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HEDGING FOREIGN CURRENCY TRANSACTION EXPOSURE

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ABSTRACT

The primary subject matter of this case is hedging foreign currency exchange rate risk. Secondary issues examined include assessing transaction exposure and comparing hedging techniques to effectively manage unwanted exposure.

St. Louis Chemical is a regional chemical distributor, headquartered in St. Louis. Don Williams, the President and primary owner, recently discovered a disturbing trend of shrinking profit margins on sales of the specialty chemical product line. After speaking with the purchasing department, Williams still had no explanation for the recent decline. The purchasing agent informed Williams that the company has been buying specialty chemicals for the past two years and their Canadian supplier had always been very competitive in terms of price and extremely reliable in on-time delivery. The only difference between the Canadian supplier and other US suppliers is the Canadian supplier requires payment in Canadian dollars. However, when ordering, the purchasing agent simply coverts the Canadian dollar quote to US dollars for comparison. With regards to specialty chemicals, the Canadian supplier quotes are often below those of US suppliers.

Williams then spoke with the sales manager in charge of the specialty chemical line. The sales manager informed Williams that the specialty chemical line was one of the fasting growing lines at St. Louis Chemical and had been responsible for adding 3 major customers last year alone. In addition, these customers purchased more than just specialty chemicals from St. Louis Chemical. The sales manager recited that when she quotes a price on specialty chemicals, the prices are good for 3 months, which is approximately the amount of specialty chemical inventory on hand. She uses the same methodology to determine the mark-up on specialty chemicals that is used for other product lines. All component costs used in pricing come from the purchasing department and are automatically updated via the company's computer network. After orders from customers are received, she uses a forecasting model to determine the amount of inventory replenishment needed in the future. She submits a replenish inventory order request back to the purchasing department and the cycle continues.

Finally, Williams contacted the accounts payable department and was informed the company follows basically the same procedure with orders from the Canadian supplier as they do with orders from US suppliers. Payment is due 60 days from the end of the delivery month; however, the Canadian supplier requires payment in Canadian dollars which is handled by the bank using the 12 PM exchange rate on the last day of the payment month. Williams concludes that the exchange rate supplied by the purchasing department and subsequently forwarded to the sales department is often different from the exchange rate used to pay the supplier. On average 90 days have past from order to payment. Any exchange rate movement between the time of the order and the time of payment results in differences between the cost estimates used to determine the appropriate mark-up and the actual cost of the inventory to St. Louis Chemical. Over the last year, the cost difference was mixed, sometimes working in St. Louis Chemical's favor and other times working against them. Williams is seeking information about available alternatives to reduce or eliminate foreign exchange rate risk associated with future transactions.

CAPE SHOE COMPANY

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CASE OVERVIEW

The primary subject matter of this case concerns entrepreneurial start-up and strategic management and marketing issues. The objective is to provide students the opportunity to apply their research skills and knowledge regarding a highly competitive industry and buyers, and to develop strategic management and marketing strategies. It is suitable for a senior-level course as well as students in an MBA program and can be taught in a 75 minute class session with two hours of preparation by students outside of class.

CASE SYNOPSIS

The Cape Shoe Company case focuses on an entrepreneurial start-up in the highly competitive shoe industry. Upon the closing of a Florsheim shoe factory in a region of the Midwest that was once home to a large number of shoe and apparel manufacturers, with the majority of these having closed over the previous 30 years due to lower cost of overseas production, and concerned about the continuing loss of shoe manufacturing in the U.S., an entrepreneur from Chicago with minimal experience in the shoe industry visited a Florsheim factory prior to its closing by Florsheim. After deciding that the facility represented too valuably a resource to be abandoned, the entrepreneur subsequently purchased the shoe plant and named his new venture the Cape Shoe Company. Based on his concern about losing American manufacturing jobs, and the belief that he could produce a competitively priced product, his plan was to produce ***100 percent Made in America*** *shoes.*

The interesting focus of this particular case and ensuing discussions is that the entrepreneur has made the decision to go forward with Cape Shoe Company and his ***100 percent Made in America*** *theme, although having yet to determine target market(s), competition, product differentiation, marketing channels, marketing strategies, etc. Regarding the rather unique nature of the Cape Shoe Company start-up, and current industry scenario, students virtually have a clean slate in which to begin discussions concerning recommendations on strategic management and marketing questions.*

INTRODUCTION

Manufacturing has been a primary source of America's wealth for almost 200 years. In the early 1800's America obtained virtually all of its manufactured goods from Europe. During the War of 1812 the British blockaded many European harbors preventing America from obtaining needed goods. As a consequence, America began to develop its own manufacturing capabilities in the Northeast. After the War, in order to help pay for the war effort and to protect nascent manufacturing concerns, the Federal government placed a large tariff on imported goods. Southern states, which were primarily agricultural at the time, opposed the tariffs threatening civil war. Despite these divergent interests, a compromise on tariffs was reached to benefit the North and the South. Incipient manufacturing businesses needed to be cultivated for the future of the country.

Nearly two hundred years later the issue of free trade and tariffs has again become a salient polemic. Unlike the early 1800's, the antagonists are not regionally delineated. Like the early 1800's, the adversaries are defined by differences with respect to the nature of their work—manufacturing based businesses versus information-based industries. As manufacturing diminishes in both volume and perceived significance, the majority of workers who are employed in service-oriented firms are more concerned with purchasing goods at the lowest possible costs, regardless of their production origin. In most developing countries labor is brutally exploited enabling manufactured goods to be produced at costs substantially below U.S. made goods.

A *Business Week* magazine feature article titled, "A Life of Fines and Beating—Wal-Mart's Self-Policing in a Chinese Sweatshop Was a Disaster. What Kind of Monitoring System Works?" describes the inhumane conditions in which Chinese workers are forced to produce leather goods for Wal-Mart, Kathie Lee Gifford, New Balance Shoes, and Timberland Shoes. Migrant workers from the countryside desperate for work take jobs in factories like the Chun Si Handbag Factory. Chun Si made handbags sold by Wal-Mart and Payless ShoeSource. A factory job offers living quarters and a temporary-residence permit that migrants need to stay out of jail. Workers were paid $22 a month and charged $15 a month for food and lodging in a crowded dorm. Additionally, the factory issued expired temporary-resident permits. This means workers are subject to arrest if they ventured out of the immediate neighborhood. The workers were captives of the factory. Abuse of this nature can only occur with the tacit approval of the local authorities.

Chun Si Factory's 900 workers were locked in the walled factory compound for all but 60 minutes a day for meals. Guards regularly punched and hit workers for talking back to managers or even walking too fast. Workers were fined $1 for infractions like taking too long in the bathroom. Wal-Mart, Payless, and others denied these conditions existed. But investigations by *Business Week* confirmed products sold in their stores was made in this factory under these circumstances. The article further described the elaborate schemes developed by owners to circumvent independent oversight.

By purchasing low-priced imports, many well paid American manufacturing jobs are lost. In 1965, 31 percent of the U.S. labor force was engaged in manufacturing. Early 21st Century, only 15 percent of U.S. laborers worked in manufacturing. This was the same as the number of people working in government. In 1965, CEO salaries were 44 times average worker pay. CEO salaries now exceed 212 times the average worker pay. The growing income disparity between the top one percent of U.S. households and the bottom 90 percent of U.S. households had been monitored by the Federal Reserve. The Fed had revealed that in the 1990s wealth controlled by the top one percent of households increased from 30.1 percent to 34 percent. The share held by the bottom 90 percent of households decreased from 33 percent to 31.3 percent. The top one percent then controlled more wealth than the bottom 90 percent by a margin of 34 percent to 31.3 percent.

Prosperity at the top of the economic pyramid has obscured declining incomes on the lower portions of the pyramid. There are abundant employment opportunities for elite information workers. Sufficient opportunities to earn a "Living Wage" must also exist for non-elite workers. These job prospects are found in the manufacturing sector. Manufacturing jobs usually pay better wages than growing service related positions because there is a greater value-added component—manufacturing creates more wealth.

It has been estimated that more than 20 percent of working Americans or more than 25 million people are **under**employed. Even while working eight hours a day, forty hours a week, they do not earn enough to keep a family of four above the poverty line. This is almost double the number of **under**employed in the early 1970's. Real wages have fallen about 20 percent since then.

In the industrial Midwest, as well as in the Northeast and West, American shoe and apparel makers are closing factories at an alarming rate. Virtually all of this production has moved to low wage, Third World countries in Asia – China, in particular. As a result, our annual trade deficit with

China is expected to approach one hundred billion dollars. This deficit amount is added to the two to three hundred billion-dollar annual trade deficit the U.S. has with Germany and Japan.

CAPE SHOE COMPANY

Abbey Manufacturing, a plastic molding manufacturer, had produced a line of plastic molded display material for the shoe trade. The success Abbey realized in the intensely competitive plastic molding industry was based primarily on selling high quality product at low prices. Profitability was achieved by carefully controlling overhead costs, including administrative, sales and capital expenditures. People involved with production also handled many product development and front office responsibilities.

Eli Fishman, the CEO of Abbey Manufacturing, believes strongly in the importance of manufacturing in the U.S. economy. And, since Abbey sold model display products mainly to the shoe trade, it had provided him the opportunity to become knowledgeable about the industry. In 1999, Florsheim, a well-known nationally branded shoe manufacturer announced the closing of its Cape Girardeau, Missouri plant, ending a long history of producing high quality men’s shoes in America.

Mr. Fishman, concerned about the continuing loss of shoe manufacturing in the U.S., decided to visit Cape Girardeau to inspect the plant. After inspecting the plant, prior to its closing by Florsheim, he decided that the facility represented too valuable a resource to be abandoned. The physical plant and employee skill levels were virtually irreplaceable in the U.S. Cape Girardeau, a town of approximately 40,000 inhabitants, is located in Southeast Missouri along the Mississippi River. This region of Missouri was home to a large number of shoe and apparel manufacturers, but most of these have closed over the last 30 years due to the lower cost of overseas production.

Mr. Fishman was subsequently able to purchase the Cape shoe plant and its equipment for a relatively low price. The Cape shoe plant was a 92,000 square food facility on 12.6 acres formerly owned and operated by Florsheim Group. At full capacity, the plant will employ more than 300 skilled workers. Production employees had an average of almost 20 years of shoe making experience. Supervisory personnel average over thirty years of shoe making experience. The plant was equipped with more than eight hundred separate shoe making machines and three assembly lines. The building, fully air-conditioned, was designed for all safety and health related considerations. Mr. Fishman decided to name his firm Cape Shoe Company.

Mr. Fishman’s plans included paying all Cape Shoe Company employees an hourly rate which was *higher* than the locally determined “Living Wage” which was $8.84/hour, and also paying full medical benefits. Living Wage is defined as a wage sufficient to maintain a family of three above the eligibility level for food stamps. The Living Wage contrasts sharply with the federally mandated Minimum Wage of $5.15/hr. with no benefits. Minimum wages are more closely associated with unskilled service jobs, such as those in the retail and food trade.

While Cape Shoe Company would have higher labor costs than most producers overseas, it will have an excellent production facility, modern equipment, and a highly skilled workforce. Because the plant purchase price was low, it would help to keep overhead low. Mr. Fishman also believed that he could reduce selling costs, and that, along with low overhead costs, would allow him to price competitively. He believed that the market for American-made goods was substantial, as long as items were priced competitively with foreign-made goods. Based on his concern about losing American manufacturing jobs, and the belief that he could produce a competitively priced product, his plan was to produce **100 percent Made in America** shoes. While there are some competitors who still tout their products as American made, many use components that are made outside of the U.S. and some assemble their products outside the U.S.

Mr. Fishman’s plan to produce a **100 percent Made in America** shoe was born, not having yet decided, however, on target market(s), what kinds, styles, and brands of shoes he should produce, how to differentiate his product from competitors, what channels he should use to sell his products, how he should promote his products, what should be his pricing strategy, and so on.

TASK AT HAND

Based on the facts presented herein, and your research skills and knowledge regarding the shoe industry and shoe buyers, your task is to help Mr. Fishman develop strategic management and marketing decisions. Specifically, you are asked to develop recommendations on five strategic points:

1. Identify specific industry target markets and provide appropriate recommendations and reasoning for Cape Shoe Company.
2. Identify industry competition and provide appropriate recommendations and reasoning for Cape Shoe Company.
3. Identify various ways in which industry products are differentiated and provide appropriate product line and differentiation recommendations and reasoning for Cape Shoe Company.
4. Identify various marketing channels for the industry and provide appropriate recommendations and reasoning for Cape Shoe Company.
5. Identify specific marketing strategies and provide appropriate recommendations and reasoning for Cape Shoe Company.

