BATNA, given that it is the "best" alternative. A formal discussion of BATNA may be found in *Getting to Yes* by Fisher and Ury or

---

*The Mind and Heart of the Negotiator* by Leigh Thompson (See also “Negotiation Terms,” included as part of this case). The instructor should also discuss “ATNA” – Alternative To a Negotiated Agreement. This is the generic derivation of BATNA, simply identifying one or more alternatives to a negotiated agreement without specifying such as the “best” alternative. For a buyer, establishing a BATNA determines the highest price he or she is willing to pay (because if he or she must pay more than that specific amount, then such a buyer would rather do something else – i.e., take an “alternative” or fall-back position). Conversely, for a seller, establishing a BATNA determines the lowest price at which he or she is willing to sell.

Suggested Questions for Cn-319 (The Buyer)

**1. If CN-319 (the buyer) is unable to reach a deal with Spacey Starr, what is CN-319’s BATNA?**

CN-319 can buy the spacecraft from the dealer in the next solar system over (two hours away) for ^47,800. (This is certainly a pretty strong BATNA, but it is not without some possible risk, e.g. although they say they can deliver the SUV, CN-319 is *NOT* present there.)

**2. What if the SUV in the neighboring solar system is sold in the meantime?**

Student answers will vary, although the main problem with such an outcome would be that the CN-319’s boss (XR-424) would be profoundly disappointed that his/her instructions to obtain the SUV *today* were not followed. Students might suggest, however, that attempting to make the purchase over the cell-screen (rather than having to fly there in person) would obviate this problem.

**3. What if the actual price of the competing dealer in the neighboring solar system turns out to be more, e.g., a bait and switch tactic?**

It depends. Even if the competing dealer in the neighboring solar system tries to get more than the ^47,800 originally quoted, it is possible that the price would still be less than the ^51,800 price quoted by Spacey. If there is insufficient movement in Spacey’s price, CN-319 (the buyer) may simply wish to do business with the competing dealer in the neighboring solar system.

#### 4. What are the CN-319's ATNAs?

ATNA #1: Get the spacecraft from The Snicker's Galaxy dealer for ^46,000 in 2 weeks (This is very poor outcome – delivery is way too late for the honeymoon.) ATNA #2: No deal – an extremely bad outcome, given that XR-424 told CN-319 “*I must absolutely have [the Galactica SUV] by tomorrow, in time for JK-957 and me to take it on our honeymoon,*” and, also told CN-319, “*Make it happen, CN-319.*”

#### Suggested Questions for Spacey Starr (The Seller)

##### 1. What is Spacey's BATNA?

*No deal!* – such an outcome is very bad because “no deal” means no commission, no bonus, and no defraying of debt (which is the ^4,000 Spacey has already accumulated). The instructor should point out that sometimes one's BATNA may not be good, or may in fact even be quite awful, i.e., the fallback position is terrible. Considering that the “no deal” BATNA for the seller in this case is in fact quite awful, Spacey should be highly motivated to make a deal.

Let's take a look at the initial bargaining zone parameters in this case:

**Spacey's Employer (Avery) = Does not want Spacey to sell below ^51,800**

**CN-319's Employer (XR-424) = Indicates CN-319 should pay ^46,000 or less**

^0 <-----^46,000---] [---^51,800----->

There is no overlap, which = a **negative bargaining zone**. A discussion of negative bargaining zones may be found in *The Heart and Mind of the Negotiator* by Leigh Thompson. A definition may be found under “Negotiation Terms,” included as part of this case.

Consider next how the parties can move closer together:

**CN-319 (the buyer) knows he/she can go up to ^47,800 and get a spacecraft right away (at the dealership one solar system over). Spacey (the seller) has the okay to sell for ^48,000**

^0 <-----^47,880---] [---^48,000 ----->

With this understanding, there is still a **negative bargaining zone**, but it is much smaller.

2. **Spacey wants that ^4,000 bonus – he/she only needs to sell one more spacecraft to get it. What does this really mean?**

Spacey can get a ^4000 credit (his/her bonus amount) for selling any spacecraft, so if he/she sells the spacecraft for ^48,000, he/she gets:

^4,000 bonus

^1,000 commission (25% of anything over ^44,000)

^5,000 Total Bonus + Commission

If Spacey does *not* sell a spacecraft, Spacey loses his/her ^4,000 bonus and gets no commission.

3. **Can Spacey sell a spacecraft for less than ^48,000, still get a bonus and some commission, and keep his/her boss happy?**

Yes! But how...Example: What if CN-319 (the buyer) will only pay, say, ^46,000 for the spacecraft? Can Spacey still obtain his/her objectives? Here is how:

- A. Spacey sells a spacecraft, so Spacey gets a ^4,000 bonus.
- B. At ^46,000, the spacecraft is ^2000 above the ^44,000 cost, so Spacey gets 25% of ^2000, which equals ^500.
- C. Spacey's employer, however, did not authorize a sales price below ^48,000. What can Spacey do? Answer: Spacey still sells the spacecraft for a nominal ^48,000 sales price, but gives CN-319 a ^2000 rebate out of the ^4000 bonus.

RESULT: Spacey nets ^2500, which is ^2000 of the bonus plus ^500 commission. Although Spacey has to surrender ^2000 of his bonus to make this deal, such an outcome is still obviously better for Spacey than no deal. After all, no deal for Spacey means no bonus and no commission.

**Technical Argument Spacey might try to make to increase his or her take:** Spacey tells employer Avery – “I got the price you wanted (by throwing in the ^2000 of my bonus), so I should get my full commission (i.e.  $25\% \times ^4,000 = ^1000$ )

**4. How low can Spacey drop the price and still meet all of his/her objectives?**

This is the break even point, which is effectively Spacey's BATNA (and reservation point) in that it has the same financial impact on Spacey as no deal at all, i.e., Spacey makes nothing to defray his/her debt.)

Answer: **^43,000** (Spacey's break even) — How?

^4,000 bonus (for selling an SUV) – employer (Avery) pockets the bonus (47,000)  
+ 1000 commission (25% of ^4000 [the amount OVER ^44,000]) (48,000)  
^5,000

To make this point clearer, consider the analysis in question 5, which follows:

**5. Spacey tells the employer (Avery) - “Don't pay me the ^1000 commission.” What did the dealership get?**

The dealership gets a ^48,000 benefit as follows:

^43,000	Selling Price
^ 4,000	The amount of Spacey's bonus the dealership gets to recoup
<u>^ 1,000</u>	<u>The amount of Spacey's commission the dealership gets to recoup</u>
^48,000	TOTAL Benefit to Dealership

**Point #1:** If Spacey sells for anything over ^43,000, he/she has an argument to put at least some money in his/her pocket.

**Point #2:** If Spacey sells for anything less than ^43,000, he/she would owe the dealership money

**Point #3:** The nominal sales price to the buyer CN-319 under such circumstances would be ^48,000, with a special one-time only rebate of ^5,000. (A stated nominal and public price of ^48,000 with an unadvertised one-time only rebate to CN-319, obviates to some extent the concern about having to make the same deal to the next customer who walks on the lot.)



Consider now the bargaining zone parameters in this case:

^0 <-----] ^47,800 (CN-319 – the Buyer)

(Spacey – the Seller) ^43,000 [----->

## 6. What do we have now?

**positive bargaining zone** with a broad range totaling ^4,800 (also known as a **ZOPA** – Zone Of Possible Agreement – see definition in “Negotiation Terms” portion of the case).

Apart from the extensive and instructive intercultural components of this case that are thoroughly addressed in Part Two, the strength of this negotiation exercise is its ability to illustrate both 1) how to engage in an integrative negotiation, and 2) what the benefits are of an integrative negotiation. For purposes of this case, an integrative (or win-win) negotiation means bringing other considerations, not just the asking price, into the deal. The most prominent example of the integrative potential in this case is the way in which Spacey Starr can use his/her commission and bonus money to create a positive bargaining zone where none previously existed and, most importantly, to avoid his/her dreadful BATNA, which would mean no deal and no defraying of Spacey’s debt! One of the most gratifying developments to witness is when participants come up with creative possibilities not originally contemplated by the case, e.g., various added incentives to make the deal even better for both parties. Such integrative thinking, of course, serves to craft even better agreements by expanding the pie (see definition of “integrative negotiation” and “expanding the pie” in the “Negotiation Terms” portion of the case).

## HOW TO DO THE DEBRIEF – PART TWO: INTERCULTURAL ISSUES

In order to avoid the real world cultural stereotyping that inevitably occurs when conducting an international negotiation exercise, for purposes of this case two fictional cultures were created. As set forth in their respective roles, CN-319 (the buyer) is from the planet Banatar, while Spacey Starr (the seller) mistakenly believes CN-319 is from the planet Vanatar. Accordingly, in preparation for meeting CN-319, Spacey decides to acquaint him/herself with Vanatarian culture. In order to compound Spacey’s confusion, Spacey learns that v’s and b’s are sometimes pronounced same way on Vanatar. Accordingly, when CN-319 states that he/she is from Banatar, Spacey (wrongly) infers that CN-319 is simply pronouncing the “b” as a “v”.

Invariably, Spacey’s first cultural *faux pas* occurs right from the beginning when he/she attempts to greet CN-319 with some type of warmth and physical contact (usually either a handshake or hug). And while this would be perfectly appropriate for greeting a Vanatarian, it is unmistakably

offensive to a Banatarian, which is of course what really CN-319 is. Just to keep Spacey guessing, the case is set up so Banatarians and Vanatarians do share some common cultural characteristics, such as both being from matriarchal societies with similar gender-loaded phrases (with the notable “*Viva El Papa*” exception!). As a result, Spacey doesn’t know how much of his/her cultural knowledge is reliable and, not surprisingly, those playing the role of Spacey inadvertently tend to offend and insult CN-319 with great frequency. Accordingly, the cultural lessons from this case dynamic are many.

### **The Lesson of Misinformation**

Having Spacey consulting and relying upon Vanatarian cultural characteristics instead of Banatarian cultural characteristics makes two points, the first of which is the lesson of misinformation. With respect to the lesson of misinformation, what we think we know about other cultures (or what we believe other cultures to be like) is simply wrong. Rumors, urban legends, arrogance, ignorance, bigotry, and even sloppy research can all contribute to misinformation. Accordingly, it is quite possible for people to enter into a negotiation with an abundance of overconfidence and/or a host of misperceptions. This case is structured in such a way as to insure that Spacey encounters the consequences of misinformation.

### **The Lesson of Cultural Stereotyping**

The second point made by having Spacey consulting and relying upon Vanatarian cultural characteristics instead of Banatarian cultural characteristics is that, even if our cultural information is generally correct, we are still negotiating with individuals. And while it may be true that most people from a culture may conduct themselves in a similar way, it doesn’t mean that the individual with whom you are dealing necessarily conducts himself or herself the same way. This point is often made by asking a room full of mostly U.S. students, what is U.S. culture and what is the U.S. negotiating style? Such an inquiry will likely strike the class as naïve and simplistic. Substantive responses may range from comments such as it depends on the individual, to it depends on the region, to it depends on social and economic class, to it depends on education, and so on and so forth. Even so, one can easily find quick summaries on U.S culture and negotiating styles that may be generally true, but specifically useless. Accordingly, even if Spacey had become familiar with Banatarian cultural characteristics, he or she very well might have encountered a Banatarian who defied the norm. As a result, the case to some extent can be seen to provide this type of phenomenon for Spacey to experience as well.

---

### **The Lesson of Cultural Noise**

Spacey also has to work through the cultural noise of uncertainty and insecurity that often occurs during an international or intercultural negotiation. The ability to make substantive progress on a negotiation can be greatly impaired by a lack of focus or attention. Moreover, one is more likely to make a worse deal under such circumstances. In this negotiation, Spacey often finds him/herself distracted because he/she is either trying so hard to avoid making cultural mistakes or because he/she is trying so hard to recover from cultural mistakes when they do occur. Anyone who has traveled to far and distant lands knows well the disorientation component of culture shock.

### **The Lesson of Cultural Sensitivity**

The case is written with the full understanding that various aspects of Banatarian culture are likely to seem absurd or comical to Spacey, but such a reaction may, and often does, take place in the real world. (Consider, for example, the wide variety of culinary preferences throughout the world that seem quite unusual or even bizarre to cultures that do not have similar tastes.) That we may find aspects of another culture absurd or comical, however, does not mean that we get to ridicule or laugh at them, especially when trying to conduct a negotiation. Accordingly, participants are expected to be in character and stay in character throughout the negotiation exercise, which means that they should try to exercise some degree of cultural sensitivity.

### **The Lesson of Cultural Adaptation**

Finally, because Spacey inevitably makes cultural mistake after cultural mistake, Spacey has to be a quick study in order to succeed. All along the way, this case exercise repeatedly forces Spacey to figure out when a mistake has been made, figure out what the mistake was, figure out how to overcome the mistake, and learn from the mistake so it is not repeated again. In other words, Spacey's cultural adaptation skills are really put to the test.

### **Thoughts on Ways to Address the Intercultural Lessons**

1. A Socratic approach may be utilized to facilitate the debrief, e.g.:
  - CN-319, what was your reaction to Spacey's initial attempt to shake your hand?
  - Spacey, what was your reaction to CN-319's cold reception when you attempted to shake CN-319's hand?
2. A somewhat more direct approach may be adopted, e.g.:
  - Spacey, at what point did you begin to lose confidence in your knowledge of CN-319's culture?
  - CN-319, how did Spacey react when he/she made a cultural mistake?

3. Finally, a very direct and structured approach might be to write on the board the following questions (or have it as a handout in pre-drafted form):

- What lesson, if any, on cultural misinformation did you learn?
- What lesson, if any, on cultural stereotyping did you learn?
- What lesson, if any, on cultural noise did you learn?
- What lesson, if any, on cultural sensitivity did you learn?
- What lesson, if any, on cultural adaptation did you learn?

Then, before beginning the class discussion, have each participant commit to writing his or her responses to each of the questions.

### THE GALACTICA SUV - DEAL SHEET

*These questions are to be completed by each negotiating pair (CN-319/Buyer and Spacey/Seller):*

\_\_\_\_\_  
**Name of Person Playing Role of CN-319**  
**(Buyer)** [please print]

\_\_\_\_\_  
**Name of Person Playing Role of Spacey**  
**(Seller)** [please print]

If an agreement was reached on price, it was for ^ \_\_\_\_\_

-----  
**This portion to be completed by CN-319/Buyer:** (without consulting with Spacey the Seller)

If you had price objectives, they were:

<b>Low</b>	<b>Target</b>	<b>High</b>
_____	_____	_____

Did you use any of the following negotiation techniques?

<b>Reasoning</b> (e.g. discussion of dealer's supply)	<b>Hard</b> (e.g. threats)	<b>Lying</b>
_____	_____	_____

#### **Hidden agenda items:**

Did you learn that Spacey/Seller needed to sell one more SUV *today* to meet his/her quota and receive a bonus?

<b>Yes</b>	<b>No</b>
_____	_____

-----  
*Once the top portion is completed confidentially by CN-319, please fold on the dotted line and present the bottom portion to Spacey, to be filled out confidentially by Spacey without the benefit of knowing CN-319's responses.*

**This portion to be completed by Spacey/Seller:** (without consulting with CN-319 the Buyer)

**Spacey**, if you had price objectives, they were:

<b>Low</b>	<b>Target</b>	<b>High</b>
_____	_____	_____

Did you use any of the following negotiation techniques?

<b>Reasoning</b>	<b>Hard</b> (e.g. threats)	<b>Lying</b>
_____	_____	_____

**Hidden agenda items:**

Did you learn that CN-319/Buyer had to have the SUV *today* so it would be available at CN-319's boss's wedding the next day?

<b>Yes</b>	<b>No</b>
_____	_____

### NEGOTIATION TERMS (FOR INSTRUCTOR'S USE IN DEBRIEF)

**BARGAINING ZONE:** The bargaining zone is also known as the “settlement zone.”

**BATNA:** A negotiator must determine his/her Best Alternative to a Negotiated Agreement. This is so important that it has been made into an acronym. A BATNA is the point at which a negotiator is prepared to walk away from the negotiation table. A negotiator should be willing to accept any set of terms superior to their BATNA. Moreover, a negotiator should reject any set of terms that are worse than their BATNA. (Fisher, Ury, & Patton (1991), *Getting to Yes*; Thompson (2004), *The Mind and Heart of the Negotiator*).

**EXPANDING THE PIE:** Expanding the pie is a method used to create integrative agreements through the use of integrative negotiation. It is the opposite of **Pie Slicing**, also known as **Distributive Negotiation** or **Fixed Pie Negotiation**, a faulty perception that the parties' interests are completely opposed. Expanding the pie means identifying trade-offs and avoiding compromise. (Thompson (2004), *The Mind and Heart of the Negotiator*).

**INTEGRATIVE NEGOTIATION:** Integrative negotiation is also known as “win-win” negotiation. Common misperceptions are that win-win negotiation means compromise, an even split, feeling good or building relationships. What win-win really means is that both parties are better off than if there were no agreement. The very best integrative outcome -- an optimal agreement -- means all creative opportunities are exploited and no resources are left on the table. (Thompson (2004), *The Mind and Heart of the Negotiator*).

**NEGATIVE BARGAINING ZONE:** When there is no positive overlap between what the buyer is willing to pay and the seller is willing to accept, this is known as the negative bargaining zone. If the parties find themselves in a negative bargaining zone, both should exercise their BATNAs.

**POSITIVE BARGAINING ZONE:** If there is an overlap between what the buyer is willing to pay and what the seller is willing to accept, there is a *bargaining surplus*, also known as the positive bargaining zone or **Zone of Possible Agreement (ZOPA)**. (Thompson (2004), *The Mind and Heart of the Negotiator*).

## EPILOGUE

This case has been conducted in the classroom time and again with great success. The quantitative component of the case is an excellent way to introduce students to substantive negotiation concepts, such as BATNA, positive and negative bargaining zones, and integrative (win-win) agreements. The intercultural component succeeds in introducing the hard but important lessons of misinformation, cultural stereotyping, cultural noise, and cultural adaptation. What is particularly inspiring, however, is the excitement and enthusiasm consistently demonstrated by those participating in the role-play, both during the negotiation itself and during the debrief.

Another feature of the case that causes it to be embraced by the participants is the common experience component, i.e., so many people can relate to purchasing a vehicle. Given the context of a vehicle purchase, an ethical component also sometimes emerges in that such a context (rightly or wrongly) is perceived by many to be imbued with an aura of deceit and deception. Accordingly, some participants invariably seem to think that lying brings authenticity to their respective roles!

The bottom line is that this case works on many levels. It is simple in design, but intricate in its execution. It is highly educational, but it is also highly entertaining. Most important of all, the case teaches its lessons well and leaves the participants eager to learn more about intercultural and international negotiation.

## REFERENCES

Fisher, Ury, & Patton (1991). *Getting to Yes (2<sup>nd</sup> Edition)*. New York, New York: Penguin Books.

