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PROCEEDINGS

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GROUND BREAKING NEWS INC.

James J. Bagwell, Clayton College & State University
Lisa R. Henry, Clayton College & State University

CASE DESCRIPTION

This case involves the budgeting process for a fictionalized television production company. This case is designed to provide the basic knowledge of the budgeting process and would be beneficial knowledge for any business major, whether they are directly involved in the actual preparation of the budget or they are indirectly involved by providing information for the budget process. For the student to successfully complete this case, only the basic accounting knowledge is necessary. This case has a difficulty level of two and is primarily designed for a principles level accounting class. However this case may also be expanded to include concepts such as: cost accounting (allocation of overhead), financial statement preparation, income tax return preparation, and the use of Excel spreadsheets. This case is designed to be taught in one class period and is expected to require, depending on desired outcome, approximately ten hours of outside preparation by the student.

CASE SYNOPSIS

Ground Breaking News Inc. has been in business since February 5, 2001. The business started by producing a medical based show to a national cable network which first aired on April 3, 2001. The company policy is to approve the following years budget by July 31st each year.

On September 15, 2002, the company started providing a travel based show to a different network. The expenses incurred prior to September 2002 were needed to pre-produce some segments, to get file footage, and to finish the first two shows. The pilot budget was finished and approved on May 31, 2002.

The CEO has been in negotiations with another network regarding producing a technology show. The contract was signed and the budget was finished and approved on June 28, 2002. The show is scheduled to air on March 29, 2003.

The CEO determined after the second show was added that a staff assistant/office manager was needed. One was hired on September 2, 2002. With the addition of the third show, the CEO has decided to add a full time engineer, sales assistant, and staff assistant to the staff. The current staff assistant/office manager will be promoted of office manager in January 2003.

The backup that will be provided includes:
The 2002 general ledger
The 2002 operating budget (including the 2002 salary spread)
The 2002 capital budget
The pilot budget for the travel show (including capital requirements)
The pilot budget for the technology show (including capital requirements)
The 2002 - 2001 budget variance with explanations

TROPICAL TRENDS, INC.

James J. Bagwell, Clayton College & State University

CASE DESCRIPTION

This case involves issues of business law for a fictionalized beach and surf supply store. The case is cast in a dynamic environment that allows students to be more excited about learning and applying business law concepts. This case is designed to provide students with the opportunity to recognize business law issues, analyze potential legal liability concerns, discuss possible dispute resolution options, and determine appropriate loss prevention strategies. This case is designed to provide an application of basic legal concepts in a business environment, as well as to provide an opportunity to develop legal reasoning skills. Knowledge and application of legal issue recognition and analysis would be beneficial knowledge for any business major, whether they are directly involved in a business law position or they are indirectly involved by working as a manager or employee of a company, large or small. For the student to successfully complete this case, only the basic business law knowledge is necessary. This case has a difficulty level of two and is primarily designed for a principles level business law or legal environment class. This case is designed to be taught in one class period and is expected to require, depending on the desired outcome, approximately seven hours of outside preparation by the student.

CASE SYNOPSIS

Tropical Trends, located on Florida's gulf coast, has been in business since March 1, 2000. The business started by employing college students that provided beach supply rental and lifeguard services for resort hotels and condominiums during Spring Break 2000. On May 1, 2000, the company also opened a retail shop that sells beach and surf supplies to beach visitors. The store has grown to be one of the trendiest spots on the beach, employing 24 young employees, and serving approximately five thousand customers annually. The young CEO is considering opening additional stores in other beach towns around the peninsula.

A WEEK AT THE BEACH

Cool Dude, CEO of Tropical Trends has been desperately trying to order beach and surf gear to arrive in time for the start of Summer Break 2002, when thousands of college students and professors will hit the beach. Tropical Trends ordered 500 Turley t-shirts in five sizes, if Turley could promise delivery by May 1. Turley agreed. The deadline has past and no t-shirts have been received. When Cool Dude contacted Turley, he was told that they did not know when they could send the order, due to the tremendous popularity of the new t-shirt styles. However, Cool Dude was told that for an additional cost of $10 per shirt, they could insure overnight delivery for the entire order.

Tropical Trends also ordered 400 surf shirts from Boomerang. When the order arrived, however, it consisted of 700 Spring Break 2000 tank tops in pink and purple, labeled as is, all sales final, no refunds, no returns. Cool Dude promptly returned the tank tops, but Boomerang sent the tank tops back to Tropical Trends, along with an invoice for additional freight charges, and a demand letter for payment.

Tropical Trends had also ordered 200 surf shorts and 200 cargo pants from O'Keill. Before receiving the shipment, Cool Dude called and cancelled the O'Keill order, placing an order with Tip Curl instead, at a lower price. O'Keill said that the surf shorts and cargo pants had already been manufactured for Tropical Trends, and that it would hold Cool Dude responsible for the entire amount due. The shipment arrived the next day.

During Summer Break, Jana and Sam, two college students, stopped into Tropical Trends to check out the new season's coolest surf gear. Upon entering the store, the students tripped over the steel strip in the door installation in the floor. Jana fell straightforward, gashed her head open on a store shelf, and had ten bottles of suntan oil fall on her head, knocking her out. Blood sprayed out of Jana's arm onto a rack of Adidas soccer jerseys and Speedo swimsuits. Sam fell on top of Jana, breaking both of Jana's legs. At this same instant, Steven rushed over to check on Sam and Jana, slipped on the suntan oil on the floor, and fell on top of Sam, breaking Sam's hip. Carl, a sales associate, commented that several students had tripped over the door strip in recent weeks.

Tory, a high school student, noticed that the commotion was going on, struck a match to a firework fuse, grabbed four trendy surf t-shirts, and rushed out of the store. Dustin, a security guard, who also worked at Harpoon Harry's as a bouncer, saw Tory run out of the store. About that time, the firework landed in Dustin's lap, setting his uniform on fire. After putting out the fire, Dustin chased Tory, took out his club and struck Tory ten times. Meanwhile Tory's girlfriend, Amanda, ran out into the parking lot and saw the entire beating incident. She was overcome and fainted, hitting her head on a concrete curb. Shanna, a friend of Tory and Amanda, seeing this event happen, began throwing large conch seashells through the store window. Dustin carried Tory into the store's back warehouse and locked him in a closet for punishment.

Jason, a lifeguard that worked part-time as a Tropical Trends associate, pulled and used his stun gun on Shanna, who cut her face on the ice cream freezer, as she fell down. Carl called the police, who walked up and cuffed Tory's friend Ned, and Shanna, without saying a word, and whisked them downtown to police headquarters. Meanwhile, Shanna's old boyfriend Ryan arrived, and started speaking embarrassing language against Shanna in front of the shoppers. Ryan's friend Josh, however, took the opportunity to add a few of his honest thoughts about his business law final exam that he took right before Summer Break.

Tropical Trends also ordered and received t-shirts from Tuiksilver, instead of Turley, for $5 more than the original Turley price, in order to have surf gear to sell at the start of Summer Break. The Tuiksilver shirts arrived on schedule.

Meanwhile, Justin, the mayor's son, who is a sophomore in high school, set off five cherry bombs, causing all of the shoppers to leave the store, potentially costing Tropical Trends the entire afternoon sales.

Cool Dude returned to the store after a round of golf, saw smoke boiling out of the building, found Amanda sunburned and lying in the parking lot against the curb, and could not believe all that

happened. When he opened the closet door after the smoke cleared, he found Tory asleep in the closet.

ASSIGNMENTS

1. Discuss the rights of the parties that have been violated.
2. What legal theories provide the best arguments for the affected parties?
3. What possible legal outcomes may occur?
4. How would you recommend that these issues be resolved in the most satisfactory manner to Tropical Trends?
5. What policies or programs should the CEO implement to better manage legal risks and prevent potential losses from occurring in the future?

GOING GLOBAL - MANAGING HUMAN CAPITAL

Bonita B. Barger, Tennessee Technological University

CASE DESCRIPTION

The purpose of Going Global is threefold. The case is designed to increase student awareness of the issues involved in globalization at the corporate level; to raise issues relating to organizational structure and coordination in managing human capital across borders; and to bridge theory and practice. The case has a difficulty level of four, appropriate for use in a Human Resource Management and/or International Management class at the Senior undergraduate level or entry MBA level. The case is designed to be taught in a 75- minute class with about 60 minutes preparation before class.

CASE SYNOPSIS

A Fortune 200 company with corporate headquarters in the U.S. has 140 locations worldwide and identifies itself as global. While global in presentation, its structure and "mind-set" are local. The unique structure of the case unfolds over a series of meetings between key Human Resource personnel as they attempt to create paradigm shifts within a traditional organizational structure. The case requires the student to analyze decisions (i.e. make/buy) and deliverables (i.e. charts, graphs, and budgets) used/created in Human Resource Management meetings.

The case develops over time and highlights a series of meetings between Senior Human Resource Management Staff. Recommended structure is one 75 minute class with 60 minutes pre class reading and research by students. Students are given the case and references one class session before discussion and asked to read the case and source 1-2 references.

The case presents fundamental Human Resource concepts such as Mission and Strategy, Reengineering, and analyzing the company's position in educating its global workforce. Action plans are presented, asking the students to rank order the effectiveness of each and support their decisions. The student is "taken to the inter-workings" of Senior Human Resource Management meetings through dialogue and recordings on flip charts. The intent is to create a sense of "being there" and "being charged with" making senior management decisions. Instructor notes provide narratives and citations linking theory and practice.

MANAGEMENT, UPSET WORKERS, AND A UNION: FEDERAL-MOGUL IN ALABAMA

Patricia Borstorff, Jacksonville State University

CASE DESCRIPTION

The primary topics for this case are employee compensation and appraisal methods. The secondary topics are communication skills and labor relations. The case has a difficulty level of four and is appropriate for upper level courses, particularly undergraduate and graduate human resource management classes, strategic planning, and organizational behavior classes. The case can be taught in a 2-hour session.

CASE SYNOPSIS

This case focuses on a company facing a union election. When the corporate strategy began to focus on international opportunities and stray from its strength, the domestic marketplace, this Alabama facility had difficulty proving its worth. The plant faced a direct threat of closure. Wage and benefit reductions, combined with the addition of new business growth saved the plant's existence. However, the methodology in deciding upon the wage and benefit reductions appeared questionable in the minds of the employees. Communication and execution of those decisions were unfavorable. Several issues of contention developed and a union campaign began. The union is voted down. Now the company must face tomorrow and all of the days to come.

CASE: FEDERAL MOGUL

April 9th 1998 7:30pm : The management team of Federal-Mogul's Jacksonville, Alabama Plant are gathered in the conference room. "We're just sitting here waiting ….waiting for the votes to be tallied. This is the crescendo of all of the history here at Jacksonville. I've never seen anything like this before," explains Tamra Perry, the new Human Resource Manager. Tamra has been with Federal-Mogul for 11 years, but she's only been in Alabama for 3 weeks; three very intense and sleepless weeks.

History

Federal-Mogul was founded in 1899, and was a leading manufacturer of engine bearings. As the company grew and prospered, it began acquiring other industry leaders, (which remains a constant theme at Federal-Mogul to this day). Jacksonville offered lower wages, a large employment pool, cheap land, and a chance to start over again. The facility began with state-of-the-art equipment, 200 ambitious new employees, and lots of energy. The distribution center was ahead of its time in technology and personnel. Team concepts were not yet successfully attempted in the US, but Jacksonville began with the "oneness concept". Everyone was part of the large team and worked together to achieve their goals. The only difference was that the warehouse employees (hourly) are

paid for overtime but management and staff (salaried) work overtime without extra pay; beyond that, all are treated equally and fairly.

Federal-Mogul continued its growth through acquisitions and venturing into the unknown international aftermarket. Manufacturing was no longer a focus, but distribution of the products, especially in the international markets, was the key. South and Central America, Africa, and Australia were of particular interest. In 1996, Federal-Mogul owned and operated the actual auto parts stores within these continents. Federal-Mogul was their own customer in the international markets.

Jacksonville, Alabama was the largest distribution center in North America, which might appear to be a safe and secure haven; it was not. In fact, with the company focus on the international arena, the export warehouse in Port Everglades, Florida was now the 'favored facility'. However, the customers in North America still needed to be serviced. There were 2 distribution centers (Jacksonville, Alabama and Maysville, Kentucky) and 43 service centers (7 in Canada and 36 in the US). The service centers, in turn, provided a local availability of the products to Federal-Mogul's customers (i.e. Napa, Carquest, Auto Zone, Navistar).

In November 1996, at an after-market distribution meeting, the decision was made to close Jacksonville. Three main issues posed a threat against Jacksonville: hourly wages were too high, benefits were out of line, and logistically Alabama was not an ideal location for servicing North America.

Management wanted one chance to try and become competitive. Seventy percent of Jacksonville's employees had been with the company more than 20 years; they would want to save the plant. Wage and benefit surveys were conducted while process and performance analyses were dissected. Night and day, the managers and staff worked on plans for cutting costs. There was a specific dollar figure to meet, otherwise their case would be refused. These people were putting together a business case to save Jacksonville. There were offers and counter-offers. And on December 26, 1996, the final plan for saving Jacksonville was accepted by Federal-Mogul's senior managers. The plan called for serious financial sacrifices and increasing performance productivity. The three primary changes would be: implement new benefits on January 1, 1997 (Insert Figure 1); implement new wages through a stepped adjustment beginning March 1, 1997, (Insert Figure 2); and transfer the Carter Fuel and Signal-Stat Lighting product lines from Maysville to Jacksonville. All of this was communicated to employees. People found out that they would be losing roughly 15% of pay and many benefits plus having more work to do with less people. "It was like a walking morgue", recalled the Director of Organizational Development and HR Planning. "Tempers flared and interpersonal conflicts went through the roof. Workers comp cases increased nearly 60% and overtime hours increased drastically. People were trying to get their money back by any means possible." The morale was low; the mood was grim. Many people left and took advantage of the Alternative Transition Payment. Others were in disbelief.

Weeks later, employees discovered that managers had no pay cut, only the hourly workers were effected by all the cost reduction plans. "And that drove a huge wedge between 'them' and 'us'. Managers were known as 'the few, the proud, the untouched'", What the employees did not know was that the original plans called for a wage adjustment for salaried employees also. However, after careful consideration, senior management revoked that portion of the plan. Managers were willing

to be exposed to the same wage reductions as the hourly employees; they realized it was neither fair nor equitable for them to remain unaffected by these wage adjustments. They also knew how difficult it would be to deal with the consequences of their positions and the other issues that this perceived discrepancy would create. Corporate management reviewed salaried wage surveys for equivalent management positions along with the wage rates at other Federal Mogul facilities. In order to maintain balance among all managers in Federal Mogul overall, the managers at Jacksonville would not be subjected to any pay adjustments. Managers are transferable commodities and need to be capable of easily relocating to other facilities; a present pay reduction would simply mean a larger pay increase at the time of transfer. Pay now or pay later. Also, an adjustment to a manager's salary would have no cost savings effect upon the facility itself due to Federal-Mogul's budgeting procedures; salaried personnel were accounted for within the corporate overhead. So, reducing the managers' salaries would not contribute to the magical dollar figure for Jacksonville's cost reduction.

Recovery from the wage and benefit reductions was difficult. Thirty percent of the employees left the company. Some new employees were hired immediately to fill open positions, in an attempt to resume daily business. However, the old employees were still bitter and the new employees were untrained and untested. So, with most of Jacksonville's training being OJT, it was not easy to teach the new employees their new jobs. Plus, there was still that third detail, product line transfers; moving two product lines out of Maysville into Jacksonville. That new business volume needed to be maintained with thirty less people than Maysville used. (More work for less pay.) The product and equipment was squeezed into every available square inch of space. Employees worked 12-hour shifts, seven days a week in order to complete the project in time. The physical move was completed by June 15th, but other problems were ahead.

The summer of 1997 was a struggle. Trying to train new employees and integrate them into a boiling pot of frustrated workers was a battle itself. Trying to control the tempers that continually flared and the interpersonal conflicts that sparked, especially between 'us' and 'them', was an entirely different battle. Somehow, work continued and people tried to find their own ways of handling their individual concerns. Some people just settled for the hand that they were dealt, while others simply avoided anybody or anything that annoyed them. Some folks were more frustrated than others were and rumors of union activities began to spread quietly throughout the plant.

In December 1997, an incentive fund was available for disbursement. The plant had allocated $60,000 in their budget for use as incentive pay. These funds had to be distributed by December 31st or they would be lost and shuffled back into the corporate "slush fund". The HR Manager, at that time, decided that the incentive pay should be distributed based upon performance. The stronger your performance had been, the bigger your incentive check would be. That might have been a fair means of allocation, but no measurements of productivity were in place. So, instead, supervisors were told to rank their employees; rank them from highest to lowest, based upon the supervisor's observation of each employee's performance throughout the year. The incentive pay would be distributed plant-wide based upon these rankings. Little communication was given regarding productivity standards, performance evaluations, or the methods and measurements behind the ranking system. However, the incentive checks were mailed over the Christmas holiday. Some

people did quite well, but some did not receive a penny. As a consequence, when people returned to work after the first of the year, frustration had reached an all-time high.

The employees at Jacksonville were fed up. Talk of union activity reached a crescendo with the employees being quite vocal about their desire for a union to "come to their rescue". Union Cards were distributed until 50% of the people had signed. Union campaigning was heavy and organized rallies were held frequently. The employees of Federal-Mogul Jacksonville were tired of being pushed around and demanded to have a voice in the activities of their facility. The petition for election came in late March and for 30 days and 30 nights, both the union and the company tried to communicate their position to the employees. The UAW offered hope and glowing promises for better things to come. The company tried to pinpoint the major issues that needed to be addressed, held brainstorming sessions, and began solving those problems.

The employees had 6 major issues to contest: New attendance policy - loss of paid time off; Job Bidding - Panel process lacked consideration for seniority; Lack of communication; Favoritism by management; Inconsistency of policies and their execution; and Lack of an Employee Handbook.

There were meetings, letters, signs, buttons, peer pressure. And it has all come down to this day, April 9th 1998. "We're sitting here waiting for the votes to be tallied. Hoping that all of the work we have done; all of the programs we are trying to put into place; all of the blood, sweat and tears will pay off," explains Mrs. Perry. Finally, at 7:30pm it was over, ….the company had won, by 21 votes. There would be no union in Jacksonville. It was over, but all of the work had really just begun. Just because the union was not successful this time does not mean that they would never come knocking on the door again. The company had won, for now.

EPILOGUE - JUNE 1999

Company Update

In September 1997, the CEO and President were removed from office and they divested all interest in international retail stores. Jacksonville has an even bigger field of competition (11 new plants). They continue to be analyzed for their productivity and cost effectiveness. Each of the major issues has been addressed with new policies and handbook and open communication.

Jacksonville Overview
Total Employees: 415; Pieces shipped daily: 220,000; Facility Size: 365,000 square feet; Pieces shipped daily: 360,000; Annual sales volume: $480 Million

Figure 1: Benefit Adjustments '97	
Prior to '97	After '97
Pay Continuation:	*Removal of Pay Continuation:*
Paid Marriage Leave – 5 days	No Pay for Marriage Leave
Paid Sick Leave – 100%	No Sick Pay – only Disability
FMLA with pay – 100%	FMLA – without pay
Disability	*Disability*
Full Pay for 6 months / then 60%	60% pay after 7 days of leave
Paid Time Off	*Time Off Without Pay*
Full pay for ANY absence	Only holidays/ vacations allow pay

Figure 2: Pay Adjustments '97
Wage reductions Average wage reduction = 15% Average hourly pay cut = $.75 to $1.50
Levelization of Jobs: Equal work for equal pay Prior to '97: People were working the same jobs but receiving various pay levels Pay was based upon seniority, with raises every 3 months. After '97: Standardized Grade System; pay based upon job function Grade 1 = Packagers Grade 2 = Order Processors Grade 3 = Departmental Analysts and Quality Assurance Grade 4 = Technical Support and some Maintenance Grade 5 = Skilled Maintenance Everyone within the grade receives same pay With annual raises and a 4 year progression until the top of the grade is reached.
Job Bidding: Prior to '97 - EVERY job was filled by seniority After '97 – EVERY job filled by a panel interview process

BURNS, MORRIS & STEWART: SUPPLYING THE HOME CONSTRUCTION AND REMODELING INDUSTRIES

Shane Allen, Stephen F. Austin State University
Larry R. Watts, Stephen F. Austin State University
Luke Motley, III, Stephen F. Austin State University
Thomas M. Box, Pittsburg State University
Scott Fullerton, Stephen F. Austin State University

CASE DESCRIPTION

The primary subject matter of this case concerns an analysis of a firm's capabilities, competitive position, and choice of strategy. The case has a difficulty level of four, appropriate for senior level undergraduate business policy/strategy students. The case is designed to be taught in one to two fifty-minute class periods, and is expected to require ten hours of outside class preparation by students.

CASE SYNOPSIS

As the sun was beginning to rise over Nacogdoches Texas, Michael Kunk, CFO of Burns, Morris, and Stewart L.P. (BMS)- a manufacturer of wood doorframes, was still reviewing key indicator reports. It had been another long and sleepless night as Michael had worked late again while pondering the future and fate of BMS. Michael thought to himself, as he had been doing for sometime, that somewhere within all these pounds of reports were the answers that he sought. These answers were needed, because even though the senior management of BMS and the shareholders thought that everything was going well, Michael was convinced that there were problems about to cause the company troubles.

Just as Michael was about to go home to shower and shave for another day, Hank Crouse, President of BMS, entered his office. "Michael, I see you are at it again. All work and no play, not to mention no sleep, louse up your golf game." Hank continued "now I may not be as smart as you fancy MBA's, but I have been making this business successful since you were in diapers and I can assure you that nothing is wrong - the business is sound as is our future." Hank sat down next to the mountain of papers that covered the desk and continued speaking "Michael, you are a very smart person, that's why I made you CFO, and if you are convinced that we are heading for trouble - then let's bring in some consultants to go over everything and give us their opinion." Hank continued, "here is what I want you to do - I want you to consolidate all of the essential information over the next week into a report that we will give to the consultants. I know exactly the consultants to hire!"

A week later, your consulting firm was hired to review the information, discover any hidden problems, and make recommendations.

BACKGROUND

Mr. Doug Stewart founded BMS Inc. in 1977 as a "C" corporation in Nacogdoches Texas. Within five months of its founding, Mr. Hank Crouse became the general manager and by 1988 he had acquired a majority interest in the company. Mr. Crouse is the son-in-law of the founder, Mr. Stewart. BMS is a key manufacturer in the millwork products industry. BMS manufactures wood products for the construction industry and among these products are wood exterior doorframes and related moldings. The initial production facilities consisted of a 10,000 square foot building that had no doors or walls. In 1996, the newly formed partnership of Burns, Morris, and Stewart L.P. purchased the assets of Burns, Morris, and Stewart Inc.. Burns, Morris, and Stewart Inc. became inactive after the asset sale. The general partner of Burns, Morris, and Stewart L.P. is the BMS Management Company of Columbus Ohio. As part of the 1996 corporate restructuring from a corporation to a limited partnership, the Crane Group of Columbus Ohio purchased the BMS Management Company.

While their manufacturing capabilities have grown and their product mix has changed over the years, BMS is still manufacturing substantially the same products as at their inception. The company still manufactures doorframes, but is also a full service millwork shop that has been priming, weather-stripping insertion, mortising, mattering, and drilling capabilities. Emphasizing their commitment to doorframes, their company motto is "When it comes to sizing up door frames, nobody fits the job like BMS. If you can spec it, we can deliver it".

A primary product invented and patented since the company's inception is the FrameSaver™. The FrameSaver™ is a doorframe designed to resist rot and insect damage. The FrameSaver™ is manufactured using a Crane Plastics composite wood material known as TimberTech™. The FrameSaver™ composite wood material is placed at the ends of the doorframe. This product is very important to BMS as many of their customers are along the Gulf Coast and in other areas of the United States where high moisture content and insects such termites and ants are a constant problem.

The current manufacturing facilities are on a ten-acre tract of land and include a 3,600 sq.ft. administration building, a 135,000 sq.ft. manufacturing facility, and a 13,000 sq.ft. storage space. A railroad siding on the property simplifies the delivery of raw materials and the shipment of finished goods. The sales territory of BMS extends from Pennsylvania to Florida, the Gulf Coast, and Nevada. BMS has approximately 250 customers for its products. Core customers are in Texas, Arkansas, Oklahoma, Mississippi, Louisiana, and Tennessee.