CHOOSING A LANDING SITE FOR WRIGHT AIR & SPACE CENTER

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ABSTRACT

The case provides a study of the interesting challenges involved in making a site selection decision. It can be used as a "how to" guide for businesses, non-profit organizations and communities seeking sites for recreational, educational, cultural or other sorts of facilities. The decision would require analysis of quantitative issues such as regional demographics as well as qualitative issues such as the "mommy factor." This term, coined by a member of the board, refers to a set of factors that would make a location desirable to parents. Perhaps most important, lessons from the site selection process are applicable to other major not-for-profit projects that rely on community support for capital and operating funds.

TOM BROWN INC.: SURVIVING IN THE OIL AND GAS INDUSTRY

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ABSTRACT

This case and instructor's note were developed through the use of secondary research material. The case has a difficulty level of five and is appropriate to be analyzed and discussed by advanced undergraduate and graduate students in a strategic management class.

The case allows the instructor the flexibility of concentrating on one strategic issue, or as a means of examining the entire strategic management process. The major focus within the strategic analysis as well as excellent stand alone modules is in the area of legal/political influence, economic, and as a means of discussing owner succession.

The instructor should allow approximately one class period for each element addressed. Using a cooperative learning method, student groups should require about two hours of outside research on each element researched. The case also provides an impetus to explore a critical industry in our world economy, yet one that has received minimal attention in most course coverage. This case is a library, popular press and internet case that examines Tom Brown Inc. The review of annual reports, trade journals, government documents and proposed and enacted regulations must be accomplished carefully. While most students have a general understanding of the oil and gas industry, few have the current knowledge to compare this industry against more traditional production operations. A review of these resources should lead students in determining the future of the company and the current CEO, Tom Brown.

CHANGES IN ACCOUNTING FOR DEFINED BENEFIT RETIREMENT PLANS AND THE EFFECT ON COMPANIES' FINANCIAL STATEMENTS AND STAKEHOLDERS

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CASE DESCRIPTION

The primary subject matter of this case concerns changes in accounting for defined benefit pensions and other postretirement benefit plans proposed by the Financial Accounting Standards Board (FASB) and their effects on the financial statements of companies that currently sponsor these plans. Secondary, yet important issues are the potential effects of these changes on companies' willingness to offer these plans to their employees, and the resulting potential economic impact on the companies' stakeholders. This case has a difficulty level of three to four and can be taught in about 45 minutes. Approximately two hours of outside preparation is necessary to fully address the issues and concepts. This case can be utilized in intermediate accounting as part of the coverage of pensions, or in a more advanced graduate class focusing more extensively on underlying conceptual and economic issues. The case has conceptual, analytical, and research components. Both oral and written communication skills can be enhanced using this case.

CASE SYNOPSIS

Since the introduction of the first pension plan by American Express in 1875, traditional (defined benefit) pension plans have become an important source of millions of employees' retirement income. At one time, defined benefit pensions, which promise employees a specific amount of retirement income, represented the most common type of employer-sponsored plan. Legislation, especially the ERISA ACT of 1974 and the creation of the Pensions Benefit Guarantee Corporation (PBGC) added security to these benefits. Sadly, these traditional pensions have become less popular. In 1981, 81% of employees who were covered by employer-sponsored retirement plan were covered by a traditional pension plan; by 2003, that percentage decreased to 38% (Clements, 2006). This trend appears to be continuing. For example, recently, several large well-known public companies have announced that they are freezing their existing pension plans. Reasons for this reduction in traditional pension plans include the financial risk to the employer, and the uncertainty created by negative or low-performing stock markets. Other postretirement plans (e.g., postretirement health care) also have become less popular, primarily due to rising costs.

Expected changes in accounting for traditional pensions and other postretirement benefit plans may sharply increase the liabilities and expenses shown on companies' financial statements and may further increase the risk and cost of these types of plans. These changes may affect employers' willingness to continue offering these plans.

The primary focus of this case is to examine the potential short-term and long-term effects of the expected accounting change on companies' (1) financial statements, (2) stakeholders, and (3) willingness to offer these plans. The case can be taught at the same time that retirement benefits are covered in an intermediate accounting class, or in an advanced accounting class focusing primarily on underlying concepts. The case has analytical, communication, and research components.

INTRODUCTION

Accounting for pensions evolved from the "pay-as-you-go" basis to the full accrual basis. The currently pertinent primary accounting standard, Statement of Financial Accounting Standards No. 87 (SFAS 87), "Employers' Accounting for Defined Benefit Pensions," requires that a minimum liability is accrued if the present value of pension obligation at current salary levels (ABO) exceeds pension assets. The currently pertinent accounting standard for accounting for non-pension retirement plans, (such as retiree health care plans), Statement of Financial Accounting Standards No. 106 (SFAS 106), "Employers' Accounting for Postretirement Benefits Other Than Pensions," requires that companies accrue an annual expense for retiree plans, such as health care, but does not require the recognition of a minimum liability, even if the plan is underfunded.

Recently, FASB decided to reevaluate accounting for both defined benefit pensions and other postretirement benefit plans. To date an exposure draft has been issued as part one of a two-phase project. The proposed and expected changes to accounting for these plans may significantly affect companies' balance sheets if their plans are underfunded. In addition, income also may be affected by investment return volatility. These changes may lead some companies to curtail their plans and thus potentially adversely affect employees and retirees. The case presented below highlights and examines the effect of accounting changes on financial results and potentially employers' willingness to provide retirement benefits to their employees.

CASE DESCRIPTION

On August 2, 2006, Jackie McKiern, Controller of Neuman Corp., an automotive parts supplier, walked into her office to find her new boss, Chief Financial Officer (CFO) John Millern waiting for her. John, who just has joined the company on July 16, 2006 has spent most of the past few weeks familiarizing himself with all financial aspects of the company. While reviewing the company's financial statements, he noticed that pension and other postretirement benefits represented a significant amount of the company's expense. John recalls hearing at the end of the previous year that the Financial Accounting Standards Board (FASB) has decided to review and revise accounting for defined benefit pensions and other postretirement benefit plans. At that time, he wasn't concerned about this, because his previous firm sponsored a 401(k) plan, which does not fall under the requirements of FASB's pension standards. Now, that he has joined a company that sponsors a defined benefit pension and a postretirement health care plan, he feels that he must consider the potential effect of any accounting change on his new company.

John also recalls reading an article about the potentially detrimental effects that a change in the accounting standard could have on General Motors' (GM) financial statements. He quickly researches the original article and finds that on December 29, 2005, the Wall Street Journal reported that the expected change in the accounting rules may virtually eliminate GM's current net worth. He is aware that GM, one of Neuman Corp.'s customers, is experiencing serious financial difficulties. Although Neuman Corp. is financially sound, John now is quite concerned about the potential effect of the expected accounting changes on Neuman Company's financial statements. He is determined that the company preform well under his financial guidance. After considering these facts, John is concerned about both the short and long-term effect of the expected accounting change on the company's financial statements. He asks Jackie to compile information that will help the company plan for the future, and allow it to select the most advantageous strategy. John feels that in light of the company's plans to raise additional capital within the next three years by issuing corporate bonds, steps may need to be taken to avoid a negative impact of any accounting change on the company's ability to inexpensively raise capital.

John asks Jackie to compile information that will help answer the following questions regarding the expected changes in accounting for the company's defined benefit pension plan and its retiree health care plan:

ASSIGNMENTS AND QUESTIONS

Company-Specific Questions

1. What would be the short-term impact on Neuman Company's a) balance sheet, b) income statement, and c) statement of cash flows?
2. What would be the long-term impact on Neuman Company's a) balance sheet, b) income statement, and c) statement of cash flows?
3. What options does the company have?
4. How would implementing each of these options affect the company's 1) balance sheet, 2) income statement, and 3) statement of cash flows?
5. Who are the stakeholders? Who would benefit by each option?
6. How would the employees be affected by each of these potential options?
7. What are the ethical issues involved?
8. How would each of these options affect the perceptions of people outside the company?
9. What do you recommend that we, company's executives should do?

Jackie also decides to research some related questions that may contribute to the decision making process.

Researchable Questions:

1. How have other companies reacted to this proposed change?
2. Is there any historical evidence that new accounting proposals may lead to decreases in of employee retirement benefits?
3. Are other companies' pension and other retirement plans currently funded?
4. How does recent legislation impact on traditional pension plans?

John expects a briefing on the results of this research in four days. Jackie asks you, her assistant to answer/research these questions for her. You are an accounting major, and currently are enrolled in Intermediate Accounting II. You currently are discussing pensions and other deferred employee retirement benefits in class. You are excited about the prospect of applying what you are learning in class to your position of accounting assistant. You are anxious to complete the assignment to the full satisfaction of the company's controller and CFO. Your first step is to review information regarding the expected changes in the accounting rules and the company's financial statements and notes for the year ended December 31, 2005.

Jackie, a licensed CPA has already familiarized herself with the anticipated changes when FASB's intentions first had been publicized. She had prepared a short summary of the expected changes, which is shown below.

SUMMARY OF EXPECTED CHANGES IN ACCOUNTING FOR DEFINED BENEFIT PENSIONS AND OTHER POSTRETIREMENT BENEFITS

FASB expects to complete its comprehensive project in two phases, the first to be finalized by the end of 2006. On March 31, 2006, the FASB issued an exposure draft titled, "Employers'

Accounting for Defined Benefit Pensions and Other Postretirement Plans," which proposes changes under phase I of the FASB project (FASB, 2006).

Phase 1 (FASB exposure draft, FASB, 2006):

1. Entities with underfunded pension plans would be required to recognize a liability equal to the unfunded amount of the pension and other postretirement obligations on the sponsoring company's balance sheet. This unfunded pension obligation would be calculated based on the projected benefit obligation (in the case of pensions) and the accumulated benefit obligation (in the case of other postretirement benefits). For pensions, currently, the accumulated benefit obligation, which does not take into consideration future salary levels, is utilized to calculate and recognize an additional minimum liability. For other postretirement benefits plans, no minimum liability has to be recognized under current accounting rules. Benefit plan assets and benefit obligations would be measured at the balance sheet date.
2. Unrecognized actuarial gains and losses and prior service costs arising during the current period would have to be recognized as a component of other comprehensive income. Currently these costs are deferred until amortized and recognized as components of expense. Additional disclosure of the effect of deferred recognition is required.
3. Any unrecognized transition obligation would have to be recognized as an adjustment to the beginning balance of retained earnings. Currently these costs are deferred until recognized in expense. The expected effective date for phase I is for fiscal periods starting after December 15, 2006; earlier application is encouraged by FASB.

Phase 2 - Expected Changes:

FASB also is planning to further review the recognition and disclosure rules for pensions and other postretirement benefit costs in income and comprehensive income. Furthermore, its guidance on measurement assumptions (e.g., the rate assumptions) and the measurement of the obligations will be reassessed, potentially requiring the use of actual rates of return. This phase is conducted jointly with the International Accounting Standards Board. Thus, within the next few years, companies may have to utilize the actual return on pension plan assets (instead of the estimated return) when calculating pensions and other postretirement cost (expense). This return may well be negative for some of the years, which could increase expenses sharply and create income volatility.

SELECTED INFORMATION FROM THE 2005 FINANCIAL STATEMENT NOTES

On January 1, 1986, the Company established a defined benefit pension plan covering substantially all of its full-time employees. The net periodic pension cost was $76,000 in 2005. On December 31, 2005, the pension PBO was $2,170,000 and the related plan assets were 1,877,000. The unrecognized prior service cost was $145,000 and the unrecognized net loss was $135,000.

On January 1, 1988, the Company also established a retirement health care plan. The net periodic retirement health care cost was $54,000 for 2005. The health care plan currently is unfunded. The company pays the exact amount necessary to meet the health care premiums for its current retirees. That amount was $26,000 for 2005 and $24,000 for 2004. As of December 31, 2005, the plan's accumulated benefit obligation exceeds the plan assets by $1,100,000; its unrecognized transition obligation was $63,000.

