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INSTRUCTORS' EDITION

Editors
Inge Nickerson, Barry University
Charles Rarick, Barry University

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JOURNAL OF THE INTERNATIONAL ACADEMY FOR CASE STUDIES

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LETTER FROM THE EDITORS

Welcome to the *Journal of the International Academy for Case Studies' Instructor's Edition.* The editorial content of this journal is under the control of the Allied Academies, Inc., a non profit association of scholars whose purpose is to encourage and support the advancement and exchange of knowledge, understanding and teaching throughout the world. The purpose of the *JIACS* is to encourage the development and use of cases and the case method of teaching throughout higher education. Its editorial mission is to publish cases in a wide variety of disciplines which are of educational, pedagogic, and practical value to educators.

The Instructors' Notes contained in this volume have been double blind refereed with their corresponding cases. Each case for which there is an Instructors' Note contained herein has been previously published in an earlier issue of the *JIACS*. 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

NOTES

GELATO NATURAL S.A.

D.K. (Skip) Smith, Southeast Missouri State University
Carlos Aimar, University CAECE
Ariel Gustavo Davalli, Gelato Natural S.A.
Rafael Barbero, University CAECE

CASE OVERVIEW

This case challenges students to develop a strategy to rescue the company from the fact that its newly-expanded factory is coming on stream (and payments on related loans are beginning to become due) just as the Argentine economy is collapsing. The case is based on discussions conducted by the authors in Argentina. The case is appropriate for senior-level undergraduates as well as students in MBA and Executive Development programs. It is designed to be taught in a one hour and a half class session, and is likely to require at least a couple hours of preparation by students.

CASE SYNOPSIS

Ariel Davalli is the Vice President of Gelato Natural S.A., a company which (at the time of the case) was selling Chungo (it's high-quality homemade ice cream) from several locations in the northern suburbs of Buenos Aires, Argentina. Based on high demand for its products from individual consumers living in the northern suburbs, the company invested $2,000,000 U.S. dollars to significantly increase the capacity of its factory. This $2,000,000 expansion was funded by borrowing $750,000 U.S. dollars (the loan comes due in four years) and by shifting the local-currency equivalent of $1,250,000 of working capital into fixed assets. Unfortunately, just as the expanded factory started production, the economic environment in Argentina deteriorated significantly. In addition, the exchange rate of the peso with the U.S. dollar fell from 1-to-1 (at the time of the loan) to 3-to-1. Currently, demand for Chungo is stagnating, and the new factory is operating at only 30% of capacity. Additional data and information in the case include:

1. *For Argentina: Historical overview, a sample of recent statistics from the World Bank, and (for benchmarking purposes), comparable statistics for the United States.*
2. *On the company: Historical overview, current performance, and numerous factors impacting that performance.*

3. *Characteristics of the company's current strategy, including descriptive information on the product line, characteristics of the distribution system, information on the promotion and pricing strategies the company is currently using, etc.*
4. *Characteristics of the current competitive situation.*
5. *Detailed data on the attitudes and behaviors of buyers of homemade ice cream in Argentina.*

INSTRUCTORS' NOTE

Overview

Our hero, Ariel Davalli, Vice President of Gelato Natural S.A., faces the following situation: (1) Demand for Gelato Natural S.A.'s homemade ice cream had been so strong that the company had borrowed US$750,000 (repayable in four years, in U.S. dollars) and tied up the local currency (pesos) equivalent of US$1,250,000 in working capital to finance an overall US$2,000,000 program to double the capacity of their ice cream factory, to ensure that the factory would be able to keep up with demand from its customers living in the northern suburbs of Buenos Aires, Argentina; (2) During the time the factory expansion was under construction, Argentina defaulted on its overseas debt (i.e., the country had declared bankruptcy), and demand for Gelato Natural S.A.'s "Chungo" brand homemade ice cream had fallen dramatically. Looking again at the figures, Davalli saw that utilization of the expanded factory was currently 30% of capacity. Because the value of the peso had now fallen from "one peso = one dollar" to "three pesos = one dollar," the amount of revenue and profit (in pesos) needed to repay the US$750,000 loan had tripled; and (3) Unless management figures out a way to dramatically increase revenues and profits, Ariel Davalli fears that the company will follow Argentina into bankruptcy.

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

1. At the beginning of the case, students will need to consider the extent to which developed-world models and conceptual frameworks can be applied to challenges and opportunities in the developing world. By the end of the case discussion, they will have discovered that some conceptual frameworks (for example, the development of strategies to turn around failing businesses) can be useful guides to managerial action not only in the developed world but in the developing world as well.
2. Students will be able to compare their solutions to the one developed by the hero of the case, that is, Ariel Davalli, Vice President of Gelato Natural S.A.

3. Students will discover that a manager's conceptual framework (in this case, a turnaround strategy quite similar to a set of alternatives suggested by Sheth (1985)) powerfully impacts the nature of the process and/or options used to turn a business around. Specifically, a Sheth-based approach to rebuilding revenues and profitability is likely to differ considerably from a plan to rebuild revenues and profitability based on alternative conceptual frameworks such as "new product development" or "marketing strategy."
4. As they work through the case, students are exposed not only to a bit of information on an important South American market (Argentina) but also to a bit of history on Gelato Natural S.A., a small privately-owned company which has achieved a high level of success in a very difficult environment.

DISCUSSION QUESTIONS

We often select one student to lead the discussion. Another approach would be to solicit input from various students at various stages of the analysis. Either way, our usual approach to this case is threefold:

1. Solicit from many students the details of the case, including information about the macroeconomic environment at the time of the case; information on the company; information on the competitive environment; information on customers, information on strategies the company has used over the years, and information on how those strategies have been implemented. Usually, we write much of this information on the board, so that if questions on "facts of the case" arise, we will have much of that information in front of us.

2. Ask an individual student or the class as a whole to address a very specific series of questions. Those questions, and comments relating to three possible solutions to the case, are as listed below:

   1. What is the main problem?

   Students usually conclude that Vice President Ariel Davalli must develop a plan to rebuild Gelato Natural's revenues and profits. We reinforce the idea that this is a reasonable statement of the challenge Davalli faces.

2. What kind of problem is this?

Instructors should not be surprised if there are as many answers to this question as there are students in the class. Clearly, there is no one “right” answer. However, three alternative approaches, each of which seems quite relevant to the situation, are as indicated below:

1. New product development, based on the development of deep customer insight and knowledge.
2. Marketing strategy.
3. Turnaround strategy.

3. For the kind of problem selected, what are the key variables and which expert says so?

For students concluding that the main problem is to “develop new products based on deep customer insight and knowledge,” Arken (2002) suggests eleven questions which marketers can ask customers and, in so doing, develop deeper knowledge and insight of those customers: (1) What is the first thing which come to mind when you think about a product? Why is this important? (2) Tell me about a day in your life, when you are involved with the product, from the time you wake up until the time you go to sleep. (3)What is your earliest memory relating to this product? (4)What is your best/worst experience involving this product? (5) Can you think of a pivotal experience that changed your attitude toward the product? (6)Tell me about your ideal experience with the product? (7)What keeps you from achieving the ideal experience with the product? What would make it easier to achieve that ideal experience? Should or could your family be involved in anyway? (8)What concerns you most (both in general, and about the product), at this time of your life? (9)\What makes you happiest (both in general, and in regards to this product), at this time of your life? (10) What are the most important things you are trying to achieve, at this time in your life? How does this product help you to achieve these things? (11)If you had a magic wand and could do one thing to help you with regard to this product, what could that be? For students concluding that the main problem is “marketing strategy,” Perreault and McCarthy (2002) suggest that the key marketing strategy variables are: (1) Target market; and (2) The marketing mix (that is, place, price, product, and promotion). For students concluding that the main problem is the need for a “turnaround strategy,” Sheth (1985) suggests there are nine strategies which can be considered: (1) Entrenchment (that is, fight for a larger share of existing uses of products in existing markets); (2) Consider selling to intermediaries; (3) Mandatory consumption (that is, ask government to pass a law requiring the use of a product or service); (4) Go international; (5) Broaden product horizons (that is, don't sell just the computer; rather, sell the computer plus a full set of ancillary products and services); (6) In existing markets, identify new applications for products; (7) In existing markets, identify new usage situations; (8) Repositioning (that is, in new markets, identify new uses for products by changing the image of the product); and (9) Redefining markets (that is, in new markets, identify new uses for products by making functional changes in those products.

4. What data from the case relate to the key variables?

As implied above (and this is one of the key learning points of the case), the data students present will depend on the main problem they identify. For students believing that the main problem is the need to develop new products based on deep customer insight and knowledge, the "product" section of Appendix 1 contains the small amount of data from the case relating to the eleven questions identified by Arken. Students believing the main problem is "marketing strategy" will focus on the two key variables identified earlier, that is, the target market and the marketing mix. Appendix 1 identifies data from the case which relate to each of these key variables. Students believing the main problem is the need for a turnaround strategy will focus on the nine alternative strategies identified by Sheth; Appendix 2 identifies data from the case which relate to each of those alternatives.

5. What alternative solutions can be identified?

Because research suggests we make better decisions if we identify alternatives and then chose one, we require students to identify at least two alternatives. Of course, students having difficulties coming up with a second alternative can be reminded that one possible solution is to "change nothing."

6. Which one alternative does the class/student recommend, and why?

"Changing nothing" is unlikely to help Ariel Davalli achieve his objective, that is, to increase the revenues and profits of Gelato Natural S.A. Thus, it appears that students believing the main problem is the need for new products based on deep customer insight and knowledge will recommend an approach based on input from customers relating to the eleven questions listed earlier. Students believing the main problem is the need for a new marketing strategy will recommend an approach which focuses (or re-focuses) on the target market and the “4Ps” (that is, price, product, promotion, and place/distribution). Students believing the main problem is the need for a “turnaround strategy” are likely to recommend consideration of one or more of the alternatives identified by Sheth.

The approach used successfully by Ariel Davalli was a turnaround strategy based on a number of initiatives remarkably similar to those suggested by Sheth (1985). For additional information on what happened, please see the epilogue.

7. What negatives are associated with the alternative selected by the class leader and/or other members of the class?

Very few solutions are risk and/or problem-free. Negatives associated with the solution proposed by the class leader and/or other members of the class could include the following: 1) The chosen alternative, if it requires Gelato Natural S.A. to acquire specialized equipment and/or skills which the organization doesn’t currently possess, could be expensive both in terms of time and money. Also, because the case probably doesn’t provide all the data a decision maker would need (in other words, it is likely that some important data is missing), it is possible that assumptions made by the class leader regarding the actual situation faced by Gelato Natural S.A. are incorrect. If so, the proposed solution might be inappropriate.

3. The third and final step in discussing a case with students is to share with them what actually happened (that is, to provide them with an epilogue to the case) and to discuss with them the implications of that outcome. In this case, as a first step to substantially increasing Gelato Natural S.A. revenues and profits, Ariel Davalli and his team worked together to identify the various options available to the company. The options they identified included the following: (1) Sell ice cream through cinemas; (2) Sell ice cream through restaurants, hotels, and catering; (3) Sell ice cream at sporting and/or social and cultural events; (4) Sell ice cream through non-Chungo shops; (5) Sell ice cream in supermarkets; (6) Achieve ISO 9000 quality certification, so as to be able to compete more effectively for sales through other organizations; (7) Introduce a second brand of homemade ice cream; (8) Create a new image in Chungo stores; and (9) Export ice cream to markets outside of Argentina.

At this point, Ariel Davalli and his team dedicated themselves to following-up on each of the nine options they had identified. The results of their efforts included the following accomplishments:

1. Sale of ice cream to cinemas. When Davalli and his team examined this option, they discovered that Hagen-Das (that is, the company which had traditionally provided the ice cream sold at movie theaters) had dropped out of the market. As indicated in the case, ice cream sold by Hagen-Das in Argentina had been imported from France. However, once the peso fell from "one-to-one" to "three-to-one" with the U.S. dollar, importing ice cream from France was no longer economically feasible. So, Chungo was able to take the place of Hagen-Das in the movie theaters. Another big advantage of this situation was that movie theaters already had display cases for ice cream. In other words, Chungo did not need to supply freezers to the movie theaters.
2. Sale of ice cream through restaurants, hotels, and catering. Davalli and his team started out by talking with a small number of elite hotels (for example, Sofitel, Hilton, Sheraton, Marriott, etc.) to see whether the hotels would be interested in placing homemade ice cream on their menus. The answer was "yes." However, what Davalli also discovered was that once Gelato Natural S.A. sold containers of ice cream to the hotels and/or restaurants, the potential for mishandling the ice cream (for example, storing it in a freezer right next to some frozen fish) was very high. Ultimately, a number of elite hotels and restaurants agreed to purchase their ice cream from Gelato Natural S.A.; however, due to the risk of mishandling, Gelato Natural S.A. insisted that the hotels and restaurants not reveal in their menus the brand name (that is, Chungo) of the ice cream. For this reason, while purchases by hotels and restaurants did increase the volumes of ice cream Gelato Natural S.A. was selling (and increased the factory utilization rate as well), this business does not contribute in any way to increasing Chungo's brand equity.
3. Sale of ice cream at sporting, social, and/or cultural events. Davalli and his team discovered that organizers of sporting, social, and/or cultural events were eager to offer ice cream at these events. For this reason, Gelato Natural S.A. purchased several portable ice cream shops, so that company employees could load the mini-ice cream shop on a truck, deliver it to the site of an event, sell ice cream during the event, and then re-load the portable shop on a truck and take it back to the factory.
4. Sale of Chungo ice cream through non-Chungo shops. As indicated in the case, when Davalli and his team examined this option, they discovered that Hagen-Das had been selling ice cream through Blockbuster shops and a variety of other sales points including gas stations. Because Hagen-Dad had left the Argentine market, Gelato Natural S.A. was able to sign contracts with a number of these companies and take the place of Hagen-Das as their supplier of ice cream.
5. Sale of ice cream through supermarkets. Historically, most of the ice cream sold through supermarkets in Argentina has been industrial quality ice cream. When Davalli and his team examined this option, however, they found that a few

supermarkets were willing to consider adding homemade ice cream to their assortment of ice cream products. Ultimately, Gelato Natural S.A. agreed to provide Jumbo (a supermarket chain in Argentina) with the same ice cream it had always sold, but to do so under the "Jumbo" (i.e., not the Chungo) brand name. In other words, Gelato Natural began producing Jumbo homemade ice cream as a private brand. As in the case of the sales to elite hotels and restaurants, the impact on Gelato Natural S.A. volumes and plant utilization statistics was very positive, but did not lead to any positive impact on Chungo's brand equity.

Another interesting aspect of this private brand business is that Jumbo operates supermarkets in Chile. From time to time, consequently, Gelato Natural S.A. ends up exporting a container of ice cream from Argentina to Chile.

A final interesting aspect of the private brand ice cream business with Jumbo is that in Argentina, a trip to the supermarket can last for more than one hour. Since the ice cream business is far bigger in the summer, this means that the packaging of the ice cream must be good enough to keep it from melting during the shopping trip, that is, for at least one hour. For this reason, Gelato Natural S.A. ended up developing a new insulated package for the private brand ice cream it was selling through Jumbo.

6. Achievement of ISO 9000 quality certification, so as to make it easier to persuade other organizations to partner-up with Gelato Natural S.A. Readers will by now have realized that many of the options Gelato Natural S.A. has used involve the creation of partnerships with other organizations (restaurants and hotels, other shops, Jumbo supermarkets, etc.). As he prepared himself and his company for building these sorts of partnerships, Davalli found himself believing that ISO 9000 certification for Gelato Natural S.A. would be a very powerful and important feature and benefit to help the company win the partnerships it needed to survive and thrive in the newly-difficult Argentine environment. For that reason, he dedicated himself and his team to winning ISO 9000 certification for Gelato Natural S.A. as quickly as possible. As Davalli predicted, having that certification did prove to be a very important feature and benefit for many of the organizations he approached and (later) formed partnerships with.
7. Introduction of a second brand of homemade ice cream. As Davalli and his team examined their homemade ice cream business in Argentina, they found themselves believing that it would be useful to have an even more elite and expensive brand than Chungo, which could be sold through gas stations and other such selling points in packages much smaller than those traditionally used by Chungo. Ultimately, Gelato Natural S.A. introduced a new brand called "Tango & Polo," based on the Argentine heritage of these two famous activities. "Tango & Polo" ice cream is sold in 100ml

and 250ml packages (i.e., very small packages) at prices which are (on a per liter basis) very high. The product sells very well, especially (as one would guess) in the summer.

8. Creation of a new image in Chungo's shops. As indicated in the case, in Argentina, an ice cream shop can be a destination where people will go to relax and enjoy time together. As the case also indicates, however, it is much less common during the winter for people in Argentina to go to ice cream shops. As Davalli and his team considered this fact, and the fact that they were eager to introduce additional products so as to reduce the cyclical nature of Gelato Natural S.A.'s business, they found themselves believing that the range of products being sold through the Chungo ice cream shops should be increased to include the following sorts of products: (1) A range of beverages (coffee, tea, soft drinks, juices, etc.) not limited to ice cream-related drinks like milkshakes; (2) Pastries (rolls, tarts, cakes, pies, etc.); and (3) Miscellaneous products (for example, chocolates). The idea, of course, was to re-create the ice cream shop as a destination shop which would be used by customers to gather for treats and relaxation not only during the summer, but during the autumn, winter, and spring as well.

9. Exportation of ice cream to markets outside of Argentina. As indicated earlier, the private brand business with Jumbo did end up offering opportunities for Gelato Natural S.A. to export ice cream to Chile. Subsequently, Gelato Natural received expressions of interest from Shop-Rite, a supermarket operating in Southern Africa. Ultimately, Gelato Natural S.A. did end up shipping a container of ice cream to Shop-Rite's operations in Mozambique. If it sells well, it is possible that Gelato Natural S.A. will have additional opportunities to export, not only to Mozambique but also to South Africa as well.

An interesting and important point not yet addressed in this teaching note is the question of how the alternatives examined and exploited by Gelato Natural S.A. compare to the set of alternatives which Sheth (1985) believes can be considered, if one is trying to "turnaround" a business which is failing. Because the answer to this question could have important implications for Gelato Natural S.A. (for example, the possibility of identifying additional options for building the business which have not yet been considered), we turn now to that question.

1. ENTRENCHMENT. This approach, according to Sheth, involves taking market share away from competitors. He suggests four alternatives which firms may be able to use: (1) Segment the market (and introduce different products, flavors, or brand names for each segment); (2) Identify specialty markets; (3) Go after heavy users of the product; and (4) Seek multiple

channels of distribution. Gelato Natural S.A. has already developed a number of different flavors; furthermore, they have also developed “Tango & Polo” for the segment interested in buying very small packs of ice cream for a quick treat. On the point of “multiple channels of distribution,” Chungo now goes to market not only through Chungo ice cream shops (the original channel) but also through portable ice cream shops and through cinemas and Blockbuster shops. While Chungo’s ice cream also goes to market through elite hotels and restaurants (no brand name indicated), the Jumbo supermarket chain (under the “Jumbo” private brand name), and gas stations (the “Tango and Polo” brand name), the fact that none of this ice cream is sold under the name “Chungo” suggests that there may still be opportunities to develop additional channels of distribution for the Chungo brand. In other words, perhaps there is an opportunity to develop additional channels of distribution for Chungo. As for heavy users of the product, the case indicates that Chungo has already established a “frequent buyer” program. Clearly, those who buy a lot of Chungo homemade ice cream could be rewarded not only by free ice cream on their birthday but also by winning points (when they purchase ice cream) which can be traded for hats or t-shirts (these should be covered with the Chungo name) and/or other Chungo products.

2. SWITCH TO INTERMEDIARIES. Sheth suggests that marketers may be able to succeed by selling to intermediaries (wholesalers, processors of agricultural products, etc.) instead. Of course, Gelato Natural S.A. is already engaged in these sorts of initiatives, through its partnerships with Blockbuster, gas stations, elite restaurants and hotels, and (most importantly) Jumbo.

   It is of course interesting that Gelato Natural S.A. is not willing to allow the elite restaurants and hotels to tell customers that the ice cream they are enjoying is Chungo brand homemade ice cream. From a marketing perspective, this results in the loss of a huge opportunity to build the brand equity (that is, the value) of the Chungo brand. One wonders whether there is a way to provide training and/or incentives to one employee at each elite restaurant and hotel, so that Gelato Natural S.A. could be confident that its ice cream will not be mishandled. If so, the name (Chungo brand homemade ice cream) could be revealed, and the value of the brand (i.e., brand equity) would surely increase.

3. MANDATORY CONSUMPTION. Unless Gelato Natural S.A. is able to sign an exclusive supply contract with one or more units of government, it seems unlikely that any local, state, or federal government unit will pass a law

requiring that individual and/or institutional purchasers of ice cream must purchase Chungo brand homemade ice cream. However, if there are social groups which are buying large amounts of Chungo brand homemade ice cream, Chungo might be able to create a reward program so that members of heavy user social groups would feel compelled to purchase Chungo every time they buy ice cream, because they know that (through these purchases) their social group will earn additional reward points and/or rewards.

4. GO INTERNATIONAL. As indicated in the case, Gelato Natural S.A. is already doing indirect exports (through Jumbo) to Chile, and has also shipped an export order (through Shop-Rite) to Mozambique. In short, the company is already engaged in exporting.