The business process that BMS employs is unique. Scrap and rejected lumber products are purchased by BMS from lumber companies. They then manufacture these products into doorframes using a finger joining process. They then sell scrap material from the BMS manufacturing process as shavings for animal bedding, chicken house floor covering, or compost. Thus, the manufacturing cycle is very efficient in the use of natural resources.

INTERNAL ENVIRONMENT

BMS is a manufacturer of quality exterior doorframes and related components, selling to jobbers and building product distributors across the U.S. The home office and manufacturing facility are in Nacogdoches, Texas using a total of 135,000 sq.ft. To meet the doorframe competition, the company must have a good knowledge of construction industry standards, the different types and costs of lumber, construction terms, lumber sizes and other necessary characteristics of the construction industry. For example, Mr. Michael Kinked, CFO and comptroller of BMS, commented that the contractors in Houston, Texas installs the doorframes differently than the rest of the contractors in Texas and as a result Houston, they manufacture Texas doorframes differently for those contractors.

The manufacturing process at BMS begins when raw material in the form of reject and scrap pieces of dimension lumber in approximately two foot lengths and sized two inches by six inches is delivered to the plant. They receive the lumber on flat bed trucks on pallets. It is unloaded for inspection and then moved to a machine area with several operating areas for removal of all defects. After they remove the defects, they move the pieces to the finger jointing area where cutting saws form the finger joints and then to an adhesive area where they join the pieces together to form longer pieces. Approximately 50% to 60% of the input raw material is lost during this process due to poor quality such as splits, knots, uneven edges, etc. They grind the raw material that is not used in production operations up for sawdust or run through a chipper to make shavings and chips for resale to the local poultry and horse industries.

After joining, they cut the long lengths of finished boards to the desired lengths and then milled into the various BMS products such as brick mold, case, fhead, frame, full, and studs. This is also where frames are finger jointed with the wood/plastic composite TimberTech™ to make the patented FrameSaver™ doorframe. Currently, the company has five milling lines in production, which they support, by two finger joint lines and various lumber defecting lines. Two priming lines prime and paint the products with environmentally friendly water-based paints. Modern, K-Val Co., automatic mortise and miter machines are used in respective areas. Various rip saws, conveyers and double end dado and mortising equipment, further support milling lines. They deliver the finished products to customers on leased trucks.

BMS takes great pride in customer satisfaction and customizes many of their products to customer specification. Since 1977, BMS has built a reputation for producing top quality frames at competitive prices. According to Michael Kunk "it's a reputation that hinges on quality frames, fast delivery, and perhaps the most important element --- customer service". The company is more of a job shop rather than a high-speed production assembly operation. This type of operation increases the cost of products so the company has turned to import wood for approximately 1/3 of its raw material to remain competitive in its markets. BMS has traditionally used southern yellow pine for its raw materials.

Cost control in the doorframe market is critical. According to Mr. Michael Kunk, CFO of BMS, 60% of the cost of the product is from materials. The biggest problem with the predominant material used in the manufacture of doorframes is that it is southern yellow pine. Southern yellow pine typically has high moisture content, knots in the wood, wane, and finish problems. They import

substitute wood material from South America, Indonesia, and China. Imported wood is being used because its low cost and lightweight. The wood is a variety of pine, but is not as strong as southern yellow pine. The major problem with imported wood is having a long lead-time for delivery and dealing with quality issues.

Suppliers to BMS include raw material suppliers and the Crane Plastics Company. The predominant raw material used in BMS products is scrap or rejected lumber. These suppliers include the Riverwood International Corporation, Louisiana Pacific, Boise Cascade, American Paneling, and Temple Inland. The vast majority of the product used in the BMS product line is southern yellow pine. There is no shortage of southern yellow pine rejected lumber. Estimates show that the lumber industry produces approximately one billion board feet of products per year that would be suitable for BMS production operations. Of these one billion board feet, BMS purchases approximately sixteen million board feet per year, or roughly 1.6% of the available supply. Other suppliers to BMS include the Glidden Company, Schlegal Inc, National Casein Company, Senco Products Inc., and the Crane Groups Crane Plastics Company. Crane Plastics provides the material for the FrameSaver™ product.

BMS has the patent rights to all doorframe designs that prevent premature rotting by adding a different type of material to the bottom of the doorframe. This patent is not limited to the plastic compound used in the FrameSaver™ product, but also includes frames that use cedar, or any other material that differs from the main part of the frame. This insight was gained from Mr. Kunk's comment that some patent infringement may be going on which may require court action.

Of particular interest to BMS is the entry of new competitors using composite materials and products made entirely without wood. Reasons for new entrants into this market are moisture problems with wood, the desire for something different, and more stringent building code requirements. There is specific interest in the manufacture of a fiberglass door for a pultruded frame to create a complete fiberglass entry system. Pultrusion is "an automated manufacturing process for the production of consistent cross-sectionally shaped profiles of fiber reinforced composites. The profiles produced with this process can compete with traditional metal profiles such as steel and aluminum for strength and weight. The polymer-reinforced matrix can be formulated to meet the most demanding chemical, flame retardant, electrical, and environmental conditions. Pultrusion brings high performance composites down to commercial products such as lightweight corrosion free structures, electrical non-conductive systems, offshore platforms, road and railway trucks, and many other innovative new products. Pultrusion products are applied in a wide range of market areas. However, there are certain areas were pultrusions today are recognized as commodity products and have become the industry standard. Properties, such as light weight, corrosion resistance, electrically and thermally non-conductive, determine the success in these applications."

Pultrusions, along with cellular PVC products, could provide a direct challenge to BMS and the FrameSaver™ product. The customer mix for BMS's products is composed of small local shops and national chain home remodeling stores. BMS has 125 loyal, strong industrial customers. These core customers are in Texas, Oklahoma, Arkansas, Louisiana, and Mississippi. Among these core customers are Builders First, Southern Mill Work, Bison, Stripling Lake, BMC West, Cameron Wholesale, Crest Metal Doors, and many other smaller entities. Other significant sales come from Missouri, Indiana, Florida, and Virginia. They have made sales on the east coast and as far away

as London England. No single customer accounts for more than 10% of sales and production output. Besides these customers, BMS maintains a relationship with 107 dealers who carry the FrameSaver™ product.

BMS employs approximately 150 people, most of who are of unskilled or semiskilled workers. Nacogdoches has a large population of minorities, predominantly Hispanic, that are categorized as unskilled. It is therefore not surprising that a significant portion of BMS's labor force is composed of Hispanics. BMS is a non union shop and Texas is a right to work state. According to Michael Kunk, CFO of BMS, there has never been a union organization attempt made at BMS. The average hourly non-incentive rate that a BMS employee earns is approximately $9.00. Employees work one of two shifts per day, eight hours at a time, for five days per week. They thus estimate that the average hourly weekly payroll is $54,000 with a yearly payroll of $2.8 million. Now, they currently operate the plant eighty hours per week, (two shifts * 40 hours per person per week). This results in an overall plant utilization of 47% based on the maximum utilization of 168 hours per week. According to Michael Kunk, the plant is currently working at approximately 80% of capacity based on eighty hours per week. During peak seasons, the BMS uses temporary workers to cover labor shortages.

BMS has recently installed a modern Microsoft (MS) Windows-based ERP (enterprise resource planning) computer system. This computer system allows BMS to track work-in-process (WIP) and finished goods (FG) inventory and do financial analysis. BMS has a WEB presence with an informational web page at www.bmslp.com. The web site does accept the online ordering of the FrameSaver™ End Frame End™ for $14.95 plus $5.00 shipping and handling. Additionally, questions and information can be emailed to the company through a request for information screen. The manufacturing computer system software package is Fourth Shift from Computer Aided Business Solutions of Golden Colorado. The Fourth Shift software is message driven and uses Access databases and Excel spreadsheets. The Fourth Shift software is an ERP software package and not a MRP (Material Resource Planning) software package. Mr. Kunk was very pleased that the company decided to add the computer system and not add additional people in the selling and general administrative and accounting areas as the company grew. The system provides a part number that is customer specific and every customer has a number. There are 12,000 possible product numbers. They make the doorframes to order and very little is made for finished goods inventory. BMS does not support online Internet based ordering or tracking of orders for their products other than the FrameSaver™.

The Sustainable Forest management Initiative certifies BMS's commitment to the preservation of the environment(SFI). Through the SFI certification, BMS works to integrate responsible environmental practices and sound business practices to the benefit of landowners, shareholders, customers, and the people they serve.

FUTURE DIRECTIONS

BMS intends to increase market share by selling to large retailers. To be able to supply Premidor Corporation, Stanley Corporation, Lowe's, or Home Depot, with frames for their door units is definitely a long-term desire. This market is very competitive because the buyers want one price

for the frames to their door units and the supplier must make any improvements at the same price. There have been no attempts to create a strategic alliance with a door maker to increase sales. Currently, Stanley and Premidor are the largest door makers in the U.S. Home Depot and Lowe's are desired retailers that BMS would like to create an alliance with, but they have trouble getting costs down low enough to reach these customers. The strength of buyers' power hurts BMS in this area. Since doorframes are considered as commodity products, the margins on the FrameSaver™ line are not adequate because BMS cannot charge a higher price for the product. Another long-term objective of BMS is to lower costs by maximizing product runs, lowering costs to convert which are labor and overhead other than the cost of materials, and paying low wages. Labor costs currently average $9.00 per hour plus an extra 25% in benefits. If the costs for FrameSaver™ decrease enough, BMS feels that they can dominate the market. According to Michael Kunk, CFO, many customers say, "If it were cheaper, we'd buy all of our frames from BMS". Labor and overhead, other than cost of the materials, are currently $1.45 per frame side plus $.24 in other expenses to total $3.14 for the two sides of a frame.

CORPORATE PROFITS AND PUBLIC HEALTH: EXPLORING STAKEHOLDER INTERESTS IN THE MARKETING OF CLARITIN

Brian Davis, Weber State University

CASE DESCRIPTION

This case examines the approach used by Schering-Plough Corporation in marketing its allergy prescription medication Claritin. It will be of interest to those studying business ethics, the regulatory role of the FDA, the effects of skimming pricing, and competing channels of distribution.

CASE SYNOPSIS

Claritin has proven to be a financial windfall for its maker, pharmaceutical giant Schering-Plough. The world's best selling allergy relief medication, Claritin generated $2.7 billion in sales worldwide in 1999. Of those revenues, $2.3 billion (over 85%) were generated in the United States. By 2000, Claritin was the most heavily advertised drug in the United States.

Studies have shown Claritin to be a very safe drug, especially compared to current over-the-counter (OTC) antihistamine alternatives. Side effects of OTC antihistamines, such as Benadryl, include often drowsiness. A recent report estimated that sedating antihistamines contribute to some 600 auto fatalities and 47,750 auto injuries in the U.S. every year. Claritin does not have these sedative effects. In over 150 studies, the prescription drugs Claritin, Zyrtec, and Allegra have been shown to be significantly safer any of the 25+ current OTC allergy drugs on the market today. Claritin is so safe that it has no known lethal dose.

The controversy in this case relates to the way in which Claritin has been marketed. Although studies have shown it to be safer than current OTC drugs, its maker has insisted that it be sold by prescription only. The prescription status of Claritin in the United States has protected the product's profit margins.

In 2000, the cost of Claritin in the U.S. averaged $1.94 per dose, compared to $0.57 per dose in Canada, where the product is available OTC. While the same factory in North America make Claritin for both markets, FDA rules prohibit U.S. retailers from importing the product from Canada. In spite of years of consumer complaints and legal action, the U.S. Food and Drug Administration (FDA) took no steps to make Claritin available in the OTC market in the U.S.

Federal law dating back to the 1951 Food, Drug, and Cosmetic Act requires that all drugs considered "safe enough" be sold in the OTC market. The exceptions relate to drugs for which monitoring and supervision by a physician are considered necessary. Until 2002, the FDA never moved a prescription drug to OTC status without a request from its manufacturer. This situation changed early in 2002 when the FDA reversed its previous position and took steps to make a version of Claritin available in the OTC market.

IN THE WOODS: A HIGHWOODS PROPERTIES, INC. VALUATION CASE

Tracy P. Downing, North Carolina Central University
James Stotler, North Carolina Central University

CASE SYNOPSIS

This case will require the student to value the equity of Highwoods Properties, Incorporated and make a buy or sell recommendation as an independent analyst. Employees of the company are offered the option to purchase stock in the company on a discount basis. However, the equity analysis is to be prepared from the perspective of an external investor as well as a company employee. An assessment of the employees' participation in the stock purchase plan as well as diversification of individual portfolios based on present and past market conditions should be analyzed. 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.

INTRODUCTION

Jane Moore, the assistant director for human resources, sat at her desk planning out her day and the activities that she had to accomplish by the end of business. It was 8:50am, so that left her only ten minutes to review for her Employee Stock Purchase Plan presentation to the new employees. Even though she had given this presentation several times within the past month, she was still a little nervous talking to her fellow co-workers and an independent analyst. The purchase of the company's stock through the program was purely optional, but she had to deliver enough information to the audience so that they would understand all the necessary aspects of the stock plan and the company. Jane leaves the comfort of her office to begin her presentation.

HIGHWOODS PROPERTIES, INC. (HIW)

Highwoods is a fully integrated, self-administered real estate investment trust ("REIT") that provides leasing, management, development, construction and other tenant-related services for its properties and for third parties. The Company currently owns or has an interest in 590 office, industrial, retail and service center properties encompassing approximately 46.3 million square feet, including 26 development projects encompassing approximately 2.7 million square feet. The Company also controls more than 1,650 acres of land for future development. Highwoods is based in Raleigh, North Carolina, and its properties and development land are located in Florida, Georgia,

Iowa, Kansas, Missouri, North Carolina, South Carolina, Tennessee and Virginia. Just as important as the properties themselves is the attention Highwoods gives to serving the needs of their customers.

PORTFOLIO OF PROPERTIES

As of December 31, 2000, the company owned 493 in-service office, industrial and retail properties, encompassing approximately 36.2 million rentable square feet, and 1,885 apartment units. The following table provides information about the Highwoods' wholly owned in-service properties at December 31, 2000:

Table 1: Property Information

	Rentable Square Feet (1)	Occupancy (2)	Office	Industrial	Retail	Multi-Family	Total
Piedmont Triad	8,334,000	96%	6.60%	4.70%	-	-	11.30%
Atlanta	6,143,000	94.0	10.1	3.4	-	-	13.5
Tampa	4,053,000	95.0	13.4	0.3	-	-	13.7
Research Triangle	3,741,000	94.0	12.7	0.1	-	-	12.8
Nashville	2,789,000	94.0	10.0	-	-	-	10.0
Richmond	2,698,000	96.0	7.5	0.4	-	-	7.9
KansasCity	2,617,000	93.0	4.3	-	6.8	4.0	15.1
Charlotte	2,157,000	92.0	4.8	0.6	-	-	5.4
Greenville	1,220,000	93.0	3.2	0.2	-	-	3.4
Memphis	1,086,000	93.0	3.4	-	-	-	3.4
Orlando	662,000	95.0	1.4	-	-	-	1.4
Columbia	426,000	77.0	1.2	-	-	-	1.2
Other	257,000	99.0	0.9	-	-	-	0.9
Total	36,183,000	94%	79.50%	9.70%	6.80%	4%	100%

The diversification of the Highwoods portfolio across seven states and 11 core markets helps to insulate the company from economic dislocations that could occur. These cities are the fastest growing in the country and are major economic hubs in states that contained 18 percent of the nation's population, yet accounted for 27 percent of the nation's growth according to the 2000 US Census. The diverse economic drivers within the company's core markets add to the stability of the overall portfolio. There is no anticipation of additional geographic diversification beyond the southeast per Carman Liuzzo, CFO, for the company. From high-tech research and development in the Research Triangle to service centers in Tampa, distribution in the Piedmont Triad and

financial services in Richmond, the company's local market economies base their strength on a variety of economic engines.

Highwoods operates its premier properties with the client in mind. Weekly divisional meetings keep local personnel current with the latest developments in their markets. Monthly, a group meeting of senior management reviews progress on company wide initiatives. Twice a year, senior management conducts meetings with all employees to discuss company goals and objectives.

Highwoods' greatest strength in the market place, as stated by Liuzzo, is the company's people and their years of experience within the real estate industry. He also says that it is tough to get good management in other markets outside of the southeast. Beginning with Ron Gibson, the CEO, and branching down to the division heads, members of management possess a minimum of 13 years of experience and average 20 years overall in upper management. This plays an integral role even with the individuals that have daily contact with present and prospective customers. The leasing professionals are on the frontline of meeting the customers' space needs. Their experience, training and professionalism are highly regarded in the industry. They assist customers in understanding the local market, evaluating space options and understanding the details of moving into new space. With many customers in multiple buildings and markets, consistent quality and service delivery are assured with a program called the corporate host program.

Highwoods supports the notion that real estate is an inherently local business although centralization of some functions may be appropriate. Where the company touches the customer most often - leasing, asset management, build-to-suit projects and a myriad of other tasks - people and decision authority are local. Areas such as financial management, lease accounting, tax accounting, benefits management, and capital allocation have been centralized at the Raleigh, North Carolina headquarters. The following chart compiles information found in the 2000 annual report for the company.

Table 2: Historical Financial Information (in thousands)
As of December 31

Item	2000	1999	1998
Total assets	3,701,602	4,016,197	
Restricted Cash	104,780	34,496	
Total Revenue	566,431	584,935	512,471
Net Income	133,487	138,093	125,650
Stockholder’s Equity	1,791,545	1,892,470	

REIT INDUSTRY

The Real Estate Investment Trust (REIT) sector is sometimes viewed as an alternative to the fixed-income market. Based on the Value Line January 2001 report, price and earnings momentum for this industry were projected to be average. Recent Federal Reserve Bank (FRB) actions to cut

interest rates have benefited this industry in the form of lower interest costs and additional interest rate cuts by the FRB are widely expected in the near future.

The overall real estate sector may under perform in the future months. Several REITS have announced their exit from the market, although it's too early to tell whether they were strategic moves or ones based on the expectations of a cyclical downturn in the economy. The downside to the expectation that higher-growth companies will out perform is that higher-growth sectors are typically more interest rate sensitive than lower growth sectors. Nonetheless, it is anticipated that real estate stocks should continue to perform well on an absolute basis given their current low valuations and continued solid fundamentals. Even though Highwoods has been successful in gaining market share in the recent past, there are future challenges to be considered due to market fluctuations. "The greatest challenge for Highwoods is to maintain occupancy in the real estate industry and to get recognized by investors", says Liuzzo.

Companies with high-expected growth (1999 and 2000 FFO) performed better than those with lower expected growth prospects. Those companies with average annual FFO growth in 1999 and 2000 (above 10%) saw their prices rise 0.4% while those companies with growth below that level saw a decline of 1.1%. Using the 10% cut-off, approximately one-half falls into the value index. It is believed that the lower spread between performance in growth and value of real estate stocks compared with the broad market is indicative of the lower volatility of real estate stocks and is not an indication that the effect does not hold for the real estate sector.

Table 3: Office Sector Multiple Comparison
Large-Cap Office Companies

Ticker	Name	Rating	Price ($) 27-Sep	Mkt.Cap. $(Millions)	FFO 2001	FFO 2002
EOP	Equity Office Properties	SB	31.26	15,273	3.21	3.62
BXP	Boston Properties	SB	37.19	4,118	3.59	4.2
CEI	Crescent Real Estate	U	21.41	2,807	2.62	2.9
CRE	CarrAmerica Realty	B	29	2,371	3.28	3.57
TZH	TrizecHahn Corporation	B	17.8	2,642	2.19	2.68
HIW	Highwoods Properties	MP	24.15	1,861	3.83	4
CLR	Mack-Cali Realty	MP	30.49	1,959	3.7	4.03
ARI	Arden Realty Group	-	25.18	1,669	3.02	3.28
	Average			4,087		

STOCK PURCHASE INFORMATION

At this point, Jane was wrapping up her presentation. She captivated her co-workers by telling them that the company's dividend grew from 1.89 in 1996 to 2.25 in 2000 and that Liuzzo anticipates a modest change of 2-3% in the future. She went on to tell the audience that government bonds are trading near historic low yields and a 30 year government bond was recently trading

around 4.78 percent and that the Standard and Poor's 500 has earned an average return of 10.2 percent over the long run. Each employee is to receive a 15% discount on the lower of Offering and Exercise Average Stock Price. Offer dates are always the first day of each quarter beginning with January and ending with October of the year. The Exercise Date is always the last trading day of the Quarter. Jane also informed the audience that employees purchased 55,593 and 29,214 shares of Common Stock under the Employee Stock Purchase Plan during the years ended December 31, 2000 and 1999, respectively. Per Liuzzo, 30% of the company's employees participate in the plan, which makes up approximately 3-4% of the total shares.

The following chart illustrates the calculation for the current third-quarter discounted price of the stock.

Table 4: Third Quarter 2001 Employee Stock Purchase Plan Quote			
HIW stock price @ close 5 days prior to offering date:			
	29-Jun	26.65	
	28-Jun	26.12	
	27-Jun	25.92	
	26-Jun	25.95	
	25-Jun	25.67	
5 Day Average:		26.062	
HIW stock price @ close 5 days prior to exercise date:			
	28-Sep	24.75	
	27-Sep	24.15	
	26-Sep	24.05	
	25-Sep	24.00	
	24-Sep	23.75	
5 Day Average:		24.14	
Lower of Offering & Exercise Average Stock Price is:			24.14
Minus the HIW Employee Discount of 15%			x 0.85
Discounted Purchase Price for HIW Stock			20.51

THE DECISION

Jane completed the presentation by informing the employees that all forms are due on December 11th (21 days before the January 1st offering date) in order for employees to Participate in the Stock Purchase Plan for the first quarter of the next year. She gave them a packet that included the following pertinent financial data just in case employees needed a little more information to make their final decision of whether or not to participate in the program.

Current Key Financial Ratios			
Company	ROE	PROFIT MARGIN	ROA
HIW	9.1	31.6	4.71
EOP	6.86	23.8	3.39
BXP	12.4	27.6	4.24
CLR	0.81	3.7	0.39
ARI	7.58	26.5	4.04
Industry	10.13	26.32	4.29

Company Specific and Market Data	
Beta Coefficient for HIW	.31
Price/Earnings Ratio For HIW	12.33
Return on S&P 500	10.2
Recent Price for HIW	$25.23
Dividend Expected next Period	$2.34
Earnings per share estimate	$2.14

AIRPORT CONCESSION: DEVELOPING A BUSINESS PLAN AND PROFORMA ANALYSIS

Michael D. Evans, Winthrop University
Bennie H. Nunnally, Jr., University of North Carolina - Charlotte

CASE DESCRIPTION

Illustrating the interrelationship between finance and other core business courses is the primary focus of this case. This is accomplished by asking students to prepare a business plan. In order to do so, they must draw on key concepts learned in accounting, marketing and management courses. More specifically, students must prepare proforma financial statements, perform ratio analysis, choose a form of business organization and make a risk/reward assessment regarding the business venture. This is a Level 3 case. It is appropriate for the first undergraduate course in financial management or in intermediate accounting. The case can be covered in one 50-minute class and will likely require 2-3 hours of outside student preparation.

CASE SYNOPSIS

The case unfolds as Mike Thomas considers an entrepreneurial opportunity. He has a strong background in accounting and finance. However, he has no retail management experience. Nonetheless, Mike decides to investigate an opportunity to operate a food concession at the Charlotte/Douglas International Airport. He believes this offers the potential to add another income source and substantially increase his net worth. Mike is aware that he must do his homework prior to taking on such a venture. This opportunity offers substantial rewards, but poses significant risks as well.

CASE

Mike Thomas, a well-respected Professor and practicing financial planner, developed a strong desire to become an entrepreneur. Mike felt he had the background to start and run a small business successfully. He had an MBA and was a CPA. Mike had prepared winning business plans for others. Now it was his turn to do for himself. If only he could identify an attractive business opportunity.

Mike actively reviewed the listing of businesses for sale in the local paper and the Wall Street Journal. He also networked with other professionals (i.e. bankers, attorneys and accountants) to seek out business opportunities. Franchises were considered as well as buying an existing business. Months went by and Mike still had no ideas.