Thompson (2004). *The Mind and Heart of the Negotiator (3<sup>rd</sup> Edition)*. Upper Saddle River, New Jersey: Prentice Hall.

## ENDNOTE

- 1 This case is inspired by and is a modification and expansion of a case entitled "Muenster Pump Buys a Car," by Dr. David Burt of the University of San Diego, who has graciously authorized and consented to this adaptation and publication.

---

# MOUNTAIN SKIN CARE

**Jillian Tueller, University of Idaho**

**Philip D. Olson, University of Idaho**

## CASE DESCRIPTION

*The primary subject matter of this case is entrepreneurship, including the topics of industry analysis, legal structure, patents, raw material suppliers, and growth strategies. The case has a difficulty level of three, appropriate for junior-level courses. The case is designed to be taught in one class hour and is expected to require three hours of outside preparation by students.*

## CASE SYNOPSIS

*The case focuses on a business, Mountain Skin Care, which was launched in 2002 for producing and marketing hand creams and lip balms. The case begins by discussing how Judy, the owner, is able to start the business for under \$1,000. Start-up costs are low because family labor, space and equipment were used.*

*Other topics introduced in the case are how Judy developed her hand cream recipe and how she identified customer needs. An industry analysis is also covered, including: barriers to entry, rivalry among existing competitors, substitute products, complementors, supplier power, and buyer power. One key industry analysis issue is how Judy can develop a competitive advantage by building on her strengths. Another topic explored is the relationship Judy develops with a supplier. The case concludes with a presentation of three growth strategies Judy is considering: expanding the firm's current operation by hiring additional personnel to perform production and marketing activities, contracting with a wholesaler to perform marketing activities, and licensing both the production and marketing functions to another firm.*

*Mountain Skin Care is a comprehensive case. Students completing the case explore several issues that an entrepreneur faces when starting a firm with high growth potential.*

## INSTRUCTORS' NOTES

### QUESTIONS AND SUGGESTED ANSWERS

- 1. What legal structure, sole proprietorship (SP) or limited liability company (LLC), would best suit Mountain Skin Care? In particular, which one would be best if Judy decides to pursue growth for the business by using the third growth option--i.e.,**

**expanding the firm's current operations by hiring additional people and purchasing the necessary assets to perform the extended production and marketing activities? Include in your answer the advantages and the disadvantages of the SP over the LLC.**

Advantages of the SP over the LLC for Mountain Skin Care: 1) a SP is easier and less expensive to create. Sometimes no forms are necessary. In Judy's situation, however, since her business name is not her name, she needs to fill out a doing business as (DBA) form, and 2) the owner has complete authority over decisions about the direction of the business.

Disadvantages of the SP over the LLC for Mountain Skin Care: 1) the sole proprietor has unlimited liability for all claims against the firm. Any debts incurred by the firm that can't be paid by the firm need to be paid from the owner's personal assets whereas the LLC has limited liability to invested assets. Therefore, the sole proprietorship structure puts at risk Judy's personal assets (if she selects the SP structure, she needs to obtain insurance), 2) the SP is often heavily dependent on the owner's skills to manage the business. The lack of any particular skill, of course, can be complemented by hiring someone with specific skills, and 3) it is often more difficult to raise debt capital because the owner's financial background may not alone qualify for a loan. Of particular concern for Mountain Skin Care is this third disadvantage. It would appear that if Judy decides to grow her business by expanding current production and marketing activities she will need additional outside capital, either debt or equity, because she and her husband are stretched financially and would likely not be able to provide the necessary capital themselves from savings. Further, it is unlikely that Judy will be able meet the necessary bank requirements to obtain debt capital. Therefore, additional equity (ownership) capital will be needed (perhaps from her sister and her friends). Hence, the LLC would appear to be best structure because it allows for more than one equity owner.

**2. In a competitive advantage sense, discuss the strengths and weaknesses of Mountain Skin Care. (Note: the strengths and weaknesses of Mountain's competitors are presented in Table 1.)**

*Strengths:* Mountain Skin Care products contain safe and natural ingredients. This is a good selling point for customers who are concerned about harsh chemicals. In addition, the products do not contain lanolin to which some people are allergic. The products have pleasant fragrances, too. Mountain Skin Cream also has a history that is linked to an earlier successful cream, Farm Hand Cream. Another trait worth noting is Mountain's strong relationship with a major supplier, Sage Shipping. When combined, these factors have brought about products that are well received in the marketplace.



*Weaknesses:* The range of products is small when compared to Burt's Bees and Crabtree & Evelyn (see Table 1). Burt's Bees has the advantage of using all natural products yet is able to offer many different items that are healthy and fashionable. Further, Mountain Skin Care's distribution and marketing are weak. Its products are sold in only a few outlets in one US region, the Northwest. Another concern relates to Judy's abilities to expand her business. If she decides to emphasize growth as a goal, the business could do well. But, on the other hand, she has no past experiences (and perhaps no educational background) with managing growth. These weaknesses are often associated with small, new ventures like Mountain. Another weakness is that Judy does not currently have a patent on her cream. Finally, even though Judy's relationship with Sage Shipping can be considered a strength, it can also be a weakness if, for example, Sage were to close and leave Mountain without a supplier for many of its ingredients and containers. Given other vendors exist for producers of skin care products, Mountain would be able to identify other suppliers but it would be a time consuming change.

**3. Suppose that Judy applied for a patent on her skin cream after knowing her product met government regulations. How important is a patent for her skin cream? Discuss.**

A patent would protect the skin cream from being copied by others. Hence, if another company decided to copy the formula, Mountain Skin Care could pursue protection under the law. A patent would also add value to the cream if Judy decided to either use a wholesaler to distribute her product or license the product to another firm. This is true because in both cases the wholesaler or licensor would have a monopoly on what they are selling. Probably the biggest danger in NOT patenting is that it allows someone else to use reverse engineering, then to apply for a patent. If this were to happen, the patent may not be approved, since it wouldn't be considered a "new" product (if Judy can prove the product been on the market awhile), but there is still a risk. Of course, rather than patenting the product, Judy could choose to keep the recipe a trade secret. If she keeps her business local, this route could be an effective option. However, someone could use chemistry to determine the formula and then sell it without any repercussions.

**4. Judy's has reduced the number of vendors with which she does business and is using primarily Sage Shipping. Discuss the positives and negatives of this approach.**

*Positives:* Because Sage Shipping is a broad supplier to Mountain, this vendor is very knowledgeable about Mountain's needs and, as such, is able to make suggestions and provide customized services (e.g., allow Mountain to be able to purchase Sage's newest

ingredients first) as Mountain grows. Also, since Mountain Skin Care is a large customer of Sage, they are able to obtain quantity discounts.

*Negatives:* Given Sage Shipping is a broad supplier to Mountain, if the business relationship were to sour, orders from Sage may not be handled efficiently or effectively—e.g., orders could be given the lowest priority and not shipped in a timely manner causing downtime for Mountain. Even worse, if Sage Shipping were to close or shut down, for whatever reason, it would leave Mountain Skin Care without its main supplier.

**5. Discuss the positives and negatives of each of Judy's three growth strategies (expanding the firm's current production and marketing operations, employing a wholesaler, and licensing both production and marketing to another firm). Which one is the best?**

*Expanding the firm's current operations:* One positive factor is that Judy's family appears to enjoy working in the business and it provides jobs for them. Further, in a social sense, if Judy were to grow the business her self, she would need to employ people from the community, and her business could become a source of economic growth for the area. Another positive factor is that her family enjoys the business currently, and it may be something her children can inherit in the future. However, of the three possible options, this one would likely result in the slowest growth and would require the most effort on her part. A concern that needs to be addressed is: Does Judy have the background, skills and capital to grow the business? It was mentioned in the case that she lacked marketing skills. The same may be true for larger scale production skills, too. As such, even though her ideas/products have been well received, she may not have the needed complementary skills to handle growth. She also lacks capital and would probably need other investors to gain the following assets: competitive manufacturing facilities, a sales force, and access to distribution systems.

*Employing a wholesaler:* Mountain will likely grow more rapidly using this strategy than with expanding the venture's current operations. Judy would need to upgrade her production facilities and skills, but she would not need to work at building her customer base. She will not make as much per sale, since the wholesaler wants to purchase her products for 50% of the selling price, yet she can produce it for 25% of the price. Nevertheless, she will in all likelihood be able to sell MORE with this strategy than if she grows her business by expanding the venture's current operations (and perhaps be less stressed). But will the increased sales be enough to offset the lower profit margins? Judy also needs to connect with other wholesalers to make sure the wholesaler she has contacted has the best program. Perhaps there are others who have better arrangements—i.e., they serve a larger network of

retail stores and would purchase the products for the same prices (50% of the selling prices) or even less.

*Licensing to another firm:* If Judy uses this strategy she will first have to identify one or more firms interested in her proposal, as no specific firm was mentioned in the case, and then select the best one. If this is possible, she will be able to receive royalties instead of producing and marketing the products her self. Assuming she would license her products with a firm that sells nation wide, she will be able to see her hand cream sold in stores across the country, instead of merely in her region, giving her more exposure.

As for which of the three strategies is best, there really is no BEST or correct answer. Students, however, need to support their answers with the appropriate reasoning. The “expanding the firm’s current operations” strategy is seen as the slowest form of growth and, as such, is not viewed as favorably. However, some students recommend that Judy try it for a few years. If she has difficulty developing the needed skills, putting together the necessary assets and raising the needed capital, then she can opt to either work with a wholesaler or license the products to another firm.



# **MOTIVATIONAL ISSUES AND SAFETY REGULATIONS IN ARABIA: A CASE STUDY IN A MULTINATIONAL OIL COMPANY**

**Asya Al-Lamky, Sultan Qaboos University, Oman**  
**Unnikammu MoideenKutty, Sultan Qaboos University, Oman**

## **CASE DESCRIPTION**

*This case primarily deals with the consulting process within a multinational oil company in the Arabian Gulf peninsula. It brings to the fore the underlying cultural dimensions pertaining to communication, perceptions, and organizational politics operating within a multicultural desert seismic crew. This case is suitable for courses in Organization Development and Change, Human Resource and International Management at the advanced undergraduate and graduate levels and is designed to be taught in two class hours with an expected two hours of earlier preparation.*

## **CASE SYNOPSIS**

*The impetus for the consultancy was to assist the expatriate management of a seismic crew develop a better understanding of the organizational, cultural, and situational factors that impact safety management, especially driving safety violations amongst the predominantly host country employees. The intended goal was to provide recommendations that will bring about changes in the safety culture of (local) Seismic Crew employees and their motivation to comply with established safety procedures.*

*The case study presents the consulting process from initial entry, terms of reference, the desert camp field visit; multiple perceptions of the problem and the proposed intervention to manage the process. While the division management endorsed the recommendations, implementation was suspended without providing a convincing reason.*

*The case study would be of interest to students, faculty and practitioners in the field of Organizational Development and Change as well as International and Human Resource Management in analyzing the consulting process as well as addressing issues of organizational culture and politics, job dimensions and motivation as they relate to attitudes and behavior at work in a multinational work environment*

### INSTRUCTOR'S NOTE

This is an interesting case to discuss issues related to entry and contracting. Creative instructors could also adapt this case for teaching issues related to managing across cultures and organizational politics.

#### Discussion Questions

- 1. Who is (are) the client(s) in this intervention? How did this issue affect the effectiveness of the intervention?**

Generally, all those who are directly affected by the intervention are considered as the clients. In this case the contractor was an important client along with Arabian Oil. Because they are the ones who would be most affected by the change. It was essential that they should have been included in the process at an early stage.

By not including the contractors at an early stage as a partner in the change process, they felt that the Arabian Oil was imposing a change on them. Any change will have financial and operational implications. The contractor was not sure who would foot the bill. Thus their cooperation was reluctant at best.

Lack of involvement of the contractor was also a reason why the second phase of the project failed to materialize. Once Andy left there were not enough committed sponsors for the project in the organization.

- 2. What issues in contracting did the change agents fail to deal with? How did this affect the progress of the intervention?**

Since even the preliminary phase would create expectations that change will take place, the change agents should have obtained a commitment from Arabian Oil to complete the whole change process. Moreover, since Andy was the main internal sponsor of the intervention. When he indicated that he was leaving, the change agents should have discussed about the fate of the intervention after his departure. This may have lead to a transition meeting whereby Andy's successor could have been briefed by the change agents about the project and increased the probability that the intervention would continue.

---

### **3. What could be the implications of abandoning the intervention at the stage that it was abandoned?**

Collecting data through interviews and group discussion is itself an intervention. When people respond to questions about their working conditions there is an implication that something will be done to improve their lot. When this does not happen, employees become cynical about change attempts. Any future change attempt will therefore be met with scepticism. Thus, it was essential for the change agents to impress upon Arabian Oil managers that the change process should continue.

## **Appendix I**

Discussion with managers of the Seismic Group of Arabian Petroleum indicates that they are extremely concerned about the tendency of employees to ignore safety regulations. This is a matter of grave concern because the only way to prevent serious accidents is to follow safety regulations. Safety experts suggest that the potential exists for approximately one fatal accident to occur for every four hundred unsafe acts. The concern of managers is heightened by the fact that the Seismic Group had a fatal accident last year.

There are several programs in place to encourage employees to follow safety regulations. These programs have apparently heightened employee awareness about safe behaviors. Unfortunately, this awareness has not been translated into safe behaviors as much as is desirable. The Seismic Group managers are interested in identifying the reasons for this gap between awareness of safe behaviors and engaging unsafe behaviors. This understanding is expected to lead to more effective programs for promoting safe behaviors in the workplace.

The consulting group needs more information about the various issues related to unsafe behaviors before developing a full-fledged consulting proposal. This preliminary proposal outlines the activities to be carried out in order to develop a full-fledged proposal, the time required for carrying out these activities and the consulting fees.

### **Proposed activities (Phase I):**

1. Review of secondary data on accidents and unsafe acts.
2. Review of various safety programs currently in operation. This will involve review of secondary data and interviews with concerned managers.
3. Literature review of safety issues
4. Visit to one or more camps to observe first hand the nature of work and working/living conditions and the operation of safety programs
5. Interviews with HSE advisors.

These activities will lead to a better understanding of the issues related to unsafe behaviors and will help in formulating a full-fledged proposal for investigating these issues. More specifically, the product of these activities will be a report that outlines the major issues related to unsafe behaviors and a detailed process for investigating these issues. Based on this report, a second phase of the project will be initiated which will entail a proposal to carry out the following:-

1. Identification and ranking of key motivational issues for the seismic crew
2. Assessment of the effectiveness of the current motivational schemes on the seismic crews
3. Identification of the underlying reasons for non compliance with safety requirements
4. Recommendations on what improvements can be made to tailor current schemes to meet the motivational needs of the workforce in addition to other needed interventions to modify the undesired behavior among the seismic crew

It is estimated that phase I of this proposal will require approximately 100 consulting hours and can be completed in about Eight weeks. The fee for this phase of the project is outlined below.

## **Appendix II**

It appears that Seismic Crew employee safety performance has improved to the maximum level possible under the current set of programs and incentives. It is our considered opinion that further improvements are likely to be more difficult to come by and can only be expected if issues concerning the general morale of the workforce are addressed. Long-term improvements can also be expected from programs that attempt to integrate safety culture within the national culture. The following recommendations provide some broad guidelines for addressing these issues.

1. Safety research suggests that internalisation of safety values and norms can take place through social (group) pressure. The standard practice is to have safety groups that discuss safety issues and develop consensual behavioural norms. These groups may consist of a few employees who meet periodically.
2. Employees perceive that the management does not hear their concerns. We recommend a communication audit to identify specific blocks to communication and the development and implementation of suitable structures for upward communication. This will help not only in obtaining useful ideas from employees, but also resolve problems, and motivate and encourage organizational commitment.



3. Employees also express a sense of disempowerment. There is a feeling that they have no voice in any work related issue that affects them. It is necessary to identify areas in which employee input is possible and to develop mechanisms for obtaining this input.
4. An important source of intrinsic motivation for those working under difficult conditions may be the social significance of the work. Attempts must be made to highlight the social significance of the work of seismic crews. Their contribution to the economic development of the country needs to be highlighted at every opportunity.
5. Effectiveness of current safety schemes and awards needs to be evaluated. This can be accomplished through a survey of the employees. Schemes and reward programs can be modified based on the feedback with the involvement of employees.
6. Research indicates that the first-line supervisor is a strong source for internalization of values in the workplace. This means that supervisors are a potent source of influence in the workplace. In fact, commitment to supervisor's values and goals is often a stronger source of influence than commitment to organizational values and goals. The first line supervisors need to be empowered. Problems that foremen face in being effective supervisors need to be investigated. Based on this investigation a program for supervisory development needs to be implemented.
7. Research also indicates that internalization can be increased with the use of role models and social pressures. A possible role model is the foreman. Perhaps with adequate training the foremen can serve as role models and transmitters of safety values to the employees.
8. Commitment based organizations pay serious attention to the development of employee skills. This involves providing both intrinsically satisfying work and the opportunities for training and career advancement.
9. Employees have concerns about job security. Employees need to be provided realistic information and advice about future prospects, retirement plans, savings social security. Since employment opportunities are shrinking in the seismic crew operations, attempts can be made to enhance the employability of individual employees. Employees can be counseled on alternate employment opportunities. Perhaps training can be provided to enhance employability.
10. Conduct attitude surveys. Responses will inform managers as to how employees view their jobs, their supervisors, their wages, their working conditions and other aspects of their employment. Responses can also be fed back to employee problem solving groups and action plans developed to address specific areas of concern. Goals can also be set for managers related to improvements in areas covered by the survey.



---

## CHINA AUTOMOTIVE SYSTEMS, INC.: THE CASE FOR REVERSE MERGERS

Vaughn S. Armstrong, Utah Valley State College  
Norman D. Gardner, Utah Valley State College

### CASE DESCRIPTION

*This case concerns a "reverse merger" by which a Chinese corporation obtains publicly traded status in the United States. The objective is to familiarize students with this alternative to an initial public offering, the more widely known method by which a company can become publicly traded, and to sharpen their analytical and research capabilities as they access the SEC website and EDGAR database as well as websites that provide other financial information for the answers to specific questions.*

*This case is appropriate for use in an advanced corporate finance class, an entrepreneurship or new business formation class, or an international finance class. Some aspects of the case may also be of interest to a business law or securities class. The case has a difficulty level of four, and should take from one to two hours of class discussion. Students will require three to four hours of preparation time.*

### CASE SYNOPSIS

*The "reverse merger" is an alternative to the initial public offering (IPO) method of "going public". This back-door SEC registration technique is relatively common in practice, but is entirely ignored in finance textbooks as well as the academic literature.*

*The case considers China Automotive Systems, Inc., formed when Visions-In-Glass, Inc., a US non-operating, public "shell" company, acquires Great Genesis Holdings Limited, a closely held Hong Kong company that indirectly owns joint venture interests in mainland China. After the merger, Great Genesis stockholders own most of the stock of Visions-In-Glass, Inc., thus controlling the corporation and Visions-In-Glass retains its publicly trading status. The privately traded Hong Kong company becomes a publicly traded U.S. company.*

*In addition to focusing on the process of the reverse merger and the financial returns to various investor groups, this case examines how recent SEC actions may affect future reverse mergers. These actions include the suspension of trading in 26 shell companies for delinquent reporting, and the promulgation of regulations adding reporting requirements for shell companies*

or reverse mergers. These actions may reduce the advantages of a reverse merger in the future. Students gather information and render an opinion as to whether the China Automotive reverse merger presents evidence of a fraudulent "pump and dump" scheme, as well as whether reverse mergers remain advisable in the future. A further unique aspect of this case involves restrictions on investment and/or currency exchange that a foreign country may impose on its residents. The case demonstrates how transactions may avoid or circumvent such restrictions. Finally, the case illustrates the layering of funding common in a start-up business, and how firms use exemptions from SEC registration (for private placements and the Reg S exemption) in connection with funding.