5. BROADEN THE PRODUCT HORIZON. Sheth indicates that this approach often involves focusing on the function that a product performs and then thinking of the product as a component in a system. Clearly, Gelato Natural S.A.'s "Chungo Brand" is used not only as a dessert (i.e., a nice end to the meal) but also as a way to create social opportunities (i.e., a chance to socialize with friends and/or relatives). The case indicates that while the business is very seasonal (i.e., using ice cream to create social opportunities is much more common in the summer than in the winter), the increase in the range of products now being sold through the Chungo shops (i.e., beverages, pastries, chocolates, etc.) is addressing the seasonal nature of the ice cream business, and represents an example of this approach to a turnaround strategy.

   A small elaboration on the above point might be useful. If one regards the Chungo shops as being in the business of recreation and socialization (i.e., the sort of expanded view of the product suggested above by Sheth), perhaps Chungo should get involved in sponsoring recreation events for certain groups (for example, senior citizens) at its shops. If, for example, a group of senior citizens or a social club gathered once a month at a Chungo store for recreation (cards, bingo, etc.) and/or socializing, this could lead to large increases in patronage, revenues, and profits.

6. NEW APPLICATIONS. Perhaps the idea discussed above (that is, that the purchase of ice cream and other products Chungo is now selling in its shops relates less to the idea of "dessert" and more to the idea of "opportunities for socialization") is also an example of "new applications."

7. NEW SITUATIONS. Sheth indicates that this strategy requires marketers to seek out different times, places, and/or positioning for product usage. While the case does not indicate the time of day during which customers tend to

patronize Chungo shops, it seems likely that most patronage would be in the afternoon and/or evening. If this is true, perhaps it would be possible to motivate social groups to patronize the Chungo shops earlier in the day. Alternatively, perhaps there are additional products and/or services which the shops would offer, so as to motivate consumers to think of Chungo not only as an "afternoon and evening" destination, but as a morning destination as well.

8. REPOSITIONING. According to Sheth, this strategy involves redefining a product's image into new usage situations within the same general application context. For example, when Marlboro cigarettes (the first full-length cigarette with a filter) failed to appeal to women (the original target market), Marlboro was repositioned to be the cigarette of choice for rugged, outdoor, male smokers. The case indicates that Chungo has already re-positioned itself, away from the image of "ice cream shop" and toward a positioning which offers possibilities for relaxing and/or socializing with friends, not just in the summer but at other seasons of the year as well.

9. REDEFINE MARKETS. Sheth identifies four alternative approaches to using this strategy: (1) Generic to specialty products; (2) Primary to secondary products; (3) Industrial to consumer products; and (4) Consumer to industrial products. The first alternative is not applicable to Gelato Natural S.A. because the company's products are already branded. As for the second alternative (that is, bundling other products or services around Gelato Natural S.A. products), it might (at first glance) seem unlikely that services (other than delivery by motorcycle) could be bundled around ice cream and/or other dessert products. Having just said this, however, it does seem worth noting that consumers in Argentina (like consumers in much of the rest of the world) are getting older. While many of us older customers still enjoy very much the sorts of ice cream and dessert products which Chungo is selling, many of us are also to the point where we have to be much more careful about how much sugar we eat, the amounts of calories and/or fats and/or cholesterol and/or carbohydrates we ingest, and so on. So perhaps there could be an opportunity, for Chungo to create a range of products which includes information and advice about the nutritional characteristics (and/or reduced levels of sugar, fat, carbohydrates, etc.), for those consumers needing to be careful about nutrition-related issues.

As for moving from industrial products to consumer products, Gelato Natural S.A. is currently selling consumer products so this option is not relevant. As for the idea that the product could be converted to an industrial product (that is, a product sold not to individual consumers one-by-one but to other companies, the case makes clear that while Chungo is already deeply engaged in selling its ice cream through other companies (elite hotels and restaurants, the "Jumbo" chain of supermarkets, etc.), these sales are not done under the "Chungo" brand name. Perhaps there is an opportunity to sell product under the "Chungo" brand name through other supermarkets and/or other organizations.

APPENDIX 1
CASE DATA RELATING TO MARKETING STRATEGY MODEL

Target Market. Since its inception, the primary target market for Chungo has been families and individuals falling in the "ABC1" category. As indicated in the case, characteristics of these individuals include: High purchasing power, culturally sophisticated, buyers who make decisions in terms of innovative flavors and quality products, people who look for recreation and a pleasant moment; families who want to enjoy ice cream in a very comfortable store, families accustomed to having ice-cream (as a dessert) at home, sophisticated customers who make decisions in terms of new sensations (flavors, names, innovative combinations). As the case also indicates, in Argentina, 80% of consumers classified in the ABC1 category live in Buenos Aires.

Product. Since the company's beginning in 1973, the product offered by Gelato Natural S.A. has been very consistent: a top-quality homemade ice cream. Over the years, the only changes in the product line have been the addition (from time to time) of new flavors of ice cream. In other words, Gelato Natural S.A. started out making (and continues to make) one and only one high quality homemade ice cream.

Prices. The case indicates that the relationship between the price of ice cream from big factories (i.e., industrial ice cream) and the price of homemade ice cream like Chungo has (over the years) remained fairly constant. Usually, homemade ice creams cost a bit more than twice as much per liter as industrial ice creams. The case indicates that at the time of the case, the price per kilo for industrial ice cream was in the range of 10–12 pesos per kilo, and that the price for homemade ice creams (including Chungo) was in the range of 24–28 pesos per kilo.

Promotion. The case indicates that Chungo buys very little radio, television, and/or print advertising. Much of the advertising is by word of mouth, that is, satisfied customers sharing their experiences and reactions with friends, neighbors, etc. Chungo does print up little promotional flyers listing phone numbers and flavors which customers can pick up at the shop and take home with them. The case also indicates that a continuity program (Fildelization Customer Card) has been introduced to reward heavy-user customers. Special promotions for frequent customers (for example, a gift on their birthday) have also been created. Also, Chungo has become involved in sponsoring cultural events organized in cooperation with neighbor associations and/or institutions.

Distribution. The case indicates that at the time of the case, Chungo was selling its homemade ice cream through five shops, all of which were located in the northern suburbs of Buenos Aires.

APPENDIX 2
CASE DATA RELATING TO THE "TURNAROUND STRATEGIES" MODEL

1. ENTRENCHMENT. This approach, according to Sheth, involves taking market share away from competitors. He suggests four alternatives which firms may be able to use: (1) Segment the market (and introduce different products, flavors, or brand names for each segment); (2) Identify specialty markets; (3) Go after heavy users of the product; and (4) Seek multiple channels of distribution. It appears that Gelato Natural S.A. has already developed a number of different (and unique) flavors including Dulce de Leche Bombom, Malaga al Rhum, Quinotos al Whisky, Super Sambayon con Almendras, Tiramisu, Tramontana, Yema Quemada, Trisapore, Spaghetti Pasta, Mascarpone con Frutos del Bosque, Gianduia, Manzana, Melon, and so on. As for option #2, specialty markets (for example, consumers wishing to order out for ice cream) have been identified and are being serviced. As regards option #3, heavy users can benefit from the continuity program. At the beginning of the case, Chungo was distributing ice cream products through only one channel, that is, its own ice cream shops.
2. SWITCH TO INTERMEDIARIES. If getting products into the hands of consumers is difficult for some reason, Sheth suggests that marketers may be able to succeed by selling to intermediaries (wholesalers, processors of agricultural products, etc.) instead. The case indicates that consumers in Argentina do purchase ice cream through a number of different intermediaries, including hotels and restaurants, supermarkets, video shops, gasoline stations, etc. At the beginning of the case, it was clear that Gelato Natural S.A. was not exploiting any of these intermediaries.
3. MANDATORY CONSUMPTION. Sheth indicates that sometimes it is possible to revive a business by getting government (state, local, or federal) to pass a law making in mandatory for consumers to purchase certain categories of products. In the U.S., for example, infants traveling in cars must be strapped into a car seat. In this case, it seems unlikely that government is likely to make mandatory purchase of Gelato Natural S.A. products.
4. GO INTERNATIONAL. Sheth indicates that sometimes it is possible to revive a business by beginning to sell the product in markets outside the home market. The case indicates that Gelato Natural S.A. has five outlets in the northern suburbs of Buenos Aires; the probability

that the company could succeed through its own direct exports to overseas markets seems small.

5. BROADEN THE PRODUCT HORIZON. Sheth indicates that this approach often involves focusing on the function that a product performs and then thinking of the product as a component in a system. Clearly, Gelato Natural S.A.'s "Chungo Brand" is used not only as a dessert (i.e., a nice end to the meal) but also as a way to create social opportunities (i.e., a chance to socialize with friends and/or relatives). The case indicates that the business is very seasonal, and that using ice cream to create social opportunities is much more common in the summer (i.e., when the weather is warm) than in the winter.
6. NEW APPLICATIONS. According to Sheth, new applications usually involve some sort of functional change in the product. He indicates that a good way to search for new applications is to ask consumers how they actually use the product. An example from the U.S. would be the introduction by a raisin growing cooperative from California, of very small boxes of raisins which mothers could give their children as a snack. In this way, raisins (traditionally sold in the U.S. in one pound boxes, for use by cooks) suddenly became a snack food as well. Aside from the suggestion that eating ice cream is used by some customers as a way to socialize with friends and/or family, the case does not contain any information suggesting that new applications-related opportunities might be available.
7. NEW SITUATIONS. Sheth indicates that this strategy requires marketers to seek out different times, places, and/or positioning for product usage. A U.S. example is Sunkist, which has been working for many years (with very limited success, unfortunately) to convince consumers that orange juice is not just a breakfast drink. It is not clear from the case whether there might be new usage situations which could be exploited.
8. REPOSITIONING. According to Sheth, this strategy involves redefining a product's image into new usage situations within the same general application context. For example, when Marlboro cigarettes (the first full-length cigarette with a filter) failed to appeal to women (the original target market), Marlboro was repositioned to be the cigarette of choice for rugged, outdoor, male smokers. The case does not contain any information suggesting that re-positioning-related opportunities are available.
9. REDEFINE MARKETS. Sheth identifies four alternative approaches to using this strategy: (1) Generic to specialty products; (2) Primary to secondary products; (3) Industrial to consumer products; and (4) Consumer to industrial products. The first alternative is not applicable to Gelato Natural S.A. because the company's products are already branded. The second alternative would involve bundling other products or services around Gelato Natural S.A. products; the case does not suggest that services (other than delivery by motorcycle) are likely to be bundled around ice cream and/or other dessert products. As for moving from industrial products to consumer products, Gelato Natural S.A. is currently selling consumer products so this option is not relevant. The idea that the product could be converted to an

industrial product does appear to be a viable option which Gelato Natural S.A. could consider.

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THE FUSION ENERGY EXPERIMENTAL TOKAMAK SITE NEGOTIATION

J.R. Burruss, University of San Diego
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 international negotiation simulation exercise, derived from a specific setting adapted from a real situation, that tests the ability of students to overcome cultural and political obstacles while engaging in coalition building in order to structure an integrative and mutually beneficial agreement. The case is appropriate for upper division undergraduate students or graduate students, depending upon the depth with which the instructor wishes to explore the case and the instructor's comfort level with the issues included in the case. The negotiation exercise is designed to take about two to three hours (including the debrief), although more time may be spent on it. The case requires that students devote approximately one hour of preparation for the case, but this time can be spent outside class if necessary.

CASE SYNOPSIS

The Fusion Energy Experimental Tokamak ("FEET") Site Negotiation simulation is a multi-party and coalition building negotiation exercise. Inspired by the real-world negotiations surrounding the International Thermonuclear Experimental Reactor (ITER), this fascinating multi-party negotiation simulation provides outstanding lessons in coalition building, difficulties in maintaining coalitions, intercultural communication, real world politics and, of course, negotiation skills. The real-world ITER negotiations (pronounced "ee-ter", which is Latin for "the way") had their roots in a 1984 proposal by the Soviet Union seeking a method to harness nuclear fusion as an energy source. More specifically, the proposed ITER reactor would essentially be a gigantic vacuum vessel surrounded by super-conducting coils that magnetically confine hydrogen plasma in the shape of a doughnut. Once accomplished, the temperature of the plasma will then be increased to the point of igniting fusion, a method that scientists view as a credible first step to capturing fusion as a feasible commercial energy source.

Despite having had its genesis in 1984, the real-world negotiation involving ITER was not completed until June of 2005. Distilled to its essence, the ITER negotiation resulted in France being designated as the location for the reactor with Japan being granted the lead role in managing and *directing the effort. Accordingly, the research related jobs primarily will go to Japan, and the construction jobs will go to France. This real-world outcome – after such protracted negotiations spanning over 20 years – is provided for informational purpose only and is not at all suggestive of what should or should not happen when conducing the FEET simulation.*

FEET, while inspired by ITER, is nevertheless separate and distinct from ITER and, in fact, the outcome with the most possible points for ALL of the parties in the FEET simulation would be for the parties to agree to build two reactors. Interestingly, none of the six parties individually has the allocated resources to fund one FEET reactor, but collectively the six parties actually have the resources to fund two FEET reactors. Despite intense disagreement by the parties over where to build any FEET reactor, the parties nevertheless share a desire to fund FEET. Given that, no one party has enough money its budget to fund a FEET reactor on its own, the parties are required to negotiate over 1) where to locate the FEET reactor, and 2) how to apportion the cost.

While none of the parties knows for certain whether there are sufficient funds for two FEET reactors, if any one party withdraws from the negotiation it is certain that there will only be enough money for one FEET reactor. In addition to each party's primary motivation to fund at least one FEET reactor, each party has a secondary motive: For Russia it is to procure funding for a second FEET reactor, for all others it is to advance their preference for the site location.

Each party's tertiary goal is to minimize cost (i.e., to reduce its financial contribution to FEET). While this cost reduction motive may lead some parties to withdraw from the negotiations and let other parties bear the full financial burden of FEET, this is balanced by the risk of triggering a cancellation of FEET (which requires $15 Billion to fund) and the lost opportunity to influence the site location of FEET (or in the case of Russia, the funding of a second FEET reactor).

Given that the best outcome for ALL parties is to agree to build two reactors, the scoring component in this simulation operates less as a pie-expansion or trade-off mechanism and more as an incentive to prioritize. In addition to the specific prioritizing function of getting at least one reactor funded (if not two), the scoring component also provides a modest incentive for the participants to assume various cultural and political roles during the simulation. A remarkable phenomenon to observe during the simulation is how the secondary cultural and political components can overtake what should be the dominant objective of agreeing to fund at least one FEET reactor.

INSTRUCTORS' NOTES

Background

The Fusion Energy Experimental Tokamak ("FEET") Site Negotiation simulation is a multi-party and coalition building negotiation exercise. None of the six parties individually has the allocated resources to fund one FEET reactor, but collectively the six parties actually have the resources to fund two FEET reactors.

FEET is inspired by the real-world negotiation involving the International Thermonuclear Experimental Reactor ("ITER"), which involved the same six parties. ITER (pronounced "ee-ter", which is Latin for "the way") was suggested in 1984 by the former Soviet Union as a proposed method of harnessing nuclear fusion as an energy source. The concept behind ITER is to construct a gigantic vacuum vessel surrounded by super-conducting coils that magnetically confine hydrogen plasma in the shape of a doughnut. Once that is accomplished the temperature of the plasma will then be increased to the point of igniting fusion.

Despite having begun in 1986, the real-world negotiation involving ITER was not completed until June of 2005. (It is suggested that less time than that be used to conduct the FEET the simulation!) In real life, the ITER reactor costs were divided thus:

EU (host): 50%;
Other 5 parties: 10% each.

The foregoing distribution would correspond to the host in the FEET simulation paying $7.5 Billion and each of the other five participants paying $1.5 Billion. Interestingly, this real-life outcome is entirely possible in the fictional FEET case.

The proposed costs for the real-world ITER project are 10 billion Euro for the construction of ITER, its maintenance, and the research connected with it during its lifetime. It was at the June 2005 conference in Moscow that the six participating members of the ITER cooperation agreed on the funding contributions of 50% by the hosting member (the European Union) and 10% by each non-hosting member. Although Japan's contribution as a non-hosting member is only 10%, the EU agreed to grant it a special status so that Japan will provide for 20% of the research staff at Cadarache and be awarded 20% of the construction contracts, while the European Union staff and construction components contributions will be cut from 50 to 40%.

This real-world outcome – after such protracted discussions spanning almost 20 years – is provided for informational purpose only and is not at all suggestive of what should or should not happen when conducting the FEET simulation. FEET, while inspired by ITER, is nevertheless separate and distinct from ITER and, in fact, the outcome with the most possible points for ALL of the parties in the FEET simulation would be for the parties to agree to build two reactors.

Despite the parties' differing views regarding the various site locations, the parties are nevertheless motivated to come together by a common desire to generate enough funding to launch the FEET reactor project. As indicated, no one party has enough money in its budget to fund construction of a FEET reactor on its own, leaving 1) where to locate the FEET reactor, and 2) how to apportion the cost as the main points of contention.

Also as indicated, it is possible to fund two FEET reactors – there is $32 Billion at the table, $2 Billion more than is needed for two FEET reactors. If, however, any party withdraws from the negotiation there will only be enough money for one FEET reactor. In addition to each party's primary motivation to fund at least one FEET reactor, each party has a secondary motive: For Russia it is to procure funding for a second FEET reactor, for all others it is to advance their preference for the site location.

Each party's tertiary goal is to minimize cost (i.e., to reduce its financial contribution to FEET). While this cost reduction motive may lead some parties to withdraw from the negotiations and let other parties bear the full financial burden of FEET, this is balanced by the risk of triggering a cancellation of FEET (which requires $15 Billion to fund) and the lost opportunity to influence the site location of FEET (or in the case of Russia, the funding of a second FEET reactor).

Given that the best outcome for ALL parties is to agree to build two reactors, the scoring component in this simulation operates less as a pie-expansion or trade-off mechanism and more as an incentive to prioritize. In addition to the specific prioritizing function of getting at least one reactor funded (if not two), the scoring component also provides a modest incentive for the participants to assume various cultural and political roles during the simulation. A remarkable phenomenon to observe during the simulation is how the secondary cultural and political components (from a point value standpoint) can overtake what should be the dominant objective of agreeing to fund at least one reactor, let alone two reactors.

The take-aways from this exercise are many. A main objective is to expose the student to the many dimensions of multi-party negotiations. A multi-party negotiation is one in which a group of three or more individuals, each representing their own interests, attempt to resolve their actual and/or perceived differences (Thompson, 2004). In multi-party negotiations, issues of process abound as coalitions form and social interactions become more complex. Trade-offs are more difficult. There are problems of voting and majority rule, as well as communication breakdowns.

A coalition is formed when two or more individuals from the multi-party negotiation combine their resources to affect the outcome (Thompson, 2004). Coalitions are a vehicle for otherwise weak members to get a greater share of the resources. Ironically, the members of the coalition also compete with each other regarding allocation of any share the coalition obtains.

Another problem to be dealt with in multi-party negotiations is that it is more difficult to obtain trade-offs. Students should learn to achieve trade-offs in multi-party negotiations through circular logrolling and reciprocal trade-offs. In circular logrolling, each member must offer a concession on one issue and receive a concession from another member on a different issue. Reciprocal trade-offs are when two members of the larger group directly engage in trade-offs (Thompson, 2004).

A problem that tends to arise in multi-party negotiations is the desire of group members to simplify the negotiation by instituting voting and/or decision rules. These types of rules can result in less effective outcomes in terms of pie-expansion. For example, some of the group members may decide to institute majority rule. Such voting completely ignores individual preferences, regardless of how strong a member may feel about the particular issue being voted on (Thompson, 2004). Accordingly, there is no integrative trade-off among issues.

Another problem with majority rule is the condorcet paradox, in which who wins a majority rule election will change depending upon the order in which various alternatives are proposed (Thompson, 2004). An alternative presented later in the voting is more likely to survive. A negotiator well versed in the condorcet paradox could arrange to have his or her preferences voted on in the latter stages of sequential voting. Strategic voting may also occur. This is when a group member strategically misrepresents his or her preference so that a preferred option is more likely to be favored by the group. An example would be when a group member votes for his or her least preferred option to ensure that a potentially more competitive second choice option is eliminated.

Other groups may institute a unanimity rule. Though time-consuming, outcomes are often more efficient than with groups using the majority rule (Thompson, 2004). Members must consider ways to satisfy the interests of the other members of the group. This can result in more creative outcomes. Absent unanimity, parties may make consensus decisions. These require everyone to consent before an agreement becomes binding, however, unanimity may not exist. This is because while the parties must publicly agree to a particular settlement option, their private views may be in conflict. Multi-party negotiations that use consensus decision making often result in compromise, with the lowest common denominator becoming the agreed upon option (Thompson, 2004).

Finally, multi-party negotiations sometimes involve breakdowns in communication. Participants may fail to send a message that needs to be sent, an inaccurate message may be sent, or a message may be sent but not received. All parties need to listen to one another and any misunderstandings need to be cleared up immediately. Sometimes, in an effort to prevent miscommunication, parties may break up into smaller groups and privately caucus. This is unfortunate because if the parties are able to maintain communication with the larger group there is a greater likelihood of increased profitability and more equal distribution among the group members (Thompson, 2004).

Multi-party negotiations, like other negotiations, may fall prey to typical miscommunications. People hear what they want to hear, interpret things in ways that are favorable to them, and ignore information that does not support their position. Moreover, most people are not very skilled in seeing the other party's perspective. When one party has information that the other party is unaware of, that party nonetheless acts as if the other party is aware of the information. This is known as the curse of knowledge (Thompson, 2004).