In November 1995 Jost International, Inc. (Jost) ran an ad in the local newspaper inviting interested parties to submit a proposal to operate either a Kentucky Fried Chicken (KFC), TBCY or TBCY/Mr. Felds concession at the Charlotte/Douglas International Airport for a term

commencing when the concessions were available for occupancy (expected to be January 1, 1996) through December 31, 2004. These concessions were to be part of a new food court built at the Airport. It was estimated that 6,100,000 passengers would pass by the food court each year in route to board their flight.

Mike contacted Jost to request additional information. Mike learned that Jost had a master lease to operate all of the concessions at the Airport. As part of its master lease agreement, Jost is required to sublease some of the concessions to local small businesspersons.

Mike's research revealed that the Airport is ranked 10th nationwide in total operations and 22nd nationwide in total passengers. In 1994 a total of 18,275,339 passengers utilized the Airport. In addition, the Airport employs approximately 10,000 individuals.

This opportunity looked attractive. It presented the opportunity to operate a well-established franchise in an airport environment. Mike had previously explored operating a KFC stand alone franchise. He had visited KFC headquarters in Louisville, KY. Unfortunately, there were a limited number of stores available at that time and all were located in the Northeastern part of the U.S. Mike was not interested in moving to any of these locations.

Mike was undecided regarding which concession to pursue. He decided to accumulate as much background information as possible on all three. He received franchise information and visited existing stores to determine staffing patterns and menu prices. It became readily apparent that food prices at the Airport were significantly higher than those of a stand alone operation.
After conducting preliminary research, Mike decided to pursue the KFC concession. Table 1 contains key information received from Jost and KFC. Note that there was no historical data regarding airport concessions since franchisers were just beginning to open them. The information provided by Jost and KFC represented their estimates of revenues and cost of goods sold. Jost based its estimates on airport demographics and experience operating other food concessions at airports. KFC based its estimates on average sales per store for existing locations. In addition, the rent to be charged was 15% of sales for each of the concessions. Mike also learned that royalties would be charged by the franchiser. The Airport would charge each concession for maintenance. This charge was expected to be 3.5-4.5% of sales. The average hourly wage rate paid to concession workers at the Airport is $6.00.

Table 1: Key Assumptions Provided by Jost and KFC

	Jost	KFC
Projected Sales	$700-750,000	$600-675,000
Cost of Goods Sold (% of Sales)	25%	28%
Annual Royalty (% of Sales)	10%	10%

Mike wasn't sure which estimates to use in preparing proforma financial statements.
The sales forecast was extremely important. Once projected sales were established, other expense items could be determined. He learned that he could expect payroll costs to be 20% of sales. Employee benefits would be 20% of payroll.

An investment of $425,790 was required to open the KFC concession. $15,700 of this amount was for equipment. Construction costs were expected to total $395,423. The remaining funds ($14,667) would serve as working capital. Construction costs would be depreciated over 31 years. The equipment would be depreciated over 7 years. The Airport would retain title to all improvements and equipment.

Mike would have to arrange his own financing. Neither Jost nor the Airport would provide any financing assistance. Mike had approximately $50,000 to invest in the deal. He also had a family member who was willing to provide some additional capital.

PRECISION MANUFACTURING: THE RISKS AND REWARDS OF MINORITY BUSINESS VENTURING

Michael D. Evans, Winthrop University
Keith Robbins, Winthrop University

CASE DESCRIPTION

The primary subject matter of this case involves the intricacies of negotiating and financing the acquisition of a small manufacturing company. The case also provides insight into the risk/reward assessment potential entrepreneurs face as they contemplate business venturing opportunities. More specifically, the case provides insight into the personal considerations and financial decisions that must be made prior to starting or acquiring a business. One of the distinguishing features of the case is its focus on the unique challenges faced by minority entrepreneurs.

Secondary issues examined in the case include financial statement and ratio analysis for decision making, implications of capital structure and the attractiveness of the Small Business Administration's 8(a) and Small Disadvantaged Business Certification Programs.

This case has a difficulty level of three or four. It is relevant for an introductory or advanced entrepreneurship class or an undergraduate or first-level graduate business finance course. It can also be used in an intermediate accounting course, junior level management course or senior level business policy course. In an introductory entrepreneurship course, the instructor may wish to minimize/avoid discussion of financial ratios and financial statement analysis. These topics would be more appropriate for students that are taking or have completed the business finance course. While historical and proforma financial information is provided, this is not a business valuation case. It is recommended that the case be used to highlight the challenges, both internal and external, faced by aspiring entrepreneurs. The case is designed to be taught in 1 class hour and requires 3-4 hours of outside preparation by students.

CASE SYNOPSIS

The case unfolds as two African-American CPAs contemplate the risks and rewards of becoming entrepreneurs in the southeastern United States. They conclude that business ownership, as opposed to their traditional role as salaried accountants, provides a more realistic path to wealth accumulation and financial independence. More specifically, the principals believe that manufacturing affords the best opportunity for extraordinary wealth creation. They realize that manufacturing venturing runs counter to the prevailing trends among minority entrepreneurs who have typically targeted the service sector. Further, they are well aware of failure statistics that could transform their pursuit of the "American Dream" into their financial demise.

Despite the risks, the CPAs begin to actively search for the right business opportunity. One such opportunity is identified in eastern North Carolina within a hundred miles of the city in which

the potential partners reside. The target is a manufacturing facility that is being offered by its current corporate parent.

The focus of the case involves the intricacies of negotiating and financing a deal for the manufacturing business and ultimately the go/no go decision facing each of the entrepreneurs. One must decide whether he is willing to leave corporate America in order to pursue his dream. The other CPA must determine whether he will invest a significant sum of money in a venture that shows substantial promise, but poses significant risks.

INTRODUCTION

Richard Thomas could not sleep. He had recently celebrated the birth of his daughter. His thoughts now focused on what kind of life he could provide for her. Life had seemed so simple. He and his wife had successful business careers. They owned their own home, drove nice cars. They were active participants in the Charlotte, North Carolina social scene. Recently, this had come to seem insufficient. Though Richard and his wife enjoyed their lifestyle, their daughter's birth served as a wake-up call. Richard realized that he presently lacked the financial resources necessary to assure his daughter's education much less assure his family's future financial independence. He wanted to provide his family with a level of financial security that would accommodate a more affluent lifestyle and build his net worth to the point that his daughter's financial independence would be assured. From discussions with friends and colleagues, Richard became interested in an opportunity to acquire a manufacturing firm. Though he had no manufacturing experience, he believed that his extensive administrative and managerial experience would facilitate a successful transition. Richard's insomnia resulted from his churning of the pros and cons of just such an opportunity: financial independence or financial ruin.

As an African-American, Richard was aware of the fact that most minority entrepreneurs initially venture into service-sector businesses. The barriers to entry in the service sector are typically substantially lower. Most importantly, starting a service business does not usually require such a substantial capital investment. Lack of access to capital has been a significant impediment to entrepreneurship among African-Americans. On the other side of town, Mike Jones, a friend of Richard's, found himself in a similar position. Mike was a Certified Public Accountant (CPA) with a wife and three kids. He had a successful financial planning practice and was a business school faculty member at a nearby state university. Mike's wife had been a judge since she was first elected eight years ago. The Jones' had a comfortable annual income yet Mike, like his friend Richard, yearned to increase his family's net worth by developing sources of income that did not require his time; he was comfortable with the prospects of serving as a passive investor. His goal was to develop sources of income that did not require his time.

RICHARD THOMAS

After graduating from Ohio University with a BS in accounting, Richard joined a major public accounting firm. While there, he passed the CPA exam completing the certification requirements. In 1982, he left public accounting to join a major real estate development firm in

Dallas, TX. He was transferred to the Charlotte office in 1986. In 1988, principals of the Dallas-based firm decided to start their own real estate development firm. Richard was recruited to join the new firm. He served in a number of managerial capacities and ultimately became Chief Administrative Officer.

Richard's wife, also a CPA, started a CPA firm in partnership with another female CPA. Her goal was to build a successful CPA firm by providing quality accounting and tax services to small businesses and not-for-profit organizations.

AN OPPORTUNITY?

In September 1993 Richard spotted the following ad for the sale of a precision machine shop in the Wall Street Journal. The company was located in a small community in Eastern North Carolina. Richard felt the opportunity was worth pursuing even though the facility was a 3-4 hour drive from Charlotte.

Precision Machine Shop
Sharpsburg, NC
Fortune 500 Customers
CNC Machining
$800K Annual Revenue

Richard contacted the owners of BARO, AG. He learned that two employees bought the company in a leveraged buyout. The company, headquartered in Schoolcraft, MI, had a subsidiary, Precision Manufacturing, in Sharpsburg, NC. The owners decided to sell the Sharpsburg facility because they did not believe they could manage this facility effectively given the distance involved.

PRECISION MANUFACTURING

Precision Manufacturing was established as a subsidiary of BARO, AG in 1983. It produced full precision machine parts for customers in the East and Southeast. Precision's primary customers were aircraft, aerospace and medical equipment manufacturers. Sales at BARO, AG grew steadily through 1990 as the number of employees increased to 28. After 1990, sales began to decline and the number of employees was cut back to 13.

Table 1: Summary of Operations for the Periods ended May 31					
	1988	1989	1990	1991	1992
Sales	1,202,483	1,310,696	1,544,376	1,077,170	908,843
Cost of Goods Sold	858,010	954,076	1,253,521	902,788	809,501
Gross Margin	344,473	356,620	290,855	174,382	99,342
Operating Expenses	202,508	260,873	269,797	270,027	207,483
EBIT	141,965	95,747	21,058	(95,645)	(8,141)
Interest Expense	13,261				
Earnings Before Taxes	128,704	95,747	21,058	(95,645)	(108,141)
Income Taxes	55,343				
Net Income	73,361	95,747	21,058	(95,645)	(108,141)

From a personal perspective, Richard was not willing to relocate his family. How could he effectively manage a business in Sharpsburg and uphold his family obligations?
He had limited cash available to finance the purchase ($50,000) and he had limited manufacturing experience.

Richard believed that the opportunity was worth pursuing despite his concerns. He believed that onsite management and marketing personnel would result in additional sales and improved profits. Further, the company would qualify for 8(a) certification from the Federal government's Small Business Administration (SBA) as a minority-owned business.

Richard anticipated that this would lead to business opportunities with the government and to joint ventures with major corporations seeking to do business with the government.

Richard negotiated a purchase price of $500,000 with BARO, AG for the assets of Precision Manufacturing. This did not include the land and building that were leased by the sellers. It was Richard's intent to continue to lease the real property under the same terms as the seller. Richard had $50,000 to commit to the project. Accordingly, his challenge was to raise $450,000.

Richard sent a copy of his business plan to the larger banks in Eastern North Carolina. He also sent the plan to the Small Business Investment Corporation (SBIC) of one of the major banks. He met with investment groups and other interested parties to secure financing.

Table 3: Proforma Summary of Operations for the Periods ended December 31					
	1994	1995	1996	1997	1998
Sales	1092481	1212907	1470094	1662358	1751023
Cost of Goods Sold	683772	813757	1030576	1157483	1208288
Gross Margin	408709	399150	439518	504875	542735
Operating Expenses	255927	252130	331756	368936	397604
EBIT	152782	147020	107762	135939	145131
Interest Expense	29186	27379	25128	22715	20126
Earnings Before Taxes	123596	119641	82634	113224	125005
Income Taxes	50675	49052	33880	46422	51252
Net Income	72921	70589	48754	66802	73753

January 16, 1984 Richard received a bank's commitment letter from a regional bank. The bank agreed to provide $350,000 and establish a $100,000 line of credit under one condition: Richard must move to the Sharpsburg area.

Richard sent a copy of the commitment letter to the SBIC. In February, Richard received a commitment letter from the SBIC for $100,000 of debt financing. The SBIC agreed to $100,000 in 12% subordinated debentures. The new entity would pay interest only for the first year. The loan would be fully amortized in years 2-6. In addition, the SBIC would have the option to purchase 40% of the company at the end of year 6 at a bargain price. The SBIC would also have an option to put the shares back into the company at fair market value.

Richard had discussed his pursuit of a manufacturing company with Mike Jones. Mike had, in turn, expressed his interest in investing in a manufacturing company. When Richard detailed the proposed financing, Mike stated that he would take the place of the SBIC under the same terms. Richard preferred to have Mike involved in the deal. To induce Mike to participate, Richard offered him a 20% equity interest upfront. Mike had the option to sell his equity interest back to the company at fair market value at any time after year six.

The bank determined that the deal structure for the asset purchase was unacceptable. They were not comfortable with 90% debt financing. The bank required 20% equity. Richard had no additional capital to contribute. The only viable option was to recharacterize Mike's investment from 100% debt to 50% debt and 50% equity.

Mike was not enthusiastic about the proposed change. The debt financing offered a fixed 12% return and a fixed repayment schedule. At the time, the prime rate was 7%. The change in the characterization of Mike's investment would introduce additional uncertainty regarding the return of the initial capital invested.

Mike also learned that Richard was successful in securing financing to purchase the real property. The lender, however, would require that Mike subordinate his loan to both the bank loan and the real estate loan (i.e. a third position). This further increased Mike's risk. Mike agreed to consider the change in exchange for a greater equity interest (40%). See Table 4 for the terms of the financing.

Table 4: Proposed Financing of Assets	
Bank Loan	$350,000
Richard's Equity	50,000
Mike's Equity	50,000
Mike's Loan	50,000
The terms of the bank loan were as follows: *Prime + 1.5%* *Interest only for year one* *Loan balloons in 10 years*	
The terms of Mike's loan were as follows: *12% fixed; Interest only for year 1; Fully amortized over years 2-6*	

So Richard sat sleeplessly in his chair reviewing his options. All the pieces were in place to close the purchase of Precision Manufacturing including the real estate. Richard would serve as President of the company. He would have an initial annual salary of $40,000. This amount would escalate annually at $10,000 per year for the next four years. He would also have the opportunity to receive bonuses based on the amount of annual profits generated. Closing the deal would also put his family's finances at substantial risk. Richard would be required to personally guarantee both the bank debt and the real estate financing. He would be financially ruined if the deal didn't work.

Mike also had a serious decision to make. He had long wanted to invest in a manufacturing company. Was this the right opportunity? Was Richard capable of successfully managing this business? Was this a good deal structure? An investment of $100,000 was quite significant. This money could be used to educate his children.

Richard and Mike both pondered into the night. Each knew that the decision they would make in the morning had the potential to secure their financial future or to destroy it: make or break?

CAPITALIZED CUSTOMER ACQUISITION COSTS AND EARNINGS QUALITY: A CASE STUDY OF PHOTOWORKS, INC.

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ABSTRACT

This case examines issues related to accounting method choice and the effect on earnings quality. Specifically, the case examines a company (PhotoWorks, Inc.) that chose the less conservative approach of capitalizing and then amortizing a certain type of advertising expenditure rather than expensing the costs as incurred. The primary purpose of this case is to illustrate the concern of the financial community related to "quality of earnings" and the role of judgment by accountants in the possible management of earnings. If there is a perception of earnings management, then there is a decrease in the quality of reported earnings. We explore in this case the "fine line" between the judgment required in the accounting for many transactions and earnings management. Because of the particular issues in this case, the differences between the financial accounting and tax accounting treatment of the advertising expenditures also are revealed. Both financial accounting and tax accounting require a judgment as to the length of period for which the advertising expenditures provide a benefit.

AMAZON.COM

Javad Kargar, North Carolina Central University

CASE DESCRIPTION

The primary subject matter of this case concerns Strategic Management/Business Policy. It explores the unique challenges that an entrepreneur, Jeff Bezos, founder and CEO of Amazon.com faces as he grows his venture from one product to many variations. It provides a good opportunity to analyze the business strategy as it relates to the financial alternatives. Secondary issues examined include assessing the long-term attractiveness of the online retail industry, assessing Amazon's strategic situation, growth prospects, and comparing strategy in e-commerce with strategy in traditional firms. The case is designed to be taught in two class hours and is expected to require three hours of outside preparation by students.

CASE SYNOPSIS

Amazon had lost money since it opened, with the accumulated deficit near the end of 2000 reaching over $1.7 billion. Amazon's total loss within the past three quarters of 2000 was over $866 million, and the company's working capital was about $504 million, much less than the $900 million in cash and marketable securities at the end of third quarter, 2000. From 1997 through the third quarter of 2000, the company had reported $2.9 billion in revenues, but it raised $2.8 billion to meet its cash needs. In 1999, when Amazon's sales grew 170% from the previous year, its inventories ballooned by 650%. On $676 million in sales in the fourth quarter of 1999, Amazon took $39 million write-down on inventory. In addition, competition was becoming stronger, and all of a sudden dot-com land changed abruptly and capital market was looking at the bottom line-profitability. Moreover, Amazon's revenue growth was declining.

As Jeff saw it, there were two questions they needed to answer. First, could the company establish profitability on a sustainable basis before it runs out of cash? If the existing leadership could not help solve the company's performance problems, what level person should add to the team? What sort of background should they be looking for? It was clear that the company had not yet figured out how to run its business consistently and profitably. Further, Jeff was not entirely certain that the hiring question should be the focus. Cash was running out, and it was not clear more cash could be raised. Should he forget about hiring someone for now and renew his efforts to address the company's strategy and performance problems himself?

BACKGROUND

After receiving his B.S. in Electronic Engineering and Computer Science from Princeton University in 1986, Jeffrey Bezos joined FITEL, a high-tech start-up company in New York. Two years later, Bezos moved to the Bankers Trust Company and helped manage more than $250 billion in assets. From December 1990 to June 1994, Bezos helped build a hedge fund for D.E. Shaw &

Co. During the summer of that year, one statistic about the Internet quickly caught Bezo's attention. The statistic revealed that Internet usage was growing at 2,300 percent a year. That was his wake-up call.

He quit his job and drew up a list of twenty possible products that could be sold on the Internet, and quickly narrowed the prospects to books. There were about 1.5 million English-language books in print and 3 million books in all languages worldwide. There were about 4,200 US publishers and the two biggest bookstores, Barnes & Noble and Borders Group Inc. accounted for less than 12% of total market share. But the largest physical bookstore in the world had only 175,000 titles.

Working out of his garage in Seattle, Washington, Bezos opened the virtual doors of Amazon.com in July 1995. The company's revenue was about $5 million in the first year of operations, which was comparable to Barnes & Noble superstore. Amazon went public on May 15, 1997, and the Initial Public Offering (IPO) price was $1.50.

MERCHANDISING STRATEGY

Amazon rapidly diversified into other industries. It was the Internet's number one music, DVD/video, and book retailer based on its 1999 revenues. By offering over 13 million titles in books, music and DVD/videos, Amazon was the largest online retailer, with over 18 million customers in more than 160 countries.

In 1998, Amazon launched two international sites, one in England, and one in Germany, and had products and services tailored to the local markets. The Amazon.de Web site was presented in the German language. Revenue for the International segment was $167.7 million and $21.8 million in 1999 and 1998, respectively. Forrester Research Inc., the Boston consultancy, predicted total e-business in Europe to $1.6 trillion by 2004.

Amazon entered the toy category in 1999. Sales of toys hit $95 million in less than five months after the company's toy store opened. In July 1999, Amazon introduced another store to sell electronics. With lack of confidence in Amazon's distribution capability, some manufacturers refused to supply Amazon. For example, Pioneer and Sony, two of the biggest manufacturers announced that they would not allow Amazon to sell their products and would take action against third-party dealers that try to sell their products through Amazon's consumer electronic site. Amazon introduced its person-to-person auction site in March 1999. The number of auctions on Amazon grew from 140,000 to 415,000 during the second half of 1999.

In September 1999, Amazon added another new category, the zShops, where an unlimited number of independent shops could set up shop under the Amazon umbrella. The zShops allowed individuals and businesses to offer popular as well as hard-to-find items. The biggest benefit for Amazon was steady cash flow without the costs associated with a warehouse of products. Each online store was charged a $9.99 monthly fee, and commissions of 1 percent to 5 percent in return for access to Amazon's customer base. During 1999 and early 2000, the company formed partnerships with NextCard, Ashford.com, Living.com, Gear.com, Homegrocer.com, Della.com, and Pets.com.

AMAZON'S TECHNOLOGY INFRASTRUCTURE

Maintaining a viable and reliable technology was very critical to Amazon's operations. Because its operations were dependent on the continuous use of computer software and hardware, Amazon had invested significant resources in the development and maintenance of its technology base. Amazon spent $47 million in 1999 to keep its Web site on the cutting edge of technology. Bezos saw site and systems improvements as necessary to avoid losing out to other online competitors. Merrill Lynch Internet analyst Henry Blodget said, "If you're trying to service a mass market, you need to maintain an expensive Web site that costs around $50 million, whether you have $1 or $1 billion in revenue."

Amazon's Web sites, network operations, and transaction processing systems were monitored continuously. The continued, uninterrupted operation of its Web sites and transaction processing systems was critical to Amazon's business. As of October 2000, the company used the services of three Internet service providers so it could maintain constant connectivity, both domestically and internationally.

DISTRIBUTION CENTER OPERATIONS AND ORDER FULFILMENT

In late 1999, most leading e-tailers were making some moves to build their own distribution infrastructure for 2000 and beyond, as they struggled to contain costs and control the quality of their customer service contacts. Amazon knew the design of its Web site would be meaningless if it failed to ship its products on time. Amazon also believed that by expanding its own distribution centers it could decrease shipping costs and make order fulfillment more efficient. In 1999, Amazon expanded its US distribution infrastructure with building six new distribution facilities in five States. Overall, the company had 10 warehouses including one in England and one in Germany.

Although the distribution decision promised cost savings through larger volume ordering and lower shipping costs, it also meant that Amazon needed to generate much higher sales to justify its costs. But, order volume had not yet reached levels that allowed Amazon's warehouses and order fulfillment operations to realize scale economies. The cost of marketing and fulfillment operation was 25% and 22% of sales revenues during the year 1999 and nine months in 2000 respectively. That was about 20% of annual revenue for most of land-based retailers, and 12% for catalog retailers.

By adding product lines, and building distribution centers all over the country, the job of policing its inventories became much more difficult for Amazon. In fact, on $676 million in sales in the fourth quarter of 1999, Amazon incurred $39 million write-down on inventory, which significantly decreased its gross margins.

MARKETING AND CUSTOMER SERVICE

Amazon's marketing strategy was designed to strengthen the Amazon.com brand name, increase customer traffic to the Web site, build customer loyalty, encourage repeat purchases, and develop incremental revenue opportunities. The company used a variety of media, promotional

methods, and public relations activities to achieve its marketing goals. Innovations such as personalized programs and services, as well as flexible merchandising, were all part of Amazon's approach to marketing. To attract more customers, Amazon offered lower price than a conventional store and free or subsidized shipping. Amazon, and particularly Jeff Bezos, was featured in news publications and in other news sources quite frequently.

From the beginning, Amazon's focus had been on offering customers compelling value. Customer service representatives were available 24 hours a day, seven days a week to provide assistance via both e-mail and toll-free telephone. The company's more than 200 customer service representatives, working in five customer service centers were trained to work with customers to resolve their problems. Amazon's A-to-Z guarantee also gave protection to its customers by providing a $250 guarantee for regular purchases and a $1,000 guarantee for purchases made through its 1-Click ordering capability.

FINANCIAL SITUATION

Amazon had not generated cash or profits since its inception. The company had over $900 million in cash going into the fourth quarter of 2000. The company was depleting its cash reserves to cover the negative cash flows from operations. The company lost $866 million within nine months of operations in 2000, $720 million in 1999 and $125 million in 1998. Interestingly, much of the revenues that Amazon had recognized from its corporate partners had come as stock.

Amazon essentially funded its revenue growth through a variety of sources in 1999 and 2000. From 1997 through the third quarter of 2000, the company had received $2.2 billion from its bond offering, while its revenues had been $2.9 billion. In January 1999, Amazon sold $1.25 billion of 4.75 percent convertible bonds maturing in 2009. In February 2000, it sold $681 million of 6.88 percent convertible bonds maturing in 2010. Amazon also had $264 million of 10 percent senior discount notes outstanding, maturing in 2008. Convertible bonds featured fixed interest payments to coupon holders paid in two chunks a year. When Amazon issued the debt, the market for e-commerce stocks was flying, and it looked like the company might be able to call the notes and force investors to convert their notes for shares of its stock. But, in a stunning turnaround in 2000 from its previous years of growth, Amazon's stocks and key convertible bonds started dropping sharply and top tech-fund managers began to reduce and even eliminate Amazon from their portfolios. In October 2000, Amazon stock was trading in the $20 - $25 range, down about $88 from its high $113 in December 1999.