REQUIRED

Answer the questions listed in the Assignment/Question section of this case as assigned by your instructor. Provide concise answers.

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BUSINESS OR SOCIAL EXPERIMENT?

David A. Kunz, Southeast Missouri State University

CASE DESCRIPTION

The primary issue of this case is to examine the fundamental concept that the objective of business management is to maximize long-term shareholder wealth. Business students are studying to become business managers and will be expected to make decisions and a decision framework is necessary. The case requires students to have an introductory knowledge of 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 50 minutes. The case is short and does not require calculations. It is designed to generate discussion, thus its best use may be to distribute the case at the beginning of the class, allow students to read and record their thoughts and then discuss the case.

CASE SYNOPSIS

The case is based on a newspaper article chronicling the short life of a shoe manufacturer. The owner/founder of the company had a noble vision of a shoe company that provides quality employment and generates a profit. The article has limited information but it appears the owner/founder placed quality employment as his top priority with minimal consideration of a workable business model or the needs of other shareholders. The company operated for five years but ultimately was unable to generate sufficient sales volume to continue in business.

THE OBJECTIVE OF BUSINESS

Since the 1980's it has been an accepted principle that the objective of business management is to maximize long-term shareholder wealth. Most finance textbooks emphasis this point in the first chapter.

> "Shareholders are the owners of a corporation, and they purchase stocks because they want to earn a good return on their investment without undue risk exposure. In most cases, shareholders elect directors, who then hire managers to run the corporation on a day-to-day basis. Because managers are supposed to be working on behalf of shareholders, they should pursue polices that enhance shareholder value. Consequently, throughout this book we operate on the assumption that management's primary objective should be shareholder wealth maximization."
>
> *Financial Management Theory and Practice*, Eugene F. Brigham and Michael C. Ehrhardt, 11th Edition, 2005, Thompson, South-Western.

A similar statement can be found in most financial management textbooks.

A firm's stock price is used to measure shareholder wealth and long-term shareholder wealth is measured by the cash flow the business is expected to generate. This principle provides management a framework for decision-making. Management must determine if a decision will contribute to the company's long-term shareholder wealth by increasing its cash flow or reducing its risk.

The following article recaps the story of a local shoe manufacturer and raises a number of interesting questions regarding the enterprise. Did the owner/founder have reasonable expectations regarding starting a shoe manufacturing operation in the United State? Did the owner/founder have a workable business model? And most importantly, was the owner/founder operating a business?

“The Mysterious Mr. Fishman”
Southeast Missourian ~ Wednesday, August 10, 2005
By Scott Moyers ~ Southeast Missourian

As an 18-year-old in the late 1960s, Eli Fishman drove a Good Humor ice cream truck on the politically charged streets of Chicago. One summer afternoon, Fishman, a Vietnam War objector himself, drove his truck into a park packed with police and protesters. "I wanted to sell the ice cream to the protesters, but I also wanted to make my commission," Fishman said. He opted to sell to both. That was one of Fishman's first dilemmas as a self-described "entre-radical." Put away your Webster's. It's a word Fishman made up to describe his admittedly curious world view, a messy mixture of pure entrepreneurial spirit and a radical save-the-world mentality that defies traditional business acumen. "That's sort of been the theme of my life," Fishman said. "Odd, huh?" Maybe. But that philosophy, flawed or not, was the driving force behind the unique experiment that was the Cape Shoe Co., a business Fishman poured his passion and his fortune into for five years until closing its doors in July. The experiment: Try to reverse, in some small way, the alarming trend of sending U.S. manufacturing jobs overseas while at the same time using only U.S. materials to create a product that could compete with cheaper imported footwear.

After Fishman started the company from the remnants of the old Florsheim Shoe Co. -- which had followed suit and sent its jobs overseas -- the business struggled along for five years, selling 10,000 shoes a year, about half the amount Fishman estimates he needed to survive. Along the way, Fishman spent -- and subsequently lost -- millions of his own dollars. He admits he lost his shirt. "But it's only money," he said. "You can't tell people who don't have money that, but it's true. It doesn't mean anything at this point. I've enough human capital to last a lifetime." Still, he acknowledges the experiment failed, due to lack of sales and his dwindling coffers. But those are only ancillary reasons. He says the main reason was a disingenuous customer base as much as foreign competition. "Bring on the foreign competition," Fishman said in a Chicago accent, pronouncing "the" as "da." "I can deal with the competition," he said. "I underestimated the strength of unbridled consumerism. People say they want to buy American-made products, but only if it's at the same price. It's the Wal-Mart mentality." Fishman compared it to people saying they're not racist, but then cringing at the thought of black children being bused to their child's all-white school. "But it's a joke, it's strictly a ruse," he said. "It's just people talking. They don't mean it. Same with American-made products. It just seems like the right thing to say."

Fishman, a self-described contrarian, came to Cape Girardeau in 1999 from Chicago in a slightly better disposition. In Chicago he owned a factory that manufactured shoe racks. One of his customers was Florsheim. A representative told him the company was shipping its jobs to India and closing in Cape Girardeau. "I said, 'Jeez, how do you throw away all that talent?'" Fishman said. "I knew there were a lot of people out there talking about supporting U.S.-made products, so I got this idea." He sold his factory and another he owned., slapped down $1.1 million of his own money and bought the Florsheim Shoe Co. factory on Southern Expressway, hiring many of the laid-off employees.

"I thought I wouldn't have to sell a lot of shoes to maintain a profit, just enough to prove my point and keep some people in good paying jobs," he said. "But I overestimated the niche." One of the first people he met was Jay Knudtson, who was then a Cape Girardeau mayoral candidate and banker at Bank of America at the time. Though Knudtson is now at First Missouri State Bank, he remembers that Bank of America loaned Fishman some working capital. But most of all he remembers Fishman himself. "He was one of the most interesting characters to arrive in Cape Girardeau that I can remember," Knudtson said. The mayor recalls Fishman was wearing all-American made clothes, even down to picking out the right sort of Levis that are made in America. He also drove an inexpensive American-made car. "It was like he did not want this international movement to occur, and it was like he really believed in his heart that he could penetrate it," Knudtson said. "I really think, with all due respect to Eli, that maybe it was hard for him to differentiate between his passion for patriotism and making good, sound financial decisions." But Knudtson said he came to admire Fishman's dedication to the American worker and American products. "He thought he could buck the system," he said, "but the system is an international system that nobody could buck." Knudtson warned Fishman that his goal was too far-reaching. He said he questioned in this age where price drives everything whether there were enough Americans out there who would make a decision with their heart rather than their pocketbook. "I told him, 'I hope you're right, but I don't know that you are,'" Knudtson said. "From the day he opened, he had an uphill battle. He was going to a gunfight with a switchblade. That's a sad fact. But I still think Eli did a good thing by trying to leverage the American theme."

Not that there weren't high points. In 2001, the Wall Street Journal did a post-9-11 article on Fishman's patriotic "made in America" theme. A U.S. government contract after Sept. 11, 2001, boosted sales by 15 percent, but that dwindled as the ground war abated. Fishman beat the pavement, placing his work boots and shoes in several area stores, such as Bob's Shoe Service, Brown's Shoe and Qwick Fix Shoe & Boot Repair. He also had them in stores across the Midwest, from Chicago to Detroit. "He had his loyal customers," said Qwick Fix owner Gene Benthal. "I've had a lot of people who have come by since he closed because they knew they weren't going to be able to get them anymore. Some people are bumming about it." But not enough. Benthal said Cape Shoe never sold as many as the brand names, like Red Wing and Wolverine. "He was competing with the big names," he said. "His boot was as expensive as their boot, but he didn't have the name recognition. Cape Shoe was a fine name, but maybe it could have been catchier."

Fishman later unionized his own workers, another puzzling move, some say, though he says he did it to back up his "worker first" mentality. The union also promised to promote his shoes to its members, which resulted in only moderate improvement in sales. Cape Shoe switched to a smaller, more affordable building on Rusmar. His work force remained stable at a manageable 30 to 40 workers. Still, he couldn't compete. "They said they wanted American made, but they really wanted to spend a little less money," Fishman said.

Now, he says, he's ready to move on. He's finishing up his doctorate at Southern Illinois University-Carbondale. Soon, he will return to his beloved Chicago. His new dream is to start a not-for-profit tutoring program for elementary school children on the Internet. "A lot of these groups do it for profit, but not me," he says.

THE TASK

1. Was Fishman starting a business or conducting a social experiment? Explain your answer.

2. Is maximizing long-term shareholder wealth always the appropriate primary objective?

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A MODEL FOR PRIVATE-PUBLIC HEALTH CARE SUCCESS

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CASE DESCRIPTION

This case discusses the successful performance of a regional not-for-profit dental care center. The primary objectives of this case are to show that a not-for-profit health care center can support itself financially and use its retained earnings to improve the quality of life of its patients and employees. The case will also show that this success will lead to new opportunities for growth. These opportunities then lead to decisions regarding diversification into new opportunities and the possibility of overexpansion, increased bureaucratic costs and diseconomies of scope. This case will work well as a team project and can be used for senior-level or first-year MBA students in Strategic Management courses. The case is designed to be taught in one class hour and is expected to require 2 to 4 hours of outside preparation by students.

CASE SYNOPSIS

In March 2004 the Sarrell Regional Dental Center (SRDC) was opened in Anniston, Alabama. After struggling for a year a new management team led by a former CEO from the packaged goods industry took over. By the end of its second year in business the dental center was seeing a financial gain. The problem is: What should the SRDC management do with the excess cash? Should the management expand to new dental centers or expand to new not-for-profit opportunities? This case challenges the students to analyze the business model used by the management team of the SRDC and consider the strengths and weaknesses of the model as they consider expansion into new locations and other health-related fields.

INTRODUCTION

The Sarrell Regional Dental Center (SRDC) was founded in March 2004 as a not-for-profit dental center in Calhoun County, Alabama, with the goal of providing preventative, restorative and emergency care for Alabama Medicaid eligible children ages 3 to 20 and emergency care for qualified adults. The dental center's primary mission is to provide care for children in Calhoun County and surrounding counties who do not visit a dentist on a regular basis and may not be able to afford dental care. Services are free to children on Medicaid and other low cost plans like Blue Cross and Blue Shield of Alabama's (BCBSAL) All-KIDS insurance.

The SRDC was founded with donations from corporate sponsors, the Alabama Department of Public Health and the School of Public Health at the University of Alabama-Birmingham. Founded as a not-for-profit corporation, the center opened without a full-time dentist and was staffed with personnel typical for most public dental facilities.

A MARKET IN NEED OF SERVICE

A report by the US Department of Health and Human Services (HHS) in 2000 indicated that the major barriers to improved oral health among low-income children include several socioeconomic factors. The primary factors are a lack of dental insurance and/or the inability to pay out-of-pocket. Secondary problems involve access to facilities and the inability to get transportation or the time off from work to address health needs (US Department of Health and Human Services, 2000). Over 100 million Americans lack dental insurance while nearly 45 million lack health insurance. Insurance is a key factor in oral health maintenance. Insured children are 2.5 times more likely to receive dental care than uninsured children. Those children without dental insurance are 3 times more likely to have unmet dental needs as compared to their insured peers. Minimal coverage is provided for adults in the public sector, and programs like Medicaid are available for children. However, many of these programs have not reached the eligible beneficiaries.

The 2000 HHS report addressed the need for public-private partnerships. These partnerships are a key solution to dental health-related problems. Free oral care, or oral care paid for by programs like Medicaid, can help alleviate this epidemic problem by reducing limitations to receiving proper care. The SRDC was started in Anniston, Alabama, to help alleviate this problem. The area of Eastern Alabama served by the SRDC includes Calhoun, Cleburne and Talladega Counties. The total population of these counties is approximately 210,000. Of those, 27% are under 21 years of age and 45% of these children are Medicaid eligible (see Table 1). Therefore, the market is underserved but has great potential.