The goal of this negotiation exercise is for the parties to experience a multi-party negotiation, analyze what happened during the exercise, and through the debrief with the instructor understand what happened. More importantly, by recognizing classic errors in negotiation performance, process, and communication, it is hoped that the student will leave with a better understanding of how to increase one's likelihood of success in multi-party negotiations.

Running the Simulation and Scoring the Results

With six parties to the negotiation, it is recommended that each party be represented by one or two people (two seems to work very well). If only one party is represented by a second negotiator, it works well for the E.U. to be that party so, for example, one E.U. representative could serve as chair and would abstain from making (or seconding) motions or voting, while the other could serve as a voting, motion-making member. [NOTE: Such a distinction in the E.U. roles if there are seven participants is merely a suggestion.] If only 5 participants are available, remove Russia (say, for example, that Russia withdrew from the negotiations.) For 8 or more, consider assigning multiple negotiators for each party, but each party must still be restricted to a single vote and should not second its own motions.

Each party is provided with 1) a specific Role sheet, 2) a specific Negotiation Style sheet 3) an identical General Information sheet, and 4) the same Rules of Order sheet. (As an aside, the Rules of Order sheet provides a nice summary of, or in some cases, a brief introduction to basic rules surrounding how formal meetings are often run.)

The simulation is designed to take place over three “days”. The facilitator is free to determine how long each “day” is to last, but a “day” should be a minimum of 15 minutes – and considerably longer if time allows. While the meetings are in session, the parties are not free to leave the table and privately caucus. After the first and second “day”, the parties should be given a timed break (5 to 10 minutes) during which they can 1) withdraw from the negotiation, 2) refuse to speak to anyone, or 3) privately caucus. To the extent private caucusing takes place, this could be a fertile topic of discussion during the debriefing session. More specifically, it should be interesting to hear various perspectives on how or whether any private caucusing that occurred advanced or impeded the negotiation.

At the outset of the simulation, certain patterns are likely to occur. Japan and Korea form a natural coalition. The U.S. and the E.U. take positions for Spain and France, respectively. China is opposed to Japan, but otherwise uncommitted. Wanting two FEET reactors, Russia is neutral with respect to the site selected for a second FEET reactor, but demands that the first FEET reactor be in Russia. Each party has a very poor BATNA (Best Alternative to a Negotiated Agreement), and is eager to reach an agreement.

[NOTE on 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, et al. (1991), Thompson, 2004).]

BATNAs (before cultural points)	
U.S.	40
Japan	15
Korea	15
E.U.	40
Russia	15
China	65
TOTAL	190 (exclusive of cultural points)

The Biggest Possible Pie: The highest possible score (exclusive of cultural points) is achieved when all parties agree to fund FEET reactors in both Japan and France, and to apportion the cost so that the leftover $2 Billion is kept by Russia, China, and Korea. This is an unlikely outcome, however.

U.S.	100
Japan	150
Korea	150-190
E.U.	150
Russia	130-170
China	100-140
TOTAL	820 (exclusive of cultural points)

Biggest Reasonable Pie: After three days of coalition building, Japan and Korea convince the U.S. to join together to fund a FEET reactor in Japan. China and Russia join with the E.U. to a second FEET reactor, thus increasing their scores.

U.S.	100-120
Japan	150-160
Korea	150-190
E.U.	150
Russia	130
China	100
TOTAL	790-820 (exclusive of cultural points)

U.S. Power Play: The U.S. joins the Japanese coalition. The U.S. persuades China to join the Japanese coalition, thus blocking the French site. China is better off since they can now obtain a higher financial contribution score. Russia and E.U. join because they can make minimal financial contributions and improve their scores.

U.S.	105-145
Japan	130-170
Korea	130-170
E.U.	105-145
Russia	80-120
China	120
TOTAL	745-825* (exclusive of cultural points)
*Maximum score in this range is unlikely	

For large groups of people, it is also recommended that each party have assigned to it at least one person acting as a formal observer. Any such formal observer should be given 1) all of the information provided to the specific party being observed, and 2) a Score Sheet (see “Scoring Guide,” earlier in this paper) with the understanding that all observers are expected to score the party he or she is assigned to and to contribute significantly to the debriefing process. Such a format has the virtue of actively engaging those who are not directly negotiating in the simulation.

Observers should use the score sheet that follows (provided separately to each observer) to assist in totaling the negotiation score. For items with * (an asterisk), see notes below.

The Political Component

The political component integrated into the simulation not only adds interest, but also has a basis in reality from the real-world ITER negotiations concluded in June of 2005. Consider the following excerpt from an article in The Economist that appeared shortly after agreement was reached:

ITER is a joint project between America, most of the European Union, Japan, China, Russia and South Korea. For the past 18 months, work was at a standstill while the member states wrangled over where to site the reactor in what was generally recognized as a proxy for the debate over the war in Iraq. America was thought to support the placing of ITER in Japan in return for Japan’s support in that war. Meanwhile, the Russians and Chinese were supporting France, which, like them, opposed the American-led invasion. That France was eventually chosen owes much to the fact that the European Union promised to support a suitable Japanese candidate as the next director general of ITER. (*Nuclear ambition*, The Economist, June 30, 2005)

Conclusion

The real-world tension integrated into the FEET simulation is very much appreciated by the participants, who tend to do an admirable job of animating various political motivations. The FEET simulation has been run very successfully with U.S. military officers and Intelligence officials, who seem particularly adept in understanding the political nuances. Regardless of the background of the participants, however, the FEET simulation plays out extremely well and provides everyone with an interesting and engaging educational experience. The real-world nature of the FEET simulation – derived straight from the headlines – creates a context rich in learning opportunities with respect to dealing with multiple parties, building coalitions, maintaining coalitions, managing intercultural communications, contending with political biases and, of course, cultivating negotiation skills. Accordingly, the simulation provides no shortage of topics to discuss and explore during the post-negotiation debriefing analysis.

NEGOTIATION TERMS (FOR INSTRUCTOR'S USE IN DEBRIEF)

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, et al. (1991), Thompson, 2004).

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).

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).

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PUT A LEADER ON THAT HORSE (ASSOCIATION)

LaVon Green, Purdue University Calumet
Susan E. Conners, Purdue University Calumet
Sherry Green, Purdue University Calumet
Michael Mick, Purdue University Calumet

CASE DESCRIPTION

The primary subject matter of this case involves the strategic direction of a not-for-profit equine breed association. Additional issues are organization structure, leadership, and financial stability. The case has a difficulty level of one, appropriate for freshman level courses. The case is designed for one class session and will require about two hours outside preparation.

CASE SYNOPSIS

The Arabian Horse Association is responsible for the breed registry, membership, marketing and promotion, and member programs for Arabian and Half-Arabian horses in the United States. The growth of the organization resulted in poor financial planning and no long term strategic plan to guide the organization.

INSTRUCTORS' NOTES

This case provides an example of a non-profit organization in a specialized industry. While not a "for profit" organization, it still requires strategic planning and management to be successful. This case raises the important issue of developing a viable strategy for a not-for-profit organization. This case is best suited for an introductory undergraduate course in business that addresses strategic planning and management. The degree of difficulty is 'easy'. The case can be used for a group assignment, individual homework, or class discussion. Additional research can be conducted to expand the discussion questions, but the students can complete the assigned questions without additional information.

The web site of the Arabian Horse Association is http://www.arabianhorses.org . If students need help navigating the site, direct them to select the Market Development option. Here they will find the mission statement and objectives of the AHA. In addition, the MDP 2005 Year-In-Review Convention Presentation offers information regarding the significant changes made in the organization.

A related web site for the Quarter Horse Association is http://AQHA.org . This web site provides a comparison to that of the AHA. The mission statement and details of this organization are easily found by clicking The Association link, then clicking the Who We Are tab on the menu bar of The Association web page, and then selecting the appropriate option from the corresponding drop-down menu. The ease of navigation of this site points out the need for a revision to the site of the AHA.

DISCUSSION QUESTIONS

1. What one aspect of strategic planning was the most beneficial to this organization and its restructuring? Explain how it helped them.

The most significant aspect of strategic planning was recognizing the need to have a plan. This resulted in the following changes:

- ♦ Following best practices to establish a new structure that included staffing the positions with professionals in information systems, marketing, and finance.
- ♦ Improving information systems most likely generated improvements in registration information, tracking Breeders Sweepstakes information, and the maintenance of the web site.
- ♦ Conducting market research to determine the appropriate client base allowed the organization to increase membership from its previous decline.
- ♦ Establishing best practices in finance allowed the organization to generate revenue to become solvent. The Breeders Sweepstakes is no longer running at a loss.

2. Evaluate the benefits and pitfalls of this rapid restructure.

The benefits of combining the Arabian Horse Registry and the International Arabian Horse Association into the Arabian Horse Association are:

- ♦ The most significant benefit of the restructure was the awareness of the lack of a strategic plan and the effort of the organization to correct that situation at the request of its members.
- ♦ The new organization can operate more efficiently by eliminating the redundancy of activities in the two organizations.
- ♦ The promotion of the Arabian horse through two organizations must have been confusing to prospective buyers. An individual trying to decide between the purchase of an Arabian versus a half-Arabian previously would have had to deal with two

competing organizations. Now a prospective owner can be advised through experts in one organization by pointing out the differences of the two types of breeds.

The pitfalls of this rapid restructure were:

- ♦ There was probably membership loss due to member loyalty to the former organizations. Explaining the reasons for the change could have convinced members to make the change to the new organization.
- ♦ Explaining the restructure and establishing new connections to other equestrian organizations and publications must have taken a massive effort and must have caused major confusion for a short time.

3. What suggestions would you make to the Arabian Horse Association for future strategic planning?

The most significant area of strategic planning as indicated by the mission statement is the promotion of the breed to prospective owners. Setting goals for growth in number of members will have the most positive impact on the organization. Improving communications on the web site to make it more user-friendly can provide the promotional material that will attract new members. This is where comparison to the American Quarter Horse Association would be most helpful as it is the largest breed in the United States.

4. What would you have done with this organization to correct the situation after the merger?

The market study began with the membership and then expanded to identify successful strategies used by other equine breed associations. The membership study included researching how people used their horses for show or pleasure and how many of them were still breeding their horses.

This organization had never used traditional strategic planning methods in the past. The new leadership undertook basic strategic planning methods and formulated a plan for the next 5 years and presented it to the membership. The new plan included bringing in new professional people to address issues like marketing and information systems as part of the permanent staff. These methods were already in use by other successful breed associations. Their market study of the membership revealed that the majority of the membership did not show their horses at horse shows. This was a major departure from the thinking of the past that horse shows were the most important issue for the association.

THE STITCH HOUSE: A CASE OF ENTREPRENEURIAL FAILURE

Karl F. Kampschroeder, St. Edward's University
Nancy Ludwig, Valero Energy Corporation
Mary Ann Murray, St. Mary's University
Prasad Padmanabhan, St. Mary's University

CASE DESCRIPTION

This case concerns why entrepreneurs fail. Issues related to the case include how entrepreneurs make decisions, the marketing, financial, and accounting issues that should be considered when starting a new business. A secondary issue illustrated by the case is the risks involved in mixing business and personal finances in a start-up business. This case has a difficulty level of three. However, it may be used, with time allowed to develop alternate scenarios of the business owner's choices, in both senior and first-year graduate courses. The case is designed to be taught in one 75 – 90 minute class session and is expected to require one to two hours of outside preparation. Alternatively, an instructor may elect to use this case to challenge advanced students to create a business plan that would have a greater likelihood of success. For such use, the case may require up to 5-6 hours of outside preparation. Additionally, a shortened version of this case has been used effectively as an examination case in a senior-level Entrepreneurship course.

CASE SYNOPSIS

Why did The Stitch House fail so quickly? Louise had business experience, adequate start-up capital, and people with experience in marketing her product. But, in less than six months time what seemed like a certain success consumed her capital, was abandoned by her erstwhile partners, and left her with substantial personal debt. This case gives students the opportunity to learn from one of the majority of new small business startups – those which fail in less than two years. Based on an actual entrepreneurial situation, the case illustrates the impact that each decision an entrepreneur makes may have on the ultimate survival of the business and how easily a new business can fail. It presents students with the opportunity to analyze the basic decisions that an entrepreneur must make in creating a new business. Alternatively, advanced students may be challenged to re-construct the business concept and create a business plan for The Stitch House.

INSTRUCTORS' NOTES

Recommendations for Teaching Aproaches

The authors recommend two possible approaches to using this case in a course. The first focuses on analyzing the decisions that the entrepreneur made during the process of forming and starting up the business. The second approach focuses on analyzing the market and formulating a business plan using the information provided.

A Decision-making Approach to the Case

For use in a single 75 – 90 minute class session, use of the case may focus on exploring and analyzing the decisions that may have contributed to the ultimate failure of the business. We suggest the following structure for management of the discussion:

- ➤ 10-15 minutes – free-form student discussion of what went right and what went wrong in the business;
- ➤ 15 minutes – list each decision that Louise made;
- ➤ 30-45 minutes – go through the list of decisions Louise made and critically evaluate each one; analyze her presumed motive for deciding as she did and the effect this decision had on the conduct of the business;
- ➤ 15 minutes – wrap-up.

If this approach is followed, students should be expected to list the following specific decisions the entrepreneur made in the course of establishing and operating her business:

1. She decided to start a new business, in a field in which she had no experience, based on personal contacts and weak information. She also did not do adequate research on the business background of her partners.
2. The initial market (thread bobbin supplies) targeted was changed with little examination of the risks inherent in the new market (embroidered goods).
3. The business was established as a sole proprietorship, thereby making Louise personally liable for any debts of the business.

4. She made two other people "partners" using a self-written contract. However, although they were partners, Louise seemed to most of the work and kept total control of the decision-making process when setting up the business. While one might wonder what the partners were doing, it appears that they were standing by – waiting for Louise to give them direction.

5. Production equipment was selected without considering how its capacity might limit sales volume and, it appears, without consulting either partner, both of whom had experience in the industry.

6. Funds were spent on advertising and setting up a website, although Robert seemed to base his expectations for success on personal selling.

7. She spent funds to "do things the right way" without considering the impact on the cost structure of the business.

DISCUSSION AND ANALYSIS

Students should be encouraged to discuss and critically analyze each of the above decisions and its effect on the business. Three specific questions can then be used to guide further discussion.

1. Using Michael Porter's model of the five forces that shape an industry, describe the structure of the embroidered products industry, specifically the portion of the industry that The Stitch House (TSH) sought to compete in.

TSH faces intense rivalry with 60 local competitors of all sizes currently listed in the San Antonio Yellow Pages directory (2005 edition). There are few suppliers so there is little opportunity to bargain for lower prices on inputs but there are also many small buyers. Inter-firm rivalry enables even small buyers to bargain with competing firms to drive down prices. It also appears that there are very low barriers to entry into the business. At the same time, consumers may elect, in many applications, to substitute lower-cost screen printed apparel for embroidered apparel.

2. Is there one decision that Louise made which, more than the others, contributed to the current failure of the business?

It appears to the authors that the most critical decision Louise made – once she decided to start the business – was in the selection of production equipment. The equipment selection severely limited production capacity and, therefore, the types of business The Stitch House could pursue and its ability to compete. Some argument can be made to the effect that the lackadaisical manner in which she selected her business partners contributed to the failure of the business.

3. Do you think this business can be salvaged or not?

Making some crude assumptions, we could say that TSH's contribution margin is $5.00 per blanket (selling price minus $4.00 raw material + assumed $1.00 variable labor cost). With fixed expenses of $1635/month (rent has been eliminated by moving operations to Louise's house), the business needs to sell 327 pieces per month, or 82 pieces per week just to break even. This is within their production capacity, but profits will are likely to be very low. The real question may well be whether or not they can get orders for this much product without Robert. Reduction of expenses such as advertising and general office expenses, and stretching out the Visa payments will further reduce the breakeven quantity. It is, however, optimistic to expect the business to generate much profit given the production constraint.

A MARKET ANALYSIS/BUSINESS PLAN APPROACH

This approach is most appropriate for use with senior or first-year graduate students and may be used in conjunction with the questions in the previous section. Using the approach, instructors will find it most convenient to introduce the case in one class session and assign the analysis or business plan as a written assignment or presentation for a subsequent class session.

First, instruct students to analyze the market the business proposes to serve, based on the planned main product: embroidered baby blankets. Students should develop a definition of the target market and an estimate of the market size. Census data at http://www.census.gov for San Antonio (Bexar County, Texas) should be used to estimate the number of babies in the market area. Geodemographic lifestyle data based on PRIZM segmentation profiles, which may be found on the Claritas Corporation website, http://www/claritas.com, may also be useful. Instructors should note, however, that the PRIZM data is compiled by zip code; so students should survey a number of zip codes to gain understanding of the San Antonio market. In the analysis, students should be encouraged to be creative in assessing the market and the behavior of buyers. While the financial aspects of the business are important, in this phase of the assignment, students should be encouraged to focus on the potential buyers of the product and potential demand. A good analysis will include: 1) a profile of potential buyers and the buying occasion, 2) an estimate of the potential market demand, 3) a description of how the product may be marketed and the marketing channels used, and 4) a pro-forma breakeven analysis.

Second, students should attempt to develop a business plan for the next twelve months of operations. Using the data given in the case, and the information developed in the market analysis, the business plan should map the operations, marketing, and projected financial of the business. Depending on the organization of the course, instructors may specify different levels of detail in the plan. At a minimum, the plan should describe the production process, state the plans' assumption about production quantities, and project production costs. It should then describe the marketing channels for the product and estimate unit volume and marketing expenses. Finally, the business plan should project the financial results from the planed operations and marketing activities. While the plan itself is important, of equal importance in teaching entrepreneurship is the process of developing the business plan for The Stitch House. The process should be used to illustrate the problems – many unforeseen by Louise – of creating a successful small entrepreneurial business.

CENTRAL CITY MAKES A PROMOTION – PART A

Steven C. Palmer, Eastern New Mexico University
Lee Weyant, Kutztown University of Pennsylvania
George W. McNary, Creighton University

CASE DESCRIPTION

The primary subject matter of this case concerns the alleged discriminatory promotion practices within a governmental agency. Secondary issues examined include the development and application of affirmative action plans affecting several protected classes. The case has a difficulty level of four, appropriate for senior level. The case is designed to be taught in three class hours and is expected to require three hours of outside preparation by students.

CASE SYNOPSIS

Are Affirmative Action Plans meaningful guidelines to employment decisions? Or, are these plans merely an exercise in satisfying legislative directives? The Central City Police Department faces these questions concerning their recent promotion list to sergeant. Specifically, what is the department's justification for not promoting the individual with the second highest score on the promotion test? How can an individual with excellent performance evaluations and a clean discipline record not be promoted? Could it be the individual is a woman?

This case explores the integration of minorities into a predominately white male work environment. For example, the organization as a whole (i.e., city government) has developed affirmative action plans for over a decade. Only in the last several years has the branch level (i.e., police department) developed separate goals addressing their specific operation. Branch managerial decisions over the years did not eliminate discriminatory practices. In fact, branch management faced separate lawsuits from African American and then Hispanic employees over employment discrimination issues based on race. Now, branch management faces the integration of a new protected class within the workforce. Will they follow their previous managerial behavior?

[NOTE: This case is a fictionalized version of a real-life situation. Names and other potentially identifying information have been changed to protect identities. The applicable fact situation is true to the real case.]

INSTRUCTORS' NOTES

Objectives

This case can be used in a variety of undergraduate classes. The authors believe that it fits into any of the following courses: Principles of Management, Human Resource Management, Business Ethics, Business Law and Employment Law. The analysis of the case can be from a managerial or a legal perspective. The case has also been successfully used in an Organizational Communication class.

Depending on the class the teaching objectives will vary. Therefore, we are setting forth the objectives from a managerial and a legal viewpoint.

The teaching objectives if the case is being used in a Management class are:

1. Students should be able to summarize the purposes of an Affirmative Action Plan (AAP).
2. Students should be able to conduct a training needs analysis.
3. Students should understand the necessity of establishing thorough policies and procedures in an organization.

If this case is being used in a law class, the teaching objectives are:

1. Students should be able to identify the elements of a prima facie case of employment discrimination.
2. Students should be able to understand and apply the 4/5ths or 80% rule in evaluating a fact situation.
3. Students should be able to review a fact situation and recognize red flags regarding employment discrimination issues.

MANAGERIAL ISSUES PRESENTED

1. **What is the purpose of an Affirmative Action Plan (AAP)? Is this a regulatory document prescribed to address past actions? Is this a document that guides recruitment and promotion opportunities? Only senior management can develop the answer to these questions. Organizational communication of their "true" answer will be seen by employees not through bulletin board, or policy statements, but through managerial actions. That is, what role will social learning theory play in the implementation of a company's AAP?**

Organizations operate through the application of some level of human capital performing the jobs of the company. Each job requires a specific level of knowledge, skills, and abilities (KSAs) for successful performance. Management, therefore, is tasked with determining the needs of the organization and having the appropriate human resources to perform the job requirements. One approach to this problem is for management to conduct a training needs assessment, or analysis. This assessment will provide management with information from three perspectives – the organization, the task, and the individual. The organizational analysis provides the macro view by looking at the business strategy and the resources available to support training activities. Task analysis is the micro perspective. This assessment focuses on the specifics of the job. Finally, the needs assessment must address the talents of the individual hired to perform the job.