INDUSTRY AND COMPETITIVE ENVIRONMENT

Several factors made the online retailing business attractive relative to traditional retail stores. The Internet technology dampened the bargaining power of distribution channels by providing online retailers with new, more direct avenues to customers. While it was relatively easy to create a Web site that functioned like retail store, the big challenge for an online retailer was to generate traffic to the site in the form of both new and returning customers.

Physical-store-based retailers had to make significant investments in real estate, inventory, and personnel for each store location. Online retailers generally incurred a fraction of these costs due to centralized distribution and virtually unlimited merchandising space. Online retailers, however, faced significant technology costs associated with operating a cutting-edge online store and sizable marketing and promotion costs to build site traffic, which offset many of their cost advantages over brick-and-mortar retailers.

The Internet technology also expanded the geographical market by bringing many more companies into competition with one another. On the Internet, buyers could often switch suppliers with just a few mouse clicks. For example, companies like PayPal provided settlement services -so-called ewallets-that enabled customers to shop at different sites without having to enter personal information and credit card numbers. OnePage allowed users to avoid going back to sites over and over to retrieve information by enabling then to build customized Web pages.

Online retailers were more aggressive in discounting their prices and running special promotions like free shipping than traditional store retailers, and brick-and-mortar retailers with online stores. They could offset the revenue loss from price discounting with the fees they earned from selling advertising space on their Web sites. But, the rate of growth of Web advertising was slowing.

To build sales and market share, online retailers had to build strong brand awareness and generate heavy site traffic. One way of doing this was by allying with Yahoo!, American Online, and the other portals that Web surfers used as gateways for sessions on the Internet and paying them substantial sums of advertising space. Getting lots of exposure on the major portals was deemed critical to building traffic, since it was difficult for online retailers to differentiate on the basis of product selection.

In year 2000, Amazon was competing with a variety of online and off line companies. Several traditional store-based such as Wal-Mart, Kmart, and Target, and some online competitors had larger customer or user bases, greater brand recognition and significantly greater financial, marketing and other resources than Amazon did. Traditional store-based retailers also enabled customers to see and feel products in a manner that was not possible over the Internet. In addition, as the use of the Internet and other online services increase in the future, larger, well established and well-financed entities could join with online competitors or suppliers of products, including toys, video games, books, software, and music.

FUTURE OUTLOOK FOR AMAZON

Going forward, Jeff faced several challenges. The company had a weak balance sheet, massive negative operating cash flow, competition was becoming stronger, and all of a sudden dot-com land changed abruptly and the capital markets were looking at the profitability. It was widely agreed among analysts that most sources of funding, such as the capital markets and bank loans, were likely to be off-limits to Amazon. So, the issue of survivability was a very salient one for those investing in Amazon. The main issue seamed faced by Amazon was whether the company could establish profitability on a sustainable basis before it runs out of cash. Thus, Jeff had to decide which business model and strategy made the most sense for Amazon.

There was still another issue that related to the company's efforts to implement its strategy for growth. By adding product lines the job of policing its inventories became much more difficult. On $676 million in sales in the fourth quarter of 1999, Amazon was forced to take a $39 million write-down on inventory. In 1999, when Amazon's sales grew 170% from the previous year, its inventories ballooned by 650%. It was widely believed that the excessive debt and poor inventory management would make Amazon's operating cash flow situation worse the more it sells.

WAVE OF THE FUTURE?

Javad Kargar, North Carolina Central University
Chuck Hutson, North Carolina Central University

CASE DESCRIPTION

The primary subject matter of this case concerns entrepreneurship. It explodes the unique challenges the Peter, the founder faces as he grows his venture from chip manufacturing to digital content distribution. Secondary issues examined include managerial and financial issues involved in strategic planning. This case for example, could be positioned early in the Strategic Management capstone course as a means to motivate the study of various elements of strategic analysis. The case has a difficulty level of appropriate for senior level. The case is designed to be taught in one hour class hour and is expected to require two hours of outside preparation by students.

CASE SYNOPSIS

In August 2001, gazing out his office window toward the sky, Peter Sprague, founder and Chairman of Wave Systems (Wave), started thinking of possible future financing options for his thirteen-year-old company. After 12 years of fund-raising from friends and family, IPO, bridge loan, and private placement, in March 2000, he again raised $122 million through institutional private placement of approximately 3.6 million shares of Common Stock at $34.00 per share. This infusion gave the company a positive net worth, and provided enough working capital to carry the company for about two years as operating cash flows took off. Since the company's inception in 1988, the company had only about $600,000 operating revenues and generated cumulative net operating losses of over $150 million. With the stock price trading around $2.00 per share, Sprague had two concerns about operations that bore directly on the survival of the company. The cash burn rate was about $4 million per month, and the company's capabilities no longer seemed to match its strategy. Unless these issues were carefully resolved, he feared that he would run through the cash before any significant revenue materialized. Such scenario would seriously jeopardize the future of the company.

COMPANY CONCEPT AND HISTORY

Peter Sprague started the company in 1988. It was initially built around the concept of designing and manufacturing the technology necessary to facilitate distribution of information over data broadcast. Wave's initial strategy was to provide few large customers like Lexus-Nexus or Dialogue, with a secure system for distributing the information to their professional users. The challenge with the strategy was creating a critical mass of metering devices in the marketplace where the number of users was limited and competition was well entrenched.

In developing the financial strategy, Peter first approached wealthy individuals through a number of money raisers. At the same time, Peter also was calling on wealthy friends in a more casual way. Overall he raised about $6 million over a two-year period.

In 1994, the management decided that the only way the company could stay alive was to go public. Two months after going public, the company changed its focus and directed its efforts toward distribution of commercial information, competing with its previous customers.

A STRATEGIC SHIFT

By understanding the limitations of transactions over the Internet, in 1997 Wave developed the first trusted client platform, EMBASSY technology (EMBedded Application Security System) to extend trust from the network server to the end-user's PC. In short, EMBASSY provided protection of digital content, securely store secrets such as personal data, and securely execute applications during an electronic transaction at the end-user's PC and other end-user devices such as set-top boxes. Securing such information from illegally copying, theft, or illegal distribution was important in maintaining a trustworthy digital economy. A key element of the EMBASSY system was an advanced hardware device, which provided critical secure resources, including non-volatile storage, a secure microprocessor, real time clock, a unique ID and cryptography accelerators. Secure storage within the EMBASSY system provided additional protection by protecting the end-user's secrets within the security boundary of the EMBASSY device.

In February 1999, Wave secured a $2 million no-interest bridge loan from a private investor in return for discounted stock warrants to fund operations. In March 1999, it also raised $23 million through the institutional private placement of 2.1 million shares of Class A Common Stock at $11.00 per share.

In November 1999, Peter began approaching various institutional investors for financing. In the late 1999 and early 2000, the e-commerce was in the high-growth phase, and the equity-financing environment was very favorable and many e-commerce companies had no trouble raising equity financing. On March 7, 2000 the company secured $122 million through the private placement of approximately 3.6 million shares of Class A Common Stock at $34.00 per share to institutional investors. Since then, the company's share started dropping and it was traded in the range of $2.00 to $3.00 per share by late 2001.

WAVE'S BUSINESS MODEL AND MARKETS

The Company's strategic objective was to achieve broad market acceptance of the Wave System as a distributed trust platform for commerce performed in user devices. To achieve broad market acceptance, Wave pursued strategic relationships with several main PC manufacturers, and companies involved in the development of commerce in electronic content and services. Peter's biggest challenge was shifting the paradigm and getting PC makers to realize that the current security architecture was inherently insecure, and an isolated environment was needed to manage transactions. Initially, Wave targeted music, video, and print media on demand and educational software market segments, as a mean of rapidly achieving the broad installed base of its technology.

Wave's business model had evolved to support a growing array of trust security and e-commerce functions, which provided three principal revenue streams:

1. One-time per-unit fee revenue from licensing the EBMASSY platform.
2. Revenue from licensing of services based on the Wave Commerce System, which would enable client-side transactions or metering content protection through digital rights management technologies.
3. Hosting revenue from secure applets that would utilize the EMBASSY platform. This license revenue from third party services such as financial services, and privacy solutions was based on an annual, per-platform license fee.

SECURITY AND TRUST IN THE DIGITAL ECONOMY

The Internet had proven to be a revolutionary distribution medium for digital goods. It had dramatically changed the world by greatly reducing the barriers associated with communicating information on a global basis. The highly efficient distribution network was rapidly being melded into a digital marketplace supporting the buying and selling of digital content. This exchange of digital content, such as music, movies, applications software, entertainment games, and books was the basis for the new Digital Economy.

The benefits to this new marketplace were substantial: distribution of content to a far broader target market, reduced costs due to the elimination of both physical goods and the retail distribution chain, and optimized target marketing were all key advantages. Perhaps most significantly, content creators could have access to a wide range of merchandising models that were unavailable. The opportunity to sell music by the individual track, sell book chapters, rent software applications for a limited period or even offer a free trial program would change the way information was presented to the user.

In the early stages of the evolution of the Digital Economy, it was already witnessed how the very same elements that represented the core benefits of the Internet, facilitated malicious and unscrupulous behavior. The efficiency of the Internet as a distribution vehicle had been repeatedly demonstrated in recent high profile piracy cases, including counterfeit Sega Dreamcast games, and the devastating "I Love YOU" virus. Napster had indoctrinated the world on the issues of content protection, intellectual property values and the surging need for systems to manage digital content with any value greater than free.

Another key weakness in the existing infrastructure was the lack of privacy for the user. Personal information was the primary vehicles for identifying consumers in the marketplace. The existing insufficient privacy and protection of the user's personal information was yielding various forms of abuse, including usage monitoring and identity theft. All of these obstacles were tied to the lack of sufficient security and trust in the digital marketplace and should be solved in order for the Digital Economy to flourish.

COMPETITION

Wave operated in a highly competitive and fragmented environment that was characterized by rapidly evolving technology. Many of the Wave's competitors and potential competitors had

substantially greater financial and technical resources than the Company. Also, many existing and potential competitors had greater name and recognition and more extensive customer bases that could be leveraged. Wave Systems competed with conventional information delivery systems, such as AOL, subscription services on CD-ROM, and services on the Internet. However, Wave's metering capability was competitive with other electronic content delivery systems in a number of applications as it was designed to provide advanced protection against unauthorized usage, accurate and detailed information on content usage, and transparent operation.

Many large information industry players were forming alliances and attempting to capitalize on the information delivery options offered by the Internet. In electronic content delivery via the Internet, Wave Systems competed with electronic commerce payment technologies developed and offered by IBM, Micropayment Services, Broadvision, Connect, CyberCash, and Open Market.

THE PERSONNEL

Peter Sprague, Wave's 60-year-old founder and Chairman graduated from Yale and studied economics at Columbia. Previously Peter was Chief Executive Officer of the Company from July 1991 to March 2000. In 1962, Peter started Iran's largest chicken farm. Meanwhile, he spent three decades as chairman of National Semiconductor, which he took from receivership in 1965 to a company with $2.4 billion in revenue when he left in 1995. Peter had also served as Director of Enlighten Software, and Imagek, and was a member of Academy of Distinguished Entrepreneurs, Babson College.

Steven Sprague, Peter's son was elected President and Chief Executive Officer of the Company on June 26, 2000. Previously Steven was President and Chief Operating Officer of the Company from May 23, 1996 until he was elected Chief Executive Officer. Steven had also served as Vice President of Engineering for Krofta Inc., a worldwide environmental water and wastewater treatment company.

As of April 2001, Wave employed 217 full-time employees and 40 consultants. The Company compensated its key employees and consultants mainly with Common Stock. Among Board of Directors was George Gilder, Senior Fellow at the Discovery Institute in Seattle, Washington; author of nine books, and contributing editor to Forbes Magazine.

BUSINESS DEVELOPMENT

The Company's biggest challenge was shifting the paradigm and getting PC makers to realize that the current architecture was inherently insecure, and an isolated environment was needed to manage transactions. Although Wave had spent more than five years trying to convince PC producers to integrate EMBASSY technology in their hardware products, no hardware producers had yet integrated the technology into their products.

In order to bring added value to the PC manufacturers, Wave also focused primarily on promoting the acceptance of EMBASSY by electronic content providers via the Internet. The initial market was targeted on entertainment and educational software developers and distributors. The

Company had invested heavily in developing relationships with entertainment and educational software providers. As of April 2001, Wave had over 100 titles functional for demonstration.

In 1999, Wave and Sarnoff Corporation jointly established WaveXpress to develop technology and services that would allow content providers to send electronic content to properly equipped PCs by utilizing unused bandwidth in the Digital Television spectrum. Wave also formed MyPublish site, a fee-free Internet commerce service to allow individuals and small businesses to harness the Internet to publish, promote, and sell various types of electronic content. In addition, the Company launched CharityWave, a free online charitable contribution service that guaranteed participating non-profit organizations 100 percent of all monies donated.

In 2000, Wave demonstrated the EMBASSY V1.0 chip in Compaq smart card keyboard. It was designed specifically to meet stringent European banking standards, this smart-card reader was developed by Compaq for Cyber-COMM, a consortium led by French banks whose mandate was to find technology solutions to solve online consumer security, trust and privacy issues. Wave also formed an alliance with Advanced Micro Devices (AMD) to provide extended functionality based on an evolving standard for PC platform security being created by the Trusted Computing Platform Alliance (TCPA).

FINANCIAL PERFORMANCE

Wave had losses totaling about $146 million over its last three years of operations. Since its inception in 1998, it had posted only $450,000 in operating revenue and generated cumulative net operating losses of $151 million. In the past year alone, it had lost $48 million. At the end of 2000 it had $80 million in cash.

Clearly, if Wave grew as rapidly as anticipated, it would need additional external financing for 2003. However, the enormous revenue growth projections, although viewed as realistic and based on successful deployment of technology, carried an amount of uncertainty with it.

THE DECISION

Sprague realized that, at present, Wave had been spending about $ 4 million a month to support about $300,000 of monthly revenue. Clearly, this situation could not last long. No amount of expense reduction could make the company profitable from its operations. Even though the financial deal that was closed on March 7, 2000, left them with about $122 million in working capital, several questions troubled Sprague:

1. Should he reduce corporate expenses? Would such a move jeopardize the success of strategic alliances?
2. If he were to educe expenses, what should he cut?
3. Was Wave doing everything it could to ensure the growth of the current revenue streams? What should be the relative emphasis for generating additional revenues?
4. Were new options necessary? Was the current organizational structure adequate?
5. How to finance the production cost of millions of EMBASSY technology?

6. How to deploy EMBASSY in the new consumer electronic devices such as PCs and set top boxes?
7. How to deploy EMBASSY in hundreds of millions of owned consumer electronic devices?

Peter sat back and contemplated the decisions he had to make. He had a lot of work to do to finally get Wave off the ground.

ETOYS.COM - A SURVIVAL CASE

Javad Kargar, North Carolina Central University

CASE DESCRIPTION

The primary subject matter of this case concerns analyzing the business strategy as it relates to the financial alternatives. Secondary issues examined include adequacy of cash flow and working capital. In addition, the case provides students an opportunity to determine what the management team could have done to make the company survive. The case has a difficulty level of appropriate for both senior level and second year graduate level. The case is designed to be taught in two class hours and is expected to require four hours of outside preparation by students.

CASE SYNOPSIS

January 12, 2001, was a dismal Friday for eToys, Inc. and for Toby Lenk, Chief Executive Officer and founder. That day's layoffs would be the first in a series of cutbacks that would reduce eToys' payroll by over 50 percent. The layoffs and other cost reductions were painful, but Lenk realized that things could still get worse.

Toby Lenk founded eToys in 1997. The company went public in May 1999 at a price of $20 per share, raising $192 million in equity capital. In October 1999, eToys' stock was traded at a peak of $86 per share. In 2000, it was one of the world's largest pure-play e-tailer with the biggest selection of kids' products. Visitors to its website (www.etoys.com) could choose from a lineup of more than 100,000 items and more than 750 brands that included toys, video games, software, video, books, children's clothing and baby items.

However, eToys had yet to make profit; in fact, since its inception, the company's losses totaled about $430 million. In June 2000, the company was forced to raise $100 million from investors specializing in distress financing. eToys expected that Internet growth would continue to soar, enabling it to double its sales year over year until it reached profitability, projected for 2003. But, actually eToys' sales during the 2000 Christmas season, despite a spiffy TV ad campaign and expanded line of goods grew only by 40%. As of December 31, 2000, the company owed its creditors about $250 million, had $62.8 million in cash, and its stock was trading at less than $1 per share.

Running out of ideas, Toby thought of hiring Goldman Sachs & Co. as a financial advisor to explore a range of strategic options. Based on the company's position in the market place, Toby still believed that eToys could become a profitable company.

COMPANY BACKGROUND

eToys, based in Santa Monica, California, was founded by Toby Lenk, 38, in March 1997. The concept for eToys came to Toby Lenk when he was a Corporate Vice President with the Walt

Disney Company in the Strategic Planning Group. Toby and his first employee, Frank Han, had a long discussion on niche option. Frank thought the company should stay small and focus on educational toys. But he wanted to shoot for the stars, building a massive online toy warehouse. Realizing that the Internet was a hassle-free way for parents to buy toys for their kids, Lenk quit a job as a strategic planner for Disney to start the e-tailer. eToys was born in early 1997, with financial backing from Intel Corporation. Sales were $500,000 during the 1997 holiday season. The company had sales of $34.7 million in its fiscal year ended March 31, 1998.

The company went public in May 1999 at a price of $20 per share, raising $192 million in equity capital. In the first trading day, its stock soared into the $70s, and closed at $66.63 a share, giving eToys a market value of about $7.7 billion. The proceeds allowed the company to invest heavily in brand development, new product and service offerings and the infrastructure to support the best customer experience for buying children's products. eToys was spending heavily to promote its web site and to develop the systems needed to grab a chunk of the $25 billion toy industry and a piece of the $30 billion spent on children's video game, music, videos, software and baby products.

In early summer 2000, top executives of Toys 'R' Us set up a meeting with Toby to discuss how the two companies might work together, according to a source close to Toys 'R' Us. But he held fast to his belief that eToys could make a go of it without an offline partner. He was devoted to that vision, pounding the table and repeating the mantra "all kids, all Internet," even after investors started demanding quicker progress toward profitability.

ETOYS' MERCHANDISING STRATGY

eToys started by offering toys and then attempted to diversify its product lines beyond toys. Eventually, the company had added video games, books, videos, software, music, children's apparel and baby-oriented products and planned to add more categories in the future. The company focused exclusively on online retailing of children's products and intended to become the primary place for consumers to purchase children's products. eToys categorized the products into different departments, including toys, video games, books, software, videos, music and baby.

In Christmas 2000, eToys carried a significant level of inventory. As a result, the rapidly changing trends in consumer tastes in the market for children's products subjected the company to significant inventory risks. It was critical to the company's success that they accurately predicted those trends and did not overstock unpopular products. The demand for specific products could change between the time the products were ordered and the date of receipt. eToys was particularly exposed to this risk because it derived a majority of its sales in the fourth calendar quarter of each year. In addition, to the extent that demand for products increased over time, the company was forced to increase inventory levels, which would subject them to additional inventory risks.

In addition to the breadth and depth of product selection, eToys offered customers a multitude of services that were not quite available through other online toy retailers. These services included award-winning toy lists, picks of the Month, Dr. Toy's tips, and a list of affordable toys from the "200 Treasures Under $20" feature. Additional convenience features enabled consumers to locate items easily using keyword Quick Search or the sophisticated Toy Search.

ETOYS' WEB SITE TECHNOLOGY

In 1999, eToys made a great effort to keep its web site on the cutting edge of technology. The company's web site and technology expenses of $43 million in the fiscal year 2000 (versus $3 million in the fiscal year 1999) reflected increased spending for the systems and telecommunications infrastructure necessary to support increased traffic and transactions volume. eToys' technology costs ended up climbing so high that many wondered whether any online-only retailer that wasn't selling multiple product categories to a broad market could survive. eToys' pioneered parent-friendly innovations, including a sophisticated search engine had proved a key element in its climb into the ranks of leading online toy retailers.

ETOYS' SALES AND MARKETING STRATEGIES

Unlike established traditional retailers, the focus at eToys was on brand-building rather than revenue building. Toby was reluctant to use coupons and other promotional tools, even while competitors were handing them out left and right. He had always insisted that after getting established reputation, eToys could continuously decrease its huge advertising and marketing costs, and not only retain, but increase its customer base. But, by late 1999, it became clear that advertising costs were rising higher than the company and investors had expected. During 1999 Christmas season, eToys increased its marketing budget by 30% after a flock of unexpected competitors crowded into the online toy category and spent lavishly on advertising. In year 2000, he spent about two-thirds of eToys' $56 million annual marketing budget on pricey TV ads to build brand recognition.

In the summer of year 2000, the company spent $8 million in the summer marketing campaign. The goal was to persuade parents to spend big on a wide variety of summer-themed children's products. Meanwhile, eToys' revenues for the entire third quarter of 2000 rose 23% to $131.2 million. The company had been expecting holiday sales of at least $210 million. In fact, eToys spent $33 to acquire each new customer, who spent an average of $67 per order.

ETOYS' STRATEGIC MARKETING ALLIANCES

In addition to TV advertising described above, eToys secured key partnerships with all of the major Internet gateways, including American Online, Yahoo!, Excite, Lycos and Info seek, and was the exclusive online toy store for Moms Online. eToys' biggest promotional and marketing alliance was with American Online, where in August 1999, it singed three-year, $18 million agreement with AOL. Under the agreement, eToys would be the exclusive provider of products promoted in the Toys, Video and Video Games categories of the Holiday and Birthday Wish Lists area in the AOL kids only channel.

ETOYS' DISTRIBUTION SYSTEMS

eToys was expecting to sell $75 million to $85 million of toys, books, video games and other products in 1999 holiday season. And the company knew the design of its Web site or the number of site hits would be meaningless if it failed to ship its products on time. The company's cost of distribution and customer service was $50 million in 1999. In 1999 Christmas season, eToys used outsourcing organization to ship its products to the customers, but under this setup eToys delivered 96% of its orders on time. During the 1999 holiday season, the e-commerce industry, including eToys, was the subject of widespread negative publicity relating principally to shipping and related customer service issues.

In early 2000, most leading e-tailers such as Amazon were making some moves to build their own distribution infrastructure for 2000 and beyond, as they struggled to contain costs and control the quality of their customer service contacts. In a related move, in the spring of 2000, eToys leased over 400,000-square-feet of additional warehouse capacity to develop its own state-o-the-art fulfillment center in Danville, Virginia. Still in year 2000, some direct-mail companies were subcontracting their product distribution. But unlike books, music, or apparel, toys required special handling because of their different sizes, breakable nature and urgency for the holidays or other occasions.

Although the distribution decision promised cost savings through larger volume ordering and lower shipping costs, it also meant that eToys needed to generate much higher sales to justify its costs. The amount of money eToys had invested in property and equipment increased to $124 million as of September 2000, from $23 million a year earlier. According to Kevin Silverman, an analyst at ABN Amro, "That equated around 95% of the company's revenue, compared with about 20% of annual revenue for most of land-based retailers, and 12% for catalog retailers."

ETOYS' CUSTOMER SERVICE

eToys management believed that attentive customer service was critical to retaining and expanding its customer base. Customer service representatives were available 24 hours a day, seven days a week to provide assistance via both e-mail and toll-free telephone. Customer service representatives handled questions about orders, took credit card information over the phone, and helped customers find items.

ETOYS' GROWTH AND EXPANSION STRATEGIES

The company's strategy was to stock the deepest selection anywhere from mass-market to specialty toys. At the same time, eToys was branching into other children's categories with the aim of becoming the dominant Internet retailer of merchandise for children up to age 12. By January 2001, it had added music, videos, software, video games, books, baby, and hobby supplies. In April 1999, it acquired BabyCenter, an education and community site that also sold such items as maternity wear and strollers. It planned to launch a hobby store as well as create new and distinct content areas focused on topics of interest to parents and children in the future. The company

entered the United Kingdom toy market in October 1999 with the hope of gaining first-mover advantage in the English spoken language country and using the Internet as a new distribution model.