## INSTRUCTORS' NOTES

### RECOMMENDATIONS FOR TEACHING APPROACH

Students should be encouraged to read the case, access the SEC's EDGAR database to obtain additional information about the companies and the reverse merger transaction, and respond to the questions listed in the case.

### DISCUSSION OF CASE QUESTIONS

- 1. Briefly describe the purposes and process of a reverse merger. Compare and contrast a reverse merger with an IPO, a private placement and an ADR. What are some advantages and disadvantages of each?**

#### *Initial Public Offering*

In an Initial Public Offering (IPO) a corporation sells or issues shares of its common stock to the public. In order for a corporation to legally sell stock to the public, it must first register the stock issue with the Securities and Exchange Commission (SEC). Registration requires full disclosure to potential investors of all relevant information about the stock issue as well as the company's management, the nature of its business, and its financial condition.

Companies meet the disclosure requirement by preparing a legal document called a prospectus, which contains all relevant information about the company. A prospectus must be filed with and approved by the SEC before the securities may be sold to the public.

When the proposed public offering has been approved by the SEC, the process of selling the securities to the public may begin. This process, called underwriting, is normally carried out by an investment bank, which contacts its clients to see if they may have interest in purchasing the securities. In each case the potential purchaser of the securities must be given a copy of the prospectus prior to the completion of a sale.

---

The initial sale of securities to investors is referred to as the primary market. Once securities have been sold by the corporation to the public, secondary market trading in these securities may begin. The issuing corporation is not a party to transactions in the secondary market. Investors that previously purchased securities from a corporation in the primary market, may enter the secondary market and sell to another investor. Such trades are normally facilitated by securities brokerage firms and may be executed on an exchange or other organized market.

The effective cost of an IPO can be quite high. <<costs>> Accountants and attorneys work with management to prepare the prospectus and other registration materials. These costs along with the costs of printing the prospectus will usually be in the range of \$150,000 to \$200,000. Fees collected by the investment bank that underwrites the sale to the public are substantial. These fees may exceed ten percent of the sales price of the issue. See, for example, "Considerations of an IPO" at [http://library.lp.findlaw.com/articles/file/00446/002605/title/Subject/topic/Science,%20Computers,%20and%20Technology\\_Initial%20Public%20Offerings/filename/science,computers,andtechnology\\_1\\_990](http://library.lp.findlaw.com/articles/file/00446/002605/title/Subject/topic/Science,%20Computers,%20and%20Technology_Initial%20Public%20Offerings/filename/science,computers,andtechnology_1_990). Management time is spent meeting with advisors, preparing documentation and attending sales presentations where prospective investors learn about the offering.

In addition to the financial costs of an IPO there may be significant delays in the process. The time required to prepare the registration materials and secure SEC approval may extend for months. For these and other reasons some corporations have sought other means of "going public."

### *Reverse Merger*

A reverse merger is an alternate way of going public. In a reverse merger a private corporation merges with another corporation which has already "gone public." In the typical reverse merger case, the public corporation has few or no assets and little or no ongoing business. Such corporations are sometimes referred to as corporate "shells." Notwithstanding their lack of assets or business activity, the shares of such corporate shells may still be bought and sold by members of the public in the secondary market.

In the reverse merger, the shell corporation acquires the private operating corporation by issuing stock to the owners of the private corporation. The number of shares the shell corporation is required to issue for this acquisition is normally quite large in relation to the number of shares previously outstanding. The result is that the majority of the post-merger stock of the shell corporation is owned by the stockholders of the private corporation, who have transferred the assets and business activity of the private corporation to the shell. The

new majority stockholders from the private corporation will normally elect new officers and change the name of the corporation.

Of course those members of the public who previously held stock in the shell corporation, still own stock in the corporation and may continue to trade their shares in the secondary market. The value of the shares will likely increase after the reverse merger because they now represent ownership of an operating company rather than a corporate shell.

Like an IPO, the reverse merger results in the shares of a corporation being traded publicly in the secondary securities market. Unlike the IPO, the reverse merger does not usually result in an immediate inflow of cash to the corporation.

The Costs associated with a reverse merger involve purchasing enough of the outstanding shares of the public shell to have clear control of the corporation. Typically these shares are purchased from someone who already has purchased most of the outstanding stock and is offering to sell control of the shell corporation. Such a transaction will usually cost from \$300,000 to \$400,000 for a shell which is current in its reporting obligation to the SEC. For a shell which is not current it may only cost \$150,000. See for example, "Reverse Merger Offers Alternative to the Traditional IPO" Dallas Business Journal May 2000.

#### *Private Placement with Secondary Trading Under Rule 144 or Rule 144A*

An exemption in the Securities Act of 1933 allows corporations, both public and private, to make private placements of their stock. Under certain limited circumstances corporations may sell stock without registering the issue with the SEC. Such sales must be limited to only a few investors. Additionally the corporation must provide evidence that such investors are knowledgeable, sophisticated investors.

Those who purchase stock on a private placement receive restricted shares which may not be freely sold in the secondary market for two years (under Rule 144) or earlier if sold to "qualified institutional buyers" (under Rule 144a).

Although private placements may be made by either public or private corporations, in general they will be much more successful for public corporations. This is so because the secondary market for the public corporation establishes the value of the stock, which may be used as a guide in the private placement.

The costs associated with a private placement are normally much less than either an IPO or a reverse merger. Typically prospective investors will require financial statements as well as a legal opinion regarding the status of the company and the status of the shares being offered in the private placement. There are no brokerage fees or printing costs, and there is no lengthy approval process from a governmental agency.

---

*China offering coupled with a sponsored ADR*

An American Depository Receipt is created when a depository (frequently the London-based subsidiary of a US commercial bank) purchases stock of a foreign firm trading on a foreign stock exchange, holds that stock in a trust account, and offers shares that represent an interest in the trust account to investors in the United States. The shares offered to US investors, known as American depository receipts, represent a proportional interest in the foreign company stock held by the depository. The ADRs are denominated in dollars rather than the foreign currency and, when the foreign stock pays a dividend, the depository handles currency exchange and distribution to the ADR holders. ADRs may be privately held or trade publicly on an exchange; secondary market trading of ADRs is similar to that for a domestic company's stock. When ADRs trade publicly, the reporting requirements for a US public company apply to the foreign company.

In a sponsored ADR, the foreign company cooperates with the depository in order to create the ADR. The stock purchased by the depository may be newly issued stock making this a vehicle to raise additional capital from US rather than the foreign company's domestic capital market.

Costs for a sponsored ADR include the cost of issuing stock in the foreign capital market (which may be greater or less than issuance costs in the United States), the cost to arrange the depository relationship and create the trust, and the cost of issuing the ADR in the US (which are likely to be comparable to costs associated with a US domestic stock issue).

The discussion on this topic will require the students to draw some conclusions regarding the intentions of the Great Genesis owners. Clearly if they wanted to raise additional funds immediately, they would have selected an IPO (although the IPO market in 2003 may not have been receptive to such an offering) or a private placement. The 2003 annual report filed by China Automotive indicates a desire to expand with strategic acquisitions. As a result of the reverse merger, the company has publicly traded stock available as acquisition currency which may facilitate such plans.

**2. Why did Yarek Bartosz pay \$100,000 to acquire 94.5% ownership of a firm with no assets and no apparent business prospects?**

The public registration of Visions-In-Glass, Inc. has value. Bartosz determined that it was worth \$100,000. As a dealer in public "shell" corporations, Bartosz acquired the company and then looked for a private company that was interested in going public without the necessity of filing a registration statement with the SEC. Assuming such a company

could be found, Bartosz expected either cash or stock to compensate for the amount paid and the risk assumed.

Some students may find other transactions involving Yarek Bartosz on the SEC website. (Searching for “Bartosz” as the “company name” in the “EDGAR company search” page generates a Form 3 and a Form 4 indicating the ownership of stock in Parallax Entertainment, Inc. by Yarek Bartosz.) In August 2002, Bartosz purchased a controlling interest in Parallax Entertainment, Inc. which he later sold to a corporation incorporated in the Republic of China.

**3.a. What return (total and annualized) did the founder of Visions-In-Glass, Inc. realize in the sale of stock to Bartosz?**

Investment of \$1000; receipt of \$100,000 3.16 years later. Return is 9900%; 328.5% per year.

**b. What return (total and annualized) did Bartosz realize on the investment in Visions-In-Glass stock?**

Investment of \$100,000; receipt of \$250,000 and stock worth \$233,275 (using \$3.10 initial trade as per share value and 75,250 shares not cancelled) 0.55 year. Return is 383% (1698.6% annualized).

**c. What return (total and annualized) did the seven private placement shareholders realize on their investment in Visions-In-Glass, Inc.?**

Investment of \$0.01 per share grew to \$10.85 (3.5 post-split shares at \$3.10 per share). Return is 108400% (557.8% per year).

**d. What return (total and annualized) did the 48 Reg. S offering shareholders realize on their investment in Visions-In-Glass?**

Investment of \$0.10 per share grew to \$10.85 (3.5 post-split shares at \$3.10 per share). Return is 10750% (356.7% per year).

The calculations in these questions should be in the nature of review for most students. However, the return levels are higher than they will typically have seen. Some students may struggle with calculating annualized returns, so it may be appropriate to spend some time on this topic. For the returns involving stock prices, the answers provided above



---

use the first price at which stock traded after the reverse merger. Students may elect to use other prices, e.g., the \$18.50 maximum post-merger price, in which case their results will differ. Obviously, the actual return realized by an investor will depend on the price at which the stock is actually sold.

In connection with the calculation of these returns, it may be appropriate to discuss the fact that early-stage investors frequently demand higher returns than those realized on investments in established companies. The additional risk borne by those funding a development stage business justifies the additional return.

**4. Why did Great Genesis Holdings Limited select a reverse merger rather than an IPO, a US private placement, or a China offering together with a sponsored ADR to enter the US capital markets?**

*Considerations common to all reverse merger decisions*

The advantages of a reverse merger over an IPO are that it may cost significantly less and take much less time to accomplish. Once the reverse merger has been completed, the corporation will find it much easier to acquire new assets or subsidiary companies in exchange for its stock, and consultants and key management personnel will be more likely to accept stock or options on the company's stock in lieu of cash for services rendered. Of course such transactions by private corporations are also possible, but in the absence of an ongoing secondary market for the shares of the corporation, the value of such transactions is difficult to determine.

Another advantage of the reverse merger is that the operating company can become a publicly traded company without having to pass the scrutiny of the SEC. Foreign corporations may find this appealing since the SEC is not likely to approve an IPO for a foreign company whose financial statements were prepared by foreign accountants who are not bound by the same accounting standards and procedures as those required in this country, and therefore its financial statements may be incomplete or misleading. Note however that after the reverse merger, the company's financial statements will have to comply with SEC standards in order for the company to retain its publicly traded status.

A foreign or domestic corporation that goes public in the United States through a reverse merger may establish a track record for several years and then file a registration statement with the SEC and, provided it is approved, sell additional shares of stock or other securities to the public in order to raise needed funds.

The principal advantage of a reverse merger over a US private placement is the publicly traded status a company obtains in the reverse merger. However, a private

placement would generate additional capital for the company while a reverse merger does not.

A sponsored ADR requires that the depository be able to acquire the company's stock in the foreign market, presupposing sufficient liquidity in the foreign market and availability of a block of shares, or that new shares be issued specifically for the purpose of creating an ADR. In addition to market characteristics that may make an ADR more difficult, it is possible that regulatory requirements attaching to shares issued in a non-US market conflict with the company's objectives making a sponsored ADR less attractive.

*Considerations that arise from China's restrictions on investment and currency exchange*

Additional reasons favoring a reverse merger may lie in the limitations Chinese nationals face in making investments outside of China. The reverse merger allows the owners of Ji Long to effectively export their investment capital outside of China and into the United States. They have exchanged their interests in joint ventures in China for shares in a publicly traded US corporation. Although these shares are restricted and may not be immediately sold in the US secondary market, over time it may be possible (pursuant to Rule 144) that some of these shares could be sold for cash. This cash could then be used to invest in other US-based assets.

Essentially the same result can be obtained immediately without actually selling China Automotive stock. The corporation can acquire other investment assets or subsidiary companies in the US or other countries and pay for the acquisition by issuing additional shares. Such acquisitions will reduce the portion of China Automotive that the Chinese investors own, but their investment will have changed in character from an investment in strictly Chinese businesses to include businesses in other countries. The Chinese investors can thus diversify their country-specific investment risk.

In addition, the market value of the Chinese investors' holdings may significantly increase simply as a result of this reverse merger. It is possible that valuation of the company in the US equities markets will be greater than it would be in Chinese equity markets. This difference in valuation may reflect the diversification such an investment offers to US investors, which may be fundamentally different than the diversification such an investment provides to an investor in China. Disparities in the valuation of securities would not be expected to persist in efficient markets. However, the current situation is characterized by inefficiency arising from investment restrictions and currency controls imposed by the Chinese government. Valuation differences may well persist for extended periods due to the resulting segmentation of international capital markets. If inefficiencies exist also in the US market, valuation of China Automotive stock may reflect limited information about actual operations in China together with publicity about the size and

growth of the Chinese economy. This may lead US investors to overvalue an investment such as China Automotive during times that direct investment in comparable Chinese entities is not available.

**5. What proportion of Great Genesis did each of the 5 Chinese investors in the Ji Long Holding Company own before the merger? What proportion did each receive of the shares issued by Visions-in-Glass to acquire Great Genesis? Comment on your findings.**

	Great Genesis Shares Owned	% GG Owned	Visions in Glass Shares Received	% VIG Received
Guofu Dong	2,340	3	627,429	3
Liping Xie	3,900	5	2,091,425	10
Qizhou Wu	3,900	5	2,195,996	10.5
Tse Yiu (Andy) Wong	3,900	5	1,359,426	6.5
Hanlin Chen	63,960	82	13,280,547	63.5
Shaobo Wang		0	731,998	3.5
Shengbin Yu		0	627,429	3
Total	78,000	100	20,914,250	100

There is a substantial difference between the percentage that some investors owned of Great Genesis and the proportion of the Visions-in-Glass shares they receive in exchange for their shares. Clearly the differences must be due to private agreements among the investors. They may be designed to adjust differences in the parties investments in the Ji Long Enterprise Investment Limited, ownership of which is not reported and may differ from ownership of Great Genesis, or in the individuals' various managerial roles in Ji Long or Great Genesis, or they may represent compensation for services or other consideration provided. From a disclosure point of view, since the differences are well documented in the merger transaction, they present no real reason for concern.

**6. Were the warrants issued at the time of the reverse merger ever exercised? If so, on what terms? Who do you think may have exercised them?**

The warrants were issued to the designees of the Great Genesis stockholders. In the 2003 annual report of China Automotive Systems, Inc. available on the EDGAR database at <http://www.sec.gov/Archives/edgar/data/1157762/000101054904000267/china10ksb123103.txt>, we find that they were issued to consultants and that 509,856 of the warrants issued were exercised on a "cashless basis" in December 2003, despite the fact that they were originally issued with the understanding that each warrant would require the payment of \$1.36 in exchange for one share of common stock. It is likely that at least some of the warrants were given as payment for services from the law firm of Loeb and Loeb where closing of the reverse merger occurred and which likely advised Great Genesis in connection with the transaction, to the investment bank that located the shell company and provided advise regarding the financial aspects of the reverse merger, or to the public relations firm retained by China Automotive. Payment for services with stock or stock equivalents is not uncommon.

To the extent exercise of the warrants dilutes the value of the Great Genesis stockholders' interest in China Automotive, there is no difficulty assuming they contracted for the services for which warrants were issued as compensation. These shareholders bear the cost of those services in dilution of their stock value.

To the extent exercise of the warrants dilutes the interests of the original Visions-In-Glass shareholders who did not contract for the consulting services but have the value of their interest in China Automotive diminished by dilution of their proportional ownership, there may be reason for concern.

It should be noted however that when shares of stock are received in lieu of payment for services, the stock is restricted and may not be sold for an extended period. See discussion of restricted stock below.

**7.a. Describe the "pump and dump" scheme and the concerns of the SEC regarding shell corporations and their role in the reverse merger process.**

Historically shell corporations have not enjoyed a high degree of popularity with the SEC. This apparently stems from the presumed opportunity for manipulation and fraud. There is concern that unscrupulous promoters may acquire control of a publicly traded "shell" corporation and then manipulate its stock price by disseminating false or misleading information about new assets being merged into the corporation. Once the stock price has been pumped up by these rumors, the promoter then dumps the stock on the market, selling it to unsuspecting investors.

The SEC's action to halt trading of the stock of 26 shell corporations which had not filed timely reports reflects this concern. Without timely reporting, investors have difficulty

---

valuing a company and the risk of manipulation or fraud increases. When the stock of the shell company ceases to trade in the secondary market, it becomes more difficult to use it in a pump and dump scheme, and also is much less desirable as a merge partner for a reverse merger. The proposed regulations that would require enhanced disclosure after a reverse merger also reflects the SEC's concern that investors have adequate information to evaluate stock value prior to allowing the stock to trade publicly.

**b. Is there any evidence of "pump and dump" in the reverse merger which resulted in the formation of China Automotive Systems?**

In the case of China Automotive Systems there appears to be no evidence of a "pump and dump" scheme. The company reported the reverse merger transaction promptly on Form 8-K, and provided financial statements reflecting the Great Genesis assets and operations. The 2003 annual report indicates that none of the shares received by the Chinese investors in exchange for Great Genesis stock had been sold as of December 2003. Nor have any been sold since. Such sales must be reported to the SEC since the stockholders are officers and directors of China Automotive. Students should be encouraged to scan China Automotive's SEC filings to verify this. Purchases and sales of stock by corporate insiders are reported on Form 4.