The issues that arise from the lack of proper policies and procedures quickly become apparent in this case. The city lacks a formalized procedure for the referral of names. Instead, the policies that are in place are not written to cover foreseeable and common situations. The modifying of policy is not consistent nor is it done in a formal manner. Of course this will create situations, as the one in this case, that may lead to legal problems for the organization.

LEGAL ISSUES PRESENTED

Prima Facie Case

In employment discrimination cases, the United States Supreme Court [*McDonnell Douglas Corp. v. Green*, 411 U.S. 792 (1973)] set forth the requirements for the establishment of a prima facie case in employment discrimination cases. The elements are: (1) the plaintiff is a member of a protected class; (2) the plaintiff applied and was qualified for the position; (3) the plaintiff, despite being qualified, was not hired; and (4) after plaintiff's rejection the position remained open and the employer sought others with the plaintiff's qualifications.

Disparate treatment/disparate impact

Under law there are two theoretical bases for Title VII legal actions, disparate treatment and disparate impact. Disparate treatment occurs when there is evidence that the discriminatory act was an intentional act based on race, color, sex, national origin or religion on the part of the employer. Under the theory of disparate impact, the discriminatory act was the result of a facially-neutral policy that has an adverse impact on members of a protected class. Statistics are frequently used in establishing disparate impact. The four-fifths rule (sometimes called the 80% rule) is frequently used as the preliminary tool to determine disparate impact. Under this rule, it is expected that members of protected classes will have a success rate that is at least 80% of the majority's success rate on selection devices. If the success rate is less than 80%, then the employer must show that the selection device was relevant to the requirements of the position and that the there was no other devise that could be used to measure, as accurately, the applicants' performance that has a less adverse impact on members of the protected class.

Defenses

There are several defenses that an employer can raise in employment discrimination cases. The first defense available is a legitimate, nondiscriminatory reason for the employment decision. The plaintiff can counter this defense if he/she can show that the reason was actually pretext. Another defense is that there is a bona fide occupational qualification (BFOQ) that requires the discriminatory act. Race and color can never be a BFOQ under Title VII. In defense of a claim of disparate impact the employer may argue business necessity. This argument maintains that the policy was a business necessity thus making the policy a legitimate requirement of the job. Employers may also avoid liability under disparate impact even if a particular selection device is discriminatory if the overall process is not. Of course the employer may also prove that the plaintiff's evidence is not truthful or is inaccurate.

MANAGERIAL QUESTIONS

1. **What actions should the city police department management implement to meet the goals for recruitment and promotion of women as outlined in the AAP?**

   Divide the class into groups to develop specific action plans. One group of students will be assigned the responsibility to focus on recruitment; the other will focus on promotion. Each group must develop specific action plans. For example, the recruitment group must identify how they would recruit more females for the police force. They should develop specific marketing items such as newspaper, radio, and television advertisements.

2. **Does this situation provide evidence of any managerial training needs?**

   a. Divide the class into three groups. Give each group a marker and several pieces of self-adhesive flip chart paper. Assign one group to conduct an Organizational Analysis, one group a Task Analysis, and one group an Individual Analysis. Give each group 20 minutes to focus on their particular assignment. After 20 minutes have each group post their results. Using these visuals the class should begin a discussion of the items requiring training intervention. Each student should choose one item requiring a training intervention and write a learning objective for that specific issue.

b. For a web-based activity, divide the class into three groups - Organizational Analysis, Task Analysis, Individual Analysis. Assuming the course management system has the capability, create a group discussion board (group presentation area, or group chat room) for the various work groups. Each group will prepare a one page document listing their results to the class Discussion Board (or Chat Room) for this assignment. Students should be engaged in a discussion concerning which items require a training intervention. After this discussion students should choose one item requiring a training intervention and write a learning objective for that specific issue. These objectives should be uploaded to the class Discussion Board for further discussion.

LEGAL QUESTIONS

1. Can the plaintiff establish a prima facie case of employment discrimination? Explain.

In order to establish a prima facie case, Jones must show that (1) she is a member of a protected class; (2) she applied and was qualified for the position; (3) despite being qualified, she was not promoted; and (4) after her rejection the position remained open and the employer sought others with the plaintiff's qualifications. The first element is not difficult to show. Jones is female and therefore is a member of a protected class. She clearly applied and was qualified for the position; otherwise, her name would not have been on the eligibility list. Jones was not even a finalist in the consideration for either promotion, much less promoted. Therefore, the third element of the prima facie case can be shown. The final element is a little more difficult. However, since her name was not referred and the city did continue to seek qualified people for promotion after rejecting Jones, it appears that the fourth element can be proven.

2. If you were the attorney for Mary Jones what theoretical bases of discrimination would you argue in court? Explain.

An argument can actually be made that both theories of discrimination, disparate treatment and disparate impact, can be successfully asserted. In this case, the disparate treatment argument is not as strong as the disparate impact argument. Disparate treatment is intentional discrimination against a person because they are a member of a protected class. The decision was made that no woman would be promoted by the decision to only refer the names of the black candidates. Likewise, the decision not to apply the affirmative action in regard to women but to do so for all other protected classes is another example of a specific act that discriminated against women.

However, the case for disparate impact may be stronger. Over the three periods of time identified by affirmative action plans, the testing process has always resulted in a success rate for women of less than 80% of the success rate of men. In two of the three time periods the hiring rate for women was less than 80% of the hiring rate for men. In fact under the current plan the hiring rate for women is 20% that of men.

3. If you were the attorney for Central City what defense(s) would you argue? Explain.

As the attorney for the city I would argue that there was a legitimate, non-discriminatory reason for the hiring decision. The city was under a federal court order to promote black police officers to the rank of sergeant. At the time of the promotions the city was two black sergeants short of the goal. By promoting only black police officers, the city would attain the hiring goal for sergeants. Court orders take precedence over the city's affirmative action plan. Further it was only coincidental that the decision to refer only the names of black officers resulted in only males being referred. Had there been female black police officers on the list, their name(s) would have been referred.

Further, the change in determining affirmative action goals at the rank of sergeant was a business necessity to more accurately reflect the current situation. Because the percentage of female police officers eligible for promotion to sergeant was significantly less than 22%, such a goal is not realistic.

4. If you were the judge, how would you decide this case? Explain your decision.

(The students' answers to this question will vary.)

EPILOGUE

Although this case has been fictionalized to protect the identities of the people involved, Central City Makes a Promotion – Part A is based on a true story. Below is a summary of what happened in the real-life case.

Mary Jones' attorney filed a lawsuit on her behalf when the state court opened on promotion day. Among other relief, she sought a temporary restraining order and a preliminary injunction preventing any promotions to sergeant unless she was also promoted. The state judge assigned the case, after a brief hearing involving the attorneys for both sides, issued a temporary restraining order and set a hearing for a preliminary injunction. At the hearing Jones' attorney suggested that the city be allowed to promote Williams because he was first on the list. The judge agreed and entered a temporary restraining order prohibiting any promotions to sergeant, except for Williams, unless Jones was promoted to sergeant. The judged also order the city to turn over volumes of documents requested by Jones' attorney. The matter was set for hearing on the preliminary injunction.

The day before the hearing on the preliminary injunction the city removed the case to the federal court. The federal judge maintained the temporary restraining order until a hearing on the preliminary injunction could be held about a month later. After a three-day evidentiary ruling, in his ruling on the motion for preliminary injunction the federal judge wrote that there was substantial evidence that Jones had been discriminated against. However, the judge denied the preliminary injunction and extinguished the temporary restraining order because Jones could not demonstrate irreparable harm and the city assured the judge that Jones would be promoted immediately after the order was extinguished because another vacancy at sergeant had occurred.

Once the judge ended the temporary restraining order, Jones and White were promoted to sergeant. The city backdated White's promotion so he would have seniority over Jones.

After considerable discovery (interrogatories, depositions and requests for production) by both sides, the parties started serious settlement negotiations. Ultimately, the case was settled three years later without trial. Jones was promoted to lieutenant as part of the settlement. White was still a sergeant so the seniority issue no longer existed.

CENTRAL CITY MAKES A PROMOTION – PART B

Steven C. Palmer, Eastern New Mexico University
Lee Weyant, Kutztown University of Pennsylvania
George W. McNary, Creighton University

CASE DESCRIPTION

The primary subject matter of this case concerns the alleged discriminatory employment practices within a governmental agency. Secondary issues examined include the development and application of affirmative action plans affecting several protected classes and management policies to insure equal employment opportunity. The case has a difficulty level of four, appropriate for upper level undergraduate and graduate students. The case is designed to be taught in three class hours and is expected to require three hours of outside preparation by students.

CASE SYNOPSIS

Are Affirmative Action Plans meaningful guidelines to employment decisions? Or, are these plans merely an exercise in satisfying legislative directives? What is an equal opportunity employment environment? The Central City Police Department faces these questions concerning their recent employment practices. More specifically, what is the department's justification for not promoting the individual with the second highest score on the promotion test? How can an employee with excellent performance evaluations and a clean discipline record not be promoted? Could it be that the individual was a woman? Does the work environment penalize women? Finally, are supervisors and employees appropriately trained and supervised regarding employment discrimination issues?

This case explores the integration of women into a predominately white male work environment. For example, the organization as a whole (i.e., city government) has developed affirmative action plans for over a decade. Only in the last several years has the branch level (i.e., police department) developed separate goals addressing their specific operation. Branch managerial decisions over the years did not eliminate discriminatory practices. In fact, branch management faced separate lawsuits from African American and then Hispanic employees over employment discrimination issues based on race. Now, branch management faces the integration of an additional protected class within the workforce. Will they follow their previous managerial behavior?

[NOTE: This case is a fictionalized version of a real-life situation. Names and other potentially identifying information have been changed to protect identities. The applicable fact situation is true to the real case.]

INSTRUCTORS' NOTES

Objectives

This case can be used in a variety of undergraduate and graduate classes. The authors believe that it fits into any of the following courses: Principles of Management, Human Resource Management, Business Ethics, Business Law and Employment Law. The analysis of the case can be from a managerial or a legal perspective. The case has also been successfully used in an Organizational Communications class.

The learning objectives for this case are:

1. Students should be able to summarize the purposes of an Affirmative Action Plan (AAP).
2. Students should be able to summarize the necessity for employment discrimination policies and procedures within an organization.
3. Students should be able to analyze a situation for disparate impact and a disparate treatment employment discrimination practices.
4. Students should be able to apply the 4/5ths or 80% rule in evaluating a fact situation.
5. Students should be able to synthesize managerial alternatives to alleviate employment discrimination within the workplace.

RESOURCES AVAILABLE

Students may find the following U.S. Department of Labor and the U.S. Department of Justice resources on affirmative action and equal employment opportunity useful:

http://www.dol.gov/esa/regs/compliance/ofccp/pdf/sampleaap.pdf

http://www.eeoc.gov/

ISSUES PRESENTED

What is the purpose of an Affirmative Action Plan (AAP)? Is this a regulatory document prescribed to address past actions? Is this a document that guides recruitment and promotion opportunities? Should this document provide guidance in any other areas of employment? Only senior management can develop the answer to these questions. Organizational communication of their "true" answer will be seen by employees not through bulletin board, or policy statements, but through managerial actions. That is, what role will social learning theory play in the implementation of a company's AAP?

The issues that arise from the lack of proper policies and procedures quickly become apparent in this case. The city lacks a formalized procedure for assignment of officers to particular duties or light duty assignments. The city also appears to lack a definitive process for handling complaints of possible illegal discrimination. The city's promotion practices do not reflect the goals established in its affirmative action policy. Instead, the policies that are in place are not written to cover foreseeable and common situations. The modifying of policy is not consistent nor is it done in a formal manner. Of course this will create situations, as the one in this case, that may lead to legal problems for the organization.

Prima Facie Case

In employment discrimination cases, the United States Supreme Court [*McDonnell Douglas Corp. v. Green*, 411 U.S. 792 (1973)] set forth the requirements for the establishment of a prima facie case in employment discrimination cases. The elements are: (1) the plaintiff is a member of a protected class; (2) the plaintiff applied and was qualified for the position; (3) the plaintiff, despite being qualified, was not hired; and (4) after plaintiff's rejection the position remained open and the employer sought others with the plaintiff's qualifications.

Disparate treatment/disparate impact

Under law there are two theoretical bases for Title VII legal actions, disparate treatment and disparate impact. Disparate treatment occurs when there is evidence that the discriminatory act was an intentional act based on race, color, sex, national origin or religion on the part of the employer. Under the theory of disparate impact, the discriminatory act was the result of a facially-neutral policy that has an adverse impact on members of a protected class. Statistics are frequently used in establishing disparate impact. The four-fifths rule (sometimes called the 80% rule) is frequently used as the preliminary tool to determine disparate impact. Under this rule, it is expected that members of protected classes will have a success rate that is at least 80% of the majority's success rate on selection devices. If the success rate is less than 80%, then the employer must show that the selection device was relevant to the requirements of the position and that the there was no other devise that could be used to measure, as accurately, the applicants' performance that has a less adverse impact on members of the protected class.

Defenses

There are several defenses that an employer can raise in employment discrimination cases. The first defense available is a legitimate, nondiscriminatory reason for the employment decision. The plaintiff can counter this defense if he/she can show that the reason was actually pretext.

Another defense is that there is a bona fide occupational qualification (BFOQ) that requires the discriminatory act. Race and color can never be a BFOQ under Title VII. In defense of a claim of disparate impact the employer may argue business necessity. This argument maintains that the policy was a business necessity thus making the policy a legitimate requirement of the job. Employers may also avoid liability under disparate impact even if a particular selection device is discriminatory if the overall process is not. Of course the employer may also prove that the plaintiff's evidence is not truthful or is inaccurate.

Improper conduct is mentioned throughout the case

Some actions may individually rise to the level of illegal conduct. Other actions collectively may create a hostile work environment. Students should be able to determine if a hostile work environment exists. To do so, they will have to determine if the conduct is pervasive, abusive, offensive or intimidating workplace.

QUESTIONS

1. **Is the AAP a good one? What could be done to make it better?**

   Divide the class into groups to focus on each particular issue. Each group should develop a one page response for each question. Each group should report their findings to the class using flip chart paper which is posted in the classroom during the discussion period.

   For a web-based activity, divide the class into groups. Create group work areas (i.e., group discussion boards, chat rooms, email). Each group will prepare a one page document listing their collaborative discussion to the class Discussion Board created for this assignment.

2. **Is there evidence of employment discrimination? If so, does Jones have a good case?**

   In order to establish a prima facie case, Jones must show that (1) she is a member of a protected class; (2) she applied and was qualified for the position; (3) despite being qualified, she was not promoted; and (4) after her rejection the position remained open and the employer sought others with the plaintiff's qualifications. The first element is not difficult to show. Jones is female and therefore is a member of a protected class. She clearly applied and was qualified for the position; otherwise, her name would not have been on the eligibility list. Jones was not even a finalist in the consideration for either promotion, much less promoted. Therefore, the third element of the prima facie case can be shown. The final element is a little more difficult. However, since her name was not referred and the city did continue to seek qualified people for promotion after rejecting Jones, it appears that the fourth element can be proven.

3. What could her attorney argue?

An argument can actually be made that both theories of discrimination, disparate treatment and disparate impact, can be successfully asserted. In this case, the disparate treatment argument is not as strong as the disparate impact argument. Disparate treatment is intentional discrimination against a person because they are a member of a protected class. The decision was made that no woman would be promoted by the decision to only refer the names of the black candidates. Likewise, the decision not to apply the affirmative action in regard to women but to do so for all other protected classes is another example of a specific act that discriminated against women.

However, the case for disparate impact may be stronger. Over the three periods of time identified by affirmative action plans, the testing process has always resulted in a success rate for women of less than 80% of the success rate of men. In two of the three time periods the hiring rate for women was less than 80% of the hiring rate for men. In fact under the current plan the hiring rate for women is 20% that of men.

4. What could the city's attorney argue in its defense?

As the attorney for the city I would argue that there was a legitimate, non-discriminatory reason for the hiring decision. The city was under a federal court order to promote black police officers to the rank of sergeant. At the time of the promotions the city was two black sergeants short of the goal. By promoting only black police officers, the city would attain the hiring goal for sergeants. Court orders take precedence over the city's affirmative action plan. Further it was only coincidental that the decision to refer only the names of black officers resulted in only males being referred. Had there been female black police officers on the list, their name(s) would have been referred.

Further, the change in determining affirmative action goals at the rank of sergeant was a business necessity to more accurately reflect the current situation. Because the percentage of female police officers eligible for promotion to sergeant was significantly less than 22%, such a goal is not realistic.

5. If you were the judge, how would you decide this case? Explain your decision.

(The students' answers to this question will vary.)

EPILOGUE

Although this case has been fictionalized to protect the identities of the people involved, Central City Makes a Promotion – Part B is based on a true story. Below is a summary of what happened in the real-life case.

Mary Jones' attorney filed a lawsuit on her behalf when the state court opened on promotion day. Among other relief, she sought a temporary restraining order and a preliminary injunction preventing any promotions to sergeant unless she was also promoted. The state judge assigned the case, after a brief hearing involving the attorneys for both sides, issued a temporary restraining order and set a hearing for a preliminary injunction. At the hearing Jones' attorney suggested that the city be allowed to promote Williams because he was first on the list. The judge agreed and entered a temporary restraining order prohibiting any promotions to sergeant, except for Williams, unless Jones was promoted to sergeant. The judge also order the city to turn over volumes of documents requested by Jones' attorney. The matter was set for hearing on the preliminary injunction.

The day before the hearing on the preliminary injunction the city removed the case to the federal court. The federal judge maintained the temporary restraining order until a hearing on the preliminary injunction could be held about a month later. After a three-day evidentiary hearing, in his ruling on the motion for preliminary injunction the federal judge wrote that there was substantial evidence that Jones had been discriminated against. However, the judge denied the preliminary injunction and extinguished the temporary restraining order because Jones could not demonstrate irreparable harm and the city assured the judge that Jones would be promoted immediately after the order was extinguished because another vacancy at sergeant had occurred.

Once the judge ended the temporary restraining order, Jones and White were promoted to sergeant. The city backdated White's promotion so he would have seniority over Jones.

Shortly after the hearing on the preliminary injunction, the plaintiff filed an amended complaint that broadened the lawsuit into a class action on behalf of all Central City female police officers and police applicants. Over the objections of the city, the federal court certified the lawsuit as a class action after another two-day hearing.

After considerable discovery (interrogatories, depositions and requests for production) by both sides, the parties started serious settlement negotiations. The settlement efforts intensified after approximately 8-10 female officers testified by deposition about their personal experiences related to discrimination and harassment. Ultimately, the case was settled three years after being filed without trial. The settlement involved a comprehensive plan for correcting the practices and policies that resulted in the alleged illegal discrimination. Jones and another female sergeant who had been passed over for promotion were promoted to lieutenant as part of the settlement. White was still a sergeant so the seniority issue no longer existed.

The rest of the story: Jones was passed over for promotion to captain although she was the top name on the list approximately four years after her promotion to lieutenant (see Part C).

Fourteen years after Jones was promoted to lieutenant, she was a lieutenant preparing for retirement with 25 years of service. Retirement was just six months away. Robert White had become police chief in Central City. Just five months earlier, Jones was passed over for promotion to captain for a second time. Again Jones was the top name on the list at the time of the promotion. Just as when she was passed over the first time, there were no apparent reasons in her records to indicate that she was not promotable. However, White decided not to promote her. Jones decided not to fight the decision. On this day with about six months left in her tenure with Central City Jones' phone rang unexpectedly. It was Chief White congratulating Mary Jones. He advised her that he decided to promote her to captain.

CENTRAL CITY MAKES A PROMOTION – PART C

Steven C. Palmer, Eastern New Mexico University
Lee Weyant, Kutztown University of Pennsylvania
George W. McNary, Creighton University

CASE DESCRIPTION

The primary subject matter of this case concerns the alleged discriminatory employment practices within a governmental agency. Secondary issue examined is the management policies to insure compliance with equal employment opportunity laws. The case also introduces ethical issues that should be discussed. The case has a difficulty level of four, appropriate for upper level undergraduate and graduate students. The case is designed to be taught in three class hours and is expected to require three hours of outside preparation by students.

CASE SYNOPSIS

What is an equal opportunity employment environment? What constitutes illegal retaliation under the 1964 Civil Rights Act? The Central City Police Department faces these questions concerning their recent employment practices. More specifically, what is the department's justification for not promoting the individual whose name is on top the promotion list at the time the promotion is being made? How can an employee with excellent performance evaluations and a clean discipline record not be promoted? Could it be that the individual was a woman? Was the fact the woman had previously filed a sex discrimination lawsuit a factor in the decision? Does the work environment penalize women or people who stand up for their legal rights? Finally, are supervisors and employees appropriately trained and supervised regarding employment discrimination issues?

This case explores the integration of women into a predominately white male work environment. A woman has previously filed an employment discrimination lawsuit against Central City for its discriminatory employment practices regarding women. The city eventually chose to settle the lawsuit rather than go to trial. The settlement is a comprehensive plan to address the issue of sex discrimination. The case picks up several years later when the woman is being considered for promotion. Despite her being the top candidate on the eligibility list at the time, the new police chief decides to pass her over for promotion. There is a new police chief but has the workplace environment changed?