ETOYS' COMPETITVE ENVIRONMENT

The toy industry was changing, not only in the type of product sold, but also where products were sold. The changing face of toy retailing was evidenced by the multitude of discount stores, warehouses, specialty merchandisers and e-commerce toy traders all grabbing for their piece of the pie. Of the ten retailers on the list of the top toy retailers in 1998, six (Wal-Mart, Kmart, Target, Ames, Meijer) were discount stores, two (JCPenney, Sears) were department stores and only two (Toys 'R' Us, KB Toys) were categorized as toy stores.

While retailers competed fiercely, the Internet provided yet another outlet for a quickly growing generation of technologically tuned-in consumers. Boosted by the introduction of more affordable PCs and a higher comfort level of consumers using their credit cards over the Internet, online shopping grew beyond expectations, with toy site usage rising at a record pace.

Competition in the children's product industries was based upon brand-name recognition, selection, convenience, price, perceived quality, speed and accessibility, quality of site content, customer service, and reliability and speed of shipment. A web site could offer a vast amount of information on those products, and at the same time eliminated the cost of printing and mailing catalogs. Yet, like catalog companies, online retailers didn't have to ship products to hundreds of stores. They didn't have to stock shelves. And they didn't have to rent space. Yet, online retailing was not an inexpensive way to do business. For one thing, maintaining a large Web site was costly. Then there was the cost of marketing a site. And, finally, there was the unglamorous task of processing and shipping orders.

THE FUTURE OF ETOYS

The company's costs were ballooning just as funding for dot.coms dried up in 2000. The company owed its creditors about $250 million, and as of December 31, 2000 it had $62.8 million in cash left on the company's balance sheet. In 1999 and early 2000, eToys failed to tap the market for a secondary offering of stock while its shares were relatively high. And in the Christmas of 2000, despite a spiffy TV ad campaign and expanded line of goods, there weren't enough customers. Investors lost their interests in the company when in December 15, 2000, eToys announced that holiday sales would be about half of what it originally projected.

In early January 2001, eToys laid off 700 employees, shut down two warehouses, and closed its British operation. Running out of ideas, Toby hired Goldman Sachs & Co. to explore a range of strategic alternatives. He still believed that eToys could become a profitable company, but questioned how investors would value the business.

There was considerable speculation as to who might be interested in participating with, acquiring, or merging with eToys. One potential alternative was to find a large retailer that did not have significant online retailing operations, such as Target or Kmart. Another possibility was KBKids.

ST. LOUIS CHEMICAL: THE CASH DILEMMA

David A. Kunz, Southeast Missouri State University

CASE DESCRIPTION

The primary subject matter of this case concerns the difference between cash and accounting profits and the problems a company can encounter if profits and cash are assumed to be the same. Secondary issues examined include the preparation and interpretation of the Statement of Cash Flows, fundamentals of working capital management, and financial statement analysis. 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.

The case can be used independently or as follow-up to St. Louis Chemical: The Beginning and St. Louis Chemical: The Start Up

CASE SYNOPSIS

The case tells the story of Don Williams, President and primary owner of St. Louis Chemical, and his current dilemma. By almost all measures the performance of St. Louis Chemical has been outstanding over the last three years. Double-digit sales growth has been achieved, new product lines have been added and profits have more than tripled. But despite this apparent success, cash flow has been a problem. It has been a struggle for Williams to maintain sufficient cash to pay obligations in a timely manner. The company reached its bank-borrowing limit at the end of last year but Williams successfully negotiated an additional $3,000,000 in borrowings using fixed assets as security. The additional capacity was used during the year just ended as well as an extra $2,000,000 working capital loan extended by the bank. The bank has refused to grant additional loans until the debt ratio can be lowered to below 50% and the Times Interest Earned Ratio increased to above four.

BACKGROUND

St. Louis Chemical is a regional chemical distributor, headquartered in St. Louis. Don Williams, the President and primary owner, began St. Louis Chemical five years ago after a successful career in chemical sales and marketing. The company reported small losses during it first two years of operation but performance over the last three years has been outstanding. Sales have grown at double-digit rates, new product lines have been added and profits have more than tripled. The growth has required the acquisition of additional land, equipment, expansion of storage capacity and more than tripling the size of the work force.

At the insistence of Williams, the company has promoted "next day delivery" since its inception. Other chemical distributors can seldom provide this service because they don't stock the

number of products and the quantity of each carried by St. Louis Chemical. Not surprisingly, "next day delivery" has proven very popular with its customers and has allowed St. Louis Chemical to capture a large market share. The sales force is also a strong supporter of the service but because inventory shortages occasionally cause sales to be missed they are constantly arguing for even greater amounts of inventory to be maintained by the company. Williams has tended to agree with the sales force and has over the years instructed the purchasing department to error on the side of carrying too much rather than too little inventory.

Another factor contributing to the double-digit sales growth has been Williams' use of a liberal credit policy to stimulate sales. Credit terms offered by its main competitors are net 30 days, which conforms to general industry practices. St. Louis Chemical also sells using net 30 day terms but Williams has encouraged the firm's credit manager to take a "soft approach" when collecting past due accounts. As a result, the credit department has been slow to press past due accounts for payment. Not surprisingly, the relaxed collection effort has proven to be popular with both customers and the sales force but has resulted in a increasing number of customers paying late. To further increase sales, Williams suggested credit standards be lowered so that more customers can qualify for credit. The credit standards were lowered two years ago and again at the beginning of the year just ended.

THE SITUATION

Despite the apparent "success" experienced by St. Louis Chemical over the last three years, cash flow has been a problem. It has been a struggle for Williams to maintain sufficient cash to pay obligations in a timely manner. The company reached its bank-borrowing limit at the end of last year (2000) but Williams successfully negotiated an additional $3,000,000 in borrowings using fixed assets as security. The additional capacity was used during the year just ended (2001) as well as an extra $2,000,000 working capital loan extended by the bank. The bank has refused to grant additional loans until the debt ratio can be lowered to below 50% and the Times Interest Earned Ratio increased to above four.

The company has the opportunity to add a product line of high margin water treatment chemicals but an investment of $700,000 is required to finance the special handling and packing equipment necessary. Inventory investment will require another $600,000. Williams has been attempting to acquire this attractive product line since starting the company and if he cannot obtain the necessary capital the line will be offered to its primary competitor. To finance the expected sales growth for 2002 (to $86,000,000), Williams has estimated the firm will need at least $2,000,000 for additional current assets and another $1,200,000 for capital expenditures. Putting it all together the company needs approximately $4,500,000 in new financing to add the water treatment line and provide the necessary resources to achieve the planned sales growth for 2002. Issuing more common stock is not an option since Williams does not want to further dilute his ownership position. The stock is not publicly traded.

THE TASK

Assume you are a newly hired assistant to Williams. Evaluate the firm's current situation using the information provided in Schedules One and Two. In your analysis answer the following:

1. Prepare a Cash Flow Statement for 2000 and 2001. Interpret the information provided by the cash flow statements. How has St. Louis Chemical been using its cash and why is additional cash needed?
2. Calculate the return on equity for the last three years using the extended DuPont equation. Interpret the results. What does the equation reveal regarding the company's profitability, used of assets and sources of financing?
3. Evaluate the company's performance for the last three years using ratio analysis.
4. Calculate the firm's Cash Conversion Cycle for the last three years. Interpret the results. How can the Cash Conversion Cycle be used to evaluate a firm's working capital policy? Evaluate the firm's working capital management.
5. Based on answers to questions 1-4, summarize why the firm is experiencing cash problems? Provide your recommendations to improve the cash situation.
6. What alternatives are available to the firm to acquire the new water treatment product line and finance the required sales growth for 2002?

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Schedule One
St. Louis Chemical

Income Statements (000's/$)						
	1999		2000		2001	
	$	%	$	%	$	%
Revenue	43,755	100.00	59,962	100.00	78,953	100.00
Cost of Goods Sold	36,369	83.12	49,828	83.10	65,847	83.40
Gross Profit	7,386	16.88	10,134	16.90	13,106	16.60
Operating Expenses						
Selling	3,894	8.90	4,725	7.88	6,237	7.90
General & Admin.	2,949	6.74	3,958	6.60	4,990	6.32
Total	6,843	15.64	8,683	14.48	11,227	14.22
Operating Profit	543	1.24	1,451	2.42	1,879	2.38
Interest Expense	160	0.37	298	0.50	582	0.74
Earnings Before Taxes	383	0.87	1,153	1.92	1,297	1.64
Income Tax Expense	127	0.28	380	0.63	428	0.54
Earnings After Taxes	256	0.59	773	1.29	869	1.10

Schedule Two
St. Louis Chemical

Balance Sheets (000's/$)						
	1999		2000		2001	
	$	%	$	%	$	%
Current Assets						
Cash	25	0.21	39	0.23	14	0.05
Receivables	3,889	32.10	6,829	38.40	10,966	38.96
Inventory	3,839	31.68	6,505	36.58	9,511	33.79
Other current assets	27	0.22	32	0.18	76	0.27
Total current assets	7,780	64.21	13,405	75.39	20,567	73.07
Fixed Assets						
Land	610	5.03	610	3.43	1,710	6.08
Gross fixed assets	4,996	41.23	5,496	30.91	8,096	28.77
(less accum. depreciation)	(1,269)	(10.47)	(1,729)	(9.73)	(2,229)	(7.92)
Net fixed assets	3,727	30.76		21.18		20.85

Total fixed assets	4,337	35.79		24.61		26.93
Total Assets	12,117	100.00	17,78217,782	100.00	28,144	100.00
Current liabilities						
Account payables	2,223 2,223	18.34	4,429	24.90	8,780	31.19
Short-term notes	1,300	10.73		13.50		15.64
Accrued liabilities	292	2.42		1.01		1.14
Total current liabilities	3,815	31.49		39.41		47.97
Long-term liabilities	1,000	8.25		15.18		20.25
Total liabilities	4,815	39.74		54.59		68.22
Shareholders' equity						
Common stock	2,000	16.50		11.25		7.11
Paid in capital	1,500	12.38		8.44		5.33
Retained earnings	3,802	31.38		25.72		19.34
Total equity	7,302	60.26		45.41		31.78
Total liabilities & equity	12,117	100.00		100.00		100.00

APPLEBEES

Wilburn Lane, Lambuth University
Michael McCullough, University of Tennessee at Martin

CASE DESCRIPTION

This case deals with the competition among Applebee's, Darden, Brinker and Outback in the casual dining segment of the restaurant industry. Each company is profiled and the student will be asked to assess the competitors from the point of view of Applebee's International, where they are with respect to the competition and where should they be for optimum advantage during the next several years. The case should be appropriate for Senior or MBA level strategy and policy courses. The case is designed to be taught in one and one-half hours and should require about the same amount of time to prepare before class.

CASE SYNOPSIS

Applebee's and its three main competitors see the casual-dining segment of the restaurant industry quite differently. This case indicates how this is so. Students will be interested and challenged by this case as it contains information about the subtleties of competition among restaurants with which they are likely already familiar. The information in this case is discussable and relevant. The case is written from the perspective of Applebee's International as this company competes in the casual dining segment of the restaurant industry. Bill and T.J. Palmer opened a restaurant called T.J. Applebee's Edibles and Elixirs in Atlanta, GA in November, 1980. They sold the concept to Abe Gustin and John Hamra in 1988. From 1993 through 2001, Applebee's has added at least 100 restaurants each year, the fastest growing single concept within this segment of the industry. The entire restaurant industry is analyzed and Applebee's is compared to three of its major competitors, Darden, Brinker and Outback. Financial data and historical information invite numerous comparisons among these relatively equal players in a fast growing segment of a fast growing industry.

APPLEBEE'S INTERNATIONAL

Applebee's International, Inc. is headquartered in Overland Park, Kansas and operates casual dining restaurants in 49 states and eight countries under the Applebee's Neighborhood Grill and Bar brand. The décor inside each restaurant celebrates the surrounding community with photographs and memorabilia of local heroes, schools and history. In 2000, Applebee's was the largest casual dining "concept" in America with 1001 franchises 285 company-operated restaurants, for a total of 1286 locations. By November of 2002, they had 1382 restaurants.

Bill and T.J. Palmer opened a restaurant called T.J. Applebee's Edibles & Elixirs in Atlanta, GA in November, 1980. They opened a second store in 1982 and then in 1983 sold the concept to W.R. Grace and Company. As part of that deal, Bill Palmer was named president of the Applebee's

Division of W.R. Grace. The Palmer's became franchise owners in 1985 and currently own and operate 25 stores in Atlanta.

In 1988, Abe Gustin and John Hamra of Kansas City, purchased the concept and named it Applebee's International Incorporated. The name of the stores were changed to Applebee's Neighborhood Bar and Grill to reflect Palmer's original idea of it being a place "people could call their own." They completed and initial public offering (IPO) of its common stock in 1989. Currently the stock trades on the NASDAQ under the symbol APPB.

When Gustin and Hamra bought the concept in 1988 there were only 54 restaurants. By 1998 they had over 1000 and the most recent count is 1382. Thirty-five of their restaurants operate in eight foreign countries. Total systems sales for Applebee's International reached $2.67 billion in 2000. The year 2001 marked nine consecutive years that Applebee's had opened at least 100 stores. The plan for 2002 is another 100 or so new restaurants with 25 being company owned and 80 or 90 being franchised.

Eighty percent of all Applebee's were built in the last nine years, so the chain is young in that respect. They have opened over 100 restaurants in each of those years and this level of growth appears to define their strategy, to increase profits by unit growth.

Applebee's slogan, "Eatin' good in the Neighborhood" is used to support their emphasis on Applebee's as a neighborhood bar and grill. They appear to want the public to see them as a "local" restaurant only, even though they have over 1300 stores in 49 states and several foreign companies. In 2001 Applebee's spent $51 million to promote their image as a "neighborhood" restaurant, hardly something a real neighborhood restaurant could afford to do.

They employ what they call a cascade training program (High Impact Training) for both company and franchise management and hourly associates. This program is designed to fit the "lifestyles" of those who are likely to work for Applebee's. To help feed this training and other management programs, home-office associates occasionally work a shift in a restaurant to refresh their understanding of what it takes to consistently deliver good service. The goal of Applebee's is to instill in their associates that the customer should get a feeling of warmth, comfort and trust. They want Applebee's to be a gathering place.

DARDEN RESTAURANTS, INC.

Darden Restaurants, Inc. is the largest publicly held casual dinning restaurant company in the United States. It has literally clawed its way to the top-using lobster claws. The Orlando, Florida based company has nearly 1200 restaurants in United States and Canada. The flagship chain is Red Lobster with about 660 units in all. They also own the 480 units of the Olive Garden Italian restaurant chain. In addition, they have the 24 unit chain Bahama Breeze Caribbean restaurants. With the exception of the 34 Red Lobster units in Japan, Darden has built its restaurant empire without using franchising. Its oldest chain, Red Lobster, serves lobster, crab, fish and shrimp, while its Olive Garden chain features Italian appetizers, soups, salads, pastas, grilled entrees, and seafood. The smallest chain, Bahama Breeze offers Caribbean cuisine with an array of beef, pork, chicken, and seafood dishes. Darden has recently started a new chain called Smokey Bones BBQ that is a barbecue/sports bar concept. They currently have 10 units, but plan to take the concept nationwide.

The history of Darden Restaurants is a colorful one. Darden was started by Bill Darden, who in the late 1930's (at the age of nineteen) owned a luncheonette called Green Frog in Waycross, Georgia. The restaurant became a big hit, and the restaurant's slogan "Service with a Hop" launched Darden's career in the restaurant business. By the 1950's Darden owned a variety of restaurants, including several Bonanza, Howard Johnson's, and KFC outlets. In 1963, Darden and a group of investors bought the Orlando, Florida restaurant, Gary's Duck Inn. This was Darden's prototype of a moderately priced, sit-down seafood chain. He decided to name the new chain Red Lobster.

The first Red Lobster opened in Lakeland, Florida. Joe Lee, who had worked at one of Darden's other restaurants became its first manager. It was so successful that it had to be expanded within a month. By 1970 there were three Red Lobsters in operation and two more under construction. At that time, General Mills purchased the chain, but kept Darden to run it. General Mills had been in the restaurant business before, but this was their first successful venture. Rather than franchise the Red Lobster name, General Mills chose to develop the chain on its own.

In 1975, Darden became the chairman of General Mills Restaurants, and Joe Lee was named president of Red Lobster. While the Red Lobster chain continued to grow, General Mills began searching for another type of restaurant to complement its seafood chain. Some of the concepts discarded were steak house, Mexican, and health-food restaurants. The company decided to go with an Italian theme, and in 1980 opened its first Olive Garden in Orlando, Florida. The restaurant featured moderate priced Italian food. As General Mills added outlets in the mid-1980's Olive Garden became another Darden success story in the casual-dinning industry.

In 1990, General Mills opened it first China Coast restaurant in Orlando, Florida. The chain grew rapidly-opening more than 45 units in a single year. By 1993, Olive Garden had begun to cool off. Same store sales slid as competitors added Italian items to their menus. Olive Garden responded by increasing its advertising budget, introducing new menu items, and began testing new formats, including smaller cafes for malls. In 1995, General Mills decided to concentrate on consumer foods, and spun off the restaurant business as a public company. The company was named Darden Restaurants in memory of Bill Darden, who had died in 1994, ironically the same year that Joe Lee was named CEO. The new company abandoned its chain of China Coast restaurants that same year.

Constantly looking for new ideas to meet consumers ever changing needs, Darden opened a test restaurant called Bahama Breeze in Orlando in 1997. Red Lobster's sales fell in 1997, but the company initiated a turnaround in 1998, by revamping its menu. The company decided to get into the barbeque business and in 1999 opened its first Smokey Bones BBQ in Orlando, Florida. In 2000, Darden announced plans to open 36 new restaurants and renovate more than 150 other units by 2001. As the largest restaurant chain in the casual dinning (dinner house) segment, Darden is continually looking for new ideas to help it maintain and build on its position in the industry.

BRINKER INTERNATIONAL, INC.

Brinker International, Inc. is engaged in the ownership, development and franchising of the Chili's Grill & Bar, Romano's Macaroni Grill, On The Border Mexican Grill & Cantina, Cozymel's Costal Mexican Grill, Maggiano's Little Italy, Corner Baker Café, and Big Bowl restaurant concepts.

In addition, Brinker International is involved in the ownership, and has been involved in the development, of the Eatzi's Market and Bakery. Currently, Brinker has nearly 1170 units. The flagship chain is Chili's with about 750 units. In the often-fickle world of casual dining, Brinker's Chili's chain has experienced continued popularity. However, the CEO of Brinker, Ronald McDougall has shut down restaurant concepts that were not working, such as Grady's American Grill and Kona Ranch. Also, Brinker sold Wildfire, a 1940's style steak house. In their place he developed concepts that did not face competition from big chains, including Big Bowl Asian cuisine created in partnership with Lettuce Entertain You Enterprises. With Phil Romano, founder of Romano's, Brinker also has developed Eatzi's Market & Bakery, a high-end take-out and grocery business.

The Brinker story began when Norman Brinker pioneered the so-called "casual-dinning" segment in 1966 when he opened his first Steak & Ale in Dallas. In 1971, he took the company public and watched it grow to mare than 100 locations by 1976. In that year, Brinker sold the chain to Pillsbury and became the president of Pillsbury Restaurant Group (which included Steak & Ale, Poppin' Fresh Restaurants, and Burger King). In 1983, Brinker left Pillsbury to take over Chili's, a restaurant chain of southwestern-styled eateries founded by Larry Lavine in 1975. Brinker took Chili's public in 1984. The company began recruiting joint venture and franchise partners.

Chili's expanded its menu to include items such as fajitas, staking the company's growth on aging baby boomers who were looking for something more than fast food. When Brinker's attempts to acquire such fast-food chains as Taco Cabana and Flyer's Island Express, Brinker decided to focus on the casual, low-priced market. In 1989, Chili's acquired Knoxville, Tennessee based Grady's Goodtimes and Romano's Macaroni Grill, a small Italian chain founded by Texas restaurateur Phil Romano in 1988. The company name was changed to Brinker International in 1990 to reflect the expansion of its restaurant offerings.

In 1992, Brinker started Spageddies, a casual, lower-priced pasta restaurant. While playing polo in 1993, Brinker suffered a major head injury that left him comatose for two weeks. Even though this was a traumatic event and the early prognosis was poor, Brinker made a rapid recovery and returned to running the company. Wanting to cash in on the popularity of Mexican food, Brinker acquired Cozymel's Mexican Grill in 1994 and bought the 21-unit ($50 million) On The Border Mexican food chain in 1995. Ronald McDougall became CEO in 1995, but Brinker remained chairman. McDougall sold Grady's and Spageddies to Quality Dining because they no longer fit the company's overall strategy.

In 1996, the company acquired two restaurant concepts, Corner Bakery and Maggiano's Little Italy, from Rich Melman's Lettuce Entertain You Enterprises. In collobration with Romano the company opened a test location (in Dallas) of Eatzi Market & Bakery in 1996. This was a take out restaurant that the company used to capitalize on the public's increasing desire not to cook. Brian Kolodziej, a former chef at Dallas' ritzy Mansion on Turtle Creek hotel, engineered a major overhaul of Chili's menu in 1997.

In 2001, it gained complete control of Big Bowl and bought a 40% stake in Rockfish Seafood Grill. The company has shifted its emphasis to company-owned restaurants rather than franchising. Brinker purchased 47 Chili's and On The Border restaurants from New England Restaurant Company and 39 Chili's restaurants from Sydran Group in 2001. Also, Brinker acquired Sydran's

rights to develop locations in all or part of 14 western states. It is obvious that Brinker is not afraid to try new things and that they are quick to rid themselves of properties when the concept does not work.

OUTBACK STEAKHOUSE

Outback Steakhouse, Inc. is based in Tampa, and is one of the largest casual dinning steak house restaurant chains. It has about 700 units. The flagship is its Outback Steakhouse chain. The restaurants have an Australian theme and are decorated with boomerangs, surfboards, and other items associated with Australia. The chain features moderately priced dinners of steak, prime rib, chicken, fish, and pasta in a family dining atmosphere.

The company operates in 19 countries including Australia. Outback also owns 84 units of Carrabba's Italian Grills offering Italian dishes prepared in an exhibition kitchen. It has six Fleming's Prime Steakhouses that are in the upscale dinning segment. The company also owns one Zararac unit which features Creole cuisine. Outback has opened six Roy's, which is a chain of restaurants featuring Euro-Asian food. It also operates one Lee Roy Selmon's restaurant that offers southern comfort foods. Most of its units are company owned, but it does have 101 domestic franchised units and 32 international franchised units. Outback keeps its growth rate high and management turnover low by giving managers a stake in the restaurants. Multi-Venture Partners, a partnership controlled by Outback chairman and CEO Chris Sullivan, President Robert Basham, and Senior Vice President Timothy Gannon own about 10% of the company.

In 1987, Chris Sullivan and Robert Basham (who had worked together under casual dinning guru Norman Brinker of Steak and Ale fame) founded Multi-Venture Partners to house their new restaurant concept, an Australian-themed eatery inspired by the success of the movie Crocodile Dundee. They opened their first Outback Steakhouse in Tampa, Florida in 1988. While Sullivan had never been to Australia, it did not stop him from creating a kitschy-yet-fun Australian eatery with food items that had unusual names like "Shrimp on the Barbie" and the Bloomin' Onion.

The restaurant was a huge success and realized a profit in its first year-a rarity in the restaurant industry. Sullivan and Basham got another Steak and Ale employee to join them. His name was Timothy Gannon. The three of them went to work to expand the business. They opened seven restaurants in 1989 and 14 more in 1990. Also, in 1990 Multi-Venture Partners changed its name to Outback Steakhouse. The company went public in 1991. With the Outback brand firmly established, the company decided to branch out. It bought a half interest Carrabba's Italian Grill in 1993. These were two upscale eateries in Houston, Texas.

In 1995, Outback purchased sole rights to develop the Carrabba's concept, although the original joint venture remained in place in Texas. Also, in 1995, the chain bought back 47 franchised Outback units for 138 million dollars in stock. In 1996, it opened 76 Outback Steakhouses (including the first international Outback-in Toronto) and 25 Carrabba's Italian Grills. The Carrabba's concept was not as unique as Outbacks and did not fair as well as Outback.

In 1997, the company closed nine Carrabba's units and the following year began remodeling the rest. Over the next two years, Outback expanded the steak house concept to Latin American and Asia while continuing to grow in the United States. In 1999, the company bought Fleming's Prime

Steakhouse. The company continued to expand in 2000, opening its first Zazarac restaurant and developing the Roy's restaurant chain. In the latter part of 2000, the company also opened it first Lee Roy Selmon's restaurant. Armed with several years of experience under the wing of Norman Brinker, the owners of Outback were able to hit the ground running and have never looked back. Their sales have continued to grow, and they are now one of the major players in the casual dining (dinner house) segment of the restaurant industry.