**c. Given the negative view the SEC appears to hold of reverse mergers, what would you advise a private corporation today which is considering the use of a reverse merger in order to "go public"?**

Although not widely publicized, some well-known companies have used the reverse merger process to go public. These include, e.g., Turner Broadcasting and Travelocity.com. The technique is a valid and appropriate business transaction that can be misused in ways that create a risk to uninformed members of the public. Similar risks exist in connection with other business transactions regulated by the SEC. However, the SEC has selected the reverse merger process for increased regulation, making it more costly and possibly less desirable. Students will need to determine whether the objectives advanced through a reverse merger

The discussion may extend to whether additional regulation that affects only "shell" companies is appropriate. After any merger between a public and private company, investors have incomplete information about the surviving company. The information they do have may not be adequate to accurately judge stock value whether the public company is a "shell" or not.

## ADDITIONAL TOPICS THAT MAY ARISE IN DISCUSSION OF THE CASE

### **Layered financing**

The case provides a limited illustration of the layered financing of development stage firms. Founders and a few private investors provided the initial funding. A second stage of funding came from a small offering that was exempt from SEC registration. The company registered its stock and began reporting perhaps in anticipation of future funding needs that could not be satisfied from private or exempt sources.

### **Offerings that are exempt from SEC registration**

Two different types of exempt offerings appear in this case. The section 4(2), private offering exemption, is likely to be familiar to students. The Reg S offering is not as well known. This regulation exempts stock issues that are sold entirely outside the US from registration with the SEC. More information about the Reg S offering is available from the SEC at <http://www.sec.gov/divisions/corpfm/forms/regs.htm>. (Other exemptions from registration exist but are not used by the companies in this case. Students may be familiar with, e.g., the Reg A, small issue, or Reg D, limited offer, exemptions).

### **Restricted stock**

The Visions-In-Glass stock involved in the China Automotive reverse merger is specifically recognized as restricted stock in the Share Exchange Agreement. This limits the ability of the Great Genesis stockholders to sell the stock in the secondary market. Although not widely understood, shares of stock received from a corporation, even a public corporation, in exchange for assets or services, may be restricted, and not be immediately tradable. This is the case when the shares are not issued in connection with a public offering (accompanied by an SEC approved prospectus), e.g., stock issued under an exemption from registration. When restricted shares are sold, the seller has the burden to establish that the sale is not part of an unlawful issuance or distribution of stock (that is, an issuance or distribution that is subject to registration with the SEC but has not been duly registered). Safe harbors exist under which sale of restricted shares by non-affiliated investors after a two-year holding period (Rule 144) or to a “Qualified Institutional Buyer” (Rule 144A) may be presumed to be not in connection with an unlawful issue or distribution.

---

### **Uncertainty of cash flow from China joint ventures**

The regulation of currency exchange by China raises additional issues that affect the value of China Automotive stock. China Automotive's income consists of distributions by joint ventures in China. Foreign exchange rules require Central Bank of China approval of transfer of currency out of China. Even if there is income, it is not certain when or whether that income can ever be distributed to China Automotive and thus to its stockholders.

The dividend discount model suggests that the value of a stock is the present value of all futures expected dividends. All businesses are subject to some uncertainty regarding the timing and amount of future cash flows. That uncertainty is magnified in this case by the uncertainties associated with the location of the operating business of China Automotive and the regulation of foreign exchange by China. Restriction on currency flowing out of China may interfere with China Automotive's ability to pay dividends to its stockholders even if the joint ventures interests it owns do generate profits.

If the market expects that no dividends will ever be paid on a stock, the stock value should be zero. Clearly the market has assigned positive value to China Automotive stock. Apparently, the market anticipates forecasting an easing of currency controls in China. In that event cash dividends paid by the Chinese joint ventures Ji Long would flow to Great Genesis and ultimately to China Automotive. For a reference to the problems stemming from currency controls in China, see the Wall Street Journal article, "Snowed in Beijing" Sept. 3, 2003.





# REIT VALUATION: THE CASE OF EQUITY OFFICE PROPERTIES

**James Stotler, North Carolina Central University**

## CASE DESCRIPTION

*This case will require the student to value the equity of Equity Office Properties, Incorporated (NYSE: EOP) and make a buy or sell recommendation as an independent analyst. The data given should be examined to determine whether or not the company's stock is valued above or below the market price in order for investors to make a buy or sell decision. The student must assess the real estate industry environment using Porter's five-force model of competitive strategy and the DuPont identity. Valuation techniques employed include the capital asset pricing model, the two-stage dividend-discount model, the P/E valuation approach, and the Gordon model.*

## CASE SYNOPSIS

*The student is placed in the role of an equity analyst and asked to prepare a buy or sell recommendation for Equity Office Property (NYSE: EOP) stock. EOP is the nation's largest office building owner and manager, as well as the largest real estate investment trust (REIT) in the United States. The student must assess the competitive environment of EOP using the DuPont identity and Porter's five force model of competitive strategy as well as estimate the value of EOP stock. All information in the case is publicly available.*

## INSTRUCTOR'S NOTES

### **Pedagogy**

The valuation of the common stock for Equity Office Properties, a large cap stock, is the focus of this case. The student must remember, however, that they are to interpret the case from the perspective of an external analyst or investor. Implementation of processes that address industry concerns through Porter's Five Force Model and the usage of the Dupont identity will identify the company's strength and weaknesses among its competition. The difficulty level of the case is

appropriate for seniors or first year graduate students. The case should take a maximum of two hours of class time and two and one-half hours of student preparation outside of class.

Stock evaluation issues relating/but not limited to the following are to be discussed:

- the expected return
- risk-free rates
- security's beta
- discount rate
- growth rates

### **Teaching Plan**

Class discussion should be initiated with the students identifying Porter's five competitive forces and the strength of these pressures. Instructors may want to focus on the following topics for class discussion.

1. List and describe the sources and strengths of the five competitive forces.
2. Analyze the ROE, Profit Margin, and ROA using the Dupont identity.
3. Calculate the expected return for EOP stock.
4. Estimate the value for EOP stock using the constant growth model.
5. Determine the value estimate using a Price/Earnings valuation approach.
6. Find the value estimate for EOP using the two-stage Dividend Discount Model.
7. Present an overall external investment recommendation to buy or sell the stock based on your analysis. Explain.

### **Discussion Questions**

**1. List and describe the sources and strengths of the five competitive forces.**

- Threat of entry by new competitors
- Threat of substitute goods
- Bargaining power of buyers
- Bargaining power of suppliers
- Rivalry among existing competitors

---

*Threat of entry by new competitors*

No matter the industry, the threat of new companies entering into the market will always prevail. However, the real estate industry seems to be a quite different monster when it comes to new companies coming into a geographical area and breaking new ground. Once a location gets saturated, there may not be any more land available for development.

EOP is in a relatively good position as far as the competition is concerned. The total capitalization of EOP is approximately \$25 billion and they manage 124.1 million square feet of office space in 721 buildings in metropolitan areas all across the United States. The companies size and geographic diversification afford it access to low cost capital, acquisition opportunities and top quality management talent in the industry.

Some of the biggest barriers for new competition to enter in the real estate market are the location, need for the product, timeliness.

- *Location*- no company should try to open up a business where the location would not be advantageous for the customers. If the customer needs office space in one part of the state and all of the company's properties are located mile and miles away, then the company would not be able to serve the consumer. Finding land that is available for sale at an acceptable price and location could prove to be a very difficult task. Land is a non-renewable resource and once it is gone, it cannot be replenished.
- *The need for the product*- if in a given location there seems not to be a lot of economic development, the need for office space is not there. It would not be reasonable to build commercial properties ready to be leased where no companies are interested in locating or there isn't a need for anyone to rent the space.
- *Timeliness*: It takes a significant amount of time to construct commercial rental properties. Time and planning must take place in order for the product to be developed, constructed, and in the end leased.

*Threat of substitute goods*

Product substitution plays a huge role in the real estate industry due to the competitive nature and the location. Strengths feeding on the substitute of goods could be determined by the company's profits and the growth of sales by the substitute company.

EOP is in a relatively good position with respect to substitute goods. Since it takes a significant amount of time for a company to construct new commercial space EOP is in a good position to meet customer demand more quickly than competitors because they

significant experience in the construction and management of commercial properties throughout the United States. Many of their competitors have limited geographic experience because they operate only in a certain region of the country. The company's brand name brings a reputation for quality to its product and the tenants are able to enjoy a comfortable residence in the leased space with the assistance of a highly regarded property management team.

- *Company profits*- if the company is not profiting from a given location because gross rent revenues are declining, additional marketing may be required. Company profits allow the additional research and development to meet customer's needs as well as some pricing flexibility to attract new tenants.
- *Growth of sales*- as the sales for a company grow, so does the company's ability to expand. Expansion allows a company to penetrate the market, to make space readily available and to offer substitutes for customers.

#### *Bargaining power of buyers*

Due to the nature of real estate there is a low margin of bargaining power of buyers. Prices are at a market rate with an additional profit margin tied in. Customers are able to negotiate what they are willing to pay to rent a given space marginally, but it is up to the firm to accept or reject the offer considering that there may be substitutes available with competing firms. Additional bargaining power is captured by the buyer when the company is of great size and/or there are substitutes readily available.

Low and declining interest rates, among other factors have meant that the real estate industry has been able to expand dramatically in the last decade. Firms compete on the availability of space, the company's ability to build to suit, and measures such as the ability to deliver a quality product in a reasonable amount of time. Some areas that seem to be the deciding factor in a customer's decision to lease space with a particular firm are price, quality, and service. With interest rates beginning to edge up slightly, price is likely to become a factor where the bargaining power of buyers will increase.

#### *Bargaining power of suppliers*

Suppliers are critical in the real estate industry because their product allows the company to get ahead of competitors or be placed at a disadvantage. If the supplier does not deliver the product when needed, the development for a company can be held up, which could be detrimental to the construction process. The bargaining power of given suppliers results from

---

the quality of the product delivered, terms and conditions of contracts, and the timeliness of delivery.

EOP has to choose carefully the suppliers that they choose to do business with. Vendors involved in the construction process and the daily management activities must be selected to ensure that the construction is completed in a timely manner and the end user (the tenant) is satisfied. EOP has existing, long-standing relationships with suppliers of construction materials and labor which helps to assure consistent quality of the product, but at the same time giving significant bargaining power to suppliers.

- *Quality of product* - when constructing office space, choice materials are often used and this allows the company to gain a competitive advantage over its peers. In addition, timeliness in servicing maintenance concerns can prove to be detrimental if not handled properly. Durability of product offerings is important when selecting a supplier.
- *Terms and conditions* - contracts need to be made on a basis that is acceptable to all parties involved. Items in a contract should be evaluated with due diligence.

#### *Rivalry among existing competitors*

Competition in any industry can always be an ongoing concern of a corporation. It is often the most powerful of all the competitive forces. Companies have to be pro-active as well as reactive when it comes to dealing with steep competition in their market niche. Companies compete on promotion, price, product, and the placement of goods. Therefore, rivalry among existing competitors is the umbrella that links the other four aspects of the Five-Force Model.

Rivalry among existing competitors in the commercial real estate industry is somewhat high although probably not as high as in most other industries. In most industries the products or services being marketed can be made exactly the same as the competitors, but every commercial real estate property is unique due to its location and lack of mobility and location is usually the most important factor in determining the value of real estate.



---

## **RFP, COLORFUL ORIGAMI TURTLES FOR DR. WRIGHT'S DECORATING DEBRIS, INC.: AN EXPERIENTIAL CASE STUDY**

**Christine M. Wright, Central Missouri State University**  
**Jo Lynne Koehn, Central Missouri State University**

### **CASE DESCRIPTION**

*The focus of this case is to determine the manufacturing cost of an origami product in order to respond to a request for proposal (RFP). Specifically, the case requires students to utilize concepts of cycle time, line balancing, work measurement, standard times, learning curves, product and process design, capacity, layout and costs. Secondary issues include supply chain management and cost accounting. The case is designed to be integrated into an Operations Management class over the course of several weeks, utilizing between three and five in-class hours and five to seven hours of outside preparation by students.*

### **CASE SYNOPSIS**

*The case is based upon a real RFP format<sup>1</sup>. Student teams are presented with an RFP and are expected to submit a completed proposal. This case works best in a very unstructured environment where students are forced to ask questions and use the textbook to find methods for completing the proposal. This case reinforces the concepts listed in the case description above as well as critical thinking, decision making and oral and written communication skills. It assists students in understanding how to apply knowledge to real situations, and can be used to discuss cost accounting, manufacturing management and new product introduction.*

## INSTRUCTORS' NOTES

### OVERVIEW

One of the authors has utilized this case study in various forms for the past 5 years as an experiential learning activity. The author found that most students had never been inside a manufacturing plant and thus found it very difficult to understand the concepts related to manufacturing. The concepts of cycle time, line balancing, work measurement, standard times, learning curves, product and process design, capacity, layout and costs appear to be fairly simple in most texts until students try to apply them to real products. Furthermore, students had some difficulty seeing the connections among the various topics in a typical operations management class and were likely to view the topics as unrelated. The use of a fictional request for proposal (RFP) based on a standard RFP format is effective in tying together all of the concepts listed above.

Students are first given the case study and asked to develop a game plan for developing the proposal. They are told that they will be given crayons, colored pencils, scissors and black and white printed turtles only after they have a complete plan for collecting relevant data to develop costs as they prepare their eight prototype turtles. The information collected during the creation of the prototypes is then used to prepare the proposal. The instructor can modify the assignment from our suggestions to better fit course content. As we have presented it, the ultimate goal in this case is for the student to prepare a final written proposal.

### CASE OBJECTIVES

1. To understand the connections among cycle time, line balancing, work measurement, standard times, learning curves, product and process design, capacity, layout and costs.
2. To learn to ask relevant questions and utilize reference books, including the text, to solve real operations management problems.
3. To practice problem identification and discernment of the core concerns that must be addressed in order to find an acceptable solution.
4. To practice applying academic knowledge to real business problems.
5. To reinforce group, critical thinking, decision making and oral and written communication skills.
6. To give students experience in unstructured decision making situations.



---

## SUGGESTED CASE QUESTION

You and your fellow team-mates were recently hired by the Terrific Turtle Company (TTC) to turn the company around. TTC has recorded 12 months of losses. The old proposal response team, which you replaced after their mass firing last week, consistently placed job bids that ended up being lower than the actual costs. Therefore, upper management is very concerned about your diligence on the request for proposal which was received from Dr. Wright's Decorating Debris Inc. (DWDDI) yesterday. However, while underbidding is not acceptable because it causes losses when the bid is accepted, overbidding to pad the numbers may well result in the loss of contracts. For that reason, management will pay close attention to all requests for proposals and requests for quotes that you respond to. They are particularly interested in seeing that all the information related to the final cost is presented in a professional and logical format.

## IMPLEMENTATION AND ANALYSIS ISSUES

The case can be handled in many different ways. Typically, the author who uses this case presents it as an experiential activity. First, the students are given the case and asked to read it before the next class period. At this point, the students have been assigned readings on topics including, but not limited to, operations strategy, competitive priorities or distinctive competencies, product and service design, capacity planning, process selection and facility layout, design of work systems, and learning curves. Typically, between four and six class hours have been spent lecturing about and discussing these topics. Rather than cover the topics in great detail, the author has found that it enhances students' problem solving and decision making skills to encourage them to determine how the information in the text can be utilized to solve the problem (i.e., find all the information needed to complete the proposal). However, this case could be utilized as a capstone towards the end of the semester in an equally effective manner.

During the first class period after the students have read the case, the instructor gives the students one fifty-minute class period to meet with their teams and suggest action steps needed to respond to the RFP. The author informs the students that they will be issued crayons, colored pencils, scissors and black and white copies of the printed turtles upon submission and approval of a complete plan for collecting relevant data needed to develop costs as they prepare their eight prototype turtles. This step is really for the students' protection. If they do not understand what information they must collect, for example, to apply learning curve concepts or conduct a stopwatch time study, they are likely to end up with the wrong information and therefore waste their time. It is the author's experience that students struggle for twenty to thirty minutes before they realize that they will need to systematically review the information in the text and decide what material is relevant.

During the next class period, the instructor uses two problems to exhibit some of the relevant issues. The first is a problem where tasks from a precedence diagram are assigned to workstations to minimize idle time. Any line balancing problems from an Operations Management text are probably suitable. Students are reminded that they cannot begin to assign tasks to workstations until they know "the" amount of time it takes for each task (e.g., usually the standard time). Additionally the problem in Figure 1 can be utilized to show students that, assuming the factory also has other uses for its employees, factory A actually pays for less manufacturing time per unit than factory B. A has 5 workstations with a cycle time of 30 seconds and B has cycle time of 40 seconds. This necessitates total manufacturing times of 150 seconds and 160 seconds, respectively.

<b>Figure 1</b>			
Factories A and B make Origami Turtles. Their workstation information for their turtles is shown below (assume all times are in seconds). Assume that all hourly labor costs, benefit costs, fixed costs, materials costs, etc. are the same for both factories. Will it cost less to make 100 units at factory A or B? Explain why.			
Factory A		Factory B	
Workstation	Time	Workstation	Time
1	30	1	33
2	27	2	35
3	28	3	40
4	27	4	30
5	28		

Upon submission of a plan for data collection, the students are given the appropriate materials to make their prototypes. Students typically pursue one of two plans for the data. In either case, they decide on all the tasks needed to complete a turtle (e.g., color blue eyes, color green toes, dark green on shell, etc.), such as those shown in Table 1. Then they time separately each of the tasks eight times using wristwatches. This results in data similar to that shown in Table 2. Often they must be encouraged to use the same person for all eight trials on any particular task; if this is not done, the learning curve cannot be calculated. Additionally using different people on different trials leads to increased variation in the times.

Task	Description	Task	Description
A	Light green shell	F	Toenails, hat eyelids, eyes
B	Green shell	G	Cut ends by legs
C	Dark green shell	H	Cut Triangle on head
D	Brown shell, head tail	I	Cut head
E	Brown legs	J	Fold

Students can either use the eight times per task, such as the example shown in Table 2, to calculate the learning curve percentage or the observed time, normal time and standard time<sup>3</sup>. They quickly realize that it is difficult to calculate the learning curve because they have only eight trials which results in only 3 doublings of the units, for example, as shown in Table 3. Recall that the learning curve theory is based on an assumption that at each doubling of units produced there is a predictable percentage change in the time required to manufacture a unit. The difficulty in using this theory is that a learning curve percentage is hard to determine because the percentage change is typically different for each doubling (see Smunt and Watts<sup>4</sup> for information on how this can be handled). If, however, the students choose to use this approach, they will have to determine "the time" that best represents the time needed to complete each task. For example, the students may decide to use the time to complete the 100th, or nth, unit.