Table 1: Population and Medicaid Figures for Surrounding Counties

	Total Pop.	Medicaid	Total Child Pop.	Medicaid Eligible
County	**Population**	**Eligible Pop.**	**Population**	**Children**
Calhoun	112044	27786	30229	13800
Cleburne	14769	3416	4036	1728
Talladega	83110	21383	23200	10579

Source: http://www.medicaid.alabama.gov

REPORTED BUSINESS PROBLEMS OF INDIGENT CARE

Several issues have been cited as problems in establishing privately funded clinics in support of indigent health care. In the dental arena four areas of concern have been mentioned: oral health programs are not ordinarily integrated with other public health programs; it is difficult for public dental facilities to retain qualified dental personnel; Medicaid reimbursement for services are below the reasonable and customary levels paid by insurance carriers; and, there is a perception that there is a general apathy among Medicaid patients towards fulfilling appointments. These major areas have led to the failure of many public-private dental health facilities (Griffith, 2003). Important it is to recognize that all of these reported business problems can lead to an unattractive business climate, increased operating costs and possible failure of public-private enterprise clinics (Griffith, 2003).

A PRIVATE SECTOR MODEL IN THE NOT-FOR-PROFIT SECTOR

SRDC began in 2004 with $450,000 from corporate sponsors including the Alabama Department of Public Health and the School of Public Health at the University of Alabama-Birmingham. Since that time the clinic has operated primarily from payments for services rendered. These payments come from Medicaid and a public non-Medicaid health insurance plan, All-Kids, supported by Blue Cross and Blue Shield of Alabama (BCBSAL). The State of Alabama has fully funded Medicaid Dental Reimbursement for the immediate future (through 2007.) A cutback in reimbursements or the dental services payment schedule would have a significant negative impact on the SRDC.

With reimbursed revenues of only $300,000 in 2004, the success of the center was in doubt. A change had to be made and it was. A retired CEO, with experience in the package goods field, agreed to take over in January 2005. Things quickly changed, from the quality of care and equipment to employee pay and culture.

PERSONNEL AND BUSINESS CHANGES

Personnel changes were the first issues to be addressed under the new CEO. With these new changes the SRDC grew from just 4 employees at the new CEO's arrival to over 30 by year end. In fact, the culture was changed to focus on hiring only the best candidates and assuring them of being part of the highest paid workforce in the area's dental community. Soon dentists, hygienists, dental assistants and front office staff from all over the area approached the SRDC for employment.

Even with a substantial increase in payroll, labor cost as a percentage of sales decreased. Higher salaries led to raised expectations and an emphasis put on pay for performance. Performance was measured daily. Daily revenue and output per employee numbers were posted daily. As a result, revenue increased dramatically and was reinvested in the business by purchasing state of the art equipment and information technology. The center itself was also refreshed by changing the "sterile" practice environment to being "kid friendly."

MODEL PRODUCTIVITY AND FINANCIAL DISCUSSION

Fottler (1987) stated that one of the keys to the success of new clinical operations was to shift the power from the doctors to the professional managers. This shift was done at SRDC and in doing so the clinic has been able to use the refined business skills of the managers to make sound business decisions, to integrate clinical and financial cost accounting and to apply new technologies in business management as well as in patient care. The management has also applied the same skills to lowering costs. Since R&C from Medicaid (and All-Kids) has traditionally paid less than private insurance, keeping costs low is a primary consideration to the operation of the clinic.

The SRDC must balance efficiency of operations with effectiveness of care in order to succeed. Efficiency is measured in cost of operations versus revenues. In 2005 the clinic's average revenue per procedure was $47.28 (19,755 procedures) and the average expense per procedure was $39.51. As a percentage, indirect overhead was 7% of revenues. Dentists and Hygienists salaries were 46% of revenues. The remaining costs were direct in nature. This gives a profit of $7.77 or 16.4% per procedure.

The SRDC uses a low-cost leader functional business strategy. That is, the management tries to limit their indirect costs and create a high volume of services through the clinic. Indirect costs (not related to dental services) are limited to administrative salaries, facility rental and some depreciation of equipment. Because the CEO takes a minimal salary, the office managers and office support staff can be paid salaries commensurate with their experience and expertise. Facility rental cost is also kept low. Through an agreement with the local health department, rent is set at $1 per year. Rent expense is a key factor in lowering overall expenses and a key negotiation point for future expansion.

Direct costs are those associated with servicing the dental patient. These include materials and supplies, hygienist salaries and dentist salaries. Efficiency for the dental center is built around these direct costs. By increasing the number of patients per day, having fewer missed appointments, performing more procedures per hour and managing materiel the clinic is able to keep direct costs per patient/procedure low.

"[Effectiveness] is not to be in terms of expansion and growth, but in terms of how well patients, physicians, employees, and payers are satisfied with the quality of health services being provided" (Fottler, 1987). SRDC has been successful in retaining patients. The SRDC listed 3,557 active patients on their patient analysis report for 2005. Sixty percent of the clinic's active patients have been seen in the last year, and over ten percent have appointment times in the future, a good sign of patient retention. The employee turnover rate is low, and the recent audits from the state Medicaid administrator and OSHA were completed with minimal recommendations for correction. In order to continue providing dental care in the counties served by the SRDC, the clinic must continue to operate with a financial gain. This gain can then be reinvested into new clinics, new public-private healthcare opportunities, better equipment and continuing education for SRDC employees. These operational gains will also allow the clinic to continue fulfilling its mission to low-income families in need of dental care.

PUBLIC-PRIVATE OPPORTUNITIES FOR THE FUTURE

All seems well at SRDC. So what could concern the leadership? First, there is the question of what to do with the excess cash. This is a good problem for the SRDC. Although this seems easy to handle, the leadership is uncomfortable with a non-profit sitting on cash reserves while there is a demand and need for dental care in the surrounding counties.

The possibilities of expansion into new counties with the dental clinic are enticing to the leadership of SRDC. Fottler (1987) mentioned the importance of economies of scale and scope in making a health clinic more effective. Multi-clinic systems can lead to fixed administrative costs being spread over more activities, facilities and procedures, thus reducing overall cost per procedure. A multi-clinic system would fit into the SRDC business model that has been designed around low overall costs and high volume of services.

Second, there are opportunities in medical clinics, optometry clinics and childcare centers. The management feels that their model for not-for-profit administration can be used in opportunities like these, also. However, they are concerned about the nuances and special business needs of each particular business.

Finally, continued growth may cause changes to the culture, overhead structure and flat organization. It may even complicate this simple business model. Many opportunities are presenting themselves. The question is: What to do for the future?

ASSIGNMENT

Use data from the case to identify critical issues related to the SRDC and its ongoing success. From your informational analysis, answer the following questions.

1) Perform a SWOT analysis on SRDC. What are the SRDC's competitive advantages? Are they sustainable?

2) The SRDC is looking to expand to two nearby counties (Cleburne and Talladega). Should SRDC expand? Quantify and defend your answer.

3) The SRDC's business model works well but is predicated on volume. What are the risks to their overall model?

4) What inhibits public health facilities like the SRDC from being successful?

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FIDUCIARY FOLLY LEADS TO FIASCO: THE CASE OF CONSOLIDATED PIPELINE AND EQUIPMENT CORPORATION (CPEC)

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CASE DESCRIPTION

The primary subject matter of this case involves the agency relationship between Steve Shelton, a fiduciary (the accountant) and his client and friend, Paul Jameson. Paul's son, Jim Jameson, is bringing a lawsuit against Paul and Steve, because of his dissatisfaction with a payment made to him recently for questionable purposes. Secondary issues include gratuitous agent issues, agent liability, and confidential relationship liability. The case has a difficulty level appropriate for undergraduate Business Law or Accounting courses. The case can be taught in 1-2 class hours, depending on the desired detail level for the discussion. It should take approximately one hour of outside preparation by students.

CASE SYNOPSIS

Jim Jameson, former president of Consolidated Pipeline and Equipment Corporation (CPEC) has brought an action against his father and his father's accountant. His father, Paul, is the 100% owner of CPEC, and has arranged the sale of the business to a third party for $65 million. Jim's position (CPEC president) had been terminated for alleged mismanagement in the year prior, and his father had taken over Jim's responsibilities during the structuring of the sale of the business.

Jim had recently been paid $6.8 million by CPEC (at his father's direction) for a parcel of land that Paul had given to him five years before. The value of the land was about $1.2 million. The purpose of the purchase in excess of the actual value was to transfer an "inheritance" of sorts to Jim while avoiding the tax consequences of a gift tax. The burden of the tax was then Jim's, a further irritating aspect of the transaction.

Jim claims that the $6.8 million that he received for the land did not represent an amount acceptable for an inheritance. Jim also felt that the land was of substantially higher value to the firm, and that the sale of the business was somehow tied to the inclusion of the land. His conclusion was that the land is actually worth substantially more than the $6.8 million he was paid.

Interestingly, if Jim's conclusion is correct, then the amount paid does not exceed the value of the land, and there would be less suspicion of a fraudulent avoidance of taxes by Paul. If Jim is wrong in his conclusion, Paul and the firm would be suspected of fraudulent avoidance of taxes, but would have greater wealth to offer the firm's purchaser. The main question addressed by the case is whether or not the accountant owes Jim a fiduciary duty as well as being a fiduciary to the firm.

CHILDREN AND FAMILY SERVICE CENTER CASE STUDY

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ABSTRACT

In this case, you are asked to take the role of the Director of Fiscal Operations of a not-for-profit organization, Children and Family Service Center. The Trustees have hired you because of concerns that the accounting records are not adequate. You identify numerous areas of concern and attempt to determine the appropriate treatment for each item. Thus, this case addresses a number of issues affecting not-for-profit organizations. The case attempts to help you better understand the basic principles and concepts that differ between for-profit and not-for-profit organizations. This case specifically addresses Statement of Financial Accounting Concepts 4 and Statement of Financial Accounting Standards 116 and 117. The case can be used in either undergraduate or graduate classes depending on the requirements the instructor wishes the students to complete.

RANDY DANDY: FROM THE FRYING PAN INTO THE FIRE

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CASE SYNOPSIS/ABSTRACT

Randy quit his job as a plant manger because of stress and formed a partnership with a building contractor only to have it dissolve within two months. He then set about building his own construction company. He and his father-in-law formed an alliance to flip houses and build new homes. During his first year Randy began to experience problems that many new contactors encounter including problems with sub contactors, real estate agents, shady brokers, financing, contracts, and an ever-increasing workload. His stress level is beginning to interfere with his work...

PAINTING A PICTURE THAT IS REPRESENTATIONALLY FAITHFUL: ACCOUNTING FOR MAINTENANCE COSTS OF A MERCHANT MARINE FLEET

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CASE DESCRIPTION

This case addresses issues in accounting for certain repetitive maintenance costs occurring at multi-year intervals. Is a more meaningful measure of periodic economic performance obtained by allocating a part of these costs to each accounting year or allocating all of the cost to the year in which the maintenance takes place? The student is confronted with key issues in accounting theory involving expense and liability recognition, definitions of elements of financial statements, the matching principle, objectives of financial reporting, the issue of income smoothing, the concept of quality of earnings, and the characteristics that make accounting information useful.

CASE SYNOPSIS

A decision must be made about how to account for materially significant maintenance costs which occur periodically every few years. In this particular case, management of the company incurring the maintenance costs prefers allocating a part of the costs to each annual accounting period as opposed to charging all of the costs to the annual period in which the costs are incurred. Management believes this is the most accurate way to account for the costs because each accounting period benefits from the maintenance and therefore each accounting period should be charged with some of the costs. In addition, management prefers allocating the costs to each annual accounting period smooth periodic income. This will avoid overstatement of income in annual accounting periods which had no maintenance and the understating of income in annual accounting periods in which maintenance was performed.

THE CASE OF REOPENING THE MAQUILADORA PLANT-TEACHING AN INTERNATIONAL NEGOTIATION

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ABSTRACT

Negotiating successfully in international business requires understanding cultural influences that impact business and the negotiation process. Every country has unique economic, legal, and political influences. Not as transparent to the international negotiator are the culture, ethics and moral values that influence the negotiation process. An effective negotiator in international business must gain an understanding of these influences. The case of "Reopening the Maquiladora Plant" provides a comprehensive international negotiation for the participants and instructors notes to guide the process. This negotiation simulation will help students gain an understanding of the influence of differing business cultures upon international negotiations.

SHOULD ABC COSTING BE USED?

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CASE DESCRIPTION

The primary subject matter of this case concerns the appropriate use of ABC costing. Secondary issues include cost allocation in general. The case has a difficulty level of two or three. The case is designed to be taught in an introductory managerial accounting course or a cost accounting course in one to two hours and is expected to require two hours of outside preparation by students.