CAMBRIDGE CAPITAL, LLC CASE

Philip Little, Western Carolina University
Robert J. Barnett, Wells Fargo Mortgage Services

OVERVIEW

You are asked by Bobby Harnett, President of Cambridge Capital, LLC, to serve as a financial and accounting consultant for the new company he has formed with his capital provider, Rondell Luther, and Judd Kipson, a seasoned veteran of the sub-prime mortgage industry. Rondell Luther is the sole provider of financial capital. Bobby Harnett and Judd Kipson will provide "sweat equity" to establish and operate the business. In addition to his investment of $1 million, in the form of a line of credit that the company can draw down, Rondell will serve as the chief executive officer and will establish overall company strategic guidance for Bobby and Judd. Also, Rondell's considerable wealth will allow the company to establish the critical relationships with financial institutions that are necessary to establish warehouse lines of credit to allow the company to originate the sub-prime mortgage loan product line that is the company's main source of revenue. Distribution of cash flows by the LLC to the owners are as follows: Rondell Luther: 60%, Bobby Harnett: 25%, Judd Kipson: 15%. All of the distributions will occur on the last day of the month following year end of March 31.

STARBUCKS

Shawna Loyd, The University of Texas of the Permian Basin
William T. Jackson, The University of Texas of the Permian Basin
Corbett Gaulden, The University of Texas of the Permian Basin

CASE DESCRIPTION

This case was developed through the use of secondary research material. The case has a difficulty level of five and is intended to be appropriate to be analyzed and discussed by advanced undergraduate and graduate students in a Strategic Management class. The case focuses on external issues, but allows the instructor the flexibility of concentrating on a variety of strategic issues, or as a means of examining the entire strategic management process. It is practical to specify to students what element, or elements, is the focus of analysis. The instructor should allow one class period for each element addressed. Using a cooperative learning method, student groups should require about two hours outside research on each element researched.

CASE SYNOPSIS

When a small coffee bean shop called Starbucks opened in Seattle's Pike Place Market in 1971, the owners had agreed on the importance of specializing in the sale of high quality, roasted coffee beans. After sixteen years the Company had only 100 employees and 11 stores, all in the Seattle area. When Starbucks employee Howard Schultz convinced the owners to open their first coffee bar in downtown Seattle, hand crafted coffee drinks were unknown in the United States. To the surprise of everyone but Schultz, the coffee bar was wildly successful. The owners were still hesitant to deviate from their goal of educating the public on the superiority of quality, dark-roasted coffee beans and the subsequent sale of those beans for home use.

Schultz left Starbucks to open Il Giornale, his own chain of Italian style coffee bars. Il Giornale was quite successful but lacked the brand recognition, experienced staff, roasting facilities and channels of distribution of Starbucks. In 1987 Schultz and Il Giornale acquired and consolidated all Il Giornale and Starbucks stores under the name of the Starbucks Corporation. Schultz served as CEO and chairman until 2000. He now serves as chairman and chief global strategist. Since 1987, Starbucks has demonstrated phenomenal growth.

Today Starbucks' operates more than 3,300 retail locations in North America, the United Kingdom, the Pacific Rim and the Middle East, as well as its online store at starbucks.com.

The purpose of this case is to illustrate the environment for Starbucks at the year-end 2000 and to determine if the strategies that management proposed at that time were appropriate for the rapidly changing specialty coffee/coffeehouse industry. Which company strengths could be used to take advantage of opportunities in the market? What internal weaknesses might be magnified because of corresponding external threats? Considering Starbucks situation at that time, what recommendations should be made regarding these critical issues?

COMPANY BACKGROUND

Starbucks originated in 1971 when the company opened its first location in Seattle's Pike Place Market. The firm experienced moderate success through the 70s and into the early 80s. In 1987 (five years after originally joining the company as director of retail operations), Howard Schultz purchased Starbucks through his company, Il Giornale. Starbucks grew from 17 locations at the end of that year to over 3,300 by the end of 2000.

Schultz stayed as the CEO until 2000 when he assumed the position of chairman and chief global strategist. During Schultz's tenure the company grew significantly, not only in terms of number of locations, but also in related business activities: roasting plants; blended beverages; alliances; and even compact disc sales. It seems that everything that Schultz touched turned to gold.

STARBUCKS' MISSION

In 1990, Howard Schultz, Starbucks CEO sent a senior executive team to a retreat for the sole purpose of drafting a mission statement. The company's values and beliefs were to be analyzed and Schultz insisted the mission statement convey a strong sense of organizational purpose and that the company's beliefs and principles were clearly set out. The resultant statement was then submitted to employees for review. Changes were made to the statement as a result of employee comments. In addition to the development of the statement, a "Mission Review" system was developed so that employees could voice concerns whenever they felt management decisions were not consistent with the mission statement. Mission statement comment cards were, and still are, available to employees. The Mission Review team receives hundreds of comment cards every month. Essentially, the company has a team of employees monitoring management and holding it to its own high standards. Teams of people from different parts of the company meet to address employee concerns, seek solutions and to provide a report at the quarterly Open Forum.

EXTERNAL ENVIRONMENT

Many people make Starbucks a part of their daily routine by either stopping for coffee in the morning or evening, or by brewing Starbucks coffee in their own homes. The mermaid logo on the cup has become a prestigious symbol in this country and abroad. The company claims to sell "the coffee experience" along with its' physical offerings of coffee and related equipment/goods.

The importance of Starbucks as a "third place" or community-meeting place is very important to the Starbucks product offering. The "coffee experience" reflects the Italian-style concept of enjoying the full-bodied flavor of espresso made from the best dark-roasted coffee beans in a certain, romantic place or manner. Starbucks promotes the use of its shops as gathering places where friends can meet and relax and the cares of the day can be left behind, at least temporarily. As the public continues to move away from the consumption of alcoholic beverages due to increased alcohol awareness campaigns, Starbucks offers an acceptable alternative that can be consumed in a social environment.

Starbucks does not specifically target any particular market, adhering to the concept that its products are purchased on a needs based schedule by much of the population. While there is truth to the Company's methods, perceptions and attitudes toward coffee as a refreshment differs by age of consumer. People from the ages of 20-29 are generally satisfied with the quality and quantity of coffee they consume, feel good about drinking coffee, and are less price conscious and more attuned to the popularity of the beverage. This age group is also more likely to increase their coffee consumption in the future and is accepting of espresso-based drinks. Consumers in the 30 to 59 age bracket are also satisfied with the quality and quantity of coffee they consume and like their younger counterparts, are aware of the popularity of coffee.

The 60+ market of coffee consumers are not as easy to please. They are less satisfied with coffee quality, although they are comfortable with the amount of coffee they consume. They are more likely to drink coffee to relax but are concerned about medical/health reports regarding consumption of caffeine. The variety of coffee available appeals less to this group and they are not excited about espresso-based drinks. They are also more price-conscious than other consumer groups.

Coffee consumption continues to increase, reaching an all time high in 2000 with 161 million people (79%) of the adult population consuming the brew, according to National Coffee Assn. annual trend reports. During this time period approximately 54% of Americans drank coffee every day and 25% were occasional consumers. The number of occasional drinkers is an important factor and is of special interest to coffee purveyors since the retail value of the coffee industry has grown 5.5 billion in five years to $18.5 billion in 2000.

Economic recession could provide a threat to the consumer view of the product. An economic downturn resulting in less discretionary income could mean fewer sales of Starbucks' coffee products. Although each individual purchase averages less than $3.50, the possibility that luxury purchases may be eliminated from many consumers' budgets still exists. On the other hand, recession may offer an opportunity for Starbucks to offer a gathering place or haven for concerned consumers who no longer feel prosperous and need a relatively inexpensive, socially acceptable pick-me-up and/or hang-out. The popular press calls the daily latte one of the "pampering items" that consumers will not give up, along with Coach handbags and massages. It seems that consumers polled would rather not give up the things they do "for themselves." Additionally, the role of caffeine in everyday life should be considered. As Motley Fool Analyst Lou Ann Lofton notes, "While people may slow their spending on clothes or other stuff, they still need their caffeine fix."

On a more global note, while Starbucks has caught on wherever the company has dared to take it, there is no lack of criticism for the cultural invasion of the stores. Charges of "cultural imperialism" have been levied. The most controversial store opening was in November 2000 when the Company opened a kiosk in Beijing's Forbidden City, palace of the emperors for centuries. Tempers cooled when the Starbucks agreed to remove the familiar green mermaid logo sign, perceived by many Chinese as a cultural defilement of the historic palace grounds.

As the Company moves into international markets, care must be taken to find a cultural "fit". All international stores are currently joint partnerships in order to make the transition into the new area easier by drawing on the experience and knowledge of the local partner company. North American unit stores are all company owned. Local business partners are sought out in International

markets and the local baristas receive 13 weeks of training in Seattle. The coffee lineup doesn't vary, but Starbucks does adapt foods to local tastes. Peter Maslen, president of Starbucks Coffee International, claims that stores are not stamped out in "cookie-cutter" fashion-Starbucks stores are designed to fit in with local culture, regardless of where they are located.

The company is essentially at the mercy of the supplier who is in turn at the mercy of the rules of their home country. However, Starbucks buys massive quantities of coffee beans from numerous suppliers, and should enjoy power over those suppliers. In apparent response to growing criticism from global labor advocates and human rights organizations, Starbucks announced plans (02/01) to purchase 75,000 pounds of Fair Trade certified coffee beans. Starbucks annual purchase of coffee beans exceeds 50 million pounds. The Fair Trade Commodities Program began in Europe decades ago with the intent of encouraging smaller growers of goods and better working conditions for tea and coffee growers. The organization's goal is to bring coffee bean prices to at least $1.26 per pound. Large growers routinely receive as little as $ .50 per pound. Starbuck's ability to raise prices for their products is limited and company profitability could be compromised should prices increase. However, with the exception of the Fair Trade bean purchase, the current price for coffee beans worldwide is low and does not indicate the need for price increases at the store level.

While the nature of Starbucks business is essentially low-tech, efficient coordination of the company's 25,000+ employees is important. Another issue is distribution of Starbucks products to its retail units. Company-operated stores in 34 states, the District of Columbia and five Canadian provinces (which comprise the Company-operated North American retail operations), as well as the United Kingdom, Thailand and Australia (which comprise the Company-operated international retail operations) represents a significant distribution challenge.

The U.S. restaurant industry/specialty sector is a low-growth area with many competitors vying for the same consumer dollars. Starbucks performance in relation to that of the industry and the sector have been well above norms.

Although the popularity of coffee and coffeehouses is increasing and competitors are rapidly entering the market, Starbucks still maintains 90% of the market share. The Company certainly has competitors but none who operate at the same scale. Such large-scale operations afford the Company the luxury of considerable leverage over suppliers that most competitors would not have access to.

According to a 2000 US Business Reporter Industry Report, the industry in which this specialty coffee segment is classified (restaurant) is expected to show domestic growth of no more than 2% in the next five years. Additionally, no large increases in the size of the U.S. population, amount of food/drink consumed by Americans or percentage of dollars spent in restaurants is expected in the near future. The restaurant industry environment is quite competitive, even cut-throat, but the outlook for the specialty coffee/tea segment of the industry is quite different. The total value of this segment has grown by more than one-third since 1984 and coffee consumption continues to rise. As was noted previously, Starbucks maintains the vast majority of market share in this segment and boasts 35.2% company growth for the last five years while the segment continues to grow at approximately nine percent. The Company is focused on differentiation through brand recognition and image. However, other companies are able to offer comparable quality in coffee products. Lack of differentiation in the basic physical product (coffee based drinks) makes

the choice of patronizing either Starbucks or a competitor one of personal choice (atmosphere, habit, price, prestige).

Increased coffee consumption and lowering interest rates (as of 4/01) create a favorable atmosphere for the coffeehouse entrepreneur. Lower cost for start up capital and the chance to cash in on the popularity of coffee products is encouraging growth in the ready-to-drink coffee sector. The retail value of all U.S. coffee sales was $18.5 billion in 1999 (National Coffee Association, New York) - a number that analysts predict will continue to grow well into the new century. The new business person taking advantage of coffee and tea consumption and popularity faces few obstacles. However, competing with Starbucks on an equal basis is not feasible.

A company entering this segment faces prohibitive economies of scale in purchasing, labor, real estate, marketing, etc. Entry on a smaller scale is much more probable, even with issues such as less purchasing power, little if any brand recognition and labor costs. The learning or experience curve is also in Starbuck's favor, since they have been in business for more than 25 years. While many Starbucks clones have come on the coffeehouse scene in recent years, none have been able to dent the market share the Company holds due to strong brand identification and customer loyalty. Entrants into the market would be forced to spend a considerable amount of time and money to overcome the momentum of Starbucks.

Conversely, the specialty coffee/tea market is growing, most notably in the occasional sector. These occasional coffee drinkers are less interested in the product; the appeal is the social atmosphere and community of the coffee experience. Starbucks may offer these consumers a known commodity or prestige-need fulfiller but more often, the ambiance and flavor of the establishment, whether it be Starbucks or another is more of a personal choice. This being the case, newcomers to the specialty coffee business have just as good a chance at capturing this developing market as does Starbucks.

Starbucks management claims that there is room for everyone in the market and, the Specialty Coffee Association concurs. The policy of clustering stores in popular locations actually increases customer traffic in that area. Unfortunately, development of such a cluster can also further the difficulty would-be competitors encounter as they search for affordable lease space for a start-up business.

Substitute products abound in the Industry segment in which Starbucks operates, and, while any product (coffee, tea, soda, ice cream, fruit drink) can reasonably be substituted for Starbuck's products, the Company offers more than just refreshment. According to Howard Schultz, chairman and chief global strategist, Starbucks offers "the coffee experience."

The popularity of coffee products is growing but there is always a part of the consumer population that is ready for a change at any time and many consumers are "mood-driven." Although coffee is a staple for many consumers, the risk of being overtaken by other products remains constant. Starbucks continues to diversify through development of new products and as well as searching for new channels of distribution. The Company also takes advantage of the economies of scale and channels of distribution offered by its carefully chosen business alliances, both domestically and abroad.

While consumers of Starbucks products are certainly critical to the Company's success, no one buyer or group of buyers is powerful enough to influence Starbucks in any significant manner.

As previously mentioned, the core product of the coffeehouse industry is high quality coffee in the form of hand crafted drinks or roasted beans. If this product were the only element consumers were considering, the product would be undifferentiated and coffeehouses could expect to be pitted against one another by the customers. In this case, however, all things are not equal since Starbucks maintains such a large market share. Rather than following the "group" as pressure is applied by consumers, Starbucks continues to be the trend setter (according to the National Coffee Association) but that is not to say that the company does not feel pressure exerted by consumers or consumer groups.

The Company was the target of protesters in 1999 and 2000 when Fair Trade and anti-Fair Trade advocates alike picketed Starbucks' Seattle offices. According to a company spokesman, pressure from protesters did not influence long standing buying policies; the decision to purchase Fair Trade certified beans from authorized vendors was existing Company policy in keeping with Starbucks values, views, quality standards and decisions to support developing coffee producing regions by paying a fair price for quality green coffee beans. The very issue of coffee house products as morally objectionable, or not, is actually one of education. From the beginning, one of Starbucks' goals was to educate the consumer about the superior quality of dark roasted coffee from exotic parts of the world. It stands to reason that such education would go past the coffee in the educated consumer's cup to the origin of the product. Additionally, it has been suggested that many consumers find it much easier to justify their $4.00 latte or espresso when they are assured the beans were grown and harvested under conditions that were fair, humane and that hopefully enhanced the lives of the farmers in those remote areas of production through payment of a living wage.

Most individual suppliers of green coffee beans do not have strong positions relative to Starbucks. The Company is the purchaser of more than 50 million pounds of green coffee beans annually and on the surface it would appear that all bargaining power was with Starbucks. This is true - and false. Starbucks is a major purchaser of high quality coffee beans and wields a considerable amount of influence over coffee brokers but since the product is organic, a certain lack of control is inevitable. Prices can be locked in through long term contracts but natural catastrophes occasionally happen and in such circumstances, power is meaningless. Most coffee beans are sold through brokers but are grown by individual family farmers in dozens of countries and regions around the world, sometimes on as few as two acres of land. The crop is vulnerable to natural catastrophes such as drought, flood or freeze, and damage in one growing region could affect the availability of crops worldwide. The cost of green coffee beans would naturally rise if a large region such as Brazil were to suffer a crop crisis such as the dual freeze in 1985. Overall, it is in the best interest of coffee bean buyers to pay a fair rate for green coffee beans. Although low prices help the short-term bottom line figures of coffee buying businesses, these cut-rate practices damage the long-term industry needs for increased coffee bean availability. It is in the best interest of the industry to encourage individual coffee growers to expand their coffee bean growing operations. Increased production is critical if the specialty coffee industry intends to accommodate the growing thirst for premium coffee and coffee products.

Starbucks enjoys considerable buying power and, therefore, leverage due to the size of the company. Starbucks was recently able to obtain lower prices from regional dairies for milk products,

a significant part of the Company's cost of good sold. By exercising this leverage, Starbucks was able to increase its gross margin for the North American Sector during the first quarter of 2001.

LEADERSHIP AND POWER

Howard Schultz became the CEO and Chairman of Starbucks after he purchased the company in August of 1987. His promise to investors at that time was to merge existing Starbucks and Il Giornale stores and open 125 new stores within the year. Although the acquisition was actually that of the smaller Il Giornale buying Starbucks, Schultz opted to keep the Starbucks name because of brand recognition. According to Schultz, "having a name people could remember and recognize…and relate to provides enormous equity." Starbucks opened more stores per year than originally planned, expanding aggressively to today's level of more than 3,300 stores world-wide. In 2000, Schultz stepped down from the office of CEO and became Chief Global Strategist. In his current capacity, Schultz uses his experience and charisma to encourage employees and investors and to guide them as Starbucks continues to grow.

Schultz managed to escape a common entrepreneurial trap, reluctance to delegate. Entrepreneurs often feel ownership for the idea and have the passion to pursue it but lack the skills and experience critical to manage a growing and ever more complex company. Senior management at Starbucks has and for the most part, always has had these qualifications. To Schultz' credit, he recognized his own limitations and recruited managers specifically suited for the tasks and challenges of Starbucks. Many of Starbucks' executive officers came to the Company from major brands and often at a pay cut. Not only were Schultz and his advisors looking for professional qualifications, but also the type of character and culture that would fit with Starbucks' own.

Management in the early days of Starbucks was entrepreneurial, or as Schultz calls it, the "ready, aim, fire!" approach to running a company. In 1990, Orin Smith, current CEO, was hired to turn Starbucks into a professionally managed company that could endure the pain of growth. He recruited seasoned professionals in key areas such as finance, legal, supply-chain operations and management information systems. A clearer strategic direction was developed - one that would support the creative spirit at the heart of the company (entrepreneurship) with process and structure, without overdeveloping bureaucracy. Not only can Schultz be characterized as a "transformational" leader; so can many of the officers responsible for the tremendous growth of Starbucks. Schultz and other executives have not only a role models, but also as a coaches and teachers.

HELL'S GATE POWER PLANT: SUPERVISING THE SUPERVISOR

Philip McGough, Sonoma State University
Leon Dunklin, Sonoma State University
Duane Dove, Sonoma State University

CASE DESCRIPTION

This case can be used to illustrate several important topics in the management of human resources, including: 1) management styles, and McGregor's classic distinction between Theory X and Theory Y assumptions about employees' behavior; 2) a progressive system of employee discipline; 3) the importance of communication within organizations, and the value of "voice systems," organizational mechanisms that allow the voices of employees to go upward in the organization, providing important information to management on the performance of supervisors and creating an environment conducive to employees' loyalty and morale; 4) workers' compensation, including the problem of potential worker's compensation fraud, and the potential hardship to employees when claims are mismanaged by employers. The case is a difficulty level of 2 or 3 and is suitable for a junior or senior or graduate level course in human resource management. It is best taught in the last half of the course when students are better able to handle the intersection of the various topics.

CASE SYNOPSIS

A conflict develops between an employee and his supervisor. The supervisor has given what he considers a strict order during a shift. The employee thinks it is a request that is overridden by the crisis situation continuing throughout a twelve-hour shift. The supervisor, contrary to the company's policies and the union contract, gives the employee a menial assignment as a punitive measure, and the employee injures his knee while carrying out the assignment. The employee files for worker's compensation, but the company uses its 90-day wait and see policy before accepting the employee's claim as valid. This puts the employee in a difficult situation, his health insurance won't cover his medical bills because it is a workers' compensation case. Workers' compensation, however, won't begin coverage until the employer accepts the claim. Eventually the company accepts the claim. The employee files and wins a grievance against the supervisor.

PRICE WATERHOUSE V. HOPKINS: ARE GENDER STEREOTYPES ILLEGAL?

Philip McGough, Sonoma State University

CASE DESCRIPTION

This case uses the facts of the landmark law-suit, Price Waterhouse v. Hopkins, to cover sex discrimination and gender stereotyping. Ann Hopkins, a senior manager at a large public accounting firm, was able to use evidence of gender stereotyping to prove that Price Waterhouse had discriminated against her on the basis of her sex in refusing her partnership status in the firm. The case addresses the issue of gender stereotyping and how conscious and unconscious attitudes can shape our attitudes, influence our opinions, and affect employment decisions. It is best presented in the context of the law that has developed around sex discrimination under Title VII of the 1964 Civil Rights Act. In a business law class, the case can also be used to illustrate the role of evidence in a law- suit, how facts and expert opinion can be used to prove an assertion, in this case, that a woman was evaluated differently for partnership status because she was a woman and not a man. The case is of a difficulty level of 2 to 3 and can be used in any level course-- business law, management, human resource management, government regulation of human resources--in which there is coverage of sex discrimination.

CASE SYNOPSIS

A woman, Ann Hopkins, goes up for partnership consideration at Price Waterhouse, a large partnership providing audit, tax, and consulting services to corporations and government agencies. Nationwide at this time Price Waterhouse, out of 662 partners, has 7 female partners. This year, of the 88 candidates throughout the entire firm for partnership status, Ann Hopkins is the only woman. If made partner, she would be the first female partner in the division where she works. At first the decision of whether to make her partner is postponed. Then the following year, the partners in her unit decide not to propose her again for partnership, and she resigns. Ann Hopkins sued Price Waterhouse for sex discrimination and was able to use evidence of gender stereotyping to prove that she as a woman was evaluated differently for partnership status than male candidates. Price Waterhouse appealed the case to the U.S. Court of Appeals and the U.S. Supreme Court and lost.

NIGERIAN PACKAGED GOODS, LTD.

D.K. Smith, Southeast Missouri State University

CASE DESCRIPTION

Ever wished you had a full-length case (lots of issues, lots of data) about a large under-performing company in the developing world? This case challenges students to use the information provided to develop a plan to dramatically increase profitability and to double the number of tons of products sold by Nigerian Packaged Goods Ltd. within a four-year period. The case is based on field research conducted by the author in Nigeria. At first glance, students may believe the central issue in the case is ?marketing strategy.? As they will discover in the epilogue, however, the solution developed by the company?s Managing Director involves initiatives on a very wide range of factors with the potential to impact corporate performance. Those factors include not only marketing strategy-related issues (that is, target market and the four marketing mix variables) but also company, competitor, and customer characteristics; industry considerations; and the macro-economic environment in Nigeria. 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

Brian Keith is the newly-appointed Managing Director of Nigerian Packaged Goods Ltd., a large subsidiary of Global Packaged Goods Ltd. and a major manufacturer and marketer of consumer packaged goods (foods, cosmetics, soaps, detergents, toothpastes, etc.) in Nigeria. The company has just reported a massive loss, and the former managing director together with most of the senior management team have retired. To ensure continued support for the company from worldwide headquarters in Belgium, Keith believes that he will need to dramatically improve profitability and to double sales volumes within the next four years. Data and information in the case include:

1. *Description of the challenge the company faces.*
2. *For Nigeria: Historical overview, a sample of recent statistics from the World Bank, and (for benchmarking purposes), some comparable statistics on the United States.*
3. *On the company: Historical overview, current performance, and numerous factors impacting that performance.*
4. *Characteristics of the marketing strategy, including descriptive information on the product line, characteristics of the distribution system, and information on the promotion and pricing strategies the company is currently using.*
5. *Characteristics of the competitive situation.*

THE SITUATION

Boarding his flight to Lagos, Brian Keith wondered again whether his decision four months ago to accept his old friend Johnson Ojo?s offer to become Managing Director of Nigerian Packaged Goods, Ltd. would make or break his career at the multinational parent company, Global Packaged Goods, Ltd. As former Managing Director of a major Nigerian Packaged Goods Ltd. subsidiary, Keith had hands-on senior management-level knowledge and experience of the Nigerian business environment. Thus, while he knew very well the tremendous opportunities and successes which can be achieved in Nigeria, Keith also knew how problematic the Nigerian business environment can be. Difficulties Nigerian Packaged Goods had faced recently and/or was currently facing included:

1. For the most recent year, Nigerian Packaged Goods, Ltd. had written off more than 1.5 billion naira (approximately US$15,000,000) of old accounts receivable and inventory. As a result, the company would be posting a large annual loss.
2. As the magnitude of the problems Nigerian Packaged Goods, Ltd. was facing had become more clear, Keith had requested a three-month suspension of the company?s listing on the Nigerian Stock Market. When it resumed trading, the price of a Nigerian Packaged Goods, Ltd. share fell from around 13 naira to 5 naira. Clearly, the public image of the company had been badly damaged.
3. The former Managing Director and most of his senior management team had retired, and both staff morale and motivation were currently very low.