[NOTE: This case is a fictionalized version of a real-life situation. Names and other potentially identifying information have been changed to protect identities. The applicable fact situation is true to the real case.]

INSTRUCTORS' NOTES

Objectives

This case can be used in a variety of undergraduate and graduate classes. The authors believe that it fits into any of the following courses: Principles of Management, Human Resource Management, Business Ethics, Business Law and Employment Law. The analysis of the case can be from a managerial, ethical or a legal perspective. The case can also be successfully used in Organizational Communications, Leadership and Conflict Management classes.

The learning objectives for this case are:

1. Students should be able to evaluate the necessity for a performance management system.
2. Students should be able to analyze a situation for disparate impact, disparate treatment and retaliatory employment discrimination practices.
3. Students should be able to synthesize managerial alternatives to alleviate employment discrimination and retaliatory practices within the workplace.
4. Students should be able to analyze a situation for potential ethical issues and develop strategies for resolving the ethical dilemmas.
5. Students should be able to recognize organizational communications issues and develop strategies for resolving the same.

RESOURCES AVAILABLE

Students may find the following U.S. Department of Labor and the U.S. Department of Justice resources on equal employment opportunity useful.

http://www.dol.gov/esa/regs/compliance/ofccp/pdf/sampleaap.pdf
http://www.eeoc.gov/

ISSUES PRESENTED

The issues that arise from the lack of proper policies and procedures quickly become apparent in this case. The city lacks a performance management system for the evaluation of their police officers. The city also appears to lack a definitive process for handling complaints of possible illegal discrimination. The city's promotion practices incorporate the goals established in its affirmative action policy and previous court rulings. However, the application of the promotion policies by the current chief administrator may lead to legal problems for the organization.

Disparate Treatment/Disparate Impact/Retaliation

Under law there are two theoretical bases for Title VII legal actions, disparate treatment and disparate impact. Disparate treatment occurs when there is evidence that the discriminatory act was an intentional act based on race, color, sex, national origin or religion on the part of the employer. Under the theory of disparate impact, the discriminatory act was the result of a facially-neutral policy that has an adverse impact on members of a protected class. Statistics are frequently used in establishing disparate impact. The four-fifths rule (sometimes called the 80% rule) is frequently used as the preliminary tool to determine disparate impact. Under this rule, it is expected that members of protected classes will have a success rate that is at least 80% of the majority's success rate on selection devices. If the success rate is less than 80%, then the employer must show that the selection device was relevant to the requirements of the position and that the there was no other devise that could be used to measure, as accurately, the applicants' performance that has a less adverse impact on members of the protected class.

Title VII makes it a separate violation for retaliation regardless if the underlying claim of discrimination proves to be true or not. Title VII provides that it is unlawful to discriminate against anyone for making charges, testifying, assisting, or participating in enforcement proceedings. It is also an unlawful employment practice, under the law, for an employer to discriminate against any employee or applicant for employment because he/she has opposed any practice made an unlawful employment practice or because he has made a charge, testified, assisted, or participated in any manner in an investigation, proceeding, or hearing under Title VII.

Burden Shifting/Prima Facie Case

In disparate treatment cases the plaintiff can prove the case through direct evidence of intent to discriminate. The courts, however, recognized that rarely will there be direct evidence available to prove disparate treatment. Therefore the burden shifting approach was developed. Under this approach the plaintiff must prove the existence of a prima facie case. If successful the burden shifts to the defendant to articulate a legitimate, nondiscriminatory reason for the alleged discriminatory action. After the employer puts forth the legitimate reason, the plaintiff has the opportunity to show that the proffered reason was pretexual.

The United States Supreme Court [*McDonnell Douglas Corp. v. Green*, 411 U.S. 792 (1973)] set forth the requirements for the establishment of a prima facie case in employment discrimination cases. The elements are: (1) the plaintiff is a member of a protected class; (2) the plaintiff applied and was qualified for the position; (3) the plaintiff, despite being qualified, was not hired; and (4) after plaintiff's rejection the position remained open and the employer sought others with the plaintiff's qualifications.

A prima facie;1015;1015 case of retaliation;1018;1018 under Title VII has generally been held by the courts to require a showing that: (1) employee engaged in statutorily protected activity; (2) adverse employment action was taken against him/her; and (3) causal connection exists between two events. Many courts have held that a temporal proximity is sufficient to establish the third element. However, for the most part that temporal proximity has been held to be a relatively short period of time.

Defenses

There are several defenses that an employer can raise in employment discrimination cases. The first defense available is a legitimate, nondiscriminatory reason for the employment decision. The plaintiff can counter this defense if he/she can show that the reason was actually pretext. Another defense is that there is a bona fide occupational qualification (BFOQ) that requires the discriminatory act. Race and color can never be a BFOQ under Title VII. In defense of a claim of disparate impact the employer may argue business necessity. This argument maintains that the policy was a business necessity thus making the policy a legitimate requirement of the job. Employers may also avoid liability under disparate impact even if a particular selection device is discriminatory if the overall process is not. Of course the employer may also prove that the plaintiff's evidence is not truthful or is inaccurate.

Improper Conduct Is Mentioned Throughout The Case

Some actions may individually rise to the level of illegal conduct. Other actions collectively may create a hostile work environment. Students should be able to determine if a hostile work environment exists. To do so, they will have to determine if the conduct is pervasive, abusive, offensive or intimidating workplace.

LEARNING ACTIVITIES

1. Divide the class into groups to answer this question, "Does the city police department have a performance management system?" Each group should develop a one page response for this question. The groups should be given the additional instruction "As you develop your response, consider what are the reasons an organization would, or would not, have a performance management system?" Each group should report their findings to the class. The instructor should use these responses to explore the rationale for performance management systems.

   Keeping the students in the same groups, give them this instruction. "You have been hired as a HR consulting firm. The city has asked you to recommend a possible performance management system. As part of your report, the city would like for you justify your recommendation and to provide a sample of the new system." Each group should be given time to write a report with their recommendation and to present their recommendations in class.

2. Divide the class into three groups, plaintiff counsel, defense counsel and jury. Have the two groups representing the respective parties write down all of the points/arguments that they would use to support their client's position. Then each group should present their case to the third group, the jury. After hearing argument from both sides, the jury should decide which party should win and why.

QUESTIONS

1. Does the city police department have a performance management system?

Students need to define the term performance management system. For example, according Mathis and Jackson[1] (p. 328) performance management systems are "composed of the processes used to identify, measure, communicate, develop, and reward employee performances." Using this definition, students could conclude that placing Jones in the "temporary captain" position, the city is trying to develop their employees. However, the city has no apparent processes to address the other elements of the definition.

The city could address these missing elements through the adoption of a performance appraisal system. According to Mathis and Jackson (p. 329), this system is "the process of evaluating how well employees perform their jobs and then communicating that information to the employees." Possible methods for appraising employees include (Mathis & Jackson, 342-350):

- Graphic Rating Scales
- Behavioral Rating Scales
- Ranking
- Forced Distribution
- Critical Incident
- Management by Objectives
- 360˚ Systems

2. Does the evidence indicate a prima facie case of retaliation? If so, does Jones have a good case?

In order to establish a prima facie case of retaliation, Jones must show that (1) employee engaged in statutorily protected activity; (2) adverse employment action was taken against him/her; and (3) causal connection exists between two events.

The first element is not difficult to show. Jones filed a federal, class action lawsuit accusing Central City of employment discrimination based on sex in violation of Title VII. It also could be argued that Jones' meeting with Chief Adams regarding the FBI National Academy in which she claimed that Deputy Chief Schmidt was retaliating against her was also a protected activity

There can be little doubt but that Jones suffered an adverse employment action. Jones was passed over for promotion to captain. It also could be argued that her not being sent to the FBI National Academy constituted an adverse employment action. So the real question comes to the third element of the prima facie case.

It is based on this third element, the causal connection, that it might be argued that Jones does not have a strong case. The City will argue that there is no evidence of a causal connection. It has been more than four years since the lawsuit was settled. Four years is too long of a period of time for temporal proximity to be established. The case shows no other evidence of retaliatory intent.

However, it may also be argued that a causal connection can be made based on temporal proximity. Several events could be argued to have created the causal connection:

A. This was the first opportunity the city had to retaliate against Jones in the promotion process. So even if four years had passed, the City could not have retaliated earlier because it was the first opportunity that the retaliatory action could be taken.

B. The meeting that Jones had with Adams constituted a protected activity. The decision making process regarding the captain promotion was within a short window of time after that protected activity.

C. Chief Adams was potentially impacted by the Jones Agreement when his hiring as chief was challenged in court as a violation of the Jones Agreement. That occurred less than six months prior to the captain promotion decision.

D. The Jones Agreement was still impacting policies and decisions being made by the police administration. Its terms had not been completely met and therefore it was in full force and effect. In Title VII law there is a recognition of the concept of continuing violation. Under this doctrine, if any act of discrimination within a continuing practice of discrimination occurred within the statute of limitations period, then all discriminatory acts within the continuing violation are actionable. This same doctrine should be extended to the temporal proximity test of retaliation. Since the Jones Agreement still must be considered in the decision and policy making processes, it is a continuing protected activity.

3. Can an argument be made by Jones that she is the victim of disparate treatment or disparate impact discrimination? How strong is the claim, if there is one?

It is doubtful that a case of disparate impact discrimination would be successful. Disparate impact discrimination occurs when the employer has a policy that appears to be neutral on its face but in practice treats a protected class in an unfair manner. Nothing presented in this case indicates that any facially-neutral policy impacted the captain promotion decision.

An argument may be made that disparate treatment occurred. Disparate treatment is intentional discrimination against a person because they are a member of a protected class. The elements of a disparate treatment prima facie case are: (1) the plaintiff is a member of a protected class; (2) the plaintiff applied and was qualified for the position; (3) the plaintiff, despite being qualified, was not hired; and (4) after plaintiff's rejection the position remained open and the employer sought others with the plaintiff's qualifications. There is no question that Jones met the first two elements. Jones would argue that she was qualified and Central City will argue she was not qualified for the job. However, for the purpose of the prima facie case she did meet the technical qualifications for the position. She had been a lieutenant on the Central City Police department for more than two years at the time she applied, she tested successfully for the position and she was within the top three names on the eligibility list at the time of the promotion. Since Jones, who was on top of the eligibility list at the time, was not promoted, it can be argued that the city continued to seek another candidate.

It can also be argued that there is direct evidence of disparate treatment against Lt. Jones. In the chief's interview as part of the promotion process, it can be argued that an illegal question was asked and was part of the basis for the decision. The chief acknowledged that part of his reason for not promoting Jones was her failure to answer one particular question in the interview. The question was only asked of Jones, and no candidate other than Jones was asked different questions than the other candidates. Also the question itself related to a claim of discrimination that Jones had made previously. Therefore, the asking of an illegal question and basing the decision in part on the lack of answer constitutes disparate treatment discrimination.

Finally, an argument concerning disparate treatment could be made because Chief Adams did not investigate her claim of employment discrimination and retaliation. In fact he testified that he would never investigate such a claim because Jones was simply expressing her opinion. An employer has a duty to investigate claims of illegal actions under Title VII. The failure to do so implicates the employer in any illegal conduct that occurred.

4. If a prima facie case of discrimination is shown, what might the city articulate as a legitimate, nondiscriminatory reason for its decision?

As the attorney for the city I would argue that there were legitimate, non-discriminatory reasons for the hiring decision. Lt. Jones was not qualified to be a captain because she lacked trust and confidence in leadership, she did not demonstrate the ability to meet deadlines, and finally her reactions under stress were questionable. In addition, secondary reasons for her lacking qualifications were demonstrated by her improperly pressuring citizens to write letters of recommendations and her lack of networking with citizens during the open house. In regard to the disparate treatment claim, Central City would also argue that they were not discriminating against women because they promoted a woman to the position.

5. Is there evidence of pretext?

It appears that all of the legitimate, non-discriminatory reasons that the chief has given are pretext. Below is an examination of each reason set forth by Central City for not promoting Lt. Jones:

A. Lt. Jones lacked trust and confidence in leadership: This argument is based the meeting Chief Adams had with Jones regarding the FBI National Academy. Chief Adams says that she challenged his veracity. However, Jones paints a much different picture, with a tape recording to support her position. She will testify that after the point in the conversation that Chief Adams claims he lost trust in her, he started talking about a politically embarrassing issue. If the chief did not trust her, why would he share information that could result in political embarrassment? The chief can give no other incidents in which Jones demonstrated an alleged lack trust or confidence in his leadership. This particular incident involved Jones complaining to the chief that she was being treated illegally by a deputy chief; this would be a protected activity.

B. Lt. Jones did not demonstrate the ability to meet deadlines: Chief Adams based this determination on one assignment issued to Jones while she was acting captain. Adams testified that he did not investigate the circumstances of this incident. He simply blamed Jones for being late. Adams gave the assignment to Deputy Chief Schmidt. Adams did not blame Schmidt for the assignment being late. Likewise, he did not blame the lieutenant assigned to do the task, Wayne Fox. Rather, Adams placed sole blame for the assignment being late was Lt. Jones. Adams also admitted that he never looked at Jones' file to see if she was late on other assignments. He also stated that he did not know, nor cared, if the person who was promoted, Patricia Meyer, was ever late with any assignments.

C. Lt. Jones' reactions under stress were questionable: This finding was based on Jones' inability to answer one question in the chief's interview. Chief Adams could not identify any time in her career that Lt. Jones did not perform under pressure in the field. Another problem with this item was that the question was only asked of her and no other candidates for promotion. None of the other people were asked a meaningful question that was not asked of all the candidates. Regarding the question there is also an argument to be made that the question was an illegal question as it went to Jones' prior claim to Adams that Schmidt had been discriminating against her. It should also be noted that Chief Adams could not answer more than 100 questions in his deposition.

D. Lt. Jones improperly pressuring citizens to write letters of recommendations: The problem with this claim was that Adams admitted that he also included letters of recommendation with his application to be Central City police chief, despite the process not requesting letters of recommendation. Adams tries to justify the difference as Jones' letters were job specific while his letters were in general and not to a particular person or potential employer. Also without talking with any of the people who wrote letters or looking in Jones' personnel file, Adams assumed that Jones put undue pressure on these people to write letters.

E. Lt. Jones did not network with citizens during the open house: First, Adams could not remember whether or not this was a factor in his decision. Even though he made the decision six weeks earlier and the lawsuit was filed immediately after the decision was made. Chief Adams testified that he had no knowledge of Jones' relationship with any of the attendees. Also he did not know what she was talking about with people as she served drinks and cookies.

6. If you were the judge, how would you decide this case? Explain your decision.

(The students' answers to this question will vary.)

EPILOGUE

Although this case has been fictionalized to protect the identities of the people involved, "Central City Makes a Promotion – Part C" is based on a true story. Below is a summary of what happened in the real-life case.

Central City Makes a Promotion Parts A and B outline the circumstances of Jones' protected activities that were the foundation of Part C. Originally, Jones was passed over for promotion to sergeant by Robert White. Jones was number two on the original eligibility list for that promotion and the city was making two promotions. White was 19 on the original eligibility list. Although Jones was successful in temporarily blocking White's promotion, the federal district court extinguished the temporary restraining order after a hearing and the city's assurance that Jones would also be promoted. Central City did promote both White and Jones at the same ceremony, but back-dated White's promotion to the original date White was to be promoted. This meant that White had seniority over Jones. Because in the settlement agreement between Jones and Central City Jones was promoted to lieutenant, the seniority issue became moot.

When the circumstances in Case C arose, Jones, based on state law, asked the state court to temporarily restrain the city from promoting any one before Mary Jones. The judge ruled that there would be no irreparable harm from promoting Patricia Meyer. In the judge's ruling he stated that Jones could be made whole through damages and injunctive relief if she is successful in her lawsuit. The city promoted Meyer.

Jones then filed an EEOC claim, as required by Title VII. The EEOC District Director learned of the pending lawsuit based on state law and administratively dismissed the EEOC claim. In doing so, the District Director issued Jones a right-to-sue letter.

Once the right-to-sue letter was issued, Jones' case was amended to include Title VII claims of disparate treatment and retaliation. Central City removed the amended case to federal court. Shortly thereafter, due to a conflict of interest that had arisen, Jones' attorney had to withdraw from the case. Matlock had represented Jones in the first case. He was extremely well versed in the issues, personalities and nuances of the case. Jones retained new counsel.

The matter went to trial in the federal district court. After the plaintiff's case was presented, the judge granted the city's motion for directed verdict. The judge based his decision on the plaintiff's failure to prove the third element of the prima facie case, a causal connection exists between the protected activity and the failure to promote Jones.

In hindsight Jones stated that her new attorney was not as well versed on her case as Matlock was. This resulted in her new attorney oversimplifying the facts of the case in the presentation of evidence. Jones stated that she wished Matlock had been able to remain on the case because he understood how to present the case to the jury and judge. Rumor has it that Mason also made comments to members of the legal community that Matlock withdrawing from the case made their efforts easier.

THE REST OF THE STORY: Ten years after being passed over for promotion, Jones was a lieutenant preparing for retirement with 25 years of service. Retirement was just six months away. Robert White had become police chief in Central City. Five months earlier, Jones was passed over for promotion to captain a second time. Again Jones was the top name on the list at the time of the promotion. The city, again, dropped down the eligibility list to take another female rather than promote Jones. Again Jones had been an acting captain for three months when the promotion decision was made. By this second occasion Central City had instituted a performance evaluation system. Jones' evaluations were very good. There were no apparent reasons in her records that would indicate that she was not promotable. However, White decided not to promote her. Jones decided not to fight the decision. On this day with about six months left in her tenure with Central City Jones' phone rang unexpectedly. It was Chief White congratulating Mary Jones. He advised her that he decided to promote her to captain.

ENDNOTE

[1] Mathis, R. L., & Jackson, J. H. (2006). *Human Resource Management (11th ed.)*. Mason, OH: South-western

NINE DRAGON THEME PARK: MARKETING STRATEGY IN CHINA

Jindong Zhang, Tourism Bureau of Dongcheng District, Beijing
Kuan-Chou Chen, Purdue University Calumet
Keh-Wen arin Chuang, Purdue University North Central
Denise M. Woods, Purdue University Calumet

CASE DESCRIPTION

The primary subject matter of this case concerns the destination marketing strategies used for a Chinese amusement theme park. The case follows the theme park from its inception and discovers how the changing tourism environment in China affected the success of the theme park.

CASE SYNOPSIS

This case examines the development and role of destination marketing in the China tourism industry in general and in the theme park in particular. A case study of Nine Dragon Theme Park in Beijing, China is demonstrated to explore the detonation marketing development. The China tourism industry has effectively merged its service with that from local attractions to the development of global and modern theme parks. This study provides a comprehensive viewpoint for China destination marketing development and strategies.

INSTRUCTORS' NOTES

This paper studies the case of a theme park in China, its destination marketing practices, and the market reaction during the different development stages. By presenting and analyzing this case, the paper strives to identify the role of destination marketing to theme parks in the future China market. Students should be asked to critique the NDA situation throughout its three stages. They should be able to make recommendations for each stage, paying particular attention to the third, and least successful, stage.

STUDY OF DESTINATION MARKETING IN CHINA

Destination in the tourism industry always refers to a physical place that can provide visitors with sightseeing, entertainment, shopping and other services and experience. In this study, the following reasons demonstrate that the destination marketing approach is unique in the Chinese tourism industry. estination marketing has become increasingly necessary in the modern travel and tourism industry as places seek to be distinctive and attractive, aiming to establish a favorable position and sell themselves in a highly competitive environment (Henderson, 2000, p. 37)..

Second, as one of the first artificial theme parks opened to the public, NDA endured the successes and difficulties of such kind of amusement park. With this effort, they revealed some important things in common for reference of the future development of the theme parks in China. Third, the period when NDA was established and operated is one that the Chinese tourism industry developed from early rapid growth in the early stages to severe competition in its mature stage. The macro environment and government policy also changed according to this situation. The marketing approach of NDA also reflected this change and the market response.

DISCUSSION QUESTIONS

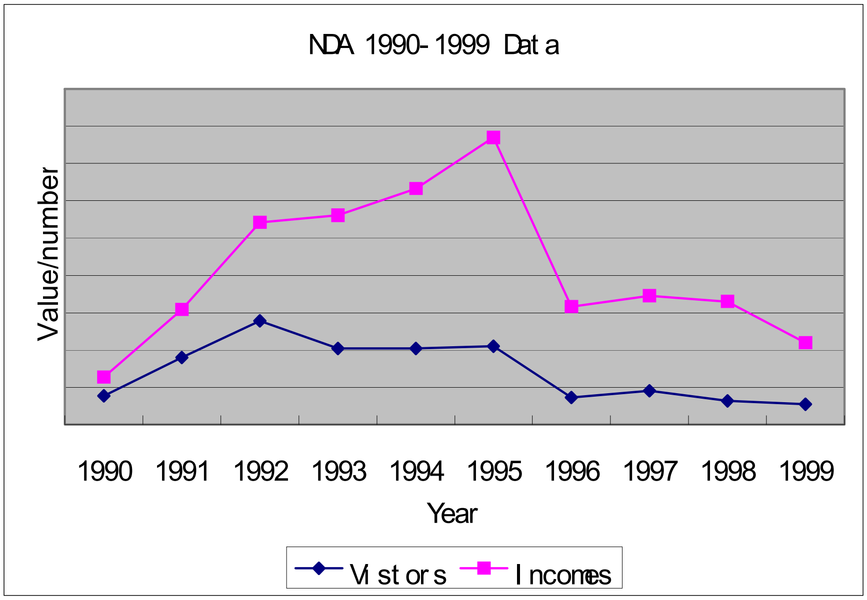
1. Identify the destination marketing strategies that apply in the in each of the three periods in the NDA case.