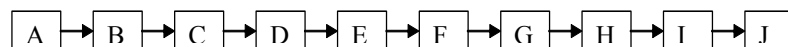
Task	T1	T2	T3	T4	T5	T6	T7	T8	Observed Time	Normal Time	Standard Time
A	37	30	28	26	25	23	25	33	28.37	34.0	38.08
B	56	45	54	47	45	38	43	37	45.62	54.7	61.26
C	134	110	114	80	76	75	73	68	91.25	109.5	122.64
D	65	51	52	47	42	45	52	41	49.37	59.2	66.30
E	32	32	32	37	32	26	25	24	30.00	36.0	40.32
F	20	18	20	16	19	13	13	13	16.50	19.8	22.17
G	15	15	17	13	10	12	9	13	13.00	15.6	17.47
H	55	50	33	25	25	25	25	25	32.87	39.4	44.12
I	19	21	17	12	13	12	11	12	14.62	17.5	19.6
J	8	7	10	12	12	10	8	7	9.25	11.1	12.43

\*Performance rating = 20% (1.20) and allowance factor = 12% (1.12)

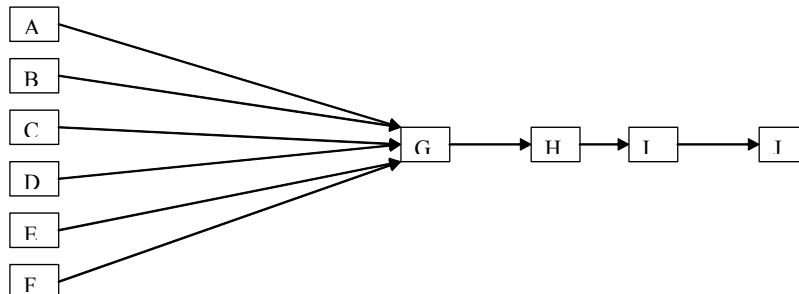
Task	T1	T2	T3	T4	T5	T6	T7	T8
A	37	30	28	26	25	23	25	33
	1st doubling of units 81.1% Learning Curve							
		2nd doubling of units 86.7% Learning Curve						
			3rd doubling of units 126.9% Learning Curve					

Most teams of four students can completely make their eight prototypes within a one-hour class period. However, this could also be assigned as an out-of-class step. Additionally, if the instructor prefers, the data for the eight times (or more) for each task could be given to the student. Table 2, without observed time, normal time and standard time could serve as that data. There are advantages and disadvantages to this approach. The advantages include saved time as well as not requiring students to color, cut and fold. However, the disadvantages are that the students may fail to see that it is usually advantageous to have many small tasks versus a few large tasks. The result of many small tasks is that, depending on the precedence, they can usually be arranged to minimize idle time. When only a few tasks are created, there is usually more idle time. Also, initially, most students decide that the precedence of the tasks is strictly linear, as shown in the example in Figure 2. Upon discussion with the individual student teams, they can be shown that more tasks with less strict linear precedence will usually allow more options for work station arrangement and less overall idle time. Figure 3 shows a precedence diagram with less strict linear precedence.

**Figure 2. Precedence diagram with strictly linear precedence**



**Figure 3. Precedence diagram without strictly linear precedence**



Once the students have collected the data for the eight (or more) repetitions of each task, it is a rather simple task to calculate observed time, normal time and finally, standard time. Then the student teams must calculate the costs for the 40,000 units as well as the cost for any one of those 40,000 units. This is relatively straightforward if students are given some basic costs. We provide those costs to student teams in a handout as shown in Figure 4. Each team is given slightly different costs and the number of regular and overtime hours available is varied for each team. These are shown in Table 4. Occasionally, a student team will need to exceed the 4-week period to manufacture enough units within the given regular time and over time labor hours available. This is negotiated with the instructor on a case by case basis.

**Figure 4, Input Costs - Team 1***Cost of Each Unit*

Direct Materials  
Direct Labor  
Overhead Applied

*Direct Labor*

\$8.00 Cost per hour per employee (regular time)  
\$12.00 Cost per hour per workstation for hours beyond 40 hours per week (overtime)  
(Treat overtime costs as direct labor since the overtime is due to production constraints directly related to the product. This contrasts with overtime that could be incurred as a result of delays or interruptions of an assembly line which would not be directly traceable to the product and, therefore, should be classified as overhead.)  
1,200 hours of employee regular time labor per week may be utilized for the production of origami turtles.  
600 hours of employee overtime labor per week may be utilized for the production of origami turtles.

*Direct Materials*

Printed Paper = You will need to seek costs for this  
Packaging = \$5.00 cost per box (capacity is 100 units per box)  
Capacity of box: 100 units (turtles)  
Size of box 12"x12"x12"  
Weight of box: 16 oz  
Weight of one unit (turtle): 0.5 ounces

*Overhead Costs*

Indirect Labor - Assembly line labor costs of those assisting direct laborers but whose efforts are not linked to specific units of product.  
Indirect Materials - Crayons, Pencils and Scissors  
Other Overhead - Heating, Lighting and Supervision  
Overhead is applied at a rate of \$3.00 per regular direct labor hour  
\$4.00 per regular overtime labor hour

*Shipping Costs*

You will need to seek costs for this. Fedex.com and UPS.com are excellent sources for this information.

	Team 1	Team 2	Team 3	Team 4	Team 5	Team 6	Team 7
Cost per hour per employee regular time	\$8.00	\$9.00	\$7.50	\$8.50	\$9.25	\$7.75	\$8.75
Cost per hour per employee overtime	\$12.00	\$13.50	\$11.25	\$12.75	\$13.88	\$11.63	\$13.13
Hours labor available regular time	1200	1300	1100	1250	1350	1150	1300
Hours labor available overtime	600	650	550	625	675	575	650
Direct regular time labor hour overhead	\$3.00	\$3.15	\$3.00	\$3.07	\$3.15	\$3.25	\$3.35
Direct overtime labor hour overhead	\$4.00	\$4.30	\$4.00	\$4.14	\$4.30	\$4.50	\$4.70

Lastly, students often request an example proposal for use in writing their proposal. The author has not yet conceded to this request. This exercise provides much needed practice for students in creating written reports and working in an unstructured environment. The disadvantage of this refusal is that many different formats are received from the student teams. However, with a simple spreadsheet, the number of workstations and cycle time, costs from the input sheet and packaging, printing and shipping costs can easily be input and final costs compared with students'.

### EXAMPLE CALCULATIONS

The example tables and figures shown throughout this instructor's note are from Team 1, with the exception of Figures 1 and 2. Team 1 had ten tasks, as shown in Table 1, with the times for each of the eight trials shown in Table 2. The precedence diagram for this team is shown in Figure 3. The workstation diagram for Team 1 is as shown in Table 5. Example calculations are shown in Table 6.

<b>Table 5. Workstation Diagram for Team 1, Cycle Time is 76.15 seconds</b>			
Workstation Number	Tasks Assigned	Station Time	Station Idle
1	A and F	60.25	15.9
2	B	61.26	14.89
3	C	61.32	14.83
4	C	61.32	14.83
5	D	66.30	9.85
6	E and G	57.79	18.36
7	H, I and J	76.15	0

\* Because of the length of time required for task C, two workstations are assigned to the task which takes 122.64 seconds. However, because there are two stations, one unit is available, on average, every 61.32 seconds.



<b>Table 6. Example Calculations for Team 1</b>		
Number of workstations	7	
Cycle Time	76.15 seconds	
Seconds to produce one unit	$7 * 76.15 = 533.05$	
Total seconds per 10,000 units	$533.05 * 10,000 = 5,330,500$	
Total hours per 10,000 units	$(5,330,500/60)/60 = 1,480.7$	
	Regular time	Overtime
Hours available per week	1200	600
Labor cost per hour	\$8.00	\$12.00
Overhead cost per hour	\$3.00	4.00
Totals for 10,000 units	$200 * (\$8 + \$3) = \$13,200.00$	$(1,480.7 - 1,200) * (\$12 + \$4) = \$4,491.20$
Totals for 40,000 units	$4 * \$13,200 = 52,800$	$4 * \$4,491.20 = \$17,964.80$
Shipping	\$484.00*	
Paper & Printing	\$500.00*	
Boxes	\$2,000.00#	
Total cost per 40,000 units	\$73,748.80	
Per unit cost (based on 40,000 forecast)	\$1.84	
* determined by students through sources i.e., Office Depot.com or Kinkos.com and UPS.com or Fedex.com etc. # given in the case		

### **SOURCE OF ORIGAMI ORIGINALS**

This case utilizes origami turtles from "Paper Folding with Origami Techniques: Reproducible Craft Patterns, Grades 3-6" part of the Create-a-Craft series published by Frank Schaffer Publications<sup>5</sup>. The pattern for the turtles and folding directions are shown as drawings 12344 and 12345 at the end of the case study. Other origami products could be substituted with minor modifications to the case.

### ADDITIONAL DISCUSSION TOPICS

After all the student teams have turned in their completed proposals, the instructor can use the cost comparisons from each team to exhibit a number of points. Typically, teams with more tasks and less restrictive precedence diagrams have less idle time. This concept can be reinforced through a comparison of the team's total hours to produce 40,000 units. Often students encounter capacity problems. These problems can also be discussion topics.

Students can also be "pre-qualified" and allowed to participate in an on-line reverse auction. Often if the class is large or the student teams' costs are very different, the teams can be divided into two groups for the auction. However, a short lesson and readings<sup>6</sup> related to reverse auctions should also be included as this procurement practice is currently controversial<sup>7</sup>.

The concepts of product and process design/redesign are also topics which can be readily related to this project. Students can be encouraged to discuss what role innovation played during the "production" of the eight prototypes. Some groups will say that they did not innovate at all while others will decide to print two turtles per page, fold the turtles in half to cut them more quickly, unwrap crayons and use them sideways to color the turtle legs more quickly, etc. Students can be asked to relate these innovations to those which might occur as the production processes in an organization are designed or redesigned.

Within the proposal, students are asked to submit an inspection plan for the turtles. Students can be asked to discuss the advantages and disadvantages of inspection of final product versus built-in monitoring throughout the manufacturing process. The turtles also give a concrete item for students to discuss what would be inspected and how quality could be identified. The author does not ask students to include inspection costs or cost of defectives in their proposal. However, depending on what has already been covered during the course of the semester, this could be added as a section in the RFP.

After the projects are completed, students can be encouraged to brainstorm a list of questions they would ask if they were involved in new product introduction. Such brainstorming is a particularly useful exercise if each student is asked to list questions related to his or her major. It also helps exhibit that every business major (e.g., management, marketing, finance, accounting) should be interested in and concerned about cost estimates. For example, the marketing majors can see that the cost estimates will affect the pricing and thus their ability to sell the product and make a profit.

This case can be expanded to include additional cost accounting topics. For example, if the instructor supplies selling price and fixed cost data, teams can also compute contribution margin per unit and breakeven points in units. Then, during discussion, students can compare different student supplier teams to determine which would be most cost effective at different volume levels. To do this effectively, each student team would need to have different fixed costs.

---

However, the authors have chosen to only include variable cost data in the case. As given, the case is quite challenging for students. The addition of accounting elements to the case would likely increase the challenge factor for most students. Also, the primary learning objectives of the case relate to manufacturing objectives and not accounting ones. Eschewing fixed costs does not necessarily detract from the realism of the case. Firms, when bidding on a one-time job (as might be the case with this RFP), may very well bid by concentrating on the variable product costs with the recognition that the firm's regular product line adequately covers fixed costs.

### ENDNOTES

- <sup>1</sup> The RFP format was adapted from "REQUEST FOR TECHNICAL PROPOSALS AND QUALIFICATIONS NO. 07-0019 SPHERICAL BEARINGS FOR BLUE LINE RAIL CARS" at <http://www.ism.ws/MembersOnly/BidSpec/BidSpecDetails.cfm?DetailsID=617>. This document is accessible with ISM membership.
- <sup>2</sup> Examples of such problems include problems 2 and 3 on page 263 of Operations Management, Seventh Edition by Stevenson or solved problem 3 on page 435 and problems 11, 12, and 13 on page 441 of Operations Management: Strategy and Analysis, Fifth Edition by Krajewski and Ritzman.
- <sup>3</sup> See, for example, Operations Management, Seventh Edition by Stevenson pp. 324-329 or Operations Management: Strategy and Analysis, Fifth Edition by Krajewski and Ritzman pp. 178-184 for information on Stopwatch Studies.
- <sup>4</sup> Smunt, T. L. and Watts, C. A.(2003) "Improving Operations Planning with Learning Curves: Overcoming the Pitfalls of 'Messy' Shop Floor Data," Journal of Operations Management, Vol. 21, No. 1, pp. 93-107.
- <sup>5</sup> Source of drawings 12344 and 12345 is Paper Folding With Origami Techniques, Grades 3-6 by Nakata Atsuko ISBN is 0768201535. This is a Frank Schaffer Create-A-Craft title. Frank Schaffer is now owned by McGraw Hill Publishing.
- <sup>6</sup> Inside Supply Management and the Institute for Supply Management (ISM) website ([www.ism.ws](http://www.ism.ws)) are excellent sources of articles about on-line reverse auctions. One particularly appropriate article is "Electronic Reverse Auctions: The Benefits and the Risks," Inside Supply Management, October 2003, pp. 32-36.
- <sup>7</sup> Kaufmann, L., and Carter, C. R. (2004). "Deciding on the Mode of Negotiation: To Auction or Not to Auction Electronically," The Journal of Supply Chain Management, Vol. 40, No. 2, pp. 15-25.



---

# **STEPPING OUT OF THE BOX AT NORTHERN BOX COMPANY: PARTS A & B**

**Robert Golove, Long Island University  
Barry Armandi, SUNY-Old Westbury  
Herbert Sherman, LIU-Southampton College**

## **CASE DESCRIPTION**

*The overall purpose of this case is to examine the managerial and organizational nuances associated with supervising a dysfunctional high level and loyal employee. Students obtain a "real-world" feel for the overall business setting, and, in particular, the individual forces that help shape the work environment. Students are asked to probe beyond personalities and the immediacy of the moment (Richard's resignation) and examine the broader issues posed in the case.*

*This case was written for two distinct audiences: students taking a human resource management course and students in a business ethics course. In terms of the human resource management course, the case places students in management's shoes. Students need to understand the ramifications associated with accusing an employee of theft from both an issue of procedural integrity and employee rights. This case (Part A and B) should be introduced after the students have read material on workplace justice and the handling of employee theft (Kleiman, 2000, Chapter 11; DeNisi and Griffin, 2002, Chapter 15), and career planning (Newman and Hodgetts, 1998, Chapter 15; Dessler, 2003, Chapter 10).*

## **CASE SYNOPSIS**

*This case deals with an important issue that many students may themselves have to deal with during their own professional careers; how to deal with an employee who you believe has been dishonest with you (and perhaps stealing or planning to steal from the company) and how to deal with accusations by others of dishonesty, disloyalty and possible theft.*

## INSTRUCTORS' NOTES

This case deals with an important issue that many students may themselves have to deal with during their own professional careers; how to deal with an employee who you believe has been dishonest with you (and perhaps stealing or planning to steal from the company) and how to deal with accusations by others of dishonesty, disloyalty and possible theft.

### SUMMARY - PART A

Peter Mitchell, had a long history with the NBC Box Company, having originally been hired as a sales person, then being promoted to co-sales manager under the auspices of Bruce Caesar due to his excellent sales skills. When Bruce became regional general manager he hired a new general manager, Michael Useliz, to replace him and had Peter report directly to Michael. When Peter's relationship with Michael became very rocky (Peter claimed that Michael set him up to purposely fail at a meeting by not informing Peter of the changes to the sales force compensation plan), Peter returned to the sales force and became NBC's largest producer. Michael was subsequently fired for poor work.

An incident occurred with one of Peter's accounts, POPCO, that led to accusations of theft and dishonesty by the owner of NBC, Joe Green, and his son, Morgan. Peter did not directly respond to the accusations but presented evidence indicating that the allegations were quite false. The owner apologized stating that the ex-general manager had accused Peter of stealing and that he had a signed affidavit from an employee supporting the charge. Peter stated that his integrity had been challenged and that he was quite upset.

Peter's ex-boss Bruce (who still worked for the company) took him out for dinner and tried to convince Peter not to quit given the fact that he had a family to think about and that he was making an excellent salary. Peter discussed the issue with his wife and was going to make a decision to either stay or leave.

### SUMMARY - PART B

Peter e-mailed Bruce that he was resigning but would stay on to help the company train his replacement and service his current customers who he felt he owed a lot to. He proposed a new wage package and a consulting arrangement with the company. A month later, with no response from Joe or Morgan concerning his resignation letter, he is accused by Morgan of hiring an ex-truck driver in order to steal accounts from NBC.

---

## **Intended Instructional Audience & Placement in Course Instruction**

This case was written for two distinct audiences: students taking a human resource management course and students in a business ethics course. In terms of the human resource management course, the case places students in management's shoes. Students need to understand the ramifications associated with accusing an employee of theft from both an issue of procedural integrity and employee rights. This case (Part A and B) should be introduced after the students have read material on workplace justice and the handling of employee theft (Kleiman, 2000, Chapter 11; DeNisi and Griffin, 2002, Chapter 15), and career planning (Newman and Hodgetts, 1998, Chapter 15; Dessler, 2003, Chapter 10).

For the ethics course, students are to consider the employee's position at the end of Part A and Part B. In Part A and B, the employee must balance the needs of his family with his need to work in an environment where there is trust and respect; where an employee is innocent until proven guilty. This case may therefore be introduced after the students have read material on employees and the corporation (Post, Lawrence and Weber, 2000, Chapter 17; Carroll and Buchholtz, 2003, Chapter 16) and ethical dilemmas in business (Post, Lawrence and Weber, 2000, Chapter 5; Carroll and Buchholtz, 2003, Chapter 7)

For other management courses, the case could be introduced after a discussion of developing an environment of employee trust (DuBrin, 2003, Chapter 11), and disciplinary procedures (Schermerhorn and Chappell, 2000; Chapter 7).

## **Learning Objectives**

The overall purpose of this case is to examine the managerial and organizational nuances associated with supervising a dysfunctional high level and loyal employee. Students obtain a "real-world" feel for the overall business setting, and, in particular, the individual forces that help shape the work environment. Students are asked to probe beyond personalities and the immediacy of the moment (Richard's resignation) and examine the broader issues posed in the case.

Specific learning objectives are as follows:

- ◆ For students to analyze the implications of Richards leaving the firm and what actions David Ming should take have taken prior to Richards resignation as well as those actions he now needs to take.
- ◆ For students to employ leadership theory in analyzing Ted Shade's style of management.
- ◆ For students to develop recommendations concerning Ted Shade's future with the company.

## TEACHING STRATEGIES

### Preparing the Student Prior to Case Analysis

There are several approaches, none of which are mutually exclusive, that an instructor may employ in terms of utilizing this case. It is strongly recommended that regardless of the specific methodology employed, that students prior to reading this case be exposed to some material on leadership theory (Yukl, 1994), how to deal with difficult employees (Perry, 2001), and employee termination (Bayer, 2000). Furthermore, it is suggested that a brief overview be presented on the chip manufacturing process (specifically the use of advanced manufacturing technology) so that students understand the workflow as it relates to both the organizational charts and Ted Shade's position (Noori, 1990).