CASE SYNOPSIS

This is a case about the non-profit, Tribeca. Tribeca desires a more detailed cost accounting system to ensure the proper charges are made for outside groups using their retreat center for on campus meetings, daily stays, and overnight stays. Tribeca has five departments that they use for their financial statement breakdown: (1) retreat center, (2) cemetery, (3) development and marketing, (4) museum and church, and (5) snack and wine shop. Tribeca's administrative overhead needs to be allocated to the five cost centers. Tribeca's overhead includes administrative salaries, utilities, workman's compensation, data processing, insurance, and repair and maintenance. The majority of the overhead appears to be a result of the retreat center's overnight rooms, meeting rooms, and kitchen. Tribeca needs to ensure that the proper amount is allocated to each cost center such that the correct figures are used to determine meeting room charges, charges for daily stays with meals, and charges for overnight stays with meals. The cost allocation becomes more complex when it is learned that employees are allowed to eat meals from the kitchen during the day and some employees live on campus and regularly eat all meals on campus from the retreat kitchen.

MEDIMMUNE - ENABLING GROWTH THROUGH MANUFACTURING ALLIANCES IN THE BIOTECH INDUSTRY

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CASE DESCRIPTION

This case looks at a biotech company that rapidly grew from a small research company to a multinational biopharmaceutical company by reinvesting the profits from its block-buster drug, Synagis. A key to MedImmune's growth strategy was the use of strategic alliances and selective acquisitions in R&D, manufacturing, and in marketing and distribution. This case focuses on manufacturing alliances. Critical risk factors faced by MedImmune's decision to outsource manufacturing are identified. Secondary factors include the nature of competition in the biotech industry, global expansion, the unique barriers in the industry to market entry, government regulation. Students are asked to consider the effects of a price reduction for FluMist, MedImmune's newest selling product. The common flu shot is therapeutically equivalent and sells at one-third the price. This case is appropriate for college seniors or MBA students in Business Strategy or Operations Management course. This case can be read in one to two hours and discussed in one or two class hours.

CASE SYNOPSIS

In reviewing 2005 sales in the first quarter of the new year it was clear that sales of FluMist, MedImmune's newest product have had fallen considerably short of expectations. A drastic price reduction was proposed to remedy the situation. However, the likely result would be a sharp increase in sales with a corresponding demand for manufacturing capacity. MedImmune has been able to keep their independence by employing a growth strategy that relies heavily on strategic alliances in R&D, marketing, and manufacturing. These alliances are necessary to conserve capital, to develop a diverse product pipeline, and to overcome the unique barrier to marketing inherent in the industry. This case uses a hypothetical price increase to elicit a review of manufacturing strategy to evaluate the balance between in-house production and contract production both in the US and abroad. Thus it forces a reconsideration of strategic alliances in manufacturing. A number of manufacturing related risk factors are introduced that need to be considered in the analysis. The pharmaceutical industry has a challenging business environment. It involves technological change, fierce competition and exposure to legal risks. It is one of the most heavily regulated of all industries. Students are asked to develop a manufacturing strategy that balances corporate performance objectives and minimizes risks.

INTRODUCTION

During the first quarter of 2006 the Senior Vice President of Operations for MedImmune was asked to evaluate the manufacturing strategy for FluMist, the company's newest product. Of particular interest was the potential impact of a proposal to sharply reduce the price. FluMist had failed to meet sales expectations because it is priced at about three times the cost of the standard flu shot. Important health care providers such as HMOs and other health insurers have refused to pay a premium over the common flu shot, which is therapeutically equivalent. In order to improve sales consideration is being given to sharply reduce the price of FluMist to compete directly with the flu shot. If approved, the price change would greatly change FluMist sales revenue, profit margin, and production requirements. There is no certainty that the proposed strategy would increase earnings. For the strategy to work production economies must reduce costs enough to support the price decrease. At present FluMist manufacturing is subcontracted to others.

COMPANY HISTORY

Biotech firms employ the biological sciences to produce products for agriculture such as improved crop seeds, the environment, such as substances to treat sewage or oil spills, and biopharmaceutical products that are medical drugs developed from living organisms. MedImmune was able to develop, manufacture, and market a blockbuster drug, Synagis. Many biotech firms sell the firm to an acquiring firm once they develop a product with the potential of becoming a blockbuster. The acquiring company proceeds to manufacture and market the drug. MedImmune has been different, retaining ownership and control of manufacturing. In doing so, MedImmune has set up strategic alliances, which conserved capital.

Founded in 1988 and headquartered in Gaithersburg, Maryland, MedImmune is committed to advancing science to develop better medicines that help people live healthier, longer and more satisfying lives (MedImmune annual report, 2005). The company operated facilities in the United States and Europe to manufacture and distribute one or more components of each of its products. A U.S.-based marketing team and a highly trained technical sales force sells primarily to physicians through personal/professional relationships that have been developed over a lengthy period. A large highly skilled scientific staff conducts research, clinical trials, and product development. Together they manage an impressive pipeline of product candidates for potential commercialization. In addition to their internal efforts, the company has established clinical, R&D, manufacturing, clinical testing, and marketing collaborations with other companies and organizations.

The company has three areas of product focus: infectious disease, cancer, and inflammatory disease. Four products were being marketed in early 2006: Synagis (palivizumab) and FluMist (Influenza Virus Vaccine Live, Intranasal) to help prevent two common respiratory infectious diseases; Ethyol (amifostine) to help reduce undesired side effects of certain anti-cancer chemo- and radiotherapies; and CytoGam (cytomegalovirus immune globulin intravenous (human)) to help prevent cytomegalovirus (CMV) disease associated with solid organ transplantation (MedImmune 10K Report to the Securities & Exchange Commission, 12/31/2005. Unless other wise cited, the information used in this case is based upon MedImmune's 10K and annual report for 2005).

The company's success has been primarily due to Synagis, an antibody medication that was approved by the FDA in June 1998. Synagis prevents serious lower tract respiratory disease caused by respiratory syncytial virus (RSV), which threatens a small percentage of infants, about 125,000 each year in the U.S. By 2003 MedImmune passed the $1 billion mark in sales.

RESULTS OF OPERATIONS FOR 2005

A brief summary of financial results from 2005 give some sense of the profit potential of the company, its aggressive growth through acquisition, its commitment to R&D. Total revenues for 2005 were $1.2 billion, an increase of 9% over $1.1 billion in 2004, primarily reflecting 13% growth in sales of Synagis to $1.1 billion. A net loss of $17 million, or $0.07 per share, was reported for 2005 compared to a net loss of $4 million, or $0.02 per share, in 2004. Both periods included significant charges associated with the acquisition of research and development (R&D) assets that expanded the product pipeline. The 2005 results reflect the impact of $48 million of charges for acquired in-process research and development ("IPR&D"), and 2004 results include acquired IPR&D and impairment charges totaling $102 million for the reacquisition of Wyeth's interest in the influenza vaccines franchise. MedImmune continues to invest aggressively in building its future with R&D expenditures excluding acquired IPR&D, which increased to 31% of product sales in 2005, compared to 29% in 2004.

MANUFACTURING

MedImmune operated commercial manufacturing facilities and distribution facilities in the U.S. and Europe. In addition, the company entered into manufacturing, supply and purchase agreements with other companies to provide certain portions of the production capacity for all marketed products and to produce clinical supplies for development-stage products. Certain materials necessary for commercial manufacturing of MedImmune's products were proprietary products of other companies, and in some cases, these proprietary products were specifically cited in the drug application with the FDA such that they must be obtained from that specific source. In addition, certain materials necessary for commercial manufacturing were only available through one approved single source supplier, although other unapproved suppliers were capable of providing the materials. The company managed the risk associated with sole-sourced and single-sourced materials by active inventory management and, where feasible, alternate source development. Suppliers were subject to continuous review.

The primary manufacturing facility for Synagis bulk product was MedImmune's Frederick, Maryland manufacturing center ("FMC"). The FMC was a biologics facility with cell culture production and associated downstream processing equipment for recombinant products. Supplying Synagis bulk was Sicor Pharmaceuticals, Inc. Packaging was performed by Cardinal Health PTS, LLC. Supplemental supply of Synagis for the U.S. market was from Boehringer Ingelheim Pharma GmbH & Co. KG ("BI") under a manufacturing and supply agreement. BI also filled and packagee Synagis produced at its German facility. BI was also the sole supplier of Synagis outside the U.S. BI was responsible for obtaining regulatory approval of its facilities.

All bulk drug substance for Ethyol was from a contract manufacturer. In 2005, filling and finishing of all bulk products was completed at MedImmune's manufacturing facility in Nijmegen, the Netherlands. To backup the company's filling and finishing capabilities, MedImmune had an agreement with Ben Venue Laboratories, Inc., a subsidiary of BI, to fill and finish Ethyol for sale in the United States.

FluMist was produced at several facilities either owned or leased by MedImmune. It manufactured key components, specifically the bulk monovalents and diluents, at a facility in Speke, the U.K., pursuant to a sublease arrangement with Evans Vaccines Limited, a division of Chiron. The master virus seeds were prepared at the company's Mountain View, California facility. In 2005, the bulk monovalents and diluent were produced at leased facilities in Speke, in the United Kingdom. In December 2005, the FDA approved MedImmune's recently constructed bulk manufacturing facility, which is also located in the United Kingdom. The company planed to manufacture FluMist at this site later in 2006. Blending FluMist into its trivalent formulation and filling of the final vaccine into the Accuspray applicators, the non-invasive nasal spray delivery system developed and supplied by Becton, Dickinson and Company, took place in MedImmune's Philadelphia, Pennsylvania facilities. In addition to these manufacturing facilities, the company owned a distribution facility in Louisville, Kentucky from which FluMist was distributed to physicians, pharmacies and government agencies.

MedImmune was in the process of transferring CytoGam manufacturing responsibilities to a different contract manufacturer, a process which was expected to be completed during the second half of 2006. Until the transfer is complete and the new manufacturing sites were approved by the FDA, the company expected supply to be limited and sales to be adversely affected.

RISK FACTORS FOR OUTSOURCING AT MEDIMMUNE

1. A significant portion of MedImmune's business is dependent on third parties. This reduces the degree of company control over the both product pipeline and supply chain and thereby increases the risk of unforeseen or unanticipated events disrupting sales and earnings. This is situation is more difficult in the pharmaceutical industry than in others as the supply of products is affected by several industry-specific manufacturing variables, including the number of production runs, production success rate, product yield and the outcome of quality testing.

2. Ninety percent of MedImmune's sales are from Synagis and FluMist, both of which are highly seasonal in nature, as sales are tied to the flu season. The severity of flu season varies from year to year, which further complicates forecasting. While the seasonality factors are known, forecasting demand remains difficult. Outsourcing introduces added uncertainties which make it more difficult to forecast demand and reduces control over supply. This increases inventory buffering costs and the risk obsolescence due to out-of-date products, as MedImmune's products have a finite shelf-life.

3. MedImmune's primary manufacturing facility for influenza vaccines is in the U.K. If there is in an influenza pandemic, the U.K. government may limit the company's ability to export product outside of the UK, or may nationalize the plant to produce vaccines to defend against a flu pandemic.

4. Defending product liability claims that may arise is costly and diverts management's attention from business operations. An adverse finding in court may have very serious economic consequences for the company. The loss of control over outsourced manufacturing operations increases the risk to the public and exposure to product liability. It should be noted that there are safeguards, as the FDA must approve and license any manufacturing facility that produces pharmaceutical products for sale in the US.

5. MedImmune's dependence on outsourcing includes packaging, such as inhaler-type devices for FluMist, and precursor materials used by it and by its contract manufacturers, for which there is no redundant supply.

6. Because various company and contractor manufacturing processes are highly complex and are subject to a lengthy FDA approval process, alternative qualified production capacity may not be available on a timely basis or at all.

7. Manufacturing facilities in the UK are unionized and manufacturing may therefore be interrupted due to a labor action.

8. Technological developments by competitors may render MedImmune products obsolete. One of the benefits of outsourcing is reduced exposure to the risk of obsolete manufacturing facilities.

9. Changes in foreign currency exchange rates or interest rates could result in losses. Expenditures relating to MedImmune's manufacturing operations in the U.K. and the

Netherlands are paid in local currency. The company has not employed hedging strategies with regard to these expenditures, which increases the currency risk.