Destination market organizations (DMOs) focus mainly on marketing as the principal management function Marketing, therefore, is the principal purview of DMOs. More specifically, recognizing that marketing entails much more than just elling or dvertising, destination promotion is normally the DMOs major activity and budget item (Dore and Crouch, 2002, p. 137).

NDA opened to tourists on August 1990 after five years of construction. The income and numbers of visitors increased excessively, to a peak in 1995 and then had a sharp decrease in 1996. The operation can be divided into three periods by the numbers of tourists and incomes: The first increase period from 1990 to 1995, the 1996 fall of the business and the continuing decrease from 1997. Both the macro environment and the management practices, especially the marketing approach, played an important role in these three periods.

Figure 1 displays the periods of NDA case.

Figure 1. Growth Trends of NDA



2. What specific suggestions would you make to NDA for a new marketing strategy, taking into consideration their limited revenue and investor funding?

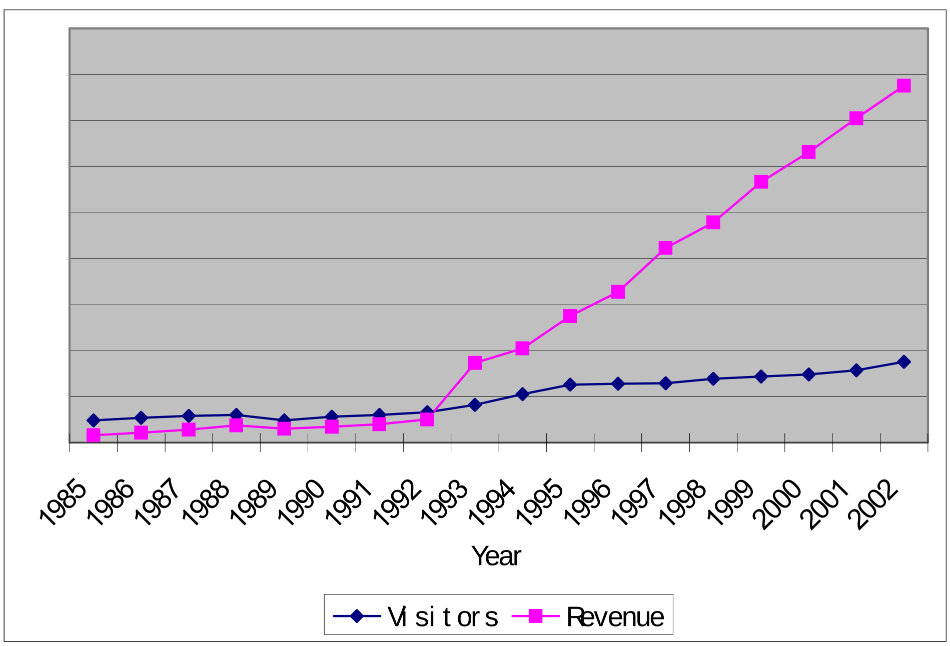
Answers will vary widely for this question. Students should base their suggestions on proven strategies employed by other amusement companies specifically in China. Things the students should consider is: how to improve the attractions that are already available at NDA, how to incorporate new attractions that fit in with the general water theme of the park, how to add new attractions that are more current to the Chinese culture, and how to market these products. Special consideration should be paid to the accessibility of the theme park to other Chinese tourist attractions. How can the NDA experience be best advertised throughout China? Students should also consider how to go about doing a thorough market analysis to determine what their target audience wants for their tourism experiences.

Students can also answer from the perspective of the Disney Company. Answers should include a thorough review of the tourism options available through the Disney company. Analysis of Disney World and Disneyland in the U.S. as well as in Europe, Hong Kong, and Japan should be included. One thing that Disney does well is to partner with airlines, car rental agencies, and hotels to give customers a vacation package. What companies can NDA partner with in order to be a more full-service tourism provider? What partnerships are currently available in China that could be duplicated? Tickets to the Disney properties can all be purchased online. Whole vacation packages can also be selected via telephone by using the Disney 800-number. Disney provides links to its many destinations and shopping as well as links to games for the children. What can NDA do on their Web site in order to pull customers in?

3. What did you learn from this case regarding the tourism industry in China using a destination marketing approach?

With the beginning of the Chinese open policy in the 1980s, the Chinese tourism industry has made great progress and became the key industry in the development of China (Figure 2). According to the statistics from the National Bureau of Statistics of China, the revenue of Chinese domestic tourism industry is $46.7 billions in 2002, with 877.82 million domestic tourists. According to the estimate of the World Travel Organization, China is going to be one of the major destinations in the near future.

Figure 2. Domestic Tourism of China: 1985-2002



China is rich with tourism resources because of its long history, large territory and great diversity in landscape, geography, climate, customs, culture and people. With these unique advantages, the Chinese tourism industry will play an important role in China development.

Increasing competitiveness in the Chinese tourism industry is forcing operators to take greater leaps in the race to provide quality service and guest satisfaction. According to Pyo (2002), the destination can use the knowledge to determine its marketing strategy and tactics in real time, as changes develop in the market place and new tourist demands arise. This study reviews the destination marketing strategy for a Chinese theme park. It is proposed that by understanding China destination marketing, one can determine a better premise and structure for the processes, the potential tourist demands, the barriers of the China tourism system as well as China tourism policy. For tourism investors and researchers, China destinations can therefore effectively use marketing strategies in their search for a tourism investment, competitive positioning, and growth within a worldwide tourism industry.

CHILDREN AND FAMILY SERVICE CENTER CASE STUDY

Vickie Tomlinson, Tennessee Children's Home, Inc., Retired
Terry J. Ward, Middle Tennessee State University
G. Robert Smith, Jr.,Middle Tennessee State University

CASE DESCRIPTION

Students often fail to understand that much of the FASB's work does address not-for-profit entities. This case attempts to demonstrate to students the differences between for-profit and not-for-profit organizations and how SFACs impact the theory underlying subsequent FASB standards on reporting. Thus, this case attempts to help students better understand the basic principles and concepts that differ between for-profit and not-for-profit organizations. This case specifically addresses SFAC # 4 and SFASs 116 and 117.

This case was designed to be used in a graduate theory or financial reporting class that has a nonprofit component. The case allows students to see through basic research how nonprofits fundamentally differ from for profit entities conceptually and theoretically.

An instructor could also use this case in an undergraduate nonprofit class as a project to introduce students to parts of the FASB's Conceptual Framework that relate to nonprofits, thus helping students to understand the theory behind reporting in a nonprofit environment. Thus, this case can be used in either undergraduate or graduate classes depending on which of the requirements the instructor wishes the students to complete.

CASE SYNOPSIS

In this case, you are asked to take the role of the Director of Fiscal Operations of a not-for-profit organization, Children and Family Service Center. The Trustees have hired you because of concerns that the accounting records are not adequate. You are give ten areas of concern and asked to answer various questions related to these concerns. Thus, you attempt to determine the appropriate treatment for each item. This case will help you to better understand the basic principles and concepts that differ between for-profit and not-for-profit organizations.

INSTRUCTORS' NOTES

Solutions to Requirements

1. **Explain what makes a not-for-profit entity distinct from a for-profit entity? You may wish to include in your discussion how Statement of Financial Accounting Concepts (SFAC) # 4 distinguishes the two types of entities.**

According to SFAC # 4, the major distinguishing characteristics of a not-for-profit entity from a for-profit entity are as follows:

Receipts of significant amounts of resources are from resource providers who do not expect to receive either repayment or economic benefits proportionate to the resources provided. These resource providers are interested in the services the organization provides.

Operating purposes are not to provide goods and services at a profit or profit equivalent. A not-for-profit's purpose is to use resources to provide goods and services to its constituents and beneficiaries, and it is generally prohibited from distributing assets as dividends to its members, directors, officers, or others.

Absence of defined ownership interests that can be sold, transferred, or redeemed, or that convey entitlement to a share of a residual distribution of resources in the event of liquidation of the organization (SFAC # 4, paragraph 6).

2. **According to SFAS # 117, what is the primary purpose of not-for-profit financial statements? Based on SFAC # 4, what are the objectives of not-for-profit financial reporting? Compare these objectives to the objectives of financial reporting for business enterprises described in SFAC # 1. What are the similarities and dissimilarities?**

According to SFAS # 117, "the primary purpose of financial statements is to provide relevant information to meet the common interests of donors, members, creditors, and others who provide resources to not-for-profit organizations" (SFAS # 117, paragraph 4). These users have the common interest in "assessing (a) the services an organization provides and its ability to continue to provide those services and (b) how managers discharge their stewardship responsibilities and other aspects of their performance." According to SFAC # 4, the objectives of financial reporting for nonbusiness organizations are:

> To provide information that is useful to present and potential resource providers and other users in making rational decisions about the allocation of resources to those organizations (SFAC # 4, paragraph 35).
>
> To provide information to help present and potential resource providers and other users in assessing the services that a nonbusiness organization provides and its ability to continue to provide those services (SFAC # 4, paragraph 38).
>
> To provide information that is useful to present and potential resource providers and other users in assessing how managers of a nonbusiness organization have discharged their stewardship responsibilities and about other aspects of their performance (SFAC # 4, paragraph 40).
>
> To provide information about the economic resources, obligations, and net resources of an organization, and the effects of transactions, events, and circumstances that change resources and interest in those resources (SFAC # 4, paragraph 43).

According to SFAC # 1, the objectives of financial reporting for business enterprises are:

> To provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions (SFAC # 1, paragraph 34).
>
> To provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans (SFAC # 1, paragraph 37).
>
> To provide information about the economic resources of an enterprise, the claims to those resources, and the effects of transactions, events, and circumstances that change its resources and claims to those resources (SFAC # 1, paragraph 40).

Both sets of objectives focus on providing information that would be useful in deciding whether to provide resources to an entity. However, the two sets of objectives reflect different interests of the respective resource providers; investors and creditors seek monetary repayment of, and a return on, resources they provide. Nonbusiness resource providers expect no, or disproportionate, benefits to the resources provided.

One of the primary objectives of financial reporting in SFAC # 4 was providing information to assess how managers have discharged their stewardship responsibilities. This objective is important in not-for-profit organizations because these organizations are not profit oriented and are dependent upon the continuing support of resource providers. However, in SFAC # 1, this objective is viewed as less important in financial reporting for business entities.

The objectives regarding economic resources of an enterprise are very similar. The main distinguishing difference is in the terminology that reflects one of the distinguishing characteristics of nonbusiness organizations—the lack of ownership interests entitled to a residual distribution in the event of liquidation.

3. SFAS # 117 requires that the net assets of nonprofit organizations be classified in one of three ways. Identify these three classifications and briefly distinguish between them.

The classifications required by SFAS # 117 were first identified in SFAC # 6. These classifications are: permanently restricted; temporarily restricted; and unrestricted. Permanently restricted net assets result from:

contributions of assets where donors impose limitations that do not expire,

other asset changes subject to similar limitations, and

where donors require reclassifications from (or to) other classes of net assets (SFAC # 6, paragraph 92).

These assets include endowments whose term lasts indefinitely and other certain assets that must be maintained or used in a certain way. The assets will be restricted so long as the organization has custody of those assets. Temporarily restricted net assets result from:

contributions of assets where donors impose limitations that expire as time passes or may be fulfilled by other organization actions,

other asset changes subject to similar limitations, and

where donors require reclassifications from (or to) other classes of net assets (SFAC # 6, paragraph 93).

These assets include term endowments where the term lasts for a specific period or expires once certain requirements are met. Unrestricted net assets result from:

all revenues, expenses, gains, and losses that are not changes in permanently or temporarily restricted net assets, and

reclassifications from (or to) other classes of net assets (SFAC # 6, paragraph 94).

All assets are assumed unrestricted unless there are specific donor limitations.

4. Based on SFAC # 6 and SFAS # 116, explain the difference between a donor-imposed gift restriction and a conditional promise to give. How is a conditional promise to give reported on the financial statements?

According to SFAS # 116, a donor-imposed gift restriction is a donor stipulation that specifies a use for a contributed asset that may be temporary or permanent (SFAS # 116, paragraphs 11 through 16). The donor has already transferred the asset to the organization, but the asset must be used according to the specific use set by the donor. However, the use must fall within the broad limits resulting from the nature of the organization, the environment in which it operates, and the purposes specified in its articles of incorporation or bylaws or comparable documents.

A conditional promise to give depends on the occurrence of a specified future and uncertain event. The donor does not transfer the gift to the donee until the conditions on which the promise depends are substantially met.

Recipients of conditional promises to give are to disclose the following in the financial reports:

The total of the amounts promised.

A description and amount for each group of promises having similar characteristics, such as amounts of promises conditioned on establishing new programs, completing a new building, and raising matching gifts by a specified date.

5. Following the enumerated items in this case, prepare the journal entries necessary to reclassify net assets at December 31, 2001 into the various classes required by SFAS # 117. Explain the reason for each reclassification and the reason for each non-reclassification.

1) SFAS # 116, paragraph 14, requires that a donor's restriction to restrict use of an asset be explicit or clearly evident as an implicit stipulation. It is impossible for the CFSC to determine the nature of the restriction in this case. Since the accounts were

established before any accounting standard addressed the concept of donor restrictions, and since no documentation on the purpose of the accounts can be found, it may be assumed that the accounts represent unrestricted net assets.

2) One of the requirements for an asset to remain restricted is that the asset be under the control of the entity from which the donation was made. Since the Institute for Family Services no longer exists, it may be interpreted to mean that these monies are no longer restricted. To confirm this, the entity should attempt to gain the signatures on the Authorization for Termination of Accounts.

3) The will stipulated the principal amount be restricted for a specific purpose—college scholarships. The will did not stipulate the earnings from this fund also be restricted for this purpose. Kate cannot determine that no student resident of CFSC would ever attend college; some may attend if funds were available. Therefore, since the restricted use is within the nature and purposes of CFSC, the corpus amount would need to be reclassified to temporarily restricted net assets.

Dr. Unrestricted Net Assets	$50,000	
Cr. Temporarily Restricted Net Assets		$50,000

As the funds are used for college scholarships, an entry would be made to release temporarily restricted net assets by debiting Temporarily Restricted Net Assets and crediting Unrestricted Net Assets.

4) According to SFAC # 6, paragraph 96,

> “Donors need not explicitly limit uses of contributed assets for a not-for-profit organization to classify the increase in net assets as restricted if circumstances surrounding those receipts make clear the donor’s implicit stipulation of restricted use. For example, use of contributed assets is restricted despite absence of a donor’s explicit stipulation about use if the assets are received in a fund-raising drive declared to be for a specific purpose. . .”

Therefore, the journal entry needed is:

Dr. Unrestricted Net Assets	$800,000	
Cr. Temporarily Restricted Net Assets		$800,000

According to SFAS # 116, paragraph 9, “Contributions of services shall be recognized if the services received (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation.” Therefore, an additional journal entry needed is:

Dr.	Diagnostic Treatment Center, Bristol, TN	$20,000	
Cr.	Temporarily Restricted Net Assets		$20,000

According to SFAC # 6, paragraph 115,

“Restrictions are removed from temporarily restricted net assets when stipulated conditions expire or are fulfilled by the organization. . . Purpose-restricted net assets generally become unrestricted when the organization undertakes activities pursuant to the specified purpose, perhaps over several periods, depending on the nature of donors’ stipulations. The resulting reclassifications increase unrestricted net assets, often at the same time that the activities that remove the restrictions result in expenses that decrease unrestricted net assets. Temporarily restricted net assets may become unrestricted when an organization incurs liabilities to vendors or employees as it undertakes the activities required by donor stipulations.”

Therefore, an additional journal entry needed is:

Dr.	Temporarily Restricted Net Assets	$120,000	
Cr.	Unrestricted Net Assets		$120,000

It does not matter that more was raised than needed for the project. Once the project is completed, the remaining balance of gifts temporarily restricted for this purpose will be transferred to Unrestricted Net Assets.

5) No journal entry is required for this board designation of endowments. Board designations are not the same as donor restrictions. SFAS # 117 discusses this issue as part of unrestricted net assets (paragraph 116). The standard allows disclosure of board designations in the notes or on the face of the financial statements. However, these designations would be shown as a component on unrestricted net assets.

When the Statement of Financial Position is prepared, the net unrestricted net asset amount, shown as a “Board-designated Endowment”, should be $9,455,350 (the $10,305,350 investment account, less the restricted amounts in journal entries 3 ($50,000) and 4 ($800,000) above).

6) SFAS # 116, paragraph 16, addresses the issue of what may be done with long-lived assets that have no donor restrictions. This land is clearly restricted as to use. The covenants restrict the CFSC from ever selling the land or using it for a purpose consistent with the purpose of the organization. Therefore, it should be recorded as permanently restricted.

If the land had not been recorded in the accounting records of the entity, the following entry should be made:

Dr. Land	$20,000	
Cr. Permanently Restricted Net Assets		$20,000

7) SFAS # 116, paragraph 14, clearly requires reporting this type of donation as restricted net assets. Therefore, the entry to correct the receipt is:

Dr. Unrestricted Net Assets	$25,000	
Cr. Permanently Restricted Net Assets		$25,000

SFAS # 117, paragraph 22, requires that changes in fair values of investments be reported as increases or decreases in unrestricted net assets, unless the use of the change in value is restricted by the donor. In this case, the donor said that interest and dividends were to be used for ongoing operations. Thus, these amounts would be reported as changes in unrestricted net assets. Therefore, the loss on the investment should also be reported as a change in unrestricted net assets.

8) SFAS # 116, paragraph 22, states that conditional promises to give should be recognized when the conditions are substantially met. Clearly, this situation exists. Assuming that the donor has not yet been notified, the following entries should be made:

For the amount due from the businessman:

Dr. Promises Receivable	$30,000	
Cr. Permanently Restricted Net Assets		$30,000

For the amounts already received from the "matching donors" and the amount to be reclassified by the CFSC:

Dr. Unrestricted Net Assets	$30,000	
Cr. Permanently Restricted Net Assets		$30,000

9) According to SFAS # 116 paragraph 20, not-for-profit organizations "shall report the contribution income as an increase in either temporarily or permanently restricted net assets if the underlying promise to give is donor restricted." According to paragraph 15, "Receipts of unconditional promises to give with payments due in future periods shall be reported as restricted support unless explicit donor stipulations or circumstances surrounding the receipt of a promise make clear that the donor intended it to be used to support activities of the current period."

In addition, according to SFAS # 116, "Recipients of unconditional promises to give shall disclose the following:

> The amounts of promises receivable in less than one year, in one to five years, and in more than five years.
>
> The amount of the allowance for uncollectible promises receivable.

Therefore, the journal entry needed is:

Dr. Pledges Receivable	$5,000	
Cr. Allowance for Uncollectible Pledges		$ 500
Cr. Temporarily Restricted Net Assets		$4,500

According to SFAS # 116, paragraph 155, the Financial Accounting Standards Board (FASB) decided to permit contributions with restrictions that are met in the same reporting period to be reported as unrestricted support provided that an organization reports consistently from period to period and discloses its accounting policy. Therefore, the gifts of $15,000 would not need to be reclassified to Temporarily Restricted Net Assets because the stipulation has been fulfilled during the same year that the gifts were received.

10) According to SFAS # 116, paragraph 7, "A donor-imposed condition on a transfer of assets or a promise to give specifies a future and uncertain event whose occurrence or failure to occur gives the promisor a right of return of the assets

transferred or releases the promisor from its obligation to transfer assets promised." Therefore, the gift must be returned to the donor. The journal entry needed is:

Dr. Unrestricted Net Assets	$10,000	
Cr. Gifts payable due to unfulfilled condition		$10,000

6. SFAS # 117 further requires certain financial statements be prepared for nonprofit entities. Identify these financial statements and briefly describe what is reported in each. Based on the data provided in the case and the journal entries prepared in question five, prepare an adjusted Statement of Financial Position.

Three financial statements are required of all nonprofit organizations. These three statements are as follows.

Statement of Financial Position. This financial statement reports in three broad categories: assets, liabilities, and net assets. The net asset classifications were discussed in a previous question. The standard does not require that assets and liabilities be reported in the same classifications.

Statement of Activities. This financial statement reports the revenues, expenses, gains, and losses of the nonprofit entity. These elements must be reported by net asset classification. In addition, the standard requires that reclassifications between the classes of net assets be reported.

Statement of Cash Flows. This statement follows the guidelines of SFAS # 95, *The Statement of Cash Flows*, with some modifications, including: requiring that donor-restricted contributions be reported as cash flows investing activities; and interest and dividends that are part of donor restrictions not be reported as cash flows operating activities.

A fourth financial statement, *Statement of Functional Expenses*, is required of all voluntary health and welfare organizations. This statement is to be prepared as a matrix showing natural classifications of expenses (salaries, rent, depreciation, etc.) by functional activity. This information may be presented by other nonprofit entities in the notes to the financial statements.