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

- ◆ a short lecture and/or discussion session on the above noted topics.
- ◆ a reading assignment prior to reading the case that covers several of the topics mentioned.
- ◆ a short student presentation on each topic.
- ◆ a guest lecturer on one of the topics.

### Traditional Case Method

In the traditional case method, the student assumes the role of a manager or consultant and therein takes a generalist approach to analyzing and solving the problems of an organization. This approach requires students to utilize all of their prior learning in other subject areas as well as the field of management. This case, in particular, will also require students to draw upon their knowledge of leadership and human resources. It is strongly suggested that students prepare for the case prior to class discussion, using the following recommendations: allow adequate time in preparing the case, read the case at least twice, focus on the key management issues, adopt the appropriate time frame, and/or draw on all their knowledge of business (Pearce and Robinson, 2000).

The instructor's role in case analysis is one of a facilitator. The instructor helps to keep the class focused on the key issues; creates a classroom environment that encourages classroom discussion and creativity, bridges "theory to practice" by referring back to key concepts learned in this or prior courses, and challenges students' analyses in order to stimulate further learning and discussion. There are several variations of the aforementioned approach including written assignments, oral presentations, team assignments, structured case competitions, and supplemental field work.



---

Regardless of the variation employed, it is recommended that the students' work be evaluated and graded as partial fulfillment of the course's requirements.

### **Role-Playing**

Role-playing "enacts" a case and allows the students to explore the human, social, and political dynamics of a case situation. There are several opportunities for role-playing in this case with the most obvious role-play being a meeting between Ted Shade and his supervisor, David Ming, to discuss Ted's future with the company. A second role-play could entail David Ming discussing the recent resignation of Chuck Richards with senior management with a third role-play being the exit interview with Richards.

Prior to role-playing the case, students should be asked to read the case but and answer the following questions:

- (a) Who are the key participants in the case? Why?
- (b) What is the "role" of each of these participants in the organization?
- (c) What is the motivation, rationale, or benefit these participants derive from the situation?
- (d) How do the assigned readings relate to the case?
- (e) Are there legal and/or ethical issues related to the case?

The instructor may either go through these questions prior to case enactment or wait for the role-playing exercise to be completed in order to use this material to "debrief" the class.

### **Starting the Role-Playing Exercise**

The case ends with Mr. Ming learning of Mr. Richard's resignation. This would seem to be a logical place to start the series of role-playing exercises in that the student who role-plays Mr. Ming can now summarize the case with two issues in mind: "How do I deal with Richards' resignation?"; and two, "How do I deal with Shade's ineffective management style?"

#### *Step 1: Assignment of Roles (5 minutes)*

The class should be broken up into groups of 5-6 students. Assign the key roles of Mr. Ming, Mr. Richards, and Mr. Shade to three of the members of each group. Class members not chosen for the role-playing exercise become members of the management team. (See Organizational Chart 2 for management team members.) Students are observers for parts of the role play in which they are not active participants.

*Step 2: 1st Enactment (10 minutes)*

The student enacting the role of Mr. Ming should be instructed to start the role play with a summary of the situation (including problem definitions) and include comments concerning both Richards' resignation and Shade's future with the company. The student should then be directed to develop a series of meetings (one with Richards, one with Shade, and one with Ming's management team) to try to solve the identified problems. The instructor during this phase of the exercise should note how well the student enacting Ming's role covers the major issues surrounding the case. Student observers may also be given specific assignments by the instructor or may be asked to merely summarize their observations.

*Step 3: First Meeting (15 minutes)*

Based upon the decision of the student enacting Mr. Ming, the first meeting may be with either Mr. Richards, Mr. Shade, or the management team. At the end of the meeting, the observers should be asked to report on their specific "assignments" and/or to comment on the general flow of the meeting. The instructor should assist the observers by helping them to focus on both the group process and meeting results.

*Steps 4 and 5: 2nd and 3rd Meetings (15 minutes each)*

Repeat Step 3 until all three meetings have been completed.

*Step 5: Exercise Debriefing (20 minutes)*

The three meetings should be debriefed as a whole in each group. Once the in-group debriefing is completed, the management team should then address the class as a whole and then the discussion should be opened to the entire class. The instructor might want to ask the following questions or provide these questions to each group for guidance:

- ◆ With whom was the first meeting with and why did the student enacting Mr. Ming choose to meet with that person or group first?
- ◆ What were the goals and results of each meeting? Did Mr. Ming accomplish his objectives?
- ◆ What alternative results might have occurred from this meeting? Best and worst scenarios?
- ◆ What theory(ies) from the course helped the students to understand the case situation and recommend solutions to the defined problems?

Students should also be given the opportunity to comment on the role-playing exercise as a learning instrument. The instructor might ask the class the following questions:

- ◆ Did this exercise animate the case? Did students get a "feel" for individual and organizational issues surrounding the case?
- ◆ What were the strengths and weaknesses of the exercise? What changes would they make to the exercise given their experiences with it?

### SUGGESTED QUESTIONS AND ANSWERS

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

- **What actions should David Ming have taken to prepare for or reduce the possibility of Chuck Richards leaving the firm?**

There are at least two actions that David Ming could have taken prior to Chuck Richards leaving the firm that might have minimized the impact of this eventuality.

- *Employee Retention* - it is clear that the V.P. for Manufacturing (VPM) is one of the most critical positions in this organization (departmentation by function - see Chart 2) since the lion-share of departments report to this senior manager. Since it is apparent to Mr. Ming that Ted Shade cannot go back to being VPM (see Chart 1) given his ineffective leadership style, Ming's comment about having to "reconsider my entire organization" demonstrates his lack of foresight in either retaining or eventually replacing Chuck Richards. In terms of employee retention, Perry (2000) recommends that managers: provide career growth and opportunity, talk with employees (get to know them), encourage feedback and participation, recognize achievement, provide adequate training, and hire the right person for the job. The case does not provide information on what actions Ming took in retaining Chuck Richards, except for Richards receiving a promotion from "trouble shooter" to VPM in order to handle the Ted Shade situation.
- *Management Succession* - Although normally discussed in the context of employee retirement, management succession can be applied to issues of employee turnover

in key management positions. "Succession planning is vital, particularly in closely held companies, and needs to be considered years in advance" (McCrea, 2001, p.63). It usually involves anticipating management needs, comparing those needs to an employee skills inventory, creating replacement charts, and providing management development training for those individuals scheduled to fill senior level positions. (Dessler, 2003, p. 205) Again, Ming's comment about the need to reassess his organization demonstrates his lack of planning for Richard's possible departure.

- **What are some of the implications of Chuck Richards leaving the firm at this time?**

There are several implications associated with Chuck Richards' departure. First, Mr. Ming's surprise at Mr. Richards' resignation denotes Mr. Ming's relative detachment from Mr. Richards. As his direct supervisor, Mr. Ming should have had some inkling as to Mr. Richards' unhappiness with the current work situation, especially given the problems associated with Ted Shade.

Secondly, Mr. Ming might have thought that his new employees, like Chuck Richards, would exhibit what Laabs (1998) would have called "old fashion loyalty." This loyalty, as exhibited by Ted Shade over the years of his employment, includes: long-term attachment to the employer, no interest in changing jobs, and the firm and its goals are the employee's top priorities. However, as Laabs (1998) pointed out, "the old brand of loyalty is dead." (p. 35) Employees put their own interests above the organizations, have short-term attachments to their employers, and are therefore quite prepared to change jobs.

Chuck Richard's leaving might also serve as a signal to Mr. Ming that perhaps his own management and leadership style should be reconsidered (besides those of Ted Shade's). Certainly Mr. Ming should be questioning his protection of Ted Shade (which will be addressed in question three) and its broader impact on the firm -- not only in terms of the departure of lower level employees but his inability to retain his valued VP for Manufacturing.

Lastly, Mr. Ming must be prepared to deal with the "aftermath" of Richards' departure, not only because of the direct impact on the firm's performance relative to the VP for Manufacturing position, but also due to the message his departure sends to the rest of the firm. Weick (1995) argued that "people can make sense out of anything" (p. 49) and that managers "need to pay close attention to ways people notice, extract cues, and embellish that which they extract." (p. 49) Ming must deal with the possible negative rumors associated with Richards' resignation and must be prepared to directly address them.

### 3) What actions should Ming take now, post resignation?

David Ming has at least two issues he needs to confront: the resignation of Chuck Richards, and the disruptive behavior of Ted Shade. Although these concerns on the surface may seem to be separate (the first a short term problem, the second a more long-term and insidious dilemma), they are tied together by the fact that numerous employees have left the firm due to the harsh treatment they have received from Ted Shades and his supervisors.

The departure of Chuck Richards, interestingly enough, can be viewed as an opportunity for David Ming to become reacquainted with the operational aspects of the firm and experience some of the problems caused by Ted Shade and his supervisors. Mr. Ming will certainly have to step into the VP's position, even on a temporary basis, given the fact that there is currently no one described in the case who has the expertise in which to take over managing the operation. Plainly, putting Ted Shades back into his old position would be disastrous.

While the search for a new VP of Manufacturing is being conducted, David Ming can then finally resolve the Ted Shade situation. Ming will have to:

- *Analyze Ted Shade's behavior as a manager* -- does he seem to demonstrate leadership characteristics?
- Given Ted Shade's leadership style, determine if Ming can re-engineer either the man or a job to create a better employee-task fit.

Once Ming has made these decisions (see questions 4 and 6), he then needs to turn his attention inward and ask himself how he could have let the situation with Ted Shade become so volatile. Yet facing problem subordinates is not easy.

Veiga (1988) cautioned managers to "face your problem subordinates now!" (p. 145) but noted that a "problem subordinate often produced a kind of autistic hostility" in managers, managers' anger would "feed upon itself." (p. 146) Managers become quite frustrated with these subordinates and search for "overwhelming proof" (p. 146) before taking any action - the data gathering process becomes another method for avoiding the need to deal with the problem employee.

Veiga would recommend that Ming should be candid and direct when confronting Ted Shade but Ming should also be supportive to assist Ted in confronting his own behavior. Veiga observed that most managers, however, try to apply restrained stress on the subordinate to leave the firm. Secondly, Veiga warns that the current deviant behavior of the employee can be inextricably coupled to past performance - in Ted's case his hard work in dedication (especially during the formative years of the firm). "Once previously held views are put aside, the potential for new insights can be enormous." (p. 150) Third, Veiga

indicated that managers tend to ignore early warning signals and need to own up to the part that they played in creating and harboring the problem employee. David Ming needs to understand that he has aided and abetted Ted Shade's behavior by continuing to neglect the problem once it had been uncovered. He needs to act and he needs to act now.

**4) Analyze Ted Shade's behavior as a manager -- does he seem to demonstrate leadership characteristics?**

Ted Shade was appointed by the organization and given formal authority to direct the activity of others in fulfilling organization goals, however, he seems ineffective as a leader in that he is unable or incapable of influencing and empowering others to accomplish their goals. His methodology for influencing others seems to be punitive in nature and his ability to communicate with his staff is minimal. He does appear to be highly organized, hard working, and technically competent however he lacks the people-skills necessary in order to create a team environment and positive employee morale. His immediate subordinates do not perceive him as a good role model and they question his selection as a Vice-President.

**5) Describe Ted Shade's leadership style employing contingency, path-goal theory and transformation leadership theory.**

Employing the Fiedler contingency model results in the following findings. Ted Shade describes his co-workers and employees in a very negative manner and would therefore receive a low score on the least-preferred co-worker (LPC) questionnaire. Given Shade's low LPC score, his leadership style would be labeled as "task oriented." A task-oriented leader is appropriate, according to Fiedler, when the three contingency variables (leader-member relations, task structure, and position power) create very favorable or very unfavorable managerial situations. (Fiedler, Chemers, and Mahar, 1994)

- a) *Leader-member relations*: given the comments of Ted Shade's three subordinates and the fact that Ted has described his current dealings with his associates as being very formal in nature, one could classify these relationships as unfavorable to very unfavorable.
- b) *Task structure*: the jobs seem highly structured (production operations) and could be classified as favorable to very favorable.
- c) *Position power*: Ted Shade's power position within the organization has recently decreased (change in job title and reduction of duties) reducing his position power.

It also appears that Ted would fire his "lazy" workers if he had the authority to do so. We could then classify his position power as unfavorable. See Figure 2, below.

<b>FIGURE 2</b>		
<b>TED SHADE'S LEADERSHIP STYLE: FIEDLER'S CONTINGENCY APPROACH</b>		
Leader-Member Relationship	Task Structure	Position Power
Unfavorable/very unfavorable	Very favorable	Unfavorable

The cumulative effect of the three variables is that Ted Shade is managing in a "mixed" (between favorable and unfavorable) situation -- a situation that calls for a relationship oriented leader. Given the fixed nature of leadership (according to Fiedler), Ted's effectiveness can only be improved by changing the amount of power the leader has over organization factors such as salary, promotions and disciplinary action or by moving him into a leadership position that better matched his style of leadership.

It is interesting to note that the application of House's path-goal leadership theory leads to a differing set of analyses. In the path-goal theory, the leader's job is to modify his or her style of leadership in order to assist followers in attaining goals, and to provide direction and support needed to ensure that their goals are compatible with the organization's. (Bass, 1990) This differs from Fiedler's theory which treats leadership style as a fixed or "given" in the leadership equation.

For House, a leader's behavior is acceptable to subordinates when viewed as a source of satisfaction, and motivational when need satisfaction is contingent on performance, and the leader facilitates, coaches and rewards effective performance.

It is apparent from the case that Ted Shade's leadership style could at best be described as achievement-oriented since he set challenging goals and expected subordinates to perform at their highest levels. It is also obvious from the case that the workers were highly dissatisfied with Ted Shade's leadership style given the subordinates' perception of their own abilities to do the job coupled with their work experience -- they wanted more control of their work environment.

Secondly, the highly stressful nature of the work environment (caused by the need to meet production schedules as dictated by industry competitiveness), as described by the subordinates, necessitated providing emotional support (empathy). Since employee performance and satisfaction are likely to be positively influenced when the leader compensates for the shortcomings in either the employee or the work setting, Ted Shade's leadership style needed to be more supportive to defray the stress in the work environment.

Transformational leadership, the ability to create and articulate a realistic, credible, and attractive vision for the future of the organization that improves upon the present

situation, is certainly not evident in Ted Shade, or his boss (David Ming). (Hughes, Ginnett, and Curphy, 1999)

The CEO (Robinson) of the company had a vision of "to create and maintain an organizational commitment to satisfying customer needs, staying on the cutting edge of technology, and engendering a mutual respect among and between employees", however, his departure and subsequent return did not engender inspiration or a particular value system.

More importantly, Galactic's rewarding of Ted Shade (who merely emulated his previous boss's behavior) sent a clear message as to the real values held by Galactic management -- loyalty and meeting deadlines! Ted Shade was not the only senior level manager to practice punitive style management and can be perceived as a product of the real work environment at Galactic.

**6) Given Ted Shade's leadership style, determine if Ming can re-engineer either the man or a job to create a better employee-task fit.**

The answer to question five (5) determined that Ted Shade was not well suited for a leadership position in the firm given the people-centered requirements of the task as compared to Ted's task-centered approach. This question forces students to confront the question "what do we do with Ted?"

In determining what should be done with Ted, Ming needs to take a hard look at Ted. First, Ted is 49 years old and therefore the easy way out of "early retirement" is not an option. Ted's interview with Dr. Robinson (the consultant) should reveal to Ming that Ted is a very structured individual who seems to understand his limitations but is still a slave to them. Ted knows that "a person who is negative to you, people who yell and don't understand the employees' jobs, they're probably bad managers" yet the three things he would like to change about himself is "my ability to communicate ...; being able to accept other peoples' shortcomings and walk away from them without getting upset ...". Ted's most revealing statement is his concept of the perfect and worst job, "The most ideal job for me would be as a forest ranger in the mountains. You are away from everything, and you are with the animals, the forest, and nature overall. The worst job I can imagine is any job in Manhattan. There are too many people there. There's too much of everything."

David Ming should be able to discern from Ted's comments that Ted not only knows that he lacks interpersonal skills but would prefer a job that has minimal contact with coworkers. Since most managerial positions involve managing people and/or supplier/customer interface, it may not be possible for Ming to find Ted an equivalent high level position in the firm (Ted has already had the equivalent of a demotion moving from VP of Manufacturing to VP of Supplier Management). Students might recommend that given



---

Ted's penchant and interest in planning and structure that Ming might suggest "Peter Principling" Ted and making him a VP for Planning reporting directly to the President. At first brush this might be considered a viable option, except that Ted had a very bad experience with both the President and the Chair of the Board. "In retrospect, if I could change the past I would make certain that I didn't present anything in front of Al (President) and Pat (Chairperson & CEO). One time I was asked to make a presentation before them, and they shot down what I was saying. I began arguing with them, but it was no use; they had their minds made up. From then on I just kept my mouth shut. Also, I never volunteered for anything. It was always given to me. These two items may have hurt me more than anything else." The VP of Planning would not seem to be a viable option either.

If students believe that Ming cannot engineer the job to fit the person, students might suggest that Ted Shade take some form of human relations training (i.e. sensitivity training) in order to help deal with his poor interpersonal skills. It is evident that Ted knows what makes for a "good and bad" manager, however, the real question is whether Ted is willing and able to work on changing his behavior. Ted wants to be able "to communicate and work with my kids better" and perhaps this could provide Ted with the motivation he would need in order to assist in the change process.

Mr. Ming must be prepared support Ted if he decides that human relations training is a viable option. Mr. Ming must mentor Ted through this process. This may include Ming giving Ted a leave of absence (preferably paid), providing coaching, counseling and role modeling appropriate employer-employee interaction.

Some students may assume that the training would fail or that Ted Shade would not be willing to participate in any human relations training. If this is the case, then Mr. Ming is left in a very difficult position. What does he do with a "loyal" employee who just isn't working out? Mr. Ming must unfortunately be prepared to do what Ted Shade himself would do, lay him off. In Ted's own words "the best way of handling a problem is getting rid of people who should be let go. You can't keep deadwood. It wastes resources." Ted acknowledges that firing people is a difficult job, by one that has to be done for the benefit of the company. Mr. Ming must put his personal feeling about Ted aside and do what is best for the firm. Students might suggest that Ted's departure would serve as a positive indicator to the employees - that inhumane treatment of employees will not longer be tolerated and rewarded.

## EPILOGUE

At this point, Peter called Bruce and told him what had happened. He told him that the "games were over". He was leaving and moving his business to a competitor. Realizing that the loss of business could be disastrous to the Division, Joe, Morgan, and the executive vice president met

with Peter three times to ask him to stay. The first meeting they told him that they would accept his plan. He told them that the plan died with the second accusation. At the second meeting they threatened to sue him if he left, due to his "non-compete clause." He told them that the customers and his fellow salespeople would revolt, shutting down the Division immediately. At the third meeting, they offered to have give Peter anything he wanted as long as he stayed. Peter reminded them that it was not about money, but rather about respect. He went on to say that "once respect is gone, it can not be replaced."