10. Outsourcing may facilitate technology appropriation. It is more difficult to safeguard knowledge of proprietary product formulations and processes technology. This knowledge could be used to pirate or counterfeit expensive prescription drugs. The risks are greater with overseas expansion where law enforcement agencies may have fewer capabilities than those in the US and where laws respecting intellectual property may be weak, or not well enforced.

SUMMARY: FLUMIST PRICING AND CONSEQUENCES FOR MANUFACTURING

The Senior VP of Operations had a lot to consider. Strategic alliances had made it possible for his company to grow quickly by conserving capital for R&D and by avoiding delays for plant construction. Manufacturing alliances had also reduced risk exposure should sales projections fail to materialize due a change in the business environment. While some of his dedicated staff people could crunch the numbers and work out the details, they needed some direction. He needed to convey the forces that would be at work if the price cut was put into effect. If a decision is made to sharply reduce the price of FluMist to compete directly with the flu shot, what effect would there be on the overall business? To what extent should outsourcing be used to meet the sharp increase expected in FluMist demand? Should the firm's basic manufacturing strategy be revised to cope with this new development? In particular, should MedImmune assume direct control for all FluMist manufacturing? Are there any deficiencies in MedImmune's current outsourcing strategy that should be looked at as part of the current analysis?

WILD FLOWER WINERY, PART 1: BACKGROUND

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CASE DESCRIPTION

The primary subject matter of this case concerns entrepreneurship. In particular, the case contains information on the background and psychological traits of the person starting Wild Flower Winery, plus information about the wine industry. The case has a difficulty level of four, appropriate for senior level. The case is designed to be taught in one class hour and is expected to require three hours of outside preparation by students.

CASE SYNOPSIS

Wild Flower Winery is the oldest family owned wine producer in Idaho. Producing about 2000 cases of wine per year, it is considered a "boutique winery" within the industry. Stu Scott started the winery in 1983, as a second job in the basement of his home. Its creation and evolution are very much part and parcel of his hopes, dreams and lifestyle. The case is largely Stu's story and the fictionalizations are few. That is, the story for the most part is a factual account of his thinking, planning process, successes and mistakes.

Stu moved to Moscow, Idaho in 1981 from one of California's many wine regions. In California, as a hobbyist, he made wine and had planted his own vineyard. He loved the lifestyle that he saw among the small wineries, and found satisfaction in making and sharing his wines. He saw a small winery as his "dream" future activity. His assets included serving in the military, directing a school for disabled children, and completing a BA and MA in psychology. His MA thesis concerned "locus of control. Stu believed that he could significantly control his own fate through planning and hard work and thus saw himself as being "internally controlled." Another asset included running his own office for a branch of the Federal Courts. This required self-direction, independent thinking, investigative skills, personal discipline and time management. What he lacked regarding starting a business, perhaps, was any formal training in business.

Also included in the case is a review of the wine industry, which originated in colonial Virginia. The modern Northwest wine industry started in 1968, and by 1983, there were about 50 wineries each in Oregon and Washington, and 10 in Idaho, one of which was medium-sized and nine were very small-sized producers. Never having seen itself as a wine producing state, Idaho liquor laws were slow to come around to being supportive of the fledgling industry. For example, prior to 1986, producers could only sell their wines at their own tasting room or through licensed distributors who resold the wine to stores and restaurants. This is often referred to as a "three tiered system." When a distributor is used, it costs the winery 30% of the potential profit on wine sales.

SIT EASY FURNITURE COMPANY GOES INTERNATIONAL: PRELIMINARY CASE

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CASE DESCRIPTION

The primary subject matter of this case is the first introduction of a company's products into International Markets. Secondary issues include conducting secondary market research by small firms in foreign markets; international terms of trade; identifying relevant tariffs; market segmentation; exchange rates and exchange rate fluctuation. This case has a difficulty level of 4-5 and is targeted at business students in a first course in international business or international marketing. The case can be used either as an introductory course case, as it covers many of the problems typically encountered as a business expands into international business, or as a relatively straightforward functional case on pricing in the international environment. One hour of class time should be sufficient to handle the case discussion and students should budget 3-4 hours of time for case preparation.

CASE SYNOPSIS

The SitEasy Corporation is a small manufacturer of quality furniture located in Colorado Springs, Colorado, USA. Sales at the 12 year old company have grown steadily and the company expanded two years ago into a much larger factory capable of doubling their output, while maintaining their quality level. However, the housing market peaked shortly after their move in 2005 and in 2006 it started to soften. Current distribution is to exclusive stores on the west coast and the upper northeast in the U.S. The idea for foreign expansion was initiated in response to flat sales in current markets and a lot of excess capacity in the new factory. Past comments from two, large northeastern retailers that a large number of their customers were shipping the furniture directly to Canada led to the idea of exploring international markets. Following a discussion of the relative change in value of the US dollar and the Canadian dollar, the case fast forwards to the issue at hand, answering the inquiry from a potential Swedish distributor met at a German furniture trade show.

Pricing must be established for a portion of their exclusive furniture line for the Swedish market, along with forecasts of expected sales and expected effect on plant capacity and firm profitability. This requires identification of accepted terms of trade, relevant tariffs on the type of goods being offered, consideration of exchange rates, and most importantly, the expected size of the market for SitEasy furniture in Sweden.

INTRODUCTION

The SitEasy Corporation is a small privately held manufacturer of tables and chairs made from the hardwoods of the northwest located in Colorado Springs, Colorado, USA. The company was formed 12 years ago by two old college friends, Bill Martin and Greg Huth. They had been involved with industrial design for a number of years and were quite successful. They wanted to furnish their homes with quality, contemporary pieces and found it difficult to find the type of furniture they desired to match their lifestyles in the marketplace. After an extensive search of the furniture market in Colorado, they identified a niche in the market for residential furniture that they stated in the following way: people desiring high quality pieces if contemporary furniture, made largely by hand, resembling some of the early twentieth century classics and bringing them into the contemporary homes of the affluent. Each piece should be signed by a craftsman and numbered. Given the vision for the products to be produced, great emphasis was placed on quality workmanship in production and achieving placement in the right retail environments. These were defined as retailers of similar lines of expensive, quality furniture, who could be counted on to properly display and merchandise their products. The company achieved moderate success during the first five years with distribution in west coast markets. They have since expanded into east coast markets, primarily in the northeast.

SUCCESS BRINGS NEW PROBLEMS

Sales grew steadily and the company expanded two years ago into a much larger factory capable of doubling their output, while maintaining their quality level. The new factory had both a larger production floor for more specialized machinery and a much larger warehouse for storing raw materials. One problem they had experienced was high materials cost for the small orders of exotic hardwoods the company was forced to make in its original factory. They moved into the new factory in 2004 and material cost per unit did decline in the second half of that year by almost 5 percent. In 2005 the new housing market peaked and in 2006 it actually started to soften. Sales of all kinds of furniture are closely correlated to, and slightly lagged from, the amount of new housing. This relationship is known in the industry.

Thus, in early 2006, Lisa Morgan, Vice President for Marketing, was meeting with Bill and Greg regularly to discuss strategies for continued success in this new, more competitive market for high end furniture. Bill, CEO, outlined the issues for the group.

"Clearly, we made a risky strategic move three years ago when we decided to double our capacity. I have reviewed that decision and while it looked like a slam dunk at that time, we may have placed an overly high probability on our forecast of continued almost double digit growth for the rest of the decade. Our new factory is fantastic, but, as you all know, we need $15 million in new sales just to break even on the cost of our additional overhead. So far the best we have been able to come up with is 8 million. Sales for the fourth quarter of 2005 were actually flat from the previous year and the first two quarters of this year have seen negative growth. Greg, production manager of the plant reminded the group that at least in terms of materials cost, the new factory, even at current operating levels showed a significant savings. We are also able to attract a higher quality of wood, given our larger orders, which is further improving the quality of our product. They turned to Lisa, hoping for answers. She responded with the same 'excuses' for the flat sales that they had already heard.

Under further questioning, Lisa mentioned that two of her best performing retailers, both in the Boston area, had mentioned when she was last in their showrooms that they were getting a healthy trade from Canadians taking delivery in Quebec, Montreal, and as far away as Toronto. One of them stated that the Canadian dollar, 'the Loonie', was appreciating against our dollar. "I looked into this and they were correct. Four years ago their dollar was only worth 72 cents U.S. and today it exchanges for 90 cents. That's quite a difference. Maybe we should consider moving into international markets?"

They agreed that Lisa should do some preliminary market scans, which she did. In the process she contacted the Colorado Office of Economic Development and International Trade, which led to them inviting SitEasy to attend a Trade Show being organized for furniture manufacturers and distributors in Düsseldorf, Germany. Bill decided to personally attend the show in September, 2006 with a group of business people from the Denver Chamber of Commerce. His purpose is to explore new markets for the specialty line of tables and chairs manufactured by the SitEasy Corp. Their line of furniture has come to be accepted in 'better' middle class homes across the United States. This is Bill's first experience on a trade mission and he was understandably shocked to find that people actually come to these shows with their checkbooks in hand.

While he was still in Germany, Lisa returned from lunch to find the following e-mail message from his boss marked URGENT! - This was not the way she planned to spend her Friday afternoon.

Lisa: Great trade show. More interest in our model 1308 and 1600 chairs than I thought possible. Check market in Sweden for viability. Looks like that will be our first move into the EU.
Need your reply tomorrow. Have a meeting scheduled for 10 am with our new distributor.
Bill

Lisa looked at her watch and tried to remember the time difference to Frankfurt - Düsseldorf, whatever. Failing on the instant conversion, the next step was to punch in 'time in Germany' on her favorite search engine: 10:12 pm. Looking at her watch she noted that it was 2:12 pm in Denver. Eight hours time difference meant that tomorrows meeting would actually take place in a few short hours. She would have to make use of materials on hand and whatever she could find on the internet to provide the needed answers.

Lisa quickly identifies three general areas for research on the Swedish market. First is the overall size of the market. The company would like to expand into new markets to optimize capacity utilization in their plant, without causing capacity constraint problems for the firm of 62 employees producing 73 million dollars in sales for 2005. They are currently operating at about 73 % of capacity and domestic expansion, which had been at the rate of 8% per year for the first four years of the decade slowed to 6% last year and has been flat so far this year. However, their labor productivity gains have been averaging higher than the average for non-farm labor over the same period, or about 4%. This is due primarily to the fact that the business is relatively new and invested in the latest equipment. This has helped to hold down labor cost. She ponders how to answer. First, she decides it would be good to have an estimate the number of years to capacity for their facility given current estimates of domestic demand?

Getting back to the issue at hand, answering her boss, she decides to begin her search for Swedish data at government websites. http://www.buyusa.gov/sweden/en/ccg.html and choosing Sweden as the country brings her to the Country Commercial Guide for Sweden, produced by the Department of Commerce staff at their office in Stockholm, Sweden. Here she finds a general narrative about the country and its business climate. Nothing specific to the market size here, but there is a wealth of information on her second issue: general economic climate. Information includes an assurance that Sweden has signed the European Patent Convention of 1973. She notes although import tariffs should be low, there is a 25% V.A.T. This is a form of sales tax preferred in a lot of countries, Lisa remembers. She finds the following list:

> The value for customs purposes is directly based on the value of transaction and the following additional costs:
> - freight costs up to the place of importation to EU
> - insurance costs
> - loading/other handling costs
> - broker fees
> - package costs
> - royalties or license fees
> - the seller's yield in case of further sale to a third party
>
> Most goods imported to Sweden are subject to customs duty and also a value-added-tax (VAT). The general VAT rate is 25%, with a lower rate of 12% for food and certain services, and 6% for books and periodicals.

She makes a note to tell Bill about that so he will be sure to specify who is to pay this in the contract. It appears that the way customs calculates the applicable fees is by the following formula: (CIF + duty) * 25% = VAT. She finds what she hopes is the applicable tariff information on the web (Table 1), but is still not entirely clear about the VAT. A mistake here could easily turn any foreign sale from profitable to a large loss. For the purpose at hand she decides to assume that the beginning point for negotiations on selling price to the Swedish distributor should be at least as profitable as domestic sales. Therefore, she makes the following notes;

> *Our fob East coast distributor's dock cost is currently $602 for the 1308 and $791 for the 1600 model chairs. These prices allow for a 15% mark up on cost for SitEasy.*

A quick call to her freight company tells her that a ballpark figure would be an additional $50 per chair for export packing and shipping in container loads to Gothenburg or Oslo, Norway, and an additional $10 to Malmö, or Stockholm.