STRAYER EDUCATION, INCORPORATED: AN EQUITY VALUATION

James Stotler, North Carolina Central University

CASE DESCRIPTION

This case will require the student to value the equity of Strayer Education, Incorporated, (NYSE:STRA) 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 Strayer Education, Incorporated(NYSE:STRA) stock. Strayer Education, Inc. through its subsidiary, Strayer University, offers graduate and undergraduate degree programs in business, information technology, education and public administration. The student must assess the competitive environment of Strayer using the DuPont identity and Porter's five force model of competitive strategy as well as estimate the value of the stock. All information in the case is publicly available.

INSTRUCTORS' NOTES

Pedagogy

The valuation of the common stock of Strayer Education, Incorporated, the holding company operating Strayer University, 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 STRA stock.
4. Estimate the value for STRA stock using the constant growth model.
5. Determine the value estimate using a Price/Earnings valuation approach.
6. Find the value estimate for STRA 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.

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

Competition in this industry could be evaluated in two ways. It could be viewed as just other publicly traded for-profit educational services corporations. In this case, the threat of entry by new competitors would be quite high, particularly in the online sector since the entry costs would be much lower. The threat of new competitors is somewhat less in the campus based area, but it is still significant since it is common in the industry to lease instructional space (typically in a local office complex).

On the other hand, if the potential new competition is viewed as all degree granting institutions, the threat of entry by new competition would still be high. While it is unlikely that new public or private non-profit universities would be created to compete with companies like Strayer, it is very possible that existing non-profit universities could change their focus to target students who would have otherwise chosen to attend a corporate University.

Threat of substitute goods

The product offered by this industry (educational services) is a college degree or certificate. There are essentially no goods which could be substituted for a college degree. During good economic times many individuals choose to enter or stay in an employment position rather than going to college, but even this is not a substitute, it is just deferred consumption.

Bargaining power of buyers

The bargaining power of buyers in this industry is quite low. The buyers would be the students who are seeking a degree and the price would be the tuition, books and supplies. Tuition is typically set for given academic year and not negotiable. It also typically rises each year at most universities annually at a rate greater than inflation. In this industry, about one third of students rely on some type of government funding program, about one third rely on employers paying for tuition, and about one third rely on private funding sources including loans.

Bargaining power of suppliers

Suppliers in this industry would come in basically two forms. First, there would be faculty who supply the campus based or online instruction. Individual faculty negotiate their contracts in an open and union-free environment, however, due to the ample supply of potential faculty in most disciplines bargaining power is fairly low.

The other type of supplier in this industry would be the suppliers of campus instructional space. It is common in this industry for companies to own some of their instructional space, but most of the space is leased. In the case of leased instructional space the bargaining power of the suppliers of space will depend mostly on the local market factors such as occupancy rates. Suppliers bargaining power would be higher in markets with higher occupancy rates and lower in markets with lower occupancy rates.

Rivalry among existing competitors

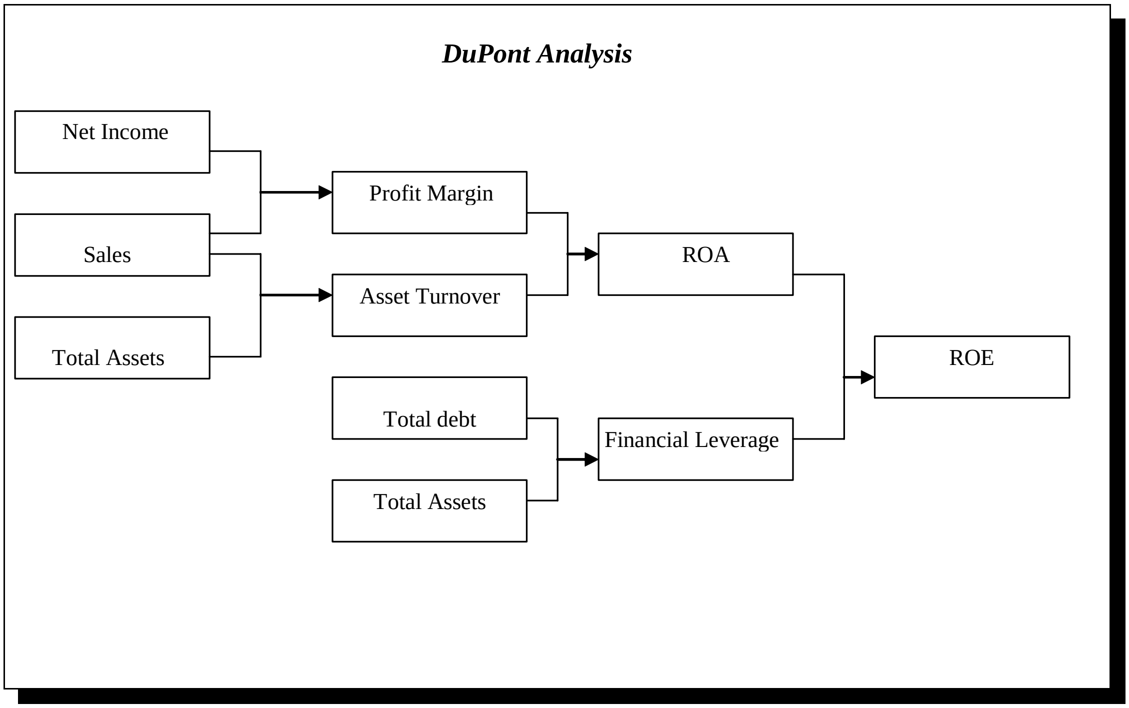
The rivalry among existing competitors in this industry is moderate to high. The primary focus among competitors in this industry is recruitment and retention. Most firms in the industry spend large amounts of advertising money to recruit new students, particularly in markets where new campuses are opened. To assure that students continue to take courses, most firms in the industry utilize retention managers. Typically, firms in this industry lack some of the factors that a traditional universities might be able to offer, such as campus life, athletics, student organizations and other extra-curricular activities. To compensate, many firms in the industry emphasize cost, convenience and an accommodating schedule in order to compete with traditional universities.

2. Analyze the ROE, Profit Margin, and ROA using the DuPont identity

The return on equity (ROE), profit margin, and return on assets (ROA) for Strayer, a select group of competitors, and the real estate industry was given as supplemental information. Knowing this information, the students can analyze the company's placement in the market and its profitability. Only one competitor has an ROE higher than Strayer. It can be seen from the relatively high profit margin that the company is more effective at controlling costs than other firms in the industry.

Strayer has an ROA of 31.7 percent which is second only to Apollo Group, Inc. and well above the industry average of 19.68 percent. As noted above Strayer's ROE is also above the industry average and also equal to the ROA of 31.7 percent. Students should recognize that since the ROA and ROE for Strayer are equal, they have no debt in their capital structure. For other firms in the industry ROA and ROE are not equal, indicating the other firms do have debt in their capital structures. This does not mean that a change is needed. It just indicates that Strayer operates with a more conservative capital structure.

Even though there were not any computations that were needed to determine the ratios, the students should recognize that the ROA is a component of the ROE. Refer to the diagram below:



3. Calculate the expected return for stock.

The Capital Asset Pricing Model (CAPM) will be used to calculate the expected return for Strayer stock. The formula for the CAPM model is as follows:

$$R_E = R_F + \beta * (R_M - R_F)$$

R_E - Expected return on a security
R_F - Risk-free rate (long term government bond yields)
β - Beta of STRA: This is a measure of systematic risk. The beta measures the correlation of a stocks total return with the market return.
R_M - Expected return on the market (The S&P 500 used as a proxy)

The expected return estimate:

$$R = .05 + ..85\ (.10\text{-}.04) = .101 \text{ or } 10.1\%$$

4. Estimate the value for the stock using the constant growth model.

The Constant Growth Model can be used here. It allows the students to determine the value estimate for stock by using the discount rate and finding the growth rate. The formula for the stock value is:

$$\frac{Div}{(r-g)}$$

Div – the expected dividend to be paid in the next period
r – the discount rate also termed as the expected return
g – the growth rate

As stated in the case growth rate expectations are about 16 percent per year for the next 5 years.

It is not reasonable to assume that this growth rate will continue in the future for valuation purposes. It will likely decline at some point in the future. As a result, the constant growth model would not be appropriate to use in this type of valuation. In this case the growth rate of 16 percent exceeds the required return of 10.1 percent estimated above. The 2-stage Dividend Discount model would be more appropriate in this valuation.

5. Determine the value estimate using a Price/Earnings valuation approach.

The value of the stock will now be determined in this segment using the Price/Earnings approach. The earnings per share and the price earnings ratio is needed. It should be noted that most analysts expect the forward looking P/E ratio to decline. The formula is as follows:

EPS * P/E = Stock Value

$3.55 * 30 = $106.50

6. Find the value estimate using the two-stage Dividend Discount Model.

5 Year Projection: $EPS_5 = EPS * (1+g)^5 =$
$EPS_5 = \$3.55 * (1+.16)^5 = \$7.46$
$P_5 = 30*7.46 = \$223.80$

The value of the stock will now be calculated using a discount rate of .101 +/- .01 and growth rates from .14 to .18 varying by +/- .02 for the next 5 years. The formula for DDM is:

$$P_0 = PV(D_1) + PV\ (D_2) + PV(D_3) + PV(D_4) + PV(D_5 + P_5)$$

Sensitivity to changes in the required return and growth rate

	r =.091	R = .101	R = .111
g = .14	150.51	143.89	137.63
g = .16	150.83	144.21	137.93
g = .18	151.15	144.52	138.23

7. Present an overall external investment recommendation to buy or sell the stock based on your analysis. Explain.

The price quote for a share of Strayer Education, Incorporated given in the case $106. Given the valuations methods exhibited in this case the stock seems to be undervalued. The stock should be given a buy recommendation based on the results of the sensitivity analysis using the 2-Stage dividend discount model. All value estimates in the sensitivity analysis indicate that the stock is undervalued. In addition, the P/E model indicates a buy as well. Overall, a buy recommendation is appropriate. Other profitable strategies would include buying a call option, selling a put option or a long margined position.

CAPE CHEMICAL: CASH MANAGEMENT

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

CASE DESCRIPTION

The primary subject matter of this case concerns the development and use of a cash budget as a key component in a cash management system. The case also allows an examination of the difference between accounting profit (based on accrual accounting) versus cash flow. The case requires students to have an introductory knowledge of accounting, finance and general business issues, thus the case has a difficulty level of three (junior level) or higher. The case is designed to be taught in one class session of approximately 1.25 hours and is expected to require 3-4 hours of preparation time from the students.

CASE SYNOPSIS

Cape Chemical is a regional distributor of liquid and dry chemicals. Growth has been steady since its beginning, but cash to pay employees and vendors in a timely manner has frequently been a problem. While the company ended its last year with a healthy cash balance, there were many occasions during the year that it was necessary to delay vendor payments or obtain short-term bank loans in order to keep the company operating. On one occasion when a major vendor threatened to stop shipments until all outstanding balances were current and the bank credit was fully used, company credit cards were used to obtain $20,000 to pay (satisfy) the vendor. In an effort to resolve the cash problems, the company has developed a projected income statement, balance sheet and cash flow statement for the next year of operation. Cape Chemical's bank officer suggested the company prepare a monthly cash budget as another cash management tool and as an additional test of the adequacy of the current $200,000 line of credit.

INSTRUCTORS' NOTES

Case Overview

Cape Chemical is a relatively new, regional distributor of liquid and dry chemicals, headquartered in Cape Girardeau, Missouri. The company, founded by Ann Stewart, has been serving southeast Missouri, southern Illinois, northeast Arkansas, western Kentucky and northwest Tennessee for three years and has developed a reputation as a reliable supplier of industrial chemicals. Stewart's previous business experience provided her with a solid understanding of the chemical industry and the distribution process. As a general manager for a chemical manufacturer Stewart had Profit & Loss (P&L) responsibility, but until beginning Cape Chemical she had limited exposure to company accounting and finance decisions.

To improve management of the accounting and finance area, Stewart hired Kathy Ford, an accountant who had worked with the accounting firm that conducted Cape's first audit. Ford was hired near end of the second year of operation.

During the first three years of operations, Cape Chemical operated with a sales forecast and a few operating budgets but a complete set of pro forma statements were not prepared. In an effort to resolve the cash problems, Stewart, with the help of Ford, developed a projected income statement, balance sheet and cash flow statement for the next year of operation (tables one, two and three).

Ford thought the statements indicated the company's cash problems where solved. "Look Ann, if our forecasts are correct, and our forecast should be accurate, since our assumptions were based on historical data and current market conditions, we are in a very good financial position. We begin the year with a cash balance of $226,350 and our projections indicate an ending cash balance of $85,645, well above our target of a minimum balance of $20,000. The income statement projects our highest profit ever and while our ending cash balance is lower than our higher cash balance, we will not have used any of the $200,000 bank line of credit. Our cash problems should be history." Stewart agreed the projected performance looks good, but she was still not ready to agree that cash problems were history.

When Stewart and Ford were reviewing the projections with Cape Chemical's bank officer, he suggested the company prepare a monthly cash budget as another cash management tool and as an additional test of the adequacy of the current $200,000 line of credit. Stewart liked the idea. Later when Stewart and Ford discussed preparing a cash budget, Stewart indicated she had no experience in preparing or using a cash budget. Ford stated that she also had limited experience preparing and using a monthly cash budget but she thought it was similar to preparing forecasted financial statements. The big difference is that monthly rather than annual projections would be needed. The Ford stated the first step would be to prepare a list of monthly operating assumptions.

DISCUSSION QUESTIONS

1. Construct a monthly cash budget for Cape Chemical for the period January through December 2007. Assume that all cash flows occur on the 15th of each month. Is the current $200,000 line of credit sufficient to meet the needs of Cape Chemical during the year? Explain your answer.

The complete cash budget is provided in Table One. A summary of the budget is as follows: (based on a collection schedule of 25% collected in the month of the sale, 60% collected in the month following the sale and 15% collected in the second month following the sale). For example, 25% of January sales will be collected in January, 60% of January sales will be collected in February and 15% of January sales will be collected in March.

	Cash Inflows	Cash Out Flows	Net Cash	Beginning Cash	Ending Cash Before Borrowing	Required Borrowing *	Cum. Borrowing Revolving Credit
	$	$	$	$	$	$	$
							0
Jan	294,600	385,700	(91,100)	226,350	135,250	0	0
Feb	267,900	354,450	(86,550)	135,250	48,700	0	0
Mar	306,000	422,550	(116,550)	48,700	(67,850)	87,850	87,850
Apr	351,000	512,335	(161,335)	20,000	(141,335)	161,335	249,185
May	375,000	491,250	(116,335)	20,000	(96,250)	116,250	365,435
Jun	426,000	579,350	(153,350)	20,000	(133,350)	153,350	518,785
Jul	486,000	610,935	(124,935)	20,000	(104,935)	124,935	643,720
Aug	546,000	628,050	(82,050)	20,000	(62,050)	82,050	725,770
Sep	606,000	650,550	(44,550)	20,000	(24,550)	44,550	770,320
Oct	666,000	568,035	97,965	20,000	117,965	(97,965)	672,355
Nov	711,000	293,650	417,350	20,000	437,350	(417,350)	255,005
Dec	690,000	369,350	320,650	20,000	340,650	(255,005)	0
Jan				85,645			
*To maintain a minimum cash balance of $20,000							

The cash budget indicates that Cape Chemical will exceed the $200,000 line of credit during the months of April (borrowing required $249,185) through November (borrowing required $255,005). A peak borrowing requirement of $770,320 occurs in September. Based on the assumptions used to prepare the cash budget, the current $200,000 line of credit will fall well short meeting the needs of Cape Chemical.
Note: Students answers may vary by a few dollars due to spreadsheet rounding.

2. The cash budget contains both cash inflows and cash outflows. Which do you feel are likely to be the most accurate? Explain your answer.

Cash outflows result from expenditures (purchases of inventory, capital investments, selling expenses, general and administrative expenses and interest expense) controlled by Cape Chemical thus are likely to have a higher degree of accuracy (both the amount and timing of the outflow) than the inflows. Inflows depend upon sales activity and collections. Product must be sold and receivables collected. Cape Chemical has less control over the amount and the timing sales and collections, thus inflows are likely to be less accurate than the outflows.

3. Stewart thought it would be beneficial to prepare an additional cash budget based on the 2006 collection schedule (a less optimistic assumption).

2006 Collection Schedule	% of sales
Current Month	20.0
Month following the sale	50.0
Second month following the sale	30.0

Will the $200,000 line of credit be sufficient? Explain your answer.

Note: Assume $39,000 of November and $195,600 of December revenue will be collected in January. Assume $48,900 of December revenues will be collected in February.

The complete cash budget is provided in Table Two. A summary of the budget is as follows: (based on a collection schedule of 20% collected in the month of the sale, 50% collected in the month following the sale and 30% collected in the second month following the sale). For example, 20% of January sales will be collected in January, 50% of January sales will be collected in February and 30% of January sales will be collected in March.

	Cash Inflows	Cash Out Flows	Net Cash	Beginning Cash	Ending Cash Before Borrowing	Required Borrowing *	Cum Borrowing
	$	$	$	$	$	$	$
							0
Jan	282,600	385,700	(103,100)	226,350	123,250	0	0
Feb	228,900	354,450	(125,550)	123,250	(2,300)	22,300	22,300
Mar	294,000	422,550	(128,550)	20,000	(108,550)	128,550	150,850
Apr	342,000	512,335	(170,335)	20,000	(150,335)	170,335	321,185

	Cash Inflows	Cash Out Flows	Net Cash	Beginning Cash	Ending Cash Before Borrowing	Required Borrowing *	Cum Borrowing
	$	$	$	$	$	$	$
May	372,000	491,250	(119,250)	20,000	(99,250)	119,250	440,435
Jun	414,000	579,350	(165,350)	20,000	(145,350)	165,350	605,785
Jul	474,000	610,935	(136,935)	20,000	(116,935)	136,935	742,720
Aug	534,000	628,050	(94,050)	20,000	(74,050)	94,050	836,770
Sep	594,000	650,550	(56,550)	20,000	(36,559)	56,550	893,320
Oct	654,000	568,035	85,965	20,000	105,965	(85,965)	807,355
Nov	702,000	293,650	408,350	20,000	428,350	(408,350)	399,005
Dec	696,000	369,350	326,650	20,000	346,650	(326,650)	72,355
* To maintain a minimum cash balance of $20,000							

The cash budget indicates that Cape Chemical will exceed the $200,000 line of credit during the months of April (borrowing required $321,185) through November (borrowing required $399,005). A peak borrowing requirement of $893,320 occurs in September. Not surprisingly, the slower collection schedule increases the cash needs of Cape Chemical. The current $200,000 line of credit will not be sufficient to meet the needs of Cape Chemical.

Note: Students answers may vary by a few dollars due to spreadsheet rounding.

4. Why is depreciation expense not part of the cash budget?

Depreciation is a non-cash expense, thus it is not explicitly included in the cash budget. Depreciation expense does reduce a firm's income tax payments thus it does have an indirect impact on the cash budget.

5. The monthly cash budget prepared assumes that all cash flows occur on the 15th of each month. Suppose most of Cape Chemical's outflows are at the beginning of the month, while its collections are toward the end of each month. How would this fact alter the cash budget?

If outflows were mostly at the beginning of the month and inflows mostly at end, the monthly net would remain the same but the cash deficit during the month would be larger than indicted by the monthly balance. The cash deficit during the month can be identified by preparing a weekly or daily cash budget for the month.

6. Temporary excess cash can be invested in marketable securities. What are the characteristics of marketable securities? If excess cash is projected to be continuing rather than temporary, are marketable securities the appropriate investment? Explain your answer.

Cash is a non-earning asset. Marketable securities are short-term (maturities less than a year) debt instruments which have low-risk and are highly liquid and are held in lieu of cash. Given the characteristics of low-risk and high liquidity, the expected return on marketable securities is low but it is greater than the zero return on cash. Treasury bills, bank certificates of deposits (CDs) and money market mutual funds are marketable securities.

If the forecasts showed surpluses indefinitely, the firm would want to evaluate how to best use the surplus. They could consider reducing debt, paying or increasing dividends or repurchasing stock.

7. Once again assume all cash flows occur on the 15th of each month. How large of a line of credit would you recommend Stewart and Ford arrange with the bank? Defend your answer.

There is no correct answer but it should be apparent to the students at this point that the proposed $200,000 credit agreement is not sufficient. The consequences of insufficient cash (delaying payment to vendors, employees, and the bank) are much greater than having excess cash (higher interest expense). It is better to error on the side of conservatism; by having too much cash, than risk an unexpected cash shortfall. The cash budget based on a collection schedule of 25% collected in the month of the sale, 60% collected in the month following the sale and 15% collected in the second month following the sale indicates a maximum cash requirement of $770,320. A revolving credit agreement of $1,200,000 or more would not be excessive.

8. Suppose the bank refused to grant a larger line of credit what options are available to the company?

If the bank fails to provide a larger line of credit Cape Chemical has two basic options, find another source of credit or reduce or delay internal cash requirements. Approaching another bank for the short-term credit would represent an external source. If an external source is not an option then the firm may reduce cash outflows by reducing or postponing expenditures (promotion and advertising, capital expenditures, etc). The company currently purchases inventory two months prior to the sale, perhaps a better inventory system may allow the company to purchase inventory one month prior to the sale, thus reducing the average inventory balance and capital required. Another option would be to negotiate extended credit terms with suppliers or delay payments to suppliers without negotiations to receive additional vendor credit.