Bruce eventually stepped into the negotiations and reached a settlement with Peter. Peter left the Company and worked for a company in a different industry. Sometime after Peter's departure he received a phone call from a designer at NBC who told him that he found one of the missing dies in the plant. When the designer informed the production staff, they told him not to say anything to Peter.

### **BIBLIOGRAPHY**

- Barnard, Chester I. (1938) *The Functions of the Executive*. Cambridge, MA: Harvard University Press.
- Bass, Bernard M. (1990) *Bass & Stogdill's Handbook of Leadership: Theory, Research, and Managerial Applications*. New York: The Free Press.
- Bayer, Richard (2000) "Termination with Dignity" *Business Horizons*, September/October, 4-10.
- Brown, L. David (1983) *Managing Conflict at Organizational Interfaces*. Reading, MA.: Addison-Wesley Publishing.
- Conger, Jay A. and Rabindra N. Kanungo (1998) *Charismatic Leadership in Organizations*. Thousand Oaks, CA: Sage Publications.
- DeNisi, Angelo S. and Ricky W. Griffin (2001) *Human Resource Management*. Boston, MA: Houghton Mifflin Company.
- Dessler, Gary (2003) *Human Resource Management*. 9th Edition. Upper Saddle River, N.J.: Prentice-Hall.
- DuBrin, Andrew J. (1998) *Leadership: Research Findings, Practice, and Skills*. Boston, MA: Houghton Mifflin Company.
- Fiedler, Fred E., Martin H. Chemers, and Linda Mahar (1994) *Improvong Leadership Effectiveness: The Leader Match Concept*. 2nd Edition. New York: Wiley.
- Field, Richard H.G. and Robert J. House (1990) "A Test of the Vroom-Yetton Model Using Manager and Subordinate Reports," *Journal of Applied Psychology*, June, 362-366.
- French, Wendell L. and Cecil H. Bell, Jr. (1995) *Organization Development: Behavioral Science Interventions for Organization Improvement*. 5th Edition. Englewood Cliffs, NJ: Prentice-Hall.

- 
- Hater, John J. and Bernard M. Bass (1988) "Supervisors' Evaluations of Subordinates' Perceptions of Transformational and Transactional Leadership," *Journal of Applied Psychology*, November, p. 698-704.
- Hughes, Richard L., Robert C. Ginnett, and Gordon J. Curphy (1999) *Leadership: Enhancing the Lessons of Experience*. 3rd Edition. New York: Irwin McGraw-Hill.
- Laabs, Jennifer (1998) "The New Loyalty: Grasp it. Earn it. Keep it." *Workforce*, November, 35-39.
- Lawrence, Paul R. and Jay W. Lorsch (1969) *Developing Organizations: Diagnosis and Action*. Reading, MA: Addison-Wesley Publishing Company.
- Lussier, Robert N. (2003) *Management Fundamentals: Concepts, Applications, Skill Development*. Mason, Ohio: South-Western.
- Maidment, Fred H. (2000) *Annual Editions: Human Resources 00/01*. 10th Edition. Guilford, CT: Duskin/McGraw-Hill.
- McCrea, Bridget (2001) "When Good Employees Retire" *Industrial Distribution*, March, 63.
- Nelson, Debra L. and James Campbell Quick (2000) *Organizational Behavior: Foundations, Realities, & Challenges*. 3rd Edition. Cincinnati, OH: South-Western College Publishing.
- Pearce II, John A. and Richard B. Robinson Jr. (2000) *Strategic Management: Formulation, Implementation, and Control*. 7th Edition. Boston, MA.: Irwin/McGraw-Hill.
- Perry, Phillip M. (2001) "Disengage the Rage: Defusing Employee Anger" *Rural Telecommunications*, January/February, 64-67.
- Perry, Phillip M. (2000) "Retaining Top Employees In a Tight Labor Market" *Die Casting Management*, September, 32-34.
- Peters, Thomas J. and Robert H. Waterman (1982) *In Search of Excellence: Lessons from America's Best-Run Companies*. N.Y.: Harper & Row.
- Peters, Tom (1987) *Thriving on Chaos: Handbook for a Management Revolution*. New York: Harper Perennial.
- Robbins, Stephen P. (2001) *Organizational Behavior*. 9th Edition. Upper Saddle River, N.J.: Prentice-Hall.
- Veiga, John F. (1988) "Face Your Problem Subordinates Now!" *The Academy of Management Executive*, 2 (2), 145-152.
- Vroom, Victor H. and Arthur G. Jago (1988) *The New Leadership: Managing Participation in Organizations*. Englewood Cliffs, NJ: Prentice-Hall.
- Weick, Karl E. (1979) *The Social Psychology of Organizing*. 2nd Edition. Reading, MA.: Addison-Wesley.
- Yukl, Gary (1994) *Leadership in Organizations*. 3rd Edition. Englewood Cliffs, NJ: Prentice-Hall.



---

## HOLE IN ONE BAGELS

**Barbara K. Fuller, Winthrop University**

**Michelle Burns, Winthrop University**

### CASE DESCRIPTION

*The primary subject matter of this case concerns the purchase of an established bagel business during a period of economic recession and industry consolidation. The case focuses on the examination of financial strategies with an emphasis on cost analysis and the development of marketing strategies. The secondary issues include decisions dealing with relocation and growth. This case has a difficulty level congruent with entrepreneur majors with junior or senior status. In order for students to examine this case effectively they should have background knowledge in analyzing financial statements, and developing marketing strategy. The case is designed to be taught in one class session of approximately 1.25 hours and is expected to require four to six hours outside preparation time from the students.*

### CASE SYNOPSIS

*In June 2002 Phillip McGuthry, a long time resident of Fort Mill, SC, purchased Hole in One Bagels, a small independent bagel shop with a great reputation in the community and a good customer base. The economic environment at the time of the purchase showed signs of weakness. In addition, the 911 terrorist attacks, and the low-carb diet trend were also somewhat worrisome. However, the bagel shop offered McGuthry a way to get out of the corporate world of advertising and step into what he thought would be a quieter more relaxed environment. He felt that with a few adjustments in the store's operation, he would make a reasonable profit. Overtime, he would learn more about the business thus increasing efficiencies and margins. Currently the only type of promotions was word of mouth. Certainly he could make improvements in the marketing area. However, after a mere five months McGuthry found that running the business was more challenging than he originally thought. Some months the business was profitable and other months cash flow was negative. He also found it necessary to hire a weekend manager so that he was not working 7 days a week. This added to his current labor expenses. McGuthry loved his new business, but was faced with some serious decisions if he is going to make the business profitable. He must either cut expenses or increase market share and customer demand. The case looks at the challenges that face McGuthry as the new owner of Hole in One Bagels. His initial objectives were to increase efficiency in operations and to retain his current customer base while attracting new customers to the shop.*

*Decisions about location and possible expansion of the business would need to be addresses after tackling the initial operational issues.*

## **INSTRUCTORS' NOTES**

### **RECOMMENDATIONS FOR TEACHING**

The case was placed in Fort Mill, South Carolina, which was located on the outskirts of Charlotte, North Carolina. Fort Mill was not the actual location of the business but provides an atmosphere much like the city in which the bagel shop was located. Charlotte had grown significantly with the additions of the NASCAR speedway and the Carolina Panthers NFL team. Small cities surrounding Charlotte such as Fort Mill were stable and were showing signs of growth at the time of this case, even in the aftermath of September 11, 2001. Industry, competitor, and customer information have been provided in the case to give students a feel for the type of environment that existed for Hole in One Bagels at the time McGuthry purchased the business. The case also provides information on a new industry segment that was forming in the late 1990's called the "quick casual" dining industry. Hole in One Bagels fits into this industry with an average ticket sale above those of fast food but below casual sit down dining. Several references are provided that look at the quick casual industry and its growth.

It should be noted that, the bagel industry was in its prime in the mid-90's. If students search for industry information about bagels, they will find a lot of industry information up to the mid-90's. Then in the late 90's the bagel craze seemed to end and not much was written. This may be frustrating to students; therefore, a discussion of the industry would be helpful at the time that the case is assigned. The most helpful resource dealing with current information on the bagel industry was the website for the Retail Bakery Trade Association at <http://www.rbanet.org>. However, since the industry figures are provided in the case for the relevant time period, most of the emphasis for class discussion should be placed on using those figures as a basis for the development of strategies for marketing, lowering expenses, growing market share, and increasing customer demand.

Students were given a good picture of McGuthry, a new entrepreneur, who purchased a business and the environment in which he found himself. The case described the competitors, the bagel industry, and the targeted customer segments. The menu, personnel policies, advertising, and financial statement are available in the figures at the end of the case. The students should be encouraged to use all of the information to evaluate the current situation and make recommendations to McGuthry. The questions below guide the student through the process of making specific marketing and financial recommendations for Hole in One Bagels. Students should be given freedom to be creative in their solutions. The suggestions given here should be used by the instructor as examples of one of many answers that could be given in this situation.

---

NOTE: Hole In One Bagels and the location Fort Mill, SC were both fictions. The business name was changed and the shop was placed in a small town with demographics similar to the original shop's location. Financial figures were also altered but kept proportional to the original business. This allows student to utilize the figures for financial analysis and they should be highly encouraged to do so.

## QUESTIONS

### 1. Identify the two consumer target markets that purchased bagels at Hole in One Bagels.

The customer base of Hole in One Bagels consisted mainly of people from the age of 18-55 in the middle class income bracket and above. However, because the shop was located near a college, its target market was somewhat complicated. McGuthry focused not only on the major segment of white-collar professional including teachers, lawyers, accountants, and doctors; but also advertised to high school and college students. The students and the business community were separate target markets with different needs and wants; therefore, a distinct promotional strategy should be developed for each segment.

The student segment, made up of younger 18 to 22 year olds, was interested in a unique place to meet fellow students for coffee and a bagel. They also wanted a place to study, talk with friends, or have a quality breakfast on the run in a venue away from the cafeteria. About 20 % of Hole in One Bagels' consumer market consisted of students.

The community segment, somewhat older professionals, was made up of doctor's, attorneys, teachers and business people that stopped by on their way to work. For these customers, Hole in One Bagels provided a quick casual menu as an alternative to fast food. These consumers were interested in a fast, healthy, quality option for breakfast on the run. This part of the target market made up 80 % of Hole in One Bagels' consumer business.

### 2. Develop a six-month promotional campaign for Hole in One Bagels that would best target the two customer segments identified in question 1. (Note: Two different target markets require two different promotional strategies)

Two sample promotional plans are provided as a starting point for discussion. The first is for the student market and the second for the professional community market. Students may be creative in this section and develop additional ideas other than those listed below. This creativity should be encouraged. Research on the bagel customer indicated that they are looking for a fast, healthy, quality breakfast item that is made fresh from scratch. The bagel is perceived to be a luxury breakfast product therefore; the promotional campaign should reflect the quality aspects of the product.

<b>Sample Six-Month Promotional Campaign for Students</b>				
<b>Month</b>	<b>Newspapers</b>	<b>Press Releases</b>	<b>Sales Promotions</b>	<b>Loyalty Cards</b>
<b>January</b>	Convocation	Back to school eating contest*	10% off Tuesdays for students	Valid all times
<b>February</b>		Open-mic night*	10% off Tuesdays for students	Valid all times
<b>March</b>	Mid-term study hours school newspaper		10% off Tuesdays for students	Valid all times
<b>April</b>			10% off Tuesdays for students	Valid all times
<b>May</b>	Final exam study hours school newspaper		10% off Tuesdays for students	Valid all times
<b>June</b>			10% off Tuesdays for students	Valid all times
* Will require additional hours of operations and costs				

The media vehicles (newspapers, press releases, sales promotions, and loyalty cards) shown in the above chart were suggestions for developing a promotional campaign to increase sales from the local college students. This campaign was designed to make students more aware of Hole in One Bagels and what they had to offer. The different vehicles have been spaced out over the semester at opportune time to connect with students. Keep in mind this promotional plan addresses only the students and the Fort Mill community will be addressed in the next section.

Taking into account costs and the habits of college students, advertising in the campus newspaper was a top choice. Also, posting flyers around campus buildings was inexpensive and should produce good results. Extended hours for study or a place to take a study breaks should be promoted to increase student awareness during mid-terms and finals. Also, college student would be more aware of Hole in One Bagels if it were involved in campus activities such as the opening convocation for the school year. During convocation Hole in One Bagels could give out samples of their food and coffee to students and faculty. This would be an opportune time to publicize the other events they will be sponsoring for students during the year.

Other suggested activities that would attract student attention included a welcome back to school cinnamon-bun eating contest and an open-mic night at the end of the semester with advertisements and press releases to make students aware of the events. Keeping the



students involved throughout the year was felt to be a key factor in increasing business. Some of the activities included in the schedule would increase the hours the bagel shop was open and therefore the overall expenses. McGuthry would need to evaluate the cost and benefits before adding these types of activities. The decision to extend the hours of operation (say from 6:30 am to 2 pm and from 6:30 pm to 9:30 pm) would also affect the menu offerings. Hole in One Bagels would need to offer a wider variety of specialty coffees and sandwiches. With the addition of more specialty coffees may also come the need to add desserts during the night hours.

Another way to get the attention of students was to offer promotional discounts. Hole in One Bagels could give students 10% off their purchases on Tuesdays with a school ID. This would increase business on a slow day and give students the feeling that their business was appreciated. In addition, customer loyalty cards could be offered to students. The loyalty cards would promote customer retention by allowing student customers to get a free bagel sandwich once they have purchased 12 bagel sandwiches at the regular price.

A more aggressive tactic would be to open a bagel kiosk on campus for several hours in the morning to catch students and faculty as they were going to class and as classes were changing. This would require permits from the campus, additional equipment, and labor costs would increase.

<b>Sample Six-Month Promotional Campaign for Community</b>				
<b>Month</b>	<b>Newspapers</b>	<b>Press Releases</b>	<b>Sales Promotions</b>	<b>Loyalty Cards</b>
<b>January</b>	New Years			Valid all times
<b>February</b>			Free cookie with a bagel purchase	Valid all times
<b>March</b>		Sponsor YMCA T-Ball team		Valid all times
<b>April</b>		Sponsor road race Host Easter egg hunt		Valid all times
<b>May</b>	Summer		10% off for Mother's Day	Valid all times
<b>June</b>		Sponsor youth summer league		Valid all times

A second promotional plan was developed for the Fort Mill community. The major portion of the Hole in One Bagels' business came from the community segment of business and professional workers. To attract this segment, the store needed to differentiate itself from competition. Therefore, McGuthry must continually search for new flavors of spreads;

different formats for bagels such as gourmet sandwiches; increased product offerings such as new breads, wraps, and rolls; as well as, different specialty coffees and even different business venues such as lunch and dinner options. Each of these should be looked at seriously with input from customers on where improvements need to be made.

With the bagel industry being in the maturing stage of the product life cycle, the marketing tactics outlined focused more on persuading consumers to buy. Competition in this stage generally grows intense. Individual companies must change their marketing mix to differentiate themselves from the competition and to attract new business. This is more of a defensive strategy that maximized profits while defending market share. One of the tactics used during this stage was offering sales promotions such as coupons, loyalty cards, or special events. Hole in One Bagels could use coupons on Teacher Appreciation Day, Mother's Day, and other holidays. The promotional chart above has a 10% coupon for Mother's Day as an example.

Another sales promotion idea was the introduction of a customer loyalty card. This would increase Hole in One Bagels' customer retention and loyalty. Customers would receive a free bagel after purchasing 12 at the regular price. After some research, it was also found that several organizations celebrate a national Bagel Day. Although, several dates came up, all of them were in February. Therefore, during February a special promote called "Bagel Month Madness" was suggested. During the month, Hole in One Bagels would give customers a free drink or a free cookie on certain days of the week or month with the purchase of a bagel. Students could be creative and develop other special offers during the month.

Sponsorships provide a great way for the business to get involved with the community and increase awareness about the company. The bagel shop could get involved in a sponsorship for a youth summer sports league such as with the local YMCA. In addition, holidays provide opportunities for fun activities that could take place at the store. An Easter Egg Hunt for children on Saturday around Easter time would be a great way to get people into the store. All of these activities involved making people aware of the bagel shop and letting word of mouth take its course.

Hole in One Bagels could proactively seek alliances with other stores in the area by exchanging business cards and/or flyers to be posted on bulletin board or left on counter tops. The shop could also have a business card drawing bimonthly. Customers can drop their business card in a basket and win a breakfast for their company for a discounted price. Hole in One Bagels could also make a profit out of old bagels by selling old left over bagels as doggy bagels. This product could also be marketed to veterinarians or pet stores as delicious treats for dogs.

---

**3. Evaluate the personnel policies and procedures outlined in the case. Are they effective in training and keeping employees on task? What changes would you make?**

Reviewing the policies and procedures for the Hole in One Bagels employees, indicated that there were detailed rules outlining employee duties and responsibilities. Following these procedures allowed the business to run efficiently and provided the best possible service for customers. They were used as the basis for the training that was provided for employees. McGuthry felt that the policies and procedures were important but not at the expense of good relationships with employees. He constantly worked to make sure there was a good balance between fun and work. In looking at the various policies and procedures, the following recommendations are suggested:

1. Investing in T-shirts for the employees - This would offer the shop a warmer atmosphere. They would give the business a professional look.
2. Check To-Go-Orders for accuracy. Have the employees check twice to make sure the customer is getting everything they ordered.
3. Have meetings with employees and keep them up-to-date on the day to day problems and challenges. Also allow employees to express their opinions on certain issues about work and incorporate their suggestions into the procedures.

**4. Hole in One Bagels' labor costs were above the industry average. What could McGuthry do to lower these costs?**

After researching labor cost, there were several options that may be helpful to Mr. McGuthry in lowering labor costs. To maintain standards and the level of service expected by McGuthry's customers, he studied the labor situation carefully and considered the following recommendations:

1. Implement of a training program that would assure that employees understood their duties and responsibilities. This would make sure that the staff had complete knowledge of the business.
2. Provide reward incentives for them to reach at the end of the week (i.e. a pizza party). Happier employees lead to happier customers and therefore a larger customer base.
3. Maximize each employee's time by assigning them to a station with specific duties and responsibilities. Much like a production line, each employee could be assigned a station. For example, one person could be preparing the coffee when orders are made. The second person could prepare the bagel and the third person could take the

money. The stations still provide the customer with one-on-one service, but in a more timely fashion. Setting up stations with more efficiency could eventually lead to a drive through system.