Putting his career-related concerns behind him, Keith began thinking again about the performance objectives which he and Ojo had discussed earlier in the day. The two of them had agreed that to ensure continued support for Nigerian Packaged Goods, Ltd. from Global Packaged Goods, Ltd. headquarters in Belgium, it would be necessary both to double Nigerian Packaged Goods, Ltd. sales volumes within the next four years and to dramatically increase profitability as well. The challenge of course would be to actually achieve those objectives.

THE COMPANY

Global Packaged Goods, Ltd. (hence, GLOPAG) the parent Belgium-based consumer products company of Nigerian Packaged Goods, Ltd. (hence, NIPAG) has been exporting products to Africa for more than 100 years. At the beginning of the 20th century, the company opened its first manufacturing plant in Africa, a soap factory in South Africa. Over the years, the company greatly expanded its operations in Africa. Currently, GLOPAG has operating subsidiaries not only in Nigeria but also in Cote D?Ivoire, the Democratic Republic of the Congo, Ghana, Kenya, Malawi, Namibia, Niger, South Africa, Tanzania, Uganda, Zambia, and Zimbabwe.

Most GLOPAG activities in the above countries including Nigeria involve food and non-food consumable consumer items. Products in the foods category include bouillon cubes, cooking oils, ice cream, and margarines. Non-foods products include baby care lotions and powders, detergents, petroleum jellies, soaps, toothpastes, and other personal care products. Across all countries, laundry detergents is the largest and strongest GLOPAG category.

Over the years, GLOPAG and its predecessor companies have had a huge presence in Nigeria. In 1993, then-Chairman Erasmus Adepo announced that NIPAG?s annual revenues had, for the first time, exceeded one billion naira. As indicated below, each year till 1996 NIPAG reported very impressive increases in turnovers:

	TURNOVER (000 naira)	PRE-TAX PROFIT (000 naira)
1991	617,500	12,480
1992	891,000	18,600
1993	1,538,559	29,561
1994	2,758,971	(302)
1995	4,186,993	(827)
1996	4,284,072	(919)
1997	3,406,224	(46,111)

At the end of 1997, NIPAG announced that CEO Adepo and most of his senior management team had retired, and that Mr. Johnson Ojo, one of the most distinguished businesspersons in Nigeria, had been appointed NIPAG?s non-executive Chairman. It was at this time that the head of GLOPAG?s business group for Africa offered the Vice Chairman/CEO post to Brian Keith. After spending a few days wondering whether this assignment represented a huge opportunity or a kiss of death, Keith had accepted GLOPAG?s offer to become NIPAG Chairman and CEO.

CHARACTERISTICS OF THE NIGERIAN MARKET. As the economic environment in Nigeria deteriorated, receiving high ?value for money? became very important to many consumers. Offering well-known brands had at one time been sufficient for success, but by the 1990s performance and ?value for money? had become far more important for most consumers. For a substantial portion of the market, low prices are very important as well.

PRICE AND PRODUCT-RELATED INFORMATION. In the face of the deteriorating economic environment, NIPAG moved to protect profits by increasing prices and reducing costs. One approach NIPAG used was to reduce the active ingredients of many of the international brands it manufactured and sold in Nigeria. In the process, NIPAG substantially lowered the 'value for money' for consumers and debased the brand equity of these products.

One implication of the above 'debasing' is that world-class brands smuggled into Nigeria began to represent better 'value for money' for consumers than the NIPAG products manufactured locally. Furthermore, and in contrast to packaging innovators (milk-products companies, some detergents companies) who began offering single-use packs or sachets which were more affordable for Nigerian consumers, NIPAG continued to use traditional (that is, large developed-world-sized) packaging. Thus, over the years, NIPAG not only moved away from its original promise of 'superior value for money,' but also failed to deliver on the explicit promise of GLOPAG's Corporate Purpose, that is, 'to anticipate consumer aspirations and to respond creatively and competitively with branded products and services which raise the quality of life for our customers.'

PROMOTION-RELATED INFORMATION. Over the years, NIPAG?s competitors in Nigeria (both formal and informal sector) have massively increased their marketing spends. The percentage of revenues spent by NIPAG on advertising, however, is almost the same now as it was many years ago when sales were nearly twice as high. For this reason, NIPAG's 'share of voice' (that is, total promotional funds spent by NIPAG, divided by total promotional funds spent by all sellers of consumer packaged goods in Nigeria) is far lower today than during NIPAG's glory days.

DISTRIBUTION-RELATED INFORMATION. NIPAG has 28 depots serving 850 wholesalers and large retailers. Nearly all of these direct customers are located in major urban areas (i.e. rural coverage is very weak), and many compete against each other. For example, the company has 20 distributors in the Northeast: Six in Jos, four in Maidugari, and so on. Very few of these direct customers are making any money.

NIPAG salespeople are of course calling regularly on the direct customers, trying to persuade these distributors and large retailers to buy additional products and to maintain inventories. However, NIPAG does not use its leverage with banks in Nigeria to assist its direct customers with their financial arrangements. In other words, the direct customers are responsible for developing their own lines of credit from banks. Typically, NIPAG's direct customers end up paying 4 or 5 points more for their credit facilities than the rate paid by NIPAG for similar facilities.

ADDITIONAL CONSIDERATIONS. As Keith reviewed the situation, he noted the following points:

1. While the business environment in Nigeria had deteriorated enormously since the glory days of the 1970s oil boom, NIPAG had done little to update its business model or its strategy. NIPAG had always been a dominant ?second-to-none? company, and the members of the Board of Directors still embraced and reflected this attitude, even though various measures of NIPAG?s performance (for example, turnover and profits) no longer justified such a conclusion. For example, while NIPAG?s product turnover in 1989 had been 46,000 tons, the corresponding figure for 1997 was only 24,000 tons. Of this huge decrease, some had been lost to other companies in Nigeria which manufacture products similar to those produced by NIPAG (foods, cosmetics, soaps, detergents, toothpastes, and so on). However, as noted earlier, the most serious competition was coming from products manufactured at world-scale plants elsewhere in the world and then smuggled duty-free by traders into the Nigerian market.
2. Regarding profitability, NIPAG found itself in a 'Catch 22' situation. On the one hand, NIPAG's existing system (5 old factories full of old equipment) was very expensive to run and generated very little profit. On the other, because there was very little profit being generated, senior overseas managers were unwilling to spend money updating factories and/or equipment. NIPAG?s plants are dirty and antiquated. This led to various sorts of odd situations. For example, although NIPAG?s headquarters were located on a very impressive harbor-side compound with a private jetty capable of handling ocean-going vessels, and although these facilities were conservatively estimated to be worth at least one billion naira, a substantial portion of the communications and office equipment in the complex dated back to the early 1980s. Furthermore, the office did not possess central airconditioning. Given the age of the headquarters communications infrastructure, readers will not be surprised to learn

that only a few of the most senior NIPAG executives had e-mail access in their offices. Furthermore, there is no automated sales processing, no on-line communications links to depots and/or major distributors, and so on.

3. While NIPAG continued to provide a full range of expensive services and benefits for employees (food from company-owned and operated canteen, car purchase schemes for senior managers, medical scheme, security scheme, etc.), none of these schemes had been updated recently and none of them are competitive with benefit plans offered by other major firms in Nigeria. For example, while some companies offer house purchase schemes to senior managers (the company co-signs the note and the manager receives a subsidized interest rate), NIPAG had never provided this sort of benefit to its staff. Furthermore, the quality of these non-essential services which NIPAG provides to its employees (canteen, medical care, etc.) tends to be quite low.
4. As indicated earlier, the economic environment in Nigeria had changed dramatically over the last several years. Nonetheless, NIPAG had made no major revisions or adjustments to its compensation schemes for managers.
5. As indicated earlier, NIPAG provided no incentives for junior staff (supervisors, people working on a production line, etc.) to strive to improve throughput, productivity, and/or quality. Furthermore, NIPAG exhibited no particular interest in safety, worker health (important to productivity), working conditions (important to morale), etc. There was no emphasis on and little interest in cross-functional teams and other newer approaches to doing business. Furthermore, there was no emphasis on establishing and then promoting to everyone a mission/vision as to who NIPAG is, what NIPAG seeks to achieve, and so on. In other words, there was no attempt to capture workers' hearts and heads, and to get them to be entrepreneurial/proactive in improving the company and its operations. NIPAG provided no rewards for staff interested in any of the above attitudes or performance, even though it was clear that at first-class plants elsewhere in the world, junior (i.e., production) staff can double their salary if they take responsibility for and then deliver high levels of product quality, productivity, safety, throughput, and so on. NIPAG provided no recognition or any other rewards for employees adopting such attitudes.
6. Traditionally, NIPAG has been a very hierarchical company. Directors of NIPAG's various functions (marketing, finance, human resources, etc.) are clustered together in a directors wing at headquarters, rather than being located near the mid-level managers who report to them.
7. With its 'glory days' history of being able to sell everything it could manufacture, NIPAG has never devoted much time or energy to customer service. The company does have customer service representatives, but both the leader of the customer service organization and the individuals in the customer service roles are low-level employees.

THE CHALLENGE

Assume you are Brian Keith, the new Vice Chairman/CEO of NIPAG. How will you go about achieving the performance objective which you and your chairman (Johnson Ojo) have identified, that is, to double NIPAG's sales in the next four years?

SOUTHERN ELECTRIC OF THE CAROLINAS, INC.: A TWO-PERSON WORK RELATIONSHIP

Martha C. Spears, Winthrop University

CASE DESCRIPTION

The primary subject matter of this case concerns the relationship between business partners. The secondary issues examine leadership, personality, behavior, and change. The case has a difficulty level of three or four to be used in management and organizational behavior courses to introduce and understand the dyadic relationship of business partners in a small business. The case is designed to be taught in two class hours and is expected to require three to four hours of outside preparation by students.

CASE SYNOPSIS

Southern Electric of the Carolinas, Inc. is a small entrepreneurship begun eight years ago by partners, Tommy Palmer and David Ard. This case focuses on the interpersonal style of these partners, awareness of the differences, and an understanding of the two-person work relationship. In a small business, the dyadic relationship of partners is the smallest form of a group and the basis for the development of the organization. This relationship involves communication processes, expectations for behavior, role relationships, leadership skills, and consequences for productivity, satisfaction, and development. The interpersonal relationships and emergent behavior in this partnership are examined through personality and behavioral methods.

THE BEGINNING

Although Tommy Palmer and David Ard grew up in the same hometown, they didn't meet until some years later while helping with high school football during summer breaks from college. Although David's plan was to someday coach high school football, his father's untimely death led him to take over the small, family owned electrical business. Tommy had worked at various construction jobs since his early teens and had a talent and interest in the electrical field. After graduating from college in business administration/management, Tommy took the appropriate courses and became a licensed electrician. His first job after college was with a large electrical contracting company.

By 1994, both Tommy and David were in their late 20's and looking for a change. Tommy was not pleased with the way the company he worked with was operated. He wanted more control over his livelihood. David, on the other hand, had his own company but wanted consistency with the internal structure. David and Tommy both agreed that it was reasonable for them to establish a business partnership and start their own company - Southern Electric of the Carolinas, Inc.

STRATEGY AND STRUCTURE

With the assistance of one of Tommy's former business professors and the local Small Business Development Center, the friends started by forming a 50/50 partnership. Their mission statement was simple, "Provide our employees an enjoyable work place with no unfulfilled promises; be where we promise to be, when we promise to be there, and provide high quality work while we are there." It was decided that David would continue to take care of the "field" operation and Tommy would manage the "office" procedure. They decided that their ultimate goal as an organization would be to hire eight employees and have sales of $250,000 per year.

Tommy and David have now been partners for eight years. As a business, Southern Electric has exceeded the partners' original financial goals - they have fourteen employees and yearly sales of $1,000,000. Although they never had a formal, written business plan, they made yearly goals and conducted planning sessions at the end of each year to determine if goals and objectives had been met and what could be done to improve the organization the following year. But since the start-up, the responsibilities of the partners, the organizational structure, the business objectives, and their personal relationship have changed substantially.

Southern Electric now has two distinct divisions: service and commercial. The service/residential repair side is operated by David and the commercial/contracting side by Tommy. Each is solely responsible for making operational and personnel decisions in each division. They hired a business manager, Keith Ivey, to take care of the day-to-day operation of the office. Keith makes sure the bills are correct and sent on a timely basis. He is also responsible for ordering the required job materials for crews in both divisions.

Although Tommy and David still see each other on a daily basis, their interaction with each other is limited. They are mainly concerned with the crews working in their own divisions and with their close contact with Keith. In private conversations with each partner, their perception of how Southern Electric should operate is very different.

David is very outgoing, he likes to meet new people, and wants the company to be a fun place to work. He is satisfied with the size of the organization, although he would like to hire additional employees to take responsibility for the management of the service division. He often states that his ultimate goal is for the business "to run itself".

Tommy, on the other hand, sees the operation somewhat differently. He is much quieter and is more focused on how to meet the goals of the organization. He pays close attention to the financial information for the company. He wants the company to grow and to be there to manage and oversee the expanding operation.

Tommy and David realize they each have unique perspectives of how Southern Electric should be operated. They now see each other as having conflicting views of what should happen next to their organization. To better understand their interpersonal relationship, they consented to take a battery of personality and behavioral tests.

THE FALL OF ENRON: DID MANAGEMENT BURN THE EMPLOYEES?

Neal F. Thomson, Columbus State University
Olice Embry, Columbus State University

CASE DESCRIPTION

The primary subject matter of this case concerns business ethics. Secondary issues include business law, management stewardship and fraud. The case has a difficulty level of three, appropriate for junior or senior level courses. This case was designed to be taught in one class hour and is expected to require three hours of outside preparation by students.

CASE SYNOPSIS

Enron Corporation was, until recently, the seventh largest corporation in the United States of America. As such, Enron employed over 21000 individuals, many of whom were invested heavily in Enron stock, either directly, or through the company's 401k plan (Kadlek, 2001). Enron's employees had an average of 62% of their retirement savings invested in Enron. The company executives were instrumental in this situation, heavily hyping the company's stock to employees, right up to the point that the company declared bankruptcy (Kadlec, 2002). This case examines the fate of these employees, and the losses they incurred in Enron stock. It discusses the role of the top executives in worsening the situation, by hyping the stock, while they were simultaneously selling their own shares. The ethical implications of this situation are examined, setting up the background for classroom discussion of the case.

INTRODUCTION

Enron Corporation, one of the United States largest energy companies, was formed in 1985 through the merger of Houston Natural Gas, and InterNorth, a natural gas company based in Omaha, Nebraska. The merger created a multistate bag pipeline company, with over 37000 miles of pipe (Geomemphis.com, 2001). The company diversified from these roots into a nationwide company involved in energy and energy related services including electricity, natural gas and communications. They also became involved in the trading of wholesale energy, and energy related financial instruments, including derivatives (biz.yahoo.com, 2002; Forest and Zellner, 2001). During this time, Enron grew rapidly, becoming America's seventh largest corporation. The company's revenues increased from $9.2 billion in 1995, to over $100 billion in 2000, and the company's stock returned approximately 500% during that period (Forest and Zellner, 2001). However, a significant portion of these gains was created using accounting tricks, by setting up partnerships and hiding massive amounts of debt. Once these tricks were discovered, Enron had to consolidate several of these shell corporations, and over $1.2 billion in shareholder equity evaporated overnight (Weber,

Little, Henry and Lavelle, 2001). The company was forced to apply for chapter 11 bankruptcy protection, and the price of their shares plummeted from a high of $90 per share in October of 2000, to a low of $0.26 per share by December of 2001, a loss of over 99% of the value of the firm.

The losses to investors are staggering, including many mutual funds, 401k funds, and state pension plans. The estimated losses to Ohio's state pension fund alone was $69 million, with New York and California following close behind with losses of $60 million and $5 million respectively. The total loss in the market value of all the shares of Enron outstanding exceeded $60 billion (Kadlec, 2001). The ethical questions relating to the actions of Enron, and the senior management of the company will most likely keep legal and ethics scholars busy for several years to come. This case however, is limited to an examination of the harms that were suffered by Enron employees, who were heavily invested in Enron stock, primarily through their retirement accounts. Many of these employees had losses in the millions of dollars when the shares crashed. In the following sections, the actions of Enron's management will be examined, and the role these actions played in the employees losses will be discussed.

ENRON'S CORPORATE STRUCTURE AND FINANCIAL WOES

Enron corp. at its beginning, was a traditional style natural gas pipeline company, who's primary business was the distribution of natural gas to customers through their 37000 mile pipeline network. However, in 1989, the company began to diversify by trading in natural gas commodities, building themselves into North America's largest natural gas merchant (gomemphis.com, 2001). In 1997, this trend would be expanded. The new CEO, Jeffrey K. Skilling, came on board with an ambitious plan to expand Enron's trading business to include all types of energy and energy related services (Zellner et al., 2001). Since the natural gas industry was maturing, and profit margins were declining, their strategy was to broaden their reach. Looking for new markets to enter. One of their first expansions was to purchase Portland Electric, in July 1997, moving them in to the electrical power business. As they had done with the gas business, they began trading in wholesale electricity, and related instruments. Since this strategy initially seemed to work, they quickly branched out into other types of commodity trading, buying and selling metals, steel, advertising time and space, wood products and even weather related derivatives (Zellner, et al., 2001). By 1998, Enron had expanded the energy business into international markets, including India and Brazil. They then expanded into the water business, purchasing Wessex Water Company in Britain. However, some of these investments, including the Wessex water deal, and the broadband purchases they made, ended up losing large amounts of money, as the markets for the products collapsed at inconvenient times, or regulators changed the prices the company could charge (Zellner et al, 2001).

These losses came at a time when the company could ill afford to report the kind of results they had created. Expectations for company growth were high, and any report that fell below expectations would devastate the company. The share price would fall, and their bond ratings would drop, ending their grandiose plans for expansion. However, their CFO, Andrew Fastow, had an answer to these problems. Through the use of complex business partnerships, he was able to keep most of the debt they had incurred "off balance sheet." The company continued to show rising profits, and the stock price soared. However, there was a problem. Certain provisions in the

partnerships required that Enron be held accountable for their partner's debts (really Enron's debts, but moved to the partnerships to keep them off balance sheet), if their bond rating dropped below investment quality. The hammer finally fell, and Enron was forced to absorb their partners into the main corporation, which ended up adding $1.2 billion to the balance sheet. This started a downward spiral in the stock price, bond ratings, and overall financial situation of Enron. It finally reached the point that at the end of 2001, Enron Corporation filed for chapter 11 bankruptcy (Forest, Zellner and Timmons, 2001). During this time frame (2001) the company's share price fell from a high of near $90 per share, to a low of $0.26. This situation was devastating to investors, and none were hit harder than Enron's own employees, many of whom had most of their life savings in Enron stock through their retirement plans.

ENRON EMPLOYEE RETIREMENT PLANS

Enron employees were encouraged to contribute to their company sponsored, and controlled, 401k plan, through the use of a company-matching fund. However, the funds provided by the company HAD to be invested in Enron stock, and could not be moved until the employee had turned 50. Furthermore, employees were encouraged to invest the remaining portion of their retirement funds into company stock. In August of 2001, Kenneth Lay, then Enron CEO, told employees that he "never felt better about the growth prospects of the company. Our growth has never been more certain" (Kadlec, 2002, pg 34). As if these tactics were not enough, Enron switched plan administrators, and froze the assets in the retirement accounts for 10 days, during the period in which Enron stock was plummeting, keeping the employees from having any chance of minimizing their losses (Kadlec, 2002). Ironically, Enron executives had already begun unloading their shares of stock, with then CEO Jeffrey K. Skilling alone selling $17.5 million in company stock by June of 2001. Enron executives, including Jeffery Skilling, CFO Andrew Fastow, and 27 other Enron executives are estimated to have made over $1 billion from the sale of stock, during the year of 2001 (Zellner, et al, 2001). Since this occurred at the same time that these executives were hyping the stock to employees, they inevitably ended up selling some of their shares to their own employees.

Employees in the Enron 401K plan had an average of 62% of their retirement savings invested in Enron stock (Kadlec, 2002). One couple, Bobbie and Jerry Dodson, of Baker, Florida lost nearly $1.5 million dollars from their retirement account during the collapse. Bobbie, who filed for retirement in 2001, was expecting her monthly retirement check to be around $800. The revised estimate is now slightly over $300. One would expect that Jerry's monthly check would drop similarly.

Certainly, Enron employees are not the first to lose pensions, or retirement fund assets when their company went bankrupt. However, the Enron case is somewhat unique, in that the management was actively encouraging investment in the company, and painting a rosy picture of the company's future, while dumping all of their shares as quickly as possible. Enron Chairman, Kenneth Lay, claimed in recent interviews that he too was suffering staggering financial losses, and shared the pain of his employees. Evidence of this can be seen in the fact that he recently had to sell one of his vacation homes, for an approximate price of $10 million. However, the fundamental fact remains,

these executives were selling their shares, while simultaneously hyping the stock to their own employees.

DISCUSSION QUESTIONS

1) Did the Enron Executives do anything wrong? Why, or why not?

2) What should they have done differently, if anything?

3) Should the government step in and create new regulations regarding this issue?

4) Who bears the most blame in this situation? The Enron executives, the government, or the employees and other shareholders?

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C.A.W. CONSTRUCTION COMPANY: A PROPOSAL FOR DIVERSIFICATION

John J. Withey, Indiana University South Bend

CASE DESCRIPTION

This case explores 'intrepreneurial behavior' in a large organization. Several mid-level managers are proposing a diversification into a very small, but related market. Parameters of the diversification opportunity are presented, including competitive information and financial data. Required is a complete feasibility analysis, identification of significant variables surrounding the decision, and a recommendation on the diversification issue. The case is derived from an actual situation, although company names and some of the financial data are disguised. A portion of the financial information is time-dependent, but the majority of case content is generic to the point of resisting rapid obsolescence. The case is best suited to undergraduates with a difficulty level of "3." It fits well in courses which focus on entrepreneurship, marketing principles, and/or general business policy.

CASE SYNOPSIS

A large heavy-and-highway construction firm investigates the potential for diversifying into the much smaller, ready-mixed concrete business. Available data allow managers (students) to project investment levels, marketing shares held by competitors, break-even point, and general financial expectations that influence the decision. The case also provides information that directs the reader to see how unique differences in market segments and purchase behavior between the firm's traditional customers and the proposed new market create significant challenges to diversification. Alternative competitive reactions to the new entrant are also developed. Especially interesting and relevant is the material surrounding the internal turf wars and ingrained company culture that operates outside the more straightforward financial analysis. The case is macro-policy in nature, but issue-specific enough that a clear decision can be made and defended. Complete teaching notes accompany the case.

BACKGROUND

"The cost of ready-mix is going up again! This is the third time in the last 12 months. We are now going to have to pay $60.00 a cubic yard for this stuff!"

Frustration over the price of ready-mix concrete was nothing new to Paul Carter, general manager of C.A.W. Construction Company. Ready-mix concrete was only available from a handful of local suppliers, and they all demanded the same price per cubic yard. Negotiation rarely took place, and due to the length of time it takes for concrete to harden, purchasing from more distant suppliers was not feasible.