Marine insurance is an additional 1% of product cost and a 40 foot container will hold 32 chairs.

Lisa realizes that the firm attempts to earn a minimum of 15% mark up on cost on all domestic sales, she decides to use this target as her starting point on the pricing of the international sales, as well. At the same time is gathering this information she notices that families get 12 months of childcare leave after the birth of each child to be taken by either spouse. She wonders if Bill is aware of this, as he just had his second child.

Table 1
European Union Common Customs Tariff
Furniture; Bedding, Mattresses, Mattress Supports, Cushions, Page 370

C N Code	Description	Rate of Duty (%)
9403	Other furniture and parts thereof Exceeding 80 cm in height	
9403 40	Wooden furniture or a kind used in the kitchen:	
9403 40 10	Fitted kitchen units	2.7
9403 40 90	Other	2.7
9403 50 00	Wooden furniture or a kind used in the bedroom	Free
9403 60	Other wooden furniture:	
9403 60 10	Wooden furniture of a kind used in the dining room and the living room	Free
9403 60 30	Wooden furniture of a kind used in shops	Free
9403 60 90	Other wooden furniture	Free
9403 80 00	Furniture of other materials, including cane, bamboo or similar materials	5.6
Source: International trade Administration, August, 2006		

She looks in the World FactBook for general information about Sweden. At https://www.cia.gov/cia/publications/factbook/index.html The World FactBook is compiled and published by the CIA, which seems to be interested in gathering information useful to business, as well as government. Here she found interesting comparisons between the statistics for Sweden and the US markets. Remembering that her market is particularly upper-middle class consumers with high disposable incomes, she paid particular attention to the Household consumption figures. The CIA reported that in Sweden the income of the highest 10% of households was 20.1 % of total income and the lowest 10% was 3.7%. Comparing with data listed under the US she found it was 30.5 % and 1.8%. She will need to examine this information further to determine how it might affect demand for furniture.

Next, she looks at the Composition of the market. At http://www.census.gov/ipc/www/idbnew.html The international database of the US Census Bureau provided a wealth of statistics on the population of Sweden. She stumbled on this data almost by accident and realized her time was running out. She copied the following tables for Sweden and the US. Highlighting the target age group of 40 - 70 and computing some summary statistics, she arrives at the following tables. She assumes that their products are currently marketed to approximately one third of the United States population and given the small size of the Swedish market she thinks she should include all of it.

Table 2
Sweden: Midyear Population, by Age and Sex: 2005 and 2025 (Population in thousands)

	2005			2025		
AGE	TOTAL	MALE	FEMALE	TOTAL	MALE	FEMALE
TOTAL	9,002	4,459	4,543	9,316	4,601	4,715
0-34	3,800	1,943	1,855	3,627	1,858	1,768
35-39	625	318	308	645	327	318
40-44	641	327	314	554	280	274
45-49	580	294	286	540	270	270
50-54	577	291	286	586	293	293
55-59	620	311	310	602	299	303
60-64	592	297	295	602	300	303
65-69	429	210	219	525	257	269
70-74	349	163	186	490	234	255
75-100+	790	304	486	1,143	482	661

Source: U.S. Census Bureau, International Data Base, August 2006 version

Table 3
US: Midyear Population, by Age and Sex: 2005 and 2025 (Population in thousands)

	2005			2025		
AGE	TOTAL	MALE	FEMALE	TOTAL	MALE	FEMALE
TOTAL	295,734	145,309	150,425	349,666	171,918	177,748
0-34	142,569	72,766	69,801	158,597	80,859	77,737
35-39	20,903	10,479	10,424	23,080	11,654	11,425
40-44	22,748	11,294	11,454	22,319	11,232	11,087
45-49	22,458	11,080	11,377	20,682	10,327	10,355
50-54	19,984	9,772	10,212	20,044	9,914	10,130
55-59	17,359	8,415	8,944	20,292	9,945	10,346
60-64	13,017	6,203	6,814	21,128	10,185	10,944
65-69	10,123	4,712	5,412	19,647	9,284	10,363
70-74	8,500	3,804	4,697	16,041	7,346	8,695
75-100+	18,072	6,783	11,289	27,835	11,171	16,666

Source: U.S. Census Bureau, International Data Base, August 2006 version.

She realizes that the information she has gathered so far may be somewhat biased, given its US governmental sources. Therefore, she looks for a Swedish source and found the Swedish Statistical Bureau. At http://www.scb.se/eng/index.asp Lisa found little to help her here. A wrong keystroke put her into what she assumed was a wealth of statistical information. Unfortunately, it was written in a foreign language, probably Swedish. She was right, and had stumbled onto a stark fact of international research. Governments tend to publish data in their own languages. In fact, Sweden was the first country to begin conducting a regular census of the population hundreds of years ago. Information was readily available - in Swedish - on median disposable income for households by age, number of households by age, size of households by age, and the usual variety of statistics used in secondary marketing research. Making a note to herself to find out more about researching international markets, Lisa began to prepare her e-mail to Bob around the three themes: Market size, Economic climate, and future potential for SitEasy expansion.

What should her response include? After exhausting the information included here, visit the websites she used in her analysis and look for facts she overlooked in her haste to compile her response. How could this new information affect her response concerning the Swedish market? Be specific in your comments and remember to source all information.

CASE QUESTIONS, INSTRUCTOR'S NOTES and REFERENCES

Available from the author upon request.

HOTEL WEBSITES IN NEPAL : A CASE STUDY

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CASE DESCRIPTION

Mohan Singh, a graduate assistant from Nepal, has been asked by Professor A.B. Jones to evaluate the quality of websites of hotels located in Nepal. Specifically, Professor Jones has requested that Singh perform the following two tasks: 1) Design a research study to collect data on the quality of the websites of hotels located in Nepal; and 2) Design a format for the report to report out the results of the study. Thus, the case challenges students not only to design a data collection effort but also to develop a format for a research report. The case is appropriate for senior-level undergraduates as well as students in MBA programs. It is designed to be taught in a class session of 1.5 hours, and is likely to require a couple of hours of preparation by students.

CASE SYNOPSIS

The authors' experiences lead them to believe that very few students (either undergraduate or masters level) know how to go about designing a research project and/or developing a research report to report out the results of their research. This objective of this case is to provide students with an example of how to design a research project and how to develop a research report to report out the results of their research. Data in the case include: 1) Description of the research design-related assignment given the graduate assistant by his professor; 2) For Nepal (the home of the graduate assistant and the setting of the research assignment): A bit of information on the country, the economy, the people, the history, and the hotel industry in Nepal; and 3) In the "epilogue" section of the teaching note, a description of the research study the graduate assistant actually designed and as well as copies of the tables (and elaborative text) around which he organized his research report.

URBAN OUTREACH MINISTRIES' ORGANIC GARDENS: DEVELOPING A SUSTAINABLE, TRIPLE-BOTTOM-LINE BUSINESS FOR A NONPROFIT SOCIAL ENTERPRISE

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CASE DESCRIPTION

The primary subject matter of this case is a for-profit or nonprofit organization developing and implementing a triple-bottom-line strategy, including concern for people, profit, and planet, to help assure the profitable sustainability of its operation in the long run. Secondary issues include the challenges of developing a business plan that will accomplish the desired results, identifying and weighting relevant stakeholder values in order to develop organizations that maximize the value of stakeholders in the long run, and issues of the competency and capacity of the management team, including the Board of Directors, to implement such a strategy. The case has a difficulty level of 3 to 5 and works well in the undergraduate senior Business Policy Strategy class, first-year MBA, as well as final policy course in MBA. It can either be used requiring 50 to 75 minutes of class time with no outside preparation or 30 minutes to 2 to 4 hours of outside preparation.

CASE SYNOPSIS

Nonprofits or for-profits with an explicitly responsible social agenda, from microenterprise to highly scaleable operations, are increasingly venturing into new territory -- how to do social good, make money, and be responsible to relevant stakeholder groups, especially the people, profit, planet of the triple bottom line. This case study can give useful insights to potential clients and consultants inside and outside the classroom who have been previously assumed to not be affected by triple-bottom-line/sustainability issues. In this post-Enron era, these issues are seen as a basis for strategic competitive advantage that will help maximize a profit or social agenda. These issues will be increasingly relevant to doing business in the 21st century.

The executive director of the nonprofit Urban Outreach Ministries engaged a team of consultants to do a business plan for an organic garden that would be environmentally friendly, provide jobs, and job training for Urban Outreach's target immigrant population. In addition, it would generate profits which could help support other Urban Outreach activities and its outreach. A preliminary feasibility study showed a profit the first year if the $200,000 startup and land costs would be donated. What should the executive director do with the study results?

What are the critical factors for long-term success in an entrepreneurial startup within an organization? Social responsibility, triple bottom line, sustainability, ethics, values, and environmental consciousness are issues increasingly vital to business and nonprofits in this post-Enron era. What else needs to be measured? How does one compare/weigh social return on investment?

STRAYER EDUCATION, INCORPORATED

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ABSTRACT

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

The student is placed in the role of an equity analyst and asked to prepare a buy or sell recommendation for Strayer Education, Incorporated(NYSE:STRA) stock. Strayer Education, Inc. through its subsidiary, Strayer University, offers graduate and undergraduate degree programs in business, information technology, education and public administration. The student must assess the competitive environment of Strayer using the DuPont identity and Porter's five force model of competitive strategy as well as estimate the value of the stock. All information in the case is publicly available.

FEDERAL RESERVE DILEMMA: 1974

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CASE DESCRIPTION

The primary subject matter of this case concerns the dilemma facing the Federal Reserve in the mid 1970s when inflation and unemployment were reaching high levels simultaneously. From a historical perspective, the levels of both inflation and unemployment were reaching post war record highs. Secondary issues examined include arguments about proper policies from a variety of economic modeling perspectives. This case has a difficulty level appropriate for upper-level undergraduate courses and perhaps first year master's level courses. The case is designed to be taught in one class period and should require two hours of outside preparation by students.

CASE SYNOPSIS

The mid 1970s experienced a variety of economically profound events. Among these were post Vietnam volatility in U.S. markets, oil price shocks, economically questionable fiscal policies, middle-east unrest, and a period of high unemployment combined with high inflation, confounding the conventional economic wisdom of the day. This case presents background, data and commentary concerning this period, and tasks the reader with deriving "appropriate" policy responses by the Federal Reserve. Readers must discern the uniqueness of the situation from past history, reconcile conflicting policies that had been pursued in the past, either targeting high inflation or high unemployment (not both at the same time), and deal with policy prescriptions that differed among various policy objectives.

INTRODUCTION

The U.S. macroeconomy was considered relatively healthy at the end of 1973, but some problems loomed. Growth of real output was healthy and the unemployment rate was on the decline. By the fourth quarter of 1973, the U.S. was enjoying robust growth in Gross Domestic Product (GDP), which was up an annualized rate of 3.9 percent in the fourth quarter. In fact, real output had increased in thirteen of the fifteen quarters following the 1969-1970 recession (from the fourth quarter of 1969 through the first quarter of 1970).

This certainly wasn't the longest expansion following World War Two. Yet, real GDP had grown at an average annual rate of 4.8 percent, which exceeded average real GDP growth of 3.9 percent following the Second World War Concurrently, national unemployment rates fell. Unemployment reached a forty-two month low of 4.6 percent in October, 1973. This rate was down substantially from the post-recession high of 6.1 percent during the summer of 1971.

The positive increase in real output fueled a faster rate of increase in prices. Inflation had decreased following the 1969 – 1970 recession, and reached a low of 4.5 percent in 1972. However, inflation was rising through the year (measured as the percentage change in prices for Gross Domestic Purchases), averaging 7.1 percent during 1973. A higher rate of growth in the money supply was one cause of higher inflation rates. M2 (one measure of money) increased 13.4 percent in 1971, twice as high as the average annual rate of growth for the 1959 through 1970 period. This high rate of money growth was sustained through 1972, increasing 12.9 percent in that year. Consumers bore a large portion of these price increases. One measure of consumer prices, the

Consumer Price Index (CPI), grew 6.2 percent in 1973. Therefore, inflation became a looming concern at the end of 1973.