Table One: Cash budget based on collection schedule of 25/60/15

Cash Budget	Jan.	Feb.	March	April	May	June	July	August	Sept.	Oct.	Nov.	Dec.
	$	$	$	$	$	$	$	$	$	$	$	$
Cash Inflows												
Collections (1)	**294,600**	**267,900**	**306,000**	**351,000**	**375,000**	**426,000**	**486,000**	**546,000**	**606,000**	**666,000**	**711,000**	**690,000**
Cash Outflows												
Purchases	273,600	273,600	319,200	364,800	410,400	456,000	501,600	547,200	547,200	456,000	212,800	266,000
Plt Op. Exp (2)	42,375	42,375	42,375	42,375	42,375	42,375	42,375	42,375	42,375	42,375	42,375	42,375
Selling Exp (2)	40,925	18,125	18,125	36,125	18,125	18,125	37,925	18,125	18,125	40,625	18,125	18,125
G&A Exp (2)	20,350	20,350	20,350	20,350	20,350	20,350	20,350	20,350	20,350	20,350	20,350	20,350
Capital Exp.				40,000		20,000						
Interest Expense			22,500			22,500			22,500			22,500
Income Taxes	8,450			8,685			8,685			8,685		
Total	**385,700**	**354,450**	**422,550**	**512,335**	**491,250**	**579,350**	**610,935**	**628,050**	**650,550**	**568,035**	**293,650**	**369,350**
Net Cash Flow	**(91,100)**	**(86,550)**	**(116,550)**	**(161,335)**	**(116,250)**	**(153,350)**	**(124,935)**	**(82,050)**	**(44,550)**	**97,965**	**417,350**	**320,650**
Beg Cash	226,350	135,250	48,700	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000
Net Cash Flow	(91,100)	(86,550)	(116,550)	(161,335)	(116,250)	(153,350)	(124,935)	(82,050)	(44,550)	97,965	417,350	320,650
Borrowing	0	0	87,850	161,335	116,250	153,350	124,935	82,050	44,550	(97,965)	(417,350)	(255,005)
Ending Cash	135,250	48,700	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	85,645
Cum Borrowing	0	0	87,850	249,185	365,435	518,785	643,720	725,770	770,320	672,355	255,005	0

(1) see table one (a) for details; (2) see table one (b) for details.

Table One (a)

Collections												
	Jan.	**Feb.**	**March**	**April**	**May**	**June**	**July**	**August**	**Sept.**	**Oct.**	**Nov.**	**Dec.**
	$	$	$	$	$	$	$	$	$	$	$	$
Sales	240,000	300,000	360,000	360,000	420,000	480,000	540,000	600,000	660,000	720,000	720,000	600,000
Collections												
Month of sale	60,000	75,000	90,000	90,000	105,000	120,000	135,000	150,000	165,000	180,000	180,000	150,000
2^{nd} Month	195,600*	144,000	180,000	216,000	216,000	252,000	288,000	324,000	360,000	396,000	432,000	432,000
3^{rd} Month	39,000**	48,900*	36,000	45,000	54,000	54,000	63,000	72,000	81,000	90,000	99,000	108,000
	294,600	**267,900**	**306,000**	**351,000**	**375,000**	**426,000**	**486,000**	**546,000**	**606,000**	**666,000**	**711,000**	**690,000**

*from December sales; ** from November sales *from December sales; ** from November sales

Table One (b)

Out Flows												
	Jan.	**Feb.**	**March**	**April**	**May**	**June**	**July**	**August**	**Sept.**	**Oct.**	**Nov.**	**Dec.**
	$	$	$	$	$	$	$	$	$	$	$	$
Cash Outflows												
Plt. Oper. Exp.												
Mgr Salary	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375
Wages/Benefits	18,750	18,750	18,750	18,750	18,750	18,750	18,750	18,750	18,750	18,750	18,750	18,750
Lease Expense	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000
Utilities Expense	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
R & M Expense	500	500	500	500	500	500	500	500	500	500	500	500
Supplies Expense	750	750	750	750	750	750	750	750	750	750	750	750
Delivery Expense	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Misc. Expense	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
	42,375	**42,375**	**42,375**	**42,375**	**42,375**	**42,375**	**42,375**	**42,375**	**42,375**	**42,375**	**42,375**	**42,375**
Selling Expenses												
Sales Reps	8,750	8,750	8,750	8,750	8,750	8,750	8,750	8,750	8,750	8,750	8,750	8,750
T&E	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Commissions	9,300			4,500			6,300			9,000		

Table One (b)												
Out Flows												
	Jan.	**Feb.**	**March**	**April**	**May**	**June**	**July**	**August**	**Sept.**	**Oct.**	**Nov.**	**Dec.**
	$	$	$	$	$	$	$	$	$	$	$	$
Auto Expense	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Int. Sales Reps	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375
Prom. & Advert	13,500			13,500			13,500			13,500		
Bad Debt Exp.	0	0	0	0	0	0	0	0	0	0	0	0
	40,925	**18,125**	**18,125**	**36,125**	**18,125**	**18,125**	**37,925**	**18,125**	**18,125**	**40,625**	**18,125**	**18,125**
G & A. Exp.												
Officer's Salaries	6,975	6,975	6,975	6,975	6,975	6,975	6,975	6,975	6,975	6,975	6,975	6,975
T&E	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Auto Expense	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Admin. Staff	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375
Utility Expense	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Office Supplies	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Insurance	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Legal & Prof.	500	500	500	500	500	500	500	500	500	500	500	500
Miscellaneous	500	500	500	500	500	500	500	500	500	500	500	500
	20,350	**20,350**	**20,350**	**20,350**	**20,350**	**20,350**	**20,350**	**20,350**	**20,350**	**20,350**	**20,350**	**20,350**

Table Two: Cash budget based on collection schedule of 20/50/30												
Cash Budget	**Jan.**	**Feb.**	**March**	**April**	**May**	**June**	**July**	**August**	**Sept.**	**Oct.**	**Nov.**	**Dec.**
	$	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**
Cash Inflows												
Collections (1)	**282,600**	**228,900**	**294,000**	**342,000**	**372,000**	**414,000**	**474,000**	**534,000**	**594,000**	**654,000**	**702,000**	**696,000**
Cash Outflows												
Purchases	273,600	273,600	319,200	364,800	410,400	456,000	501,600	547,200	547,200	456,000	212,800	266,000
Plt Op. Exp (2)	42,375	42,375	42,375	42,375	42,375	42,375	42,375	42,375	42,375	42,375	42,375	42,375
Selling Exp (2)	40,925	18,125	18,125	36,125	18,125	18,125	37,925	18,125	18,125	40,625	18,125	18,125
G&A Exp (2)	20,350	20,350	20,350	20,350	20,350	20,350	20,350	20,350	20,350	20,350	20,350	20,350
Capital Exp.				40,000		20,000						
Interest Expense			22,500			22,500			22,500			22,500

Table Two: Cash budget based on collection schedule of 20/50/30												
Cash Budget	**Jan.**	**Feb.**	**March**	**April**	**May**	**June**	**July**	**August**	**Sept.**	**Oct.**	**Nov.**	**Dec.**
	$	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**
Income Taxes	8,450			8,685			8,685			8,685		
Total	**385,700**	**354,450**	**422,550**	**512,335**	**491,250**	**579,350**	**610,935**	**628,050**	**650,550**	**568,035**	**293,650**	**369,350**
Net Cash Flow	**(103,100)**	**(125,550)**	**(128,550)**	**(170,335)**	**(119,250)**	**(165,350)**	**(136,935)**	**(94,050)**	**(56,550)**	**85,965**	**408,350**	**326,650**
Beginning Cash	226,350	123,250	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000
Net Cash Flow	(103,100)	(125,550)	(128,550)	(170,335)	(119,250)	(165,350)	(136,935)	(94,050)	(56,550)	85,965	408,350	326,650
Borrowing	0	22,300	128,550	170,335	119,250	165,350	136,935	94,050	56,550	(85,965)	(408,350)	(326,650)
Ending Cash	123,250	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000
Cum Borrowing	0	22,300	150,850	321,185	440,435	605,785	742,720	836,770	893,320	807,355	399,005	72,355

(1) see table one (a) for details; (2) see table one (b) for details.

Table Two (a)												
Collections												
	Jan.	**Feb.**	**March**	**April**	**May**	**June**	**July**	**August**	**Sept.**	**Oct.**	**Nov.**	**Dec.**
	$	$	$	$	$	$	$	$	$	$	$	$
Sales	240,000	300,000	360,000	360,000	420,000	480,000	540,000	600,000	660,000	720,000	720,000	600,000
Collections												
Month of sale	48,000	60,000	72,000	72,000	84,000	96,000	108,000	120,000	132,000	144,000	144,000	120,000
2nd Month	195,600*	120,000	150,000	180,000	180,000	210,000	240,000	270,000	300,000	330,000	360,000	360,000
3rd Month	39,000**	48,900*	72,000	90,000	108,000	108,000	126,000	144,000	162,000	180,000	198,000	216,000
	282,600	**228,900**	**294,000**	**342,000**	**372,000**	**414,000**	**474,000**	**534,000**	**594,000**	**654,000**	**702,000**	**696,000**
*from December sales; ** from November sales												

Table Two (b)

Out Flows												
	Jan.	**Feb.**	**March**	**April**	**May**	**June**	**July**	**August**	**Sept.**	**Oct.**	**Nov.**	**Dec.**
	$	$	$	$	$	$	$	$	$	$	$	$
Cash Outflows												
Plt. Oper. Exp.												
Mgr Salary	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375
Wages/Benefits	18,750	18,750	18,750	18,750	18,750	18,750	18,750	18,750	18,750	18,750	18,750	18,750
Lease Expense	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000
Utilities Expense	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
R & M Expense	500	500	500	500	500	500	500	500	500	500	500	500
Supplies Expense	750	750	750	750	750	750	750	750	750	750	750	750
Delivery Expense	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Misc. Expense	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
	42,375	42,375	42,375	42,375	42,375	42,375	42,375	42,375	42,375	42,375	42,375	42,375
Selling Expenses												
Sales Reps	8,750	8,750	8,750	8,750	8,750	8,750	8,750	8,750	8,750	8,750	8,750	8,750
T&E	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Commissions	9,300			4,500			6,300			9,000		
Auto Expense	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Int. Sales Reps	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375
Prom. & Advert	13,500			13,500			13,500			13,500		
Bad Debt Exp.	0	0	0	0	0	0	0	0	0	0	0	0
	40,925	18,125	18,125	36,125	18,125	18,125	37,925	18,125	18,125	40,625	18,125	18,125
G & A. Exp.												
Officer's Salaries	6,975	6,975	6,975	6,975	6,975	6,975	6,975	6,975	6,975	6,975	6,975	6,975
T&E	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Auto Expense	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Admin. Staff	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375	4,375
Utility Expense	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Office Supplies	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Insurance	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Legal & Prof.	500	500	500	500	500	500	500	500	500	500	500	500
Miscellaneous	500	500	500	500	500	500	500	500	500	500	500	500
	20,350	20,350	20,350	20,350	20,350	20,350	20,350	20,350	20,350	20,350	20,350	20,350

DR. TALAL'S HONDA

Nile M. Khanfar, Nova Southeastern University
David Loudon, Samford University

CASE DESCRIPTION

The primary subject matter of this case concerns the consumer purchase decision process for a new automobile. Secondary isues examined include the ethics involved in certain actions by dealer representatives, how small businesses must tightly manage their sales efforts, proper business etiquette when dealing with customers, and understanding customer satisfaction issues in the automobile selling environment. The case has a difficulty level of four, appropriate for senior level. The case is designed to be taught in one class hour and is expected to require one hour of outside preparation by students.

CASE SYNOPSIS

Dr. Sultan Talal and his wife have made a decision that they need to purchase a new minivan to replace the older large-size van they own. Talal has decided on a Honda Odyssey, even without test driving the vehicle for confirmation. The case takes the reader through the various stages in the decision process from information gathering to decision and postpurchase activities. Talal experiences many typical consumer interactions in this environment. The case focuses on some of the ineffective actions taken by employees in the dealership including inadequate sales effort, rudeness, unethical behavior, and poor customer relations and follow-up.

INSTRUCTORS' NOTES

Recommendations for Teaching Approaches

This case is designed for use in undergraduate marketing courses to help students:

- learn how to deal with customer satisfaction and ethical issues in a personal selling situation for a small business organization;
- evaluate an actual sales incident and critique the approach taken to develop improved strategies for a car dealership.

It is very suitable for a written report and/or oral presentation by students. It can also be used for examination purposes. The case lends itself to a variety of marketing courses, including Principles, Services, Consumer Behavior, Personal Selling, Ethics, and Strategy. It can also be used as a role-playing device in any of these courses. Faculty may want to cover the following elements in their discussion of the case.

DISCUSSION POINTS

Brand Loyalty

Ask students "Why did Dr. Talal seek out a Honda dealer?" Brand loyalty is the key reason that he is searching for a dealership in order to buy another Honda. Satisfaction with the reliability, dependability and brand quality of his first Honda has led Dr. Talal to trust the brand so strongly that he was willing to buy another Honda without even taking it for a test drive. Ask students if they could consider spending $30K on a vehicle without a test drive. Dr. Talal did. The Honda customer profile is different from other brands. Honda customers tend to be more educated and value driven.

Location

Ask students how important they think location is for such a decision as this. The location of the nearest dealer is always an important consideration in purchase decisions. For products such as automobiles, which may need after-sale fine tuning or service, it can be a very important issue. Dr. Talal decided to purchase the vehicle from the Honda dealership closest to his house, if possible. Although he did not shop the price of the vehicle with local dealerships, he did find out the cost of the vehicle from a dealership in his previous hometown just to keep the Florida dealer "honest."

Consumer Behavior

Ask students if they can identify any stages in the consumer decision process. They should be able to generate discussion about the problem identification stage, information search and evaluation, purchase decision stage, and postpurchase behavior. An interesting situation in this case is that the early Honda brand choice determination eliminated much of the information search and evaluation that many car-buying consumers go through as they travel (or surf) from brand to brand or dealer to dealer.

Ask students if the purchase decision process in the case is highly representative of what they would expect for most car purchase situations. The first encounter the customer, Dr. Talal, has with the sales representative at the car dealership may seem somewhat unrealistic. Seldom does a sales representative at a car dealership give his best price on the first encounter with no bargaining or negotiation. The negotiation process was not the usual situation because the sales person was aware that Talal was a former Mercedes-Benz sales manager as indicated in the case; therefore, he was aware that Talal would undoubtedly find out the cost of the vehicle. As a result the rep gave Talal a very fair price of $26,994 plus fees for a vehicle considered to be a hot seller. This price results in almost $650.00 profit to the dealership. From Talal's experience, he knew that the rep's commission would likely be $50-100. Talal's goal was not to bleed the salesman, who had given him an excellent deal. Talal knew that he might need his help in the service department at some time in the future. This point can be a good issue to stimulate students' thinking about fairness and ethics in negotiation.

In the auto sector, as in many other industries, a downpayment is a normal part of the purchase process. Ask students why they think Dr. Talal, a highly intelligent professor with a PhD, did not ask the amount that would be charged before giving the sales representative his credit card? Students will find that in the car business a deposit normally does not exceed $500 dollars. In fact, Talal used to charge only that amount when ordering a $50k Mercedes-Benz for his customers. Also, a deposit is a psychological commitment to the sale. As the sequence of events in the case indicates, Talal had made them a firm commitment and, in fact, East Coast Honda had already sent a driver to the nearby dealership to pick up his minivan. All of that was done before they asked him for the deposit. Therefore, he probably assumed it was unnecessary to even ask for a deposit. Additionally, a deposit is normally used to test the credibility of the customer. The sales person should have known that Talal was credible person, since he had his business card and had called him at his office several times. The sales person also knew that Talal was not using the deposit as a down payment because he was paying for the vehicle with a cashier's check. A proper approach in this situation would have been for the rep to clearly state the amount that he intended to charge and to ask for Talal's permission.

Students might also be asked if they think there are any significant "environmental" factors that may have influenced behavior in the case. There are many possibilities they might suggest. The role of family life cycle stage, spousal power and influence, and cultural/subcultural factors are some of the obvious elements students could identify and discuss.

It is possible that prejudice arose in the buying situation with Reed because his sons were soldiers serving in Iraq and Afghanistan. Also the name Talal is a well known Middle Eastern name. It may also be possible that having Dr. Talal's extended family in Reed's office aggravated him. While it is not at all unusual in the automobile business for the whole family to be in the finance manager's office, in this situation perhaps Reed was aggravated by seeing that many foreign people, especially two females wearing middle eastern garb, and a successful middle eastern college professor. Ms. Talal's parents were there because if they were left outside the office it might be culturally disrespectful.

Students could be asked their reaction to the extended family showing up for the purchase. This could be another cultural factor in the case. From a sales standpoint, it is important that the family shows up to look and take delivery of a spotless vehicle and to even take pictures with it (most dealers will do this for purchasers to post in their company scrapbooks). These are the lasting moments that buyers will always remember. Because this vehicle was to be for Dr. Talal's wife, having her parents participate in the purchase process in which the minivan is picked up gives them a good feeling that their daughter is well cared for. Remind students that in automobile marketing (as in other settings), we are not just selling vehicles but rather we are providing solutions and great feelings of customer satisfaction, even extending to important bystanders of the purchase event.

Personal Selling Issues

Ask students to cite some of the personal selling interactions that occurred with dealership personnel that were not effective. The salespeople and finance manager need to take lessons in customer service and how to greet a customer. The initial salesperson, Mr. Donald, gave Dr. Talal a brochure when they first met and told him to look at it and let him know whenever he was ready to come back! He made some potentially fatal assumptions. He assumed that the customer would automatically return, and return to him. The salesperson needs to follow a greeting protocol and a pre-qualifying process and never to underestimate the power and options (other brands and dealers) available to the customer.

The finance manager and the salesperson should always respect the wishes of the customer. If the customer decides to pay cash for a vehicle, then it is the job of the finance manager to offer other options to the customer, but never to misrepresent or deceive the customer into financing with the dealership. In this case, the finance manager "forced" the salesperson to give Dr. Talal a blank credit application for him to sign. When Dr. Talal asked "why," he was told it was a post-911 federal law. At this point, not only was dealership policy and the law misrepresented, but also the customer was lied to and his intelligence insulted (as a highly educated person and a former Mercedes-Benz sales and finance manager). This was a clear violation of the law and could have resulted in severe repercussions for the individuals and dealership. This illustrates to students just you how far some employees in the car business will go to make an extra dollar. Even though the Honda dealership was a member of the prestigious President's Club, unfortunately the personnel reflected a negative image that has become widespread within the new car industry.

The case notes that Dr. Talal thought that pulling the credit might reduce his credit score. Dr. Talal assumed that whenever a company pulls someone's credit report, the credit agency tracks the frequency of inquires and the names of companies that pulled the person's credit. If the customer has been to several dealerships and all of those dealerships pulled his credit, a bank may look unfavorably toward this because they will wonder why he did not buy or get financed. Actually, there are "soft" inquiries and "hard" inquiries. A soft inquiry could be made by a lender to make you a preapproved offer or a car dealer to check your credit report. Hard inquiries occur when lenders pull one's credit report in response to your application for credit, and could contribute to a lower credit score depending on what else is in your credit report. Fair Isaac, the maker of the FICO score, states that its scores ignore all auto-loan inquiries made in a rolling 30-day period prior to scoring and typically count car-loan inquiries older than 30 days as one inquiry when they are made within a 45-day period.

Customer Satisfaction

Ask students how important they think customer satisfaction is in the automotive industry. They should be aware of the concept of "customer lifetime value." For example, GM believes a customer could be worth over $275K to them during their purchase lifetime. This assumes that a loyal buyer will purchase over 11 GM vehicles during that time.

Dealerships generally strive to obtain high Customer Satisfaction Index scores from customers. The scores are tabulated from customer satisfaction surveys conducted via phone or mail by American Honda Corporation, which is a subsidiary of the Honda parent in Japan. Some dealerships will offer a free oil and filter change just to entice customers into giving them high scores. Or they might offer no charge-rental cars in the service department for Honda customers whenever they bring in their cars for service.

Ask students how they think a dealer might benefit from high CSI scores. Dealerships that obtain high CSI scores will be given priority to choose from limited-availability vehicles or even get a higher quota of supply of vehicles. In a very competitive market (e.g., south Florida) this could be a very important differentiating edge for the dealership. They will also get bonus money that is tied to volume under the condition that the dealership maintains high CSI scores. The dealership may also get a designated elite status such as the prestigious President's Club. Such status may then be reflected in dealership advertising, managers' and salespeople's business cards and letterheads. The designation will help the dealership to promote itself and Honda products to the public in an impressive and convincing way.

A very important point to bring out is that dealerships spend huge amounts of money in newspaper, radio, and television ads to promote themselves and their products. Yet when a loyal customer like Dr. Talal comes along to buy a vehicle, they may fail to offer simple, honest, straightforward customer service and respect to such prospects. As marketing literature indicates, loyal customers and positive word-of-mouth are the most effective marketing methods to obtain new customers.

Lack of marketing training and supervision by dealerships and lack of understanding of customer wants and desires has cost the automobile business dearly in the poor perceived reputation they currently have. Customers are not attracted to a dealership solely because of their "need" to own a vehicle. Dealerships also need to understand their "wants" for fair price, respect, service (before and after the sale), honesty, and integrity.

A smart manager will save the dealership lots of money and earn more business and higher CSI scores if only a fraction of the budget designated for promotions were spent, instead, on training their sales force and management on these issues.