Carter's concern arose from the fact that while C.A.W. Construction was an asphalt paving contractor, many construction projects that use asphalt also require ready-mixed concrete. Commercial paving projects such as parking lot surfacing or shopping mall construction often include concrete sidewalks or concrete entry aprons. Asphalt streets in residential areas may utilize concrete curbs or special concrete areas at intersections. Even major highway construction or resurfacing that are essentially asphalt projects may still require some concrete components at entry and exit points.

Ready-mixed concrete is produced in a stationary plant (cost is only $500,000) and delivered to the work-site in special delivery vehicles that keep the mix loose and wet while in transit. The mix only has a useful life for projects located less than 50 miles from the plant. A challenging aspect of managing a ready-mix operation is to coordinate production at the plant site with availability of the delivery vehicles, and to dispatch the vehicles in a manner that matches work-site preparation and crew availability. Any error in this process results in unusable mix, and is quite costly. An efficient operation must be able to deploy a minimum of eight delivery vehicles. Some larger ready-mix companies operate several plants in adjacent markets (50 miles from one another), and attempt to use the same fleet of vehicles across multiple plants.

A ready-mix business supplies concrete to a wide range of applications. Typical is the residential market. New or remodeled housing construction frequently requires ready-mixed concrete for foundations, sidewalks, driveways, etc. Commercial and industrial applications are prevalent also, as are the road building settings described above. A common dimension of all applications for ready-mixed concrete, however, is that they demand a relatively small amount of concrete, as compared with the applications where a semi-permanent on-site plant would be appropriate.

The rationale for C.A.W.'s entry into the ready-mixed market seemed very plausible to Paul. C.A.W. Construction already is an established construction company with significant experience on projects that utilize ready-mixed concrete. While C.A.W. only provides site preparation services and asphalt paving, they do subcontract ready-mix suppliers on many of the same projects. They feel they know the local market for ready-mixed concrete and the competitors they would face if they entered this market.

Paul Carter wants C.A.W. to have ready-mix capability because it would allow the company to become a full-service provider of site preparation and paving services. C.A.W. would eliminate its expensive dependence on a crucial class of subcontractor. Ready-mixed concrete would be a new profit-center for C.A.W. Construction. For Paul, a move into the ready-mixed market appeared a natural and desirable diversification for the company.

Governmental departments of transportation are the principal customers sought by C.A.W. Construction. During the last five years, however, C.A.W. has gradually moved into the private, non-government market. This market is less predictable and more competitive. Private work can be more profitable than public sector projects and it is not characterized by the same public, inflexible bidding process. Presently, C.A.W. derives 15% of its revenues from private sector projects. Sentiment among many executives, however, remains with the traditional public sector road paving project.

THE NEW MARKET

Customer segments in the market for delivered mix include residential, industrial, and commercial builders. C.A.W. Construction presently serves a principal city of 250,000 residents, although the company's reachable market contains four times as many people. Population growth projections for the principal city are flat, but the entire market area is expected to grow at a rate of three percent per year over the next ten years. Much of the residential growth is occurring in the northern most portion of the area, roughly 25 miles from C.A.W.'s asphalt production site. There is, however, a major interstate by-pass being constructed around the southern end of the area. C.A.W. is participating in this multi-phased construction project which is expected to take an additional three years to complete. Significant commercial development is anticipated along this new highway. When making projections regarding the demand for ready-mixed concrete, industry analysts often use the rule-of-thumb of one cubic yard per resident per year.

Year-to-year changes in the demand for ready mixed concrete can be very volatile. Annual changes of as much to five or six percent are not uncommon. Key factors are new residential housing starts and renovations of existing private construction. Ready mix production in C.A.W.'s home State in the most recent year was 6.8 million cubic yards.

Due to land costs and zoning regulations, Mr. Carter and other company executives want to install a ready-mix concrete plant adjacent to their asphalt manufacturing plant. It is unlikely that a ready-mixed concrete production plant located on the same site with C.A.W.'s asphalt operation could effectively compete for business beyond the current asphalt market area. Vehicles with limited delivery and unloading time, making repeat trips carrying ten cubic yards of concrete mix to job sites that typically needing 60 to 100 cubic yards restrict the size of the geographic market that can be reached.

COMPETITORS

Four companies share the market in the area surrounding C.A.W.'s office and asphalt plant location. Weamer Concrete, Inc. and Pac-Mix, Inc. control a big portion of the total market, with Hobass Concrete Products Company a distant third. American Concrete Corporation, with a more distant production site than the other three, occasionally does some work in C.A.W.'s market area. Hobass and Pac-Mix sell a dry product that is actually mixed in their delivery vehicles while in route to the job-site. Weamer uses a central mix plant and delivers the mix to the job-site already wet. One recent survey of building contractors revealed no significant preference for either type of mixing process. Weamer and Pac-Mix operate large fleets of delivery vehicles and multiple plants. Both companies should be enjoying economies of scale that allow them attractive margins on delivered ready mix.

Despite significant differences in size and market power, there is almost no price competition. It's probable that either Weamer or Pac-Mix could make things difficult for Hobass or American with price reductions, but this has not happened. Paul Carter believes the market is large enough for all four companies to successfully participate without much head-to-head

competition. Paul hopes the market is large enough to support a new competitor but admits that it is difficult to predict what reaction might be provoked by the entrance of new competitor.

A review by C.A.W. executives of the four local competitors reveals the following:

All four do more with concrete than just ready-mix. Precast work and other concrete based products are common. Also, non-concrete products may be part of the total product mix. Tool rental, for example, is part of what Pac-Mix offers its customers.

The two smaller competitors integrate their ready mix business with other, related businesses. Hobass Concrete Products Company, for example, is also involved in above ground construction. Hobass and American have annual revenues of approximately $2.5 million and $4 million, respectively, of which less than half is derived from the manufacture and delivery of ready-mix concrete.

All four do business with a large number of small customers. Buyers include many individual home owners as well as a variety of building contractors.

Weamer and Pac-Mix use a multi-plant strategy. Operating more than one production plant allows better utilization of expensive delivery vehicles.

All four have a lengthy record of service in the local market. In spite of management and ownership changes, all four competitors have developed long term relationships with their principal customers.

COST TO ENTER

Key investments necessary to enter this market are a central-mix concrete production plant supported by a minimum of eight front-loading delivery vehicles. An installed central-mix concrete production plant costs $500,000. Front-loading delivery vehicles cost $125,000 each. Presently there is a two year wait for new delivery vehicles. It is estimated that a new production plant can be operational within 120 working days. Plants and delivery vehicles have useful lives of approximately seven years.

The need for a minimum of eight delivery vehicles derives from the relatively small pay load per vehicle, the large demands from the typical ready-mixed concrete project, and the necessary short delivery distances. With an approximate haul capacity of ten cubic yards to jobs that can require six to ten times that amount, multiple trucks are often required to complete one job. Even on single load projects (a residential driveway, for example), mix must be delivered and poured within 90 minutes. This implies a two-hour cycle per truck per load, and severely restricts the geographic reach of a single plant.

It is especially relevant that investment in delivery vehicles, compared to the cost of production facilities, is very high. A single production plant can produce 300 cubic yards of concrete per hour, while delivery vehicles are limited to 10 yard loads and are tied up for two hours between loads. This is undoubtedly the reason why many ready-mix businesses are multi-plant operations. Expensive, inefficient vehicles can be scheduled from alternative plants, allowing access to wider markets without significant increases in overhead.

While concrete production and delivery is a capital intensive business, there is still a need for additions in personnel. One driver for each vehicle and three full-time plant operators is the basic complement of labor needed. Some additional sales and office help is also required. C.A.W., a union employer, will need 13 new people year around at an average cost of $30.00 per hour.

Cost of capital rates assume a floating percentage slightly above prime, currently at 9%, and a seven year 'loan life' of the plant and delivery vehicles. Commercial lenders usually do not make equipment loans for periods longer than seven years. Depending on their usage, concrete mixing delivery vehicles are reaching the end of their reliable life after seven years. The production plant may be useful for a somewhat longer period.

On a national level, concrete producing businesses average 48% gross margin (not including labor). Local producers are probably slightly higher. This means that a cubic yard of mix with a market value of $60.00 can be produced for approximately $30.00. Working capital needs for stone and cement ash inventories, receivables, and cash are estimated at 25% of sales.

THE DECISION

C.A.W. Construction Company brings a known name, a solid reputation with subdivision developers, and considerable knowledge and experience to the concrete industry. These are strong assets and should aid with entry into the ready-mix business. Moving from working with subdivision developers to working with building contractors should be relatively easy. In some cases the two groups are the same people. Further, none of C.A.W.'s potential ready-mix competitors are involved with asphalt paving. C.A.W. expects considerable synergies across the two similar operations.

Smaller contractors and homeowners will be a new market segment for C.A.W., however, and will require some time and promotion expense to successfully attract. There is considerable turnover in the contractor segment and C.A.W. Construction will need some distinctive advantage for being chosen as a ready-mix supplier. Repeat business and long term loyalties characterize this market segment. Some contractors have done business with the same ready-mix supplier for 20 to 30 years. Short of extremely poor service, it is unusual for a contractor or builder to change mix supplier.

Unfortunately, many residential builders view ready-mixed concrete as a commodity only. No significant differences are seen in the mix available from different sources, and at this point, no significant differences are perceived among the area's four mix suppliers. In fact, there are numerous differences in characteristics of ready-mix concrete. Different grades, aggregate ingredients, set-up time, and surface appearance are just a few. At this point, the local building contractor segment is neither aware nor very interested in these differences.

Presently, the building contractor and homeowner segments seem most impressed with reliable service, suppliers with large, modern truck fleets, and liberal credit terms. No price competition exists between mix suppliers, so contractors rarely ask for price quotes. Only on bigger projects such as non-residential buildings, might there be some flexibility. Right now, Weamer and Pac-Mix get virtually all larger projects.

When asked specifically why their business uses whichever mix supplier they use, owners often have a reason that dates back to when the struggling contractor was in need of lenient credit terms. Once that loyalty is formed, it rarely changes.

Paul Carter and other management personnel are very much in favor of entering the ready-mix market in the area where C.A.W. already has a presence. They realize, however, they will have to convince the company's senior executives on the feasibility of their desires. Specifically, they will have to identify the size of the local ready-mix market, both in the short and longer term. Paul wonders what market share his company would have to achieve in order to break-even, as well as what volumes would be necessary to meet the company's 15% return-on-assets-managed objective. Both he and his associates know they will have to make a compelling case for this project if they expect the company to make the necessary investments.

PROCESS ANALYSIS AND RISK ASSESSMENT IN A NOT-FOR-PROFIT ORGANIZATION: AN ASSURANCE SERVICES CASE

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CASE DESCRIPTION

Audit education and practice have seen a shift in emphasis in recent years toward process analysis and risk assessment as an important component of evidence gathering and evaluation. With this, the concept of assurance has moved beyond the traditional notion of what a financial statement audit has been traditionally thought to encompass. As the content of practice changes it is of critical importance that instructional materials evolve to incorporate these changes.

CASE SYNOPSIS

This instructional case reviews the internal control processes of a not-for-profit audit client (specifically a Roman Catholic diocese) from both a traditional internal control and a process analysis/risk assessment framework (see Knechel, 2001). Most audit instructional cases involve more traditional for-profit clients, so students should benefit from an examination of textbook concept sin a less familiar environment. The diocese has a number of important problems associated with its pledge recording and cash collection processes. In answering questions on the case materials, students are provided with an appreciation for the difficulties inherent in establishing and maintaining an effective system of internal control in an environment that has significant cost/benefit constraints. Additionally, they gain experience in using risk documentation and analysis tools that have become increasingly common in recent assurance services practice, research and pedagogy (e.g., Bell et al. 1997; Walker, Shenkir and Hunn, 2001; Eilifsen, Knechel and Wallage, 2001, Knechel, 2001).

ARLISS INDUSTRIES, THE ERP JOURNEY

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CASE DESCRIPTION

This case is appropriate for any Management of Information Systems class or Emerging Technologies class. Either class will discuss the critical success factors for Enterprise Resource Planning (ERP) implementations, what the problems are and what strategies should be applied to address these problems. The case is appropriate for either a senior or graduate level class and should require one-two hours class time and two-three hours of outside preparation.

CASE SYNOPSIS

In early 1997 Enterprise Resource Planning offered Arliss Industries the promise of a cure for several corporate ills as well as the opportunity to streamline their operations and leverage many of their IT Resources. Early expectations included the elimination of Y2K problems inherent in their aging systems. ERP also promised a standard data language and rationalized data across the corporate environment. IT expertise could be concentrated on a common set of software modules as opposed to the forty plus existing MRP systems. This case presents an actual scenario, disguised to protect the participants, of one company's halted attempt at implementing ERP. All case facts are essentially correct and accurate. Due to a large corporate acquisition and declining market the project was delayed then halted. In an effort to improve their declining corporate stock price many capital expenditures were postponed and profits diverted to payoff debt resulting from the corporate acquisition. Due to high implementation cost, the ERP project was included in this list. Arliss Industries is now faced with numerous problems associated with restarting a halted project. Challenges are to determine not only the problems, but also strategies to overcome them based on a set of critical success factors that will help insure successes. Properly prepared the case will require the weaving together of both commonly accepted information system practices and techniques and strategies particular to ERP.

eCAMPUS.COM: THE BEGINNINGS

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CASE DESCRIPTION

The primary subject matter of this case concerns the launching of an e-commerce company. It includes information and issues concerning the volatility of the industry and how the personnel and structure comes together under the highly fluid and uncertain environment of the e-commerce industry. It describes the anatomy of creating and implementing what is essentially a virtual company where many of its functions are outsourced in the form of alliances and contract management. This case is suitable for both graduate and undergraduate strategy classes and has a difficulty level of four. Because it is an anatomy of a start up and an e-commerce case it would be especially appropriate for management information systems and entrepreneurship classes. The students should be prepared to spend from six to twelve hours outside of class analyzing the case depending on the breadth and depth of the analysis.

CASE SYNOPSIS

On January 20, a group of 10 people sat down to discuss the fastest and most convenient way to get a textbook into the hands of a college student. ecampus.com is what they came up with. With e-commerce rapidly expanding throughout the country, these few individuals knew that the best way to beat competition was to get on the Internet before someone else did. Taking that statement seriously, they anxiously began writing code on February 1st, were incorporated by April 16th, and by May 17th they had moved into their headquarters in Lexington, Kentucky.

They officially went live with ecampus.com forty-six days later. Its initial promotional campaign was so successful the web site was overwhelmed with the number of hits it received the first week slowing the system to almost a stand still. The company is expecting a tenfold increase in textbook request by the next ordering season. Details of the chaotic pre and post launch environment are described. After studying this case, students should be able to (1) better understand the operations of the textbook industry (2) identify the requirements for successfully competing in the industry; (3) evaluate the competitive strategy of using e-commerce in the textbook industry; and (4) the process of launching an e-commerce venture.

CREATION OF A SPINOFF

Steve Stevens, President of Wallace's College Bookstores, was very concerned. In the spring of 1998, the University of Maryland issued a RFP for the management of its bookstore. The announcement required the managing company to include an on-line transactional component of the

bookstore, which handled orders, shipping and payment. The University of Maryland was a huge account because of its overseas programs. Although this was the first university that made on-line service a requirement as part of an overall management contract, Stevens was sure this was a picture of things to come.

Stevens called a meeting of his top management to discuss what he saw as a real threat to their position in the industry-full service on-line textbook operations. Maryland's call for Web based services, coupled with Amazon.com's sudden rise to prominence in the retail book market, served as a wake up call. Steven's was not as concerned with Amazon.com as he was with his more direct competitors, Barnes & Noble and Follett. Follett and Barnes & Nobel managed about one third of the more than four thousand college bookstores. Both of these companies were expected to be on-line by September 1998. In addition, Stevens knew another competitor, Varsity, and two newcomers to the market, Big-Words.com and Textbooks.com, were planning to go on-line before the start of schools in the fall 2000. At the beginning of the meeting, Stevens shared his vision with the management team: Wallace's would become the number one on-line textbook seller as fast as possible.

In the fall of 1998, the management team decided to create a freestanding company called ecampus.com and have it fully operational by the next fall. Their rationale was that simple on-line transactions could be handled on a store-by-store basis, a full service operation could not. On-line consumers were expecting a rapid response, real time inventory, and fast accurate tracking capabilities. There was just no way to integrate and handle the inventory demands on a store-by-store basis during the fall rush period. This model was different from Barnes & Noble and Follett. Both of these companies were creating Web sites for college textbooks that would become part of their brick and mortar operations.

Wallace's Book Company was the prime mover for the initial round of capital. Wallace Wilkinson, the company's founder and former Governor of Kentucky, used his personal influence and the book company's successful history to persuade the likes of John Y. Brown (Kentucky Fried Chicken), Dave Thomas (Wendy's) and several other friends and business associates to invest substantial amounts in the startup of ecampus.com. Start-up cost for the new company was substantial: $50 million January through August. There were three major start-up costs for eampus.com. These were technology, legal, and distribution and logistics, with technology being the highest by far. Technology start-up costs included developing computer hardware, software, and other computer related hardware such as telecommunication lines used to conduct the operation. They also included transaction-processing systems used to conduct business online. The legal start-up costs included incorporation costs and their contractual arrangements with Wallace's.

Wilkinson maintained fifty-one percent interest in the new venture and threw the support of his company behind ecampus.com. This strong tie between the two companies became the foundation for the alliance between the two companies. ecampus.com would build, operate, and maintain a full service Web based textbook store, and Wallace' would use their buying power and distribution system to support ecampus.com.

A team of ten people, three from Wallace's and seven from Oracle, met in early February 1999 and began writing code to insure that the front end (customer ordering) had the proper support from the back end (applications) which ties the electronic storefront with the inventory and

distribution system. While code was being written and distribution was being coordinated with Wallace's, DeVito/Verdi Advertising of New York was contracted to provide marketing research and an initial advertising campaign.

THE LAUNCH

Another component of the ecampus.com vision was to recruit the strongest management team possible to help launch and run the new venture. Stevens and several other members of Wallace's staff left to head up ecampus.com. An executive placement firm was used to recruit other top executives with strong backgrounds in their respective fields. Once the key people were in place, a decision was made to begin staffing with temporary employees who fit the ecampus.com profile from local employment agencies and colleges on an as needed basis. Like most e-commerce firms, they were looking at a very young staff. It was also decided to keep the organization fluid by keeping structure minimal during the startup phase. By April 16th they were incorporated, moved into a new headquarters May 17th, and anticipated going on-line before the beginning of the fall school season.

Timing was very important for ecampus.com. The purchase of textbooks is seasonal because students basically only purchase textbooks twice a year, at the beginning of the fall semester and at the beginning of the spring semester. All systems needed to in place by fall of 1999 or the actual launch would have to be postponed until the beginning of the next year. The development team from Wallace's and Oracle felt the web site's architecture had to be in place and working flawlessly by the end of June to meet the fall deadline.

While Operations was developing the technology, Devito/Verdi was busy putting together a $10 million advertising campaign. Their preliminary research further confirmed that the primary target should be both traditional and non-traditional students. They also found out that students felt like campus bookstores had a tendency to "rip off" students. An advertising campaign was crafted to resonate across the entire post-secondary textbook market. Its theme was similar to the antiestablishment college culture found in the movie-Animal House. The message portrayed ecampus.com as a company that understood students were broke and that ecampus.com could make them less broke. The advertising firm felt one of the most important goals of the campaign would be reaching incoming freshman and create customer loyalty. In order to reach this market, ads were run on MTV and Comedy Central late at night and early in the mornings.

The organizational structure at ecampus.com had to evolve around its quick start-up. It was a simple, relatively informal structure, with functional attributes. The structure was very flat and organic which encouraged a great deal of individual initiative and self-discipline. The company used experience to create solutions and remedies to problems as they occurred. Each manager brought their style of management with them, and ecampus.com encouraged them to employee the different styles at will. The organic environment provided them with the flexibility to change and adjust their styles and ways of thinking. At the same time, this increased the level of uncertainty within the organization.

The great independence that ecampus.com required in their employees caused some problems with communication. Managers were independent, self-motivated, and highly driven; this

caused them to take on as many tasks as possible. Therefore, the managers were not very accessible to answer questions at critical times. Most of the time, managers were out of town or in meetings with other members of top management. The company typically communicated with its employees by email and voice mail. They used the same communication for outsiders as well. ecampus.com felt that these forms of communication were more personal and reflected the nature of the company. Besides electronic mail, management at ecampus.com had frequent meetings with employees to help overcome accessibility problems and to encourage coordination. These meetings were held in a forum environment. Employees were encouraged to speak openly about anything.

Most of the managers at ecampus.com allowed the employees to voice their opinions. This became part of the loose culture and lean structure that ecampus.com had sought to develop. ecampus.com hired their employees on the basis of their individuality with emphasis on motivation and creativity. The employees were allowed to go about their business in a fashion that they felt fit the situation best. Because managers at ecampus.com were also free to express their own individual styles, the style varied from department to department. Employees that transfer from another department were required to adapt to the new management style. Because of the current push for individualism, there was very little team atmosphere at ecampus.com.

Financial strategy and management, parallels the culture and structure of ecampus.com. They have used Wallace's as a basis and have remained flexible throughout the start-up phase. Bill Zimmer, CFO, stated that ecampus.com began their operations with a set of financial projections that had been borrowed from Wallace's computer model. At this point Zimmer is reluctant to divulge information concerning these projections due to the competitive nature of the business they are in. However he did state that they "looked good so far." He felt, even with the late start, the company was right on track and could become the number one Web based textbook company. Even though ecampus.com was closer to making a profit than any other firm n the industry, they were not underestimating their competition. To stay ahead of the competition, ecampus.com was continually refining their financial structure and pricing methods to keep prices lower to maintain and attract new customers. Consequently, they have maintained their financial strategy of selling books with no shipping charges. Revenues could be greater if they charged for shipping, but this was part of their original marketing strategy to give them a competitive edge.

ecampus.com does not currently operate under a recognizable type of capital budget due to the fact that they consider their budget to be basically unlimited as far as capital expenditures go. In October ecampus.com received a second round of financing of $40million. Several large financial institutions approached ecampus .com shortly after establishing themselves as the market leader. However, Wilkinson would have had to give up controlling interest which he was unwilling to do. At this point in time, their capital structure is 100% equity with plans to eventually mix debt financing into the structure as well. The financial people at ecampus.com have developed a set of budgets using a zero-based budgeting approach, but at this point in time the budgets are not being used. Zimmer said that with a company their size one or two people were able to review all expenditures.

POST LAUNCH

The winter sales season went extremely well. As anticipated, the number of hits per day was more than triple the volume during the fall sales period. Changes in the capacity were made prior to the January rush that handled the demand flawlessly. ecampus.com seemed to be well on their way to becoming the number one Web based textbook company in North America.

It was about this time that Jack Garvin, Vice President of Technology, began having doubts about his tenure at ecampus.com. Having worked at other technology based companies; he was familiar with the pressures of highly volatile environments. He had been a project manager and team leader in several of his previous jobs. The structure at ecampus.com was much looser than any company he had worked for in the past. He had noticed the placement companies were not as enthusiastic and cooperative as they were in the past. Also, the company was experiencing a heavy turnover in the temporaries who had been hired on a permanent basis. The pay was good, but the environment was intense.

Working 100 hours a week with little supervision or training during the start-up period was exciting but draining. After the selling season was over there was a let down. The employees had been screened carefully and had been hired on their ability to work in a fast-paced environment. The company was now over the excitement created by the demand for creativity and individual initiative during the launching stage. Jack knew unless ecampus.com encountered some type of crises or another growth spurt personnel would be faced with this type of work cycle from now on.

Web based companies' stellar success had taken a severe hit in the stock market. The once seemingly endless supply of capital was drying up. The employment market was being flooded with bankrupt managers of Internet companies who had become overnight millionaires through stock options when their firms went public. It was obvious to Jack ecampus.com was not going public anytime soon. Wilkinson would never give up control unless there was a personal fortune to be made in the stock market. There were still great expansion opportunities. Textbooks were selling well; however, ecampus.com was far from the one-stop shopping site for college students Stevens envisioned over a year ago. Jack wondered whether the capital and the enthusiasm would be there in the future. The anticipation of exercising his stock options any time soon was fading fast.

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