POLITICAL INSTABILITY

Political instability in the U.S. and abroad complicated the situation in late 1973. President Nixon was battling for his political life over the Watergate scandal. As a result, active fiscal policy waned and monetary policy became the primary means to alter the short run path of the macroeconomy. The U.S. withdrew all combat troops from South Vietnam and hostilities with North Vietnam ended in January, 1973. One side-effect was a reduction in the budget deficit as defense spending fell. The lessening of fiscal stimulus aided in cooling aggregate demand. The reduction in spending and rise in revenues due to the expanding economy had some impact on GDP growth during 1973.

International instability followed the domestic political instability and the withdrawal from Vietnam. Egypt and Syria attacked Israel on October 6, 1973, the day of Yom Kippur. Initial Arab gains were reversed after forty-eight hours into the fighting. By the time the U.N. cease-fire went into effect on October 24, the Israelis were driving towards Damascus and Cairo. The U.S. fully supported Israel during this conflict, which infuriated the Arab nations that supported Egypt and Syria. During the same month, these Arab members of the Organization of the Petroleum Exporting Countries (OPEC) initiated an oil embargo against the countries that supported Israel. As a result, energy prices in the U.S. soared. Prices paid by the consumer for energy rose 7.3 percent in the last two months of 1973 (an annualized rate of 52.3 percent). This supply shock started to ripple through the U.S. as suppliers' marginal costs (especially for energy inputs) increased at the end of 1973.

WEAKENING AGGREGATE DEMAND

Despite the strong growth in real output, there were signs of weakening aggregate demand. Business fixed investment growth was anemic by the end of 1973 due to rising interest rates. By the end of that year, the Aaa bond rate rose sixty-eight basis points to 7.83 percent and the yield on the ten-year treasury was nearly seven percent (a rise of fifty-five basis points). Even more alarming was the change in short-term interest rates. The three-month treasury yield rose an astonishing 236 basis points over the year, and the yield of 7.77 percent by the end of 1973 was greater than the long-term treasury yield. The yield curve inversion convinced bond market participants to expect higher inflation in the short run relative to the long run. Residential investment also declined substantially during 1973.

Another sign on slumping aggregate demand was the drop in real consumer spending. Real personal consumption expenditure growth was strong through 1972 at 6.1 percent. For 1973, the change in consumer expenditures was 4.9 percent. However, most of this change came in the first quarter. During the last three quarters of 1973, real consumer spending was stagnant falling 0.02 percent. Consumers were reducing spending on durable and nondurable purchases through the year. One contributing factor to this fall in spending was the decline in the growth of household wealth. During the 1971 and 1972 periods, real household wealth grew at an average annual rate of 7.2 percent, which helped to fuel consumption and aggregate demand. However, by 1973, real wealth grew 3.0 percent.

The health of the U.S. macroeconomy was certainly questionable at the start of 1974. The U.S. had experienced exceptional growth in real output in the years following the 1970 recession, but the growth was slowing. One reason was declining aggregate demand. Rising interest rates and falling household wealth softened business and household spending, respectively. The end of the Vietnam War and rising tax revenues reduced the budget deficit, therefore reducing fiscal stimulus on aggregate demand. On the supply side, the oil embargo increased energy costs, which raised marginal costs and reduced aggregate supply. Unemployment was low, but the potential for a weakening economy suggested that the reductions in unemployment were potentially at an end.

ADDITIONAL EXHIBITS

Table 1 provides several macroeconomic variables mentioned in this case.

Table 1: Important Macroeconomic Variables Provided to Students
(Dollar Values in billions)

Variable	1972	1973	1974
Real GDP growth	$4,105.0	$4,341.5	$4,319.6
CPI (1982-1984=100)	41.81	44.43	49.34
Core CPI (1982-1984=100)	44.04	45.58	49.36
Price Index for Gross			
Domestic Purchases (2000=100)	29.619	31.343	34.546
Real Household Wealth growth	$14, 186.3	$14,616.3	$13,368.5
Real Household Real			
Estate Wealth Growth	$3,522.9	$3,833.2	$3,609.7

BAHAMASAIR: THE NATIONAL AIRLINE OF THE BAHAMAS PONDERS PRIVATIZATION

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ABSTRACT

Suffering from a number of internal and external problems, Bahamasair, the national airline of The Bahamas is being considered for privatization. Proponents of privatization argue that such a move will make the airline more efficient, profitable, and customer-focused. Opponents of privatization feel that relying solely on private airlines is too risky an approach for a country that is dependent on tourism for much of its national income. With mounting losses, the government of the Bahamas is under increasing pressure to make a decision concerning the national airline.

The Commonwealth of the Bahamas is an independent country comprised of over 700 islands off the southeastern coast of the United States. When Columbus first arrived in the New World he landed on a small island that he named San Salvador, an island in present day Bahamas. He claimed the island for Spain and eventually the rest of the islands came under Spanish control. When pirates such as Black Beard and Calico Jack began using The Bahamian islands to raid British trading vessels, the British appointed a governor to rid The Bahamas of pirates and to claim the territory for England. When the British lost the American War of Independence, a number of British colonists immigrated to The Bahamas along with their slaves. Spain finally ceded The Bahamas to Great Britain in 1783. Prohibition in the United States provided an economic boom to The Bahamas as the islands became a source of illegal alcohol. World War II also helped with the economic development of the islands as the British built up the infrastructure of the country to use as pilot training and a strategic base for anti-submarine warfare. This infrastructure helped The Bahamas develop its successful tourism industry. Although the Bahamas gained its independence from Great Britain in 1973, the British monarchy is still recognized as its head of state. With a thriving tourism industry, and as a center for offshore business and banking, The Bahamas has managed to develop its economy well beyond that typically found in the other island states of the region.

TOURISM IN THE BAHAMAS

Although not technically located in the Caribbean, the Bahamas is viewed as a Caribbean tourist destination. The islands of The Bahamas are located in the Atlantic Ocean, close to the Florida coast and within easy reach either by sea or air. Air travel has been a popular means for tourists to travel to The Bahamas; however, increasingly tourists are arriving to The Bahamas by cruise ship. With a population of just 317,000, the Bahamas benefits greatly from this tourism. Over 5 million visitors per year, the vast majority from the United States, are attracted to the islands for shopping, beaches, water sports, and the attractions offered by the luxurious hotels such as Atlantis in Nassau. The Bahamas offers visitors parasailing, diving, snorkeling, historical tours, Caribbean dining, and much sunshine. Most tourists visit the capital, Nassau, or the other major city, Freeport. The tourism industry employs about 50% of the Bahamian workforce and contributes approximately 40% of the country's GDP. Currently, tourists spend over $2 billion a year in The Bahamas. Tourism is expected to increase in the coming years as resorts such as Atlantis expands and new mega-resorts, such as those planned in Nassau's popular Cable Beach, become operational. The government of The Bahamas is planning to develop the outer islands to attract even more tourists. The outer islands offer a slower-paced vacation and are of special interest to some tourists.

The Bahamas does face stiff competition for Caribbean tourist dollars as tourists opt for sometimes more trendy destinations such as Barbados, St. Kitts, or the Turks and Caicos Islands. The Bahamas has remained a popular tourist destination despite this increasing competition. One threat facing the entire region is a new homeland security regulation. Beginning in January 2007, Americans returning from the Caribbean must present a U.S. passport for reentry into the United States. Previously other forms of identification, such as a birth certificate or driver's license, were sufficient documentation. The effect on tourism as a result of this new regulation is uncertain.

BAHAMASAIR

Bahamasair, the national airline of The Bahamas, was born out of the energy crisis of the 1970s when British Airways ended its service to The Bahamas due to rising fuel costs. Fearing the effect of other carriers also ending service, the government decided to begin its own airline in 1973. The company has experienced difficulties with financial performance, labor unrest, and customer service throughout most of its existence. Currently, the airline requires a government subsidy of around $10 million a year to operate. Bahamasair has been accused of being poorly managed, as represented by recent groundings due to poor maintenance record keeping and late payments of a U.S. Customs bond.

Figure 1

Bahamasair flies out of four cities in the U.S. - Miami, Ft. Lauderdale, West Palm Beach, and Orlando, and it has service throughout The Bahamas. Bahamasair also flies to Jamaica, the Dominican Republic, and the Turks and Caicos Islands (see Figure 1). In 2004, Bahamasair entered into a code-sharing agreement with US Airways that allows an expansion of its market into Charlotte, Philadelphia, and New York. Code sharing allows one flight to be marketed by more than one airline and increases the market reach of cooperating airlines. Bahamasair had expanded into the U.S. market in the 1980s to include Philadelphia, Newark, and New York, but it found those routes to be unprofitable at the time. The airline is a small carrier with only eleven aircraft that includes Boeing 737 jets and smaller turboprops. Bahamasair competes directly or indirectly with a number of different international airlines including US Airways, Continental, American Airlines, Jet Blue, Spirit Airlines, and Air Tran. All six American carriers fly into The Bahamas, most to

Nassau or Freeport. Bahamasair would like to compete on the basis of its country identity and slogan (We don't just fly there. We live there); however, more often Bahamasair competes on the basis of price (see Figure 2).

FIGURE 2
Sample air fares on a round trip flight from Miami to Nassau:

American Airlines	$206
Continental	$206
US Airways	$384
Bahamasair	$199
Source: Expedia.com. July 31, 2006.	

At one time Bahamasair had exclusive intra-country routes; however, a number of private airlines have now begun operating within The Bahamas, including Pineapple Air, Cat Air, Seair Airways, Western Air, and Southern Air. These domestic competitors compete with Bahamasair on some of the same intra-country routes, and they are operating with a lower cost structure than Bahamasair. In order to offset this loss of revenue due to domestic competition, Bahamasair is considering expanding into smaller cities in the U.S. such as Cleveland and Richmond.

PRIVATIZATION

Faced with increased competition and a poor record of profitability, the government of the Bahamas has begun to explore the possibility of finding a foreign investor for Bahamasair. The government has requested bids from investors who would purchase a less than 50% equity interest in the airline. International investors will find in The Bahamas a favorable tax structure, close proximity of the country to the United States, an English speaking population, political stability, and a developed infrastructure. Additionally, the Bahamian dollar is pegged on par (1-1) with the U.S. dollar, thereby reducing exchange risk volatility.

In an effort to explore the privatization issue, the Bahamian government contracted with the American consulting firm McKinsey & Co. to provide an assessment of the issue. The consultants, reporting on the airline industry, stated that "domestic markets are mature and saturated; Florida is over-serviced; and penetration of U.S. markets will not likely generate positive margins for Bahamasair in the short or long run." Additionally, the consultants stated that it was essential that Bahamasair improve operating efficiency, reduce costs, increase market share, and right-size the present aircraft fleet. Without improvements, finding a foreign investor would be very difficult.

Bahamasair is expecting a loss of $10 million on revenues of $76 million for the fiscal year 2005-2006. Bahamasair is essentially bankrupt, and according to its managing director, the company has a negative equity of around $84 million. The company survives only through government subsidies that have ranged between $10-32 million a year. Attempts at cost-cutting have resulted in labor resistance, including groundings due to sickouts by employees.

Some see Bahamasair as a typical example of the problems of government ownership of industry. They argue that governments typically do not generate the interest in efficiency and customer service found in private companies. Furthermore, government-owned industries can become vulnerable to destructive political meddling in economic decision-making.

Others argue that many countries have state-owned airlines. Some airlines are fully owned by the government, such as British Airways and Japan Airlines International. In other cases, the government has a partial equity interest in the national carrier. Government ownership of airlines varies from 100% ownership to only a token equity interest. Scandinavian Airlines (SAS) is owned

50% by the government and 50% by private investors. KLM Royal Dutch Airlines is 25% state-owned, and the German government has a small equity interest (1.6%) in Lufthansa. According to the Bahamian Ministry of Works and Utility, "The provision of reliable, efficient, low-cost airline service is essential to the social and economic development of the Bahamas and the continued growth and development of our tourism industry." Not all government officials agree with this position, and a decision regarding the future of the airline must be made.

DISCUSSION QUESTIONS

1. Would you invest in Bahamasair as a foreign investor? Explain your answer.
2. Why do governments typically own airlines and not grocery stores?
3. Should the government of The Bahamas privatize Bahamasair, liquidate the airline, or continue to operate it? Explain your answer.

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