4. Analyze the work flow and work space productivity for possible improvements in efficiency.

**5. Hole in One Bagels made catering sales to groups and doctor's offices and school. How could McGuthry increase sales in the catering area?**

At the time of the case catering was a small percentage of the company's business; however this was an area with substantial opportunity for grow given the demographics characteristics and business growth around the area. With the fast pace of businesses today and the pressure for increased productivity, more business are ordering catered lunches. Hole in One Bagels had a chance to fill this need by providing a fast, healthy, convenient, gourmet luncheon catered and delivered at a reasonable price. To build this segment of the business, McGuthry needed to focus on menu development and quality service. Businesses expected the order to be correct 100% of the time and have little tolerance for mistakes. One mistake could cost Hole in One Bagels repeat business. Business customers don't complain they switch providers.

To take advantage of the catering business Hole in One Bagels needed to advertise in business and professional offices. McGuthry could do this by sending a personal cover letter, a flyer and a catering menu to select local businesses. The letter would be addressed to the owner or a secretary depending on who is in charge of ordering food for breakfast, lunch, or special events for the company. The letter would provide information about Hole in One Bagels' catering service. A 10% discount would be given for the first order as an incentive and other discounts would follow through the use of a loyalty card. The catering menu would suggest different breakfast and lunch packages that could be ordered. A prospect list of current businesses in the area that may potentially use Hole in One Bagels would need to be identified. Using the Yellow Pages or accessing a database like Reference USA would allow McGuthry to obtain names and addresses of potential business clients. Using Standard Industrial Classification (SIC) codes or the new North American Industrial Classification System (NAICS) sorted by geographic area would produce a list of small business contacts in the area for McGruthy to use as a mailing list. The letter should be addressed to the owner/manger and a follow-up phone call should be made to the owner and person in the office that actually orders catered meals.

---

**6. McGuthry discussed trade marking the “Bagizza.” What has to be done in order to trade mark a product and do you think that trade marking the “Bagizza” would be in McGuthry’s best interest?**

One of Mr. McGuthry’s ideas to improve the marketing strategy of Hole in One Bagels was to introduce and trademark a pizza bagel cleverly called, the “Bagizza.” His main concern was whether or not introducing this product would boost his sales enough to outweigh the costs incurred. McGuthry looked at the option on both sides of this issue. If he introduced the “Bagizza” he faced the costs associated with pursuing the trademark and those associated with purchasing the equipment necessary for producing the Bagizza. Besides the administrative and legal fees encountered in purchasing the trademark, McGuthry would also need to buy the needed materials, i.e. bagels, pizza ingredients, labor costs to train, and an additional piece of equipment costing \$2000 (used) that were required to produce the “Bagizzas.” Since the machine would be purchased used, one must also think about repair costs of these specialty machines. If “Bagizzas” became a good selling product, then McGuthry would increase his sales and recover the money invested in the trademark. If the Bagizza did not reach the required level of customer demand, the investment would be a substantial loss and hurt his attempts at other forms of marketing.

McGuthry realized that it would cost money not only to pursue the trademark but also to enforce it. If he had to go to court to enforce the trademark, the costs could be substantial. Mr. McGuthry has made it quite clear that his available capital was not at a level that could adequately handle a risky venture. He would have to have considerable confidence that this new menu item would be highly successful before making this type of investment.

The second option was to go beyond the “Bagizza” and bring back the highly popular pizzas, which were once made at Hole in One Bagels under the previous management. With the reintroduction of the Hole in One Bagels’ pizza, new dinner hours (5 PM-10 PM) would need to be added in order to appeal to a potential dinnertime market. This would require putting together a schedule, which incorporates a breakfast shift, a lunch shift, and a dinner shift. In addition to the chef for the breakfast/lunch period, a chef would be needed for the Pizza side of the business. As for marketing, additional advertisings for these new offerings would be needed to reintroduce the once-loved Hole in One Bagels’ pizza. If the sales increase through this venture, then perhaps an introduction of the trademarked “Bagizza” to the lunch and dinner customers would then be in order.

It seemed that at the present time in order to grow sales, McGuthry first needed to expand his marketing strategies, before he ventured into expanding the product line. “Bagizza,” may be an option for some time in the future.

- 7. Bagels are a part of the quick casual industry which is growing rapidly. Research what other restaurants in the quick casual industry are doing in terms of marketing and product expansion. Could Hole in One Bagels use any of these strategies or tactics to help with its objective of increasing demand or cutting costs?**

The quick casual industry provides fresh, high quality products made to order for customers who are willing to pay more instead of settling for the typical fast food value meal. There were a number of examples of companies that have been successful in the quick casual market. Companies like Chipotle a leader in the quick casual sector, focused on upscale burritos. Other restaurants like McDonald's typically considered a fast food chain realized the emergence and need for this quick casual atmosphere. McDonalds has moved into this quick casual market by partnering with Fazoli's making Italian food "quick." Other the fast food chains also entered the quick casual industry, wanting a piece of this market are companies like Arby's and their market fresh sandwiches. Other large players include Panera Bread and Atlantic Bread. In most cases the success of the store depends on creating the right experience for the customer (Technomic, Inc. 2002).

The bagel industry was seen as fitting into the quick casual market by providing customers unique flavored bagels and cream cheese along with a variety of luncheon sandwiches. If bagels continue to be a part of this market, it will be necessary for owners to continually innovate with new varieties of bagels and breads as well as new luncheon options. Consumer tastes are continually changing. To stay ahead of the game in a mature market, differentiation is essential.

- 8. Convenience stores and grocery stores are the major competitors of Hole in One Bagels in the Fort Mill area. How much do you think convenience and grocery stores effect Hole in One Bagels sales? Are these stores a major influence in the bagel market?**

In 2002 the consolidation of the fresh bagel industry, seemed to be leveling out. Some such as Ron Savelli, vice president of research and development at Einstein/Noah Bagel, have suggested that bagel sales in dollars have increased except for a slight decline in the frozen bagel market (Harter 2001). Others including Bill Rianhard, president and chief operations officer of New World Coffee – Manhattan Bagel report positive growth especially in the fresh bagel market sales but indicated declines in fast food chains and convenience stores (Harter 2001). Both see a decline in the bagel offerings of fast food and convenience stores. In the grocery store sector, bagels were reported as being one of the least profitable in-store bakery products and have therefore been cut back or total dropped from the fresh bakery options.

Overall the 2002 fresh bagel market was more positive than that it has been for quite a while. Customers who wanted quality are coming back to bagel stores and sales of in-store bagels were stable or slightly declining (Harter 2001). Geographically some market sales were better than others, with the Northeast being the most lucrative market because of the marketing dollars spent on promotion in those markets.

In the Fort Mill area there were 167 convenience stores each with a potential for selling bagels. The market saturation provides substantial competition for Hole in One Bagels. However, trends seem to indicate that the fresh baked bagel specialty store seems to have the current advantage in the market with at least slight increased in demand while grocery stores and convenience stores are showing slight declines.

**9. Analyze Hole in One Bagels' income statements and discuss its financial situation from 1998 to present.**

	June	July	August	September	October
Cost of Goods Sold	\$13,306.29	\$16,506.68	\$23,191.23	\$16,602.71	\$20,662.05
Gross Profit	\$35,938.08	\$46,602.42	\$33,092.22	\$38,799.29	\$35,246.93
Gross Profit/Sales %	73.15%	73.84%	58.80%	70.03%	63.04%
5461 SIC Average	63.31%	63.31%	63.31%	63.31%	63.31%
Difference	9.84%	10.53%	-4.52%	6.72%	-0.27%
Net Income	\$5,624.58	\$12,850.44	(\$10,759.10)	\$5,033.88	(\$1,452.45)
Net Income/Sales%	11.45%	20.36%	-19.12%	9.09%	-2.60%
5461 SIC Average	11.01%	11.01%	11.01%	11.01%	11.01%
Difference	0.44%	9.35%	-30.13%	-1.92%	-13.61%

This table compares Hole in one Bagels' financials to the industry average. These numbers came from Dunn & Bradstreet Industry Financials. The ratios show that Hole in One Bagels' gross profit is higher than the industry, but the net income for Hole in One Bagels is almost 7% lower than the industry. This means that according to sales McGuthry has a great business, but his expenditures must be cut. Some examples and suggestions on how to improve the net income ratio are discussed further in the answer to the next question.

**10. What changes could be made to help Hole in One Bagels' improve its net profits?**

Hole in One Bagels was purchased with the intend of keeping it a lifestyle business that would provide an income for the owners family, make a contribution to the community, and

create many happy hours of conversation and happiness to the owners. The following desires are outlined:

- ◆ desire to keep business a “lifestyle business”
- ◆ desire to keep current customer base.
- ◆ desire to keep family atmosphere.
- ◆ desire to increase operating profits.

With these basic desires in mind, there are two ways to grow the net profits of the business. These strategies are to: lower expenses (cost of goods sold, fixed costs, operating expenses) or to increase sales revenues (marketing product development, location). As a starting point, McGuthry should focus more on making the current sales more profitable. Any effort at improving results must begin with management of operating expenses, particularly payroll. In the retail bakery business expense control and specifically payroll is the primary driver of profitability. Once expenses are under control and producing better profits, then efforts need to be taken to increase market share. This is a very powerful combination (The Profit Gap 2001).

Recommendations for lowering expenses include:

- ◆ Explore the layout of the serving area. Do a time study analysis of the employees. Conduct a test to see how fast it takes each employee to execute an order. If possible, the most efficient employees should be on the shift during the busiest hours. (This may reduce the labor costs). It may be helpful to bring in an outside consult on workflow and workspace productivity.
- ◆ Continue to evaluate the seventeen suppliers in relationship to any changes in the business situation and the environment. Can the number of suppliers be consolidated to take advantage of economies of scale? Forming partnerships with vendors can decrease costs.
- ◆ Evaluate the expense categories that look out of proportion to the current bills (telephone, bank charges, etc) that were from the previous owners and change to the actual expenditures. This will be needed for developing accurate financial projections and comparisons.
- ◆ Level out overhead expenditures throughout the year to get an accurate picture of the cash flow rather than the turbulent rises in certain months when large bill are due such as insurance.



- 
- ◆ Provide self-service options where possible. Can customers choose their own drinks? Can items be pre-wrapped and arranged where customers can make their own selections?

Recommendations to increase revenues include:

- ◆ Differentiate from competition by adding new flavors of bagels, spreads, breads, soups, coffees, etc. These items can be rotated on and off the menu to provide variety and kept the menu fresh. The new trend was the bakery cafe concept, a neighborhood eateries a little bit out of the ordinary that carry fresh bread, sandwiches, soups, and coffees with a novel atmospheres and fast, healthy, quality, gourmet food. Hole in One Bagels may be able to take advantage of the popularity of the quick casual dining trend.
- ◆ Use the media outlined in the promotional campaign to increase sales and measure the results from each media used. This can include: coupons, advertisements, press releases, direct mail letters, loyalty cards, etc. Sales promotions would also be effective since bagels are in the maturity stage of the product life cycle. This would include the promotion of upcoming special events, sponsorships or charities activities.
- ◆ Develop a Come Back for Lunch program to current customers to increase market penetration with current customers.
- ◆ Pay attention to décor. Would new paint or a rearrangement of the furniture give the place a new feel and increase sales.
- ◆ Be creative and put together some grab-and-go items that people can pick up when they are waiting line to get their bagel.
- ◆ Gift baskets with gourmet bagel and coffee items are often profitable. Create sample baskets for holidays, birthdays, and anniversaries. Special arrangements can also be created as ‘FedEx Bagels’ to send to friend and relative as gifts for special occasions.
- ◆ Provide single serving smaller individually packaged goods catering to convenience. Keep in mind the new Toyota SUV’s feature 9-cup holders and the new Volvo has 14-cup holders. Do you have a food packaged to fit into this convenient space provided by the auto manufacturers?
- ◆ Pricing is an important issue. Prices should be review every three to six months. Increases should not be made across the board. One retailer suggests pricing be set at four time the cost of materials. Overall consumers believe that prices are high but that high prices for high quality seemed fair (Unrein 2002, October 1)

- ◆ A brand strategy is essential to gain market potential. Hole in One Bagels should be a household name. A strong branding strategy and logo will add character and value to the products sold. The brand and log should center on associations with the bagel-coffee culture and could include a variety of options like music or books that coincide with these products. Once a branding strategy is in place, it should be used in ever aspect of the business. Utilizing talent locally like university students is possible or one can consult with professionals to develop the brand.
- ◆ Hole in One Bagels could open a kiosk in any of several possible locations. One option would be to open a kiosk at Panthers Stadium. Vendors must receive approval from the stadium and pay a percent of the gross earning to the Panthers. However, there are currently no bagel vendors at the stadium and therefore the cart would most like receive approval. A second location for a kiosk would be on the near by university campus for faculty and students for a few morning hours Monday through Friday.
- ◆ A final option deals with the current location of the bagel shop. The business has occupied the same location in a small house on a side street in Fort Mill for the last seven years. The current store location has high rent and maintenance costs. Most people would agree that the bagel shop has a strong loyal customer base. Relocation within the city to a more visible location preferably with more walk-in traffic would allow the store to retained its current customer base and while increasing demand from new customers. A store closer to the Interstate would be more cost effective based on square foot dollars and traffic flow. Other locations should be considered based on walk-in traffic such as the new development of the other side of the city. The quality of the product is outstanding; therefore it makes sense that a higher traffic flow would generate higher revenues.

## REFERENCES

- Bakingbusiness Staff. (2002, July 1). Grain-based statistics: Bagel. Retrieved March 10, 2003 from [http://www.bakingbusiness.com/co\\_article.asp?ArticleID=45341&PF=print](http://www.bakingbusiness.com/co_article.asp?ArticleID=45341&PF=print).
- Casper, Carol (1997, May 15). A hole in one, *Restaurant Business*, 96(10), 109.
- Cole, Wendy (2004, May 3). Is bread toast?, *Time*, 163(18), 50-51.
- Davidson, Gordon. (2000, December 5). Convenience on-the-go eating boosts bagels. Retrieved March 10, 2003 from [http://www.bakingbusiness.com/co\\_article.asp?ArticleID=37429&pf=print](http://www.bakingbusiness.com/co_article.asp?ArticleID=37429&pf=print).
- Dietrich, Heidi (2003). Back to bagel basics. Retrieved July 13, 2003, from <http://seattle.bizjournals.com/seattle/stories/2003.03/03/smallb1.html?t=printable>.

- 
- Dun & Bradstreet (2002). Industry norms & key business ratios. Murry Hill, NJ: Dun & Bradstreet, Inc.
- Government Census. (2002, Sept. 21). Economic business statistics on restaurant industries. Retrieved Nov. 1, 2002, from <http://www.census.gov.html>
- Harter, Besty. (2001, July 1). The evolution of bagels. Retrieved March 10, 2003, from [http://www.bakingbusiness.com/archives/archive\\_article.asp?ArticleID=45373&PF=print](http://www.bakingbusiness.com/archives/archive_article.asp?ArticleID=45373&PF=print).
- Malovany, D. (2002, July, 30). Setting a new table. Stagnito Publishing Company. 117 (91). Retrieved Nov. 19, 2002, from LEXISNEXIS ACADEMIC database.
- MRI 2000. (2000, May 15) Female house makers demographics: Bagel consumers. Retrieved Nov. 20, 2002, from Media Mark Research Inc.
- ORC International (2001 Summer). Breakfast favorites, *Caravan Saray Newsletter*, Retrieved Nov. 19, 2002 from OCR International website <http://www.opinionresearch.com/us/omnibus/newsletter/SaraySummer2001.pdf>
- Profit gap. (Fall 2001). RBA Insights. Retrieved March 10, 2003 from <http://>
- Reference USA (2002). Business database, Reference USA: An info USA service, Retrieved January 2, 2002 from <http://0-www.referenceusa.com.library.winthrop.edu/index2.asp?si=22640146461274>
- Sperber, B. (2002, Sept. 2). Fast dining ahead, *Brandweek*, Retrieved Nov. 19, 2002, from LEXISNEXIS ACADEMIC database.
- Spinelliu, Anthony (2000). Once-burgeoning bagel industry now spread thin, *The Connecticut Post*, Retrieved January 2, 2002, from <http://www.s-t.com/daily/01-00/01-02/d06bu143.htm>.
- Technomic Inc. (2002, August 6). Technomic, Inc. Unveils study results on quick casual foodservice segment. PR Newswire. A90164906. Retrieved Nov. 19, 2002, from Expanded Academic ASAP database.
- Technomic Inc. (2002, January 31). Technomic, Inc. Launches study on the quick casual foodservice segment. PR Newswire, Retrieved July 28, 2003 from <http://0-web.lexis.com.library.winthrop.edu/university/documentment>.
- Tonnies, Mac. (2001, April 1). Rush job. Retrieved March 10, 2003, from [http://www.bakingbusiness.com/archives/archive\\_article.asp?ArticleID=41247&PF=print](http://www.bakingbusiness.com/archives/archive_article.asp?ArticleID=41247&PF=print).
- Unrein, John. (2001, October 1). Coupon clippers. Retrieved March 10, 2003, from [http://www.bakingbusiness.com/archives/archive\\_article.asp?ArticleID=47317&PF=print](http://www.bakingbusiness.com/archives/archive_article.asp?ArticleID=47317&PF=print).
- Unrein, John. (2002, May 1). Help yourself. Retrieved March 10, 2003, from [http://www.bakingbusiness.com/archives/archive\\_article.asp?ArticleID=53559&PF=print](http://www.bakingbusiness.com/archives/archive_article.asp?ArticleID=53559&PF=print).

- Unrein, John. (2002, June 1). Shifting gears. Retrieved March 10, 2003, from [http://www.bakingbusiness.com/archives/archive\\_article.asp?ArticleID=54066&PF=print](http://www.bakingbusiness.com/archives/archive_article.asp?ArticleID=54066&PF=print).
- Unrein, John. (2002, October 1). Pricing postures. Retrieved March 10, 2003, from [http://www.bakingbusiness.com/archives/archive\\_article.asp?ArticleID=57690&PF=print](http://www.bakingbusiness.com/archives/archive_article.asp?ArticleID=57690&PF=print).
- Unrein, John. (2002, December 1). Top 15 Retail: New world. Retrieved March 10, 2003, from [http://www.bakingbusiness.com/archives/archive\\_article.asp?ArticleID=57690&PF=print](http://www.bakingbusiness.com/archives/archive_article.asp?ArticleID=57690&PF=print).
- Wolf, Barnet, W. (2002, July 4). Casual feeding frenzy. *The Columbus Dispatch*. p. 01F. Retrieved Nov. 19, 2002, from LEXISNEXIS ACADEMIC database.
- Zion, Lee (2001). Einstein bagels launches major growth blitz, *San Diego Business Journal*, 22(44) 24.

**Allied Academies**

**invites you to check our website at**

**[www.alliedacademies.org](http://www.alliedacademies.org)**

**for information concerning**

**conferences and submission instructions**

**Allied Academies**

**invites you to check our website at**

**[www.alliedacademies.org](http://www.alliedacademies.org)**

**for information concerning**

**conferences and submission instructions**